Role of Non-Banking Financial Companies

The definition of the term ‘Non-Banking Financial Companies (NBFCs)’ entails a very wide meaning. NBFCs include not just the finance companies that the general public is largely familiar with; the term also entails wider group of companies that are engaged in investment business, insurance, chit fund, nidhi, merchant banking, stock broking, alternative investments, etc. as their principal business.

Role of NBFCs in India

a. **In Financing of Vehicles:** Asset Finance Companies play a significant role in providing a livelihood to customers who are drivers. RBI is also encouraging the activities of these NBFCs and help them in the form of enhanced bank credit, higher exposure norm ceiling and provision of External Commercial Borrowings (ECBs) under automatic route for leasing related to infrastructure.
b. **In Infrastructure Financing:** Infrastructure Finance Companies and Infrastructure Debt Funds are NBFCs which are engaged exclusively into financing the infrastructure sector. They are experts in long term project financing. The Reserve Bank of India has given them special assistance like enhanced bank credit, higher exposure norm ceiling and provision of ECB under automatic route for on-lending to infrastructure sector.
c. **In Financial Inclusion**: Financial inclusion has been defined as the “provision of affordable financial services” to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include “payments and remittance facilities, savings, loan and insurance services”. Micro finance has been looked upon as an important means of financial inclusion in India. **Microfinance is not just provision of micro credit but also other services in small quantities to the poor i.e. providing essential financial services to the poor in an affordable way.** Financial Inclusion also is aiming at the same by providing the poor with not only deposit accounts or credit but also insurance and remittance facility. Several non-bank entities for e.g. NBFC-Micro Finance Institutions (MFIs) that form the significant part of the MFIs sector have deeper reach in the rural areas. NBFC-MFIs do not formally figure in the bank led model of financial inclusion but they by their wider and deeper reach can

be catalysts in providing the necessary handhold to the poor borrowers to gain access to essential financial services.

d. **In Capital Market**: Investment activity of NBFCs sector comprises around sixteen per cent of their total assets. These constitute mainly investments in capital market. There are specialized NBFCs that are exclusively engaged in capital market investment i.e. trading in securities. These NBFCs therefore **help in giving liquidity to the capital market.** Further, NBFCs also lend to investors for investing in capital market. Regulatory challenges in this regard might come in the form of probable overheating of the market, which could be addressed through appropriate regulatory measures including enhanced disclosures.

e. **In Factoring:** Factoring service which is perceived as complimentary to bank finance is expected to enable the availability of much needed working capital finance for the small and medium scale industries especially those that have good quality receivables but may not be in a position to obtain enough bank finance due to lack of collateral or credit profile. By having a continuous business relationship with the Factor in place, small traders, industries and exporters get the advantage of improving the cash flow and liquidity of their business as also availing ancillary services like sales ledger accounting, collection of receivables, credit protection etc. Factoring helps them to free their resources and have a one stop arrangement for various business needs enabling smooth running of their business. These efforts are building a suitable institutional infrastructure which will help in enabling an efficient and cost effective factoring and will also create sufficient liquidity for all stakeholders through an active secondary market.

Regulation of NBFCs

No non-banking finance company can commence or carry on business of a non-banking financial institution (as per Sec 45-IA of the RBI Act, 1934) without:

a) getting registered under section 3 of the Companies Act, 1956
b) obtaining a certificate of registration from the RBI and without having a Net Owned Funds of ₹ two crore since April 1999.

However, to avoid dual regulations, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI. Housing Finance Companies are regulated by National Housing Bank, Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by Insurance Regulatory and Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India. Companies engaged in financial business but are regulated by other regulators like SEBI, MCA, IRDAI, etc. are given specific exemption by the RBI from its regulatory requirements for avoiding duality of regulation.

Source:

- www.rbi.org.in
- Financial Markets and Institutions (Taxmann's) by Dr. Vinod Kumar, Atul Gupta and Manmeet Kaur (January 2018).
- Financial Markets and Institutions (Galgotia Publishing Company) by Dr. Kalpana Kataria and Dr. Arshi Zareen (2018).

Disclaimer:

1. These notes are only for the students.

2. These notes are prepared after referring various books and websites.