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Fuelling NBFCs through private capital

Message from ASSOCHAM

D. S. Rawat
Secretary General | ASSOCHAM

NBFCs have continuously played a critical role in encouraging growth of the Indian economy and have made commendable contribution towards the government's agenda of financial inclusion. They have been successful in filling the gap in offering credit to retail customers in underserved and unbanked areas. NBFCs' contribution and future potential in financing micro, small and medium enterprises (MSMEs) has been duly recognised by the government.

The contribution of NBFCs to the total assets in the Indian financial system is next only to that of banks and insurance companies. Hence, this sector needs to be nurtured appropriately where regulation and development have to go hand in hand.

ASSOCHAM and PwC have come out with a knowledge report focusing on opportunities, challenges and the way forward. We hope that this study will help regulators, market participants, government departments and other research scholars.

I would like to express my sincere appreciation to the ASSOCHAM-PwC team for sharing their thoughts, insights and experiences.

Raman Aggarwal
Chairman | ASSOCHAM National Council

NBFCs have grown to play an enhanced role in the Indian financial system, especially delivering credit to the unbanked. In spite of all the challenges, the sector has shown a steady growth of around 15% on a year-to-year basis for the last two years. This impressive growth has been 'healthy', as reflected by the lower level of NPAs, ensuring better asset quality, and high capital adequacy ratio which is much above the prescribed levels. This growth is further admirable keeping in mind the regulatory framework which has been harmonised with that for banks and other FIs.

During the last fiscal, there was a temporary setback caused by demonetisation, where cash collections from small borrowers were severely affected. This was tackled by increasing digital transactions and efficient monitoring. The growth of technology has caused disruption in the financial system. The new 'kids on the block' (as I prefer to call them) in the form of online lenders engaged in P2P lending, have rapidly grown and pose a challenge not only to the NBFC sector but also the regulator. Implementation of the much-awaited GST is causing operational issues which are partly arising due to the lack of clarity and understanding.

The greater resilience and adaptability, coupled with some 'out of the box' thinking, have put the NBFC sector in a bright spot. This has resulted in a very welcome scenario where leading global financial institution like the World Bank and investment funds (including pension funds) are increasingly engaging and investing in the sector. Domestic financial institutions like NABARD and SIDBI have come forward to initiate the refinancing of NBFCs.

The Hon'ble Prime Minister's address to the nation on 30 December 2016 was historic, as it recognised the role and importance of NBFCs. The Prime Minister announced coverage of NBFCs under the Credit Guarantee Scheme (CGTMSE). This has not only addressed one of our long-standing demands, but also paved the way for aggressive lending by NBFCs to MSMEs.

It is therefore, a matter of great pleasure that ASSOCHAM and PwC, with valuable inputs and support from the Finance Industry Development Council (FIDC), have prepared this knowledge paper to be released at the 4th National Summit on NBFCs. I am confident that this report shall contribute towards NBFCs shinning brighter and play an important role in materialising the PM's vision of 'New India'.

Foreword

Hemant Jhajhria
Partner | Strategy and Digital - Financial Services | PwC

India's non-banking financial company (NBFC) sector is undergoing unprecedented change—it is digitising rapidly, adopting new technologies to assess credit more effectively and exploring new business models to scale up fast and expand its reach into new segments while defending its margin and returns.

Historically, NBFCs have prided themselves on their understanding of and hold over niche business segments. This was built with learnings gained over long periods coupled with a high touch engagement model, resulting in gains from asymmetric information accessed, which could be leveraged for acquiring new customers as well as building longer relationships with the existing client base. However, as examples from both financial services and other disrupted industries globally have shown, new tech-based business models have the potential to crunch the learning period substantially and rebalance the strategic advantage of information access by inserting themselves into the value chain with technology. NBFCs must challenge the status quo in their business and find funds to invest into operating models with the potential to disrupt the industry.

Faced with the digital advance of policy initiatives such as India Stack, Aadhaar Pay and Direct Benefit Transfer (DBT) and exponential increase in smartphone/Internet access, NBFCs need to think hard about tweaking their current business models to grow in a hybrid world (digital + physical). As some of the newer tech-based NBFCs have shown, entry barriers to building a wide but low-cost distribution model have reduced, though not minimised as yet. To ride the wave of increasing formal credit penetration in a growing economy, NBFCs will need to invest in new technologies to lower the cost of acquiring new segments (including thin files), servicing existing customers and de-risking the portfolio.

State-run and some private sector banks have been grappling with bad loans for the past three years, which in turn has given a tremendous opportunity for NBFCs to ramp up their scale. In fact, in the last two years, they have doubled their market share in SMEs and wholesale loans and have made substantial inroads in other consumer loan categories. However, in their enthusiasm to grab a larger pie of the market and increase shareholder returns, NBFCs will have to be judicious in lending to sub-prime customers, who often offer a higher return but at increased risk and probability of default.

Owing to changing demographics, coupled with increasing disposable income, the new-age customer is demanding credit facilities like never before. However, the consumers of today prefer instant gratification—they want their demands to be met instantaneously. To be able to serve these increasing number of customers well, NBFCs will have to invest in analytics and AI capabilities to be able to connect to the customer in a hyper-personalised manner. The engagement needs to be kept simple and intuitive to offer the customers the instant solution they are looking for.

Given the context, private equity (PE) firms can provide the necessary capital and the financial muscle to undertake strategic decisions—right from expanding existing markets, building newer capabilities, improving efficiency or even to refinancing existing high cost debt. PE firms are the alternative source of growth capital to small and mid-size NBFCs, allowing them to both acquire scale and strengthen balance sheets. But PE firms bring a lot more than just capital to the table—greater corporate governance requirements result in stronger organisation, PE's constant focus on future industry trends provides new avenues to explore and access to a large PE network for NBFCs enables connections with new business partners across the value chain.

However, NBFCs must note that just the mere presence of a business operation does not attract a PE firm or its capital. The existing business has to be backed by a unique, distinct and compelling customer value proposition. This could be across either a particular product line, distinct credit underwriting capability, understanding of a niche customer segment, an expansive distribution reach, cutting-edge technology or any other factor that makes the NBFC attractive enough for the PE to place its bets on.

This report is divided into two parts. The first part will present an understanding of the key drivers of PE investments in India. We have looked at how macroeconomic factors and government initiatives have propelled the inflow of both foreign and domestic investments into the financial services sector, making it the second most attractive industry for PE investments. In the second part we have looked at the key imperatives for an NBFC to become attractive for PE investment—tailoring operating models to keep up with the rapid pace of consumerism while focusing on specific high-growth sectors. We have also discussed the key ratios and valuation methodologies used to assess a target, and detailed out the various ways in which successful NBFCs have deployed PE investments. Our report will draw attention to the importance of consolidation of NBFCs and how it will emerge as a sweet spot for PE investors in the future.

We congratulate the Associated Chambers of Commerce and Industry of India (ASSOCHAM) for engaging on a subject which is growing ever more relevant with each passing year and plays an important role in the overall success of the industry. I thank Paritosh Chhabria, Pooja Parsram, Sounabh Mandal and Bhargav Yakkaladevi of the Financial Services team of PricewaterhouseCoopers (PwC) for the research and writing of this report.

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1. India – road to growth

1.1. Macroeconomic overview

According to the Central Statistics Office (CSO) and an International organisation, India is among the fastest growing economies in the world. The World Economic Outlook Update (January 2017) published by an international organisation projected that the Indian economy would grow at a CAGR of 7.2% during FY 2016–17. These expectations were closely met when the year ended with a GDP growth rate of 7.1%.[1] Over the last five years, there has been an improvement in the fundamentals of the economy, driven by strong government reforms and RBI's inflation focus, capital spending on infrastructure, positive business sentiment, and pro-growth monetary and fiscal policies.

In FY18, the economy is expected to recover and accelerate to 7.7%.[2] Recent reforms such as the Goods and Services Tax (GST), a new code to deal with bankruptcies as well as critical action being taken to resolve the non-performing assets (NPA) challenge of public sector banks will be some of the key factors to drive economic growth.

Recent developments and their impact on the economy

The end of 2016 saw several major events which had both positive and adverse effects on the Indian economy.

- **Demonetisation:** The ban of two high-value notes has had a transitional impact on the economy over the last 6–9 months. GDP growth fell mainly due to a cash crunch, leading to a slump in demand. Production and supply chains were hit because of unavailability of sufficient working capital.
- **GST:** The new tax reform has the potential to push the GDP between 8% and 10%.

In the long term, these initiatives will be responsible for bringing more individuals under the formal tax net (there was a 25% increase in the number of returns filed for FY17[3]), increasing the contribution of organised sector and providing industries with formal credit channels.

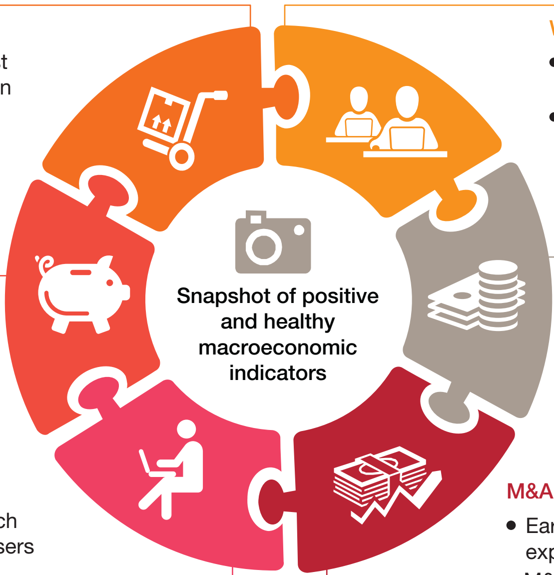
- **Monetary Policy Committee (MPC):** The government created the MPC to ensure that the RBI was independently focusing on multiple factors—inflation, growth, employment, banking stability and exchange rate—before making a decision about rates.
- **Digital India:** In order to enable consumers to seamlessly transact digitally, the Government of India (GOI) revamped USSD and Unified Payment Interface (UPI). The PM also launched the Bharat Interface for Money (BHIM) app, an Aadhaar-based mobile payment application that allows users to make digital payments without having to use a credit or debit card.

Consumption Patterns (2020)

- India is expected to be the third largest consumer economy as its consumption may triple to US$ 4 trillion by 2025
- This is owning to a shift in consumer behavior and expenditure patterns
- Estimated to surpass the US by 2040

Working Population (2020)

- India's labour force is expected to touch 160-170 million by 2020
- 65% of the population will be <35 years of age



Tax Collection

- Income tax returns up 25% in FY17
- Personal income tax through self-assessment saw a 34% rise

Savings Rate

- 28.6% of total disposable income being saved in 2020 by India's earning population, compared to major countries – 10.6% (US), China (37.7%)

Internet Penetration

- Total internet users is expected to reach 730 million by 2020; Mobile internet users will increase to 650 million by 2020
- Monthly wireless data ~1.3 billion GB a month

M&A Activity

- Early-stage start-ups in India are expected to raise US$ 800 million in 2017
- M&A deals comprise ~9% of all deals in Asia

[1] Reuters. (31 May 2017). GDP growth slows to 6.1% in Q4, 7.1% in FY17. Business Standard. Retrieved from http://www.business-standard.com/article/economy-policy/gdp-growth-slows-to-6-1-in-q4-7-1-in-fy17-117053101434_1.html (last accessed on 11 Aug 2017)

[2] IBEF. (April 2017). About Indian economy growth rate and statistics. Retrieved from https://www.ibef.org/economy/indian-economy-overview (last accessed on 11 Aug 2017)

[3] TNN. (8 Aug 2017). Income tax returns up 24% as more individuals declare income. Economic Times. Retrieved from http://economictimes.indiatimes.com/news/economy/finance/income-tax-returns-up-24-as-more-individuals-declare-income/articleshow/59964034.cms (last accessed on 11 Aug 2017)

1.2. Government initiatives

The GOI has been working extensively on growth stimulation, providing relief to the middle class and affordable housing, facilitating the digitalisation of the economy, enhancing transparency in political funding and simplifying the tax administration in the country.

- **'Housing for All' – Pradhan Mantri Awaas Yojana (PMAY):** The government has taken on the colossal task of providing affordable housing for all by 2022. For this purpose, it has set up Gramin, a rural housing programme designed to provide affordable houses to the rural population

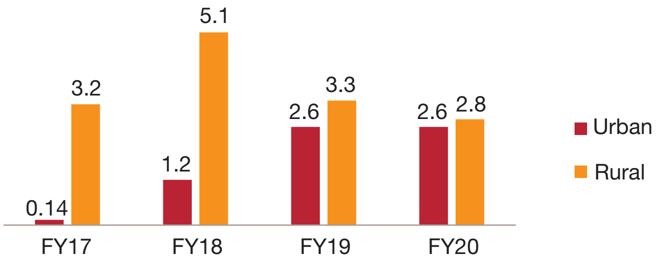
Particulars	Urban (million units)	Rural (million units)	Total (million units)
Current housing shortage (FY17)	19	40	59
Required housing units by 2022	26–29	23–25	49–54
Total need (by 2022)	44–28	63–65	107–113

Housing needs in India across regions by 2022

PwC analysis

This initiative will have several backward and forward linkages with over 250 ancillary industries.[4] This results in a positive cycle of economic activities and increases the demand for funding from financial institutions. Additionally, the success of this programme, combined with the falling interest rate regime, could mean improved loan growth for NBFCs and housing finance companies (HFCs) focused on this segment.

Credit Guarantee Scheme: At the beginning of this year, the Central Government augmented the corpus of the Credit Guarantee Trust Fund for Micro and Small Enterprises (CGTMSE) by an additional 5,000 crore INR.[5] The trust provides credit guarantee of up to 85% as collateral free loan on the total amount disbursed by NBFCs to MSMEs. The recent inclusion of NBFCs within the purview of the scheme will help to reduce the financial crunch faced by SMEs. The CGTMSE was specifically set up to lend SMEs additional money as many of them are not eligible under the normal lending criteria of a bank. To this end, GOI has doubled the eligibility amount from 1 crore INR to 2 crore INR and also enhanced the cash credit limit to 25%. The total financial requirement of the MSME sector is estimated at around 650 billion USD, of which 80% would be fulfilled by debt.



Target number of houses to be built across regions under PMAY (million units)

PwC analysis

In addition to the CGTSME, the government has pumped an additional 2,000 crore INR into the Credit Guarantee Scheme for Startups (CGSS) wherein each start-up recognised by the Department of Industrial Policy and Promotion (DIPP) is guaranteed credit upto 5 crore INR without any collateral for their business purposes. Thus far, 1,333 start-ups have been recognised by the DIPP. Other government schemes like Fund of Funds Scheme (FFS) have only been able to fund 65 start-ups,[6] indicating the challenges faced by start-ups in accessing funds.

- **Agriculture:** Agriculture plays a vital role in India's economy. Over 58% of the rural households depend on agriculture as their principal means of livelihood.[7]
  - NITI Aayog has proposed various reforms in India's agriculture sector, including liberal contract farming, direct purchase from farmers by private players, direct sale by farmers to consumers, and single trader licences, in order to double rural income in the next five years.
  - The Ministry of Agriculture, Government of India, has been conducting various consultations and seeking suggestions from numerous stakeholders in the agriculture sector in order to devise a strategy to double the income of farmers by 2022.

4 PM India website. (23 Mar 2017). Implementation of the rural housing scheme of Pradhan Mantri Awaas Yojana — Gramin to achieve Housing for All by 2022. Retrieved from http://www.pmindia.gov.in/en/news_updates/implementation-of-the-rural-housing-scheme-of-pradhan-mantri-awaas-yojana-gramin-to-achieve-housing-for-all-by-2022/ (last accessed on 11 Aug 2017)

5 Chitravanshi, R. (13 Mar 2017). Government's credit guarantee scheme to give startups a loan lifeline of up to Rs 5 crore. Economic Times. Retrieved from http://economictimes.indiatimes.com/small-biz/startups/governments-credit-guarantee-scheme-to-give-startups-a-loan-lifeline-of-up-to-rs-5-crore/articleshow/57610609.cms (last accessed on 11 Aug 2017)

6 KNN India. (17 July 2017). Start-ups can wind up businesses within 90 days from the day of making an application. Retrieved from http://knnindia.co.in/news/newsdetails/sectors/start-ups-can-wind-up-businesses-within-90-days-from-the-day-of-making-an-application (last accessed on 11 Aug 2017)

7 IBEF. (June 2017). Agriculture in India. Retrieved from https://www.ibef.org/industry/agriculture-india.aspx (last accessed on 11 Aug 2017)

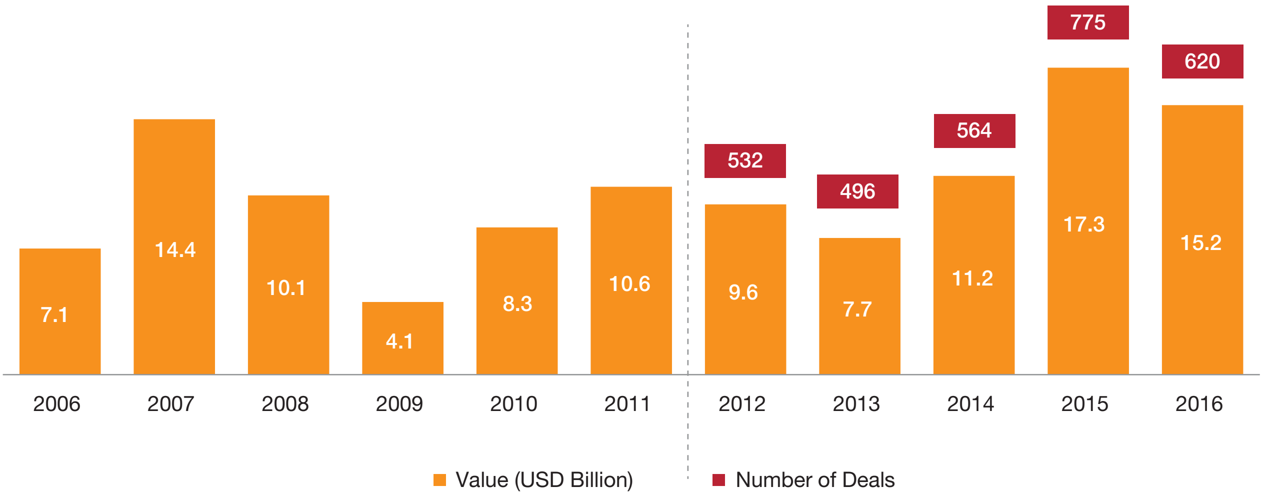
2. History of PE funding

2.1. Overview of PE funding in India

The PE sector in India has evolved over the past two decades, providing an alternative source of financing to small businesses who had limited credit options from banks and other financial institutions. Over the last 15 years, PE firms have invested close to 150 billion USD[8] in the Indian markets. In the past six years alone, from 2011 to 2016, PE firms invested over 70 billion USD, over 6.5 times what corporate India raised via IPO during the same period[9] and equivalent to the 10 years preceding this.

Over the last five years, the economy has witnessed transactions which are strategic in nature and only in high-potential sectors, namely telecom, financial services, microfinance, real estate and IT/ITeS. At their inception in 1994, PE firms barely clocked 200–300 million USD in deals. In contrast, in 2016, the market had touched almost 16 billion USD annually[10].

Most PE firms aim to implement diverse strategies, sometimes taking a majority stake and allowing the investee company's management to conduct day-to-day activities. Other firms take small strategic stakes and provide the capital primarily as growth capital. The most common uses for PE capital are to deepen the existing market, bring in new operational capabilities, augment existing businesses with innovative new age technologies and digital capabilities, and restructure existing debt to keep up with the changing market environment.



Value and volume of PE deals in India

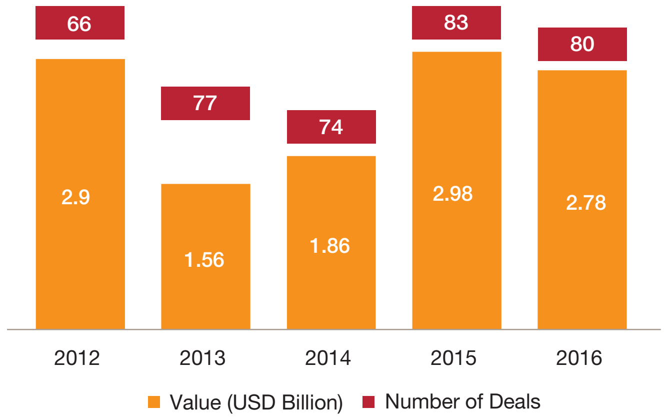
[8] Venture Intelligence. (2017). Indian Private Equity Trend Report 2017. Retrieved from http://www.ventureintelligence.com/downloads/pe-trend-report-2017.pdf (last accessed on 11 Aug 2017)

[9] Venture Intelligence. (2017). Private Equity Impact 2017. Retrieved from http://www.ventureintelligence.com/downloads/pe-impact-2017.pdf (last accessed on 11 Aug 2017)

[10] Puri, M, & Alvares, C. (3 Feb 2017). Powering India's growth. Businessworld. Retrieved from http://businessworld.in/article/Powering-India-s Growth/03-02-2017-112396/ (last accessed on 11 Aug 2017)

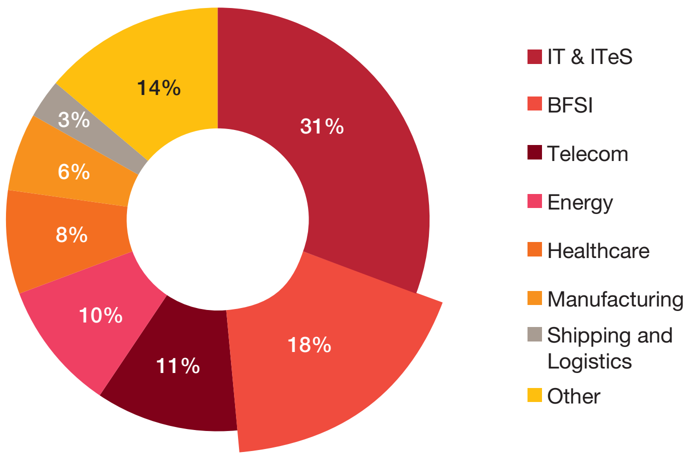
2.2. PE deals: BFSI and MFI

The financial services industry (inclusive of BFSI and MFI) is among the top 5 sectors by both value and volume of deals. Over the last 5–7 years, the sector has witnessed exponential growth due to which there has been a continuous need to raise capital through either the public markets or PE.



BFSI deals (value and volume)

While in 2016, both the value and volume of deals decreased substantially, the proportion of investments through PE in BFSI continued to be on par with investments in previous years (18% of total investments). The decline in investments was a result of the uncertain environment in 2015, driven by investments in many companies which had unproven business models, high unjustified marketing costs and discount-led businesses. This created a more cautious environment among fund managers across sectors in 2016, where the focus was primarily on viable and profitable business models.



BFSI deals made up 18% of the total deals in 2016

2.3. NBFCs and MFIs are riding the consumption boom in India

Changing demographics and low credit penetration have made NBFCs attractive over the last few years. Higher margins and falling interest rates have boosted consumption and therefore borrowings. This makes NBFCs an attractive investment target for PE firms as they ride the credit-fuelled consumption boom.

In 2016 both investments and exits by PE investors hit an all-time high for the MFI sector. The granting of small finance bank (SFB) licences by RBI led to an investment peak of approx. 2500 INR crore across 11 deals[11]. The receipt of licences was a validation of the operating model of NBFC & MFI and their capability to deliver on the field.[12]

Top 10 PE deals among NBFCs and MFIs (2012–2017)[13]

#	Name of Entity (2012 – 2017)	Year of Deal	Value of Deal crores INR	PE Firms	AUM (crore INR)
1	Janalakshmi Financial Services Pvt. Ltd.	2016	~1,365	ORG Enterprises, Morgan Stanley PE Asia, TPG Asia Buyout, GIC, Havells India, Vallabh Roopchand Bhansali	10,500
2	Bandhan Financial Services Ltd.	2015	~1,142	SIDBI, IFC, GIC Pvt Ltd.	6200
3	India Infoline Finance Ltd.	2016	~967	A major private equity firm	17,700
4	Aavas Financiers Ltd.	2016	~905	Kedaara Capital Fund and a major private equity player	1500
5	Spandana Sphoorty Financial Ltd.	2017	~816	JM Financial India Fund , Kedaara Capital Fund ,Ontario Teachers Pension Plan	1320
6	Hero Fincorp Ltd.	2016	~687	A foreign private equity player and ChrysCapital	8000
7	Home First Finance Company Pvt. Ltd.	2017	~650	True North Managers LLP	850
8	Janalakshmi Financial Services Pvt. Ltd.	2014	~490	QRG Enterprises Ltd. , Morgan Stanley Private Equity Asia IV LP , TPG Asia Buyout Fund VI ,Alpha TC Holdings Pte Ltd. , Global Financial Inclusion Fund	2500
9	A newly formed (SFB) in Indiaimf	2015	~454	IFC, CX Partners Fund, Newquest Asia Fund, Elevar Advisors and other major private equity firms	2200
10	Janalakshmi Financial Services Pvt. Ltd.	2013	~371	Citi Venture Capital International Growth Fund II, India Financial Inclusion Fund , Tata Capital Growth Fund , QRG Enterprises Ltd. , Morgan Stanley Private Equity Asia IV LP	1200

In fact, of all the deals in the country, BFSI has emerged as one of the go-to sectors for PE investors, attracting 56% of all PE deals and within BFSI, the NBFC sector garnered over 70% of these deals.

Total PE Investment

1.95

20 deals totalling to
1.95 $ billion across sectors

Financial Sector

56%

56% of the PE deals in
financial sector

NBFC

70%

NBFC attracted 70% of the
financial sector deals in FY 17

[11] PwC analysis – VCEdge

[12] Ray, A. (20 Apr 2016). Firms are now looking to invest in MFIs after RBI awarded small finance bank licenses. Economic Times. Retrieved from http://economictimes.indiatimes.com/industry/banking/finance/banking/firms-are-now-looking-to-invest-in-mfis-after-rbi-awarded-small-finance-bank-licenses/articleshow/51902839.cms (last accessed on 11 Aug 2017)

[13] VCCEdge data

3. PE investments in NBFCs

3.1. Pre deal

With the Indian economy poised to grow at more than 7%,[14] the demand for credit line products like consumer loans, credit cards, housing loans and other financial products like insurance has increased. The total retail asset base as on March, 2017 was 17 trillion INR,[15] growing further at an 18%[16] y-o-y. Some of the product categories which saw a significant volume growth in FY17 are depicted below:

At a time when banks are tightening their purse strings with increasing bad loans, Indian NBFCs are growing their market shares. The total NBFC retail credit along with SME exposure stood at 6.2 trillion INR as on December 2016.[17] Notwithstanding this, the fact that NBFCs are small, their retail portfolio is expected to grow between 16–18%, surpassing that of traditional banks. NBFCs have a certain operating advantage over banks, which helps them scale up effectively across their operations and customer target segments. Effective distribution reach across tier 2, 3 and 4 towns lends them the advantage of reaching out to a larger customer base. Coupled with lower cost, a focused approach on limited credit products and strong underlying risk management capabilities help NBFCs to not only underwrite credit to a targeted set of customers but also to control bad debts, making them one of the attractive sectors for PE funding.

Not enough to satisfy the growing requirements of the growing middle class

Reaching out to the financial need of customers in tier-II & tier – III cities

Addressing customer demand basis the historical behavior

How NBFCs are addressing the issues of Indian consumers

- Better distribution network in tier –II and tier- III cities
- Increase presence by tie-up with commercial centres

- Better customer profiling based on past behaviour
- Reduction of losses due to less NPA

- Faster disbursal of loans through the online channel
- Omni-channel product experience (Online/offline) model

[14] Prasad, S. (29 May 2017). Indian economy likely to grow at 7.2% this fiscal: World Bank. Hindu Business Line. Retrieved from http://www.thehindubusinessline.com/economy/world-bank-pegs-indias-gdp-growth-at-72-in-fy18/article9715141.ece (last accessed on 11 Aug 2017)

[15] PwC analysis

[16] Dhanjal, S. S. (28 Sep 2016). Retail lending NBFCs emerge as a sweet spot for PE investors. Livemint. Retrieved from http://www.livemint.com/Industry/sbuiFnQClwcRJNrKyqR6UO/Retail-lending-NBFCs-emerge-as-a-sweet-spot-for-PE-investors.html (last accessed on 11 Aug 2017)

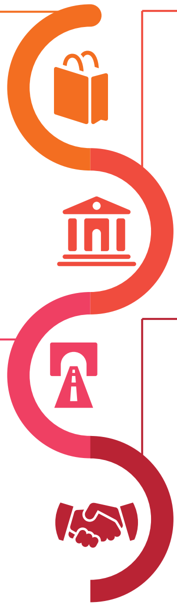
[17] India Infoline News Service. (25 Apr 2017). ICRA: Retail NBFC portfolio growth in FY17 & FY18 to be around 16-18%. Retrieved from http://www.indiainfoline.com/article/news-top-story/icra-view-on-nbfcs-icra-retail-nbfc-portfolio-growth-in-fy17-fy18-to-be-around-16-18-117042500350_1.html (last accessed on 11 Aug 2017)

To contain the current growth momentum, NBFCs will have to focus on four major market sentiments to ride the growth wave and capture the retail/corporate credit market. Some of the key aspects of the four levers are:

Changing Profile of NBFC Customers

Consumer / Personal Lending

- With an increase in disposable income, needs and wants of the customer have increased leading to a higher demand for loan products
- NBFCs have enhanced their operating model and are more accurately profiling their prospective customers thus reducing the rate of default
- This has greatly improved their financial performance, making them more attractive to PE funds



Housing Finance

- Government push to provide “Housing for All“ by 2020 has increased the requirement of houses by 1.87 crores
- In addition, the realty sector in India has been growing at more than 40% Y-o-Y since 2011 and was ~3.8 billion USD in 2016
- Rise in NPAs among banks has reduced their exposure to this sector
- PE firms are funding focussed rural NBFCs who cater to the low and middle income groups

Infrastructure Finance

- Urban development, rural infrastructure and government plans for an expansion of roads and highways to improve connectivity over the next 3 – 5 years has increased the need for loans from NBFCs catering to this sector
- Traditionally banks would provide the funding requirement for these large ticket loans, however given the lower cost of funds PE firms are now a more appealing option

SME Lending

- The SME segment has become prominent over the last few years with a surge in demand for funding
- As compared to banks, NBFCs has better credit assessment models, which are largely driven by their adoption of digital methodologies and a wider distribution network
- NBFCs also focus on regions in the hinterlands which are typically not accessible to formal banking channels

Ways for NBFCs to attract PE funding

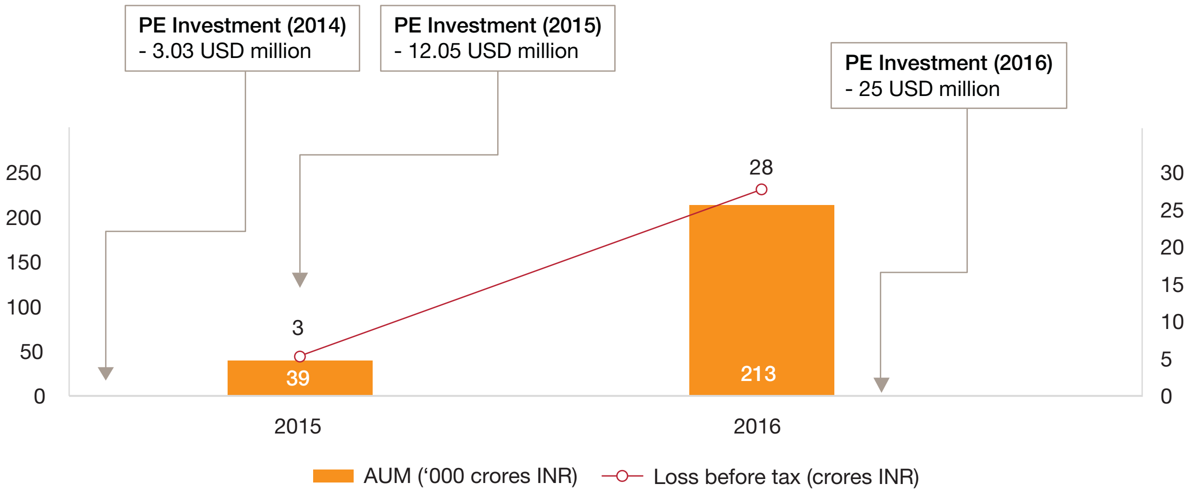
There are several ways for NBFCs to play in the market, making them leaders in their own right. While there is no set formula to attract PE capital, there are certain capabilities that NBFCs need to develop to scale their business while maintaining the overall quality of the loan portfolio. Needless to say, risk management capabilities (to keep bad debts under control) remain the main criteria for any investor to evaluate a NBFC company.

Capabilities	Unique characteristics	Case in point
Distribution reach	• Larger distribution network – targeting tier 2, 3 and 4 cities • Distribution of loan across several customer touchpoints • Omnichannel experience – combining the 24x7 availability of online channels to the offline branch and motor channel	• A large MFI player turned bank had presence in 250 districts, of which 175 were technically unbanked • A captive NBFC had distribution across 850 cities with more than 2000 touchpoints • A certain NBFC partnered with a regional bank to distribute products across tier 3 and 4 cities
Customer segments	• Targeted focus on a specific customer segment • Profiling customers on the basis of their lifestyle, needs and demands	• A NBFC targeted the daily labour (and often in groups) to distribute loan, each acting as the guarantor for the other • Another NBFC collaborated with online ecommerce firms to provide loans to online sellers / retailers • Another target were the self employed MSME entrepreneurs who had availed and repaid a 2-wheeler loan
Products	• Customized products catering to the unique characteristics of the customer segment • Variants of the products in line with the cyclical nature of business of MSME and SMEs • Targeted focus on limited line (or often monoline) set of products	• Certain NBFCs distribute loans to meet medical exigencies • An online only NBFC created products with varying repayment cycle in line with the seasonality of the SME business operations • A NBFC, through a monoline product, garnrned substantial scale and a thorough understanding of the market and its customers
Price	• Non standardized pricing of the products – in line with customer profiling • Low cost of operations and enhanced risk measures • Multiple sources of funds to optimize product pricing	• A NBFC priced its products in line with the amount sanctioned and disbursed • Another NBFC leveraged the distribution arm of a partner keeping its branch cost low to price product more efficiently • Customers with previous history with the NBFC are provided subsequent loan at a lesser ROI than the rack rates of the NBFC

Spotlight: Capital Float

***Capital Float:** The new-age NBFC Capital Float is an online lending platform specifically catering to SMEs. The company has some key differentiating features relating to its product offerings. If prides itself on product innovation and a suite of products which are optimised to suit the client's specific needs (Merchant Cash Advance, Online Seller Finance, Pay Later, Invoice Finance). The minimum loan on the platform starts at 50,000 INR and can go up to 1 crore INR with an interest rate which is between 15–20%. The borrowers are geographically spread across 100 cities, with a major portion of them being in Tier II and Tier III cities.*

Capital Float performance



Key developments:

2012-2014: Developing customer behavioral profiling tools

- Capital Float focused on analytical product development focused on SME financing and working capital as a product

2014-2015: Increased focus on e-commerce financing

- Introduction of a syndicate market place loan product. Loan disbursal through the market place model with syndication across sellers.
- Total number of disbursements was 180 and total assets of 39 crore INR

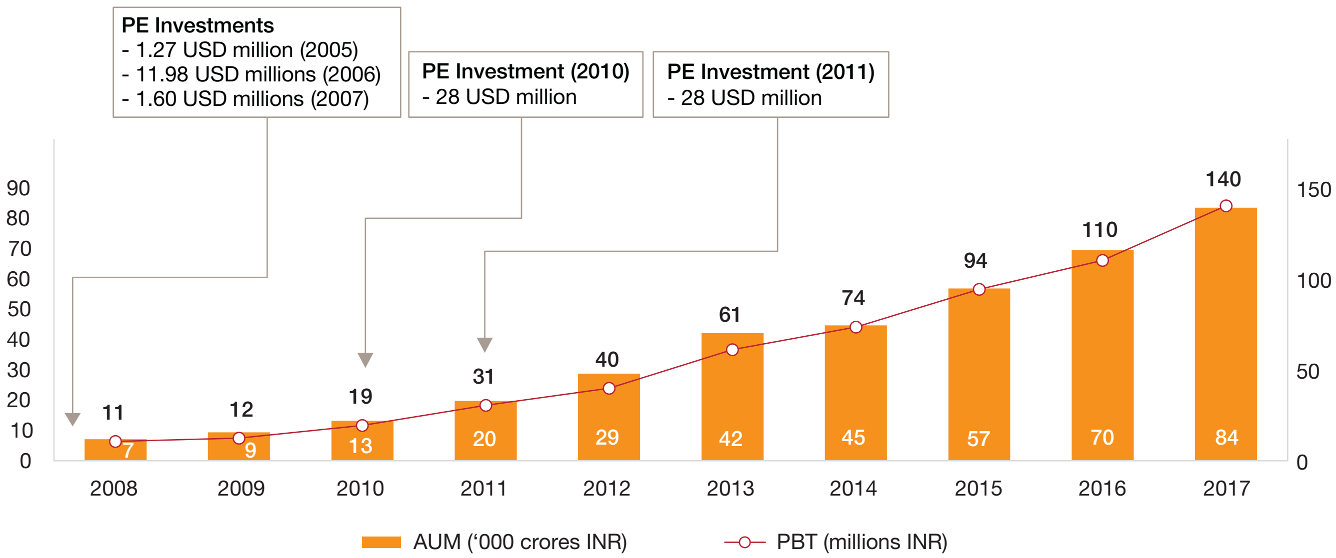
2015 onwards: Introduction of special products for private cab drivers

- Company increased focus on providing loans to sellers on e commerce platforms
- Capital Float also tied up with the driver platform like Uber to provide loans for buying taxis.
- Total asset under maintenance increased to 213 crore INR

Spotlight: Dewan Housing Finance Corp. Ltd.

DHFL is a leader in the home finance segment in India. They offer housing solutions, insurance and fixed deposit schemes. The offer their products across around 350 locations and have a total AUM of about 84,000 crore INR (FY17). In an effort to participate in the financial inclusion and 'Housing for All' initiatives of the government, the company has begun to focus on the LIG and EWS sections of society. In addition, strategic investments have been made in futuristic technologies like AI, predictive analytics, bot-based customer services and mobile apps to cater to the ever-changing needs of the digital customer.

DHFL Performance



Key developments:

2005-2008: Consistent growth of housing credit demand

- Setup of the Aadhar Housing Finance in collaboration with International Finance Corporation (IFC)
- Increase presence in North, Eastern and North-Eastern parts of India via tie ups with public sector banks
- Focusing on the new target of customer - entrepreneur and small traders
- Development of a model to evaluate the credit performance and behavioural trends
- Variety of home loan products offered to the low/middle group of customers

2008-2010: Diversifying product portfolio

- Commercial lease loans offerings to business units
- DHFL acquired stake in First Blue HFC focused on upper middle class customers -subsidiary of Deutsche Postbank Ag

2010 onwards: Venturing into SME loans and medical equipment loans

- DHFL JV with Prudential Financial Inc., 50 % stake bought of DLF Pramerica life insurance company
- Launch of products such as medical equipment loans, plant & machinery loans and property term loans for the SME clients
- Commissioned over 100 branches in tier II and tier III cities
- Launch of pay-nimo platform for online payment of loans post demonetization with in 20 days

3.2. Valuation

Stages of valuation

The valuation and amount raised by a NBFC depends on the stage at which it is raising funds. There are five different stages during which a NBFC reaches out to external investors to raise capital. Typically, the investor would want the NBFC to reach a certain size and scale and also demonstrate its capability to manage growth in book size alongside the overall quality of the lending portfolio. Consequently, book size and proportion of bad loans (or NPAs) play a primary role in deciding the valuation of the firm.

The key stages of funding have been depicted below:

Pre-Seeding Funding	Seed Funding	Early Stage Investment	Later Stage Investment	Mezzanine Financing
• Initial Capital that is used for founding the company • Difficult to get any institutional investor on-boarded at this stage due to a lack of track record or business breakeven • Investment is used to set up the basis business requirements for fulfilling the first sales orders • This form of funding is typically not applicable for NBFC's – usually backed by owner/self - capital	• Often provided by Angel investors • Usually structured as convertible notes or common stock • Investment is used primarily to grow the business and gain proof of concept to attract institutional investors in the future	• Series A: First stage of institutional investment; funds are typically used to enhance products / services, improve marketing efforts and operational efficiencies • Series B funding is usually a higher investment used for supporting businesses for around 1 – 2 years	• Series C & D: these later stage of investments usually constitute of multiple institutional investments and the volume of investment range from 32.5 – 130 crores INR	• Is the capital provided by the private equity ventures in the form of debt, equity or a convertible note just prior to the initial public offering • The investment at this stage is generally less risky as the company is expected to be solid and it is easy to "cash out"
	• Creditmate, an online lender focused in two-wheeler market • Seed Funding: ~3.3 crores INR	• LendingKart aims to make working capital finance available at the fingertips of entrepreneurs • Series B: ~ 205 crores INR	• Vistaar has credit methodology to undertake cash flow based assessment of MSEMs • Series C: ~ 160 crores INR	• MAS Financials specialized in micro-enterprise loans • Mezzanine Finance of ~40 crores INR

PwC analysis

While book size and quality are important factors in the valuation of a NBFC, there are other financial and non-financial parameters that investors consider. Some of them are:

Primary considerations

- **AUM –** This is the loan portfolio book size giving early indications into the size of the market the NBFC. With retail credit demand growing at 18%, the growth rate of the AUM for NBFC should be in the rage of 15-20% (y-o-y). AUM in NBFC not to be concentrated geographically and product wise. A major NBFC with recent PE investment has started expanding its distribution and diversifying its AUM away from the home state.

- **NPA –** This shows the understanding the company has got of the target customer segment and how robust are the risk management capabilities are of the NBFC in managing its loan book (either through underwriting credit or through collections/recovery mechanism). A lower NPA provides the platform to grow exponentially through slightly more risky bets. The NPA for all NBFC with PE investment across asset classes are <1%. With better customer profiling technology, NBFC are facing lesser defaults. One of the major NBFC has a collection trend of >99% across asset classes.

Financial considerations

- **RoA –** This explains the overall efficiency of the NBFC in managing its operations and its ability to make a profit from its current loan portfolio. ROA depends on the product mix of NBFC. From past deals, for NBFC with consumer and housing loan focus have had ROA in the rage of 1-2%, whereas for NBFC with more SME focus with PE deals have had higher ROA of around 3-4%. ROA also depends on the NIM margin of the NBFC and the product segment.

- **RoE –** Delivering higher RoE would mean lesser capital for business growth in NBFC which is un-desirable. Nonetheless, a ROE >10% at least is expected from any NBFCs to attract a PE investment. Past PE deals have been successfully done in NBFC with ROE as high as 29% and as low as 10-12%. Higher ROE guarantee bigger return for the PE entity

- **Capital adequacy –** NBFC are prescribed to have at least 15% capital adequacy across asset classes. The past deals have all indicated, PE investors looks for higher capital adequacy of around ~17-18% for NBFC
- **NIM –** This parameter helps in gauging the average interest income generated from the outstanding assets. Historically, NBFC with PE investment have had an NIM of ~10% across assets classes(retail and corporate). Product wise, Housing loans are expected to have an NIM ~4% and SME ~ 5-7%

Non-financial considerations

- **Management –** Management plays an important in adapting the NBFC to dynamic market environments and to use external conditions to their advantage. Successful executing an idea, no matter how adverse the situation, depends primarily on the management capabilities
- **Governance –** The NBFC's ownership structure has a bearing on how governance is implemented. Transparent governance with adequate safeguards is essential to the success of a NBFC
- **Future prospects –** This is growth potential of the market that the NBFC is operating is in. Typically, NBFC operating in markets with higher growth potential or in line evolving market dynamics tends to be of higher preference of investors vis-à-vis other NBFCs.

3.3. Post deal

PE firms are giving companies the opportunity to scale their businesses at a lower cost of funds. The ultimate goal for the PE firm is to maximise returns on its investment and prepare the NBFC for future sale. To ensure that it is able to maximise profits, representatives from the PE firm may take board seats. The firm might consider shuffling senior management and it provides advice, support and introductions relating to operations, strategy and financial management.

#	Name of organisation	Board of Directors representation	Level of involvement in the NBFC
1	Shriram Transport Finance	Puneet Bhatia (MD of TPG Capital and Country Head – India for TPG's Asian Business	Non-Executive & Non-Independent Director
2	Magma Fincorp	Sanjay Nayar – CEO and Country Head of KKR, India	Non-Independent Director
3	L&T Finance	Ashish Kotecha – Operating Partner with Bain Capital	Non-Executive Director
4	IIFL Finance	C Ratnaswami – Managing Director of Hamblin Watsa Investment Council Ltd.	Non-Executive Director
5	Hero Fincorp	Mr. Kukreja – MD of ChrysCapital	Leads the Business Services, Financial Services and Manufacturing sectors of the firm

This strategy is beneficial to NBFCs as they are able to leverage a PE firm's experience to expand into new markets, improve operational efficiencies, develop new products and services, innovate, and digitise and enhance the corporate governance of their company by including key stakeholders from the PE firm in their board and management teams.

- Introduce a new line of business / extend current product offering
- Omni channel presence
- Expand into new locations
- Develop differentiated capabilities and service offerings for customers
- Relationship based pricing model
- Increase penetration with new customer segments

Growth and Scale

- Digitization of end-to-end loan process
- Acquire specific digital assets to attract different customer segments (personalization, chat bots, machine learning, voice recognition)
- Invest in strategic partnerships – fintech companies to enhance sales effectiveness & expand channel reach
- Technology upgradations

Innovation and Technology

- Robotic process automation – reduce manual interventions
- Standardization and improvement of processes across products
- Improving the value derived from resources – improving productivity and efficiency
- Reduce turnaround time – improve customer satisfaction and retention levels

Operational Efficiency

Spotlight: Shriram Transport

Post-deal strategy and utilisation of funds

The Shriram Group is an undisputed destination for private equity investors. The company hosts a diversified portfolio of products and it is the leader in the commercial vehicle financing and refinancing space. However, its core business has remained commercial vehicle financing within which it has maintained a near monopoly in the under-served markets of semi-urban and rural India. Over the years the company has acquired a dominant market share in sectors where banks and other financial institutions have had limited reach or offerings. It has held a constant market share of over 25% for the last 10 years, specifically in the segment of 5 -12 year old track financing and about 75% of its portfolio consists of used vehicles finance [18].

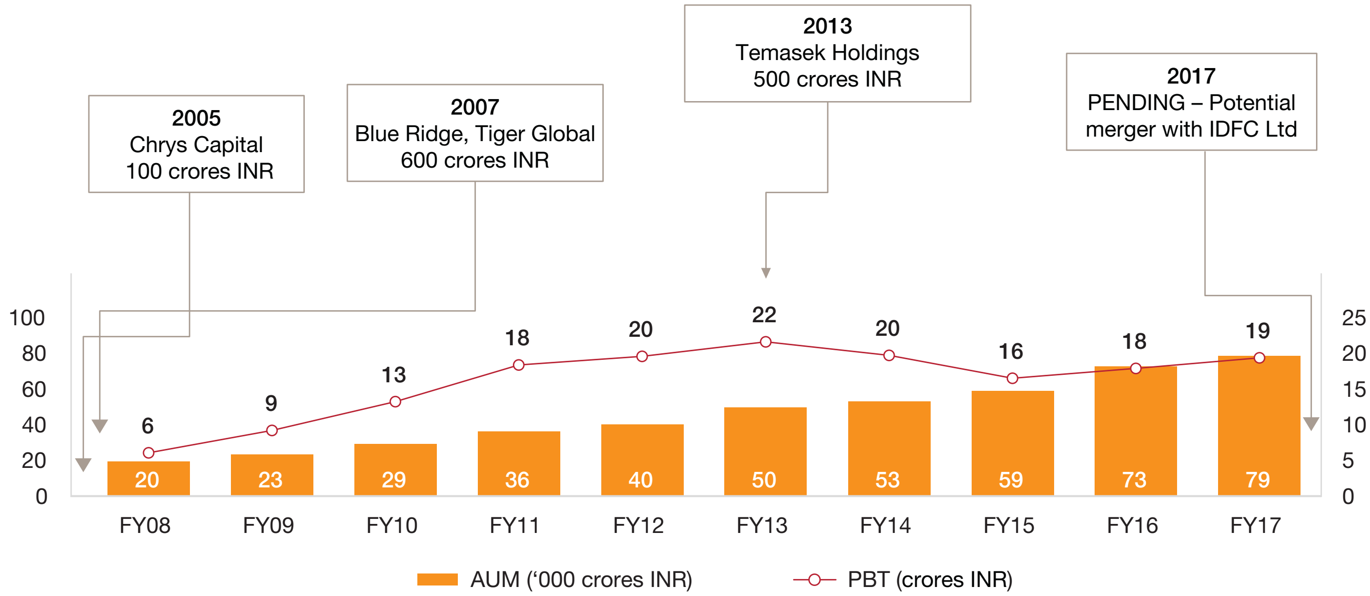
Small secrets of their huge success

- **Know your customer:** Shriram leverages their local market know-how to enhance their market share. Their field officers know the customers' specific needs. The company has a structure in place wherein the field officer acquiring the customer is responsible for collections as well
- **Profit is only a yardstick, not a goal:** Shriram is community run business – serving the community and its customers is of utmost importance to the company's success. Profitability is simply a measure to find out how well the company is servicing the community. Higher satisfaction levels drive high profitability
- **Private equity is a driver of disruption:** Shriram has had some of the largest PE firms invest in it over the last decade. The contribution from these firms was substantial and a key driver for innovation and disruption in the firm. Innovative initiatives have propelled the business further and given the PE firms returns which have ranked among the most successful in the last 15 years

[18] Shriram Transport Finance annual report and investor presentation

TPG Capital 7x returns

Chrys Capital 10x returns



Key developments:

2005–2009: Consistent track record and high growth potential has attracted PE firms to infuse growth capital

- Expanded reach & customer base (0.6 million)
- Created a steady clientele in truck finance (7–8% market share)
- Increase in repeat business and cross-sell other products
- Leveraged the pre-owned CV market – largest asset finance NBFC (20–25% market share)
- Automall initiative – Buying and selling platform for pre-owned CVs

2010–2013: PE investments have helped to enhance reach without significant investments in building infrastructure

- In 2012, AUM crossed 40,000 crore INR
- Consolidation of operations
- Foray into the deeper parts of rural India
- Using technology as a differentiator – invested in replicating access of key information on mobile platforms for both customers and field officers; were successful in reducing overall TAT
- Shriram New Look – Empowers vehicle owners to transact by correcting maintenance issues

2014–2017: Potential merger with IDFC Bank will enable them to provide their customers a one stop shop for all their FS needs

- Further expansion into low income states and expand its base to the bottom of the pyramid
- 1.4 million customer as of December 2016 and AUM crossed 79,000 crore INR
- Discussion of a potential merger with IDFC will create an organization which is built for longevity over the next several decades
- The merger will enable them to provide a whole range of financial services to their customers

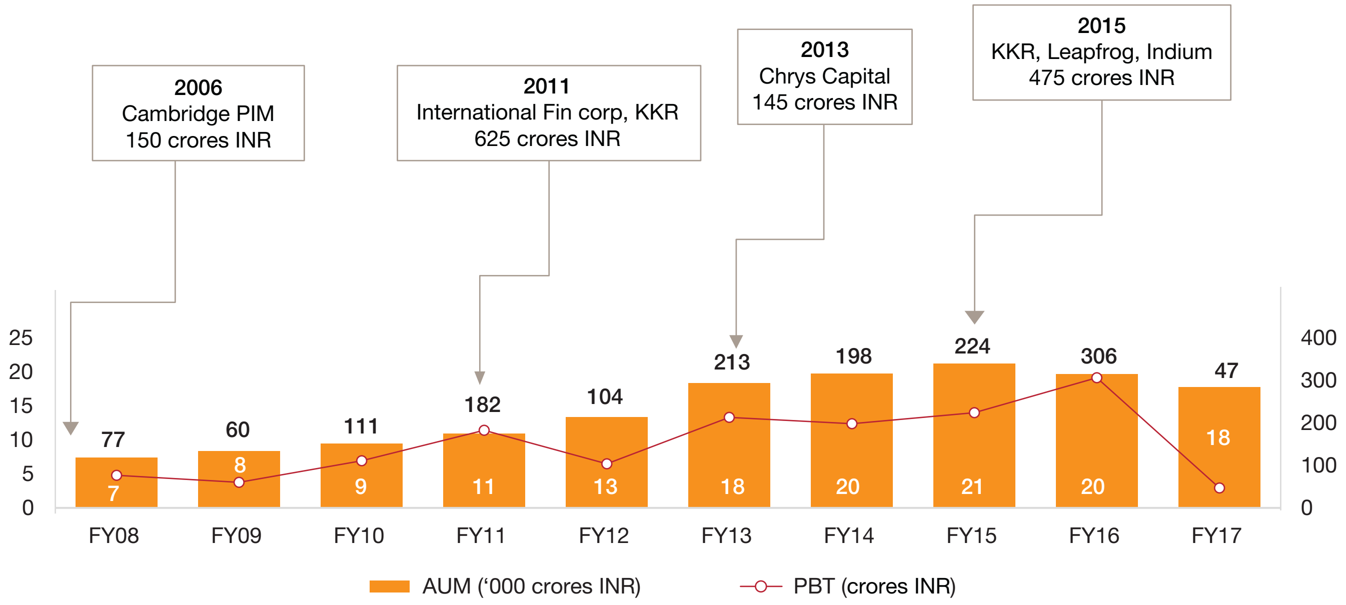
Spotlight: Magma Fincorp

Magma Fincorp has attracted several rounds of investment from top PE firms over the last decade. The company carefully selects partners who are believers in the India growth story and have confidence in Magma's unique business model which is driven by building strong, sustainable customer relationships in rural and semi-rural India. PE investors are providers of long-term capital that have helped Magma to scale and achieve the next level of growth. Magma has successfully invested these resources to increase its branch network and diversify its portfolio. It not only provides loan products but also has strategic tie-ups with general insurance companies to provide strategic bundles to its customer and satisfy all their financial needs [19].

Driving execution to excellence

- **Vertically aligned business model:** The company structure is made up of product wise verticals (Asset finance, Mortgage finance and General Insurance), collections vertical driven by customer behaviours and integrators which include marketing, risk management, people and operations
- **Customer-centric approach:** Business structure is aligned to specialize in catering to a customer's specific needs, with design and development of products based on customer feedback
- **Pan India presence:** 297 branches in 22 states; hub and spoke model with wide coverage enabling sourcing from 1,900 talukas and 2,900 locations
- Marquee sponsors and investors include IFC, Chrys Capital, Leapfrog and a leading PE firm in India

[19] Magma Fincorp annual reports and investor presentations



Key developments:

2005–2009: Capital infusion from PE reduced the firm's financial constraints and helped them achieve their business goals

- Became a universal financial services company by offering its customers a wider range of products and services
- Expanded reach to all undeserved markets and gained a first mover advantage in several locations
- Operational efficiencies – improved overall processes, upgraded technology and underwriting methodologies
- Launched new lines of business – SME loans for working capital requirements

2010–2013: PE investments have enabled the company to scale up its technology initiatives and increase reach across Pan India

- Expansion into other financial services – insurance JV in FY10
- Expanded reach by increasing number of branches and entering into new partnerships with dealerships
- Technology initiatives included enabling pan India Collection with mobile handheld device based application which helped to improved customer experience and productivity with better control on payments

2014–2017: Focus on diversification into new businesses and promoting sustainable finance as a key pillar of future growth

- Shift of focus to consolidation of businesses
- Expansion into housing finance in FY14 – integration with GE Capital; in FY17 entered into affordable housing finance
- Technology initiatives with higher levels of automation; cross sell lead management systems
- Higher level of branch network utilization has resulted in increased operational efficiency

3.4. Road to IPO

An initial public offering (IPO) or a sale essentially reinforces the management's ability to successfully run a company and allows existing investors to make a return on their investment. There have been multiple IPOs by NBFC (see table below for a select few) which have not only raised capital for the firm (and bolstered their overall capital adequacy) but also provided handsome returns to their investors.

Factors for an NBFC to consider while preparing for an IPO

While preparing for an IPO, NBFC should consider the following to increase their overall prospects for a successful share sale:

Higher transparency and better disclosure: With an upcoming IPO, the asset quality of NBFCs is expected to be in line with industry norms. While the overall rating of the company is important in order for it to raise debt capital, several firms have gone to the extent of getting their loan portfolio rated and made the information publically available. Bringing additional transparency in the overall asset pool of the firms helps build extra trust in the mind of the general public.

NPA: Controlling bad debts is a key measure of success for any NBFC. After receiving PE funding, a major NBFC has invested in technology to analyse customer's past loan payment data and understand customer loan capacity. This enhances loan payment and reduces defaults across customers.

Creating niche customer segments: Another area that NBFCs should concentrate on is creating a niche market for themselves. A major NBFC has conducted customer interviews and developed a three-stage approach—namely initiating savings habits, deploying credit and starting a small enterprise of its own. It has developed products to cater to all life stages of bottom of the pyramid customers.

Reasons for an IPO

Increasing availability of capital: One of the primary objectives of an IPO is to raise additional capital to either expand current it's business and go deeper within the market or to enter a new line of business. In the past, several companies that raised capital from the public have used it to expand their geographical distribution in order to offer their services to a larger section of population.

Refinancing the existing source of capital: The proceeds from an IPO would give an NBFC the option to re-finance the costly debt from banks and also reduce exposure to non-convertible debentures (NCDs) and other sources of financing.

Providing an exit opportunity to existing investors: An IPO is typically an exit option for PE investors who stay invested in a firm for 3–7 years.

Reducing foreign holdings: Sometimes, an IPO is a way to meet regulatory requirements. The requirements could either be in the form of foreign holding in the company or promoter holding. Liquidation of existing shareholders or issuance of new securities helps the company to be well within the regulatory norms.

PE advantage

PE funds help business owners continue their winning ways with funding for acquisitions, new product line development and geographic expansion. For example, with the recent PE investment Hero FinCorp is looking to increase the overall asset base to 35,000 crores INR by 2020 by branch expansion and new product development. PE investments also ensure management participation through either an executive role or a day-to-day operations, bringing considerable experience across sectors and thus providing valuable inputs in order to grow the business.

These enablers of PE investment boosts public sentiments and increases prospects during the IPO stage.

Successful exits through IPOs in the NBFC space

#	Name of Company	Year of IPO	Company valuation (at time of IPO)	PE Investors and their exit multiples	Comments
1	AU Finance	2017	~10,000 crore INR [20]	• A leading PE firm (10x) • IFC (16x) • ChrysCapital (7x) • Ourea Holdings (4x) • Kedaara Capital (4x)	• The PE firms have sold 33% of their pre-IPO stake • Leading PE firm sold the highest share at 5%
2	A leading NBFC which has been recently converted to a Small Finance Bank • Previously MFI & NBFC for Commercial Vehicle loans and Home loans • SFB since Sept 2015 • Primary focus is on the under-served borrower segment	2016	~3,700 crore INR	• IFC (2.5x) • Leading PE fund (2.3x) • CLSA Capital (2.3x) • FMO(2.2x) • Hellon Ventures (3.1x) • Aquarius (2.5x) • Aavishkar Goodwell (13.5x) • Indian PE Fund (2.3x) • India Financial Inclusion (4.5x) • Creation Investments (4.2x) • MicroVentures (1.6x)	• Between 2007 – 2014 the company received 11 rounds of funding worth ~1,300 crore INR • 2,200 crore INR raised through IPO
3	PNB Housing • The total loan book at the time of IPO was 15,000 crores INR	2009	~13,000 crore INR	• Carlyle (22x)	• Carlyle bought the stake from Destimoney in 2015 • (49%) – it continues to hold its stake in the company post-IPO • Through the proceeds of the sale (~3,000 crore INR) to augment loan book both in the retail and corporate segment with a focus on affordable housing finance

[20] Doshi, A. (19 June 2017). PE-backed AU small finance bank eyeing $1.6 bn valuation via IPO. Retrieved from https://www.vccircle.com/pe-backed-au-small-finance-bank-eyeing-1-6-bn-valuation-via-ipo/ (last accessed on 11 Aug 2017)

4. Regulatory impact

4.1. NBFC regulations in India

In India, NBFCs operate under one of the following seven categories.. The regulatory requirement for each of the categories differs because of the specific purpose of the categorisation of the NBFC

MFI

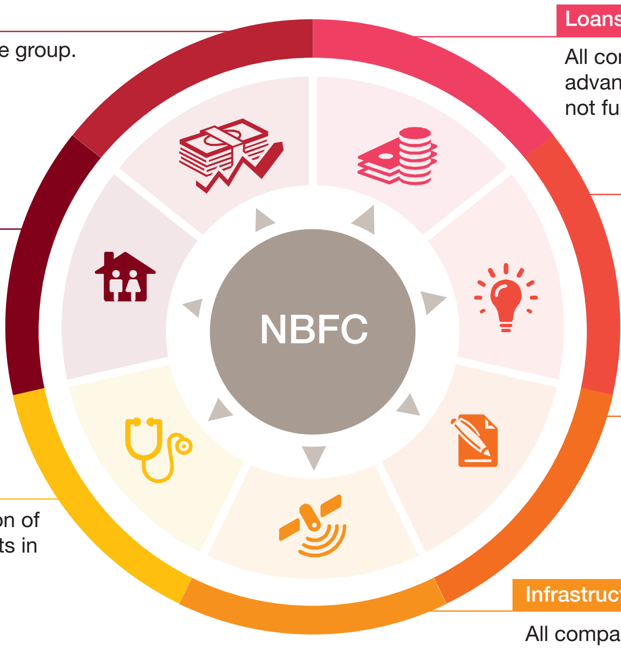
Financial services to the low income group. They are majorly focused on group lending activities

NBFC-MFI

All companies with at least 85% of assets to rural houseold, loan disbursed not more than 50K etc.

Core Investment

All companies involved in acquisition of shares and securities. 90% of assets in equity, debts in group companies.



Loans

All companies involved in making loans and advances other than asset financing and not funding its own loans

Investments

All companies involved in acquisition of securities as primary business

Asset Finance

All companies involved in the financing of physical assets for supporting the economic activity. Automobiles, tractors etc.

Infrastructure Finance

All companies deploying at least 75% of the loans in infrastructure financing.

NBFCs have been observed to consistently outperform the banks in terms of NPAs and credit ratings of the portfolio. Like traditional banks, NBFCs are in many ways regulated—in terms of capital adequacy rules, NPA norms and fair practice code. Nonetheless, there are a few differences in the way NBFCs are regulated:

Parameter	Banks	NBFCs	Comments
Core capital adequacy requirement	9%	• Phase I: 7.5%; • Phase II: 10%[21]	• NBFC-ND-SI* and NBFC-D# would have to comply with Tier I capital norms in a phased manner. CRAR Minimum would be 15% (Tier I and Tier II Capital) • Phase I deadline – March 2016; Phase II deadline – March 2017
Definition of NPAs	Non- payment for 90 days	• Non-payment for 90 days	• Sub-standard asset (NPA for a period not exceeding 18 months versus 12 months), and doubtful asset (NPA for a period not exceeding 18 months versus 12 months)
Capital requirement	500 crores INR	• 2–5 crores INR	• Equity investment by foreign entity in private banks is restricted to 74% and 20% for public sector banks

(*) – NBFC – Non deposit taking – Systematically important (asset size > 500 crore INR); (#) – NBFC – Deposit taking

[21] RBI. (1 Sep 2016). Master Direction - Non-Banking Financial Company –Non-Systemically. Important Non-Deposit taking Company (Reserve Bank) Directions, 2016. Retrieved from https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MD44NSIND2E910DD1FBBB471D8CB2E6F4F424F8FF.PDF (last accessed on 11 Aug 2017)

4.2. NBFC equity funding

NBFCs in India are majorly non-deposit taking; thus, there is a requirement for capital across all players. The fulfilment of the funding requirement is done through one of the following methods:

Wholesale Funding

Wholesale funding refers to funds borrowed by corporations, in high amounts, through financial institutions

Bank Funding

Bank provide financial assistance in the form of Working Capital Limit and Term Loans to Non-Banking Finance Companies (NBFCs)

Refinance Apex Inst.

Apex institutions in India providing financing to NBFC for financing agricultural and rural sectors

ECB Borrowings

- ECB Borrowings are loans made in India by foreign lenders in rupee or a foreign currency.
- ECB (Rupee) restricted to certain institutions.
- ECB (Non-rupee) linked to size and capacity to absorb foreign currency risk

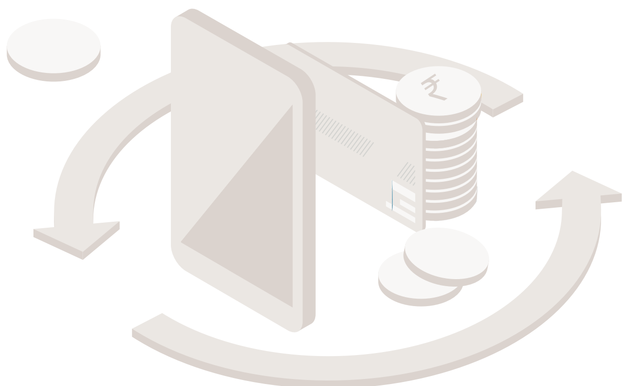
Equity Funding

- Equity financing is the process of raising capital through the sale of shares in an enterprise
- NBFC now free to raise 100% FDI through equity

The equity funding norms for NBFCs in India have recently undergone a change, leading to the opening up of the sector to foreign investments. Earlier, the limits of automatic foreign direct investment (FDI) in NBFCs were linked to the capitalisation of the firm along with the categorisation of the activity of the company. Previously, only 18 categories of activities were considered eligible for foreign equity investment.

These capitalisation requirements were difficult to meet owing to the tepid demand and interest in the domestic equity market. Thus, NBFCs had to suffer from a lack of funds, leading to an increase in the pricing of the products.

Recently, the government has liberalised the FDI norms for NBFCs and allowed 100%[22] FDI through the automatic route in 'other financial services' for all NBFCs operating under any of the regulators—RBI, SEBI, National Housing Bank (NHB), etc. The amendment to the Foreign Exchange Management (Transfer or Issue of Security by the Person Resident outside India) regulations on NBFCs will enable inflow of foreign investment into 'other financial services'. Further, minimum capitalisation norms as mandated under the FDI policy have been eliminated as most of the regulators have already fixed minimum capitalisation norms. This will induce FDI and spurt economic activity. These norms will cover all of India and are not limited to any state/district.



For NBFCs operating in financial services activities which are not regulated or partly regulated by any financial sector regulator or where there is lack of clarity regarding regulatory oversight, foreign investment will be allowed up to 100% under the government approval route.

[22] RBI. (20 Oct 2016). Foreign investment in Other Financial Services. https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=10650&Mode=0 (last accessed on 11 Aug 2017)

5. Conclusion

Future of NBFCs

Recently, the BFSI industry in India has witnessed rapid consolidation, especially among banks and insurance companies. As there are several players in each sector and competition is fierce, consolidation is an inevitable choice, as the stronger players are able to sustain and grow their market share, while the weaker ones are forced to either exit or be acquired.

NBFCs are typically not an attractive option for consolidation as compared to their banking competitors as they have higher valuation multiples and market capitalisation to lending book ratios.[23] Having said that, between March 2014 and July 2017, the number of non-deposit taking NBFCs has reduced by 5%[24] largely due to consolidation, a trend expected to accelerate in the future. With the emergence of new technologies in the form of FinTech players and a deterioration in asset quality, organic growth seems to be an uphill task. This leaves NBFCs with the option of a merger or acquisition.

Inorganic growth will enable NBFCs to become one-stop shops for all their customers' needs, especially in the rural parts of the country, where formal banking channels are not easily accessible. This will also benefit the acquiring bank, which is able to expand to new locations and new product lines without much investment or region-specific knowledge. Shriram's proposed merger with a leading NBFC in June 2017 is one such example. This merger would enable access to a leading NBFC company to get into transport finance (Shriram has the largest market share in the country) and get access to Shriram's extensive distribution network.

Similarly, Kotak Bank's acquisition of BSS Microfinance and IIFL's acquisition of Samasta Microfinance, allowed both entities to seamlessly enter into a new market (microfinance) and address the financial inclusion initiative of the GOI.

Consolidation remains an important theme in India. Given the size of the country, PE firms are looking to invest in NBFCs which can build scale. Scale provides cost reduction opportunities, market access and operational efficiencies, which then give PE firms higher returns when they monetise their stakes. Consolidation of smaller NBFCs will therefore become an attractive target for PE firms in the future as they will have the opportunity to demonstrate a successful exit with substantial multiples.

The NBFC sector has been witnessing renewed interest from PE firms since the turn of the decade. From being a marginal player in the financing industry, it has come a long way and contributes around 30%[25] of total retail credit in India today. Backed by their niche monoline models and focused approach towards cost, credit and segment penetration, NBFCs have consistently sustained higher margins and better returns, leading to a record number of deals being clinched in the industry. As noted earlier, over 70% of all BFSI investments have been targeted towards this sector. Given the sweet spot they currently find themselves in and with the overall positive sentiment in the economy, the onus is clearly on the NBFCs to keep pace with new technologies and changing customer aspirations, and to continue bolstering their distinct capabilities to attract timely PE investments.

[23] Chokkalingam, G. (11 July 2017). Consolidation in BFSI: Focus to be more on banks rather than on NBFCs. DNA India. Retrieved from http://www.dnaindia.com/business/column-consolidation-in-bfsi-focus-to-be-more-on-banks-rather-than-on-nbfcs-2497758 (last accessed on 11 Aug 2017)

[24] Dun & Bradstreet. (2016). India's Leading BFSI Companies 2016. Retrieved from http://www.dnb.co.in/Publications/IndiasLeadingBFSICompanies_2016/NBFCs&FIs.asp (last accessed on 11 Aug 2017)

[25] India Infoline. (2017). ICRA: Retail NBFC portfolio growth in FY17 & FY18 to be around 16-18%. Retrieved from http://www.indiainfoline.com/article/news-top-story/icra-view-on-nbfcs-icra-retail-nbfc-portfolio-growth-in-fy17-fy18-to-be-around-16-18-117042500350_1.html (last accessed on 16 Aug 2017)

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The Knowledge Architect Of Corporate India

Evolution Of Value Creator

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'.

ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/Associations spread all over the country.

Vision

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

Mission

As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

Members – Our Strength

ASSOCHAM represents the interests of more than 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

Currently, ASSOCHAM has more than 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Mergers & Acquisitions, Tourism, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Competency Building & Skill Development to mention a few.

Insight Into 'New Business Models'

ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India's Development, Infrastructure Development for enhancing India's Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India's Transformation.

ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin: Indian Merchant's Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

D. S. Rawat
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The Associated Chambers of Commerce and Industry of India

As a representative organ of corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment to foster a balanced economic, industrial and social development. We believe education, IT, BT, health, corporate social responsibility (CSR) and environment to be the critical success factors.

ASSOCHAM represents the interests of more than 450,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a chamber with a difference.

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About PwC

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In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

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