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CRISIS IN IL&FS ULTIMATELY AFFECTING THE CREDIBILITY OF NON-BANKING FINANCIAL COMPANIES

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Abstract: **This paper involves study of the Non-Banking Financial Companies in India and the recent crisis which is being faced by them. The aim of this paper is to study the causes of the crisis in NBFCs and to study the impact of the crisis on the economy as a whole. The paper also highlights the preventive steps which can be taken in order to avoid such a crisis in the future.**

Keywords: **Non-Banking Financial Companies, economy, crisis.**

1. INTRODUCTION TO MICRO FINANCE

Micro finance is defined as the assistance provided to lower income group of people in order to raise their standard of living by providing them with the employment opportunities and making them financially stable.

This is done by providing them small amount of loans at regular intervals. Though this function was historically performed only by banks, recently a large number of institutions have come up which perform the primary function of providing loans to lower income group of people. These include Non-Banking Financial Institutions, Small Finance Banks, Self Help Groups, etc.

The main reason which has led to the entry of new institutions is the inability of banks in providing loans to lower income group of people as they are thought to be less credit worthy by banking institutions. Other possible reason is the large amount of formalities which generally discourage people from approaching the banks and they are ultimately left at the hands of the money lenders who tend to charge huge interest rates. The above-mentioned factors have contributed to the larger share of informal credit in the Indian economy which ultimately affects the growth of economy as a whole.

As a result, various interventions were made by the government as well as the private sector in the extension of micro finance services to the women and poor sections of the society.

Thus, various types of Micro Finance Institutions emerged in India-

Co-operatives

Non-Banking Financial Companies

Self Help Groups

The focus of the current paper is on the Non- Banking Financial Companies which have gained immense popularity in providing short term loans to their borrowers and are presently facing a crisis.

The micro finance sector in India is all set to grow at a rate of 30% year on year growth to 90,000 crores in 2019 according to the estimates by an industry body Sa-Dhan. Therefore, it becomes important to look into the factors which might hinder its growth.

OBJECTIVES

The present study aims to fulfil the following objectives-

1) To study the causes of the present crisis in NBFC sector and to study its impact on the economy as a whole.
2) To present various solutions so that the present crisis does not repeat itself.

2. RESEARCH METHODOLOGY

The purpose of the research is to provide an insight into the crisis in NBFC sector. Therefore, the research is descriptive as well as analytical in nature and for this research the secondary sources of data has been used which includes journals, newspapers, magazines etc.

3. REVIEW OF LITERATURE

- In a study conducted by Dr. Taruna and Arpit Shailesh on the impact of micro finance with reference to priority states of India, they have concluded that micro finance works in an integrated manner and is instrumental in the field of poverty alleviation. But it can work effectively only when government extends full support to it.

- Dr. C. Parmasivan and R. Anandaraman in their research paper on Micro Finance by banks in India have clearly indicated that micro finance helps in reduction of poverty in rural areas and the performance of commercial banks is satisfactory but the performance of cooperative banks and regional rural banks must certainly improve.

- Tara S Nair through the research paper titled Microfinance-Lessons from a crisis has stated that a macro policy should be framed by collaborating all the stakeholders so that their experience is utilised and a crisis like that in Andhra Pradesh could be avoided. The author has also asked to implement the Malegam report recommendations.

- In a paper by S. Mohapatra and B.K. Sahoo titled Impact of Micro Finance on rural poor, they have stated that the participation of SC/ST population in micro finance programme is minimal and that the programme has left behind the poorest section of the society. They have also highlighted that monitoring of group activities and suitable training can enhance the effectiveness of micro finance

- In a paper- Microfinance in India: A Regulatory Structure by Ms. Meenu Rani and Ms. Rimmi Jain, they have discussed the present regulatory structure of micro finance in the aftermath of the crisis in Andhra Pradesh. They have also made various suggestions in the regulatory structure so that a crisis of such intensity does not occur in the future.

- In a paper published by Dr Ritu Chandna named Issues in microfinance sector in India she states that micro finance has certainly helped in lifting people out of poverty, providing self employment opportunities and making them financially stable. It also states that micro finance in India needs to adopt different models if it aims to include people who are till now excluded from it.

- Abhilash k through his paper Micro Finance and Women Empowerment with Special Reference to self help groups states that micro finance helps in raising the status of women in the society. It helps them in better decision making and makes them financially independent. He also highlights the role of training in making micro finance effective for women.

- Dr.P.Venkateswara Rao, Mrs.G. Kavitha Kiran, and Mrs.N. Bindu Madhavi in their paper Sustainable micro finance for women empowerment have shown us that micro finance helps in the overall development of poor in a country like India which also leads to enhancement of the status of women in the society. It also depicts the role micro finance plays in financial and non-financial empowerment of women.

From the review of literature it is evident that Non-Banking Financial Companies are definitely here to stay and may work wonders for the Indian economy, but only if they are saved from the crisis which it is currently facing.

BACKGROUND AND CAUSE OF THE CRISIS

Non – Banking Financial Companies, particularly the smaller ones are struggling with asset-liability mismatch and corporate governance issues.

IL&FS A Non-Banking Financial Company had borrowed short term loans from banks and lended to developers of long-term projects, which got stuck up because of various factors and ultimately became the reason for the crisis to start. It had also lent to less credit worthy customers including unscrupulous developers and wilful corporate developers indulging in round tripping of funds and ever greening of loans and ultimately it did not have cash to repay its lenders.

The crisis started when IL&FC financial services failed in meeting its obligations in September, 2018. Trillions of rupees got stuck up in various sectors including real estate, construction, infrastructure etc. The promoters of projects are not able to borrow money to complete projects and are therefore forced to enter into standstill agreements. The lenders and investors could end up poorer as they have no control over price movements of these shares.

Though currently the crisis may not pose a systemic risk but the investors are certainly worried about its impact on the overall growth. Keeping this in mind Reserve Bank of India had to take certain regulatory and supervisory steps and has issued certain norms for deposit taking and non-deposit taking NBFCs.

Accordingly, the Non-Banking Financial Companies would now have to maintain a higher liquidity coverage ratio, which is the proportion of assets which can be quickly converted into cash. It also means that the NBFCs will now have less cash to lend to its borrowers as they will have to maintain LCR of 60%. This will ensure that they do not borrow short term and lend for long term projects. The present move of the reserve bank may seem strict at first but it will definitely ensure that the crisis which NBFCs are currently facing does not show up again as now they will have to always maintain a buffer against their lending.

MEASURES TO BE TAKEN FOR THE EFFECTIVE FUNCTIONING OF NBFCs

The Reserve Bank of India should keep a strict vigil on the functioning of Non-Banking Financial Companies so that even smaller discrepancies in their functioning is noticed and prompt action is taken before a huge crisis takes place in the country.

Non-Banking Financial companies should also be careful before lending and should avoid lending to less credit worthy customers so that their balance sheet remains stable and is not affected by non-performing assets.

The new norms issued by the Reserve Bank of India should be strictly followed as they will provide a buffer against any non-payment of loans by NBFC clients.

The regulator should definitely ensure a proper inspection of books of accounts along with the regular audit. This measure can certainly help in ensuring the smooth functioning of NBFCs.

The role of rating agencies has also come into question as even after knowing about the deteriorating balance sheet of IL&FS, it was granted top notch rating and ultimately swift downgrading of its rating was bound to create a panic, which is exactly what happened. From this it is quite clear that if the rating agencies had performed their roles wisely, this crisis could have been avoided.

4. CONCLUSION

The role of NBFC in alleviation of poverty in India is understood by all but even then, enough emphasis is not laid on the development of micro finance institutions. This is clear from the recent crisis in NBFC sector which signifies that the current regulatory framework was insufficient in protecting it from various risks. It also signifies that the present regulations were not able to restrict the activities of NBFCs and they were operating without effective supervision which could not prevent them from indulging in various kinds of malpractices. Therefore, the need of the hour is to develop a more stringent regulatory structure which does not hinder their growth but certainly discourages them in following any kind of malpractices. This kind of structure is also good for the economy in the long run as it will encourage more NBFCs in setting up their operations.

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