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Clockwise from top: K.V. Kamath, chairman, Jio Financial Services; Y.S. Chakravarti, MD and CEO, Shriram Finance; Sanjiv Bajaj, CMD, Bajaj Finserv; Ajay Piramal, chairman, Piramal Enterprises

Image: Photograph by Narendra Bisht (Sanjiv Bajaj); Getty images (K.V. Kamath)

LONG READS

Catching The NBFC Wave

Just why NBFC is the latest holy grail in financial services.

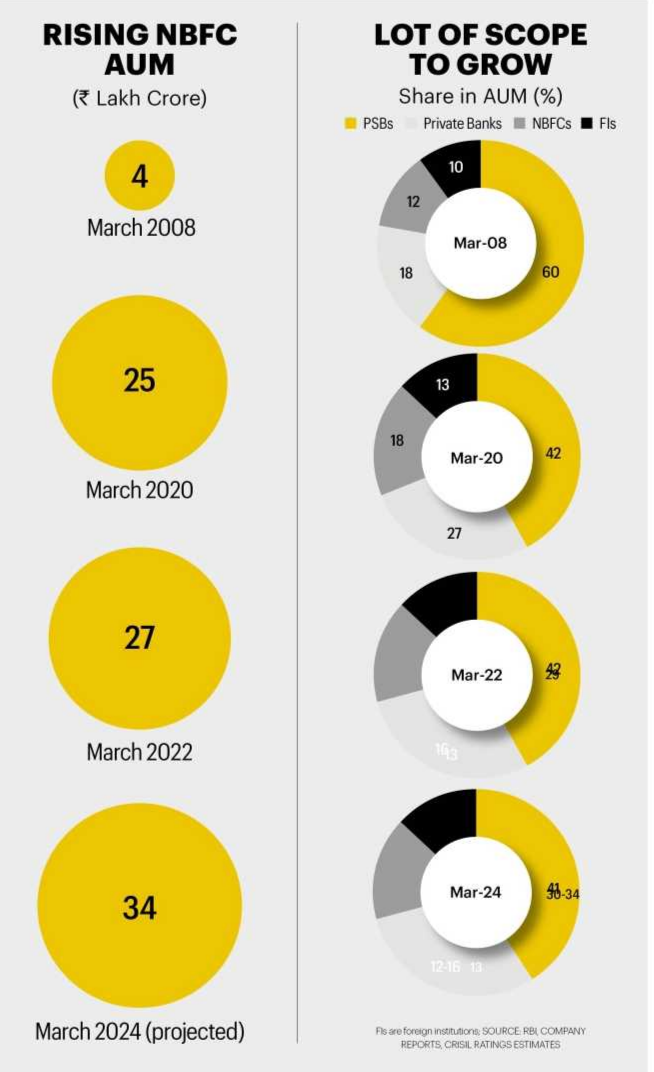
By **NEVIN JOHN**, Dec 5, 2023 | 13 min read

ADAR POONAWALLA NEVER LETS GO of a good business opportunity. In the middle of Covid, in February 2021, when his Pune-based Serum Institute was ramping up vaccine production, Poonawalla, the scion of the vaccine empire, acquired a non-banking finance company (NBFC) to build the family's newest business — finance. His investment firm, Rising Sun Holdings Pvt. Ltd., took a majority stake in Magma Fincorp for ₹3,456 crore. This gave the Poonawalla family, which had launched an NBFC business in 2019, a boost as rural and semi-urban focused Magma was already operating in 21 states with five million customers and ₹15,006 crore loan book.

Another conglomerate that ventured into the NBFC business soon after Serum was the Godrej Group, which launched Godrej Capital under Godrej Industries in April 2022 with ₹2,000 crore initial capital. The family asked Adi's son Pirojsha to head the business. Its AUM has already crossed ₹7,800 crore. Pirojsha aims to take it to ₹50,000 crore by 2028.

Reliance chairman Mukesh Ambani also made a major move in financial services. He spun off the NBFC business from Reliance Industries and got it listed. "Jio Financial Services will be a technology-led business, delivering financial products digitally by leveraging the nationwide omnichannel presence of Reliance's consumer businesses," Ambani said during the launch.

There is no shortage of action in the financial services industry. Tata Group's Tata Capital is restructuring operations and expanding the board as part of a plan to go public by 2025. Hero FinCorp, the financial services arm of two-wheeler giant Hero MotoCorp, has shortlisted eight investment banks for an initial public offer (IPO) in 2024. The targeted size of the proposed IPO is around ₹4,000 crore. L&T Finance has stopped wholesale lending and metamorphosed itself into a retail financier.



There is a reason for the rush of conglomerates into the NBFC sector. After moderation in growth post-pandemic, in FY23, assets under management (AUM) of NBFCs (including housing finance companies) saw 15% growth. NBFCs are expected to grow 16-18% in FY24 and 14-17% in FY25 on the back of continued strong credit demand across retail loan segments, says CRISIL Ratings in a report. The AUM was less than ₹2 lakh crore in 2000 and is expected to increase to ₹34 lakh crore by FY24, the rating agency said in an earlier report. Credit is expected to grow at a CAGR of 13-15% over FY23-26.The industry expects retail segments such as housing, auto and microfinance to be primary growth drivers. "We are seeing big financial inclusion in retail lending, especially from unorganised to organised," says Dinanath Dubhashi, CEO of L&T Finance.

Factors such as rapid economic growth, fast urbanisation, increased spending capacity and digital transformation of financial services have opened new avenues for NBFCs. A conducive regulatory environment and capacity to capitalise on existing resources and brand equity will lead to expansion of NBFCs within conglomerates, says Y.S. Chakravarti, managing director and CEO, Shriram Finance Ltd. The conglomerates have an advantage as they have easier access to capital and can provide the financial backbone to lending operations. They can also use their existing customer base to cross-sell financial products and services.

Opportunities Ahead

Chakravarti says significant growth areas in next five years include microfinance, consumer finance, affordable housing finance, MSME finance and agricultural finance, particularly in rural and semi-urban regions. "These segments require deeper understanding of local dynamics. NBFCs are well-positioned to provide personalised services. They can establish strong customer relationships and develop granular understanding of credit risk in these areas. Their ability to offer faster disbursal and adapt quickly to market conditions makes them the preferred choice for customers in these areas," he says.

Meanwhile, NBFC credit has become critical to economic growth, reflected in exponential increase in their AUM — from ₹3.6 lakh crore in FY08 to around ₹27 lakh crore in March 2022. They accounted for almost 16% credit in FY22 vis-à-vis 12% in FY08. The share of public sector banks in credit decreased from 60% to 42% in this period, while share of private banks increased from 18% to 29%. For decades, NBFCs have pursued businesses and customers ignored by banks, expanding their share of the credit pie through efficient last-mile delivery and product innovation.

In fact, NBFCs are going head-to-head in many segments. In auto loans, they account for 25% outstanding loans, while banks (PSU and private) are at 73%. The rest is held by small finance institutions and fintech players. NBFCs are far ahead in consumer durables loans with 73% share followed by private banks at 27%. They lead in two-wheeler loans also with 64% share. In personal, business and commercial lending, their share is around 15%. In microfinancing, they are almost on a par with banks (33% market share).

The demand and supply dynamics are conducive for large conglomerates venturing into the sector. Vishal Kampani, non-executive vice chairman, JM Financial, says retail credit is witnessing accelerated growth, supported by booming digital consumer lending. "The digital lending market opportunity is expected to witness exponential growth by 2030," he says.

While demand remains robust, NPA worries changed the supply side, especially after the IL&FS crisis and the trouble faced by private equity investors in achieving successful exits from their NBFC investments, says Manish Shah, managing director & CEO, Godrej Capital. "This has established a competitive advantage for conglomerate-backed NBFCs with substantial pools of capital. Their robust financial backing offers security and reassurance to lenders operating in the domain," he says.

16% **Credit accounted for by NBFCs in FY22 compared to 12% in FY08.**

Some believe cash-rich NBFCs will encroach into the space left open by poorly-performing public sector banks. "Private banks are bullish and won't cede ground to NBFCs. However, PSU banks are inefficient. Because of that, private bank credit has grown to 35% from zero in last three decades," says an executive with a foreign bank.

The rise of conglomerate-backed NBFCs will also challenge the incumbents like Bajaj Finserv (holding company of Bajaj Finance), HDFC Ltd. (merged with HDFC Bank) and Shriram Finance. Will this change the lending landscape?

Who Is Doing What

In 2010, Ajay Piramal, chairman of Piramal Enterprises, sold his pharmaceutical formulations business to multinational Abbott for the then record valuation of $3.7 billion and chose to start a new innings in financial services with a stake in Shriram Group companies. When his attempt to merge Shriram Capital with Piramal Enterprises failed because of size and valuation issues, he took over bankrupt Dewan Housing and Finance for ₹34,250 crore in 2021. He is now looking for takeover opportunities in mutual funds, general insurance and other segments.

Shriram Finance, with ₹1.77 lakh crore AUM as of December 31, 2022, was formed by combining Shriram Transport Finance Company and Shriram City Union Finance last year. The market leader in commercial vehicle and two-wheeler lending wants to be number one in MSME lending as well.

L&T Finance has switched focus to retail and is selling wholesale assets, largely infrastructure and real estate loans. It reduced wholesale loan book to ₹9,318 crore in September 2023 from ₹46,000 crore in March 2022. Around 88% loan book is now retail (₹69,417 crore in September). In November last year, L&T Finance exited mutual fund business by selling it to HSBC Asset Management (India) Private Ltd.

NBFCs are far ahead in consumer durables loans with 73% share followed by private banks at 27%.

"We were strong in rural financing. The board evaluated that good profit with acceptable risk is possible in retail. But risk is not priced well in wholesale lending. When a bulky accident happens, the NPA will be ₹500 or ₹600 crore in one go," says Dubhashi of L&T Finance. "In retail, ability to control the impact of an external adverse event is higher because of the granular nature of the business," he says.

Bajaj Finance (BFL), the most valued NBFC, has built its digital platform in two years since Covid. BFL has 41 million customers on its app and wants to fully transform into a digital enterprise in next 12 months. In addition to digitisation, it is branching out. It has just launched a car financing business. It will launch microfinance in November, tractor financing in January next year and commercial vehicle lending by June 2025. BFL also plans to raise about ₹10,000 crore in a restricted share sale as it shores up capital base amid entry of Jio Financial Services into retail lending.

But Rajeev Jain, managing director of BFL, doesn't see any threat from conglomerates such as RIL and Godrej. "We are 175 bps of overall outstanding credit in India. There is space for everybody as long as you are operationally efficient, agile and understand the risk and economics of business," he says. He says the country will need a lot of lending considering projected GDP growth, young population and growing demand for retail loans. "Some large players will become larger and take a part of the profit pool. Once a player becomes larger, its profit pool will multiply. That's how it has played out globally," he says. Capital, liabilities, talent and investment in technology will be the key to success of lenders, he adds.

The growth arc of any future-focused NBFC will be defined by two aspects, ability to innovate and adopt new-age digital technologies, says Kampani of JM Financial. "In consumer lending, there are opportunities in personal loan, peer-to-peer lending, short-term financing like 'buy-now-pay-later', co-lending, among others. Short-term financing will witness better adoption," he says. He says NBFCs have taken a lead in innovation and reach which puts them in a better position to drive growth in emerging segments.

HOW ARE NBFCs FARING

	NET SALES				NET PROFIT				AUM			
	FY20	FY21	FY22	FY23	FY20	FY21	FY22	FY23	FY20	FY21	FY22	FY23
ADITYA BIRLA CAPITAL	16,696	19,260	22,232	30,163	920	1,127	1,706	4,796	3,05,587	3,35,919	3,70,618	3,59,922
BAJAJ FINANCE	26,374	26,673	31,641	41,398	5,264	4,420	7,028	11,508	1,47,153	1,52,947	1,97,452	2,47,379
SHRIRAM FINANCE	16,561	17,422	19,255	30,492	2,512	2,499	2,721	6,011	1,09,749	1,17,243	1,60,227	1,85,683
TATA CAPITAL LTD	9,680	9,835	10,162	13,422	296	1,126	1,648	2,975	77,610*	77,219*	94,349*	1,20,940*
CHOLAMANDALAM FINANCIAL HOLDINGS	13,135	13,900	14,644	18,154	551	825	1,023	1,290	60,549	69,996	76,907	1,06,498
MAHINDRA & MAHINDRA FINANCIAL SERVICES	11,995	12,382	11,419	12,828	1,075	773	1,137	2,072	68,089#	64,608#	64,961	82,770
L&T FINANCE HOLDINGS	14,104	13,353	11,930	12,775	1,700	971	1,070	1,623	54,937	72,874	74,981	80,893^
MUTHOOT FINANCE	9,684	11,535	12,186	11,898	3,138	3,804	4,017	3,612	41,611	52,622	58,053	63,210
PIRAMAL CAPITAL & HOUSING FINANCE	9,558	5,082	6,039	6,644	-13,456	1,034	540	-7,401	NAVL	NAVL	51,808	50,427
POONAWALLA FINCORP	2,513	2,319	1,540	2,177	27	-559	375	684	16,434	14,225	16,579	16,143

In ₹crore; * Loan Book, ^ Total Book, # Business Assets, NAVL - Not Available
SOURCE: CAPITALINE, FORTUNE INDIA RESEARCH, ANNUAL REPORT, INVESTOR PRESENTATION

JM Financial, founded by investment banking veteran Nimesh Kampani, is also transforming itself into a digital-focused NBFC. The group, which diversified into mortgage lending, asset management, distressed debt and private equity, is now building a digital platform which it wants to grow to 50% of the business by 2030.

This doesn't mean all conglomerates are confident about pumping in funds in the sector. For instance, allegations-hit Adani has decided to exit the NBFC business. Bain Capital has agreed to acquire 90% of Adani Capital and Adani Housing. Shapoorji Pallonji Group also has an NBFC licence but is going slow by focusing on just vendor and dealer financing.

Tata Group's NBFC play is at least three decades old, when they launched their vehicle financing arm, Tata Motors Finance under the automobile company. But the group launched another lending subsidiary, Tata Capital, in 2007. Holding company Tata Sons even applied for a banking licence before withdrawing it in 2013. Tata Capital has all loan products but lags industry leaders. Tata Motors' car loan arm is still outside Tata Capital.

Aditya Birla Capital (ABCL) and Mahindra Finance (MFL) are sizable NBFCs from conglomerates that have decided to remain focused on select areas rather than pursuing aggressive expansion. Retail lender ABCL recently completed ₹3,000 crore fundraising via QIP; investors were BlackRock, Norges Bank, Abu Dhabi Investment Authority and Massachusetts Institute of Technology. Tractor financing and farm loan focused MFL is looking to improve disbursals; it disbursed ₹4,500 crore in September, a rise of 11% from the year-ago period. Disbursements in second quarter of current fiscal were ₹13,300 crore, a rise of 12.6% YoY.

In a recent development, RBI's move to curb the relentless rise in consumer loans has become a worry for NBFCs. The apex bank has been warning NBFCs about risks of an uncontrolled rise in consumer loans and has increased risk weight against consumer loans, including personal loans and credit card loans.

NBFCs Vs PSU Banks

Public sector banks have been losing ground since last 30 years when banking was opened to the private sector. They now account for 60-65% bank credit. Are NBFCs expecting a further slide in share of PSU banks to help in their growth?

Chakravarti of Shriram says traditional PSU banks are seeing increased competition from both NBFCs and private banks. "Over next five years, PSU banks may continue to face challenges in retaining market share," he says.

Bajaj's Jain says PSU banks are losing ground because of lack of agility. "Banks like SBI and Bank of Baroda are showing they can push back. The sector is intensely competitive and that makes it more efficient. The efficient players will be able to generate alpha. If you are efficient, agile and understand the risk, you will be able to sustain long term," he says.

According to Vishal Kampani, NBFCs and PSU banks can complement each other and deepen the credit delivery ecosystem. "NBFCs have been playing an effective role in facilitating last-mile credit delivery. That capability aligned with banks' infrastructure bandwidth and compliance framework will lead to development of a robust credit ecosystem in India," he says.

NBFCs have an edge over banks in product customisation and processing. In an emerging market economy like India, every lender, NBFCs, banks and other financial institutions, have a larger role to play to make credit accessible with diversified product offerings.

Godrej's Manish Shah agrees with Vishal Kampani saying India's growing GDP presents an opportunity for credit expansion. "I believe there is a role for everyone. It is crucial to adopt a mindset that emphasises growing the market as a whole," he says.

A crucial advantage for NBFCs is their ability to assess an applicant's creditworthiness better and faster. As a result, they have faster turnaround times. NBFCs also often have more flexibility in operations which can make them more agile in catering to specific customer needs and niches. However, it is important to note that PSU banks still have a substantial presence and customer base, so they will remain strong. "They are also adapting and evolving to stay competitive in the changing landscape. I believe coexistence of all these financial institutions will define the future of the finance sector," says Shriram Finance CEO.

As competition rises, cash-rich conglomerates will look to acquire successful digital lending start-ups.

Growth Strategy

Ambani's Jio Financial Services aspires to be a full-service financial services company with robust capital base, experienced team, strong brand, group customer base and technological capability. It will focus on digital lending, AMC and insurance in initial years. It is also likely to benefit from the high credit rating of RIL which will help it get funds at a lower cost, say analysts with Axis Capital. "Jio Financial Services plans to democratise access to financial services by building a digital-first institution across retail/ merchant lending, MSME financing, insurance (broking plus manufac- turing), e-broking and asset management," said the brokerage in its report.

Jio Financial and BlackRock, the world's largest asset manager, recently joined hands to set up an asset management company with a combined investment of $300 million. Jio announced its first quarterly result recently, posting a net profit of ₹668 crore for the July-September period, a 101% increase from previous quarter. The growth was largely supported by ₹217 crore dividend income; ₹154 crore worth of dividend income came through associates. The dividend is majorly from RIL in which it holds a 6.1% stake. The value of these shares is about ₹1 lakh crore.

Godrej Industries has committed an equity infusion of about ₹2,200 crore in Godrej Capital. Of this, it has already put in ₹2,000 crore. The group is determined to support it via capital infusion as required, says Shah.

The success of Bajajs in financial services is one of the factors inspiring the new entrants. Godrej family is already in the real estate business. Home financing is a natural extension. Godrej Capital has its footprint in Mumbai, Bengaluru, Delhi NCR, Ahmedabad and Pune and will soon be operational in six new cities — Jaipur, Chandigarh, Hyderabad, Chennai, Indore and Surat. "The company will continue focus on secured loans consisting of home loans and loans against property," according to the company. It started with home loans in select geographies in 2020. The company will be focused on digital-first approach. "We envision Godrej Capital as a new-age retail financial services institution," says Manish Shah.

As competition rises, cash-rich conglomerates also will look to acquire successful digital lending start-ups. They can tap into technological capabilities and customer-centric approach of lending start-ups, says Chakravarti of Shriram. "Such moves are known to enhance an NBFC's portfolio and improve customer service," he adds.

As NBFCs expand into new markets and demographic segments, diversifying their lending portfolios, and reaching a broader customer base, the lending landscape in the country will change. At the same time, it will take some time for new players to establish their base in the market.