Chapter 8
Banks and NBFCs in India: A Comparative Analysis

It is a well-established fact that banks occupy an important role in the economic development of India, through loans and investments for agriculture, industries and services sectors. India's growth is predominantly bank-financed. At the same time, the role played by NBFCs also needs to be recognized. NBFCs were pioneers in auto loans, gold loans, loans to self-help groups, etc. As explained in the previous chapters, many functions of the current banking system have the route in the lending activities of NBFCs. It is also to be noted that both have never played a substitution role but complementary one.

In fact, until recently banks were reluctant to lend to many unorganized sectors. It is only recently that in the name of 'financial inclusion', banks started lending to them. But for this group, NBFCs lent substantial money, and in the field of financial inclusion, the role played by NBFCs is significant one. This chapter is devoted to make a comparative analysis of NBFCs and Banks in India using certain selective parameters.

8.1 Asset Growths of NBFCs and Banks

In order to understand the growing importance of NBFCs vis-a-vis banks in India, we compare asset size of NBFCs with asset size of banks. The NBFCs asset ratio (as a % of GDP) increased from 8.4% in 2005–06 to 10.1% in 2007–08. During this period, banks' asset ratio increased from 75.4 to 86.8%. But in the next 3 years, the growth pattern of banks was more pronounced, but it almost stagnated for NBFCs, due to various regulatory/prudential measures implemented by RBI. After reaching a strong prudential base in 2012–13, NBFCs assets had grown to 12.9% and this is positively due to various prudential measures implemented by the RBI.

R. Kannan et al., *Non-Banking Financial Companies Role in India's Development*, India Studies in Business and Economics,
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In the case of banks, this declined to 93.2% in fiscal 2016–17, after reaching 97.7% in 2013–14. This was mainly due to an increase in NPAs and the consequent higher provisions made to take care of them. However, in the case of NBFCs, the asset size increased to 13% in 2016–17. Thus, the growth of NBFCs is impressive. NBFCs have maintained growth momentum on a par with banks in many years and even surpassed them in some years (Chart 8.1).

The proportion of NBFCs assets to bank assets has also steadily grown from 10.7% in 2008–09 to 13.9% in 2016–17, thus gaining the systemic importance (Chart 8.2). Their steady growth and increased market share are clear evidences for their success in their business models and their opportunities and potential in their target markets.

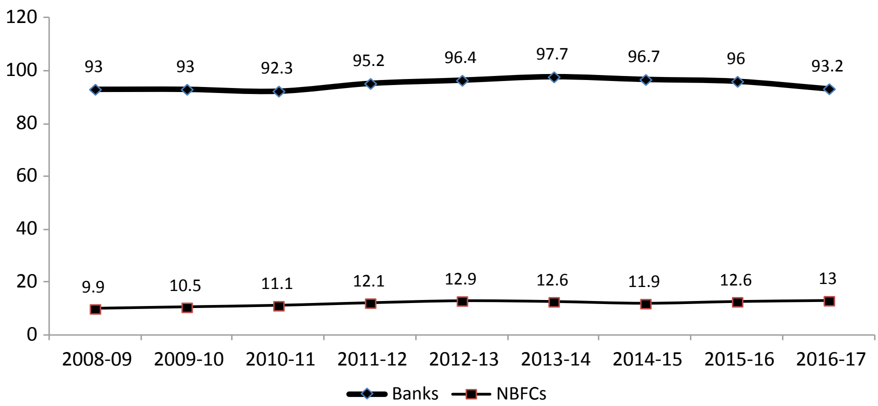

Chart 8.1 Asset growth of NBFCs and banks in India

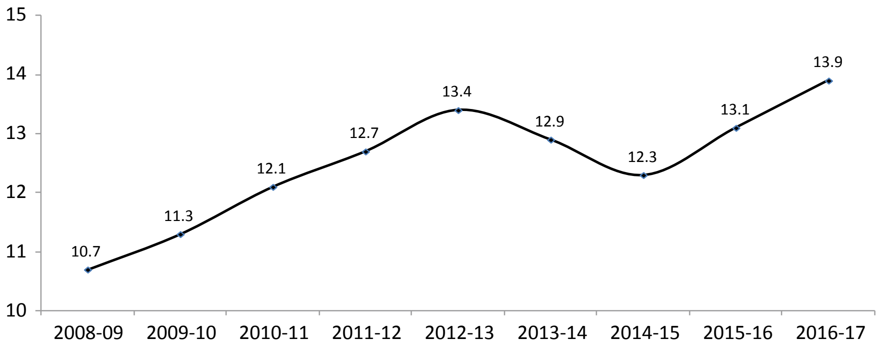

Chart 8.2 Proportion of NBFCs assets to bank assets (%)

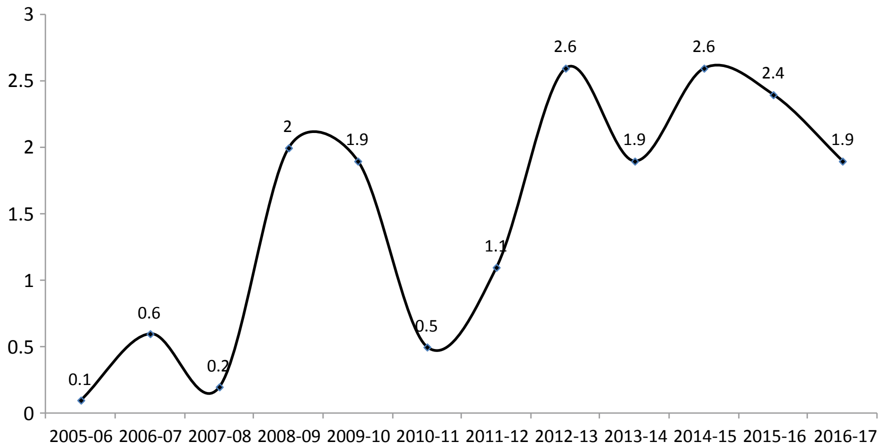

Chart 8.3 NBFC's share of deposits in the financial savings of households

8.2 NBFCs Share of Deposits

The NBFCs share of deposits in the financial savings of the households in India has been continuously increasing over time. In 2005–06, it was just 0.1%. In 2016–17, it increased to 1.9% (Chart 8.3). This clearly indicates the growing role of NBFCs in the financial savings of the households in India.

8.3 Credit Growth: Banks Versus NBFCs

The NBFCs credit also grew more rapidly as compared to the banking sector and national housing finance institutions (Chart 8.4).[1] However, the credit growth of NBFCs is highly volatile as compared to banks till 2011–12. High volatility of the NBFCs credit growth may be due to regulatory changes and positioning of strong prudential measures. After that, the growth is more or less volatile in both sectors.

8.4 Regional Coverage of NBFCs and Banking Sector

The core strength of NBFCs lies in their sizeable presence in semi-urban and rural areas (Tier III and below locations) and their strong understanding of regional dynamics which enable them to build strong customer relationship. About 60% of their

[1] According to CRISIL (2014), the market share of NBFCs in the total credit system of the country was 14.7% in 2006–07 and it marginally increased to 15.7% in 2012–13.

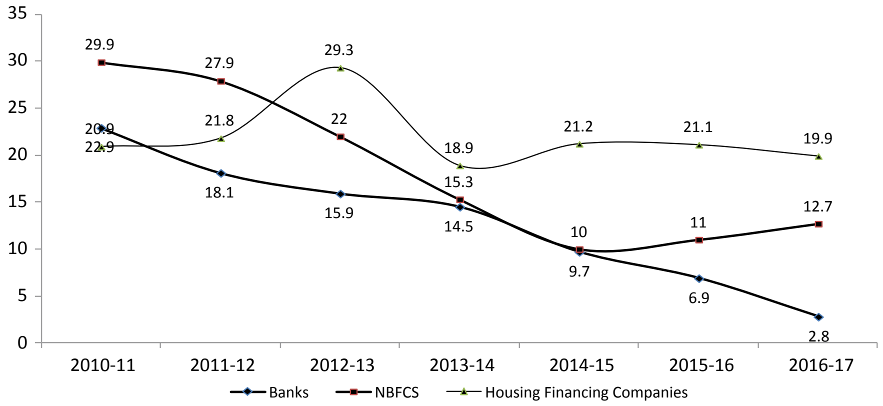

Chart 8.4 Credit growth in banks and NBFCs (%)

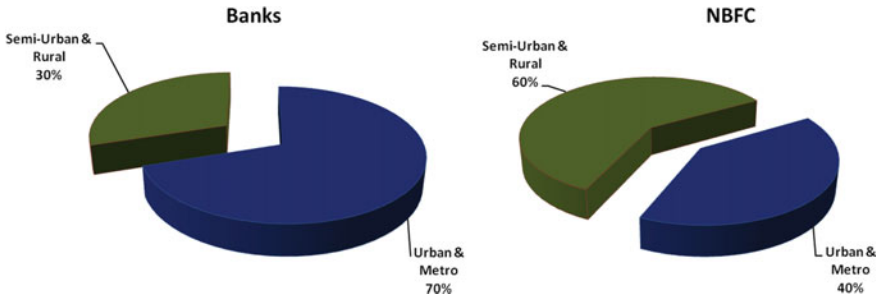

Chart 8.5 Rural and urban coverage of NBFCs and banking sector. *Source* CRISIL (2011)

business accrues from semi-urban and rural areas where retail finance penetration is low (Chart 8.5). The banks especially public sector banks, which have a significant presence in these areas, have remained largely focussed on mobilizing retail liabilities.

8.5 Share in Retail Finance by NBFC's and Banks

Over the past few years, there has been a decline in the growth rate of banking sector share towards total retail finance. This has resulted in a significant increase in the steady growth of retail financing by the NBFC sector. The NBFCs' share in the retail finance increased from 26% in 2011–12 to 30% in 2016–17 (Chart 8.6).[2]

[2]While NBFCs have grown steadily over years, the retail market share of banks has recorded a subdued growth.

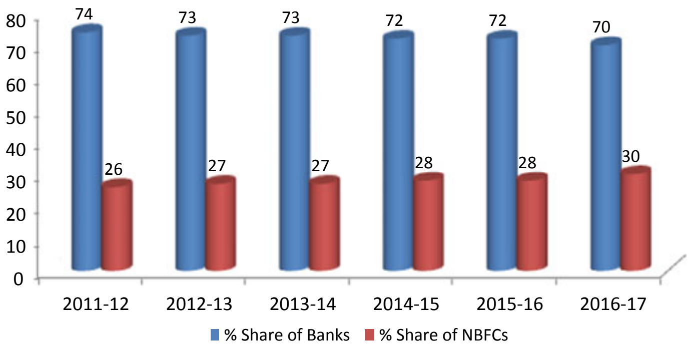

Chart 8.6 Share in retail finance NBFCs vis-a-vis banks

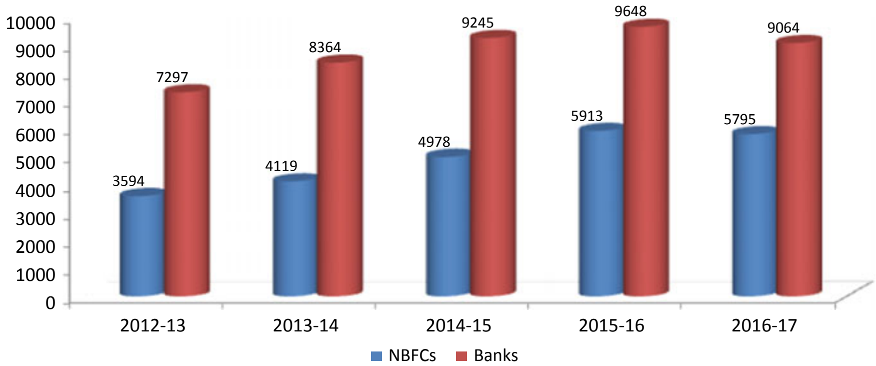

Chart 8.7 Lending to infrastructure sector NBFCs vis-a-vis banks

8.6 Infrastructure Financing by NBFCs Versus Banking Sector

The quantum of infrastructure finance provided by the NBFC sector witnessed an annual growth rate of 12.7% during 2012–13 and 2016–17. In absolute terms, during the same period the NBFCs finance to infrastructure increased from ₹3594 billion to ₹5795 billion (Chart 8.7). Moreover, the NBFCs financial support to infrastructure sector accounted for 39% and the balance is accounted for banks.

8.7 Profitability of NBFCs and Banks

Chart 8.8 provides a comparative picture on the profitability trends of NBFCs and banks. It uses trends of return on assets (ROA) of NBFCs and banking sector. The ROA of NBFCs sector is always on the higher side mainly due to its lower operating costs, and further, NBFCs do not have statutory pre-emptions like CRR. It is also

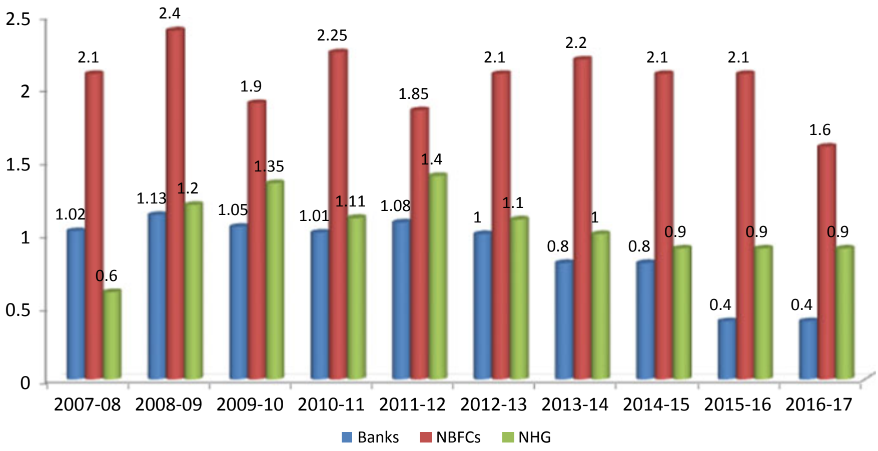

Chart 8.8 Trends in return on assets: NBFCs and banks

interesting to note that the return on assets of NBFCs has shown stability with figures ranging 1.85 and 2.4% over the years and is always higher than that for banks.

8.8 Risk Involvement of NBFCs-ND-SI in India

The NBFCs-ND-SI constitutes about 80% of the total assets of NBFCs sector. The revised regulatory framework for the NBFCs raised the threshold asset size of the NBFCS-ND-SI to ₹5 billion or more. As a result, many of the NBFCs-ND-SI were reclassified as NBFCs-ND. The asset quality of NBFCs-ND-SI has deteriorated from 1.7% in 2011–12 to 6.1% in 2016–17 (Chart 8.9). This may be partially due to the changes in asset classification norms.

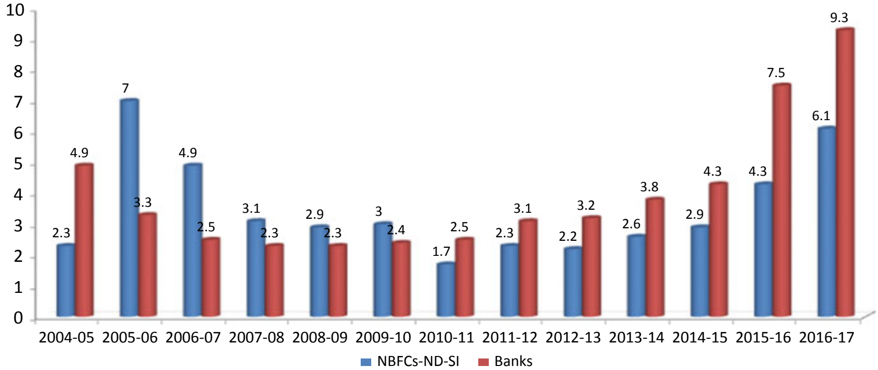

Chart 8.9 NPA ratios of NBFCs-ND-SI and banks (%)

However, it is noticed that the NPA ratio of NBFCs-ND-SI was relatively low as compared to that of banks in India. Particularly in 2016–17, the NPA ratio of NBFCs-ND-SI was 6.1% while that of banks was 9.3%. Thus, under borrowers' credit profile, the NBFCs have built-up their processes and systems to manage intrinsic risks.

8.9 Summing Up

In the last seven or eight decades, India has both banks and NBFCs. Both have grown significantly and contributed to the development of India. In the process of financial deepening, the interlinkages between these institutions have strengthened. At the same time, the RBI has positioned enough regulations and supervisory standards to safeguard each one without affecting the other. This kind of happy coexistence in India is somewhat different from what we observed under 'shadow banking' in the advanced and other emerging market economies.

Our analysis in this chapter indicates that the asset growth of NBFCs is impressive. The assets of NBFCs relative to GDP (i.e. asset ratio) increased from 8.4% in 2005–06 to 13% in 2016–17. During the same period, the asset ratio of banks improved from 75.4 to 93.2%. The proportion of NBFCs assets to bank assets has also steadily grown over the years, thus maintaining their growth momentum on par with banks and gaining the systemic importance. Their steady growth and increased market share indicate their success in their business models.

Further evidences also clearly indicate (i) the growing role of NBFCs in the financial savings of the households in India; (ii) relatively fast credit growth of the NBFCs as compared to banks; (iii) their strong presence in the semi-urban and the rural areas and their strong customer relationship; (iv) their increased share in the retail finance over the years; (v) higher financial support to infrastructure sector relative to their assets of NBFCs compared to banks; (vi) higher profitability of NBFCs than that of banks; and (vii) relatively low NPA ratio of NBFCs as compared banks' NPA.