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A STUDY ON THE CAUSES OF THE DOWNFALL OF NBFCs IN INDIA: A CASE ANALYSIS OF DHFL & IL& FS

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ABSTRACT

Non-bank finance companies are in the businesses related to loans and advances, and other types of economic activity. NBFC plays an important role in providing affordable financial services. NBFC indirectly stimulates the economy. It deals with Asset Mobilization, loan syndication, leasing, hire-purchase, insurance business, Employment generation, expansion of the financial market; raising living standards NBFC is much more important for a growing economy such as India. The current Scenario shows the crisis in organisations like DHFL (Deewan Housing Finance Ltd) and IL & FS (Infrastructure Leasing and Financial services) has a greater impact on our Indian economy. The presence of NBFC s in a country would only drift the economy in the right direction. In the past few years these institutions have been experiencing a liquidity crunch and shrinkage in credit extension due to non-repayment by the borrowers. The objective of this study is to highlight the major causes for the downfall of these institutions with special focus on DHFL and IL&FS.

KEYWORDS

NBFCs, hire-purchase, leasing, credit syndication.

JEL CODES

G20, G23.

INTRODUCTION

NBFCs (Non-Banking Financial Companies) are financial institutions involved in the business of accepting deposits, conveying credit and assume a significant job in channelizing the rare budgetary assets to capital development. They supplement the job of the financial institution in meeting the expanding budgetary necessities of the corporate segment, conveying credit to the unexplored ventures. They are not only confined to trade financing but also commercial loans, lease financing and Property financing. At present, there is no independent regulator for the NBFCs in India, therefore they come under the governance of the Reserve Bank of India. On an annualized basis, the NBFC sector outperformed the banking sector in most years between 2006 and 2013. This means that it grew by 22% per year. As it turned out, this contributes more to the annual economy.

NBFCs assume a significant job in advancing comprehensive development of the nation, by obliging the fund related requirements of bank declined clients. Further, NBFCs regularly take lead job in offering fund related assistance to Micro, Small, and Medium Enterprises (MSMEs) generally reasonable to their business. NBFCs do assume a basic job in taking an interest in the advancement of an economy by giving a fillip to transportation, wealth creation, credit in rustic fragments and to help economically more fragile areas of the general public.

REVIEW OF LITERATURE

1. Viswanathan (2010) in the study titled "the global financial crisis and its impact on India" contemplated worldwide impact of global financial crisis and its effect on India. In spite of worldwide emergency, India, China and Brazil had the option to continue the development rate and were not influenced by the emergency. The effect made was not uniform over the nations. Littler developing markets had development sway in littler manner. The investigation recognized that the financial institutions in India ought to be still exceptionally controlled and ceaselessly observed. The Reserve Bank of India has several mechanisms to control the liquidity in the system. The volume of its forex reserves permits it to participate in the international forex market to get a better platform for global trade.
2. D.K. Naurial and Bimal Kishore Sahu "The Economic Growth of the Financial Crisis in India. The "outside sector" in their study suggested that the financial crisis had a negative impact GDP, but imports, exports and FDI proved to have stimulating effects through technical effects and other external effects. The paper says that the global recover although the economy is crucial to India's economic growth, the impact of the global recession can be minimized through the use of stimulating financial and financial instruments by the RBI.
3. Deepak Mohanty (2018) "Global Financial Crisis and the Indian Economy**".** The study depicted that in spite of sound essentials and no immediate exposure to the sub-prime resources, India was influenced by worldwide money related emergency through all the channels – exchange, monetary and certainty channels – reflecting expanding globalization of the Indian economy than what is evident regarding conventional markers. The strategy reactions to the worldwide emergency were quick and auspicious and have travelled through unmistakable stages since the second 50% of 2008-09. Reserve Bank presented a thorough scope of traditional and unpredictable measures to restrict the effect of the antagonistic worldwide advancements measures attempted in light of the emergency were ended meaning come back to ordinary pace of movement

OBJECTIVES OF THE STUDY

The study primarily focuses on the following two basic objectives:

1. Analyse the various causes that led to the downfall of the non-banking finance companies in India during the tenure of 2018-2019 and its impact in the Indian economy.
2. The study also highlights on causes that led to the downfall of two large NBFCs i.e. DHFL and IL& FS

SCOPE OF THE STUDY

The study has been undertaken on the non-banking finance companies of India, primarily focussing on the recent problems faced, an analysis of the causes and its impact on the Indian economy.

To fulfil the objective, the financial year of 2018-19 has been selected as during this tenure the global economy faced recession and India was no exception specifically because the lending by NBFCs had been tightened due to liquidity crunch and non-repayment by the borrowers.

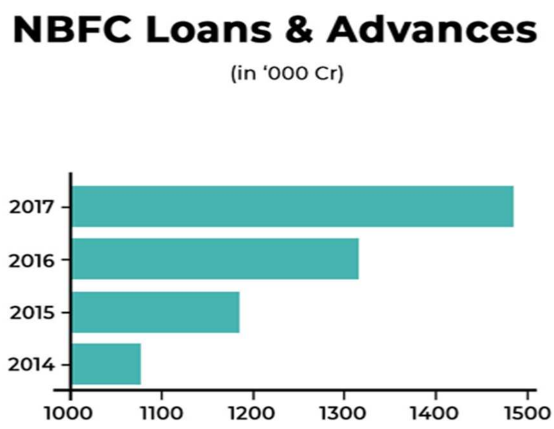
RESEARCH METHODOLOGY

This is a causal study as it deals with the analysis of various causes for the non-performance of NBFCs in India and its effect on the economy. The data collection is from secondary source by exploring the various secondary resources as company websites, newspapers, books and magazines. These sources were navigated to obtain various data and information. The variables that have been chosen for the purpose of the study is 'Net Profit of the different quarters, lending ratio, percentage of Non-performing assets.

EFFECT OF THE DOWNFALL OF NBFCs IN INDIA

NBFC centres around business identified with credits and advances, procurement of offers, stock, securities, debentures, guaranteed by and several other operations of venture capital financing.

FIGURE 1: LOANS & ADVANCE BY NBFCs



Source: www.Businessline.com

The observation from figure 1 reflects the rising credit syndication by NBFCs since 2014. This lending spree surpassed the lending by banks too. In September 2018, IL & FS were defaulted for a number of payments. The corporations and foundations that were his generous creditors were astonished. The market panicked and spread to the sectors. ICRA and CARE, the rating agencies downgraded from AA to default overnight. Previously, the same bonds had an AAA rating, which implies that the probability of default is close to zero. Other IL &FS bonds were also significantly reduced.

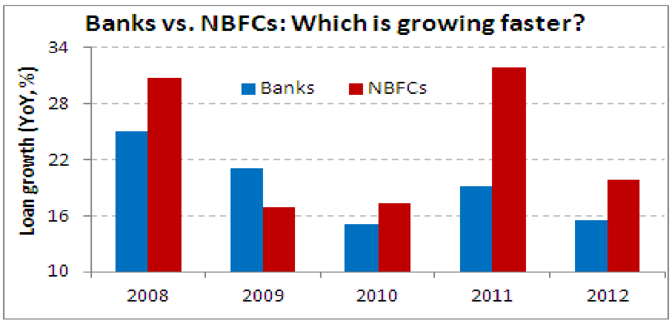
It was time for a thorough reassessment. Panic hit Sensex, and NBFC stocks fell in the following days. The investor received a warning. This has led to a general loss of confidence in the NBFC sector. The event also raised concerns about the rating methods used by rating agencies. He also questioned the role of independent audit agencies, as they could not have foreseen this, despite having access to the company's balance sheet. The situation worsened when DHFL, Reliance Capital Finance, as well as Reliance Home Finance, Stock prices decreased. Borrowings from banks' balance sheets have become NPAs (non-performing assets) and this has affected the entire financial ecosystem.

This liquidity crisis has forced banks and the NBFC to be afraid of lending. Borrowers, whose survival depended on NBFC lending, were in trouble and this disaster further aggravated the quality of banking and NBFC assets. For example, in the automotive sector, where showrooms and customers depend on NBFC funding; car sales fell dramatically and the real estate, sector lacked funds to complete the project but creditors denied credit due to liquidity problems. It hit construction plans and properties were not completed hence could not be sold to repay loans. Such debtors have been defaulted. Financial stress caused by delays, the accumulation of interest and harsh business conditions has become a solvency issue and the vicious cycle of market slowdown has begun. The companies remained with good assets, but could not borrow them.

Even 45-50% of NBFC funding came from mutual funds. But funds such as DSP, HDFC and others have suffered from IL and FS fraud and stopped NBFC funding after the financing ceased, the NBFC was forced to issue money to pay all maturities. There was a reduction in its financing, and subsequently, in January-March, the rate of GDP growth fell to 5.6% of GDP. This was reflected in the lack of buying cars, buying properties.

Third, real estate companies received most of NBFC funding worth $ 80,000 because they hardly received any loans from banks. The NBFIs provided these companies with money to start new projects, for construction and financing. According to the Kotak Mahindra report, total car and car sales in the country are approximately Rs 5 million. Monthly sales may also be around Rs 40,000 crores. Now, a 20% decrease in rupee sales by Rs 5 million would be approximately Rs 1 million, which is financed. Consequently, there is negative growth. Despite the fact that around Rs 60 billion will be profitable, of which the dealer network may also be Rs 10-15 billion.

FIGURE 2: COMPARISON OF LENDING –BANK VS NBFCs



Source: www.Economictimes.com

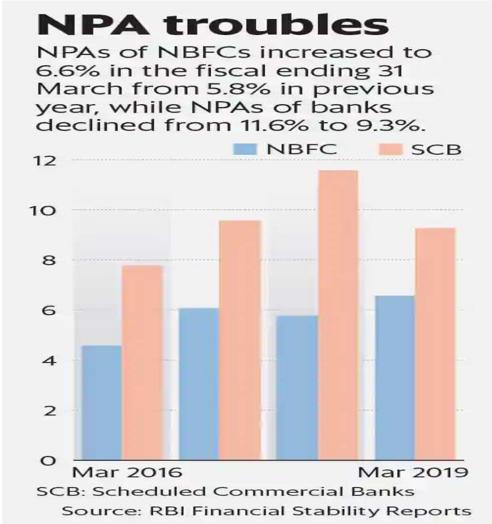
The figure 2 enumerates the increasing rate of lending by the NBFCs since 2008, which even surpassed the lending by the banks. But the situation altered in the mid of 2018 when even the lending by the NBFCs shrunk

ANALYSIS OF THE CAUSES OF NBFC CRISIS

1. IL&FS, a leading company in the NBFC sector, was established in 1987 when a consortium of banks decided that a financial institution was urgently needed for infrastructure and financial development. Due to funding and revenue from infrastructure development in the 1990s, IL&FS has become a leading contributor to the country's many infrastructure projects.
2. When economic growth slowed to below expected levels, projects stalled and payments to the company were delayed.

3. The NBFC crisis started when IL&FS stopped paying SIDBI in August 2018 on ICD (Inter-Corporate Deposit, a non-insured company with a lack of money from a fund-rich company). Payments for Commercial papers were suspended. This clearly indicated that liquidity was low and the economy was spreading like wildlife among other sectors of the economy. The reason for compliance is mainly compliance with Asset and Liability Management (ALM)
4. There is a mismatch in the Asset Liability management these institutions.
5. The Rise of Non-performing assets of NBFCs is considered another reason for its downfall. Due to the non-repayment by the borrowers on a large scale which resulted in a huge volume of bad debts.

FIGURE 3: NPA OF NBFCs & COMMERCIAL BANKS



Source: RBI stability report

The graph in figure 3 shows the comparison of the proportion of non-performing assets by banks and Shadow banks which highlights that as the lending by non-banks exceeded the banks from 2016 to 2019 hence the volume of NPA also exceeds which is not a good sign for a healthy economy. There should be stringent credit assessment criteria governing the financial institutions.

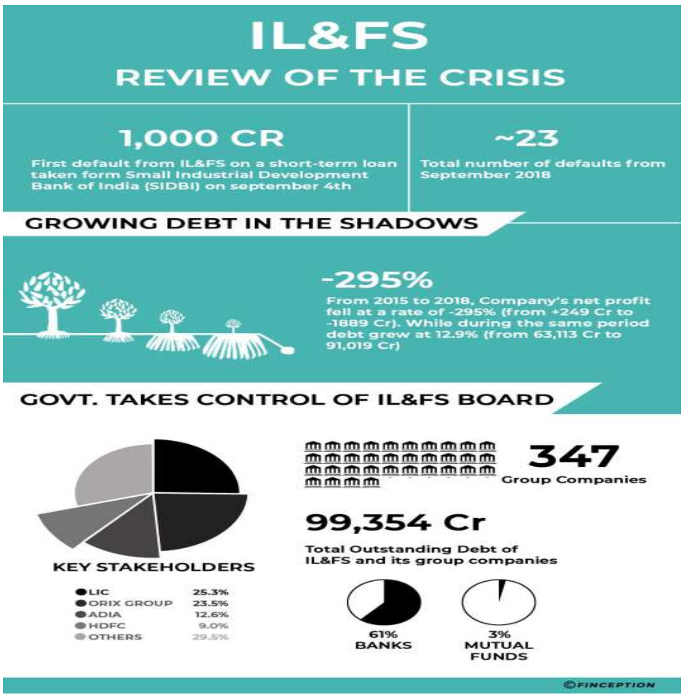
CASE OF IL& FS

IL and FS is India's one of the biggest foundation organizations which oversees framework subsidizing ventures across India built up in 1982. The IL&FS Ltd is an unlisted holding organization — which is the parent company to in any event 24 direct auxiliaries, 135 circuitous auxiliaries, four partner organizations and six joint endeavours. IL&FS has institutional investors including SBI, LIC, ORIX Corporation of Japan and Abu Dhabi Investment Authority (ADIA).

As on March 31st 2018. The biggest investors are LIC and ORIX Corporation with their stake at 25.34 percent and 23.54 percent, respectively. Other conspicuous investors incorporate are ADIA 12.56 % HDFC 9.02% CBI 7.67 % and SBI with 6.42 %. Main explanation behind disappointment of Debt-ridden IL&FS, in which different corporate had contributed through momentary instruments like Commercial papers and non-convertible debentures (NCDs), has been defaulting on its few obligation commitments since August 18. IL&FS' borrowings from banks and financial institutions adds to almost Rs 63,000 crores according to the accounting report of 2017-2018, this a case of asset liability mismatch that brought about the devastation of the enterprise.

The Infrastructure Leasing and Financial Services (IL&FS) has obligation of almost Rs 1 lakh crore — and is confronting an enormous liquidity mash at present. Investigators at Nomura Research have apparently evaluated that 64% of these credits are from banks, practically every one of them state-possessed. As indicated by reports, the IL&FS Financial Services Ltd has credit reimbursements worth $500 million (Rs 3,600 crore) coming up in the second half of this budgetary year. it has cash resources amounting up to just $27 million (around Rs 194 crore). The IL&FS Financial Services Ltd has just defaulted in reimbursing a momentary advance of Rs 1,000 crore to the Small Industries Development Bank of India (SIDBI). At least one auxiliary of IL&FS is additionally answered to have defaulted in reimbursing advance worth about Rs 500 crore.

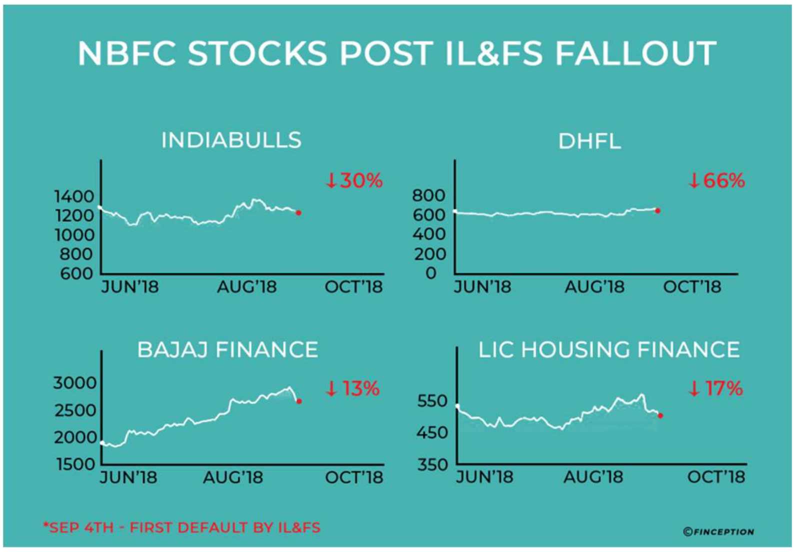
FIGURE 4: CURRENT SITUATION OF IL & FS



Source: www.business-standard.com

The figure4 enumerates the present stake holding pattern in IL& FS. As per Money Life, since IL&FS Financial Services Ltd is a Non-Banking Financial Company; it isn't secured under the Insolvency and Bankruptcy Code (IBC). On September 17,2018 FICO score office ICRA downsized the organization's financial soundness to 'D' (default grade), after it couldn't meet its reimbursement commitment for present moment and long term borrowings worth more than Rs 12,000 crores.

FIGURE 5: STOCK TREND OF NBFCs POST IL&FS FALLOUT



Source: www.Financialexpress.com

The FIGURE 5 enumerates the stock trends of the NBFCs after the fall out of IL & FS. Credit rating agency CARE also downgraded several subsidiaries of IL&FS. According to reports, the company needs to immediately raise capital between Rs 3,000 crores and Rs 4,000 crores — and there are talks of the Life Insurance Corporation (LIC) bailing it out.

CASE OF DHFL

DHFL is a non-banking financing organization associated with essentially offering credits to home purchasers in India's level 2 and level 3 urban communities. Deewan Housing Finance Corporation (DHFL), a significant organization, has been in the news for all an inappropriate reason. DHFL has been confronting a liquidity emergency since September 2018.Its stock cost has fallen by around 90 percent over the previous year and there are anxieties about the reasonability of the organization. At that point, in January, the organization's advertisers were associated with a Rs 31,000 crores cash embezzlement. The organization denied these allegations on the audit of a chartered accountant but a mix of components put DHFL in a troublesome position, driving the organization to offer some of its businesses for sale so as to ensure that it could take care of debt repayments. On June 4, the organization neglected to pay about Rs 900 crore worth of interest dues, provoking the credit rating agencies to degrade the value of commercial paper.On July 14, DHFL detailed a total deficit of Rs 2,223 crore for the final quarter (Q4) of 2018-19. The outcome was Rs 134 crore of net profit that DHFL revealed in a similar quarter of the past financial year (2017-18). The whole year's outcome indicated a huge decline. The organization posted a deficit of Rs 1,036 crore in FY 19 while in FY 18, it had declared a net profit of Rs 1,240 crores, yet the organization extended new advances even as their current advances were transforming into non-performing resources (NPAs). DHFL's gross NPAs have ascended to 2.74 %. in the final quarter of the last money related year as against 0.96 percent during Q4 of FY18. DHFL's difficulties began after Infrastructure Leasing and Financial Services (IL&FS) — defaulted on its obligation commitments in September 2018. DHFL's accounts, also endured because of declining ventures and rising requests for meeting its commitments. As of Q4 FY 19, DHFL had nearly Rs 1.2 lakh crores of assets under administration.

DHFL's financial health is a cause of concern for the common man as because some of the biggest investors in DHFL are the nationalised banks and mutual funds. If DHFL somehow managed to battle in taking care of, the misfortunes, it would not spread over the financial world. As indicated by the rating organizations, DHFL has Rs 850 crores of extraordinary commercial papers of which Rs 750 crores is expected to mature in June 2019. The first CP development is due on June 7, 2019. Estimated cash outflows remains as high as Rs 6,200 crores till July 2019. This non-banking organization has missed interest payment of Rs 960 crores. Valuation standards require degradation in the value assets in the event of default of payment dues. The NAVs of some debt funds fell by 6-53 percent on June 4, reflecting a downtrend in DHFL's commercial paper. As per the organization's recording in the Exchanges, it has paid over Rs 41,000 crores to meet its commitments during this period. It has sold over ₹30,000 crores of retail advances so far to meet its obligation commitments. The majority of the deal has been done through the transfer of a single asset or a portfolio of assets to financial entities through an assignment deed.

Additionally, for borrowers of DHFL (especially those with credits for under-developed houses) who have presented their records, the organization's hault on fund disbursement can be a reason for concern in case they are unable to raise funds from other lenders for the development of their property, they would be left with no recourse but to abandon their property. Regardless, life span of the bank and safe recovery of the title deed and different records kept as a security for the lodging advance is also a significant factor. If there should be an occurrence of DHFL, how well the organization can monetise its remaining resources would be the next challenge. Venture advances and SME credits comprise around 43 percent of DHFL's portfolio (as of Dec 2018). Of the Rs 89,387 crore credit book, about Rs 34,800 crore relates to extend advances, SRA advances (Slum Rehabilitation Authority) and mortgage loan portfolio.

The Enforcement Directorate on Thursday (14.3.2020) arrested Deewan Housing Finance Corporation promoters- Kapil Wadhawan and Dheeraj Wadhawan, in the alleged fraud caused to Yes Bank Ltd. The ED probe also found that DHFL promoters, Kapil Wadhawan and Dheeraj Wadhawan put up a proposal for the sanction of a loan of about Rs 1,700 crore from YBL in the name of Belief Realtors PVT Limited (BRPL) for Bandra Reclamation Project. Subsequently YBL bifurcated the loan into two parts as they were not sanctioned as one entity. Accordingly, Rs 750 crore was sanctioned in the name of BRPL and Rs 950 crore in the name of RKW project. The loan of Rs 750 was disbursed by the bank. The whole amount was siphoned off by the duo as the entire amount was transferred by M/s Belief Realtors Private Limited to M/s DHFL through maze of over 150 shell company M/s RKW Developers Private Limited without making investment in Bandra Reclamation Project for which the loan was sanctioned. The loan of Rs. 600 crore sanctioned by DHFL to DUVPL is a subsidiary of M/s Morgan Credits Pvt. Ltd. (MCPL). Morgan Credits, in turn, are equally held by Rana Kapoor's three daughters.

FUTURE OF DHFL

Wadhawan says DHFL is to submit the debt restructuring resolution after agreement with the creditors. The terms of the resolution will be finalized by July 25. DHFL is looking for a strategic investor, who would pump in fresh equity. However, uncertainty surmounts the circumstance and predictions cannot be made with certainty.

FINDINGS OF THE STUDY
The downfall of the NBFCs has a signalling effect. The investors start losing confidence in the domestic economy. The negative impact is observed in the financial markets by the withdrawal of Foreign Institutional Investors and foreign portfolio investors. The country fails to become a favourite destination for foreign investors despite several attempts of the government. The siphoning of funds by the promoters of the organisation should be under surveillance. The promoters' stake holding should not exceed 20% of the total stake holding. The auditors'' role is most crucial in this context. The corporate auditors should be impartial in their judgement and should make honest declarations in the greater interest of the nation.

CONCLUSION
India's economy as of now faces extreme difficulties, both local and worldwide. Some of these organizations like Jet, IL&FS and DHFL have made a story. The case of DHFL and IL &FS can have significant repercussions over the economy, which is as of now battling to set back to track. A high number of bankrupt organisations question the feasibility of NBFCs, and impact on various businesses. It will likewise order more noteworthy administrative consideration, when India's controllers need to fix more stringent standards of credit appraisal. The challenge is about the future roadmap to revive the funding institutions. Hence the regulators and the policymakers need to be more proactive in their policy making approaches.

LIMITATIONS OF THE STUDY
There were certain shortcomings in the study. Due to time constraint the study was constrained to the two NBFCs only- DHFL and IL & FS study. The study about the other NBFCs could not be undertaken. The collection of data is entirely based on the secondary sources. The corporate sources directly could not be explored for seeking relevant information relating to the study.

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