

ASSOCHAM

ECO

PULSE

STUDY

Indian Banks vs. NBFCs: Profitability Analysis

May 2009

*Prepared by
Nusrat Ahmad & Birender Kumar
Assocham Research Bureau*

INTRODUCTION

2008-09 was a difficult year, especially for the financial segment across the globe. However, India's strong macro-economic fundamentals and financial policies have shielded it from the turmoil. As the fiscal year 2008-09 comes to an end, ASSOCHAM Research Bureau has analyzed corporate results of the Indian Banks and Non-Banking Financial Companies (NBFCs). The study considered those banks that have announced their results between 15th April -20th May 2008-09 posted on the website of Bombay Stock Exchange.

The ASSOCHAM Research Bureau (ARB) have analyzed in total 29 banks (both public & private sector) and 7 NBFCs

The Assocham Financial Pulse (AFP) study has examined and compared the profitability of banks with NBFCs during the financial year 2008-09. Simple average and profitability ratio of the two segments have been studied.

Methodology -

The AFP analysis of the Indian commercial banks & NBFCs profitability is calculated using two broad parameters including net profit and total income.

Profitability is calculated as:
 $(\text{Net Profit}/\text{Total income}) * 100$

Profitability Ratio is a class of financial metrics that is used to assess a business's ability to generate earnings as compared to its expenses and other relevant costs incurred during a specific period of time.

NBFCs more profitable than commercial banks despite slowdown

Even as the world wide financial crisis and slowdown in key sectors of the Indian economy led the Non-Banking Financial Companies to face severe cash shortage during the financial year 2008-09, the overall profitability of NBFCs has remained higher than the scheduled commercial banks, an Assocham Financial Pulse Study (AFP) has stated.

The AFP study titled “**Indian Banks vs. NBFCs: Profitability Analysis**” reveals that during the financial year 2008-09, Non- Banking Financial Companies (NBFCs) average profitability stood higher at 18.90 per cent as compared to the banks with 10.08 per cent.

The NBFCs generally operates on the model of lending to riskier projects with interest rates higher than offered by the banking institutions. As the financial markets faced the heat of global crisis during the financial year 2008-09, most of the NBFCs faced problems in fund raising.

Among the seven NBFCs, in 2008-09 the highest profitability was reported by Infrastructure Development Finance Company Limited at 20.89 per cent, with total income stood at Rs.3626.38 crore and net profit at Rs.757.73 crore. It was followed by Housing Development Finance Companies Limited (HDFC) and Power Finance Companies Limited (PFCL) at 20.76 per cent and 20.67 per cent respectively.

“The Reserve Bank of India (RBI) monetary measures by cutting interest rates during 2008-09 has benefited the NBFCs since many of them finance their operations through market borrowings” said Mr. Sajjan Jindal President, ASSOCHAM.

For the banking sector ASSOCHAM Research Bureau (ARB) has considered both public and private sector banks for the study. However, aggregate net profit to total income ratio of 17 public sector banks and 12 private sector banks reported to be 10.08 per cent during 2008-09.

Top 5 Banks and NBFCs with highest profitability

Bank	Profitability Ratio (2008-09) in %	Non Banking Financial Companies (NBFCs)	Profitability Ratio (2008-09) in %
Indian Bank	15.83	Infrastructure Development Finance Company Limited	20.89
Bank of India	15.50	Housing Development Finance Companies Limited (HDFC)	20.76
Axis Bank	13.22	Power Finance Companies Limited	20.67
State Bank of Travancore	12.94	LIC Housing Finance Ltd.	18.46
Union Bank of India	12.91	Manappuram General Finance and Leasing Limited	17.86

Source: Financial Results 2008-09, ARB

Among the 17 public sector banks, the highest profitability was reported by Indian Bank and Bank of India at 15.83 per cent and 15.50 per cent respectively. Out of the private sector banks the top positions were occupied by Axis Bank and Yes Bank at 13.22 per cent and 12.46 per cent respectively, among others.

The 7 NBFCs, aggregate total income grew by a whopping 57.3 per cent to Rs.28,208.72 crore in FY'09 from Rs.17,906.84 crore in the previous fiscal. However, the aggregate total income of 29 banks have increased by 25.3 per cent from Rs 2,69,055 crore in 2007-08 to Rs 3,37,206.9 crore in 2008-09.

Year-on-year performance of the 29 banks regarding net profit to total income ratio at the aggregate level showed a marginal decline during FY'09 with 10.08 per cent as against FY'08 recorded at 10.52 per cent, while in the case of 7 major NBFCs, the ratio declined during 2008-09 at 18.90 per cent as against 21.80 per cent in FY'08.

ANNEXURE

Banking versus Non-Banking Financial Companies Regulatory Arbitrage in India

	Banks	NBFCs
Functional restrictions		
Carrying on checking accounts, remittance functions and typical retail banking	Permitted	Not permitted
Acceptance of term deposits	Permitted, subject to term restrictions (short term deposits are accepted by banks)	Permitted subject to limitations, but the term of deposit is at least 1 year .
Trusteeship function, nominee	Permitted	No express bar is there
Other functional limitations	Banking Regulation Act expressly bars any business other than that permitted by the Act [Sec 6 (1)]	a. For domestic NBFCs, no bar on non-financial business, except that on crossing of a certain barrier (50% of income or assets), the NBFC will lose its character as an NBFC b. For NBFCs having international funding under automatic route, any activity included within the 19 permitted activities is possible. Any other activity is possible only with the express FIPB approval
Leasing and hire purchase	Banks are allowed to a limit of 10% of their assets	No limit
Operating lease	Treated as a non-financial business, not permitted	Permitted, though treated as non-financial business
Securitisation	Permitted subject to capital norms and other limitations	Permitted subject to capital norms and other limitations
Licensing restrictions		
Need for a license	Any new bank needs a license. Licensing norms are tightly controlled and generally, it is perceived to be quite difficult to get a license for a bank	It is comparatively much easier to get registration as an NBFC. Besides, there are some 30000 NBFCs currently registered, many of which may be available for sale.
Ownership structure/ change in ownership		
Indian ownership	Not more than 10% of capital in a bank may be acquired without the approval of the RBI	While prior intimation of takeover is required in case of NBFCs, there is no need for express permission for a change in voting control. There is no limit as to the percentage holding permitted in case of NBFCs
Foreign ownership	Upto 74% capital in banking companies may be acquired for foreign owners.	100% capital may be held by foreign owners subject of minimum capitalisation requirements under FDI norms

Capital adequacy requirements and provisioning		
Basle norms	Present capital regulations are based on Basle I. Basle II is proposed to be implemented effective 2007. Capital requirement generally 9% of risk-weighted assets	Prudential Regulations which lay down capital adequacy have been substituted in Feb 2007, but they are based on Basle I and not Basle II. Capital requirement generally 10% of risk-weighted assets.
Provisioning	90 days past due leads to NPA characterization and calls for provisioning as per international standards	As much as 12 months' overdue is permitted in case of lease and hire purchase transactions. 6 months in case of loans and other exposures
Credit control and sectoral asset restrictions		
SLR/ CRR norms	Substantial part of assets of banks is blocked due to statutory liquidity ratio (SLR) and cash reserve ratio (CRR). These are periodically changed to control the expansion of M3 in the economy	Only 15% of the deposit liabilities of NBFCs is to be held in certain permitted securities.
Sectoral exposures	Periodic regulations place limits on the extent to which banks may invest in capital market and other specific segments. There are certain segments in which banks need to allocate minimum percentage of their assets	Very scanty limitations have been placed on assets of NBFCs. Investment in real estate and unquoted equity shares are controlled. Capital market exposure is only required to be reported.