

# Shadow Banking – A Study on Growth of them in Rural and Semi Urban Areas of India

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**Abstract:** This study shows us the growing trend of Non-Banking Finance corporation in Indian financial market. Where it has shown growth throughout these years. Shadow banking is a part of the credit system in India. NBFC can be broadly classified into two broader categories that are

- Non-deposit taking NBFC
- Deposit taking NBFC

Rural areas and semi urban area have shown a spur in the growth of micro financing NBFCs in these areas, as NBFC companies see a vast market to tap over this market where most of India's population resides. The corporations have seen a vast market in non-deposit taking NBFC as due to need of finance in these areas.

The spread of the NBFC in the rural and non- metro areas in India. It discusses about two methods to reach customers who need credit through first, physical presence and second, through technology driven methods.

The NBFC has seen a tremendous market in rural and semi urban areas, since last 2 years as the shadow banking has newly started exploring this sector. NBFCs need to invest more into this sector with vast opportunities and growth prospect.

Strategies like custom products, housing finance and decreasing paper work may attract customers in rural and semi urban areas as to grow and explore the potential of the untapped market and come out as a successful venture.

**Keywords:** Micro financing, NBFC, NBFC-MFI.

## 1. Introduction

Bursting of the housing bubble or the Great Recession in the U.S was not associated with the traditional financial crisis due to bank failure but triggered by the banking crisis initiated in the Shadow Banking system of the country. Last decade has shown a tremendous increase in the shadow banking system around the globe. The development in this sector is mainly to evade the regulations that are followed in traditional banking. (Concept of shadow banking in India by Dr. N. Nandani).

The word 'shadow bank' was given by Paul McCulley in 2007. Shadow banking is a worldwide phenomenon, but with different functions; in developed nations shadow banking is more concerned about risk transformation and where economies are still developing shadow banking works as supplementary to traditional banking system. (Concept of shadow banking in India by Dr. N. Nandani). Shadow banking includes a middle-men or intermediary, which means that

savers of money does not lend money directly to the required borrower, thus outside regulated banking system. (IMF working paper).

Non-banking financial companies (NBFC) or shadow banking in India is an interdependent structure on traditional banking system and is highly complex structure. In India shadow banking has shown little growth from other countries where shadow banking is spreading its roots on very high pace; this may be due strict supervision from the Reserve Bank of India and also lack of support from the RBI. In India NBFCs are regulated under the RBI since 1963, as due to several banks failed in India due to failure of several banks in India in the 1950's. (Shadow banking-future of Indian banking system by Ms. Namita Kapoor).

In India some of the non-bank money lending institutions had been present before 1947, year of independence, early data of existence of NBFC in India backs up to 1950s. earliest NBFC after independence was incorporated in the year 1954, Sundaram Finance. (Deosthalee, 2010, Nisar and Aziz).

Shadow banking can grow in any of these credit systems of the country. We will mainly focus on two broader forms of this that are:

- Deposit taking NBFC
- Non-deposit taking NBFC

Every sector of the economy should grow its terrain, growth prospects needs capital and finance, to grow the rural and semi urban sectors NBFCs have seen a tremendous market to tap to. Rural and semi urban areas have a vast area for growth to offer to these companies in India.

The trend of NBFC grew rapidly in the metropolitan cities after the year 2001, but the rural and semi urban areas did not see any interest in NBFC growth. But after the year 2017, NBFC saw a vast and unexplored market in rural and semi urban areas in providing small credits and microfinancing market.

Robust demand for small loans in rural areas and semi-urban areas has shown a way to NBFC in these markets to provide loans. Since the last two years that are 2017 and 2018, have opened new doors to the NBFCs with a vast market of Rs. 4.5 lakh crore, yet to be explored. (data taken from: RBI official site).

Earlier to the introduction of NBFC in the rural and semi

urban areas, people were more dependent over the traditional banking and unorganised lenders for money credits and small finances, as expansion of NBFC branches in these areas, and with attracting packages people are focusing over these corporations for small credit finances. But deposit taking NBFC does not have such a bigger scope in these areas till date, but can see a growth prospect in coming years.

As the trend of borrowing is increasing in the rural and semi urban areas, people in these regions are shifting from unregularized sector to the regulated sector. Shadow banking or NBFC is showing a growth trend in rural and semi urban areas. (PWC).

• *Shadow banking: working and difference between traditional Banking*

Depositors mainly consisting of large corporations and Institutional investors wants a place to park the funds that are liquid in nature that give them opportunity with

- readily access to money
- higher rates of interest than banks
- spare them from problems in managing their money

Banks, investment banks and brokers are willingly here to provide this service in form of repo transaction. (Sunanda Sen)

The main difference between the traditional and Shadow banking are as follow:

(Growth of Shadow banking in India by Viral Acharya)

Table 1  
Difference between the traditional and Shadow banking

Traditional Banking	Shadow Banking
Commercial banks can create money which a depository bank can do	Shadow banks cannot generate money as commercial banks
Tight adherence to rules and regulations promotes transparency and ethical conduct.	Lack of regulations in NBFC, transparency with relation to business operations is overlooked.
Banks generally raise funds from deposits through mobilization of deposits from public.	Shadow banking mainly generate funds through market- based instruments, for e.g. Commercial paper.
Government generally sure the liabilities to an extent.	Unsecured liabilities of shadow banks.
Through distress period commercial banks have access to multiple resources like central bank of nation	NBFC don't enjoy such privileges and have to defend themselves during the time of distress.

**2. Literature review**

*Pwc:* In the paper Non- banking Finance companies: the changing landscape, they discuss about the emergence of NBFC in the rural and semi urban areas. It also discusses about Micro Units Development and Refinance Agency Bank (MUDRA Bank) to finance the NBFC micro finance institution. *Bundesbank Deutsche:* contended that the growing activities of shadow banks might weaken the transmission of monetary policy measures via commercial banks (through interest rate and bank credit channel), but, on the contrary, the asset prices channel may become effective in the monetary policy transmission process. An expansionary monetary policy might

fuel asset prices, which, in turn, might increase the leverage of the shadow banks, expand their balance sheets, reduce their risk premium and thereby increase lending to non-financial sector and finally the level of real activity. Acharya V. Viral: we study the determinants of the growth of those non-deposit taking non-bank financial corporations (NBFCs) which are regarded by the Reserve Bank of India as being systemically important and have grown substantially in India over the past decade.

*Sunanda Sen:* Paper studied the meaning of shadow banking in India, it clarifies the meaning of shadow banking and how it is different from traditional banking system. Further we study about the Non-Banking Financial sector in India.

*Kapoor Namita:* This study shows us the growing trend of Non-Banking Finance corporation in Indian financial market. Where it has shown growth throughout these years. Shadow banking is a part of the credit system in India. NBFC can be broadly classified into two broader categories that are Non-deposit taking NBFC and Deposit taking NBFC.

*Advait Rao Palepu (2018)* In his paper “Low operating expense, high yields to help NBFCs' grow their rural books” Mr. Palepu discusses about the significant increase in the NBFCs in the rural areas, through his paper he shows the less cost model for vast growth for NBFC in Indian rural markets. *FC Bureau (2018)* In the paper “to boost NBFCs spread wings growth”, it discusses about the spread of the NBFC in the rural and non- metro areas in India. It discusses about two methods to reach customers who need credit through first, physical presence and second, through technology driven methods.

*Akanksha Goel* in her paper “GROWTH PROSPECTS OF NBFC IN INDIA”, she discusses about the growth prospect of NBFC in India and also in the rural region and problem it faced in growing through these years, and it also includes the HDFC as a NBFC.

*Shollapur M.R* in “The Indian Journal of Commerce”, it discusses the importance of the NBFCs in building up the current day financial system of India, paper also discusses about the financing of NBFCs to the big and as well as small corporates. It also discusses about the monitoring of new opportunities for NBFC.

*L M Bhole* in his book, he discusses about the meaning of NBFC and tried defining it, he also discusses about the importance of NBFC with the importance of it in providing individual and corporate loans to enhance the economy.

*Dr. Nandini N. (2014)* The paper studies the pros and cons of shadow banking in India, the paper also discusses about the non-banking financial corporations in India.

*E. N. Murty* The paper discusses about the working and capital providing of DBS Chula, M&M Finance, Sundaram Finance Sri Ram Transport Finance etc. In the paper, it discusses about the future growth avenues for these NBFCs in the financial market.

*R.M Srivastava & Divya Nigam:* In the book author discusses about the financial system and current trend with the money market and the financial market. It also discusses about the

enhancing of the NBFC market in the semi urban area.

*Shashi K. Gupta, Nisha Gupta & Neeti Gupta* The authors discuss about the Importance of NBFCs in monetary market as the intermediary between the money market and the investors. They are appreciated as they take quick decision making as well as the risk-taking ability with customer centric products.

*K.C Shekhar & Lakshmy Shekhar* In his book he discusses about the increasing trend of NBFC in India after 1990, it also discusses about the intermediary function of NBFC in financial market and how has it given an expansion to the sector with its ability of quick decision making, risking taking nature and custom products provided to its customers.

*Priya Basu and Pradeep Srivastava* in their paper “Exploring Possibilities: Microfinance and Rural Credit Access for the Poor in India”, they discuss about the possibilities NBFCs and micro financing companies have in the rural terrain.

*Sonu Garg, Dr. Parul Agarwal:* In their paper “Financial Inclusion in India – a Review of Initiatives and Achievements” discusses about the financial stability of the country and importance of finance sector in economy. The paper also discusses about the cost-effective finances provided by the NBFCs.

*Anil k khandewal:* in his paper “Microfinance development strategy for India” he discusses about the constraints of the banking sector and how micro-financing institutes have grown upon it seeing the opportunity in the financial market.

*N. Tejmani Singh:* in the paper “Micro Finance Practices in India: An Overview” he discusses about the growth of micro financing companies, with main aim in increasing the income level and living standards.

*Tara S. Nair:* in their paper she discusses about the growth of micro financing companies, the constraints of the banking sector and how micro-financing institutes have grown upon it seeing the opportunity in the financial market.

### 3. Scope of the study

To analyse the trend of shadow banking in rural and semi urban areas, this research paper deals with the analysis of the trends that NBFCs are following in the rural and semi urban areas of district of kullu, Himachal Pradesh and how they can grow in this market.

### 4. Objective

- To observe the meaning of shadow banking in India, it clarifies the meaning of shadow banking and how it is different from traditional banking system. Further we study about the Non-Banking Financial sector in India.
- To analyse the trend of growth of NBFCs in rural and semi urban area in district of kullu, Himachal Pradesh.
- Measures it can take for the growth of NBFCs in these markets.

### 5. Research methodology

#### Research design

- Descriptive in nature.

#### Tools and techniques used:

- Statistical Tools
  - Data Collection
  - Tables

#### Data collection techniques:

- Self-study
- Observations
- Analysis

### 6. Data source

For the research paper primary data is analysed to make the conclusions. Where the primary data is taken from studying the rural and semi urban areas in district of kullu, Himachal Pradesh.

Primary data is collected through surveys and questionnaire. As to collect first hand data through filling of the google docx. 100 respondents were recorded to complete this survey and were analysed.

### 7. Analysis of data

When respondents were surveyed over the NBFC and its growth in rural areas and semi urban area of dist. Kullu, H.P, following data was collected from the respondents:

#### A. Awareness level over NBFC

The term NBFC is not so popular in the rural areas and semi urban areas, as people are not so aware about the term, as 52% of total respondents voted negatively over knowing the term in general. But when asked about the term ‘micro financing institute’ people voted positively (54%) over knowing the term, as people are more aware about the microfinancing institutes than the non-banking finance corporation. When respondents were asked about the institutes like ‘Bajaj Finance limited, Mahindra and Mahindra Finance and Muthoot Finance’, 91% voted positively about knowing these institutes and told that they knew about these institute through tv advertisement, word of mouth and door to door selling/promotion through agents.

#### B. Services awareness of public

The respondents were asked about the awareness of the products or services provided by the NBFC that are advancing loan and depositing money, People responded that 42% were aware about the loan and financing facility provided by them, on the other hand mere 11% knew about the depositing money function and 47% were completely unaware about both these functions of NBFCs.

#### C. Comparison of service of NBFC with schedule bank

When comparison is drawn between the commercial banks and NBFC over the customer satisfaction and service quality people found scheduled commercial banks service better than

the NBFC as 87% voted over the commercial banks and only 33% were happy with services provided by the NBFC.

People when asked to rate the service of NBFC on a scale of 10, 7% voted for 1, 0% over 2, 9% for 3, 4% for 4, 14% for 5, 18% over 6, 22% over 7, 18% over 8, 3% for 9 and 8% voted for 10 over the scale.

How will you rate the service of Bajaj Finance limited, Mahindra and Mahindra Finance and Muthoot Finance...ncing company on following scale ?  
 100 responses

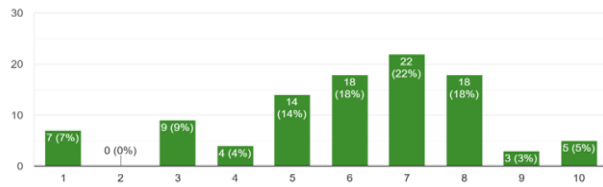


Fig. 1. Chart-1 (Responses)

### 8. Interpretation

NBFCs for these years could not step in to the rural market because of the following reasons, that are:

1. Lack of trust: people in rural and semi urban areas do not trust new entities easily, so making people trust over their company was hard for NBFCs and the micro financing companies.
2. The second is the low access of NBFC to generate capital at lower rates for expansion and growth purposes as they are very risky avenue to raise funds for.

*Strategies that can be implemented to grow NBFCs in rural and semi urban area:*

So, here are some of the strategies that NBFCs can follow to grow in the rural and semi urban market, where potential for growth is very high:

- *Customer centric products:* Micro financing companies registered with NBFCs are looking for agriculture equipment funding, as rural population is mostly engaged in agriculture sector. Shriram transport has also started a different vertical for far equipment's and plan to disburse Rs.5000 crore in next two years to fund the venture as to expand market in rural and semi urban areas. L&T finance, which focuses on infrastructure finance, has launched products with a view of Pradhan Mantri Gram Sadak Yojana (PMGSY), to target the entrepreneurs who need funding for small equipment's. Magma Fincorp has 70% operation in rural area and semi urban area, is looking to start funding the tractors, commercial vehicles and funds to small and medium and small enterprises.
- *Physical presence:* key factor for growth of NBFCs in rural and semi urban area is through opening physical branches, as people living there are more comfortable in visiting physical branches as it gives them sense of trust to take their products or bundle of products. The companies should promote them in native languages and big hoardings to

attract people.

- *Social media presence:* as increasing trend of social media platforms NBFCs should provide products through technology as well as techniques to monitor their funds through their phones. As this will give them edge in semi-urban areas.
- *Focus over medium and small enterprises:* as 45% of manufacturing units are under SMEs, but SMEs lack fund for their operations, working capital as equity market venture capital closed their doors for these enterprises. As NBFCs has come to rescue while providing loans to enterprises as well as innovative funds are also provided like second hand vehicle financing, three-wheeler financing and etc.
- *Micro financing:* many of the micro financing institutes are registered with RBI as the NBFC-MFI, providing loans to the poor rural people as which generates opportunity for growth for rural people generating employment with national growth. This has an opportunity to fill the gap that has between the private lenders and banks has created and explore this segment of market.
- *Housing finance:* targeting the people who earn around 6000-12000 providing them housing finance, people find it difficult borrow money from commercial banks. Also relaxing the documentation may attract customers towards NBFCs. As flexible documentation makes it easy to avail the services of getting loan and on other hands taking loan from banks is heavily documented task making people disinterested.

### 9. Conclusion

From the following study we reach to the conclusion that semi urban area and rural area, people trust commercial banks over the NBFCs. There is a vast market in the rural and semi urban area. In current scenario people want to access the services of the NBFCs and microfinancing companies for advancing loans because of their attractive plans but less people are interested over the deposit taking NBFC.

### 10. Future scope and limitations

#### A. Future scope

The study can be expanded to large geographical area as well as the larger sample of population can be surveyed.

#### B. Limitations

- *Language of base papers:* language used in research papers are highly technical and difficult to understand.
- *Primary data collection:* the primary data collected may result to fall result if the responded was not full heartedly involved in filling questionnaire and may have provided misleading data.
- *Area of primary research:* the area covered under the research is only in dist. of kullu and further more areas can



be included to make this research more valuable and informative.

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