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DETERMINANTS OF PROFITABILITY OF SELECTED NON BANKING FINANCIAL COMPANIES IN INDIA

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ABSTRACT

Financial institutions play an important role in the economy by channelizing funds and that act as a prominent stakeholders. Financial sector plays an indispensable role in the overall development of a country. NBFCs are financial intermediaries engaged primarily in the business of accepting deposits and delivering credit. Financial performance of a financial company basically depends on its some key financial determinants. Specially operating efficiency is main influencing factor which is calculated through operating income. Besides in capital structure of companies, total equity, total liability, operating expenses and total assets significantly affect the profitability of any non banking financial companies. This study investigates the determinants of profitability of non banking finance companies in India during the period from 2003-04 to 2012-13. Different statistical techniques such as descriptive statistics and multiple regressions have been used. This research is an attempt to analyze the trends in profitability and to find out the statistically significant key determinants variable and the level of influence over the net profit and return on total assets.

KEYWORDS
Return on Assets, Return on Capital Employed, Income Diversification, Capital Base, GDP, Inflation, Size, Interest Margin and Assets Quality.

INTRODUCTION
The financial system facilitates transfer of funds, through financial institutions, financial Markets, financial instruments and services. Financial institutions act as mobilizes and depositories of savings, and as purveyors of credit or finance. They also provide various financial services to the community. They act as intermediaries between savers and investors. All banks and many non-banking institutions also act as intermediaries and are called as non-banking financial intermediaries (NBFI). Financial institutions are divided into the banking and non-banking ones. The banking system in India comprises the commercial banks and co-operative banks. The examples of non-banking financial institutions are Life Insurance Corporation (LIC), Unit Trust of India (UTI), and Industrial Development Bank of India (IDBI). The non banking financial sector in India has recorded marked growth in the recent years, in terms of the number of Non-banking financial companies (NBFCs), their deposits and so on. Keeping in view the growing importance of NBFCs, the banking laws (miscellaneous provisions) act, and 1963 was introduced to regulate them. NBFCs are non-banking companies carrying business of a financial institution. These institutions are engaged in the principal business of loans and advances, acquisition of shares /stocks /bonds /debentures /securities issued by government or local authority, other securities of marketable nature, leasing, hire purchase, insurance business, and chit business. The institutions whose principle business is that of agricultural activity or any industrial activity or sale, purchase or construction of immovable property, do not fall under the definition of NBFCs. Unlike commercial banks, NBFCs cannot accept demand deposits, cannot write checking facility, and cannot issue cheques to the customers. NFBCs operate largely in vehicle financing, hire purchase, lease, personal loans, working capital loans, microfinance, consumer loans, housing loans, loans against shares, investments, distribution of financial products, etc. This paper made an attempt to analyse the performance of selected NBFCs.

REVIEW OF LITERATURE
To get an insight of profitability determinants, several studies have been executed with the help of ratios, Correlation and Regression analysis up to till date. But the fact suggests that, most of the researches have been conducted on banking industry. So, the evident with regard to profitability is scarce in the NBFI sector.

Suresh Vadde(2011) analysed the performance of NBFCs in India during 2008-09. Totally 1215 companies were selected as sample and were classified into five major groups according to their activity viz, share trading and investment holding, loan finance, asset finance, diversified and miscellaneous groups. A comparison is also made for the preceding two years 2006-07 and 2007-08 for the same set of companies. The study revealed that operating profits and the share of external sources of the select companies declined along with diminishing profitability during 2008-09.The major portion of funds raised during the year was deployed as loans and advances. The share of 'investment' in total use of funds increased during 2008-09 on account of investment in the mutual funds, shares and debentures of other Indian companies.

Fadzlansufian, and RoyfaizalRazali Chong (2008) examined the determinants of Philippines banks profitability during the period 1990-2005. Their empirical findings suggest that all the bank-specific determinant variables have a ststistically significantly impact on bank profitability. They also found that size, credit risk, and expenses performance behavior are negatively related to bank's profitability, while non interest income and capitalization have a positive impact. According to their analysis inflation has a negative impact on bank profitability, while the impact of economic growth, money supply, and stock market capitalization have not significantly explained the variations in tne profitability of Philippines banks.

Sarker and Das (1997) They compares the performance of public, private and foreign banks for the year 1994-95 by using measures of profitability, productivity and financial management. They found PSBs performing poorly with the other two categories. However, they give caution that no firm inference can be derived from a comparison done for a single year.

Shveeta and Satish Verma (2002) Thsey analyzed the inter-temporal profitability behavior of SBI group, other nationalized and foreign banks in India. They empirically estimated factors influencing the profitability of banks. They concluded that priority sector advances (in case of PSBs) and spread and burden (for all categories of banks) were the major and significant factors that influence the profitability of banks.

Thaigarajan et. al. (2011) They have carried out an analysis to empirically evaluate the determinants of profitability in the public and private sector banks in India using statistical tools such as correlation analysis, Multiple Regression Analysis and Factor analysis.
They have used ROA as the measure of profitability of the banks. This paper is the base for our study.

Smirlock & Brown, (1986) studied the impact of demand deposits as a function of total deposits on profitability. Their findings suggest that demand deposits had a significant positive relationship with profits.

Miller and Noulas, (1997) found that loan loss provision and net charge offs had a significant negative effect on the profitability of large banks. These results indicated that net charge offs were further affected by asset and liability composition. Thus, the asset liability portfolio decisions of commercial banks can be expected to affect the profitability of these institutions via net charge offs. It was also observed that higher salaries and benefits per employee were consistently

associated with higher net charge offs to total assets. This suggested that banks with higher salaries and benefits would require higher net interest margins to maintain profitability.

Ganesan, (2001) examined the profitability of public sector banks in India and found that interest costs, interest income, other income, deposits per branch, credit to total assets and proportion of priority sector advances were key determinants of profitability of these banks. **Ben Naceur and Goaied, (2008)** in a study done on Tunisian banks from 1980-2000, find that banks with relatively high amount of capital and overhead expenses tend to exhibit higher net-interest margin and profitability levels. They also find that bank size is negatively related to profitability. Additionally stock market development had a positive impact on bank profitability. Further private banks were found to be relatively more profitable than their state-owned counterparts.

Sufian, (2009) examined the determinants of Malaysian domestic and foreign commercial bank profitability during the period 2000-2004. It was found that Malaysian banks with higher credit risk and loan concentration exhibit lower profitability levels. On the other hand, banks that has a higher level of capitalization, higher proportion of income from non-interest sources, and high operational expenses proved to be relatively more profitable.

Sufian, (2009) found that economic growth negatively impacts the profitability of Malaysian banks. Higher inflation rates positively impacted the profitability of these banks. While studying a sample of eighteen European countries **Molyneux and Thornton, (1992)** found a significant positive relationship between the return on equity and the level of interest rates in each country, bank concentration, and government ownership.

OBJECTIVES OF THE STUDY

The study is carried out with following objectives:

1. To analyze the profitability position of selected NBFCs in India.
2. To identify the factors determining profitability of selected NBFCs in India.

METHODOLOGY

The data were collected from the official directory and data base of Center of Monitoring Indian Economy (CMIE) namely (PROWESS). The published annual reports of the selected non-banking financial companies taken from their websites, magazines and journals on finance have also been used sources of data. The study covers a period of ten years from 2003-04 to 2012-13. . Out of 14 NBFCs listed in NSE, only 4 companies were selected on convenient sampling method such as: Housing Development Finance Corporation Ltd (HDFC), Life Insurance Corporation Limited (LIC), Power Finance Corporation Limited (PFCL) and Industrial Development Finance Corporation Limited (IDFC). To assess the determinants of profitability of select non banking financial companies, the study adopted the statistical techniques like mean, standard deviation, coefficient of variation, skeweness, Kurtosis, Annual Compound Growth Rate and Multiple Regression Technique along with financial ratios.

VARIABLES FOR THE STUDY

In this section, an attempt has been done to find out the associations between profitability and performance indicating variables with assistance of few statistical tools. In this study, the Dependent Variables are Return on Assets and Return on Capital Employed and the Independent Variables are Income Diversification, Capital Strength, Size, Economic Growth, Inflation, Interest Margin Ratio and Asset Quality.

EMPIRICAL ANALYSIS

Trend in Profitability of select Non-Banking Finance Corporations have been presented in the following table:

TABLE 1: RETURN ON ASSETS AND RETURN ON CAPITAL EMPLOYED RATIO OF SELECTED NON-BANKING FINANCE COMPANIES IN INDIA DURING THE PERIOD 2003-04 TO 2012-13

Name of the Companies	HDFC		LIC		PFCL		IDFC	
Year	ROA	ROCE	ROA	ROCE	ROA	ROCE	ROA	ROCE
2003-04	2.54	3.24	2.17	2.79	4.72	5.85	4.83	5.38
2004-05	2.55	3.20	1.65	1.86	5.63	6.57	4.57	4.79
2005-06	2.42	3.10	1.17	1.67	6.32	8.32	3.60	3.83
2006-07	2.27	3.04	1.38	1.73	3.37	4.76	3.15	3.52
2007-08	2.25	3.14	1.56	1.98	2.84	3.54	2.60	3.22
2008-09	2.63	4.16	1.75	2.40	2.62	3.29	2.41	3.15
2019-10	2.25	3.32	1.92	2.63	2.55	3.47	2.49	3.26
2010-11	2.07	3.50	1.74	2.39	2.29	3.13	3.04	3.95
2011-12	3.11	6.04	2.33	3.09	2.91	3.72	3.36	4.55
2012-13	3.01	5.88	1.73	2.33	2.59	3.50	3.80	5.21
Mean	**2.51**	**3.86**	**1.74**	**2.29**	**3.58**	**4.62**	**3.39**	**4.09**
Standard Deviation	**0.34**	**1.15**	**0.34**	**0.47**	**1.44**	**1.75**	**0.83**	**0.84**
CV (%)	**0.11**	**1.33**	**0.12**	**0.22**	**2.08**	**3.06**	**0.69**	**0.71**
Skewness	**0.76**	**1.50**	**0.18**	**0.23**	**1.14**	**1.29**	**0.62**	**0.42**
Kurtosis	**-0.21**	**0.70**	**0.05**	**-0.93**	**-0.21**	**0.75**	**-0.58**	**-1.47**
Minimum	**2.07**	**3.04**	**1.17**	**1.67**	**2.29**	**3.13**	**2.41**	**3.15**
Maximum	**3.11**	**6.04**	**2.33**	**3.09**	**6.32**	**8.32**	**4.83**	**5.38**
Range	**1.05**	**3.00**	**1.15**	**1.42**	**4.03**	**5.19**	**2.42**	**2.23**
ACGR (%)	**1.38**	**6.87**	**2.12**	**3.18**	**-9.25**	**-8.42**	**-3.53**	**-0.45**

Sources: Compiled and Calculated from the CMIE Data Base.

It can be observed from Table 1 that the average Return on Assets of HDFC is 2.51 percent, which is followed by LIC 1.74 percent, PFCL 3.58 percent and IDFC 3.39 percent. The descriptive analysis reveals that the variations in the ROA were consistent during the period of study. The test of normality showed that the coefficient of skewness were positive for all the firms. The co-efficient of skewness and kurtosis indicates the non-normality of distribution. The above table also indicates the profitability of NBFCs in terms of Return on Capital employed. The average ratio of ROCE recorded at 3.86 per cent in the HDFC which is followed by LIC (2.29 %), PF (4.62%) and IDFC (4.09%). The measures of dispersion standard deviation and coefficient of variation indicates that the variation in the ROCE was consistent in the case of HDFC (0.32), LIC (0.22), PFCL (3.06) and IDFC (0.71) during the period of study. The co-efficient of skewness and kurtosis signifies the non non-normality of distribution. The annual compound growth showed an increasing trend in both measures of profitability ROA and ROCE in the case of HDFC and LIC. But in the case of Power Finance and IDFC the there has been declining trend in their profit earning capacity.

REGRESSION ANALYSIS

The empirical study has been done as a whole to find out the extent of relationship between dependent and independent variables. After performing the analysis, it will be likely to come to a supposition about the explanatory powers of the performance indicating variables towards the profitability. The dependent factors are Return on Assets and Return on Capital Employed and the Independent Variables are Income Diversification, Capital Strength, Size, Economic Growth, Inflation, Interest Margin Ratio and Asset Quality.

The specification of the model is as follows:

$$Y_{[t1,t2]} = \alpha + \sum_{i=1}^{n} \beta_i X_i + \varepsilon$$

Where,

$Y_{[t1,t2]}$ is Return on Assets (ROA)

$Y_{[t1,t2]}$ is Return on Capital Employed (ROCE)

X_i is the vector of independent variables and 'ε' is the error term

In order to understand the determinants of profitability more precisely, the above equation is elaborated as follows:

$$ROA_{it} = \alpha + \beta_1 (IDV) + \beta_2 (CAP) + \beta_3 (SIZE) + \beta_4 (GDP) + \beta_5 (INFL) + \beta_6 (IMR) + \beta_7 (AQ) + \mu_t$$ --------- *Model (1)*

$$ROCE_{it} = \alpha + \beta_1 (IDV) + \beta_2 (CAP) + \beta_3 (SIZE) + \beta_4 (GDP) + \beta_5 (INFL) + \beta_6 (IMR) + \beta_7 (AQ) + \mu_t$$ --------- *Model (2)*

IDV = Income Diversification
CAP = Capital Strength
SIZE = Size
GDP = Economic Growth
INFL = Inflation
IMR = Interest Margin Ratio
AQ = Asset Quality

To apply regression models, the ordinary least square (OLS) method have been used to find out the relationship between selected independent variables and profitability measures.

TABLE 2: REGRESSION RESULTS – MODEL I

Variables	NAME OF THE COMPANIES			
	HDFC	**LIC**	**PFCL**	**IDFC**
Constant	-19.084* (-3.913)	5.476 (0.786)	4.768 (1.204)	1.167* (2.994)
IDV	0.897** (7.359)	0.557* (3.549)	0.996*** (63.270)	0.911*** (24.272)
CAP	-2.726 (-2.772)	-3.258 (-2.030)	-0.250 (-2.282)	-0.002 (-0.982)
SIZE	4.042** (4.010)	-1.979 (-1.281)	-0.863 (-1.059)	-0.187 (-2.017)
GDP	-0.086 (-2.680)	0.233* (3.106)	-0.017 (-0.748)	-0.014* (-3.327)
INFL	-0.002 (-0.083)	0.064 (1.455)	0.003 (0.283)	0.001 (0.187)
IMR	-0.195** (-3.499)	0.451* (3.372)	-0.042 (-0.579)	0.000 (-0.036)
AQ	0.100*** (10.309)	-0.357 (-0.731)	0.010 (0.349)	0.009 (1.893)
R^2	99.9	96.5	97.9	98.9
Adjusted R^2	99.7	84.4	93.9	97.98
F value	64.65***	57.97	70.66***	90.84***

*** Significant at 10% level, ** Significant at 5% level, *** Significant at 1% level**

Table 2 presents the regression results of model (1), which indicates the relationship between dependent independent variables. It is found from the analysis that the value of adjusted R^2 of estimated regression equation is found to be statistically significant as is evident from their 'F' values, it disclose the goodness of fit of the model. The value of adjusted R^2 tends to be high ranging in between 57.97% to 90.84% in the sample firms. The very high value of adjusted R^2 shows that all the explanatory variables taken together well explained the profit behavior of the firm. As per the regression model 1 the coefficient of Income Diversification were found positive and significant impact on the profitability of the sample firms. The explanatory variable CAP negatively associated with profitability but not statistically significant. The regression coefficient of Size was positive and significant only in the case of HDFC. The economic variable GDP negatively associated with profitability but statistically significant only in the case of IDFC. Inflation does not have impact on the profitability of the sample firms. The exogenous variable interest margin found to be an important variable in determining profitability of HDFC and LIC. The other variable Assets Quality found positive and significant influence on the profitability of HDFC.

Regression Model (2) has been presented in Table 3.

TABLE 3: REGRESSION RESULTS – MODEL II

Variables	NAME OF THE COMPANIES			
	HDFC	LIC	PFCL	IDFC
Constant	1.318 (0.893)	6.845* (3.485)	20.049 (0.894)	3.882 (2.044)
IDV	0.490*** (13.291)	0.437** (9.878)	0.742** (8.329)	1.398** (7.650)
CAP	-0.218 (0.732)	-2.785** (6.156)	-0.515 (0.829)	-0.064** (5.503)
SIZE	0.001 (0.003)	-2.008** (-4.612)	-3.932 (-0.853)	-0.882 (-1.954)
GDP	-0.045** (-4.581)	-0.138** (6.514)	-0.156 (-1.176)	-0.038 (-1.812)
INFL	-0.013 (-1.770)	0.056 (2.511)	0.010 (0.146)	-0.027 (-1.347)
IMR	0.069* (4.099)	0.302** (8.014)	0.152 (0.369)	0.146 (2.469)
AQ	0.019** (6.395)	-0.125 (-0.906)	-0.043 (-0.274)	0.078* (3.338)
R^2	99.93	97.47	98.09	94.92
Adjusted R^2	99.69	92.62	95.91	94.65
F value	93.51***	53.95**	31.15**	96.03***

*** Significant at 10% level, ** Significant at 5% level, *** Significant at 1% level**

In the model (2) we use the Return n Capital Employed as the dependent variable. The analysis indicates that the value of adjusted R^2 of estimated regression equation is found to be statistically significant in the selected sample firm as is evident from their 'F' values. The high adjusted R^2 value ranging in between 31.15% to 96.03% refers to variation in dependent variables (ROCE) are explained by the variation of independent variables. The explanatory variable IDV has positive sign in all the firms and found to be important determinants of profitability (ROCE). CAP negatively related with profitability and which is found to be an important determinants of profitability of LIC and IDFC.

The GDP has negative impact on profitability, however, it has been found to be important determinants of profitability of HDFC and LIC. The explanatory variable Inflation does not have significant impact on the profitability of the firm. The other variable interest margin positively associated with profitability; however it does not have any impact on the profitability of the sample firm. Asset Quality has positive and significantly related with profitability in the case of HDFC and IDFC.

FINDINGS & CONCLUSION

This paper examined the profitability of selected NBFCs in India during 2003-04 to 2012-13. The results of the study show that there has been an increasing trend in its profitability of HDFC and LIC. But in the case of PFCL and IDFC were showed a declining trend. This study also focused on the determinants of selected NBFCs in India. The results show that independent variables like Income Diversification, Capital Strength, Size, Economic Growth, Inflation, Interest Margin Ratio and Asset Quality haven taken together have influenced the profitability of the firm in both regression models. However, inflation does not have any impact on the profitability of the sample firms. Therefore it is concluded that higher the Inocem Diversification higher the profitability and; higher the capital base lower the profitability. Again, Interest Margin Ratio is the another variable which has a major impact on Return on Capital Employed. So it is undoubtedly true that if the revenue increases, ultimately it has a positive effect over the profitability. The results of multiple regressions suggest that the selected independent variables explain more than 93.80% changes in the ROA and in ROCE. All the results are statistically significant and overall results provide an idea that income diversification is the basic determinant of profitability in NBFI sector. So it can be inferred that this promising and potential sector can flourish very fast and enhance profitability by improving diversified income and interest margin.

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