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A Study of NBFC'S Impact on the Development of the Indian Economy

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Abstract

By boosting transportation, employment creation, wealth creation, bank credit in rural sectors, and assistance for economically underprivileged groups of the community, NBFCs do play a crucial position in the growth of an economy. Although the banking industry has a significant impact on the Indian financial market, non-banking financial companies are increasingly competing with the banking industry by offering a variety of financial services and complementing other financial organisations in the Indian economy. The purpose of this study is to understand how NBFCs have influenced the growth of the Indian economy. It is highly challenging for emerging nations like India to secure financing for economic growth and entrepreneurship. Although the government has implemented numerous financial inclusion programmes, including the Pradhan Mantri Jan Dhan Yojana and many others, banks are unable to meet the needs of all classes of people because of their strict credit worthiness and loan disbursement policies. As a result, households and small business owners are unable to access banks' financial services. Therefore, NBFCs must be able to offer a variety of financial services to all societal sectors promptly and efficiently in order for entrepreneurship to flourish in our nation. NBFCs play a crucial role in the mobilisation of funds in our economy by meeting the debt requirements of diverse economic sectors, such as major infrastructure financing and small microfinance. For the aforementioned points of view, study has been done to understand the role of NBFCs in the growth of the economy in our nation and to understand its current issues.

Keywords: NBFC, economic development

Introduction

The emergence of numerous alternative financial systems, such as Non-Banking Financial Companies, which are known as the complementary to the banking sectors, has completely reversed the trend in India, which was previously renowned for having a bank-dominated financial system. Non-Banking Financial Companies are companies that are registered under the Companies Act of 2013 in India and engaged in a variety of businesses, such as loans and advances, the purchase of shares, stocks, bonds, insurance business, hire purchase business, and chit fund business. However, these institutions do not include any that have agriculture finance, industrial activities, other purchase, sale, and construction of goods, and any immovable property as their primary business. Under the terms of the 1934 RBI Act, the Reserve Bank of India tightly controls and regulates the financial operations of NBFCs. Due to the growth of various industrial sectors, the enormous need for venture capital, and the need for working capital, there has been a significant increase in the need and demand for NBFCs during the past 20 years. Due to their lack of credit worthiness and inability to meet the terms and conditions of banking sectors, these businesses offer a variety of financial services to individuals in the sector who are not qualified. These individuals are known as unbanked consumers and typically reside in rural and semi-urban regions. Therefore, NBFCs are seen as the banking industries' complimentary sectors and are essential to development. Unbanked clients are those in the aforementioned category who often reside in rural and semi-urban regions. Therefore, NBFCs are seen as the banking industry's complimentary sector and are essential to the growth of the Indian Financial System. NBFCs are now bridging the gap between the society's need for financial resources and the availability of such resources from banking institutions. These financial organisations use deposits from people's savings to mobilise those money for lending to our society's most vulnerable groups.

NBFCS's Historical Context in India

NBFCs first began operating in 1960 and were regarded as an alternative to the banking sector in India. At that time, demand for NBFCs was very low due to a lack of investor and borrower awareness, but today, demand is very high as a result of the strict and rigid lending policies that the banking sector has been implementing in accordance with the strict guidelines that are being followed by the instruction of the RBI. The companies act initially regulated the financial activities of NBFCs, but subsequently, due to the intricate and specialised nature of these activities, the RBI made the decision to regulate and oversee these activities. In the 1980s and 1990s, NBFCs gained recognition as reputable and customer-friendly financial institutions. They have since retained a significant number of industrial company clients, and the number of firms has grown from about 7000 in 1981 to almost 30000 in 1992. Since then, RBI rules and regulations have been in place to oversee the operations of Non-Banking Financial Companies.

Classification of NBFCs

The NBFCs are classified as under:

- Hire Purchase Company

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- Mutual benefit Financial Company
- Residuary Non-banking Company.
- Chit Fund Company.
- Loan Company
- Investment Company
- Asset Finance Company

Objectives of the Study

- To research the role of NBFCs in the financial services industry
- To research how NBFCs affect the nation's economic growth.
- To research how NBFCs contribute to financial inclusion in the nation.
- To research NBFCs' involvement in India's infrastructure financing.

NBFCs' Contribution to the Growth of the Indian Economy

NBFCs serve as financial facilitators between sane savers and depositors and vulnerable borrowers. Due to the size of the economies, these financial companies offer a wide range of economic services. Additionally, thanks to their skill and professional knowledge services, the risk may be readily distributed across several units. As a result, their operations and activities offer prospects for both increased investment returns and reduced risk-taking. Borrowers receive a huge and diverse range of financial services in exchange for these financial institutions' intermediation operations, which eventually aids in the improvement of our country's economic standing. Commercial banking sectors frequently provide and disburse their capital to agricultural, industrial, and commercial purposes, and NBFCs typically focus on lending to small, rural, and semi-urban retail customers, lending for electronics, durable goods, and consumables, buying and remodelling homes, and lending for trading and transportation purposes. The RBI rigorously oversees and regulates all of the aforementioned operations, much like the banking industry. Financial institutions' primary function is to channel savers' money toward borrowers' most pressing needs. As a result, they are significantly contributing to the expansion and advancement of our country's economic sectors. The importance of NBFCs in the following sectors was investigated by the RBI's export committee:

Growth and Expansion in the Transportation and Infrastructure Sectors, as well as many other Crucial Industries

- Adequate and significant job creation
- Assist in generating riches
- Growth of the Economy
- Additional involvement of financial sectors in the growth of rural loans
- Recognized as a reliable industry for rural, semi-urban, and new consumers
- Aids in loan provision to our economy's more fragile sectors.
- Acting as significant donors to the state and federal funds

Data Analysis

The growth and development of financial intermediaries is very important for the expansion and development of our country's economy. The development of the economy has increased significantly as a result of the balanced expansion of the banking sector and NBFCs. NBFCs play a number of important and crucial roles, including offering the service of risk pooling, liquidity, and divisibility which help in diversifying the amount of risks and also help in promoting the concept of risk management by encouraging the customers who are unable to bear risks or only able to take risks to some extent, as well as helping to provide those financial services that the banking sectors in our country do not adequately offer.

The below table and chart shows the distribution of capital of NBFCs in the form of credit to the various sectors of the Economy

Table 1: Credit Distributions of NBFCs (2019-2022).

S. No.	Sectors	Percentage of Credit Distributions
1	Agriculture and allied	5.00
2	Services	23.00
3	Retail loans	28.70
4	Industry	61.20
5	Others	6.60

Source: RBI Websites

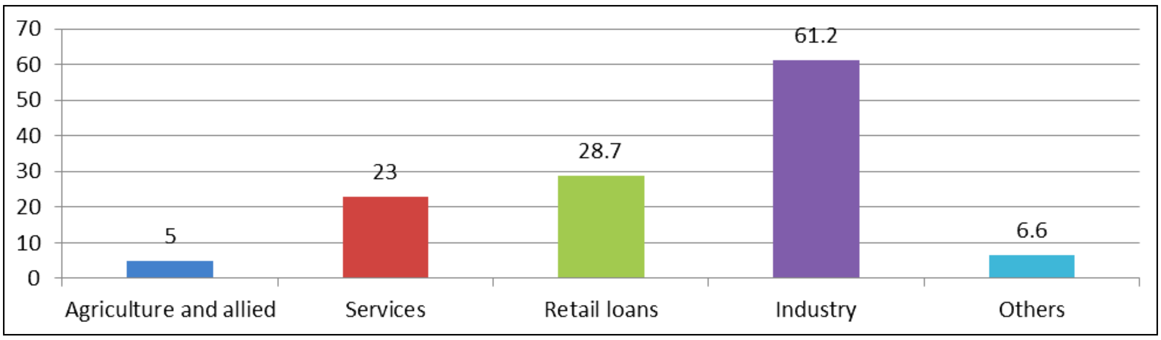

Fig 1: Credit Distributions of NBFCs (2019-2022)

The graph up top displays the allocation of loans from non-banking finance companies to the main economic sectors for development. Out of the entire share of 100%, the contributions are calculated cumulatively. NBFCs provide loans to the industry sector at a rate of 61.20%, to the retail sector at a rate of 28.70%, to agricultural and related activities at a rate of 5%, to the service sector at a rate of 23%, and to other sectors at a rate of 6.60%.

Contribution of NBFCs to Financial Stability

Banks would unavoidably have to take on risk that would otherwise be absorbed by the stock market, collective investment plans, or insurance companies because the NBFC business in India is very undeveloped. However, there are major differences between the sorts of financial contracts offered by banks and those offered by financial organisations. Banks are hence more vulnerable to failure. Since attempts to minimise financial scarcity in our nation may result in promotion and awareness-raising activities to diversify financial institutions and markets, all prudent investors may bear the risks outside of the banking sectors.

NBFCs' Part in Promoting Financial Inclusion

It is defined as the "offering of accessible and cheap financial services" for those clients who lack access to formal institutions of our traditional financial system or who have limited access to such institutions. "Payments and remittance facilities, savings, lending, and insurance services" are some of these services. The extremely important component of our nation's financial inclusion is known as microfinance. In addition to offering consumers modest amounts of credit, it also offers the people in the weaker sections of society many additional financial services in smaller amounts. In this approach, financial inclusion aims to provide credit and deposit facilities to those who belong to the poor and weaker sections of society. It also helps to provide many other supplemental financial services, such as insurance and remittance services. For the purpose of realising the basic of financial inclusion to the greatest extent feasible, we have provided chances for NBFCs to function as supplements to the banking sectors.

NBFC Issues and Difficulties in India

There is some uncertainty in today's thinking regarding how such Non-Banking Financial Institutions should mobilise the funds and to expand its leasing and hire purchase business in a material way. This is in contrast to the Reserve Bank of India's recently updated policies and rules, which state that some regulations will be appreciable and acceptable due to its capital adequacy rules and better and smoother funds management. In the current situation, it was determined after considering a number of factors that NBFCs should allocate and mobilise their own financial resources without relying on the banking industry or other financial institutions for assistance in the form of credit. Instead, they must do so independently of any supplementary institutions of finance. The percentage of deposits accepted from individuals to avoid relying on banks was loosely conceived, and in more recent times, only the AAA firms are authorised to accept individual deposits from individuals or to establish interest rates without any restrictions.

Conclusion

NBFCs are increasingly recognised as a crucial component of our financial system. Due to their poor credit standing and inadequate or missing documentation, those institutions have been providing credit to retail customers who are ineligible for loans from banks and other complementary financial institutions. As a result, they are referred to as undeserved customers from the perspective of banks. They are particularly effective at bringing cutting-edge financial solutions to bridge the gap between the They have been making significant contributions to key industries including infrastructure and road transportation, which are regarded as the engine of the nation's economic expansion and progress. The NBFCs have actively played the aforementioned role as a result of the export committee and taskforce being established with the assistance of regulatory organisations like the Reserve Bank of India. These financial institutions are now recognised as a crucial component of the Indian financial system and contribute significantly to a number of important strategic government decisions, including those involving financial inclusion. Additionally, they bridge the gap between the financial needs of retail and rural underdeveloped clients and the contributions made by banks to these customers in order to extend credit. The study's conclusions are relevant since they show that risks are crucial to NBFC operations and performance. Effective risk managers and the nation's central bank must oversee the management of such risks.

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