Banks v/s NBFCs: The Emerging Trends

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Non-banking financial companies ("NBFC") have undergone through huge transformation over the last decade. With total focus of the Government on Digitization and Rising Financial Inclusion have given a boost to Innovation, Growth and Investment in the Financial Sector.

Lately, the Government has liberalized the Financial Services Sector by permitting 100% Foreign Direct Investment in the Financial Sector under the automatic route, subject to the relevant entity being regulated by the Reserve Bank of India.

What is now needed is to harmonize the regulations applicable to various categories of NBFCs to facilitate Ease-of-Doing Business in this Sector. Information Technology has to be implemented, from top to bottom and from East to West, as in a huge country like India for proper Loan Delivery and monitoring of Loan has to be done on a daily basis and this is only possible through the technological revolution in the Information Technology.

With the rising innovation and growth in the Sector, newer business models of NBFCs such as 'Account Aggregators' and 'peer to peer lending platforms' ("P2P Lending") are catching pace. For clarification, "Account Aggregator" is a form of NBFC engaged in collecting and providing information on the financial assets of a customer's financial assets in a consolidated, organized and retrievable manner.

Moreover, P2P Lending is a form of crowd-funding which uses an online platform to match lenders with borrowers to provide unsecured loans. RBI notified P2P Lending platforms as NBFCs on 24 August 2017 and have also issued the Master Directions to regulate the P2P Lending platforms.

The NBFC sector is also seeing a surge of newer structured products like Market and Credit Linked Debentures wherein the Principal Investment of the debenture holder is protected and the interest payment, to be made at maturity, is linked to the performance of an underlying Index or a Stock.

Over the years, NBFC has taken the role for diverse Investment Structures which range from strategic investments, Private Equity Investments to Debt funding through NBFC route.

NBFCs have caught on to a niche market through Strategic investments. However, Private Equity Investments provide Capital infusion which can be utilized for expansion purposes, facilitate technology up gradation and also help in enhancing Corporate Governance of NBFCs.

Debt funding is another route through which NBFCs fund customers. We also see foreign investors setting up shops in India or acquire Indian NBFCs and use such NBFCs to further lend or invest in Indian companies through structured instruments such as Non-Convertible Debentures.

After Demonetization in Nov. 2016, there was a huge deterrent for the unorganized sector and it also led to Compulsive Financial Inclusion. Further, the Financial Sector was given a boost by the Regulatory Changes.

This Sector has evolved significantly in the past few years and the growth of financial inclusion is expected to be driven further with higher penetration into parts of the economy where public-sector banks are unable to penetrate.

Coming to the Banking Sector, it is virtually impossible to get fresh loans from Indian Banks, especially in the Public Sector.

The total Stressed Assets are anywhere between 11%-12% and with such huge NPA and other enforcement action taken by Enforcement Agency, fear psychosis has developed in the Banks. This, of course, is not healthy and good for the economic growth.

Considering the current scenario with respect to PSU Banks, NBFCs, for reasons stated above, are a great alternative source of business, especially for the MSME Sector. This will help all companies who come under SME as per the new definition of Annual Turnover up to Rs.250 crores.

NPA and NBFC are quite low and NBFCs regulated properly and with an efficient lending mechanism could be a game changer for the growth of Industry, Trade and Commerce.