

# The Growth of a Shadow Banking System in Emerging Markets: Evidence from India

Viral V. Acharya  
NYU, Stern – NBER – CBER

T. Sabri Öncü  
Center for Advanced Financial Research and Learning

# Objective of the Study

- To investigate the rapid growth of the nonbank finance corporations (NBFCs) in India to understand incentives underlying the formation of shadow banking institutions, if any.
  
- Our hypotheses for the growth and relative characteristics of NBFCs will include:
  - purely economic reasons for coincidence of certain asset-liability structures;
  - the role played by regulatory differences in:
    - licensing requirements;
    - asset restrictions;
    - asset recovery privileges;
    - foreign investment restrictions;
    - priority sector norms, etc.

# Scope of this Talk

- We are still in the process of finalizing our data needs.
- Therefore, the scope of this talk is limited to:
  - an overview of the Indian NBFC market;
  - our analysis of publicly available NBFC data.

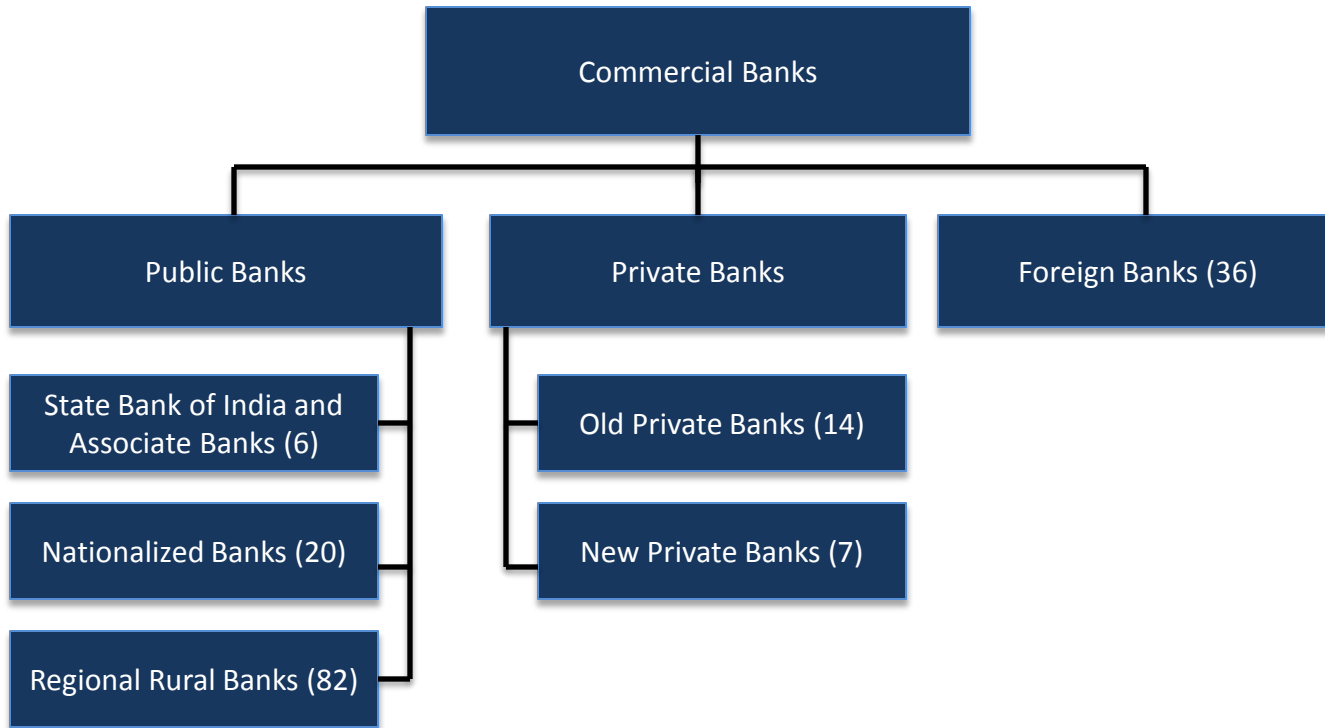
# What is Shadow Banking?

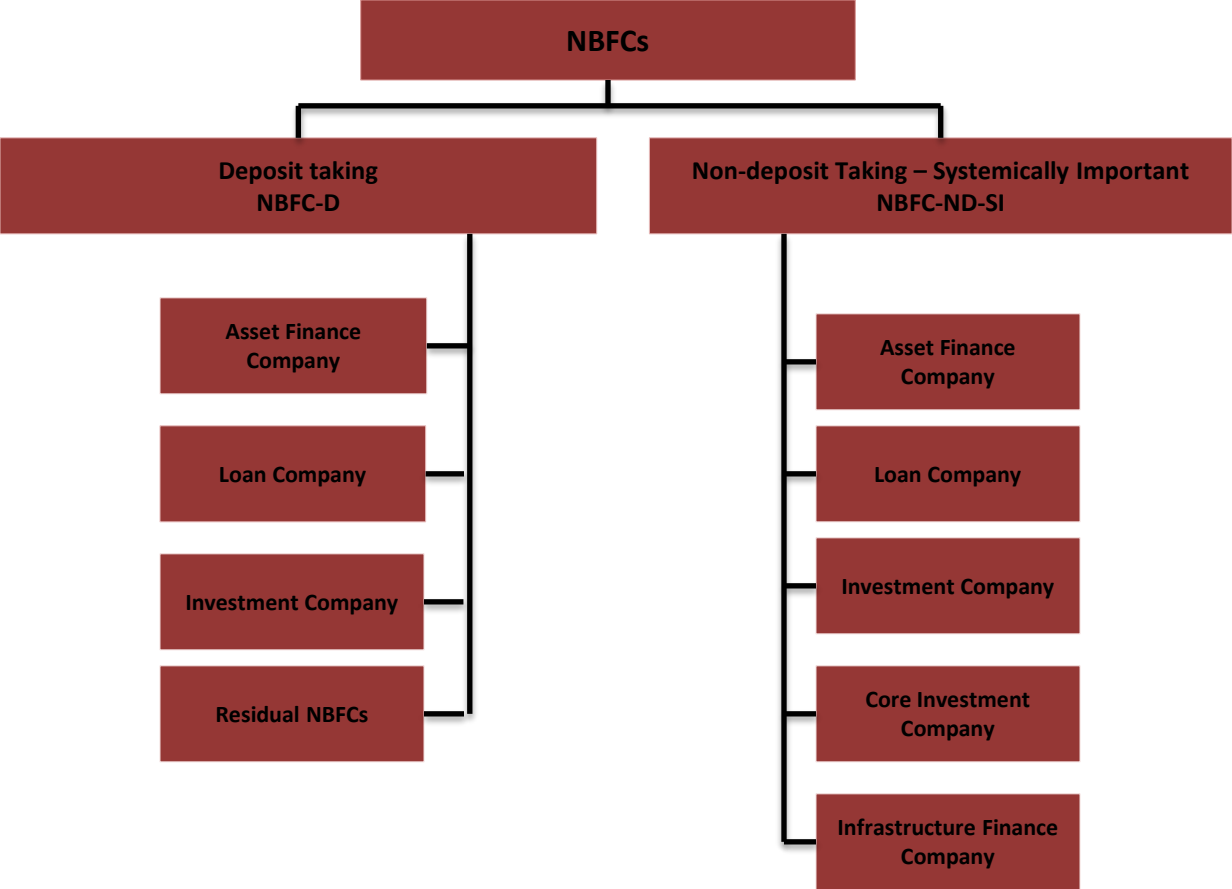
Shadow Banking is an evolving concept. Many non-intersecting but non-contradictory definitions. However, below are the key points emerged so far:

- Maturity, credit and liquidity transformation outside the traditional banking system;
- Less regulated than the traditional banking system or not regulated at all;
- No explicit access to central bank liquidity or public sector credit guarantees;

# What is Shadow Banking?

- Highly levered;
- Assets are risky and illiquid;
- Liabilities are prone to “bank runs”;
- Decomposes the process of credit intermediation into a sequence of discrete operations. Therefore,
- it can be a collection not only of
  - single financial entities acting independently,
- but also of (and usually is)
  - networks of multiple financial entities acting together or both:
    - banks, formal and informal nonbank financial institutions, and even credit rating agencies, regulators and governments.





# Classification of NBFCs

## Activity Based

- **Asset Finance Company** is a company:
  - carrying on as its principal business the financing physical assets supporting productive/economic activity: autos, tractors, material handling equipments, etc.
- **Loan Company** is a company:
  - carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own.
- **Investment Company** is a company:
  - carrying on as its principal business the acquisition of securities.
- **Core Investment Company** is an investment company whose:
  - 90% of Net Assets in equity shares, preferred shares, bonds or loans of a group of companies or
  - 60% of Net Assets in equity shares of a group of companies.
- **Infrastructure Finance Company** is a company which:
  - deploys at least 75 per cent of its total assets in infrastructure loans.



# Classification of NBFCs

## Organization Based

- **Standalone NBFCs;**
- **Bank and Financial Institution (B&FI) Sponsored NBFCs:**
  - according to the RBI, there are 28 currently:
    - 18 sponsored by foreign banks and financial institutions;
    - 10 sponsored by Indian banks.
- **Captive NBFCs:**
  - set up to put the parent company's products within the reach of consumers and to ensure that the company has a steady pool of buyers;
  - any major challenges confronting the parent could threaten the operations and asset values of the captive NBFC.
- **Multiple NBFCs:**
  - companies which have multiple NBFCs within their group;
  - example: Shriram Group;
  - their argument is that operational efficiencies arising out of specialization, dynastic reasons, tax planning were some of the reasons given for multiple NBFCs.

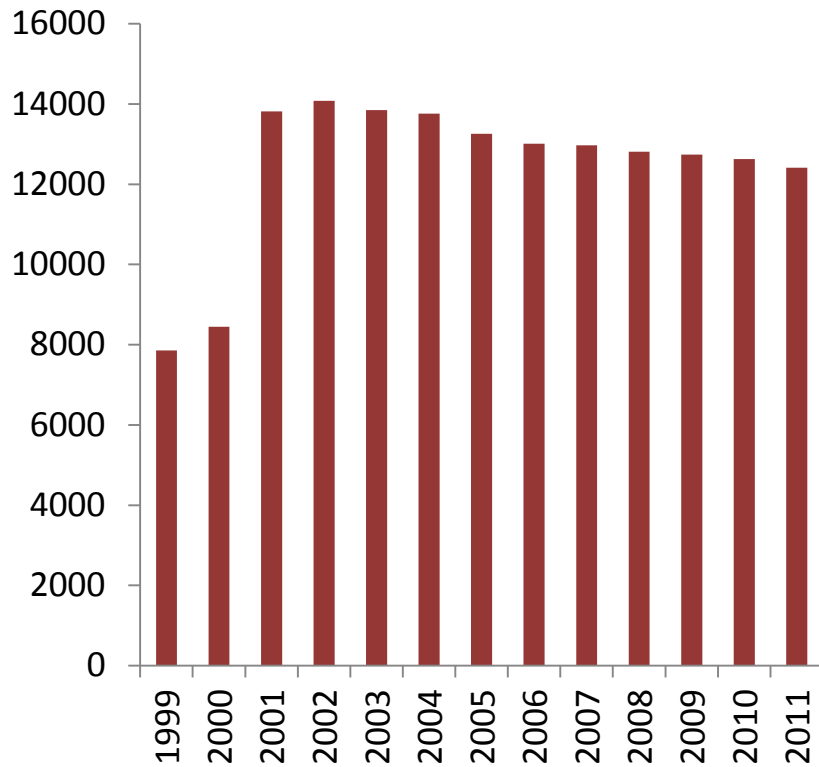
# Regulatory Differences between Banks and NBFCs

---

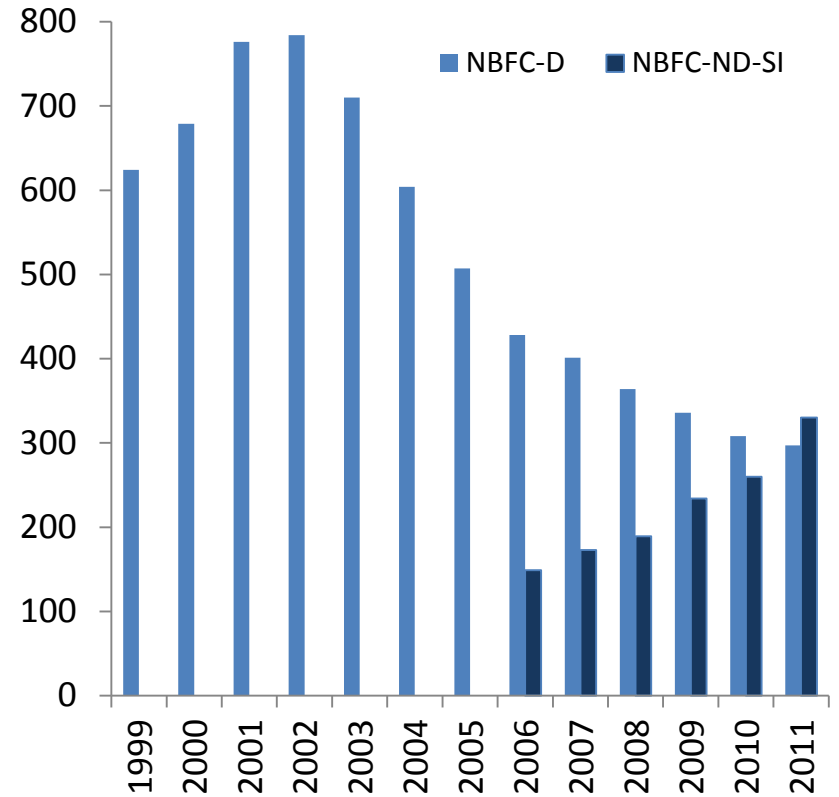
Requirement	Banks	NBFC-Ds	NBFC-ND-SIs
Liquidity as % of Demand and Time Deposits			
Cash Reserve (CRR)	6%	NA	NA
Statutory Liquidity (SLR)	24%	15%	NA
Capital as % of Risk Weighted Assets (CRAR)	9%	15%	15%
Priority Sector Lending as % of Total Credit	40%	NA	NA
Nonperforming Asset Norms (Days in Delinquency)	90	180	180
Restriction of Financial Activity	YES	NO	NO
Restrictions of Foreign Ownership	YES	NO	NO

---

# Growth of the NBFC Sector



Number of All NBFCs



Number of NBFC-Ds and NBFC-ND-SIs

# Consolidated Balance Sheet of NBFCs

## Trillions of Rupees

	FY06	%FY06	FY10	%FY10	FY11	%FY11
<b>Liabilities</b>						
<b>Share Capital</b>	<b>0.2215</b>	<b>6.70%</b>	<b>0.4328</b>	<b>6.17%</b>	<b>0.4722</b>	<b>5.57%</b>
<b>Reserves &amp; Surplus</b>	<b>0.4774</b>	<b>14.44%</b>	<b>1.3931</b>	<b>19.88%</b>	<b>1.5868</b>	<b>18.73%</b>
Public Deposits	0.2284	6.91%	0.1735	2.48%	0.1196	1.41%
Borrowings	2.0760	62.79%	4.4986	64.18%	5.7075	67.37%
B&FI Loans	0.6231	18.85%	1.3172	18.79%	1.8384	21.70%
Current liabilities	0.3027	9.16%	0.5114	7.30%	0.5863	6.92%
<b>Total Liabilities</b>	<b>3.3060</b>	<b>100.00%</b>	<b>7.0094</b>	<b>100.00%</b>	<b>8.4725</b>	<b>100.00%</b>
<b>Assets</b>						
<b>Loans and Advances</b>	<b>1.6945</b>	<b>51.25%</b>	<b>4.1964</b>	<b>59.87%</b>	<b>5.3607</b>	<b>63.27%</b>
Bill Business	0.0005	0.01%	0.0005	0.01%	0.0009	0.01%
Hire Purchase Assets	0.4472	13.53%	0.4169	5.95%	0.5002	5.90%
<b>Investments</b>	<b>0.8163</b>	<b>24.69%</b>	<b>1.5218</b>	<b>21.71%</b>	<b>1.6413</b>	<b>19.37%</b>
Cash and Bank Balances	NA	NA	0.2586	3.69%	0.2988	3.53%
Other Current Assets	NA	NA	0.4057	5.79%	0.4244	5.01%
Other Assets	0.3476	10.51%	0.2097	2.99%	0.2462	2.91%
<b>Total Assets</b>	<b>3.3060</b>	<b>100.00%</b>	<b>7.0094</b>	<b>100.00%</b>	<b>8.4725</b>	<b>100.00%</b>

NBFCs include NBFC-D, NBFC-ND-SI and RNBCs

# Comparison between NBFC and Bank Sectors

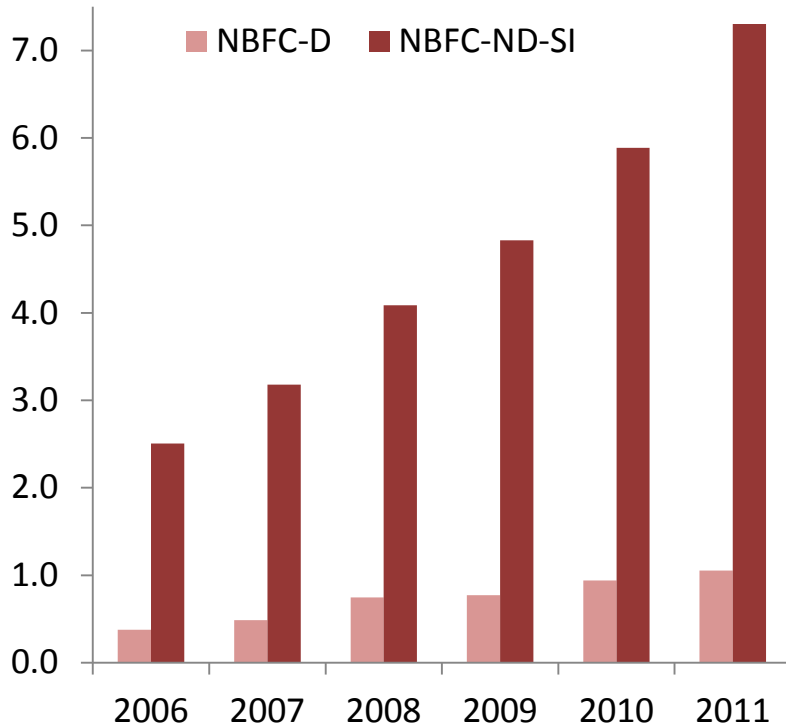
## Trillions of Rupees

	FY06	FY10	FY11
Number of NBFCs	13,014	12,630	12,409
Bank Credit of all Scheduled Banks	15.728	33.377	40.608
<b>NBFC Credit as percentage of Bank Credit</b>	<b>10.77%</b>	<b>12.57%</b>	<b>13.20%</b>
Assets of all Scheduled Banks	25.315	52.58	61.47
<b>NBFC Assets as percentage of Bank Assets</b>	<b>13.06%</b>	<b>13.33%</b>	<b>13.78%</b>
Bank Deposits of all Scheduled Banks	21.858	46.352	53.552
<b>NBFC Public Deposits as percentage of Bank Deposits</b>	<b>1.05%</b>	<b>0.37%</b>	<b>0.22%</b>

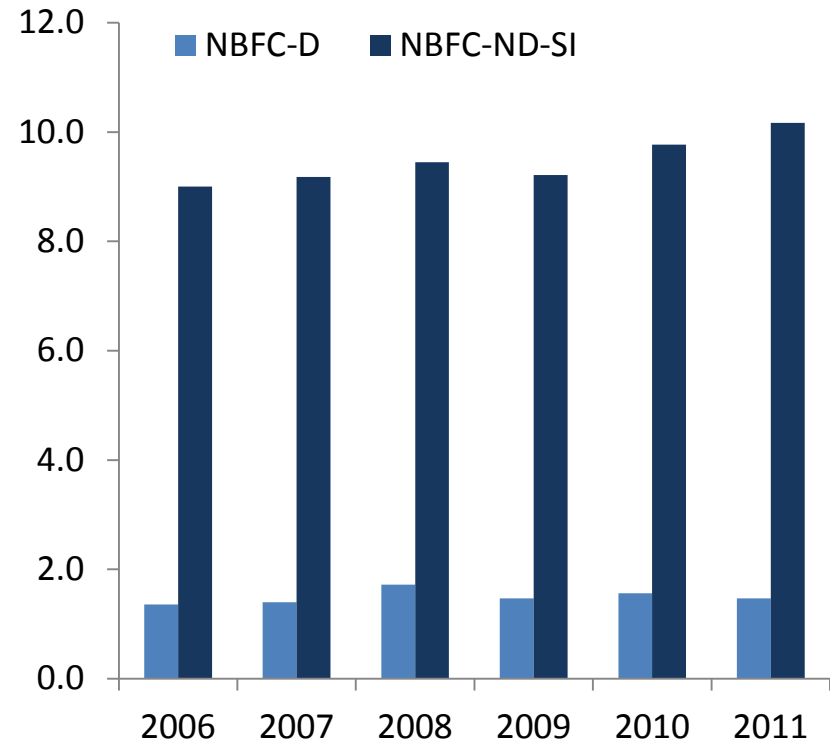
NBFCs include NBFC-D, NBFC-ND-SI and RNBCs

Scheduled Banks include Commercial Banks and Cooperative Banks

# Growth of the NBFC Sector (Excluding RNBCs)



Assets in Trillions of Rupees



Assets as percentage of Assets of Banks

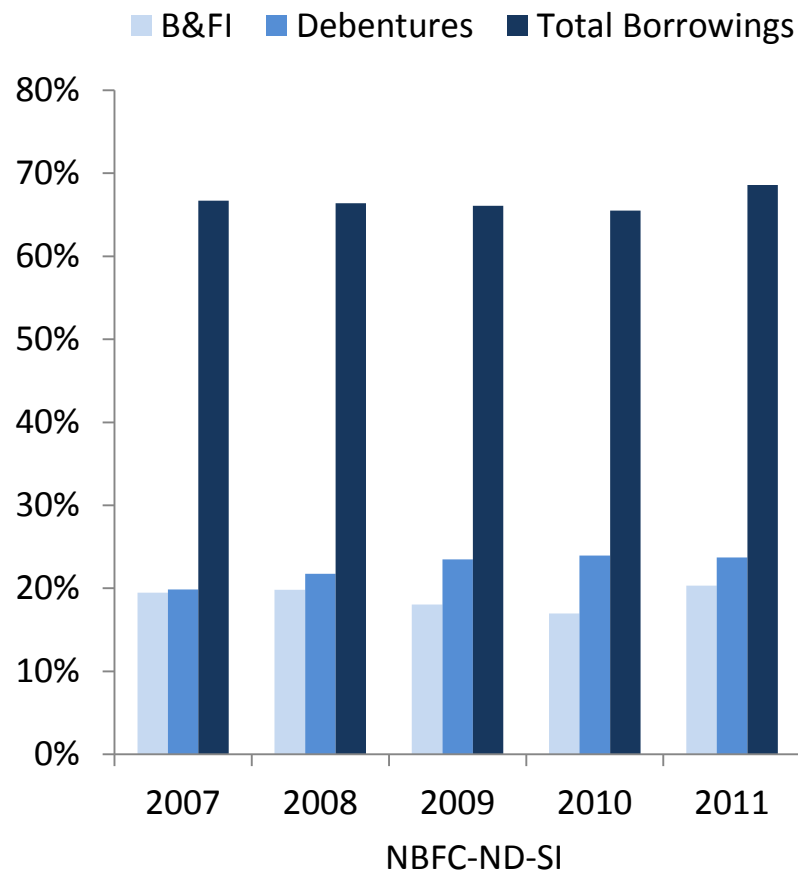
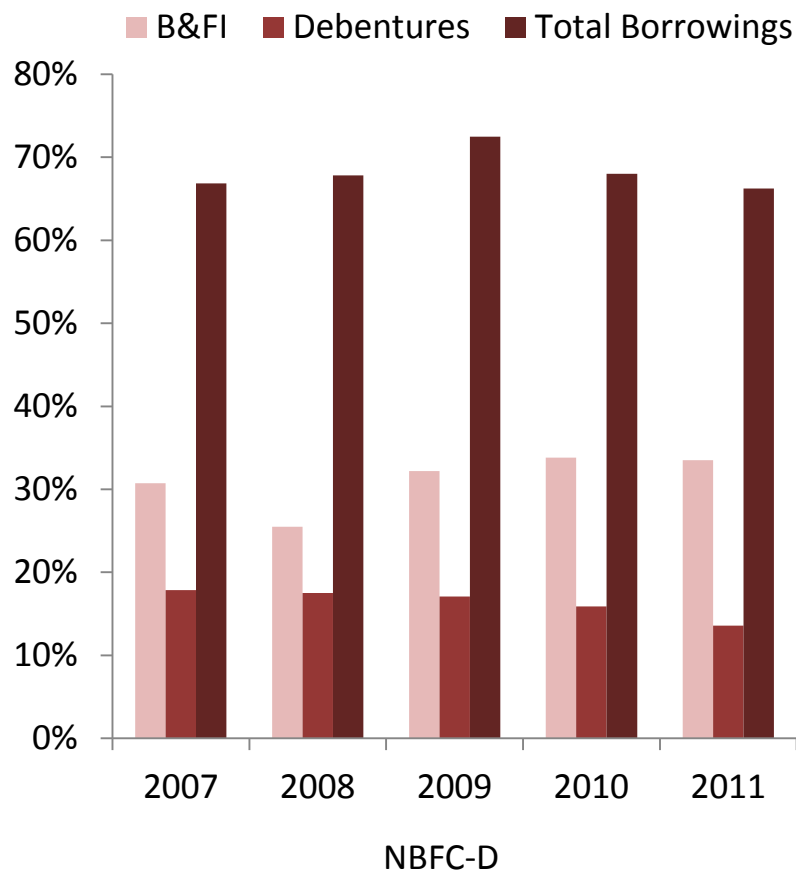
# Sources of Funds of NBFCs

## Trillions of Rupees

	FY06	%FY06	FY10	%FY10	FY11	%FY11
Share Capital	0.210	<b>6.98%</b>	0.404	<b>6.22%</b>	0.442	<b>5.61%</b>
Reserves and Surplus	0.489	<b>16.29%</b>	1.422	<b>21.89%</b>	1.617	<b>20.50%</b>
Public Deposits	0.228	<b>7.61%</b>	0.174	<b>2.67%</b>	0.120	<b>1.52%</b>
Borrowings	2.076	<b>69.12%</b>	4.499	<b>69.22%</b>	5.708	<b>72.37%</b>
B&FI Borrowings	0.623	<b>20.75%</b>	1.317	<b>20.27%</b>	1.838	<b>23.31%</b>
Debentures	0.681	<b>22.69%</b>	1.561	<b>24.02%</b>	2.053	<b>26.04%</b>
Intercorporate Borrowings	0.195	<b>6.48%</b>	0.222	<b>3.41%</b>	0.249	<b>3.16%</b>
Commercial Paper	0.131	<b>4.37%</b>	0.310	<b>4.78%</b>	0.323	<b>4.10%</b>
Other Borrowings	0.446	<b>14.84%</b>	1.088	<b>16.75%</b>	1.244	<b>15.77%</b>
Total	3.003	<b>100.00%</b>	6.499	<b>100.00%</b>	7.886	<b>100.00%</b>

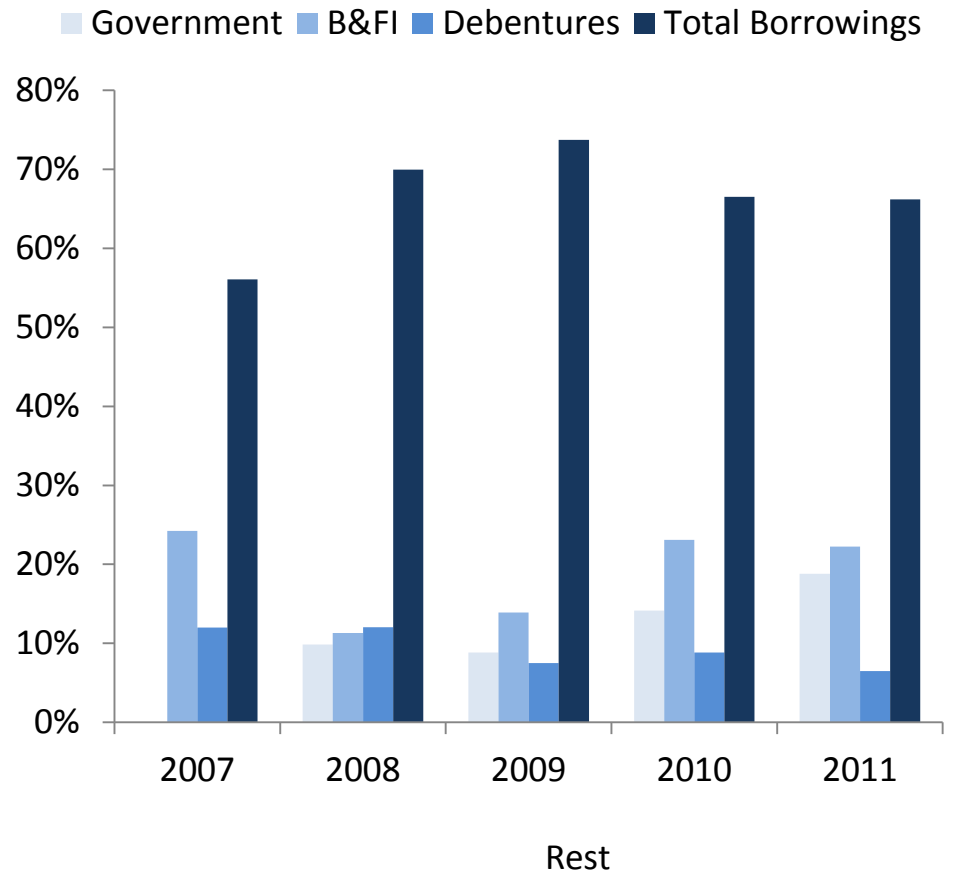
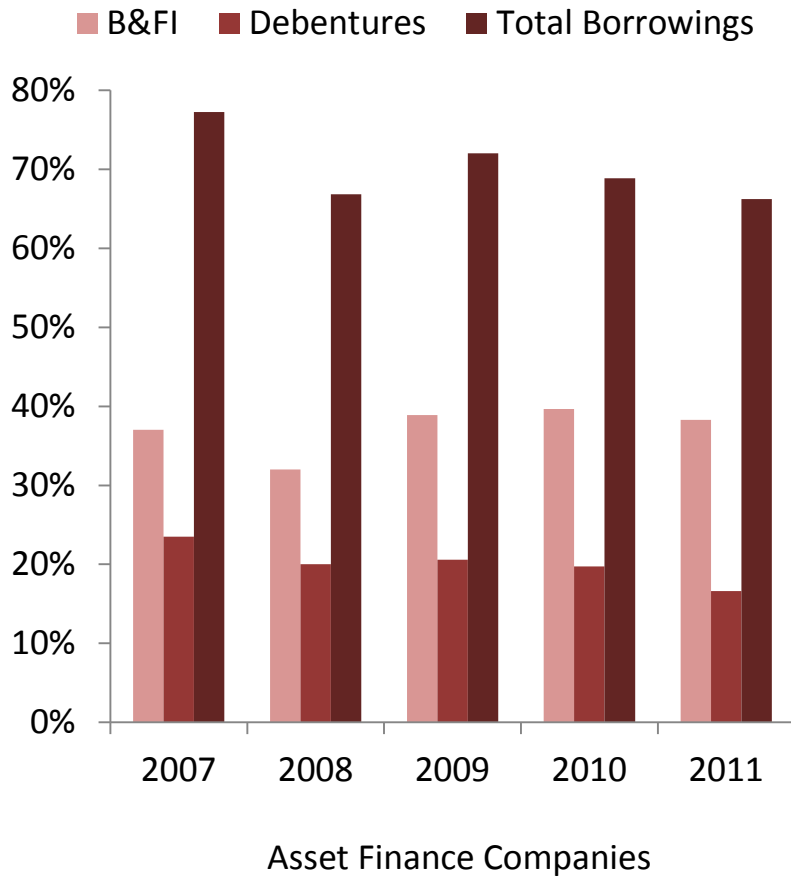
NBFCs include NBFC-D, NBFC-ND-SI and RNBCs

# Leverage of the NBFCs: Borrowings/Total Assets (Excluding RNBCs)





# Leverage of the NBFC-Ds: Borrowings/Total Assets (Excluding RNBCs)



# To Sum Up

- We are still in the process of finalizing our data needs;
- Our hypotheses for the growth and relative characteristics of NBFCs will include:
  - purely economic reasons for coincidence of certain asset-liability structures;
  - the role played by regulatory differences in:
    - licensing requirements;
    - asset restrictions;
    - asset recovery privileges;
    - foreign investment restrictions;
    - priority sector norms, etc.