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Financial Performance of Indian Non-Banking Financial Companies: Leverage Effect

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Abstract:
Non-bank financial companies (NBFCs) are an additional source of banking services for consumers and businesses. They have the potential to give banks a run for their money in the financial services market. Instead of bundling together a variety of financial services like a bank might, non-bank financial companies (NBFCs) focus on serving specific niches. In addition, some NBFCs may focus on a specific industry, giving them a distinct data advantage. By segmenting the market and offering specialized services, NBFCs increase competition among financial institutions. Non-bank financial institutions are an important part of a robust financial system that helps economies recover from and avoid financial shocks. If a country's primary means of intermediation were to fail, supplementary NBFCs would still be able to convert savings into investment capital. The investigation is causal in nature and it intends to determine the impact of leverage further on financial performance of selected top 28 NBFCs of India in past ten years from 2014 to 2023. This results demonstrates that leverage is a significant and dominant element in determining the financial performance of NBFCs in India.

Key words: NBFCs, Financial performance, Leverage, India

Introduction:
Non-banking finance companies are those financial organisations that operate in a similar manner to banking companies. They accept contributions from the general public and offer a credit facility to help the credit platform develop. It assisted in transforming the public's small amounts of retail resources that were not being used into a sizable fund that could be used to develop the credit system (Kumar & Bird, 2020). In order to aid in the expansion of the Indian economy, they used their scared financial resources in this way. When a borrower's request for credit is denied by a bank due to the bank's strict requirements, non-banking finance companies are more helpful. While banks only contribute about twenty-one percent to the GDP of India, it plays a significant role in managing financial services and makes up about twenty-four percent of that country's GDP (Kittu & Chittawadagi, 2018). By meeting the financial needs of this unorganised sector that remained unmet, credit has been able to bridge the gap between small-scale, unorganised borrowers and organised sector. However, this channel is also used to meet the small needs of the corporate world. The financial and operational performance of non-financial institutions is very important because they make a significant contribution to the national GDP as well as meeting the financial needs of a sizable portion of the population. The question of whether non-banking finance firms outperform banks is one that is frequently studied (Vadde, 2011).
Costea 2013, explained Unlike traditional banks, non-banking financial institutions (NFIs) specialise in making loans to borrowers. Credit extensions, financial leasing, and guaranteeing obligations rank among the top lending activities. Leverage is considered as a strong tool to define the efficiency of capital structure and its relevance with the asset management system in the organization. In this study leverage is represented in long term and short term both the aspect because every organization faces both type of liquidity risk; long term and short term. Long term leverage is a measure to analysis the solvency position of the organization which is computed through comparison of long term loans and Total assets. Short term leverage is an indicator of company’s capacity of managing short term financial obligations. As an extensive review of literature is done prior to start the current research and it was found that leverage has an attribute to explain the financial performance. The current research is an attempt to check the Leverage is determines the financial performance of NBFCs in India. Net worth is used as a measure to financial performance.

Determining the structure and financial position of non-banking finance companies is the goal of the current study, which was conducted. Through the use of statistical techniques, the study's chosen ratios and figures have been examined, and conclusions about their overall performance have been reached.

Review of literature:

Dardac & Chiriac (2010) Studied about existing financial crisis and suggested that the essential difference between past episodes of financial chaos and the actual crisis is the exceptional relentlessness. Further; study has covered the risk scenario of financial market and talked about the strength of financial institutions and their capacity to manage the risk. Operational risk was mainly discussed in the study as a root cause of loss for non-banking financial institutions. The study is conducted on Romanian nonbanking financial institutions and recommended that the corporative governance principles as an important risk management measure to face the challenges of operational risks.

Hossain & Hossain (2013) Identify the fund management systems of various NBFI groups and determined the impact of internal factors on the cost of funds of nonbank financial institutions. The findings that NBFIs established prior to 1990 can generate funds at a low cost to gain customer confidence and strengthen their market position were described. Age and EPS have a significant impact on fund-raising practices, but there is no correlation between equity contributions and interest-earning assets.

Gremi & Ballkoci (2016) conducted their research to know the progress of Non-Banking Financial Institutions and their contribution in Albanian Financial System. Regression model was applied to check the causal relationship between various risk parameters and financial performance which is represented by ROE as an explained variable. The study was applied. The study has revealed that Liquidity risk, credit risk and operational risk significantly affect the financial performance of Non-Banking Financial Institutions in Albania.

Perumal & Satheeskumar *(*2013) Studied customers‟ satisfaction towards the service offered by selected non-banking financial companies. The study was conducted on Sundaram Finance Limited and Lakshmi General Finance Limited. The primary objectives of the research were to investigate the customers' perceptions about the functioning, compare the growth factor and to evaluate the performance. Study recommended that a restricted regulatory framework should be framed for NBFCs and more powers should be vested with RBI to scrutinize them.

Sufian (2007) Investigated productivity changes of non-banking financial companies in Malaysia. Malmquist Productivity Index (MPI) method was applied to trace the productivity changes through post crisis period of 2000-2004. Study exposed that Technological Change and Technical Efficiency were the factors which contradictory explained the productivity of Malaysian NBFIs supported by the findings of Krishnasamy et al. (2004) on Malaysian banks.

Costea (2013) applied a benchmarking model as a two dimensional self-organizing map (SOM) to evaluate the performance of nonbanking financial institutions (NFIs) in Romania. The NFIs are exemplified by many performance measures such as capital adequacy, assets' quality and profitability. Neural network algorithm and U-matrix method were applied to assemble the NFIs in clusters with similar characteristics and to build maps that assist the idea of SOM results and select the appropriate map in terms of easiness of readability and recommend that to analyze the companies over time by studying the cluster where each company was positioned for each period.

Gul,Irshad & Zaman (2011) examined the relationship between bank-specific and macro-economic characteristics with profitability. The study was conducted on selected fifteen Pakistani commercial banks over the period 2005-2009. POLS regression model was applied to investigate the impact of assets, deposits, loans, equity, GDP, inflation and market capitalization were taken as explanatory variables and different profitability indicators i.e., ROA, ROE, ROCE and NIM were considered as explained variables separately.

Khan, Nouman & Imran (2017) Disclosed that antecedents of financial sectors such as leverage, bank size, risk parameters, and tangibility have significant effect on financial performance of financial sectors. It is recommended that financial sectors should consider these as major determinants of financial performance of NBFCs.

Rosario and Chavali (2018) Found Non-Banking Finance Companies are vital to the financial system. Initially complementing the banking system, NBFCs are now an alternative and a threat. Net profits rose from INR.222

billion in 2013 to INR.290 billion in 2014. This study examines the impact of capital structure on profitability in Non-Banking Finance Companies from 2006-2016. Analyzing data with correlation. The study includes 23 National Stock Exchange, India-listed finance companies. The study investigates the relationship between NBFCs' capital structure and their net profit, return on capital employed, return on equity, return on assets, and interest coverage ratio. The study investigates the relationship between NBFCs' capital structure and their net profit, return on capital employed, return on equity, return on assets, and interest coverage ratio. The study investigates the relationship between NBFCs' capital structure and their net profit, return on capital employed, return on equity, return on assets, and interest coverage ratio. The study investigates the relationship between NBFCs' capital structure and their net profit, return on capital employed, return on equity, return on assets, and interest coverage ratio.

Dutta, Jain, and Gupta (2020) performed a data envelopment analysis on Indian NBFC performance (DEA). As much DEA research has been conducted on banks, their study fills a void in DEA research on NBFCs. Initially, the paper calculates super-efficiencies using panel data from 2014–2018, and then regresses them on exogenous factors in stage-2. The super-efficiency model and traditional models (OTE, PTE, and SE) are used to estimate efficiency with descriptive statistics. paper investigates how the financial and social efficiency of firms influence the extent of the voluntary disclosure of Non-Banking Financial Companies–Micro Financial Institutions (NBFCMFI). Using a panel data analysis, a positive correlation was estimated between financial efficiency and profitability. There was no correlation between social effectiveness and voluntary disclosure rate. This article made a contribution to the academic literature by identifying new factors that influence voluntary disclosure.

Objective of the study:

The objective of this research is to systematically assess the impact of leverage on the financial performance of non-banking financial companies of India.

Research and methodology:

The investigation is a causal in nature. It seeks to ascertain the effect of leverage on financial performance (net worth). The study is being conducted to investigate the relationship in the Indian context. To define the impact of leverage on financial performance of non-banking financial companies in India, various indicators such as debt equity ratio (DER), long term leverage (LTLR), and short term leverage (STLR) were used as independent variables, and net worth (NWR) was used as a dependent variable. The data have taken for the last 10 years (2014 to 2023). The population of the study included all the housing finance banks. Sampling frame was top 28 NBFCs in India on their cap size basis. Non probability purposive sampling technique was used for selecting the sample. Sampling elements were Debt equity ratio, Long term leverage and Short term leverage and net worth.

Results & discussions:

Unit Root Test

It is crucial to test the stationarity of the variables because time series data were used, which will help prevent erroneous regression. Unit root testing made use of the Augmented Dickey-Fuller test. Below is a summary of the variables' unit root test outcomes:

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H_0: DER, STLR, LTLR, and NWR all have a unit root.

Table 1

Unit Root Test

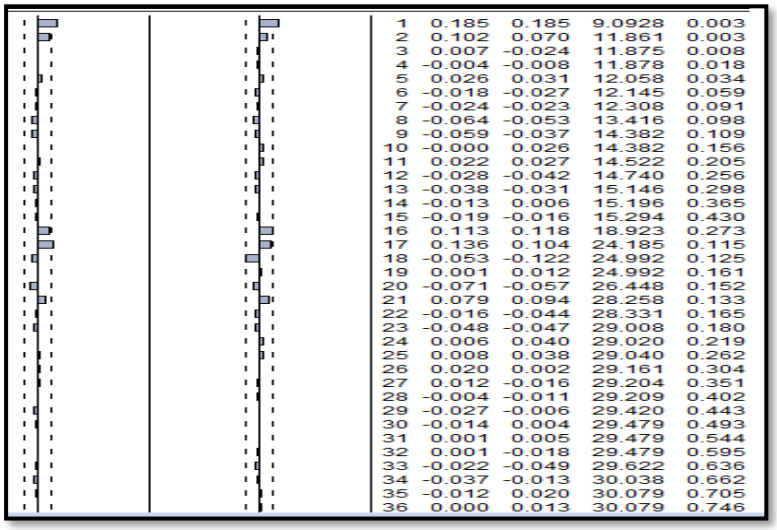
Variable	ADF-statistic	Critical value	Probability value	Level of significance	Order of integration
Debt equity ratio	-21.77531	-3.989472	0.0000	**1%**	1st difference
Short term leverage	-11.65323	-3.989908	0.0000	**1%**	1st difference
Long term leverage	-18.05487	-3.994598	0.0000	**1%**	1st difference
Net worth ratio	-17.84292	-3.993885	0.0000	**1%**	1st difference

All variables were found to be stationary at the First Difference Order of integration, as determined by the Unit Root Tests. The ADF statistic for the Augmented Dickey-Fuller test of the unit root is larger than the cutoff. Therefore, no unit root can be found for DER, STLR, LTLR, NWR.

Correlogram Residual test of autocorrelation:

Chart 1:

Correlogram Test



1	0.185	0.185	9.0928	0.003
2	0.102	0.070	11.861	0.003
3	0.007	-0.024	11.875	0.008
4	-0.004	-0.008	11.878	0.018
5	0.026	0.031	12.058	0.034
6	-0.018	-0.027	12.145	0.059
7	-0.024	-0.023	12.308	0.091
8	-0.064	-0.053	13.416	0.098
9	-0.059	-0.037	14.382	0.109
10	-0.000	0.026	14.382	0.156
11	0.022	0.027	14.522	0.205
12	-0.028	-0.042	14.740	0.256
13	-0.038	-0.031	15.146	0.298
14	-0.013	0.006	15.196	0.365
15	-0.019	-0.016	15.294	0.430
16	0.113	0.118	18.923	0.273
17	0.136	0.104	24.185	0.115
18	-0.053	-0.122	24.992	0.125
19	0.001	0.012	24.992	0.161
20	-0.071	-0.057	26.448	0.152
21	0.079	0.094	28.258	0.133
22	-0.016	-0.044	28.331	0.165
23	-0.048	-0.047	29.008	0.180
24	0.006	0.040	29.020	0.219
25	0.008	0.038	29.040	0.262
26	0.020	0.002	29.161	0.304
27	0.012	-0.016	29.204	0.351
28	-0.004	-0.011	29.209	0.402
29	-0.027	-0.006	29.420	0.443
30	-0.014	0.004	29.479	0.493
31	0.001	0.005	29.479	0.544
32	0.001	-0.018	29.479	0.595
33	-0.022	-0.049	29.622	0.636
34	-0.037	-0.013	30.038	0.662
35	-0.012	0.020	30.079	0.705
36	0.000	0.013	30.079	0.746

This test presupposes that all seasonings are contained within the regression line, estimated line, or predicted line. Autocorrelation can be tested statistically by examining the Q-Statistics' most recent P value. Q-statistics p-values greater than the expected value are required for this test to be considered significant (0.05). In this case, the Q-Statistics indicate that autocorrelation is not present because the last P value (0.746) is greater than the significance level (0.05).

Regression Analysis:

H_0 – There is no significant effect of DER, LTLR and STLR on NWR

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Table 2
REGRESSION ANALYSIS

VARIABLE	COEFFICIENT	STD.ERROR	T STATISTIC	PROB.
C	-0.576075	0.117758	-4.892024	0.0000
DER	1.063295	0.048187	22.06592	0.0000
LTLR	-0.928418	0.048473	-19.15331	0.0000
STLR	0.219335	0.047331	4.634058	0.0000

Dependent Variable: NWR

The results of the regression model show that Leverage has a significant impact on Firm value (Prob. value of t-statistic of independent variables; DER (0.0000), LTL (0.0000), and STL (0.0000) is less than 0.05).

Table 3
MODEL SUMMARY

R-squared	Adjusted R-squared	Durbin-Watson statistic	F-statistic	Prob.(F-statistic)
0.713827	0.710525	0.684261	216.1802	0.000000

The outcomes of a regression test are shown in Table 3. The DER, LTLR, and STLR account for 71.05 percent of the variance in net worth (coefficient of determination is 0.710525). Probability value of F-statistic is less than 0.05 percent, it can be concluded that the model adequately fits the data.

Regression Assumption Tests:

Heteroskedasticity Test:

H_0 – residuals are not heteroskedastic.

F-statistic	1.986169	Probability	0.1164
Obs*R-squared	5.914627	Probability	0.1158

From the above table it is resulted that P-value (0.1158) of **Observed R-square** is more than standard value (**0.05**) so, null hypotheses is not rejected. It means residuals are not heteroskedastic.

Breusch-Godfrey Serial Correlation LM Test:

H_0 - residuals are not serially correlated.

F-statistic	1.190874	Probability	0.2155
Obs*R-squared	46.98798	Probability	0.2080

The above table shows that the P-value of the Observed R-square is 0.2080, which is higher than the threshold for rejecting the null hypothesis of no effect. That the residuals are not correlated in a sequential fashion.

Discussions:

The current study has exposed that leverage is an important and dominant factor to define the financial performance of NBFCs which is supported by (Gremi & Ballkoci, 2016) analyzing the impact of risk parameters on financial performance of Albanian NBFIs. Study carried out by Costea, 2013 displayed the same facts related the financial performance of NBFCs in Romania which are discussed in the current study that debt equity ratio is a strong determinant of financial performance of nonbanking financial companies (NBFCs) in India. The outcomes of the current research is supported by the results of the study conducted by Gremi & Ballkoci, 2016 at some extent that, liquidity risk has a significant effect on financial performance (Net worth) but credit risk and operational risk has considered as an explanatory variable to net worth which is not taken in current research to explain the Net worth.

Recommendations & Conclusion:

This study limited to NBFCs in India so, it is suggested that same study can be applied on any other sector like banking, insurance etc. the management of nonbanking financial institutions and policy makers can take advantages of the study to make their strategies toward the functional areas and other practices like loan offering, management of capital structure and proportion of that debt to ownership. In the current research the financial performances is represented by net worth so it is suggested other indicators such as ROA, ROE, EPS etc. of financial performance can be taken in to consideration. The proposed study revealed that leverage has a significant effect on financial performance.

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