FIDC

Finance Industry Development Council

(A body incorporated as a Self Regulatory Organisation for Registered NBFCs)

ASSET FINANCING NBFCs

ROLE OF ASSET-FINANCING COMPANIES (NBFC-AFCs) IN SERVING THE SOCIO ECONOMIC OBJECTIVES

The Indian economy today is observing a phase of phenomenal growth. We have seen year on year growth rate of about 8 - 9 per cent in last 3 - 4 years. Financing requirement is also increasing commensurately and will continue to increase in order to support and sustain the tremendous economic growth led by asset creation. NBFC-AFCs have been playing a complementary role to the other financial institutions including Banks in meeting the funding needs of the economy. In fact diversification of financial markets is an important component of financial sector reforms. The increased consumerism in the Indian economy in past decade or so has been possible only because of the availability of credit to retail customers which has been largely supported by NBFC-AFCs and banks later joined the league. Also, the Indian economy is fairly non-corporate and these sectors, have primarily been catered to by non-banking sources. It is, therefore, evident that NBFC-AFCs in India have made significant contribution to the economic growth hitherto and shall continue to do so, given a congenial environment to grow.

Successive RBI reports, reports of the Expert Committees including The Parliamentary Standing Committee on Finance, have recognized that the financial intermediaries like NBFC-AFCs have a definite and critical role to play in a developing economy such as ours.

Asset Financing companies are now very well regulated and supervised. Just like banks, they are required:

- To be registered with RBI,
- To follow prudential norms set by RBI in the matters of capital adequacy, credit/investment norms, asset-liability management, income recognition, accounting standards, asset classification, provisioning for NPA and several disclosure requirements.
- To follow KYC norms.
- To adopt a Code of Fair Business Practices

We are also required to file regular returns with RBI and are subject to inspection on site by RBI. Indeed, RBI has clearly articulated its intent of levelling the regulatory playing field between banks and NBFC-AFCs.

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1. Role of AFCs in Funding The Road Transport Sector and Infrastructure

NBFC-AFCs play a very useful role in channelising funds towards acquisition of commercial vehicles and consequently aid in the development of the road transport industry. NBFC-AFCs are engaged in creation of assets like financing transportation and infrastructure construction equipments and projects. Needless to mention, the road transport sector accounts for nearly 70% of goods movement and 80% of passenger movement across the length and breadth of the country and the role of NBFC-AFCs in the growth and development of this sector has been historically acknowledged by several committees set up by the Government and RBI, over the years.

Road Transport Sector today is the lifeline of our economy. It is an industry on wheels and is responsible for creating self-employment opportunities – both direct and indirect - in semi-urban and rural areas. As stated earlier, the Road Transport Industry carries a major chunk of freight and passengers. Recently, Government has accorded a very high priority to this sector. It is a well-established fact that NBFC-AFCs provide 80% to 90% of funding for the Road Transport Sector.

Some of the facts related to Commercial Vehicles and their financing are as follows:

- Indian economy is becoming more dependent on Road than Rail because of the flexibility of roads. Heavy government outlay for mega road projects like the Golden Quadrangle will further accelerate this trend

- Sale of Commercial Vehicles is one of the barometers of the performance of the economy
- Ninety five percent of the Commercial Vehicles are acquired under financing.

Already we are witnessing demand for replacement of vehicles on account of the need for replacement of old Commercial Vehicles.

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It is estimated by various study groups that each commercial vehicle manufactured, sold & financed in this country gives direct & indirect employment to minimum 20 persons, thereby providing employment generation to several lakhs of people all across the country. It is the most geographically well spread network accessing the remotest villages in India.

The potential of the commercial vehicles financing industry is estimated at Rs. 15000 crores and is growing fast. Another Rs.6000 crores would be required for phasing out of commercial vehicles, which are more than 15 years old.

- Borrowers' Profile: Mainly Retail with minimum individual/group exposure and therefore, concentration of risk is reduced.

- Priority of Repayment: Being an earning asset, it ranks high in priority.

- Ticket value of each transaction: Rs. 10 to 15 lacs for new vehicles and Rs.5 lacs to Rs.8 lacs for used vehicles.

- CRISIL in its study has placed commercial vehicle financing under the "low risk" category, in its Risk Continuum.

- NBFC-AFCs have a strong presence in the rural markets where they are engaged in financing farming machinery such as tractors, and LCVs and three-wheelers used for transportation of agricultural produce. Given the necessity of increasing agricultural growth through improvements in productivity and also of generating employment in rural areas, asset-financing companies will continue to play a vital role in meeting these objectives.

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2. Asset Creation

NBFC-AFCs have demonstrated that their strength has been in creation of productive national assets through leasing and other modes of financing. In fact, most developed economies have relied heavily on lease financing route in their developmental process. NBFC-AFCs have been playing a major role in promoting leasing, hire-purchase, loan disbursals etc. in different economic activities, be it infrastructure creation or developing key support services for such infrastructure. Most developed countries exhibit impressive market penetration of leasing (a measure of leasing in capital creation). US (31.1%), Canada (20.2%), Australia (20%), UK (15.3%), Sweden (13%) and France (12.9%) enjoy double-digit penetration rates followed by Japan, Germany and Italy with near double-digit rates. Compared to these nations, India's market penetration in leasing stands at somewhere between 2-3%. Even developing economies like Russia, Mexico, Turkey have better market penetration when compared to India. This clearly reflects the conducive legislative and regulatory regime that the respective governments have created towards promotion of leasing.

For a developing nation like India where infrastructure creation has been presently accorded highest priority, leasing has immense potential. More particularly in the case of small and medium enterprise (SME) sector which accounts for the lion's share of the entire economic activities in our country, leasing offers tremendous advantages and hence needs to be promoted in a big way.

3. Observations made by RBI and various Government Committees :

In its Mid-Term Credit Policy 2006-2007, RBI has accorded recognition to the role of Asset Financing NBFCs within the financial sector by classifying them as "Asset Financing Companies", and by segregating them from NBFCs involved in the Investment and Loan business.

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As part of the overall NFBC sector, the comments in the various reports are outlined below :-

A. Observations made in the RBI's report titled "Report on trends on progress of banking in India 2003-2004"

"Notwithstanding their diversity, NBFCs are characterized by their ability to provide niche financial services in the Indian economy. Because of their relative organizational flexibility leading to a better response mechanism, they are often able to provide tailor-made services relatively faster than banks and financial institutions. This enables them to build up a clientele that ranges from small borrowers to established corporates."

B. Observations made by the Parliamentary Standing Committee on Finance in their 45th Report on The Financial Companies Regulation Bill, 2000

a) NBFCs have higher level of customer orientation, fewer pre and post sanction requirements and provide simple and speedy tailor made services.

b) NBFCs have become an integral part of the Indian Financial System in view of their complementary as well as competitive role.

c) Non-Bank credit cover 70% of the requirements for the Trading activity and more than 50% of the requirement of unregistered manufacturing.

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C. Observations of the Task Force on NBFCs (Vasudev Committee) appointed by Government of India in 1998.

a) Financial intermediaries like NBFCs perform the function of being a link between savers in the society and users of the savings.

b) NBFCs have greater reach and flexibility in tapping resources and they provide retail services to small and medium level business and road transport operators.

c) NBFCs constitute an important link between banks and the requirer of services and are an important component of a diversified financial market.

Therefore, it can be seen that Asset Financing Companies (within the NBFC segment) play a significant role in ensuring cost-effective delivery of credit to the weaker and the un-banked segments of Indian society, act as an intermediary between the banking sector and borrowers in the rural markets, and assist in the creation of real and productive assets, which in turn have a multiplier effect on employment.

The role of Asset Financing Companies within the financial sector cannot be overstated and it is keeping this in context that we request the Hon. Minister to evaluate the issues outlined in this petition and provide relief to the industry.

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