Financial Performance and Growth of Non-Banking Financial Companies

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Abstract: ***Non Banking Financial Companies are an important segment of the Indian Financial system in extending credit to the unbanked segments of the society particularly to micro, small and medium enterprises. They are classified into different categories based on their status and principal activities. In this paper, an attempt has been made to analyse the performance of the five different categories of NBFCs in India across 2015 to 2019. The performance is analysed by examining key indicators like Liquidity ratio, Profitability Ratio and Debt to Equity Ratio. The findings indicate that the selected categories of NBFCs differ significantly in terms of Liquidity and Profitability ratios from one another.***

Keywords: NBFCs, Liquidity Ratio, Profitability Ratio, Debt to Equity Ratio

1. Introduction

India is a developing country where large sections of the population are unbanked which give rise to several forms of financial intermediaries including non banking financial companies. A Non Banking Financial Company (NBFC) is a company registered under the Companies Act 1956 engaged in the business of loans and advances , acquisition of stocks , equities, debt etc issued by government or any local authority or other marketable securities like leasing, hire purchase ,insurance business , chit business. NBFC sector has evolved considerably in terms of size, operations, technological sophistication, and entered into newer areas of financial services and products. It is essential to analyse and measure the growth of NBFCs for better understanding about the transformation of financial intermediaries in the context of Indian banking system. Financial performance can be measured using solvency and profitability ratios and applying statistical tools to analyse the results.

2. Objectives

The study has the following objectives:
1) To analyze the short term solvency of the selected NBFCs.
2) To appraise the long term solvency of the selected NBFCs.
3) Financial performance of NBFCs in terms of profitability.

3. Research Methodology

Secondary information has been collected through various sources which include data from RBI Publications, Moneycontrol Website, Journals and Reports on NBFCs. For conducting the study, 10 companies of five different categories are chosen for which data is available. The five different categories of NBFCs chosen are Asset Finance Companies, Core Investment Companies, Factors NBFCs, Infrastructure Finance Companies and Microfinance Companies. In the course of the analysis in this study, the use of various accounting and statistical techniques has been made. Ratio analysis, mean, standard deviation and ANOVA have been applied. The variables selected for analysing the performance of NBFCs are Current ratio, Debt-Equity Ratio and Net profit Ratio.

Short Term Solvency

Current Ratio

Current Ratio is a liquidity ratio that measures ability of the enterprise to pay its short-term financial obligations i.e. liabilities. The Formula for calculating the ratio is

Current Ratio = Current Assets/Current Liabilities

The generally accepted standard of current ratio is 2:1 i.e. current assets should be twice the current liabilities. Table 1 provides the data related to current ratios calculated for the sample NBFCs taken for the study. These ratios are calculated for 5 consecutive years from 2015 to 2019.

Table 1.1: Current Ratio

Companies	2015	2016	2017	2018	2019	SUM	AVERAGE	VARIANCE
Armaan Financial Ltd	1.36	1.28	1.02	0.96	2.05	6.67	1.334	0.18868
Mahindra & Mahindra	1.18	1.27	1.25	3.19	2.72	9.61	1.922	0.91797
L&T Finance Holdings Ltd	1.09	1.1	0.90	845.51	1679.92	2528.52	505.704	564584.7
Reliance	1.22	0.85	1.01	31.63	28.62	63.33	12.666	255.1636
IFCI	1.299	0.93	1.233	11.977	9.575	25.014	5.0028	28.51543
Siemens	1.54	1.85	1.99	1.95	2.12	9.45	1.89	0.04765
REC	0.678	1.223	1.173	51.63	15.57	70.274	14.0548	480.9315
Power Finance	1.006	1.21	1.32	48.74	58.27	110.546	22.1092	832.7789
Muthoot Finance	1.91	1.76	1.56	20.94	33.14	59.31	11.862	210.5968
Ceejay Finance Ltd	1.64	1.73	1.46	1.60	1.69	8.12	1.624	0.01083

Source: Compiled from Moneycontrol.com

Table 1.2: ANOVA of Current Ratio

Source of Variation	Sum of Squares	Degrees of Freedom	Mean Square	F
Between Groups	1116664	9	124073.8	2.19
Within Groups	2265576	40	56639.39	
Total	3382240	49		

The current ratio of L&T Finance Holdings was highest in the year 2019 followed by Power Finance Company in 2019. All the other companies have similar ratios. In 2018, L&T Finance Holdings had the highest current ratio followed by REC. The current ratio of Power Finance has continuously increased with subsequent years. The current ratio of REC decreased to 15.57 in 2019. The current ratio of Ceejay Financials limited was similar in all five years and was close to the accepted standard ratio of 2:1.

ANOVA

Hypothesis: There is not any significant difference in current ratios of NBFCs under study.

Alternative Hypothesis: There is a significant difference in current ratios of NBFCs under study.

The table value of F for degree of freedom 49 at 5 per cent level of significance is 2.12. Since the calculated value of F (2.19) is more than the table value, the null hypothesis is rejected and alternative hypothesis is accepted. It is concluded that there is significant difference in the current ratio of NBFCs under study.

Long Term Solvency

Debt-Equity Ratio

Debt to equity ratio is computed to assess long term financial soundness of the enterprise. The ratio is computed as follows:

Debt to Equity Ratio= Debt/Equity (Shareholder’s Funds)

A high Debt to Equity Ratio means that the enterprise is depending more on borrowings or debts as compared to shareholder’s funds. In effect, lenders are at high risks. On the other hand, low debt to Equity ratio means that the enterprise is depending more on shareholder’s funds than external equities. In effect, lenders are at a lower risk and have high safety.

Table 3.1

Companies	2015	2016	2017	2018	2019	SUM	AVERAGE	VARIANCE
Armaan Finance Ltd	1.14	0.90	1.18	1.94	3.07	8.23	1.646	0.78598
Mahindra & Mahindra	3.47	3.56	4.20	4.17	4.84	20.24	4.048	0.30937
L&T finance Holdings Ltd	0.15	0.15	0.24	0.06	0.15	0.75	0.15	0.00405
Reliance	1.42	1.31	1.25	2.13	2.19	8.3	1.66	0.2125
IFCI	3.75	3.78	3.37	3.98	3.48	18.36	3.672	0.06017
Siemens	0	0	0	0	0	0	0	0
REC	5.31	5.07	4.49	6.33	7.12	28.2	5.64	1.13535
Power Finance	5.83	5.61	4.86	6.41	6.82	29.53	5.906	0.56923
Muthoot Finance	2.85	2.43	2.61	2.71	2.74	13.34	2.668	0.02502
Ceejay Finance Ltd	0.79	0.60	0.77	0.72	0.62	3.5	0.7	0.00745

Sources: compiled from moneycontrol.com

Table 3.2: ANOVA of Debt to equity ratio

Source of Variation	Sum of Squares	Degrees of Freedom	Mean Square	F
Between Groups	207.93	9	23.10	74.31
Within Groups	12.43	40	0.31	
Total	220.37	49		

Power Finance and REC do good business throughout all the five years. In case of Mahindra & Mahindra, the debt equity ratios of all the five years do not vary widely i.e. the annual debt equity ratios are around the mean only. In case of REC the growth rate of equity exceeds that of debt and as a result the debt equity ratios of REC have shown wide variations from the mean ratio. We can see that the debt of Power Finance, REC and Mahindra & Mahindra is higher than their equity. All the three companies are well established NBFCs and hence its debt level is more than its equity. As growing NBFCs they are vibrant in terms of both debt and equity and register continuous growth over the years. The debt to equity ratio was lower for Ceejay Finance ltd, L&T Finance Holdings ltd, Armaan Finance ltd. Ceejay Finance ltd and L&T Finance Holdings ltd maintain its equity almost at a constant level throughout the period of study. As the debt is negligent in these 2 companies, their solvency position is highly sound. In case of Reliance and Muthoot, the growth trend both in debt and equity with a moderate debt equity ratio exhibit an acceptable solvency position.

ANOVA

Hypothesis: There is not any significant difference in Debt Equity Ratio of NBFCs under study.

Alternative Hypothesis: There is significant difference in Debt Equity Ratio of NBFCs under study. The table value of F for degree of freedom 49 at 5 per cent level of significance is 2.12. Since the calculated value of F (74.31) is more than the table value, the null hypothesis is rejected .It is concluded that the debt equity ratio differ significantly for the NBFCs under study.

Profitability Ratio

Net Profit Ratio

Net Profit Ratio establishes the relationship between Net Profit and Revenue from Operations i.e. Net Sales. It shows the percentage of Net Profit earned on Revenue from Operations. The ratio is computed as follows:

Net Profit Ratio = Net Profit after Tax /Revenue from Operations * 100

If the Net Profit Ratio is higher the business will be better. This ratio helps in determining the operations of the business.

Table 4.1

Companies	2015	2016	2017	2018	2019	SUM	AVERAGE	VARIANCE
Armaan Finance Ltd	18.23%	15.66%	15.08%	11.74%	26.51%	87.22	17.444	31.02923
Mahindra & Mahindra	15.02%	11.49%	6.48%	16.22%	17.85%	67.06	13.412	20.47827
L&T finance Holdings Ltd	90.021%	108.47%	89.58%	58.52%	55.39%	401.98	80.396	517.244
Reliance	19.17%	23.96%	21.41%	-222.99%	6.79%	-151.66	-30.332	11642.61
IFCI	16.04%	8.83%	-16.73%	13.58%	-20.57%	1.15	0.23	305.6051
Siemens	21.15%	42.24%	13.92%	16.30%	17.67%	63.21	12.642	64.77347
REC	26%	23.80%	26.47%	19.68%	22.77%	118.72	23.744	7.49713
Power Finance	23.97%	22.25%	7.90%	16.88%	24.10%	95.1	19.02	47.24395
Muthoot Finance	15.54%	16.65%	20.54%	28.36%	28.67%	109.81	21.962	39.31837
Ceejay Finance Ltd	32.18%	30.56%	32.76%	33.93%	34.17%	163.6	32.72	2.13135

Sources: compiled from moneycontrol.com

Table 4.2: ANOVA of Net Profit Ratio

Source of Variation	Sum of Squares	Degrees of Freedom	Mean Square	F
Between Groups	34244.32	9	3804.924	3.001218
Within Groups	50711.74	40	1267.793	
Total	84956.05	49		

In terms of Net Profit Ratio L&T Finance Holdings is performing good followed by Ceejay Finance ltd. L&T Finance Holdings has the highest net profit ratio of 108.47% in 2016. The net profit ratio of Reliance witnessed a negative growth rate in 2018. Ceejay Finance ltd has maintained a stable growth rate in terms of net profit ratio for the five years. REC witnessed various ups and down in terms of NPR ratio but managed a good NPR in 2019 at 22.77%.

ANOVA

Hypothesis: There is not any significant difference in Net Profit Ratio of NBFCs under study.

Alternative Hypothesis: There is significant difference in Net Profit Ratio of NBFCs under study. The table value of F for degree of freedom 49 at 5 per cent level of significance is 2.12. Since the calculated value of F (3.001) is more than the table value, the null hypothesis is rejected .It is concluded that the net profit ratio differ significantly for the NBFCs under study.

4. Findings

From the analysis above it follows that current are high for the asset finance companies and infrastructure finance companies. The debt to equity ratio was lower for microfinance companies and Core Investment companies showing that the enterprise is depending more on shareholder's funds and lenders are at a lower risk. The Net Profit Ratio was high for infrastructure finance companies and micro finance companies predicting good returns in these sectors.

From the table it follows that for all the three ratios calculated, the value of F is more than the table value of F at 5% level of significance. This implies that null hypothesis is rejected and indicates that the majority of selected ratios for this study differ significantly between various categories of NBFCs. Different categories of NBFCs behave differently.

5. Conclusion

The analysis of solvency reveal a fact that the sample NBFCs do their business taking high risk i.e. they hold very low percentage of total assets as their owned funds and depend more on borrowed funds and holds more current assets with low percentage of liquid assets with reference to current liabilities. Profit making is in direct proportion to risk taking. Thus, these NBFCs take more risk to earn profits. However, the performance of these NBFCs proves that they have sufficient solvency, as they manage the risks and have cash generation capacity. However these NBFCs need to improve their profitability ratios and cash management. NBFCs have to focus on their core strengths while improving on weakness. Presently, the economic disruptions caused by the coronavirus outbreak, MSME sector seems to be worst hit due to both businesses coming to a standstill and reduced consumer spending. As MSMEs contribute to major chunk of NBFCs loan portfolio, in case of a default, it will affect NBFCs ability to repay the loans to other financial lenders. However, Indian authorities and regulator have taken several measures to ease borrower's financial burden. Reserve Bank of India introduced a three-month moratorium on loan repayments for distressed bank and NBFC borrowers. A sizeable Rs 3.74 trillion injection of liquidity into the system should help to improve liquidity in local credit markets.

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