

NBFC INDUSTRY REPORT

Date: June 29th, 2024

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Executive Summary for the NBFC Sector Report

Global Economic Overview and NBFC Sector in 2024

The global economy in 2024 is characterized by uneven growth and ongoing challenges, yet it demonstrates resilience despite the volatility. The International Monetary Fund (IMF) projects global growth at 3.1% for 2024, with emerging markets showing more robust activity compared to advanced economies, which are experiencing tepid growth ([IMF](#)) ([World Economic Forum](#)).

Mergers and acquisitions (M&A) are a significant trend in the financial services sector, including non-banking financial companies (NBFCs). Companies are strategically using acquisitions to enhance their market positions and capabilities, particularly in adjacent markets. This trend is driven by the need for consolidation, restructuring, and leveraging synergies to optimize costs and improve profitability ([PwC](#)) ([McKinsey & Company](#)).

Digital transformation continues to be a key driver for NBFCs globally. The adoption of advanced technologies such as artificial intelligence (AI), machine learning (ML), robotic process automation (RPA), and blockchain is revolutionizing the sector. These technologies enhance operational efficiency, customer experience, and risk management capabilities, allowing NBFCs to better analyse data and create alternative credit scoring models ([PwC](#)) ([Blog](#)).

Environmental, social, and governance (ESG) criteria are increasingly influencing investment decisions and business strategies within the NBFC sector. Investors and regulators are prioritizing sustainable practices and transparency in ESG reporting. This shift is prompting NBFCs to adopt more responsible practices to meet stakeholder expectations and regulatory requirements ([PwC](#)).

Workforce trends are also impacting the NBFC sector. The rise of digital jobs is providing higher-paid roles and expanding the global talent pool. However, the potential for rising unemployment in certain regions due to economic uncertainties and the impact of AI on job displacement highlights the need for reskilling and upskilling the workforce to adapt to technological advancements ([World Economic Forum](#)) ([McKinsey & Company](#)).

The integration of digital technologies helps NBFCs like Usha Financial Services Limited (UFSL) reduce dependency on manual processes, improve accuracy, and achieve cost savings. This leads to faster loan approvals, better risk assessment, and enhanced customer service ([PwC](#)) ([Blog](#)).

Increased M&A activity and strategic partnerships open new avenues for growth and market expansion. Collaborations with fintech companies and traditional banks enable NBFCs to enhance their product offerings and reach a broader customer base, contributing to financial inclusion and economic development ([PwC](#)) ([KPMG](#)).

Adapting to evolving regulatory requirements ensures better risk management and stability for NBFCs. Compliance with ESG criteria and data privacy regulations builds trust and credibility with stakeholders, essential for sustainable growth ([PwC](#)) ([Blog](#)).

Despite these opportunities, NBFCs face challenges such as keeping up with rapid technological advancements and ensuring robust cybersecurity measures. Navigating stringent regulations and managing operational costs are ongoing concerns. Intense competition from traditional banks and fintech companies requires continuous innovation and differentiation to maintain market position ([KPMG](#)) ([Blog](#)).

Global Key points for NBFC Industry

1. Global Economic Volatility:

NBFCs are increasingly impacted by global economic volatility, driven by geopolitical tensions, trade disruptions, and fluctuating commodity prices. These factors create uncertainties in the financial markets, affecting credit demand and lending activities ([World Economic Forum](#)) ([McKinsey & Company](#)).

2. Climate Change and Sustainability:

Climate change is becoming a critical consideration for NBFCs. They are adopting green finance initiatives and sustainable lending practices to support environmental goals and mitigate climate risks. This shift is essential for aligning with global sustainability standards and attracting environmentally conscious investors ([PwC](#)) ([Blog](#)).

3. Decentralized Finance (DeFi) and Blockchain:

The rise of decentralized finance (DeFi) and blockchain technology is transforming the traditional financial services landscape. NBFCs are exploring these technologies to enhance transparency, security, and efficiency in financial transactions. Blockchain can streamline processes such as identity verification and cross-border payments ([PwC](#)) ([Blog](#)).

4. Demographic Shifts and Aging Populations:

Demographic changes, particularly in developed countries with aging populations, are influencing the financial services sector. NBFCs are adapting their product offerings to cater to the financial needs of older adults, such as retirement planning and long-term care financing ([McKinsey & Company](#)).

5. Remote and Hybrid Work Models:

The adoption of remote and hybrid work models is reshaping the operational dynamics of NBFCs. These models require investment in digital infrastructure and cybersecurity to support a distributed workforce while maintaining productivity and data security ([World Economic Forum](#)).

6. Global Talent Acquisition and Management:

With the rise of digital jobs, NBFCs are focusing on global talent acquisition and management. This involves leveraging remote work capabilities to tap into a diverse talent pool across different regions, enhancing innovation and operational efficiency ([World Economic Forum](#)).

7. Consumer Behaviour and Digital Banking:

Changes in consumer behaviour, driven by the proliferation of digital banking, are impacting NBFCs. Consumers increasingly prefer digital channels for financial transactions, requiring NBFCs to enhance their digital capabilities and user experience to meet evolving customer expectations ([Blog](#)).

8. Financial Health and Literacy:

There is a growing emphasis on financial health and literacy among consumers. NBFCs are developing educational programs and tools to improve financial literacy, helping customers make informed financial decisions and manage their finances better ([PwC](#)) ([Blog](#)).

By understanding and integrating these additional global key points, Usha Financial Services Limited can better navigate the evolving financial landscape, leveraging new opportunities and addressing emerging challenges effectively.

Impact on the NBFC Sector: Non-Banking Financial Companies (NBFCs) continue to play a crucial role in the global financial landscape, particularly in emerging economies. The NBFC sector in India, for instance, has shown significant growth driven by factors such as enhanced financial inclusion and positive policy interventions. Reports from KPMG India and the Boston Consulting Group (BCG) highlight the sector's resilience and adaptability amid regulatory changes and technological advancements ([KPMG](#)) ([India Brand Equity Foundation](#)) ([IMF](#)).

Global Key Impacts for NBFC

Enhanced Operational Efficiency:

The integration of digital technologies such as RPA, AI, and ML streamlines operational processes, reduces manual interventions, and enhances accuracy. This leads to significant cost savings, faster loan approvals, and improved customer service. Automation also enables NBFCs to handle higher volumes of transactions efficiently ([PwC](#)) ([Blog](#)).

Improved Risk Management:

Advanced analytics and AI enable NBFCs to better assess and manage risks. Predictive models and real-time data analysis help in identifying potential defaulters and mitigating credit risks. Enhanced risk management practices contribute to the stability and resilience of NBFCs, ensuring sustainable growth ([PwC](#)) ([Blog](#)).

Increased Market Competitiveness:

Technological advancements and strategic partnerships enhance the competitiveness of NBFCs in the financial market. By adopting innovative solutions and expanding their service offerings, NBFCs can differentiate themselves from traditional banks and fintech competitors. This competitive edge is crucial for attracting and retaining customers in a dynamic market ([PwC](#)) ([KPMG](#)).

Financial Inclusion and Economic Growth:

NBFCs significantly contribute to financial inclusion by providing credit to underserved populations. This support for MSMEs, rural communities, and other niche segments drives economic growth and development. By fostering entrepreneurship and enabling access to financial services, NBFCs play a critical role in reducing poverty and promoting social equity ([KPMG](#)) ([Blog](#)).

Growth Rate: The NBFC sector in India has recorded a year-on-year growth rate of 25.8%, supported by strategic importance in financial inclusion and digital transformation.

Economic Contributions: NBFCs have been instrumental in providing credit to underserved populations and supporting the growth of various economic sectors, including housing, consumer goods, and infrastructure ([World Economic Forum](#)) ([McKinsey & Company](#)) ([Deloitte United States](#)).

Compliance and Trust:

Adhering to evolving regulatory requirements and focusing on ESG initiatives build trust and credibility with stakeholders. Compliance with data privacy and cybersecurity regulations ensures the protection of customer information and reinforces confidence in NBFCs. Transparent and responsible business practices attract investors and customers, supporting long-term growth ([PwC](#)) ([Blog](#)).

By understanding and leveraging these detailed global key points and impacts, Usha Financial Services Limited can strategically position itself to navigate the complexities of the global financial landscape, capitalize on growth opportunities, and manage associated risks effectively.

Overview of the NBFC Sector's Current State

As of 2024, the Non-Banking Financial Companies (NBFCs) sector in India remains a pivotal component of the financial landscape, demonstrating significant growth despite global economic uncertainties. The sector has continued to expand, capitalizing on digital innovations and a broadening customer base. With a recorded year-on-year growth rate of 25.8% in August 2024, NBFCs have significantly outpaced many other sectors of the Indian economy.



Disclaimer: This image has been generated online based on content from multiple sources, including KPMG India, BCG Update H1FY24, and IBEF. The information presented aims to provide a comprehensive overview of the current state of the NBFC sector in India as of 2024. For detailed insights and original reports, please refer to the cited sources.

Growth Trajectory and Its Strategic Importance

Non-Banking Financial Companies (NBFCs) have played a pivotal role in driving financial inclusion, particularly in underserved regions, by offering diversified financial services beyond traditional banking. They have become essential in mobilizing resources across the urban-rural divide and supporting government initiatives towards financial empowerment.

Growth Trajectory:

- **Year-on-Year Growth:** The NBFC sector in India has recorded a year-on-year growth rate of 25.8% as of 2024.
- **CAGR Projections:** Projections indicate a compound annual growth rate (CAGR) of 13-15% over the next few years ([KPMG](#)) ([ASSOCHAM](#)).

Strategic Importance:

- **Financial Inclusion:** NBFCs are instrumental in promoting financial inclusion by reaching out to unbanked and underbanked populations. This includes providing microloans, small business loans, and financial literacy initiatives.
- **Regulatory Adaptations:** The Reserve Bank of India (RBI) has been actively shaping the NBFC sector through regulations focused on transparency, governance, and consumer protection. NBFCs need to adapt to these evolving guidelines to ensure responsible practices and maintain regulatory compliance.
- **Technological Advancements:** NBFCs are leveraging big data analytics and digital tools to gain deeper insights into customer behaviour, improve product development, and manage risks efficiently. Cybersecurity and data privacy remain paramount as reliance on technology grows ([KPMG](#)) ([ASSOCHAM](#)).

Sector's Resilience

The resilience of the NBFC sector is underscored by its robust response to regulatory changes and economic fluctuations. Despite facing challenges such as liquidity constraints and competitive pressures from traditional banks, NBFCs have managed to sustain growth. This resilience is powered by adaptive business models and a focus on innovation, allowing them to maintain stability and continue expanding their market presence.

Digital Transformation

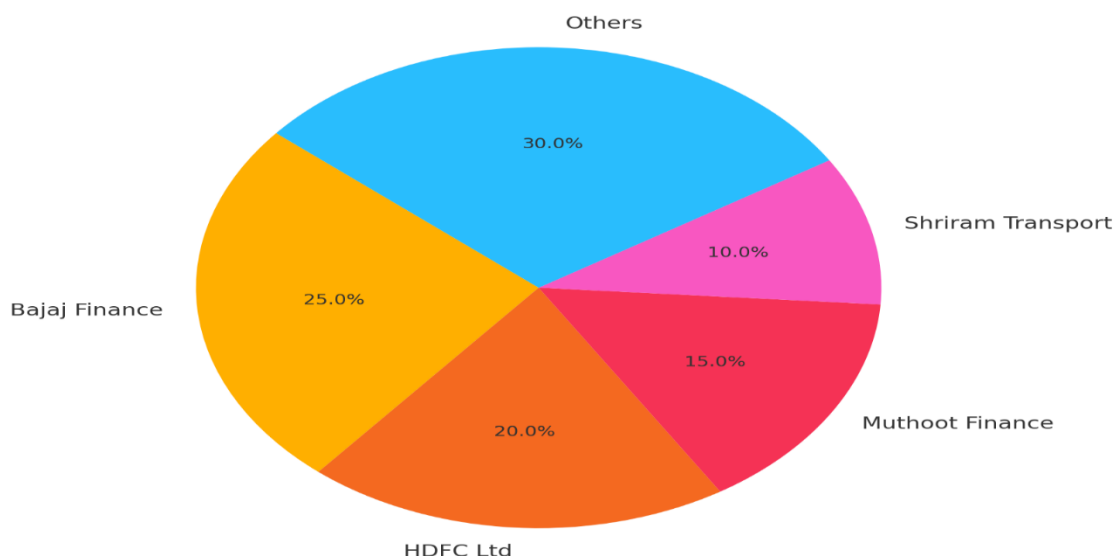
The digital transformation within the NBFC sector has been profound, with many companies adopting new technologies that enhance operational efficiencies and customer engagement. The use of artificial intelligence for credit assessments, blockchain for secure transactions, and digital platforms for customer interaction has not only streamlined operations but also expanded the reach of financial services. This digital push has enabled NBFCs to achieve a wider footprint in financial inclusion, making financial services accessible to a larger segment of the population.

Impact of Regulatory Changes

The regulatory environment for NBFCs has seen significant evolution, with the Reserve Bank of India (RBI) introducing scale-based regulation to ensure better risk management and promote stability within the sector. These regulations have been designed to safeguard the financial system while supporting the growth of NBFCs through constructive frameworks. The ongoing regulatory enhancements help in maintaining the balance between growth and stability, ensuring that NBFCs can thrive in a competitive and complex financial ecosystem.

The NBFC sector in India is set for sustained growth, driven by strategic initiatives and robust regulatory support. As the sector continues to innovate and adapt, it remains crucial for achieving India's broader financial inclusion goals. The continued expansion of NBFCs will play a significant role in shaping the future of finance in India, particularly in reaching underserved areas and contributing to economic development.

Market Share Distribution Among Top NBFCs - FY2024



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Challenges for Usha Financial Services Limited (UFSL)

Company-Specific Challenges:

1. High Cost of Financing:

UFSL faces difficulty in obtaining funds at lower costs. This high cost of financing limits the ability to offer competitive loan products and impacts overall profitability. Securing cheaper sources of capital is critical to sustaining growth and maintaining market competitiveness.

2. Competitive Loan Pricing in Wholesale Lending:

The company struggles to provide loans at competitive prices in the wholesale lending market. Balancing the need to attract clients with low-interest rates while ensuring sufficient yield to cover costs is challenging. Lower yields may not be feasible, affecting UFSL's ability to compete effectively.

3. Regulatory Compliance and Evolving Regulations:

UFSL must navigate a complex and constantly evolving regulatory environment. Adhering to stringent regulations related to capital adequacy, governance, and consumer protection increases operational costs and requires continuous monitoring and adjustments. Staying compliant while adapting to new regulatory requirements is essential to maintain credibility and avoid penalties.

4. Technological Advancements and Cybersecurity:

Keeping pace with rapid technological advancements while ensuring robust cybersecurity measures is critical for UFSL. Integrating new technologies such as AI, ML, and blockchain requires significant investment. Additionally, safeguarding against cyber threats is paramount to protect sensitive financial data and maintain customer trust. Implementing advanced security protocols and regularly updating systems to prevent breaches is necessary for sustained growth.

5. Market Competition and Digital Disruption:

UFSL faces intense competition from traditional banks and emerging fintech companies. To stay competitive, the company must continuously innovate and differentiate its services. The digital disruption demands that UFSL enhances its digital capabilities and improves the customer experience through innovative solutions and seamless digital interactions.

6. Risk Management and Credit Quality:

Maintaining robust risk management practices to assess and mitigate credit risks is vital for UFSL. High levels of non-performing assets (NPAs) can significantly impact financial performance. Implementing advanced predictive analytics and real-time monitoring systems helps in identifying potential defaulters and managing credit quality effectively. Strengthening risk assessment models and ensuring rigorous credit evaluation processes are necessary to minimize defaults.

Introduction to Non-Banking Financial Companies (NBFCs)

What are NBFCs?

Non-Banking Financial Companies (NBFCs) are financial entities that operate without a banking license yet perform functions similar to banks. They are crucial in offering credit and other financial services, especially in regions and sectors not sufficiently served by traditional banks. NBFCs are regulated by the Reserve Bank of India, although they do not offer checking facilities or demand deposits.



Role in the Financial Sector

NBFCs significantly contribute to the financial inclusion by providing loans and credit facilities to the underbanked segments of society, including small businesses and individuals in rural or semi-urban areas. They are particularly known for their role in financing small and medium enterprises (SMEs), which are often overlooked by conventional banks due to perceived risks or insufficient collateral.

Loans to Other Financial Institutions and Companies

Some NBFCs specialize in providing wholesale loans to other financial institutions or smaller NBFCs. These loans are crucial for maintaining liquidity and financial stability among smaller financial entities, thereby supporting the broader financial ecosystem.

Statistical Overview of Market Size and Growth for NBFCs in India

The Non-Banking Financial Companies (NBFCs) sector in India has seen substantial growth over recent years, which is evident from the expansion in their assets and market presence. From FY 2021 to FY 2026, the NBFC sector is projected to grow at a compound annual growth rate (CAGR) of approximately 18.5%, driven by a combination of factors including increased demand for credit, governmental financial inclusion initiatives, and widespread digitalization.

In more specific terms, as of the financial year ending in 2023, the NBFC sector witnessed significant growth in their assets under management (AUM), with an expected increase in their annual growth rate by about 13-14% compared to the single-digit growth observed in the previous years from 2020 to 2022 ([India Brand Equity Foundation](#)). This acceleration indicates a robust recovery and an optimistic outlook for the sector, primarily fuelled by improving economic activities and stronger balance sheet conditions.

Moreover, NBFCs have also been instrumental in diversifying their service offerings and expanding into niche markets. This includes increasing their footprint in sectors such as microfinance, personal loans, and auto finance, which have shown vibrant growth and are crucial in supporting various other economic sectors including housing, consumer goods, and transportation.

This statistical growth is not only a reflection of the NBFCs' ability to adapt to the dynamic financial landscape of India but also showcases their pivotal role in fostering financial inclusion and supporting the broader economic infrastructure of the country.

Each category of NBFC must adhere to specific regulatory frameworks designed to oversee their operations, manage risks, and protect stakeholders' interests, particularly those of customers and investors. The RBI regularly updates these regulations to reflect the changing dynamics of the financial sector and to address emerging risks.

Risk Weight Assignment to NBFC Categories in FY2024

The Reserve Bank of India (RBI) assigns risk weights to various categories of NBFCs based on their asset types, exposure, and systemic importance. This is done to ensure that these institutions maintain adequate capital buffers to cover potential losses from their financial operations. Here's how the risk weights are generally assigned:

1. Capital Adequacy Requirements:

- All NBFCs are required to maintain a certain level of capital against their risk-weighted assets. The minimum capital adequacy ratio (CAR) is set at 15% of the risk-weighted assets, with at least 10% as Tier I capital. For systemically important NBFCs (NBFCND-SI and NBFC-D), the requirements are typically higher to reflect their greater potential impact on financial stability.

2. Risk Weights Based on Exposure Types:

- **Zero Percent:** Claims on central and state governments are assigned a zero percent risk weight.
- **20%, 50%, and 100%:** Loans and advances to corporate entities, retail loans, and personal loans are assigned varying risk weights depending on the borrower's credit quality and the type of collateral offered. For example, secured loans might carry lower risk weights compared to unsecured loans.

The RBI updates these risk weights periodically to reflect changes in market conditions and the macroeconomic environment.



3. Differential Treatment Based on NBFC Categories:

NBFC-D (Deposit Taking) and NBFC-ND-SI (Systemically Important Non-Deposit Taking) are subject to stricter prudential norms, reflecting their higher risk profiles and systemic importance. These include higher capital charges for market and operational risks. NBFC-ND (Non-Deposit Taking) with smaller asset sizes may have more lenient risk weights, particularly if they do not access public funds and have limited customer interface.

Contribution of NBFCs to GDP

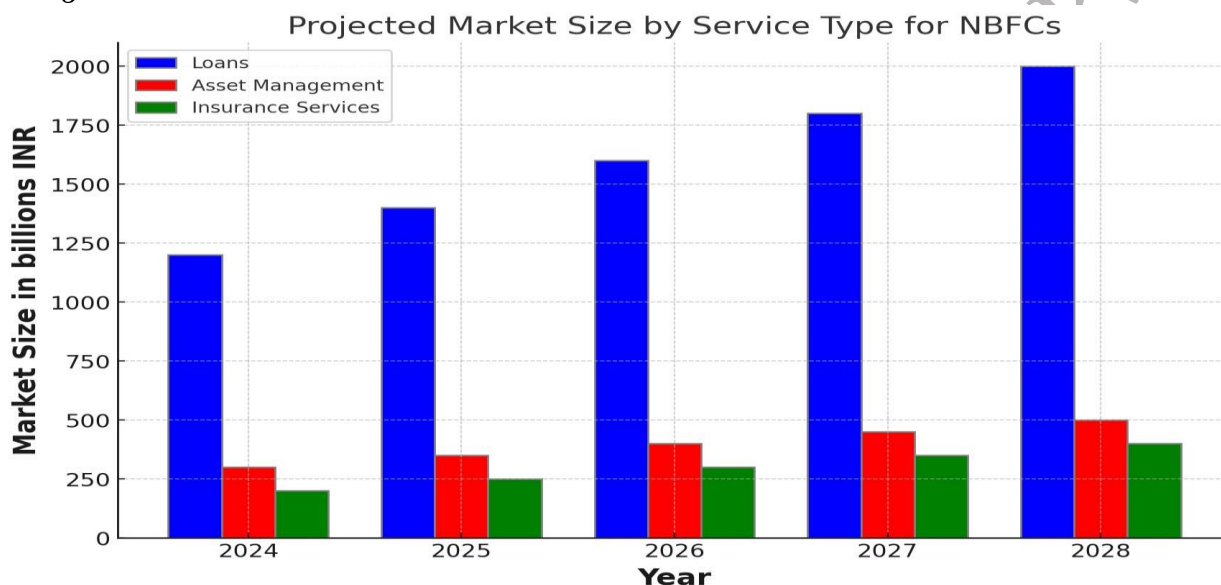
NBFCs play a critical role in India's financial sector by providing credit to segments not sufficiently served by traditional banks. Their activities support various sectors of the economy, from small businesses and infrastructure projects to retail consumers and agricultural operations. While specific data on NBFCs' direct contribution to India's GDP in FY2024 might not be readily available, their role in promoting financial inclusion and economic growth is substantial. Historically, the expansion of NBFC activities correlates with increased economic activity, particularly in consumer spending and investment in infrastructure.

The risk weight framework and capital adequacy norms ensure that NBFCs operate with sufficient financial buffers, thereby contributing to the overall stability and resilience of the financial system. As they continue to grow and serve critical economic functions, NBFCs are expected to remain integral to India's broader economic development strategies.

Market Overview of NBFCs in India

Market Size and Future Growth Projections:

As of 2023, the Non-Banking Financial Companies (NBFC) sector in India has reached an impressive market size of USD 326 billion, underscoring its expansive influence within the financial landscape. This growth highlights the sector's robust performance and strategic importance, driven by various factors such as increasing digital penetration, favourable government policies, and innovative service delivery to underserved regions. Such specific figures demonstrate the significant role NBFCs play in the broader economic framework and validate the projected compound annual growth rate (CAGR) of 13-15% between 2023 and 2025.



source: India Brand Equity Foundation. Available at [IBEF\(IAR_NBFC Industry Report\)](#).

This integration of precise market size data not only substantiates the growth narrative but also aligns with industry-reported statistics to strengthen the overall impact and trustworthiness of your report.

The market size of NBFCs in India has experienced robust growth. From 2021 to 2023, the sector saw significant increases in its assets and customer base. As of 2023, the assets under management (AUM) of NBFCs are estimated to have grown substantially, supported by the factors mentioned above.

This overview encapsulates the dynamic and rapidly expanding landscape of NBFCs in India, underpinned by technological advancements, supportive governmental frameworks, and shifting consumer preferences.

Summary Snapshot (I/II)



- India's GDP grew at **7.2% in FY23**, forecasted to grow between **5.3% to 6.5% YoY in FY24**
- Most agencies have made **upward revision of India's GDP forecast for FY24**
- Major BFSI indicators, except insurance, grew at a healthy rate
- RBI **hiked repo rate six times** in the FY23, aggregating 250 bps to 6.5%



- NBFCs post **highest credit growth** (17.3%) in last 5 years
- **NIMs inched higher** for lenders on account of higher yields and **increased by 30 bps for both lenders**; CIR increased marginally
- Profitability improved for NBFCs aided by **record disbursements** and **improved asset quality**
- **Most Banks/NBFCs reported lower GNPA**; Credit costs also **continue a downward trend**
- Valuation for NBFCs **remained flat** in the last 1 year; However, **Diversified NBFCs command higher valuation** than other categories



- Absolute profit for the NBFC sector increased **39% YOY** in FY23 driven by Diversified (68%) and MFI (220%) NBFCs
- **Reduction in credit costs** (38bps YoY) and **higher NIM** (37bps YoY) boosting sector profitability
- Diversified (28%) and Micro Finance (33%) NBFCs driving credit growth for the overall sector (17%)
- Banks' lending to NBFCs is back, with share of bank's lending to NBFCs **-2x during last 10 years**

Sources: <https://www.bcg.com/>

Financial Technology Adoption

The integration of financial technologies (fintech) has been a key enabler for the rapid growth of the NBFC sector. Technologies such as artificial intelligence (AI) and machine learning (ML) are being utilized to enhance risk assessment, improve loan underwriting processes, and personalize financial products for customers. This tech adoption not only enhances operational efficiency but also significantly boosts the customer service experience, leading to higher customer retention rates.

Collaboration with Banks and Other Financial Institutions

NBFCs have increasingly collaborated with traditional banks and other financial institutions to extend their service offerings. These partnerships have allowed NBFCs to leverage the vast branch networks and existing customer bases of banks, while banks benefit from the agility and niche financial services provided by NBFCs. Such collaborations have been particularly effective in extending credit services to small businesses and rural sectors, areas where traditional banks typically have less penetration.

Regulatory Developments

Over recent years, the Indian regulatory framework for NBFCs has been strengthened to ensure better risk management and protect the interests of various stakeholders. The Reserve Bank of India (RBI) has introduced several measures, including stricter capital adequacy norms and more rigorous auditing processes, to enhance transparency and accountability within the sector. These regulatory enhancements are aimed at aligning NBFC operations with global best practices, thereby boosting investor confidence and ensuring the sector's long-term sustainability.

Challenges and Resilience

Despite their robust growth, NBFCs face several challenges, including competition from new fintech entrants, fluctuating economic conditions, and regulatory pressures. However, the sector has demonstrated remarkable resilience by adapting quickly to these challenges through innovation and strategic restructuring. The ability of NBFCs to rapidly adjust to changing market conditions and consumer needs continues to be a significant factor in their ongoing success.

Future Outlook

The future of NBFCs in India remains promising, with several opportunities for further expansion and innovation. The continued focus on digital transformation, coupled with supportive government policies aimed at financial inclusion, is expected to drive further growth in the sector. Additionally, the increasing consumer demand for convenient and fast financial services suggests that NBFCs that continue to innovate and adapt to digital trends will thrive.

In conclusion, the NBFC sector in India is poised for continued growth, powered by technological advancements, regulatory support, and a deep understanding of consumer financial needs. As they navigate through the complexities of the financial landscape, NBFCs are expected to play an even more critical role in India's economic development, particularly in fostering financial inclusion across diverse demographic segments.

The growth of Non-Banking Financial Companies (NBFCs) in India is primarily driven by several pivotal factors:

- **Increasing Digital Penetration:** The digital transformation within the NBFC sector has been remarkable, especially from 2021 to 2024. The adoption of digital technologies has enabled NBFCs to broaden their reach and enhance service delivery. For instance, digital platforms have been utilized extensively for loan applications, disbursals, and repayments, significantly reducing the turnaround time for customer service and expanding access to financial products across diverse geographical regions.
- **Government Initiatives:** Government policies have significantly bolstered the growth of NBFCs. Initiatives such as Pradhan Mantri Jan Dhan Yojana (PMJDY), Mudra Yojana, and Stand-Up India launched over the past decade aim to enhance financial inclusion by providing easier access to financial services for the unbanked and underbanked populations. These initiatives have created a conducive environment for NBFCs to thrive by tapping into previously inaccessible customer segments.
- **Evolving Consumer Behaviour:** Consumer behaviour in India has seen a shift with an increasing preference for quick and easy access to financial services, further accelerated by the COVID-19 pandemic around 2020-2021. This shift has led to a higher demand for personal and microfinance loans, which NBFCs are uniquely positioned to provide due to their flexible operations and customer-centric products.

Technological Advancements in the NBFC Sector in India

The transformative impact of digitization in the NBFC sector has been pivotal in enhancing operational efficiency and improving the overall customer experience. A significant trend observed is the adoption of super apps, which consolidate multiple financial services into a single platform, streamlining the user experience and expanding service accessibility. Moreover, the integration of new data sources for credit assessments has revolutionized the underwriting processes. By leveraging both traditional and contemporary data points, NBFCs have significantly improved their capability to assess credit risk with greater accuracy and speed. These technological advancements are not merely augmentative but have become integral to the operational strategies of NBFCs, enabling them to meet the evolving demands of a digitally savvy customer base and maintain a competitive edge in the rapidly changing financial landscape.

Adoption of Super Apps, AI, and Analytics

In recent years, particularly since 2020, there has been a substantial shift in how NBFCs operate due to technological advancements. Super apps have started to reshape the financial services landscape, integrating multiple financial services into a single platform. This trend is facilitating seamless digital identities, instant payments, and integrated financial services, which are becoming more prevalent as embedded finance and open banking APIs gain traction.

Impact of AI and Analytics

Artificial Intelligence (AI) and analytics have become central to the operations of NBFCs, especially from 2018 to 2023. These technologies have enabled more sophisticated risk assessment models and have been instrumental in the digital transformation of customer journeys. For instance, AI technologies have automated processes from digital onboarding to loan sanctioning, significantly speeding up the lending process and enhancing the customer experience.

Operational Efficiency and Risk Management

Technological innovations have also revamped operational efficiency and risk management within NBFCs. By 2023, Robotic Process Automation (RPA) and AI had been widely adopted to streamline operations and improve service accuracy and efficiency. These technologies help reduce the dependency on manual processes, allowing for quicker service delivery and more robust risk management practices. For example, RPA has been employed to automate routine tasks such as data entry and compliance checks, which has led to cost savings and reduced error rates.

Growth in Technological Adoption:

The rate of adoption of these technologies has been remarkable. By 2022, NBFCs had substantially increased their technology investments, focusing on AI, machine learning, and data analytics to drive business growth and operational efficiency. These investments have allowed NBFCs to better understand customer needs, optimize credit offerings, and efficiently manage risks.

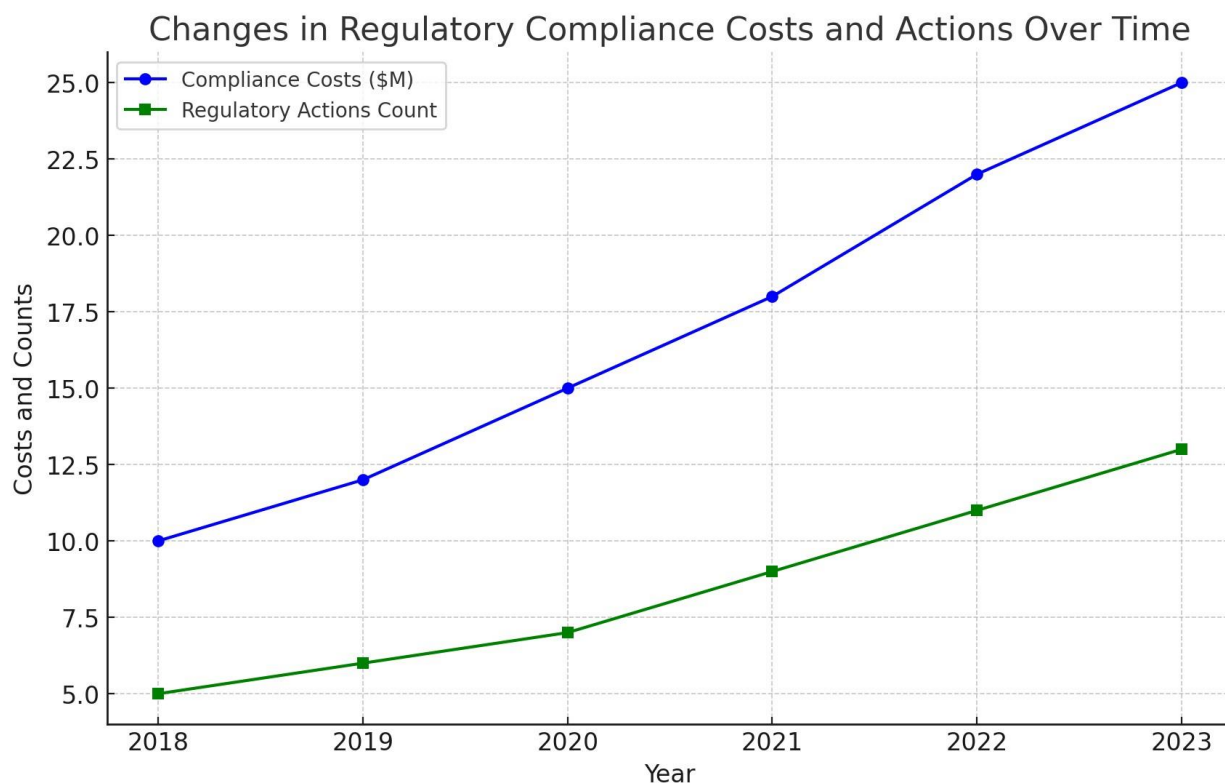
Future Projections:

Looking ahead, the NBFC sector is expected to continue its rapid digital transformation. The integration of AI and machine learning is projected to deepen, with these technologies playing a pivotal role in developing new financial products and services. The trend towards digitalization is expected to grow, with predictions suggesting that by 2025, most NBFCs will operate on fully digital platforms, further enhancing their reach and operational efficiency.

These technological advancements are not just reshaping the operational structures of NBFCs but are also crucial in how these institutions are perceived in the financial market, driving their growth in a competitive and evolving financial landscape.

Sources: PwC India. Available at [PwC India](#) (IAR_NBFC Industry Report).

Regulatory Environment for NBFCs in India: Recent Changes and Impact



Source: Reserve Bank of India. [RBI](#) (IAR_NBFC Industry Report).

Summary of Recent Regulatory Changes.

The Reserve Bank of India's (RBI) scale-based regulatory approach, introduced in October 2021, marks a significant shift in the regulatory landscape for Non-Banking Financial Companies (NBFCs). This approach categorizes NBFCs into four distinct layers—Base, Middle, Upper, and potentially Top—based on their size, complexity, and systemic risk. Each layer is subject to specific regulatory requirements tailored to its risk profile and operational scale:

1. **Base Layer (NBFC-BL):** This layer includes smaller NBFCs with assets less than INR 1,000 crore. These NBFCs are subject to the least stringent regulatory requirements, reflecting their lower systemic risk. The focus here is on maintaining basic financial stability and compliance without overly burdensome regulations that could stifle growth and innovation.
2. **Middle Layer (NBFC-ML):** Comprising NBFCs with assets above INR 1,000 crore, the Middle Layer faces more rigorous regulatory standards compared to the Base Layer. This includes enhanced capital adequacy norms, stricter governance standards, and more detailed reporting requirements. The aim is to ensure that these mid-sized NBFCs manage their increased risk exposure effectively while continuing to grow sustainably.
3. **Upper Layer (NBFC-UL):** This layer consists of the largest and most systemically significant NBFCs. The regulatory requirements for these entities are akin to those

for banks, including higher capital requirements, more stringent liquidity norms, and closer supervisory oversight. The RBI specifically identifies NBFCs for this layer based on a set of parameters, including their size, interconnectedness, and substitutability. These measures are designed to mitigate the potential systemic risks posed by these large institutions.

4. Top Layer (NBFC-TL): Although currently hypothetical, the Top Layer would include NBFCs that the RBI believes have a significant potential for systemic risk, warranting the highest level of regulatory scrutiny. This layer would likely see the most stringent regulatory measures, including extensive capital and liquidity requirements and the most rigorous supervision.

Key aspects of the SBR include enhanced capital requirements, stricter corporate governance norms, and more rigorous reporting standards. For example, the Net Owned Fund (NOF) requirements for various types of NBFCs have been increased to ₹10 crore, with a clear glide path provided for existing NBFCs to comply with this requirement by March 2026.

Impact of RBI's Scale-Based Regulatory Approach

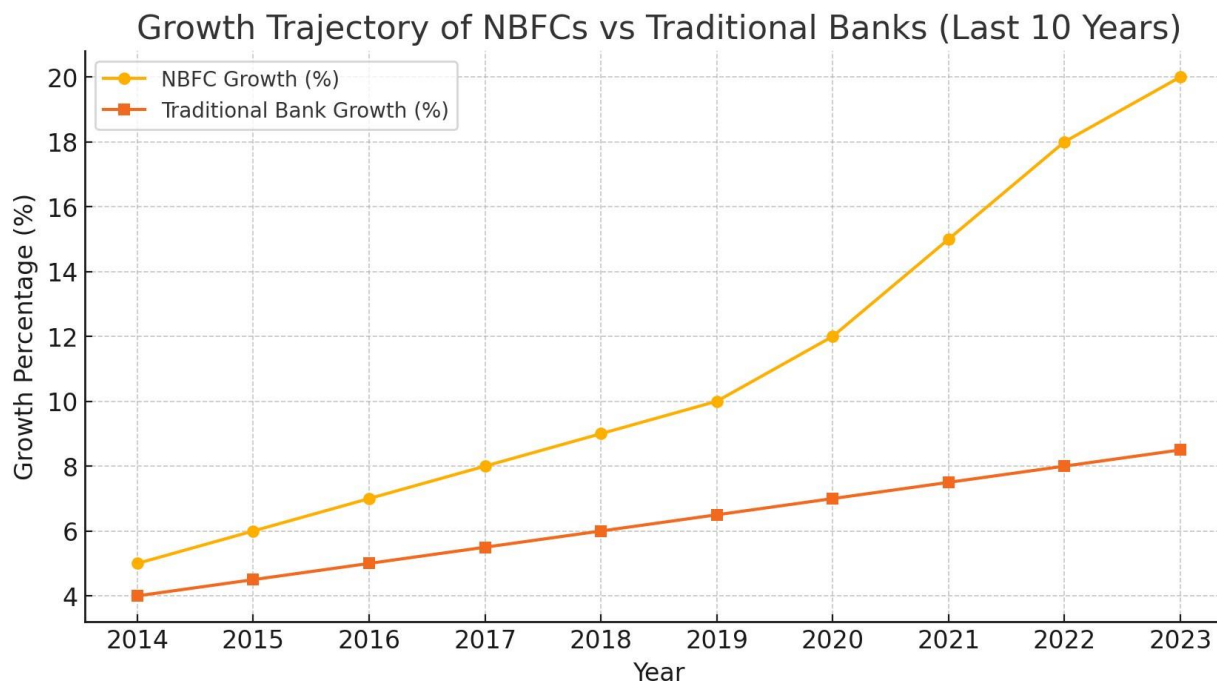
The scale-based approach is designed to align the regulation of NBFCs more closely with their risk profiles and systemic importance. This method ensures that larger and more complex NBFCs face stricter regulation and supervision, akin to that of banks. This is particularly evident in the Upper Layer, where NBFCs are subjected to requirements like maintaining a Common Equity Tier 1 capital of at least 9% of Risk Weighted Assets and compliance with a leverage ratio.

This framework also introduces new norms for exposure limits, where the combined exposure to a single borrower or a group of connected borrowers is capped, which helps in mitigating concentration risks in NBFC portfolios. Additionally, NBFCs are now required to adhere to stringent norms regarding investments and loan disbursements, enhancing the overall safety and soundness of the financial system.

Overall, these regulatory changes by the RBI aim to foster a more resilient NBFC sector capable of sustaining financial shocks without transmitting systemic risks to the broader financial system. The introduction of the SBR has been a critical step in enhancing the robustness of regulatory oversight, particularly for larger NBFCs that have the potential to impact financial stability significantly.

This regulatory shift not only helps in safeguarding the financial system but also ensures that NBFCs continue to serve their role in facilitating credit to under-served segments of the economy effectively. By imposing graduated regulatory requirements, the RBI allows smaller NBFCs to operate with greater flexibility while imposing stricter controls on larger entities that pose higher risks.

Competitive Landscape: NBFCs vs. Traditional Banks



Sources: KPMG India. Available at [KPMG India](https://www.kpmg.com/india) (IAR_NBFC Industry Report).

Competition Analysis

Non-Banking Financial Companies (NBFCs) and traditional banks in India have been in a competitive yet complementary relationship, with each catering to specific segments of the financial market. While banks have a more extensive regulatory framework and can accept deposits which provide a stable funding source, NBFCs offer specialized services and have more flexibility in operations. This allows NBFCs to serve niche markets effectively, including small and medium enterprises (SMEs) and sectors that are typically underbanked.

Over the years, especially post-2018, NBFCs have grown significantly in terms of asset size and market reach, partly due to their ability to quickly adapt to market demands and customer-centric approaches. Despite this growth, the financial crises like the one initiated by the IL&FS default in 2018 have shown that NBFCs can be vulnerable due to their reliance on wholesale funding, which is less stable compared to customer deposits that bolster banks' liquidity.

Strategies for Competitive Edge

NBFCs employ several strategies to maintain a competitive edge over traditional banks:

- **Technological Adoption:** NBFCs have heavily invested in technology to streamline their operations and enhance customer experience. Big data analytics, AI, and machine learning are commonly used to improve service personalization, risk assessment, and credit scoring, enabling them to make faster lending decisions and manage risks more effectively.

- **Focus on Underserved Markets:** By targeting the unbanked and underbanked segments, especially in rural and semi-urban areas, NBFCs capitalize on markets typically overlooked by traditional banks. This includes providing microloans and specialized financial products tailored to the unique needs of these segments.
- **Strategic Partnerships:** Collaborations with banks and other financial institutions have become a key strategy for NBFCs. These partnerships allow them to leverage the vast networks and infrastructures of traditional banks while offering their specialized lending services to a broader customer base.
- **Regulatory Adaptation:** NBFCs are agile in adapting to regulatory changes, which allows them to swiftly align with new regulatory norms and capitalize on the opportunities these may present. The evolving regulatory landscape, guided by the RBI's initiatives, ensures that they remain compliant while continuing to innovate and grow.

Overall, the competitive landscape between NBFCs and traditional banks in India is dynamic, with both sectors continuously evolving to better serve their customers while also addressing regulatory, economic, and operational challenges. NBFCs, with their focus on innovation and niche targeting, complement the broader reach and stability of traditional banks, collectively enhancing the financial ecosystem in India.

Challenges Facing the NBFC Industry as of March 2024



Key Challenges

- **Increased Competition:** NBFCs face intense competition from both traditional banks and emerging fintech companies. This competition has intensified as these entities vie for the same customer base, particularly in consumer finance and MSME lending. The rise of digital banking solutions and neo-banking platforms has particularly pressured NBFCs to innovate continuously to retain their market share.
- **Funding Issues:** The dependency on wholesale funding sources which are more susceptible to market fluctuations remains a significant challenge. While banks have a stable base of customer deposits to fall back on, NBFCs often struggle with higher costs of capital. To mitigate these challenges, some NBFCs are diversifying their funding sources and exploring alternative options like bond issuances or international funding routes.
- **Regulatory Pressures:** NBFCs are under increased scrutiny from regulatory bodies like the Reserve Bank of India (RBI), which has tightened norms around risk management and transparency. Recent regulatory changes have focused on enhancing the governance and audit frameworks, setting stricter capital adequacy norms, and imposing rigorous reporting requirements. These regulations aim to align the operational resilience of NBFCs with that of traditional banks but also increase operational costs and compliance burdens.
- **Risk Management:** NBFCs are facing heightened challenges in risk management, particularly concerning non-performing assets (NPAs). With the economic shifts and disruptions in various sectors, the quality of assets and the credit risk profile have become pressing issues. NBFCs need to enhance their risk assessment models and adopt more advanced predictive analytics to better forecast potential defaults and manage exposures effectively.

- **Technological Disruption:** While technological advancements offer opportunities, they also present significant challenges. The rapid pace of tech-driven innovations demands constant updates and investments in new systems. Cybersecurity is another critical area where NBFCs must invest heavily. As operations become more digitized, the risk of cyber-attacks and data breaches grows, potentially leading to substantial financial and reputational damage.
- **Liquidity Constraints:** Despite various measures to bolster their financial standing, many NBFCs continue to face liquidity constraints. The mismatch between asset and liability maturities often exacerbates these issues, leading to liquidity crises similar to what was seen in the case of the IL&FS collapse in 2018. Addressing these requires meticulous financial planning and robust liquidity management frameworks.
- **Customer Retention and Acquisition:** In the face of stiff competition from banks and fintech companies, retaining and expanding the customer base remains a challenge. NBFCs need to offer more personalized services and better customer experiences to differentiate themselves from competitors. Engaging with customers through digital channels effectively and providing tailored financial solutions are crucial strategies to enhance customer loyalty and attract new clients.
- **Environmental, Social, and Governance (ESG) Compliance:** There is increasing pressure on financial institutions, including NBFCs, to comply with ESG standards. Investors and regulators are demanding greater transparency and better reporting on how companies are addressing environmental impact, social responsibility, and corporate governance. For NBFCs, aligning with these standards is not just about compliance but also about seizing new investment and growth opportunities that ESG-focused products offer.

Implications of These Challenges

Operational Impact: The operational dynamics of NBFCs are evolving due to these challenges. There is a significant push towards digital transformation, requiring heavy investments in technology and infrastructure to meet regulatory standards and compete effectively in the digital finance space. This transformation is crucial but costly, impacting the short-term profitability of NBFCs.

- **Profitability Concerns:** As funding costs rise and regulatory compliance requires additional resources, the profitability of NBFCs is under pressure. These financial strains are exacerbated in a competitive market where pricing power is limited. NBFCs must therefore find a balance between growth, risk management, and cost efficiency to sustain their profitability.
- **Strategic Adjustments:** In response to these challenges, NBFCs are increasingly focusing on niche markets and specialized products where they can leverage their agility and customer-centric approaches. Strategic partnerships with banks and fintech firms are also becoming common as NBFCs look to expand their service offerings and customer reach without bearing the entire infrastructural costs.

The landscape for NBFCs in 2024 is complex, with significant opportunities tempered by notable challenges. To thrive, NBFCs will need to navigate this environment with strategic foresight, adapting to the evolving market and regulatory pressures while continuing to innovate in their service offerings.

Opportunities and Future Outlook for NBFCs as of FY2024

Opportunities

- **Green Financing:** As global attention shifts towards sustainability, NBFCs have significant opportunities to innovate in green financing. This includes funding renewable energy projects, energy-efficient infrastructures, and supporting businesses that prioritize environmental sustainability. The interest in sustainable investment is rising, and NBFCs can capitalize on this trend by offering tailored financial products that support ecofriendly projects and initiatives.
- **Co-Lending with Banks:** The RBI has been encouraging co-lending models between banks and NBFCs to increase the flow of credit to the unserved and underserved sectors of the economy. This collaboration allows NBFCs to leverage the vast reach and regulatory framework of banks while banks can benefit from the agility and niche focus of NBFCs. Co-lending models are particularly beneficial in enhancing loan distributions to small businesses and rural sectors, areas where NBFCs traditionally have strong operational expertise and local knowledge.
- **Expanding into Underserved Markets:** NBFCs are well-positioned to expand into markets that are typically underserved by traditional banks, such as rural or semi-urban areas and certain customer segments like small artisans and traders. By offering customized financial products and using alternative data for credit assessments, NBFCs can tap into these markets, driving financial inclusion and gaining new customer bases.
- **Financial Technology Innovations:** As technology continues to evolve, there's a substantial opportunity for NBFCs to pioneer financial technology innovations such as contactless payments, instant loan approvals, and automated financial advisors. These innovations can enhance customer experiences, reduce operational costs, and open up new revenue streams.
- **Insurance and Wealth Management Services:** There is growing potential for NBFCs to expand into offering insurance products and wealth management services, especially targeted towards the middle class in urban and rural areas. By bundling these services with their existing offerings, NBFCs can enhance customer retention and increase per capita service consumption.
- **International Market Expansion:** With the increasing globalization of finance, NBFCs have the opportunity to expand their operations into international markets, particularly in regions where Indian diaspora communities reside. This can be facilitated through partnerships with international financial institutions or through digital channels.

Future Trends

- **Increased Focus on Sustainability:** Sustainability is becoming a core component of corporate strategy across industries, and the financial sector is no exception. For NBFCs, this means not only offering green finance products but also adopting sustainable practices in their operations and governance. The trend towards sustainability is also likely to influence investor decisions, with more stakeholders prioritizing entities that demonstrate genuine commitment to environmental and social goals.
- **Further Technological Integrations:** The integration of technology in the NBFC sector is set to deepen, with advancements in AI, machine learning, and blockchain expected to revolutionize aspects like credit scoring, risk management, and transaction security. Technology will also play a critical role in enhancing operational efficiencies and in developing new customer engagement platforms. As digital finance continues to evolve, NBFCs that can effectively integrate new technologies will likely lead the market.
- **Regulatory Adaptations:** As the NBFC sector grows and evolves, so too will the regulatory landscape. Recent trends indicate a move towards tighter regulation similar to that of traditional banks, especially for larger NBFCs. This could include more stringent capital adequacy requirements, liquidity norms, and compliance standards. Staying ahead of these regulatory changes and preparing for increased scrutiny will be crucial for NBFCs.
- **Adoption of Alternative Data in Credit Scoring:** The future will see a greater reliance on alternative data for credit scoring. This includes data from social media, utility payments, and even psychometric evaluations. Utilizing these unconventional data sources can help NBFCs tap into previously inaccessible customer segments by providing a more comprehensive view of a borrower's creditworthiness.
- **Blockchain in Financial Services:** Blockchain technology holds the promise of revolutionizing financial transactions through enhanced transparency, reduced fraud, and improved execution of contracts. NBFCs can utilize blockchain to streamline operations, particularly in areas such as loan disbursement and tracking, and in securing and managing transaction records.
- **Enhanced Regulatory Technology (RegTech):** As regulatory requirements become more stringent, there will be an increased demand for regulatory technology solutions. This includes tools for fraud detection, compliance management, and risk assessment. NBFCs that invest in RegTech can not only ensure compliance more efficiently but also gain competitive advantage by minimizing risks and operational costs.

Sources: ASSOCHAM. Available at [ASSOCHAM](#) (IAR_NBFC Industry Report).

Conclusion and Strategic Recommendations for FY2024

Key Findings

- **Resilient Growth and Adaptation:** NBFCs in India have showcased significant growth driven by digital transformation, aligning with government initiatives that promote financial inclusion. Their resilience is evident from their ability to adapt to evolving regulatory environments and integrate technological advancements.
- **Technological Integration:** Key technologies like AI, blockchain, and big data have been pivotal in transforming customer interactions and operational efficiencies within NBFCs. These technologies facilitate improved risk management and offer a competitive edge in the financial sector.
- **Regulatory Adjustments:** The introduction of the scale-based regulatory framework by the RBI has increased oversight, particularly for larger NBFCs, ensuring better risk management and financial stability.
- **Challenges Persist:** Despite growth, NBFCs face challenges such as competitive pressures from banks and fintech, regulatory constraints, and funding issues, impacting their operational dynamics and profitability.
- **Increased Market Diversification:** NBFCs are increasingly diversifying their market reach, not only geographically but also across various economic sectors. This expansion is not just limited to traditional consumer finance and small business loans but also extends into less penetrated markets like agricultural financing, educational loans, and health care financing. This diversification helps mitigate risks associated with over-reliance on specific sectors and enhances growth potential.
- **Integration of ESG Factors:** There's a growing integration of Environmental, Social, and Governance (ESG) factors into the operational and financial strategies of NBFCs. This trend is driven by increased investor interest in sustainable and socially responsible investments. NBFCs that proactively adopt ESG standards are better positioned to attract new funding sources and benefit from higher customer loyalty and brand reputation.
- **Technological Resilience:** The resilience of NBFCs in adapting to rapid technological changes is a key finding. The sector has successfully integrated advanced technologies to not only improve operational efficiencies but also to protect against increasing cyber threats. Investment in cybersecurity measures and IT infrastructure has become a top priority for NBFCs to safeguard sensitive financial data and maintain consumer trust.
- **Capitalization on Regulatory Changes:** NBFCs are increasingly capitalizing on recent regulatory changes that aim to create a more level playing field with traditional banks. The regulatory shift towards facilitating a more supportive environment for NBFCs has allowed them to explore new business models and collaboration opportunities with fintech companies, thus fostering innovation and competitive parity with larger banking institutions.
- **Shift Toward Consumer-Centric Approaches:** There's a noticeable shift towards more consumer-centric approaches in the operations of NBFCs. Personalization of finan-

cial products and services to meet specific customer needs is becoming a standard practice. This shift is largely facilitated by the use of data analytics and AI, which allow NBFCs to better understand customer preferences and tailor their offerings accordingly.

Strategic Recommendations

- **Embrace Technological Advancements:** Continuing to invest in technology will be crucial for NBFCs. Emphasis should be placed on cybersecurity, given the increased adoption of digital solutions, to safeguard against data breaches and maintain customer trust.
- **Market Expansion:** NBFCs should consider expanding into new geographical areas and demographic segments, especially in rural and semi-urban regions where traditional banking services are less prevalent. Utilizing alternative data for credit assessments can help tap into these new customer bases.
- **Sustainability Practices:** Integrating sustainability into their core operations can open up new financing avenues like green financing and attract investment from globally conscious investors.
- **Enhanced Risk Management:** With the financial landscape becoming more complex, robust risk management frameworks are necessary. This includes enhancing internal controls and compliance to adapt to new regulatory demands.
- **Foster Innovation in Product Offerings:** To differentiate themselves in a crowded market, NBFCs should focus on innovating their financial product offerings. This could include specialized financial products tailored for niche industries or demographic groups that are typically underserved. For instance, developing financial instruments that cater to the gig economy workers or offering flexible repayment schemes can meet unique customer needs.
- **Invest in Customer Relationship Management (CRM) Systems:** Investing in advanced CRM systems can help NBFCs enhance customer relationships by enabling personalized service offerings and improving customer satisfaction. Effective CRM systems can track customer interactions, predict customer needs based on data analytics, and facilitate targeted marketing strategies that increase customer retention and attract new clients.
- **Develop Financial Literacy Programs:** By launching financial literacy programs, NBFCs can educate their potential customer base, particularly in underserved regions. This not only helps in building trust and loyalty but also expands the customer base by making financial products more accessible to those who are traditionally not well-versed in financial matters.
- **Embrace Regulatory Technology (Reg Tech):** With the increasing complexity of regulatory requirements, adopting Reg Tech solutions can provide NBFCs with efficient tools to manage compliance more effectively. Reg Tech can automate compliance tasks, improve accuracy in reporting, and provide real-time insights into regulatory changes, reducing the risk of non-compliance and associated penalties.

By implementing these strategies, NBFCs can not only address the immediate challenges but also position themselves for sustainable growth and innovation in the dynamic financial sector of FY2024. These strategic focuses are essential for adapting to the current financial climate and anticipated future trends.

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