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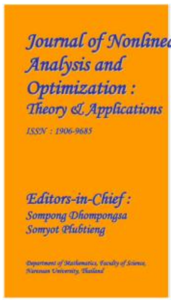

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A REVIEW OF ROLE AND CHALLENGES OF NON-BANKING FINANCIAL COMPANIES IN ECONOMIC DEVELOPMENT OF INDIA

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ABSTRACT: Ensuring financial inclusion to spur economic growth and entrepreneurship is critical for a country as huge and diverse as India. Banking penetration is minimal, and despite efforts to increase inclusion through initiatives such as the Pradhan Mantri Jan Dhan Yojana, the availability of comprehensive financial services for small businesses and people remains inadequate, as is the quality of such services. Non-banking finance companies (NBFCs) have had extraordinary success in this area. It exemplifies India's true entrepreneurial and varied spirit. The industry has grown to meet the loan needs of a variety of economic sectors, from large-scale infrastructure financing to small-scale microfinance. The sector has responded well to regulatory initiatives that aim to raise risk awareness and address concerns through law. The sector has moved from a condition of dispersion and loose control to one that is today well-regulated and, in many cases, includes best practices in risk management, innovation, and technology. The current study looks at the significance of non-banking financial companies (NBFCs) in India's economic development, as well as the issues they face.

Keywords: Non-banking Finance Companies, Banks, Financial Institutions, Lease and Hire, Purchase and Assets Growth.

1. INTRODUCTION

A strong and dynamic financial system is critical to a country's economic development and prosperity (Ebong, 2005; Shonekan, 1997). The expansion of a country's financial system boosts economic growth. Increasing financial inclusion in India, a country of immense size and diversity, should be a major goal for fostering economic growth and supporting entrepreneurial activities. Non-banking financial companies (NBFCs) play an essential role in the Indian financial system by providing a diverse variety of financial services. Non-banking financial corporations (NBFCs) offer a wide range of financial services, including credit and lending, retirement benefit programs, wealth management, underwriting, and merger and acquisition services. The introduction of industrial, venture capital, and retail organizations into the credit market during the last two decades has resulted in a significant increase in the number of non-banking financial companies (NBFCs). As a result, non-banking financial institutions (NBFCs) have had a significant impact on the country's economic structure. These businesses satisfy the required financial conditions.

It also provides a source of income for the financially excluded population in the country's semi-urban and rural regions. NBFCs have established strong grassroots links to provide effective financial services, serving as the primary point of contact and communication for semi-urban and rural people. Banks and non-banking financial enterprises (NBFCs), like other financial firms, have fulfilled social financial obligations while also contributing to the economy. They serve to bridge the gap in the public's access to financial services, which are frequently only available through traditional banks. Savers do not immediately lend money to NBFCs in the form of debt. Instead, these NBFCs serve as intermediaries, allowing for the provision of supplementary financial services using public funds. All of these businesses are classified as financial intermediaries. When they offer loans, they are referred to as investment institutions or non-banking financial intermediaries (NBFI). Most non-bank financial institutions (NBFIs) handle investment, hire-purchase, asset financing, leasing, and mutual benefit financial activities. However, they do not include brokerage, stock exchange, insurance, or insurance-related enterprises.

2. HISTORICAL BACKGROUND OF NBFCS IN INDIA AND REVIEW OF LITERATURE

Historically, India's financial intermediation structure was dominated by banks, development financing institutions (DFIs), and non-banking financial companies (NBFCs). The transformation of the Indian financial system from a small and regulated organization to a more open, deregulated, and market-oriented one, as well as its relationship to the development process, clearly demonstrate that the government is actively pushing this trend. Following bank nationalization, the banking industry played an important part in India's financial system. Commercial banks are the principal source of financing for the private sector, and they possess a significant portion of all financial assets. Their principal motivation stems from public-sector operations and policy efforts. They also donated a sizable portion of their home savings to the government. The financial system that operates independently of established institutions is prospering and evolving quickly. The introduction of refinance and development financial institutions, together with the execution of reforms in the early 1990s, broadened the scope of financial intermediation beyond the banking business. Competitiveness has improved as a result of technological advancements and increased financial sector deregulation.

In addition to financial institutions, non-banking financial corporations (NBFCs) grew significantly in the 1980s, providing depositors with a place to park their assets and borrowers with a way to replenish the cash available for commercial activity. Non-banking financial companies (NBFCs) provide a variety of services, such as equipment leasing, hire purchase, loans, investments, mutual benefit, and chit fund activities. The growth of the banking and nonbanking financial sectors, which encourage the accumulation of savings and investment within the economy, contributes to increased real economic activity. Financial intermediation increases risk transmission, creates economies of scale and scope, and enables maturity transformation, all of which benefit the economy's nonfinancial sectors. During the 1980s and 1990s, the financial system's growth process shifted from directing loans to allocating resources to various uses, which was mostly influenced by market forces. Following the 2009 financial crisis, the role of the financial system was comprehensively examined, and safeguarding financial stability is now regarded as equally crucial as promoting efficient resource allocation. Over the previous three decades, banks have retained fewer financial assets in non-bank financial institutions (NBFIs) and banks.

Raj (1999) claims that the Indian government's involvement in controlling resource allocation in the financial sector was warranted prior to the 1980s due to popular concern about potential market inefficiencies. The majority of the initial 85-year plans overlooked the role of the financial sector in driving growth (Patra and Roy, 2002). Despite its size, the Indian financial sector has been recognized for providing a limited contribution to allocative efficiency due to a system that impeded optimal pricing (Joshi and Little, 1996).

In 1960, Gurley and Shaw proposed a finance theory that looked at the role of financial intermediaries and the concept of financial institutions. Financial intermediaries were classified into two categories: non-monetary and monetary. Monetary institutions, such as banks, have the authority to create money, whereas nonmonetary intermediaries, such as nonbanking intermediates, do not. The fast expansion of Non-Bank Financial Institutions (NBFIs) has resulted in the proliferation and diversification of financial assets. Goldsmith (1969) was the first to acknowledge the role of financial intermediaries in the process of economic development. He stressed the role of financial intermediaries in formalizing deposits and channeling them to lucrative businesses. According to Shanker's (1996) study, the profitability of NBFCs in a competitive market with numerous financially strong participants is determined by their ability to raise and allocate resources in a timely and effective manner. According to Rengarajan (1997), Non-Banking Financial Companies (NBFCs) have grown in importance, both economically and in terms of the structure of India's financial services sector. As a result, Non-Banking Financial Companies (NBFCs) have a greater obligation to provide investors with alternative options while also accelerating the growth of the financial industry, notably in the credit market. Banks can level the playing field and compete more effectively with NBFCs by addressing one of the banking system's challenges, namely social banking subsidies. Levine et al. (1999) found that countries with well-developed financial intermediaries saw strong economic growth. According to the analysis, India might have seen a nearly 0.6% annual gain in real per capita GDP if Non-Banking Financial Companies (NBFCs) raised their comparatively low funding to the private sector to match the average level seen in emerging countries. As a result, the only alternative for reaching the desired outcome is to develop and strengthen this industry.

The financial market is complex. Shollapur (2005) underlines NBFCs' significant contribution to India's financial sector, stating that they enhance the services provided by commercial banks. Their capacity to provide adaptable and effective financial services has allowed them to expand their customer base to encompass both large corporate entities and small-scale borrowers. Amita (1997) analyzed the financial performance of non-banking financial organizations (NBFCs) in India from 1985 to 1986 and 1994 to 1995. This investigation discovered that some Non-Banking Financial Companies (NBFC) groups display distinct patterns of behavior.

The entrepreneur has many options based on the behavior of particular features related with the NBFC category. According to Vittas (1997), non-bank financial institutions (NBFIs) that issue new marketable securities in the leasing, factoring, and venture capital industries generate long-term financial assets and make important contributions to capital market expansion. Lakshmi (1998) discovered that NBFCs' performance can be attributed to distribution skills, customer relationship management, operational culture, and quick loan processing. Harihar (1998) examined the overall performance of all non-banking financial companies (NBFCs) using metrics such as asset turnover ratio, operational margin, net profit margin (NPM), loan cost, and return on net worth. The research found that the financial performance of several NBFC groups did not present a complete picture of NBFC performance. Sorab (1999) identified hire purchase, leasing, and car financing as the three key business sectors of NBFCs. The survey discovered that hire purchase agreements accounted for roughly 60% of all truck sales in India. Non-Banking Financial

Companies (NBFCs) assist the exchange of approximately 99% of previously owned trucks and cabs, 75% of motorcycles, and 25% of light-colored cars.

NBFCs provide financing for products. Gayathri and Madhusudhanan (2000) discovered that NBFCs significantly grew their deposit base by strategically expanding into rural areas and offering competitive interest rates. Interest rates were one of the reasons influencing the transfer of deposits from commercial banks to NBFCs.

According to Vaidyanathan (2001), nonbanking institutions have a greater influence than commercial banks in lending to manufacturing and service sectors such as commerce, construction, hotels and restaurants, transportation, and others. Hossain and Shahiduzzaman (2002) investigated the nonbanking sector's contribution to national economic growth and identified the key challenges it faces. Kantawala's 2002 study aimed to analyze the profitability, leverage, and liquidity of several NBFC groups. The study's findings show that different types of Non-Banking Financial Companies (NBFCs) display distinct patterns of behavior. As a result, entrepreneurs can make decisions based on the behavior of these components.

In his study of NBFCs, Balachandran (2006) observed that the financial industry provides a wide range of financial goods that enable successful payment and credit systems. This enables savers to easily move funds to investors in the economy. Non-Banking Financial Companies (NBFCs) are an essential part of the Indian financial sector. The researcher also observed the increase in Non-Banking Financial Companies (NBFCs) from 7,000 in 1981 to 40,000 in 1995. Deposits in these Non-Banking Financial Companies (NBFCs) have increased at a quicker rate than in traditional banks. According to a 2007 analysis by Dubey and Shubhashish, India's Non-Banking Financial Companies (NBFCs) saw a considerable transformation following deregulation in 1991. As a result, clear and simple legal processes have arisen, allowing greedy investors to deposit funds with NBFCs. Profits rose dramatically as the customer base expanded and unwise investment decisions were made. This eventually leads to discord between bad and good players, signaling the end of the NBFC's golden era. According to Jafor (2009), the contemporary financial sector's stringent regulations have a significant impact on non-banking financial institutions (NBFCs). They contribute significantly to the nation's economic revival and industrial efficiency. They operate in the loan and advance industry, providing small-business clients with short-term, low-value loans. Non-banking financial firms (NBFCs) play an essential role in allocating these funds to investments. Banks' role has been enhanced. Sundaram (2010) conducted a thorough analysis of NBFC growth, financial performance, and profitability. Given the NBFCs' comparable growth pace to that of commercial banks, the researcher advocated that the RBI have complete control over them.

Khalil (2011) investigated the financial performance of non-bank financing businesses that provide leasing, asset management, investment finance, and investment advisory services from 2008 to 2009. The ratio analysis technique was utilized to investigate this. Compared to the broader decline in 2009 caused by a multitude of factors, NBFCs' financial performance in 2008 was significantly better. Suresh (2011) examined the performance of India's non-bank financial firms (NBFCs) between April 2008 and March 2009, excluding banks, insurance companies, and chit fund companies. According to the data, total spending growth has dropped over time, but at a faster rate than revenue growth. Furthermore, the principal and secondary sources of income for financial and investment enterprises saw a slowing in growth. Sornaganesh et al. (2013) employed ratio analysis to evaluate the financial performance of five non-banking financial institutions (NBFCs) in India. The study examined the profitability of these companies, specifically STF, SF, BF, M, and MF, between April 2008 and March 2012. Based on the data, STF and M&MF had higher net profit margins (NPM) than the other two. On the other hand, SF posted increased earnings per share. Perumal and Satheskumar (2013) did a study on "NBFCs" using primary and secondary data. They analyzed the financial accounts and income statements of two companies, Sundaram Finance Limited and Lakshmi

General Finance Limited, from 2007 to 2012. The study concluded that NBFCs provide a major contribution to economic development using a range of statistical approaches such as mean, standard deviation, coefficient of variation, trend analysis, index number, and so on.

Kumar and Naresh conducted a 2013 study to compare the performance of Indian public sector banks using the CAMEL grading system. The research findings show a significant disparity in average CAMEL ratio values among public sector banks. The two banks with the best performance are designated as Bank of Baroda and Andhra Bank were chosen for their high asset quality and considerable capital sufficiency. The study recommends that banks improve their liquidity, earnings quality, asset quality, and managerial efficiency. While each bank in the State Bank group has its own ratio ranking, Kumar and Kumar (2013) emphasized this fact. However, the CAMEL ratios remain statistically insignificant. The results reveal that the State Bank group's overall performance has remained consistent, most likely due to the implementation of the recovery mechanism, banking reforms, and the application of modern technology. SBBJ should improve its management efficiency, SBP should improve the quality of its earnings, and SBI should boost its capital sufficiency and asset quality. Kumar and Afroze (2014) discovered that loans, management efficiency, liquidity, and sensitivity all had a statistically significant effect on private sector banks' capital adequacy. However, asset quality has little influence on the capital adequacy of Indian private sector banks. Furthermore, the data demonstrate that Indian private sector banks regularly achieve capital requirements that exceed those imposed by the Reserve Bank of India. Kumar and Sanjeev (2014) used the CamELS model, which takes into account capital adequacy, asset quality, management, earnings, liquidity, systems, and controls, to evaluate secondary data from Indian old private sector banks from 2007 to 2012. Six of the thirteen banks in the survey had notable or exceptional financial performance. Tamil Nadu Mercantile Bank topped the overall ranking, followed by Federal Bank. Federal Bank, Nainital Bank, and Tamil Nadu Mercantile Bank have all showed outstanding financial performance in accordance with the CAMELS standards. According to Kumar and Sanjeev (2016), the Reserve Bank of India recommended two supervisory rating models, CAMELS and capital adequacy, asset quality, compliance, systems, and controls, to evaluate the performance of Indian commercial, private, and international banks operating in the country. In contrast, Catholic Syrian Bank, ING Vysya Bank, and Dhanalakshmi Bank had the poorest financial performance of the banks. The study looked into all aspects of the CAMELS system in depth, including a thorough literature review and actual testing.

Based on the preceding literature review, the study's primary purpose is to provide a theoretical knowledge of the function and difficulties confronting Non-Banking Financial Companies (NBFCs) in India. The current study is largely qualitative and does not employ any statistical techniques for analysis. The current study drew significantly on secondary data from professional organization reports, conference proceedings, and other publications, as well as a thorough literature analysis.

3. NBFC - MEANING AND DEFINITION

"NBFC," is defined under section 45-I(f) of the Act, as under

"NBFCs" means:

i. The term "bank" refers to a financial institution that accepts deposits and makes loans. It may also include non-banking institutions that participate in similar activities, as approved by the bank with authorization from the Central Government and published in the Official Gazette.
ii. A company is classified as a non-banking financial corporation (NBFC) if its financial assets account for more than 50% of its total assets (excluding intangible assets) and financial asset income accounts for more than half of its gross income. For a company's core business to be identified, it must meet both of these criteria.

The Reserve Bank (Amendment Act) 1997 defines an NBFC as a nonbanking financial entity. Its primary activities include accepting deposits under various schemes or arrangements, as well as lending in any form. The Reserve Bank has the jurisdiction to designate additional non-banking entities or types of institutions, subject to prior approval from the Central Government (Machiraju, 1998). The term excludes financial institutions that are not principally engaged in agriculture.
Figure 1 displays the structure of non-banking financial companies (NBFCs) in India.

4. DISTINCTION BETWEEN BANK AND NBFC

Non-banking financial companies (NBFCs) and banks serve similar purposes because they both invest and lend. However, they show distinctions in the following ways:

i. The bank takes demand deposits; the NBFC does not.
ii. Non-banking financial companies (NBFCs) cannot issue checks through the payment and settlement system since they are not integrated into it. In contrast, banks are in charge of overseeing all of these operations.
iii. Unlike bank depositors, NBFC depositors are not eligible for the Deposit Insurance and Credit Guarantee Corporation's deposit insurance scheme.
iv. Currently, the SARFAESI Act does not applicable to NBFCs. Furthermore, Non-Banking Financial Companies (NBFCs) essentially perform all of the functions traditionally associated with banks.

4.1. Classification and Types of NBFCs

Non-Banking Financial Companies (NBFCs) are categorized as follows:

4.1.1. Based on their liability structure

NBFCs are classified according to their liability structures.

4.1.1.1. Category “A” companies (NBFCs accepting public deposits or NBFCs-D)

These Non-Banking Financial Companies-D must follow regulations governing capital sufficiency, liquidity maintenance, asset and liability management, adherence to exposure limits (such as restrictions on real estate, land, and unlisted shares), and report submission.

4.1.1.2. Category “B” companies (NBFCs not raising public deposits or NBFCs-ND)

Prior to 2006, non-banking financial companies that did not take deposits were mostly unregulated. Systemically Important Non-Deposit Taking NBFCs (NBFCs-ND-SI) are non-deposit taking NBFCs having assets of at least $1 billion as of April 1, 2007. They are subject to appropriate limits, including as capital adequacy regulations, exposure guidelines, and reporting requirements. These Non-Banking Financial Companies (NBFCs) are expected to follow Asset Liability Management (ALM) reporting and disclosure rules at various intervals.

4.1.2. Depending upon their nature of activities

Non-banking financial companies (NBFCs) can be classified according to the specific services they perform:

4.1.2.1. Asset finance company (AFC)

An Asset Financing Company (AFC) is a commercial company that focuses on providing financial support for physical assets that contribute to economic activity and production. These assets include earthmoving vehicles, automobiles, electric power sets, tractors, and general-purpose manufacturing equipment. The financing of tangible assets that support economic activity makes up the entirety of the company's principal operations. Revenue from these sources accounts for less than 60% of the company's total assets or income.

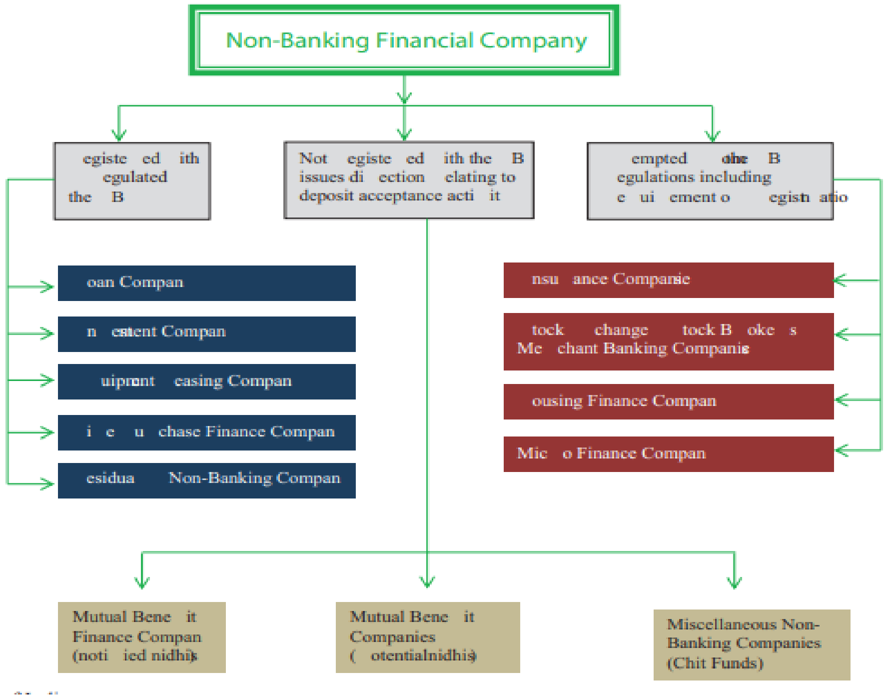
4.1.2.2. Investment company

An investment firm is a financial institution that specializes in the acquisition of securities and investments.

4.1.2.3. Loan company

A lending company is a firm that specializes in providing financial help, such as loans, advances, or other forms of cash, for non-commercial purposes. AFCs are omitted from this definition.

Figure 1: The structure of NBFCs in India



4.1.2.4. Infrastructure finance company (IFC)

IFC, as a Non-Banking Financial Company (NBFC), is required to meet three specified criteria: The fund must dedicate at least 75% of its total assets to infrastructure lending. Furthermore, it must have net owned funds (NOFs) of at least Rs. 300 crore and maintain a credit rating of "A" or above.

(d) In addition to a 15% capital adequacy ratio.

4.1.2.5. Systemically important core investment company

A non-banking financial corporation (NBFC) that meets the stipulated criteria and predominantly purchases shares and securities is categorized as a Systemically Important Core Investment corporation.

- At least 90% of its total assets are invested in debt, loans, equity shares, or preference shares of associated enterprises.
- At least 60% of total assets are invested in equity shares of associated companies, which may include instruments that must be converted into equity shares within ten years after issuance.
- Unless it engages in a block sale for the aim of divesting, it does not trade its debt or shares in group companies.
- Sections 45I(c) and 45I(f) of the Reserve Bank of India Act, 1934, apply only to investments in bank deposits, government securities, money market instruments, debt instruments, and guarantees issued on behalf of group companies. This category clearly excludes any other financial activity.
- It can handle assets worth at least Rs. 100 crore and accepts public investment.

4.1.2.6. NBFCs - Infrastructure debt fund

The Infrastructure Finance Fund (NBFC) is a well-known body that provides long-term financial support for infrastructure projects. These companies raise capital by issuing bonds in either dollars or rupees, with a minimum maturity of five years. Only infrastructure financing organizations can sponsor the Infrastructure Debt Fund (NBFC).

4.1.2.7. NBFC - micro finance institution (NBFC-MFI)

A non-bank financial institution, or NBFC-MFI, is a form of organization that does not accept deposits and meets certain requirements. It must invest at least 85% of its assets in qualified assets.

- An NBFC-MFI will make a loan to a borrower whose annual household income varies between Rs. 60,000 and Rs. 1,20,000 in rural areas, or Rs. 35,000 in urban and semi-urban areas. The loan amount would be capped to Rs. 50,000 in following rounds.
- The borrower's maximum debt limit is Rs. 50,000.
- If the loan amount exceeds Rs. 15,000, the minimum term is 24 months, and prepayment is allowed without penalty.
- The term of the unsecured loan.
- The loans earmarked for income generation account for no less than 75% of the MFI's entire loan portfolio.
- The borrower can repay the loan in weekly, bimonthly, or monthly payments.

4.1.2.8. NBFC - Factors (NBFC-factors)

An NBFC-factor is an NBFC that focuses on factoring rather than accepting deposits. The factoring business's financial assets must account for at least 75% of its total assets, and its revenue must not fall below 75% of its gross income.

5. ROLE OF NBFCS

Non-Banking Financial Companies (NBFCs), like banks and other financial institutions, serve as mediators between savers and borrowers. Financial intermediaries have the capacity to disperse risk over a large number of companies, leverage economies of scale, and provide a more efficient and cost-effective service. As a result, savers benefit from their activities, such as increased yields, lower risk, and easy access to cash. Nonetheless, owing of the intermediary function played by financial institutions, borrowers have a greater range of options. Loans supplied by Non-Banking Financial Companies (NBFCs) are typically used for trading, transportation, home purchase and maintenance, or personal consumption. Commercial banks, on the other hand, primarily provide loans for industrial, commercial, and agricultural purposes. Credit granted by Non-Banking Financial Companies (NBFCs) may not always align to national objectives and priorities due to monetary authorities' considerably lower level of regulatory monitoring compared to commercial banks. Financial intermediaries play an important role in the economy by facilitating the movement of savings from businesses with excess cash to others who need them.

The Reserve Bank of India's expert committees determined the necessity.

- The rise of industries such as transportation and infrastructure has resulted in a significant increase in job opportunities.
- Facilitate and encourage the generation of prosperity through comprehensive economic expansion. This is an important supplement to banking funding in isolated regions, with a focus on initial users and purchases in semi-urban and rural areas. It also provides financial support to areas with lower economic status and contributes significantly to government revenue

5.1. Contributions in Financial Services (NBFCS vs. Banks)

In India financial institutions including banks and NBFCs provide some or all of the following core financial services. These services are often provided in combinations:

(i) Some financial institutions offer payment services by generating claims that can be used to settle transactions. To function as a meaningful means of payment, a claim must be very stable and reliable, widely accepted in economic transactions, and related to the plans for determining value in the settlement process.

(ii) Liquidity refers to the ease with which the total market value of an asset can be realized when sold. Financial institutions improve liquidity through their large-scale and specialized operations.

(iii) Divisibility refers to how easily an asset can be traded in smaller units. To conform with societal expectations for divisibility, financial institutions combine smaller denomination claims while distributing larger denomination claims.

(iv) The ability of an item to keep its purchasing power over time is known as its store of value, and it is critical for meeting savers' preferences.

(v) Obtaining and interpreting information incurs financial costs. Financial institutions exist primarily to achieve economies of scale in the processing and evaluation of risks.

(vi) Risk pooling refers to how an asset distributes the risk of default across the underlying promises. Financial entities can combine assets to share risks more effectively than individuals.

5.1.1. Specific roles of NBFCs

Non-Banking Financial Companies (NBFCs) perform a variety of functions that traditional banks are not well-equipped to handle:

(i) Non-bank financial institutions (NBFIs) broaden the range of risks available to investors by increasing equity commitments and offering services such as liquidity, divisibility, informational efficiency, and risk pooling. They increase the promotion of savings and investment while simultaneously enhancing operational efficiency.

(ii) Their strategy entails cultivating a risk management culture in which those with lower risk tolerance are encouraged to transfer their risk to someone with stronger risk management capabilities through the use of contingent promises.

(iii) They have the potential to strengthen the financial system's resistance to economic shocks. Non-Banking Financial Companies (NBFCs) fill gaps in the financial services offered by bank-centric financial systems by providing services that banks are not well-suited to supply.

(iv) Non-bank financial institutions (NBFIs) present a substantial threat to banks in the provision of financial services. Non-Banking Financial Companies (NBFCs) compete with banks as service providers by offering differentiated services. They target specific demographics and specialize in a particular industry.

5.1.2. Role of NBFCs in economic development

Mounting empirical evidence reveals that the expansion of financial intermediaries has a significant impact on the nation's economic growth. When banks and non-banking financial businesses (NBFCs) work together to provide intermediation, the contribution increases. There is a clear relationship between economic growth and the size and dynamism of non-banking institutions and stock markets.Non-Banking Financial Companies (NBFCs) target clients with the lowest risk tolerance, filling gaps in financial services that would otherwise exist in bank-centric financial systems. Furthermore, NBFCs provide a number of critical activities that banks are unable to perform. Furthermore, they broaden the range of potential hazards by offering liquidity divisibility, informational efficiency, and risk pooling services.

5.1.3. Role of NBFCs in financial stability

In a financial industry where non-banking financial businesses (NBFCs) are underdeveloped, banks will eventually take on risk that would otherwise be managed by the stock market, collective investment schemes, or insurance companies. Nonetheless, there is an inherent conflict between the various forms of financial contracts given by banks and those issued by financial organizations. As a result, banks are more likely to fail. One potential way to reducing financial vulnerability in developing nations is to support the creation of a variety of financial markets and institutions that allow investors to take on risks other than those found in traditional banking systems. Without diversification, all risks tend to be concentrated in the banking system's balance sheet, increasing the likelihood of catastrophic financial crises. Officials made considerable use of this approach when assessing the lessons learned from the Asian currency crisis.

5.1.4. Role of NBFCs in financial inclusion

Financial inclusion is the act of providing accessible and competitively priced financial services to people who have been marginalized or abused by traditional financial institutions. These financial services include payment and remittance facilities, as well as savings, lending, and insurance options. Microfinance has been viewed as an important tool for increasing financial inclusion in India. Microfinance is the provision of basic financial services to persons living in poverty at a reasonable cost. These services include not just microcredit loans, but also other small-scale financial services. The goal of financial inclusion remains consistent: provide the economically disadvantaged with access to loans, bank accounts, remittance services, and insurance.According to the Mor Committee's report on Financial Inclusion and Financial Depth, the current situation is highly bad and unequal, both regionally and across industries. Financial Inclusion refers to the availability of financial institutions and services throughout the country, whereas Financial Depth evaluates the proportion of credit to GDP in different sectors of the economy.While the Reserve Bank's plan for financial inclusion is primarily focused on banks, we believe that non-bank entities can collaborate with banks on these projects. Non-bank groups can now help accomplish the larger goal of financial inclusion by acting as bank business correspondents. NBFCs and MFIs make up a sizable portion of the financial sector, and they have a strong presence in rural areas. While NBFC-MFIs are not explicitly part of the bank-led model of financial inclusion, their large and widespread coverage can serve as a motivator to provide necessary financial services to low-income consumers. The Mor Committee recognizes that various channels, including large national banks, regional cooperative banks, and NBFCs, have unique capabilities that can be used to address challenges that are appropriate for their strengths. By working together, these channels can successfully contribute to meeting the national financial inclusion goals.

5.1.5. Role of NBFCs in capital market

A considerable share of Non-Banking Financial Companies (NBFCs)' total assets are allocated to diverse activities. Most of these are stock market investments. Certain non-banking financial firms (NBFCs) only emphasize capital market investments, which include the purchase and sale of securities. As a result, Non-Banking Financial Companies (NBFCs) contribute to increased capital market liquidity. Furthermore, Non-Banking Financial Companies (NBFCs) provide loans to customers to help them invest in the stock market. The market may be experiencing excessive heat, leading to regulatory issues that could be resolved through the implementation of suitable regulations, such as greater disclosures.

5.1.6. Role of NBFCs in factoring

The Factoring Regulation Act of 2011 defines factoring as the process by which a factor acquires receivables, allowing the factor an undivided interest in the receivables or financing based on the receivables' security interest. This term excludes credit facilities provided by a bank as part of its usual operations, which are secured by receivables. In response to the government's issuance of the Factoring Regulation Act, the Reserve Bank established a new category of Non-Banking Financial Companies (NBFCs) known as NBFC-factors and provided them particular guidelines. NBFC-Factors' primary revenue stream is factoring services. Factoring services, considered as a supplement to bank financing, are projected to help small and medium-sized businesses obtain necessary working capital financing. This is especially true for people or firms with high-quality receivables who are having difficulty obtaining adequate bank funding due to a lack of collateral or a degraded credit rating. Small business owners, industries, and exporters who have a solid business connection with the Factor can enjoy advantages such as better cash flow and liquidity, along with extra services like credit protection, receivables collection, sales ledger accounting, and more. Factoring enables consumers to combine all of their business needs in one location, freeing up resources and assuring the seamless operation of their enterprise.

5.1.7. Role of NBFCs in infrastructure financing

Infrastructure Finance Companies and Infrastructure Debt Funds are the only non-banking financial firms that fund infrastructure projects. Many of these companies specialize in long-term project financing and have asset portfolios worth hundreds of billions of rupees. In recognition of the importance of the infrastructure sector, the Reserve Bank has permitted special disbursements like as increased bank credit, a larger exposure norm ceiling, and the provision of ECB via an automated lending mechanism. The asset liability pattern in this case is concerning since IFCs are funding long-term assets with extremely short-term obligations.

5.2. Problems and Challenges of NBFCs in India

The RBI's new policies are desirable since they address the requirement for increased capital adequacy and better fund management. Nonetheless, there is a lack of clear knowledge of the best way for NBFCs to invest resources and build their organization in the field of hire buy and leasing. The monetary authorities' negative appraisal of NBFC activities is directly related to the collapse of CRB Corporation and the subsequent disarray created by several nidhis failing to meet their depositor duties. The present moves contrast dramatically with previous years' approaches, which highlighted the necessity for NBFCs to create their own money and lessen reliance on bank funding or term loans from financial institutions. Only recently have AAA companies been granted authorization to accept deposits or set interest rates without restrictions, as the conditions for accepting deposits from the public in respect to the money held were established without limitations. Individuals that rely largely on deposit mobilization rather than bank loans will suffer negative consequences as a result of the new limitations on accepting deposits from enterprises with various ratings. The banks developed a hostile attitude toward Non-Banking Financial Companies (NBFCs) because they saw them as competitors and believed that NBFCs managed funds that the banks could have managed themselves. The management of well-positioned NBFCs recognizes the need to make adjustments to deposit and net owned funds (NOF) ratios in order to avoid impeding the growth of profitable NBFCs that have received no complaints from depositors about regular interest payments or principal repayments. Furthermore, future growth can only be secured by increasing cash credit limits and accumulating resources through NCDs. Returning surplus deposits may reverse the gains accomplished during the interim period because it requires the deployment of more resources obtained via alternative ways.Several Non-Banking Financial Companies (NBFCs) have argued that the maximum ratios should be increased to five times Net Owned Funds (NOF). They suggest that any additional deposits be reimbursed or that relevant improvements be introduced gradually over the course of two to three years. If the necessary cash is supplied, the monetary authorities will be able to efficiently monitor the activities of the NBFCs in issue, prevent a growth in nonperforming assets, and promote timely and affordable financing for small and medium-sized borrowers from NBFCs. As economic growth accelerates, non-banking financial businesses (NBFCs) may need to improve their profitability, needing additional support in the form of hire buy and lease agreements. As a result, it is critical to take a pragmatic approach to resolving outstanding issues in order to improve activity coordination across banks, financial institutions, NBFCs, and other entities.

6. CONCLUSION

NBFCs are an important part of the Indian financial sector. They have given loans to retail clients who live in underserved and financially excluded areas. They have a track record of creating unique products that effectively meet their clients' needs. They have played an important role in the growth of critical industries such as infrastructure and road transportation, which are the pillars of our economy. The Indian government and the Reserve Bank of India have established numerous Expert Committees and Taskforces, all of which recognize and actively support this commitment. Non-Banking Financial Companies (NBFCs) are gaining traction as a viable alternative to traditional banks. Furthermore, they have emerged as a critical component of the Indian financial system, contributing significantly to the government's aim of expanding financial inclusion. To some extent, they have successfully addressed retail clients' lack of credit availability in underserved and unbanked areas. The study's findings are important since risk has a significant impact on the performance of NBFCs. Both the nation's central bank and risk managers should share responsibility for risk management.The study's findings indicate that Indian NBFCs perform much better when they follow cautious risk management protocols or have fewer motivations to engage in risky behavior. It is recommended that regulatory agencies improve their inspection and enforcement of regulations, taking into account the impact of NBFCs' risk-taking operations on performance. Implementing these policies will have a significant impact on the performance of the non-banking financial institutions (NBFI) sector, resulting in an improvement to the nation's financial system.

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