

Study on NBFCs and Their Growth in the Economy

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Abstract

This research paper provides an in-depth analysis of the evolution, role, and growth of Non-Banking Financial Companies (NBFCs) within the Indian financial system. Over the past few decades, NBFCs have emerged as crucial financial intermediaries, playing a complementary role to traditional banking institutions. Unlike banks, NBFCs are more flexible in their operations and have been particularly effective in reaching the underbanked and underserved segments of society, including small businesses, rural populations, and individuals with limited access to formal banking services.

The study highlights the significant contribution of NBFCs to various sectors of the economy, especially in areas such as infrastructure financing, retail lending, microfinance, and small and medium enterprises (SMEs). NBFCs have been instrumental in bridging the credit gap by providing customized financial products and faster loan disbursement processes. Their role in promoting financial inclusion has been particularly noteworthy, as they extend credit facilities to those who are often excluded from the traditional banking system.

Furthermore, the research examines the classification and functions of NBFCs, including asset finance companies, loan companies, investment companies, and infrastructure finance companies. A comparative analysis between NBFCs and banks is also undertaken to understand their differences in terms of regulatory framework, risk exposure, operational flexibility, and service delivery.

Despite their growing importance, NBFCs face several challenges that impact their stability and growth. The paper critically analyzes issues such as stringent regulatory requirements, dependence on market borrowings, asset-liability mismatches, and vulnerability to liquidity crises. The impact of major financial disruptions, particularly the COVID-19 pandemic, is also discussed, highlighting how it affected credit flow, repayment capacity, and overall financial health of NBFCs.

1. Introduction

1.1 Background

Non-Banking Financial Companies (NBFCs) act as intermediaries between savers and borrowers, providing credit in areas often neglected by banks such as transport, housing, and small businesses. Their flexibility, customer-centric approach, and ability to innovate have made them crucial players in India's financial system.

1.2 Meaning and Definition

According to section 45-I (f) of the RBI Act, an NBFC is a financial institution which is a company, engaged in the business of loans and advances, acquisition of shares, stocks, bonds, debentures, or

securities issued by government or local authority. A company is considered an NBFC if financial assets constitute more than 50% of total assets and income from financial assets constitutes more than 50% of gross income.

1.3 History

NBFCs began in the 1960s to meet the financial needs of savers and investors not adequately served by banks. Initially limited in scope, they expanded significantly post-liberalization in the 1990s. The number of NBFCs grew from 7,000 in 1981 to over 30,000 by 1992. The RBI introduced regulatory frameworks to manage their operations, including mandatory registration and prudential norms.

2. Review of Literature

Amita (1997) analyzed financial results of NBFCs and found varying performance across categories. Vittas (1997) emphasized NBFCs' role in capital market development. Lakshmi (1998) attributed NBFC success to customer relationship management and quick loan processing. Harihar (1998) studied financial metrics like NPM and asset turnover. Sorab (1999) noted NBFC dominance in hire purchase and auto financing. Gayathri and Madhusudhanan (2000) observed aggressive deposit mobilization. Vaidyanathan (2001) highlighted NBFCs' role in credit delivery to trade and services.

3. Research Methodology

3.1 Statement of the Problem

NBFCs face challenges such as regulatory tightening, funding constraints, and market perception issues. Despite these, they remain critical for financial inclusion and economic growth.

3.2 Objectives of the Study

- To study NBFCs' role in economic development
- To analyze their functions and classification
- To compare NBFCs with banks
- To examine challenges and crises faced
- To suggest measures for strengthening NBFCs

3.3 Scope of the Study

The study focuses on Indian NBFCs, their evolution, regulatory framework, and impact on the economy.

3.4 Limitations of the Study

- Concentrates on Indian NBFCs
- Relies on secondary data
- Market conditions may change over time

4. Findings and Data Analysis

4.1 Functions of NBFCs

- Hire Purchase Services
- Retail Financing

- Trade Finance
- Infrastructure Funding
- Asset Management
- Venture Capital Services
- MSME Financing

4.2 Transparency and Disclosure Requirements

NBFC-P2P platforms must disclose borrower and lender information, credit assessment methodology, grievance redress mechanisms, and portfolio performance metrics on their websites.

4.3 Features of NBFCs

- Accept deposits for 12 to 60 months
- Interest rates regulated by RBI
- No deposit insurance
- No guaranteed repayment by RBI

4.4 Classification and Types of NBFCs

NBFCs are classified based on:

- Nature of business (e.g., Investment, Loan, Housing Finance, Equipment Leasing)
- Access to public deposits (Deposit-taking vs Non-deposit-taking)
- Size (based on asset base)

5. Hypothesis

H₀: NBFCs have no significant impact on India's economic growth.

H₁: NBFCs significantly contribute to India's economic growth.

6. Recommendations

- Strengthen regulatory framework while ensuring flexibility
- Improve transparency and disclosure requirements
- Enhance digital adoption for efficiency
- Promote financial literacy among borrowers
- Encourage collaboration between NBFCs and banks
- Develop crisis management mechanisms

7. Conclusion

Non-Banking Financial Companies (NBFCs) have progressively transformed into indispensable pillars of the Indian financial system, effectively bridging the gaps left by traditional banking institutions. By extending credit to underserved and unbanked segments, NBFCs have significantly contributed to financial inclusion, economic diversification, and overall development. Their active involvement in infrastructure financing, retail lending, microfinance, and support to small and medium enterprises (SMEs) has strengthened the backbone of the Indian economy.

Over the years, NBFCs have demonstrated flexibility, innovation, and adaptability in catering to diverse financial needs, often reaching areas and customer segments where conventional banks face operational or regulatory limitations. However, despite their growing importance, the sector continues to face several structural and cyclical challenges, including stringent regulatory frameworks, liquidity constraints, asset-liability mismatches, and susceptibility to economic shocks such as financial crises and the COVID-19 pandemic.

These challenges highlight the need for a robust and balanced regulatory environment that ensures both stability and growth. Strengthening governance practices, enhancing risk management systems, and improving transparency are essential for building long-term trust and sustainability in the NBFC sector. Additionally, embracing digital transformation and fintech integration can significantly improve operational efficiency, customer outreach, and service delivery.

In conclusion, NBFCs will continue to play a crucial role in India's financial ecosystem and economic growth trajectory. With appropriate policy support, technological advancement, and resilience-building measures, the sector can further expand its reach, enhance financial inclusion, and contribute more effectively to the nation's vision of sustainable and inclusive economic development.

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APPENDIX

❖ QUESTIONNAIRE

- Name:
- Age:
- Gender:
- Occupation:

- What is your income:

- Do you have a good knowledge about NBFCs
- Yes
- No
- Maybe
- Are you aware of the NBFCs located in your area
- Yes
- No
- Maybe

- What motivates you to choose NBFC while applying for loan
- Faster processing system
- Low interest rates than bank
- Access to loans with poor credit history
- All of the above

- NBFCs are more profitable than the banking sector because of lower costs
- Agree
- Neutral
- Disagree

- Would you encourage people to avail the services of NBFCs
- Yes
- No
- Maybe

CHAPTER 6 BIBLIOGRAPY

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