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Performance of NBFCS: A pre and post COVID analysis

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Abstract---NBFCs in India have seen diverse trends where on one hand they have given a stiff competition to established banks in the country and on the other hand have seen an emerging trend and strong complement to the banking industry. However even pre Covid19 the liquidity crunch forced the NBFCs to venture into alternative sources of revenue as the core businesses of loans and advances credit facilities were shrinking. The pandemic has been extremely challenging for the economy and this sector has been no exception. The current paper studies the impact of the pandemic on the NBFC sector of India. It studies the performance of the NBFCs using CAGR, Profitability ratios etc. in the pre and post Covid era and the business models that are being applied in order to cope up with the current situation.

Keywords---NBFC, CAGR, profitability ratios, credit trends.

Introduction

NBFCs in India have seen diverse trends where on one hand they have given a stiff competition to established banks in the country and on the other hand have seen an emerging trend and strong complement to the banking industry .The pandemic has changed the face of the economy across sectors and undoubtedly has impacted the NBFC sector too. Over the years this sector has seen a lot of variations in terms of the complexities, size etc.

The pre covid situation had seen a rise in the popularity of NBFCs especially around the years 2016-17. The portfolio of loans grew at 14.9% during the first half of 2017-18, compared to 6.2% in the case of banks. The credit granted by NBFCs as a percentage of GDP rose to 8%, thus showing the growing importance of NBFCs. However even pre Covid19 the liquidity crunch forced the NBFCs to venture into alternative sources of revenue as the core businesses of loans and

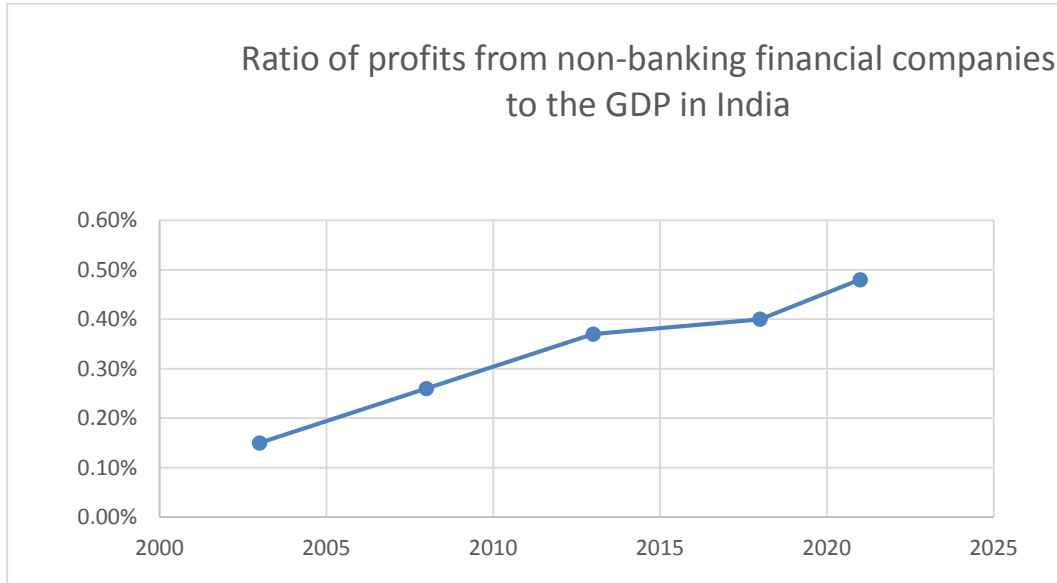
advances credit facilities were shrinking. On this count NBFCs have shown immense adaptability and agility in transforming their business models. With the changing risk profile post pandemic NBFCs have moved towards loan mix and more collateralized business. Over the years NBFCs have been instrumental for financial inclusion by providing credit to unbanked segments of the economy. NBFCs are mostly private sector institutions that specialize in meeting the credit needs and a variety of financial services which include financing of physical assets infra loans etc. As NBFCs specialise in offering loans to niche areas and cater to specific sectors, they are also categorised based on activities that they undertake. Till February 21, 2019, NBFCs were divided into 12 categories. Thereafter, these categories were harmonised in order to provide NBFCs with greater operational flexibility. As a result, asset finance companies (AFCs), loan companies (LCs) and investment companies (ICs) were merged into a new category called Investment and Credit Company (NBFC-ICC). At present, there are 12 categories of NBFCs in the activity-based classification. The recent study studies the impact of the pandemic on the NBFC sector of India

Contribution of NBFCs

Non-banking financial institutions or shadow banks have assumed importance in the recent times due to their role in expanding the credit markets of the country. They interlink with the bank's capital markets and other financial institutions. NBFCs' credit to Gross Domestic Product (GDP) ratio has steadily increased over the years which has moderated in the current period due to the pandemic. However, the sector has shown immense shock absorbing qualities and is expected to show considerable growth and increasing contribution to the GDP. Although The IL&FS default in September 2018 was a jerk on the liquidity position and confidence of the NBFCs, the sector has once again emerged with the Reserve Bank now strengthening its regulatory policy, and the NBFCs taking proactive steps in correcting asset-liability mismatches. However, just as the NBFC sector was finding its bearings, the COVID-19 pandemic struck and exacerbated the challenges faced by the sector. The impact of the pandemic due to lockdowns and general economic slowdown has hit hard on the NBFCs.

Between March 31, 2009, and March 31, 2021, the total assets of NBFCs grew at a compounded annual growth rate (CAGR) of 19.3 per cent, while the balance sheets of scheduled commercial banks (SCBs) grew at a CAGR of 12.8 per cent. In absolute terms, the asset size of NBFC sector (including HFCs), as on March 31, 2020, is Rs.51.47 lakh crore. Thus NBFCs have played an important role in financial inter mediation and have consistently contributing to the GDP of the country. Whereas the growth ratio of profits to the GDP consistently grew up to 2014. The growth considerably flattened up post the ILFS crisis and then the pandemic, however the resilience and the shock absorbing power of the NBFCs can be clearly seen

Ratio of profits from non-banking financial companies to the GDP in India



Source: statistica.com

Literature reviews

Sunita Yadav in her study “Performance of NBFCs in India” has used convenience sampling to study the financial performance for a period of 8 years using annual reports. Using ROI and CAGR, analysis showed that while some NBFCs showed a growing trend, some did see a receding trend as well. The NPAs have always been a challenge.

Dr..J.Shanmuganandavadivel and Dr..D.Sasikala Devi (2018) in their paper Performance of NBFCs-an Indian Context, have based performance of NBFCs on asset quality, profitability, exposure to sensitive sector and capital adequacy of NBFCs. They conclude in general that NBFCs had better asset quality than banks and had an ascending trend of profitability and capital positions although with some minor fluctuations

Rajeshwari Sengupta et al in their working paper – A study of Non- Banking financial companies in India have analysed the NBFC business model and their long term viability and sustainability. It highlights the advantages and the disadvantages of NBFCs and the need to strengthen that sector. Davinder Kaur (2018) in the paper “ A study of financial performance of NBFCs, analyzed the financial viability from different aspects such as revenue, net profit and quality of assets. It was found that the performance was consistent with an average growth of 2%.

Suneelkumar and Dr. Hosmani (2019) in the study “Financial Performance of Non-Banking financial companies in India studied the NBFCs with respect to their capital adequacy and certain select ratios like ROA, CRAR their capital

market exposure. They concluded that there has been a deterioration in the asset quality in cse of the NBFCs and that they needed a regulatory reform to keep performing in the long run for their stability.

Objectives of the study

- To study the financial performance of the NBFCs
- To compare the performance of the NBFCs in the pre and post pandemic period
- To understand the overall impact of pandemic on the sector

Research Methodology

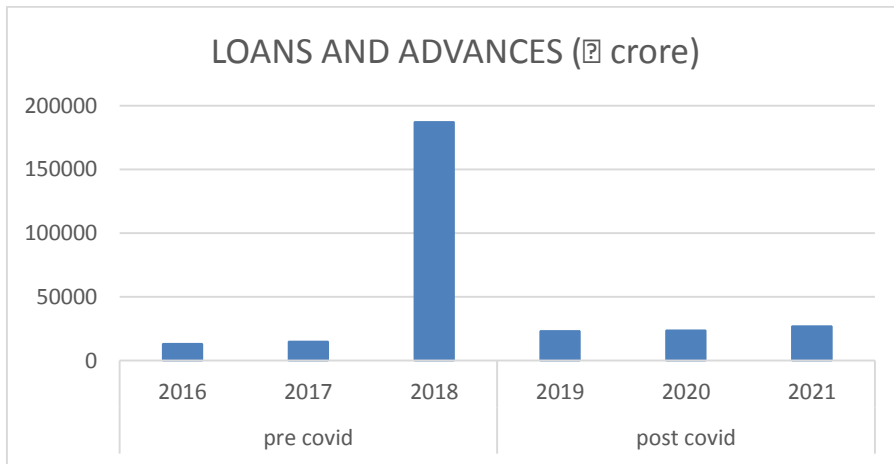
With recent trend in NBFCs trying to use alternative investment options for their liquidity and sustainability the financial viability of this sector is now a subject matter of discussion and research. While as per CRISIL reports the asset quality of the NBFCs are likely to improve by 200 bps, the sector is still struggling with credit growth. This study is undertaken in the current paper and is based on the secondary data which is collected from reliable sources viz. the RBI Bulletin, newspaper articles, journals, research papers etc. It is a descriptive analysis where mainly ratio analysis an comparative analysis are used as tools to evaluate the performance and based on the results make descriptive analysis of the financial performance of the Non-Banking financial institutions. For the purpose of this research the period prior to financial year 2018-19 is considered as precovid period whereas the period post 2019 is considered as post covid.

Analysis and findings

The financial performance of the NBFCs has been analysed on the basis of the net profitability, the quantity of loans and advances, the asset quality of these loans and advances, CAGR of the credit and sectoral analysis of the loans given in post the period viz. the pre and post pandemic period.

Loans and Advances

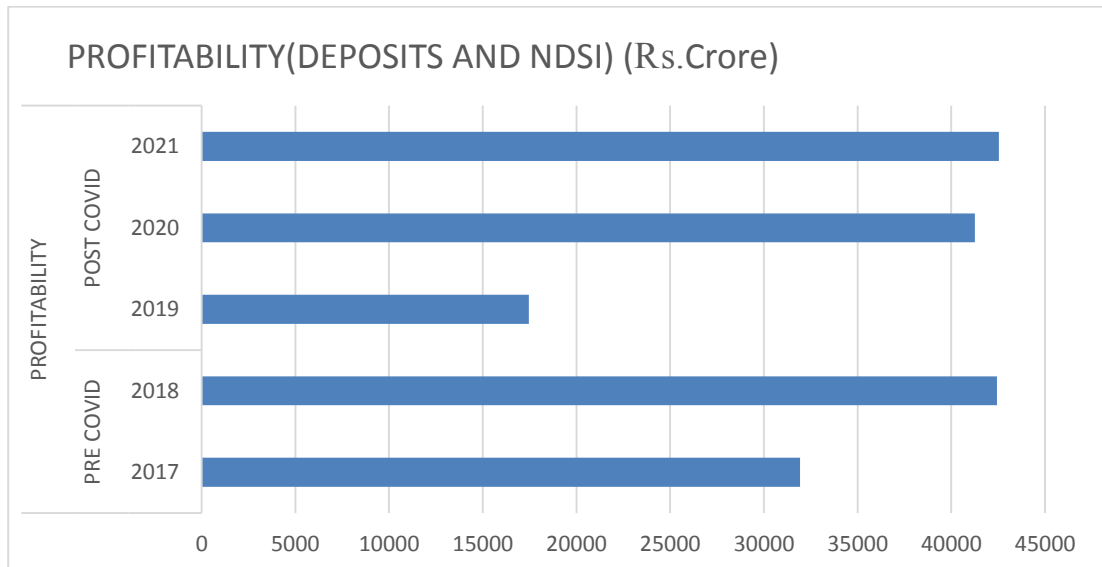
NBFCs saw a 8-10 per cent drop in loan collections in beginning of 2021 and an additional 10-15 per cent in during the financial year 2021-22. While nearly 10 per cent of borrowers have been missing their payment schedules during the second wave as against an average default rate of about 2-4 per cent, the quantity of loans and advances seems to be still moderate. As can be seen from the table below although there is a marginal increase in loans and advances from 2020-21, NBFCs have been very cautious in loan disbursement. Whereas 2017-18, saw a sudden surge in the loan and advances of the NBFCs the aftermath of ILFS have put the NBFCs on the regulatory track. Over the years NBFCs have been instrumental in the economy as a strong complement to the banking industry. Although the recent trends show that there is only a marginal increase in the amount of loans and advances, it does go a long way to prove the resilience of this sector. The growth of loans from Rs. 14846 crore in 2017 to Rs. 26937 crores shows that the sector has been progressing at a gradual level within the regulatory framework.



Data Source: RBI

Net Profits

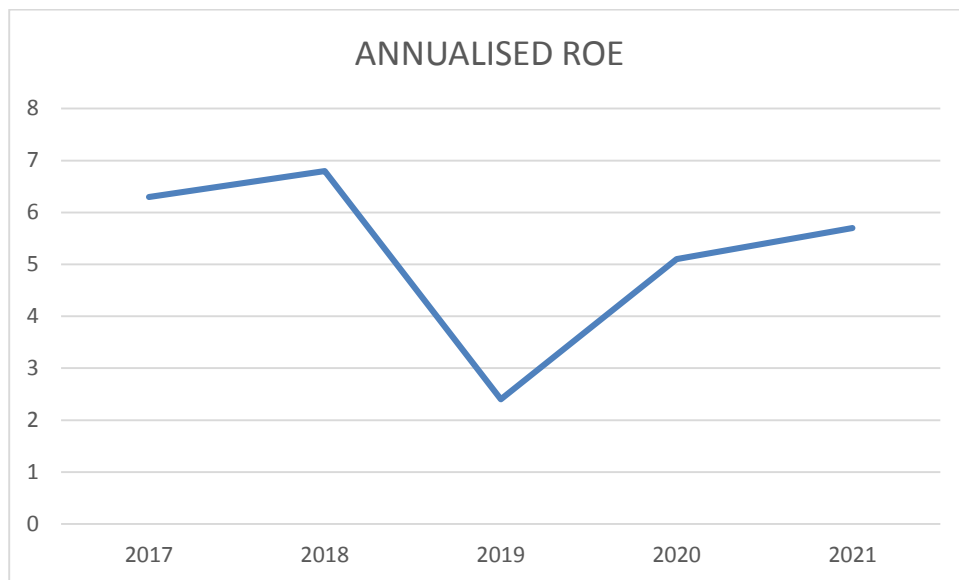
The profitability of the sector had been showing an increasing trend. This trend was interrupted by the pandemic due to slowing down of the economy as such. There was a sharp decline especially in the area of industrial and agricultural loans and an increasing percent of NPAs. This has affected the overall profitability of the NBFCs. As per financial rating sector of ICRA, although the sector witnessed an increase in AUM (assets under management) from 2019-21, the operating profitability of the NBFCs still remains moderate due to uncertainty. This has elevated the credit costs as a result of which has restricted the profits. However as can be seen the y-o-y growth in profits has been marginal which expects to improve over the years.



Data Source:RBI.ORG

Return on equity

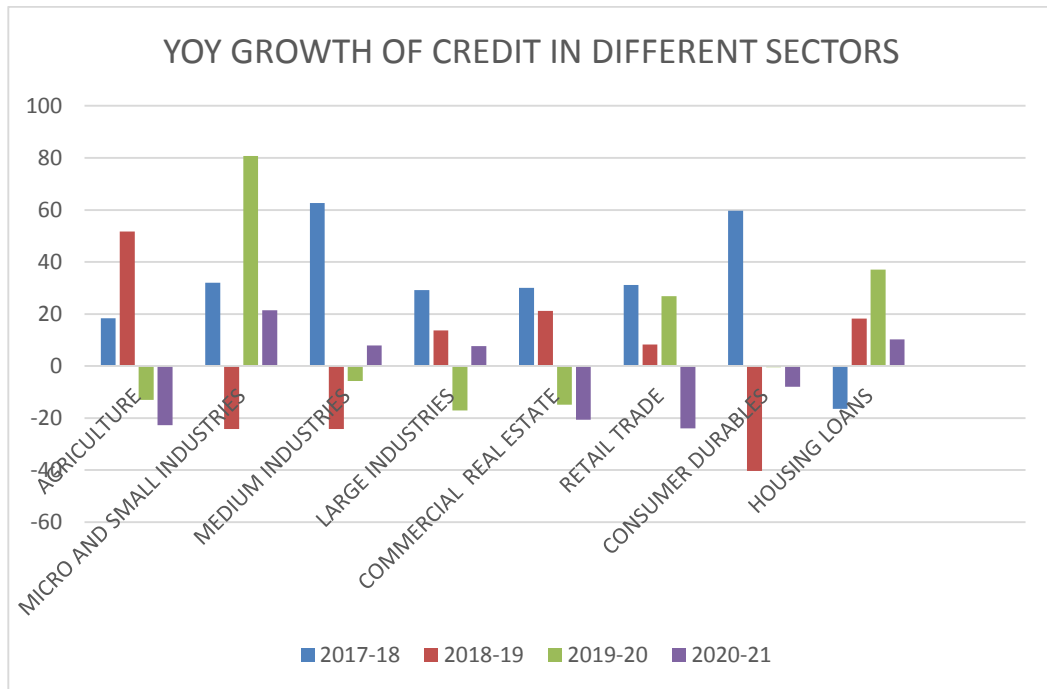
The return on equity (ROE) and net interest margin (NIM) of the NBFCs decreased in 2018-19, reflecting financial stress in the sector. As per RBI report, the overall decrease in profitability was driven by NBFCs- ND-SI. However, this effect was moderated due to improvement in the profitability structure of NBFC-D. As seen in the graph below the ROE is all time low in the first phase of the pandemic due to decreased borrowing, hauling overhead costs and uncertainty of returns. However, post pandemic this situation has been considerably improved



Data Source: RBI.ORG

Sectoral Analysis

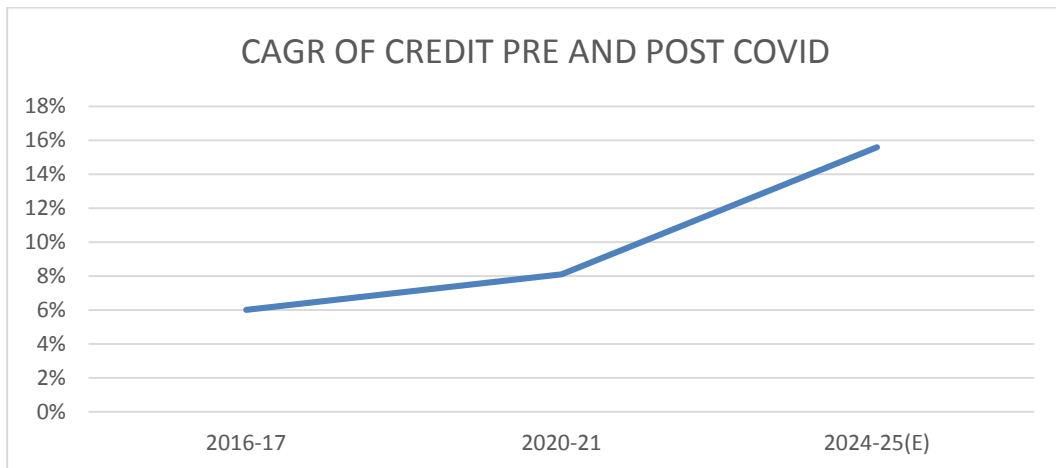
Sectoral analysis has shown an upscale in auto and housing loans with higher demand for loans in these areas and better asset quality for the sector. A sectoral snapshot shows that whereas in the pre covid period, agriculture and industry were the major stakeholders or borrowers of credit from the financial institutions, the trend is seen changing in the post covid period where housing loans and vehicle loans are the major niches. As of 20-21, MSMEs have also picked up due to the incentives and the boost by the Government policies, however the major NPAs are also in the area of industrial loans. However, loan remixes and debt restructuring have contributed towards growth in credit across sectors towards 2020-21.



Data: RBI.ORG

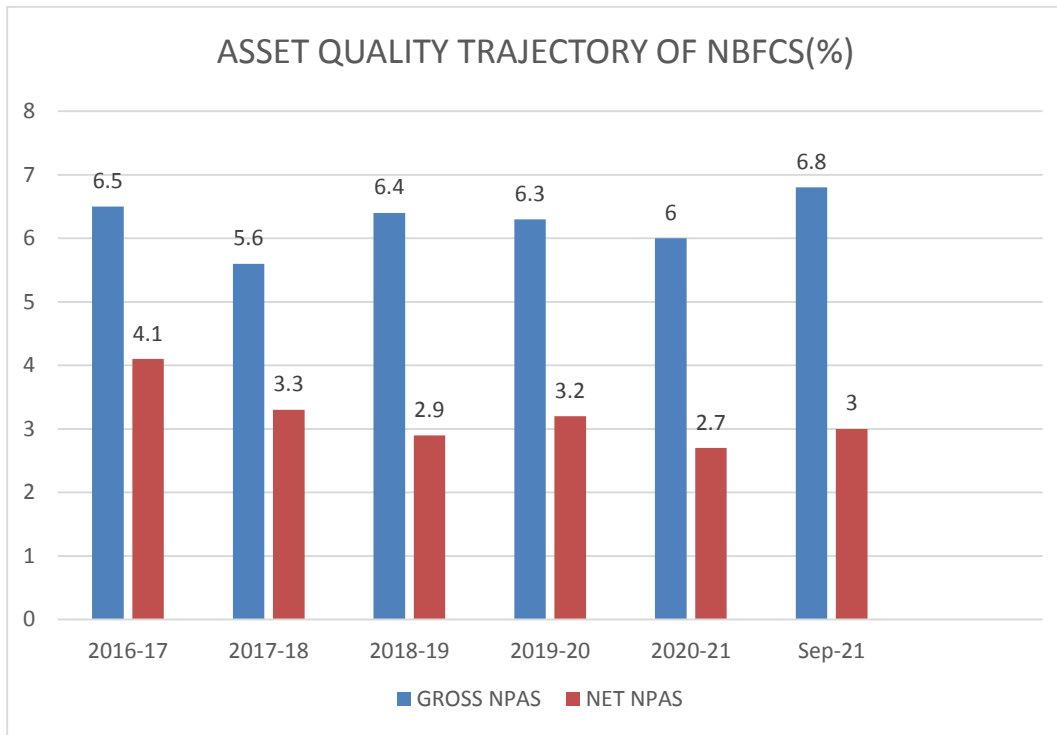
CAGR

The pre covid growth rate of the loans given by NBFCs average to about 7-8%. This was sharply hit during 2020-21 owing to pandemic. However, the strong balance sheets of the NBFCs and the re leverage policies adopted by NBFCs helped them to maintain a moderate CAGR. As per RBI reports between March 31, 2009, i.e. in pre pandemic time the total assets of NBFCs grew at a CAG of 18.6%. Although this fell to about 9% in 2020-21, the sector is predicted to grow at an average rate of 15.6% in the next 3 years. The NBFCs have shifted their strategies to maintain their CAGR. Specialized gold loan NBFCs have been efficiently serving the cash and liquidity requirements of the people from urban, semi-urban and rural areas. This has developed a robust market which is expected to grow at a CAGR of 19.5%. The credit growth has been depicted in the graph below which clearly indicates that the NBFCs are on a growth path with a predicted growth of 15.7% which looks very promising.



Asset Quality of NBFCs

An analysis in the asset quality of Assets of the NBFCs have indicated a rise in the NPAs thus indicating deteriorating quality of assets because of second wave of the pandemic. Between March 21 to September 21 itself the NPAs grew by 0.8% i.e. from 6 to 6.8. In 20-21, There was a standstill in the asset quality classification which led to improvement in the asset quality. Certain regulatory decisions by the RBI have also helped the NBFCs to improve their asset quality. The need for NBFCs in the financial economy has brought in regulatory reforms with the RBI implementing the scale based regulation. In the light of the pandemic, the RBI had announced a six-month moratorium on loan repayments till August 31, 2020, and subsequently a one-time debt-restructuring plan. A number of finance companies have now restructured a couple of their loans especially the infrastructure loans within the purview of the enhanced regulations which will lead to better asset quality post the covid period.



Overall Analysis

The pandemic has restricted the growth of the sector during the past 2 years, which saw a notable downfall in profits of 14.44% compared to the pre covid periods. This dragged the profitability ratios down as well. However, the NBFCs have shown their resilience and shock absorbing capacity with their strong balance sheets which have indicated strong growth in credit in the post covid period. The increase in cost to income ratio by around 5.7% further added to the decrease in profitability of the NBFCs. However, restructuring of loan, the growth in car and home loans as well as the robust increase in gold loans by the NBFCs have helped them to maintain their hold in the financial sector of the country. The fact that in spite of the economy dipping by almost 27% the growth in NBFCs has been plateaued at about 8% shows that it is on the path of growth.

Conclusion and Future Strategy

Although the sector faced a reduction in quantity, the quality of operations remained a positive as NBFCs capitalized on the increasing fall in asset quality of Banking sector and reacted positively to the regulatory reforms introduced by the RBI. Their assets have grown to about 33.335 in relation to the total banking sector assets presently, as compared to 22-23 percent in March 2015. With the RBI proposing to introduce a scale based regulatory system (SBR) to be effective from October 1, 2022. NBFCs would now be classified into four layers based on their activity, risk levels and size viz. NBFC-Top Layer (NBFC-TL) which is to be empty and reserved for NBFC to be specifically designated so by RBI; NBFC-Upper Layer (NBFC-UL) comprising mainly large entities assessed on parameters like

their importance to the financial system and complexity of their operations; NBFC-Middle Layer (NBFC-ML) consisting mainly mid-sized players, including deposit taking ones; and NBFC-Base Layer (NBFC-BL) having all small-sized NBFCs. Regulations and governance for NBFC-BL would be relatively relaxed compared to other layers. As per CRISIL, the non-banking finance companies may see an improvement in their bad loans ratio by as much as 150-200 basis points, due to postponement of the timeline which will give them time to revamp their collection infrastructure and align the borrowers with the new dispensation for adhering to upgraded non-performing assets (NPA) norms and improved economic activity

The post covid period will prove to be a new era for NBFCs as the MSME sector because of their a ability to tap into niche markets and provide specialized services In its report, RBI has noted that while the sector is still far from the desired position, the growth and confidence of the stakeholders is bound to increase with regulatory amendments and keen oversight which will optimise the state of NBFCs in the country. Risk assessment remains a critical area of development for the sector, as noted by the Financial Stability Report issued by RBI. The changing strategy of the NBFCs to maintain their credit flow and changing regulatory norms are bound to take the NBFCs towards growth and the economy towards financial inclusion.

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