CHAPTER VIII

SUMMARY, CONCLUSIONS AND POLICY IMPLICATIONS

8.1 Introduction

Financial intermediaries outside the purview of regulators are shadow banks. Maturity transformation, leverage and regulatory opaqueness are the determiners of shadow banking process. Share of Shadow banking assets of emerging market economies shows an increasing trend. In India, NBFCs-ND-SI are showing the characteristics of shadow banks. In this research work, an evaluation of the functioning of NBFCs-ND-SI is attempted.

Post liberalization period shows a leap in the gross domestic savings in India. Financial intermediaries play a good role in augmenting the savings as percentage of GDP. Banks could not be the sole mediator in bringing up the savings in India. Empirical literature says that, increase in the number of financial intermediaries will lead to financial development. This signifies the potential for non banking financial institutions in India. Diversity in the characteristics of financial market demand heterogeneous financial service providers in India. This is visible in the case of financial intermediation in rural and semi urban areas. Non Banking Financial Companies (NBFCs) in India are equipped with good customer reach and knowledge.

Prior to economic crisis (2007-08), monetary authority was concerned about the functioning of deposit accepting NBFCs. But the economic crisis and its implications compelled authorities to analyze the systemic importance of some financial intermediaries. In this connection, it was noticed that the functioning of Non Deposit taking NBFCs, which held huge amount of net worth, were becoming a source of systemic importance in India. To manage the risks, Reserve Bank of India (RBI) restructured the regulatory framework of NBFCs. The present research work evaluated the policy frame work of NBFCs in India. The policy framework of NBFCs is mainly evolved from RBI Act 1934, Shah Committee (1992) and Narasimham Committee II (1998). The Acts originally deals with the general governance and the functioning of NBFCs in India. NBFCs are expected to augment economic growth in the economy. The regulations were developed so as to complement the good functioning of banking and other financial intermediaries in our economy. After analyzing the regulatory framework, researcher found that the functioning of NBFCs are not up to the expected level. NBFCs are intended to augment the financial development of the economy.

The overview of policy frame work and literature survey led to the rest of the evaluations and analysis of this work. Specifically, this research work tries to achieve the following objectives;

1. To study the growth of NBFCs-ND-SI in India
2. To evaluate the financial performance of NBFCs-ND-SI in Kerala
3. To examine the contributions made by banking sector towards the NBFCs with respect to deposit and credit.
4. To evaluate the maturity transformation practices of NBFCs-ND-SI in Kerala

This research work is explanatory in nature. Secondary data is mainly used for analysis. Data has been gathered from the annual reports of various NBFCs, reports and publications of RBI and Kerala State Planning Board for various years. Discussions were conducted with branch managers of the selected NBFCs and information gathered using schedules. Simple statistical and mathematical tools are used to analyze the data. Multiple regression models are developed and relationships among the variables are established through these models.

The following paragraphs briefly discuss the major findings of this research work.

8.2 Growth of Shadow Banking in India

1. An analysis of financial ratios of NBFCs-ND-SI was made. These firms are benefitted with high leverage (debt funds). Debt equity ratio was 2.90:1 in 2007. In 2016, it is 3.20:1. These NBFCs heavily depends on debentures and borrowings from banks.

2. Scheduled Commercial Banks' advance to NBFCs-ND-SI, Scheduled Commercial Banks' advance to SSIs and Cooperative non credit societies' advances to households have an explanatory power on the growth in the assets of NBFCs-ND-SI in India. All these three factors positively contribute to the growth of assets of such NBFCs. By running this model, it is established that the growth of shadow banking is driven by the functions of other financial intermediaries. This functional linkage is a necessity for the financial development and economic growth. Thus, NBFCs-ND-SI actively participates in the financial development.

3. Leverage is a major determinant of shadow banking. NBFCs-ND-SI in India heavily depends on the leverage. So the present research work aims to analyse the impact of leverage on the growth of assets of NBFCs-ND-SI in India. Both bank borrowing and net worth positively contribute to the growth of assets of NBFCs.

8.3 Financial Performance of NBFCs-ND-SI in Kerala

1. Financial data of two major NBFCs-ND-SI is taken as sample. Profit after Tax (PAT) of NBFCs-ND-SI in Kerala is moving along with short term loans and advances, current liabilities, financial expenses and investment. There is a fluctuation in the ROE of NBFCs. Leverage (Equity/Total Assets) is stagnant during recent years.

2. Shadow Banking is the relative share of total assets of two selected NBFCs on total deposits of scheduled commercial banks in Kerala. Total assets of the

sample NBFCs is Rs 438594 million rupees as at the end of March 2017. 88 percent of total assets are short term loans and advances. This is Rs 385962.72 million. About 14 percent of branches are situated in Kerala. Thus, roughly, Rs 54034.78 million was disbursed as short term loans and advances in Kerala.

4. ROE of NBFCs is explainable by growth in advance to weaker sections by SCBs in state (0.31), growth in number of SCBs' branches in state (-1.84) and leverage of NBFCs (1.72). Here, leverage means the share of share capital on the total assets. The same is not showing a significant relation with the ROE of NBFCs-ND-SI. In Kerala, weaker sections are bound to the financial services of NBFCs-ND-SI. The credit availed to these sections by banks reasoned to the growth of NBFCs-ND-SI in Kerala. Further, financial services are fairly catered by such NBFCs.

8.4 Contributions made by Banking Sector towards the NBFCs

1. There is a high negative correlation between total income of NBFCs-ND-SI in Kerala and Rural bank credit (-0.79).

2. It is interesting to know the role of banking functions on the total income of NBFCs-ND-SI in Kerala. Semi Urban Credit by banks shows a negligible correlation with the total income of NBFCs. Thus a regression model ran with the remaining expected bank variables- Rural Deposit, Semi Urban Deposit and Rural Credit. It was found that, Rural bank deposit negatively affects (-0.33) the total income of NBFCs-ND-SI in Kerala. Semi Urban bank deposit positively affects (0.23) the total income of these NBFCs. And Rural bank

credit negatively (-0.38) affects the total income of NBFCs. Rural and Semi Urban banking practices collectively affects the functioning of NBFCs-ND-SI.

3. Three districts accounts for major banking assets and liabilities of Kerala- Ernakulam, Thiruvananthapuram and Thrissur. After running a regression model using the bank credit in these three districts as explanatory variables, it was found that, bank credit at Ernakulam district (1.67) and bank credit at Thiruvananthapuram district (-1.06) significantly affects the total income of NBFCs-ND-SI. However, bank credit at Thrissur district does not contribute significantly towards the total income of NBFC.

4. Thrissur district has a good ranking in terms of value of goods and services produced. But the district is having a low ranking in terms of CD ratio. This means that the financial services are largely provided by NBFCs.

8.5 Maturity Transformation by NBFCs-ND-SI in Kerala

Average maturity of advance/ average maturity of external liability of NBFCs-ND-SI is calculated for six years starting from 2012. The ratios were 0.37, 0.36, 0.36, 0.38, 0.53 and 0.49. The maturity transformation ratio does not cause for meaningful financial intermediation in Kerala economy. These NBFCs participate in maturity shortening process. Long term liability is converted to short term advances.

8.6 Policy Implications

1. There is lack of a strong regulatory framework for NBFCs-ND-SI in India. There is an urgent need for constituting a committee for enquiring into the functioning of NBFCs-ND-SI in India. RBI needs to monitor with special care the abnormal increase in the unsecured debentures of NBFCs-ND-SI.

2. Linkage with other financial intermediaries and the resultant financial development demand a well structured policy for NBFCs-ND-SI. The policy must be well founded and formulated largely for the development of NBFCs-ND-SI. These intermediaries are necessary for the well functioning of financial system in India.

3. There shall be a high infusion of capital to the NBFCs-ND-SI in India. CRAR shall be enhanced well. This will encourage more people to become beneficiaries by becoming owners. Present management of NBFCs must be encouraged to enhance the capital base. Further, there is a chance for ushering capital market.

4. Financial market regulator has to look cautiously into the aspect of value creation by these NBFCs for owners. Investors should evaluate the ROE of NBFCs before taking investment decisions.

5. Rural banking functions are negatively associated with the total income of NBFCs-ND-SI in Kerala. When rural bank efficiency increases, it negatively

affects the total income of NBFCs. Formal banking facilities must be developed in rural areas. In rural areas, the reach of NBFCs is good.

6. Commercial banks concentrate on northern districts whereas NBFCs concentrate on southern districts of Kerala. In fact, the southern districts are overcrowded with the financial service providers. NBFCs must try to fulfill the financial needs of northern districts.

7. There is a drastic fall in fixed capital formation in India. There are a lot of financial service providers who concentrate on the provisioning of short term advances. But there is a shortage of long term financial services in our economy. As per the policy framework, the NBFCs are expected to provide long term finance to industries. But, in practice, the NBFCs concentrate on the provisioning of short term non productive advances to households. The monetary authority shall issue effective guidelines.

This work throws light to the shadow banking characteristics of NBFCs-ND-SI in India. Three major determinants- Regulatory opaqueness, Leverage and Maturity Transformation are seriously evaluated in this research work. As part of it, policy framework of NBFCs has been evaluated. Regulatory opaqueness is largely a qualitative term and thus, generally, lies outside the purview of measurement. However, an overview has done to generalize the policy intentions and to account the actual state. Some serious pitfalls noticed and monetary authority shall study this evaluation for future decisions. Using the financial data of NBFCs-ND-SI in India, the role of other financial intermediaries and leverage is analyzed. Both monetary authority and firms shall look into the matter and take decisions accordingly. Financial data of two major NBFCs-ND-SI in Kerala is analyzed. Firms, commercial banks and even borrowers shall look into the analysis and take decisions. There is an urgent need for setting up long term financial service providers in the State. Policy makers in the State shall seriously look into the maturity transformation practices of NBFCs-ND-SI.

8.7 Scope for Further Research

An ideal Maturity Transformation Ratio of NBFCs may be developed considering the various aspects such as financial stability, efficient mediation and growth of firms. The implication of NBFCs-ND-SIs' functioning on the society and economic growth shall be examined from the perspectives of beneficiaries.

8.8 Conclusion

Growth of NBFCs-ND-SI in India is in tune with the growth of the functioning of other financial intermediaries. Scheduled Commercial Banks and Cooperatives act as supporters of such NBFCs. In India, the credit provided by the banks to the NBFCs-ND-SI directly helps in the significant growth of the NBFC-ND-SI sector. In addition, the credit provided by the banks to Small Scale Industries indirectly helps in the growth of such NBFCs. Bank borrowing along with the net worth of NBFCs-ND-SI fairly contribute towards the growth of the NBFCs-ND-SI. In Kerala, the financial service to the weaker sections, by way of banks, helps in the generation of profit of NBFCs-ND-SI. However the financial access, represented by the number of bank branches, lessens the profit of NBFCs-ND-SI. Since the profit of NBFCs is an established proxy of self sustainability, it is the banks which significantly determine the self sustainability of NBFCs-ND-SI in Kerala. The matter is factually strengthened when we look into the role of basic banking functions-deposit and credit- on the total income of NBFCs-ND-SI in Kerala. Improvement in rural banking activities adversely affects the NBFCs-ND-SI. Financial betterment of semi urban areas, represented by the bank deposits, is mattered for the total income of NBFCs-ND-SI. Likewise, bank credit in highly banked urban districts has a bearing on the total income of NBFCs-ND-SI. On the contrary to the financial intermediation theory, NBFCs-ND-SI engages in maturity shortening process.