Conversion of NBFC's in to banks in Indian prospective.

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Abstract: *With growing pace of life and shortage of time youths' try to save each second. Their curiosity to have funds easily at short notice to shape or give final touch to their ideas is also rising.So to raise the spanner of raising funds raising means, the government has initiated the RBI draft guidelines as on august 2010, which encloses the laws and regulations that would govern NBFC's conversion in to banks. The main motive behind this is the consolidation and the convergence of financial systems globally.*

In this study I have made an effort to know the perception of the managers towards this suggestion. That whether this initiative would be a success or failure. Abreast what should be the minimum capital requirements and lock in period for such NBFC's. Therespondents (managerial cadre persons) for this aretaken from both public and private banks located in Jalandhar and Ludhiana locality of Punjab.

I. Introduction
NBFC's in India

The NBFC's have a phenomenal role to play in Indian economy to have sound sources of funding. Sharing the broadening of financial services role they have come near to the banking system in meeting the shocks of economy. Having larger portfolio of products, they also improves the return prospects.as per FICCI data NBFC's have accounted for 10.5% of population only from top metros (Delhi, Haryana, Mumbai, Chennai, Kolkata, & Bangalore), who consumed 61% of bank credit in 2006-2007. near about 70% of Indian population is using NBFC's as means to raise funds.
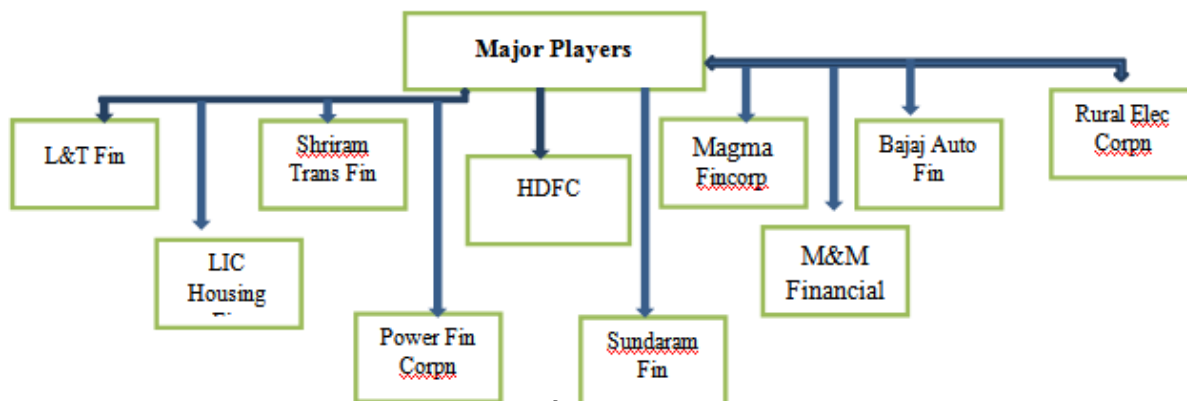
Meaning

NBFC's is a company that is licensed by the commission to engage in business categories as elaborated in its MOA & AOA, it includes:
- asset management company
- discount house
- housing finance company
- investment adviser
- investment finance company
- leasing company

&

such others as federal government may by notification in official gazette specify.

II. Literature review
Literature Review is the study of the various papers, articles, and project that have been done in the past to on the same topic NBFCS CONVERSION IN TO BANKS done in the past years. The data for this purpose has been collected from articles in the newspapers, papers on entry of NBFCs in to the banking sector presented by financial advisors and different banking institutions & articles in the Indian banker journal.

Krishnamurthy.S (2003) analysed that Kotak Mahindra getting of license to operate as a NBFC has led to an initiative in direction of NBFC's conversion in to banks**.** Now, other large profitable NBFCs such as Sundaram Finance, Ashok Leyland Finance and Cholamandalam Finance should try to avail this option in future for competition sake. Though the initial cost would be high as there higher capital requirements.

Sridhar.R (2006) reviewed that mostly NBFC's target niches. As they are oriented towards customers and try to keep the cost low, sothey can be targeted to tap unbanked areas also. He exemplified the growth story of Shriram fin corp. of being converted to top tycoon in NBFC world with a credit worth of 5000 cr. According to him these institutions have to maintain a higher CAR ratio compared to banks, as they are more risky.

Dubey.S (2007) analysed that Nbfc's in India had a great revolution after 1991 liberalization which led to simple regulatory mechanisms and allowance to greedy investors to park their money with NBFC's. With more customers base and unwise investments start rising to have large profitability. This in turn leads to weak not compatible with strong players and fading of golden era for NBFC's.

Aggarwal. M (2010) reviewed that the private banks conversion in to banks is very risky decision for RBI. As per Official estimates only 30,000 of the total 6, 00,000 habitations in the country are exposed to banking services, therefore the RBI has mainly targeted this effort towards rural India
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III. Research methodology

Research is the systematized efforts to gain new knowledge. A Research Methodology defines the purpose of the research, how it proceeds, how to measure progress and what constitute success with respect to the objectives determined for carrying out the research study. The appropriate research design being formulated is detailed below. A scientifically carried out research project has a definite framework for data collection. This framework constitutes the research design. It determines the data collection method, sampling method, the fieldwork and so on.

1.1 Data Collection:
There are two sources from which data can be collected. For the purpose of study, both primary and secondary data were required.

(A) Primary data
Primary data is that type of data which is collected first time for some specific purpose. There are various means of the primary data collection. The survey research is been used for the primary data with the help of questionnaire which were filled by the managers of banks of Jalandhar & Ludhiana in Punjab.

(B) Secondary data
The secondary data in this project has been collected from the "The Indian banker" journal, "The RBI bulletin", "RBI Discussion papers", "and journals of finance".

3.2 Research design
The research design used for the study is both exploratory &descriptive research design as its main objective is to describe something. In this research design it is assumed that researcher is having prior knowledge of the field of study. The main emphasis is given on prior formulation of hypothesis**.** The uses descriptive method as there was a clear specification beforehand of who, what, when, where, why, and way six Ws of research. its exploratory because only few persons belonging to the industry are aware of the same.

3.3 Data analysis tools
Logit regression analysis technique has been used for testing the favorable or unfavorable attitude of bank managers towards NBFCS conversion to banks.

3.4 Sampling technique
Here Convenience sampling technique has been used for selecting respondents (i.e. managers) by visiting the banks that are located in hubs and the banks from whom proper support & cooperation was provided, & the managers with whom certain links were found.

3.5 Sample size:
For this study sample size of 50 bank managers is taken from the following cities of Punjab i.e. Jalandhar, & Ludhiana.

3.6 Limitations of Study

      The study was based on finding whether the nbfcs conversion to bank would help in broadening economic growth; widen the coverage of banks in that area which are still unbanked & what will be its Impact on achieving the objective of financial inclusions.

1. First and the foremost difficulty was to find contacts for getting my questionnaires filled as in most of the cases the persons from managerial cadre don't entertain easily and try to avoid filling questionnaire by saying that they are not authorized for these purpose.
2. One another major hurdle was the stubborn behaviour of the managers who straight away try to respond negatively by saying; this topic is not at all linked with the banking sector.
3. Mixed responses were there from the respondents of different age groups.
4. Time factor-was still one issue as in most of cases I have to wait for 20-25 minutes before I was finally able to meet managers.
5. One another stumbling block was the widely scattered banks where a lot of time was wasted for covering these banks.
6. One another limitation of study was the biased attitude of the managers as they may be biased in accepting NBFCs as their competitors and don't treat this option as viable.

IV. Analysis and interpretation of data
Method of logit regression

      The study has been directed judge the attitude of respondents from the managerial cadre towards NBFCs conversion in to banks. Data for this has been collected from 50 respondents (25 of whom are in favour of exercising this option and 25 of whom are against this option) with broadening of economic growth, covering unbanked areas, experience in financial sector, low cost funds, achieving financial inclusion, impact on ticket size, addressing sectoral issues, regulatory forbearances, sources of contagion & concern, financial stability as the ten independent variables.

Dependent Variable Encoding

Original Value	Internal Value
0	0
1	1

Case Processing Summary

Unweighted Cases[a]		N	Percent
Selected Cases	Included in Analysis	50	100.0
	Missing Cases	0	.0
	Total	50	100.0
Unselected Cases		0	.0
Total		50	100.0

a. If weight is in effect, see classification table for the total number of cases.

Block 0: Beginning Block

Iteration History[a,b,c]

Iteration		-2 Log likelihood	Coefficients
			Constant
Step 0	1	69.315	.000

a. Constant is included in the model.

b. Initial -2 Log Likelihood: 69.315

c. Estimation terminated at iteration number 1 because parameter estimates changed by less than .001.

The classification table shows that model makes a correct prediction of 50% of classifying the respondents in to two groups. Of the overall 25 respondents with non-favorable attitude & the model correctly identified that 25 of them having a favorable attitude .

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 0	Constant	.000	.283	.000	1	1.000	1.000

Classification Table^{a,b}

			Predicted		
			VAR00001		Percentage Correct
Observed			0	1	
Step 0	VAR00001	0	0	25	.0
		1	0	25	100.0
	Overall Percentage				50.0

a. Constant is included in the model.

b. The cut value is .500

Variables not in the Equation

				Score	df	Sig.
Step 0	Variables	I.	Broadening of economic growth.	.494	1	.482
		II.	Unbanked areas coverage	6.129	1	.013
		III.	Experience in financial sector	.492	1	.483
		IV.	Cost of funds	3.634	1	.057
		V.	Impact on ticket size	.538	1	.463
		VI.	Achieving financial inclusion	3.954	1	.047
		VII.	Better addressing of sectoral issues	3.574	1	.059
		VIII.	Regulatory forbearances	.338	1	.561
		IX.	Source of contagion	2.023	1	.155
		X.	Financial stability	.433	1	.510
	Overall Statistics			10.053	10	.436

Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	58.176^a	.200	.266

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001.

Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	9.444	8	.306

The hosmer and lemeshow test shows lack of significance, indicating that the model predictions are not significantly different from observed values.In other words model fits well.

Contingency Table for Hosmer and Lemeshow Test

		VAR00001 = 0		VAR00001 = 1		
		Observed	Expected	Observed	Expected	Total
Step 1	1	4	4.193	1	.807	5
	2	4	3.822	1	1.178	5
	3	4	3.476	1	1.524	5
	4	4	2.980	1	2.020	5
	5	2	2.755	3	2.245	5
	6	0	1.907	4	2.093	4
	7	3	2.083	2	2.917	5
	8	1	1.803	4	3.197	5
	9	1	1.289	4	3.711	5
	10	2	.693	4	5.307	6

Classification Table[a]

			Predicted		
			VAR00001		Percentage
	Observed		0	1	Correct
Step 1	VAR00001	0	18	7	72.0
		1	8	17	68.0
	Overall Percentage				70.0

a. The cut value is .500

The classification table above shows that the overall correct classification rate of the model is 70.00%.the model predict in favorable attitude of managers towards NBFCs conversion in to banks.

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)	95.0% C.I.for EXP(B)	
								Lower	Upper
Step 1[a]	VAR00002	-.097	.224	.190	1	.663	.907	.585	1.406
	VAR00003	.456	.302	2.272	1	.132	1.577	.872	2.852
	VAR00004	.015	.381	.002	1	.969	1.015	.481	2.140
	VAR00005	.048	.216	.049	1	.825	1.049	.687	1.601
	VAR00006	.060	.224	.072	1	.788	1.062	.684	1.648
	VAR00007	.297	.256	1.343	1	.247	1.345	.815	2.221
	VAR00008	.257	.296	.754	1	.385	1.293	.724	2.311
	VAR00009	-.208	.334	.389	1	.533	.812	.422	1.562
	VAR00010	.223	.278	.640	1	.424	1.249	.724	2.155
	VAR00011	-.332	.279	1.413	1	.235	.718	.415	1.240
	Constant	-2.175	1.557	1.951	1	.163	.114		

a. Variable(s) entered on step 1: VAR00002, VAR00003, VAR00004, VAR00005, VAR00006, VAR00007, VAR00008, VAR00009, VAR00010, VAR00011.

V. Findings of study

The trends in attitude towards the NBFCs conversion in to banks are positive from the side of respondents from the managerial cadre in the banking industry. This idea was subject to criticism in the past by the banking sector but with the proposal of banking sector adopting the model of branchless banking and working through bank correspondents in near future the attitude has been totally changed. They are now favoring this option of proposed by the banks. The change in attitude has been made possible because of the following effects that it will have:

1. On the basis of survey it was found that maximum numbers of respondents were aware of the RBI discussion paper on the entry of new banks in to the private sector.
2. It was observed that maximum number of have an idea of what should be the minimum capital requirement.
3. Maximum number of respondents responded that the minimum capital requirement should be 500 crores INR which will be an ideal scenario. this amount of capital has been preferred as it will make those only those entities with adequate financial backing or capable of raising funds to go in for this option.
4. It will also help in achieving the final objective of consolidation.
5. Maximum numbers of respondents have gone for the option of current approach of 40% capital with lock in clause of 5 years or maximum 10% with requirement of approval after threshold of 5% is reached. this option were most favored as such high promoter stake in the initial stage & would bring in stability while dilution in the later stage would bring in diversity in shareholding.
6. The respondents were of believe that exercising of this option will promote financial promoting financial inclusions.
7. It was observed that only those NBFCs with adequate experience in financial sector and having sound financial backing would be able to survive.
8. Respondents were of the view that major obstacles that blocks the way of NBFCs conversion in to banks are: low capital base, heterogeneity in terms of size, heterogeneity in terms of activities, heterogeneity in terms of operations.
9. Respondents have given a balanced opinion about the conversion of NBFCs backed by industrial houses in to banks.
10. respondents who have given negative response towards conversion of NBFCs backed by industrial houses in to banks have given the following reasons for it:This would undermine the independence & neutrality of bank as arbitrator of credit allocation to real estate, Restrict the credit availability to competitors, Lead to concentration of economic power, Conflict of interest.
11. The respondents believe that NBFCs conversion in to banks would result in the increase in the ticket size which will ultimately leads to the increase in the cost of funds.
12. The ticket size according to them should be in the range of 5-6 lacks or even more.
13. The respondents were of the view that with NBFCs conversion in to banks some of the sectoral credit issues, such as infrastructure and microfinance, could be better addressed.
14. Maximum number of the respondents from the population believes that Initial stages of NBFCS conversion to banks will demand regulatory forbearances.
15. It was observed that exercising of this option will lead to NBFCs entrance in the areas which are still not explored.
16. This will lead to foster the competition in financial sector.

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