International Journal of Research in Social Sciences
Vol. 10 Issue 12, December 2020
ISSN: 2249-2496 Impact Factor: 7.081
Journal Homepage: http://www.ijmra.us, Email: editorijmie@gmail.com
Double-Blind Peer Reviewed Refereed Open Access International Journal - Included in the International Serial Directories Indexed & Listed at: Ulrich's Periodicals Directory ©, U.S.A., Open J-Gate as well as in Cabell's Directories of Publishing Opportunities, U.S.A

A STUDY OF NBFC's WITH SPECIAL REFERENCE OF LEASING COMPANIES

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Abstract
The Indian financial system comprises an impressive network of financial markets, financial institutions and financial services. Leasing companies, which have been considered Non-Banking Financial companies (NBFCs), constitute a part of financial system. Financial services sector assumes strategic role in the increasingly turbulent and uncertain business environment in the era of liberalization. The growth of NBFCs has been rapid especially during early 1990's, which has broadened the leasing and financial services markets in the financial system. NBFCs, in general, have recorded accelerated growth in mobilization of public deposits and some of them indulged in indiscriminate deployment of funds without concomitant care for the interests of the depositors, which led to certain disquieting developments in this sector**.**
Keywords: NBFC, Lease, RBI, India, Public Deposits,

1. Introduction

High growth potential in the leasing industry and the advantage of tax shield, have paved the way for formation of a large number of leasing companies in the recent past. Every industrial house has established a leasing company to function as captive finance house. Some manufacturers are using leasing as sales aid in marketing their products. Amongst the financial institutions the ICICI was the first to offer leasing in 1983. IFCI, IDBI and UTI followed the suit. Leasing companies are treated as Non-Banking Finance Companies (NBFCs) and are subject to overall discipline of the Reserve bank of India. The unprecedented growth of NBFCs particularly the leasing companies attracted all sorts of entrepreneurs ranging from top industrial houses to new chartered accountants, from banks and financial institutions to stock brokers. Though the NBFCs are registered under the companies act, they are also governed by the guidelines of the RBI as regards income recognition norms, capital adequacy requirements, public deposit, mobilization etc. The leasing companies engaged in merchant banking activities are further subject to scrutiny by the Securities Exchange Board of India (SEBI). The leasing industry came under the government regulations only in 1977. The Reserve Bank of India was entrusted with the task of regulating Non-Banking Financial companies (NBFCs) codified in the form of directions popularly known as NBFCs (Reserve Bank) directions, 1977. The main objectives of these regulations are to safeguard public interest, to enforce discipline in the growth and functioning of NBFCs and to separate good companies from bad ones and viable companies from the unviable ones. The leasing industry came under the government regulations only in 1977. The Reserve Bank of India was entrusted with the task of regulating Non-Banking Financial companies (NBFCs) codified in the form of directions popularly known as NBFCs (Reserve Bank) directions, 1977. The main objectives of these regulations are to safeguard public interest, to enforce discipline in the growth and functioning of NBFCs and to separate good companies from bad ones and viable companies from the unviable ones.

2. Review of Literature

"Legal and Regulatory Framework for Leasing in Russia During year 2000" byBloom (2005) studies that The International Monetary Fund is projecting that the gross domestic product of Russia will increase by two percent during the year 2000. Reports in the fall of 1999 indicate that the Russian economy may have grown by two percent during 1999 as compared to 1998 [1].

The paper by Gavazza(2008)on "Asset Liquidity and financial contracts: Evidence from Aircraft Leases" examines the way in which asset liquidity affects lease contracts. Leasing has grown substantially in recent years and is now extensively used in the market for corporate assets. This evidence reported in this paper illustrates how leasing becomes more popular as the market for an asset becomes more liquid [3].

"Lease Financing and Corporate Governance" by Robicheaux et al. (2008). Their main focus of the study was whether agency cost of equity reducing mechanisms and leasing are complements or substitutes. Lease financing is a well-recognized mechanism for reducing the agency costs of debt. Their study examines whether firms that attempt to control the agency costs of equity through strong governance structures, including Chief Executive Officer Compensation alignment and board structure, are more likely to use an agency cost reducing debt structure, such as leasing [21].

Franzen et al. (2009) in their study named "Capital Structure and the Changing role of Off Balance Sheet Lease Financing" uses the trend regression analysis to demonstrate the remarkable increase in Off- balance sheet (OBS) lease financing and decrease in capital lease over the period of last 27 years from 1980 through 2007. There findings include that firms rely heavily on the OBs financing in addition to conventional debt. The OBS leases increases 744.8% from 1980 to 2007, while capital leases decreases 49.8% [2].

Ladha(2011) in her article "Stamp duty on Lease Transactions in Maharashtra" studies that theprovisions of Indian Stamp Act, 1899 are applicable to whole of India and its territoriesexcluding the states which have their own legislations on the stamp duty payable there. TheIndian Stamp Act has been adopted by almost all the states with or without amendments in themain Act. However, the states where separate stamp act have been enacted are Karnataka Stamp Act 1957, Bombay stamp Act 1958, Gujarat Stamp Act (provisions of Bombay Stamp Act are applicable), Kerala Stamp Act 1959, Rajasthan Stamp Act, 1998 [7]. Meier and Ryan (2015) explain whether the new clause in oil and gas lease should be enforceable or not. Under the existing law when the landowners are approached by the companies offering for oil and gas lease, landowners make an assumptions that they have prevent their unwanted transfers of lease interest, however it is still unclear under existing laws [11]. Naaz (2015) examines the financial performance of Sundaram Finance Ltd. By evaluating the liquidity, profitability and solvency ratios. Simple Regression test was used to analyse the financial performance of SFL [12].

Brendon (2018) explains the strength and growth of global leasing report in his paper entitled "Global leasing Report". He studied that the top 50 countries in 2016 reported growth in new business volume of 9.40%, rising from US$1,005.30bn in 2015 to US$1,099.77bn in 2016. Three regions, North America, Europe and Asia, account for more than 95% of world volume. New business volume exceeded the previous year's global total by US$94.47bn. The Asian region experienced impressive growth of 30% and demonstrated by far the largest percentage increase among all the global regions [4]. Brendon (2019) explains the remarkable growth highlights in leasing's innovation and resilience. The Asian region experienced truly exceptional growth of 58.9% largely bolstered by an uplift in new business of US$59bn in China. Europe recorded a growth rate of 32.7% and North America experienced 9.3% growth over the previous year. Australia/New Zealand was up 1% and South America up 23.2%. By contrast, Africa recorded a fall from last year's figure of 15.8% [5].

Objectives of the study

The study specifically aims at:

- To study the Non-Banking Financial Companies (NBFC) of India.
- To study the regulatory measures of RBI for financing NBFC's engaged in offering lease financing services
- And finally to come out with conclusions and suggestions for enhanced growth of Lease Financing in India.

Methodology of the Study

The study is purely based on secondary sources of data for collecting facts and figures relating to the topic under study to ensure the quality of research paper. Altogether the relevant books, standards magazines, journals and periodicals, research papers, published thesis, articles, News Dailies, Financial Dailies, Websites, are also consulted by the researcher for better referencing.

3.Non-Banking Financial Companies

Non-Banking Financial companies of India are the most important segments of Indian financial system. The main aim behind these companies is to accept the deposits and to create credits for channelizing the scarce financial resources to capital formation. It is defined by the Section 45- I of the Reserve bank of India Act 1934 as "a financial institutions, which is a company, a non-banking institutions which is a company and which has its principal business the receiving of deposits under any scheme of arrangement or in any other manner or lending in any manner". NBFCs are different from banks as they can accept deposits but not demand deposits and thus are not able to raise low cost funds through savings or current accounts [14]. Non-Banking Financial Company includes only Non-Banking institution, which may be a loan company or an investment company or a hire purchase company or equipment leasing company or a mutual benefit financial company as follows:

i. **Equipment Leasing Company**: Principal business is equipment leasing or financing of such activity.
ii. **Hire Purchase Finance Company**: Any Company which is a financial institution carrying on as its principal business of Hire purchase transaction or financing of such transaction.
iii. **Loan Company**: Providing finance by making loans or advances, or otherwise for any activity other than its own but does not include equipment leasing company or a hire purchase finance company.
iv. **Mutual Benefit Financial company**: Means any company which is notified by the Central Government under Section 620A of the Companies Act 1956 (1 of 1956).e.g. Nidhis.
v. **Investment Company**: Any Company which is a financial institution carrying on as its principal business, the acquisition of securities.

Formation of NBFC

Section 12(1) of the Companies Act 1956 describes the mode of forming integrated company. NBFCs can be public limited company or private limited company. A person is required to fill in the appropriate form for commencing the business as NBFC as per the requirements of Companies act 1956, so that further formalities of drafting Memorandum of Association, Articles of Association etc. can be done. Certificate of incorporation for private limited company is required to be issued by Registrar of the Company (ROC) within 10 days of the receipt of the Memorandum of Association (MOA), Articles of Association (AOA) and other documents as per the section 33(1), 33(2) and 34(1) of companies Act 1956. As per Section 149(2A) of the Companies act 1956, a separate Certificate for Commencement of business for public limited company is required to be furnished as per the laws of companies' act 1956 in addition to the certificate of incorporation of public limited company [15].

NBFC registration in India

Liberalization, deregulation, delicensing, refunding and restructuring of the economy opened up several opportunities for the industry. Non-banking Financial Companies is the financial intermediaries extending assistance for the industrial development. In order to streamline the widespread operations of the NBFCs, the RBI has prescribed guidelines and norms to the NBFCs basing on the recommendations given by A.C Shah Committee with regard to capital adequacy, collecting deposit from public, getting loans from financial institutions, investment pattern, debt equity, assets classification provisioning and income recognition. The financial system comprises of financial institutions, financial instruments and financial markets that provide an effective payment and credit system and thereby facilitate channelizing of funds from savers to the investors of the economy. In India, considerable growth has taken place in the non-banking financial sector in the last two decades. Over a period of time they are successful in rendering a wide range of services [6].

The registration of NBFC is very important for the regulation of capital and money market and also to protect the interest of the depositors. Company which wants to be registered as NBFC is required to file an application to RBI along with required documents. After detailed scrutiny of all the documents the RBI grants certificate of NBFCs if it deems fit to them. The Reserve Bank of India regulates the working and operations of NBFC within the framework of the Reserve Bank of India Act, 1934 and the directions issued by it under the act and the NBFCs should have a minimum disposable owned funds of Rs 2 crore [13].

4. Concept of Lease Financing

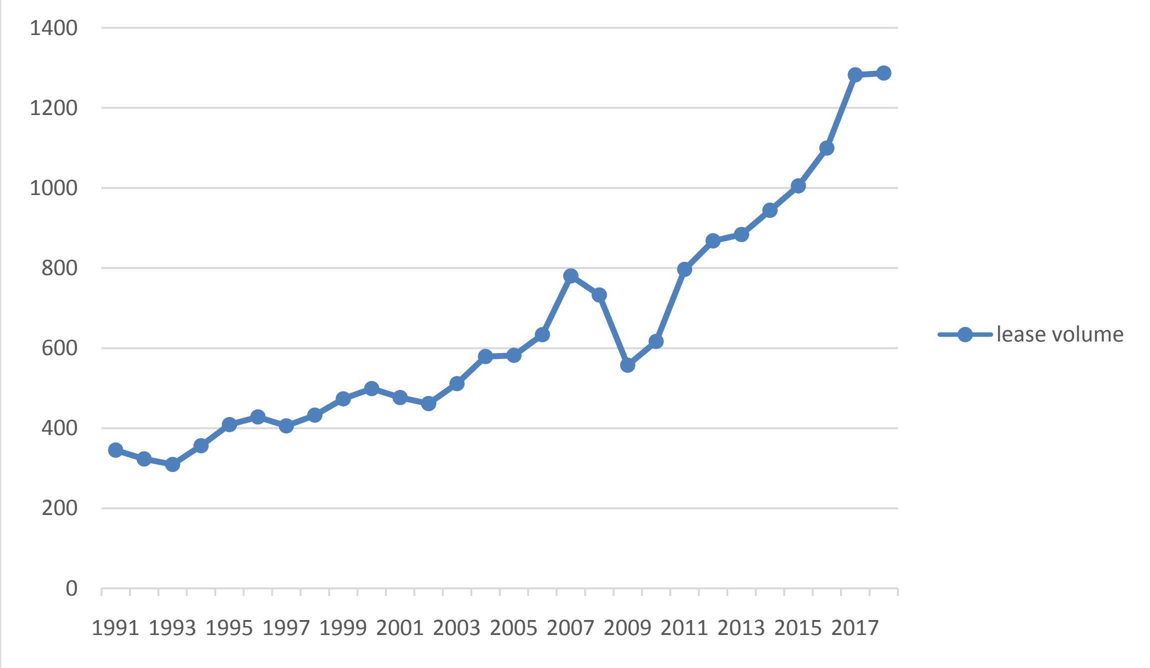
In modern time, leasing has become a unique mode offinancial use of assets, leasing as financing concept is simple an arrangement between two parties, the leasing company or the lessor and the user or the lessee, whereby the former arranges to buy capital equipment for the use of the latter in accordance with the latter's requirement and specifications. There are two parties involved in leasing – the lessor, who owns and finances the purchase of the assets and the lessee, to whom the assets is rented. The right of the use of the assets is vested to lessee for the price i.e., payment of rent at regular intervals. Under the lease agreement, the lessee uses the assets without any capital investment in it. Normally the rent of the assets is payable in advance at periodic intervals agreed by the lessor and lessee. Leasing have the fixed periodic and normally it is from 3 to 5 years. But in this regard much is depends upon the type of the equipment[10].The propensity to lease varies by industry. IT hardware, software and computer services sectors are the companies with the highest leasing propensity while those with the lowest propensity to lease are in the automobile and parts, household goods and textiles industries [8]. Leases take several different forms, the most important of which are financial leases and operating leases. Legal, tax and accounting treatments differ among these types of leasing and, they are all viewed, in the theory of finance, as part of the financing decisions of the firm [9].A historical growth of leasing worldwide from the year 1991 to 2018 is shown in the Table 1. The table reveals that there is a tremendous growth in this business as it was $ 345.3 billion in 1991, where it was increased to $ 1287.01 billion in 2018. Although there was high growth but in between there was a decline during the years 1993, 1997, 2001 and 2009 as compared to other period.

Table 1. Historical Growth of Leasing World Wide (US$, billion)

Year	**Volume**
1991	345.3
1992	323.3
1993	309.6
1994	356.4
1995	409.1
1996	428.1
1997	405.8
1998	432.5
1999	473.5
2000	499
2001	476.5
2002	461.6
2003	511.3
2004	579.1
2005	582
2006	633.7
2007	780.4
2008	732.8
2009	557.3
2010	616.8
2011	796.7
2012	868.0
2013	883.96
2014	944.31
2015	1005.30
2016	1099.77
2017	1282.73
2018	1287.01

Source: Compiled by the Author from the various reports of London Financial Group Global Leasing Report.

Graph 1. Shows the graphical representation of progress in leasing volume worldwide. There is a considerable growth in the lease financing business but in between there was a decline during the years 1993, 1997, 2001 and 2009 as compared to other period.



Graph1. Growth of Leasing Volume Worldwide (US$ billion)

5. Bank Finance to NBFCs Engaged in Lease Financing

The Regulatory policies of Reserve Bank of India relating financing of NBFCs by all scheduled commercial banks excluding Regional Rural Banks (RRBs) under Section 35A of Banking Regulation Act 1949 are as follows:

Bank Finance to Registered NBFCs

In the framework of obligatory listing of NBFCs with the Reserve Bank of India, as in addition reliablewith the strategy of bestowing superior equipped liberty to banks in the subject of creditdispensation, the upper limit on bank credit connected to Net Owned Fund (NOF) of such companieshas been withdrawn in respect of all NBFCs which are statutorily registered with RBI and areengaged in principal business of asset financing, investment business, loan financing and factoring. Banks might also offer term loans as well as need based working capital amenities to all NBFCs registered with RBI which are occupied in equipment leasing (EL), hire-purchase (HP), loan, factoring, infrastructure financing andinvestment activities**.** On the prior authorization of Board of Directors banks could supply the suitable loan plan as per the Reserve Bank of India within the prescribed guidelines and norms to the NBFCs. If the NBFCs are engaged in financing second hand assets, banks may expand their funding to NBFCs against such second hand assets [16].

Admission of NBFCs as Members

For availing financing from a major cooperative bank, its membership is an obligation. Even though, urban co-operative banks are usuallynotanticipatedto register non-banking financial companies like investment companies and any business which are conflicting with the business of banks, as their members because it would be in breach of the state co-operative societies act concerned and will also not be in compliance with their provision.

As a result, banks should not finance NBFCs, other than those occupied in leasing financing.Likewise, it is also required to acquire the prior approval from the concerned registrar of the cooperatives societies before admission of such Non-Banking Financial companies as a member which are not exclusively engaged in lease financing business as it will be contrary to the provisions of concerned state cooperative societies Act [17].

Activities Eligible for Finance to NBFCs Engaged in Leasing Activities

The cooperative banks can finance the lease financing companies with the aggregate working capital of Rs 25 crore or above. However it is confined to certain limits that the maximum limit for bank finance should be 3 times of the Net Owned Funds (NOF) of the Equipment Leasing Companies. At least 75% of their assets should be in equipment leasing and 75% of the gross income should be contributed from leasing business. However bank finance is limited to only full payout leases i.e. it includes only those leases in which cost of the asset is fully amortized during primary lease period and it should also cover purchase of new asset. Further the maximum limit of bank finance should be within the purview of overall ceiling of borrowing by NBFCs. Table below shows the different activities eligible for maximum limit on bank finance to NBFCs engaged in leasing activities [18].

Table 2. Maximum Limit on Bank Finance for Lease Financing Companies

	Type of NBFC	Maximum Limit on Bank Finance
(i)	Equipment leasing Companies having not less than 75 percent of their assets in equipment leasing, and 75 percent of their gross income from these types of activities as per the last Audited balance sheet of the companies.	3 times of the Net Owned Funds (NOF) of the NBFC
(ii)	Other equipment's and hire purchase cos.	2 times of the NOF of the NBFC

Source: RBI. (2015). Activities Eligible for Finance to NBFCs Engaged in Leasing Activities. Retrieved from https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9866#C22

Activities not eligible for finance to NBFCs engaged in leasing activities

There are certain activities which are undertaken by NBFCs engaged in leasing activities are not eligible for bank finance. It is required that such activities must be excluded from the buildup of current assets while approaching the cooperative bank for credit. Such activities includes stock in trade investments such as investments in shares, debentures etc. which are of current nature, Investment and advances to subsidiaries, group companies or the other entities, bill discounted or rediscounted by such NBFCs and Investments in and inter corporate loans or deposits to other companies [19].

Acceptance of Public Deposits by NBFCs Engaged in Lease Financing

The Reserve Bank of India had made the necessary amendment in Non-Banking Financial Companies acceptance of public deposits as per the RBI Directions 1998 which is considered to be in the public interest. As per the RBI Directions not even single Equipment Leasing Company shall accept or renew public deposits except Equipment leasing company having net owned fund of rupees twenty five lacks or more and having minimum investment grade credit rating. Such lease financing company can accept or renew public deposits which should not exceed four times of its NOF or public deposits up to Rs 10 crore whichever is less [20]. Table 3. Shows the number of reporting NBFCs and their public deposits from the year 1998-09 to 2017-2018.

Table 3. Aggregate Deposits of NBFCs Sector (Rs. in Crores)

Year (End – March)	**No. Of Reporting companies**	**Public deposits**
1998-99	1536	9785
1999-00	996	8338
2000-01	974	6459
2001-02	905	5933
2002-03	870	5035
2003-04	774	4317
2004-05	700	3926
2005-06	428	2448
2006-07	401	2077
2007-08	364	2042
2008-09	336	1971
2009-10	308	2831
2010-11	297	4098
2011-12	271	5735
2012-13	254	7085
2013-14	240	10808
2014-15	220	28941
2015-16	202	27069
2016-17	178	30624
2017-18	168	30439

Source:RBI. (2019). Public Deposits ofNBFCs. Retrieved from https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/73T_HB150920196E08913E4C424074816EC49A8E2C86D9.PDF

Conclusions

Leasing companies are treated as Non-Banking Finance Companies (NBFC's) and are subject to overall discipline of the Reserve Bank of India. The leasing industry came under the government regulations popularly known as NBFC's (Reserve Bank) directions, 1977. The main objectives of these regulations are to safeguard public interest, to enforce discipline in the growth and functioning of NBFC's and to separate the viable companies from unviable ones.

Suggestions

RBI should retain a close observe over the financial performance of NBFC's/leasing company. If preferred performance is not achieved within a reasonable time period a prompt restructuring should be explored. Lease financing companies are not disclosing their prudential income recognitions norms in their annual reports. There is a need that RBI should review such norms for lease financing companies. Such disclosure of income norms in the annual reports is helpful not only for shareholders and investors but execution of such norms is also helpful for their own interest. And finally RBI should also give relaxation to present rules and regulations for import of capital goods which will support many cross border companies in India to come to the surface.

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