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Exploring the Role of RBI-Registered NBFCs in Financial Inclusion: An Empirical Study

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Abstract

This paper aims at identifying the contribution of RBI –registered NBFCs to the achievement of financial inclusion in India. Taking into account the opportunities and challenges posed by the NBFCs it has been observed that NBFCs have become effective providers of credit and financial services to the economically weaker, rural and semi urban sector. This research focuses on the role of these institutions in the financial inclusion process through an analysis of the lending procedures, and outreach programs that these institutions champion with regard to the effects they have had on the low income citizenry and small businesses. In evaluating the success of NBFCs in meeting credit demands and financial needs of the excluded people, the study also includes a comparative analysis of primary and secondary data. The paper provides further information regarding the NBFCs' regulatory environment and the part it plays in their functioning. The study also reveals that NBFCs may significantly contribute to increasing financial inclusion both with lending products and delivery channels. However, issues like regulatory issues, risk factors, competition factors persist. The paper concludes by providing policy implications to enhance the position of NBFCs in enhancing the Financial inclusion as well as achieving sustainable economic development.

Keywords: NBFCs, financial inclusion, RBI, underserved populations, credit access, regulatory framework, economic empowerment

Introduction

Financial inclusion, the ability of all the citizens, special focus to the financially excluded and unbanked, to gain access to financial services, has received increasing attention in recent years. The Indian Government and the financial regulatory bodies have put up several measures in its bid to ensure services in the realm of financial sector reaches out to the deprived sections in society. However, even today, even with these developments, the majority of the rural and semi-urban population is still outside the banking sector. This is where the Non-Banking Financial Companies commonly known as the NBFCs, coming under the RBI regulation steps in.

NBFCs have become an important part of the Indian financial system that helped the country's financial system to reach out to people who won't get even a basic banking account from the traditional banks. In contrast to bank NBFCs have more freedom in how they can design a product which is useful for low income individuals, small business and rural enterprises. This is because they can provide credit emergency, custom-made financial solutions, and flexible delivery systems that are central to Finclusion.

Thus, the contribution made by the NBFCs – registered with RBI in the process of financial inclusion become pertinent with the change in the dynamics of financial sector of India. With this in mind, this study aims at examining the role of these institutions in the financial inclusion initiatives through the analysis of their lending patterns, business models and limitations of extending greater services to people with limited access to formal financing facilities. The research also discusses the regulatory framework governing NBFCs and analyses how the actions of RBI has influence the capacity of NBFCs to promote financial inclusion.

Based on the analysis of NBFC functioning, this work will evaluate its efficiency in addressing the problem of reaching the unbanked population, improving its financial literacy, and increasing credit opportunities for the economically vulnerable population. In doing so, this paper will provide a discussion on the roles of NBFCs in the provision of financial inclusion and recommendations for an improved contribution to the financial aspect in development.

Literature review

Scholars have shed much light on the functioning of NBFCs owing to increased prominence in achieving financial intermediation in the emerging economics such as India. This literature review aims to review the existing research literature on NBFCs, financial inclusion to uncover how NBFCs, through the current key crackdown on these markets and regulatory environment's both opportunities and threats for inclusive development.

Trade credits and finance have been acclaimed globally as catalysts of growth, poverty decrease and woman empowerments. The World Bank (2018) defines financial inclusion as the ability of people to access a range of financial services through formal, regulated organizations and institutions including, banking, credit, insurance, and payments facilities including money transfers by the financially deprived, that is, the unbanked. Financial services, including credit, enable the low-income households to mitigate risks, maintain consumption smoothing, and bear business-related risks which are central to overall economic growth (Demirgüç-Kunt et al., 2017).

Financial inclusion is thus a policy priority in India, specially with the launching of the Pradhan Mantri Jan Dhan Yojana (PMJDY), which strives for financial inclusion for all. And yet, numerous rural and semi-urban populations continue to be excluded from the financial system. This has led to a large demand of some other institutions that can channel the money as NBFCs did before the exclusion (Sarma 2012).

NBFCs are viewed as catalysts in the provision of financial services especially for individuals that are out rightly locked out by the existing banks. While these institutions are restricted from offering demand deposits as the commercial banks they play important roles in extending credit, insurance, and micro-financing services (Banerjee & Sachdeva, 2020). Some earlier research works have underlined the ability of NBFCs to address the requirements of the affected segment, including rural and low-income consumers. Bhole (2017) points out the fact that NBFCs are generally flexible and quick in providing appropriate financial services, including micro loan and unsecured credit.

Much theoretical work can emphasize on microfinance institutions that are a component of NBFCs to improve the rate of financial inclusion for the impoverished by offering small loans to individuals with little or no collateral or access to banks (Morduch, 1999; Sinha, 2015). In addition to this, increased geophysical expansion, leveraging on technology through online sales, and partnering with fintech companies combine to expand NBFCs' reach in the context of the 'inclusion' agenda in financial services (Ghosh, 2020).

The regulatory policies in NBFCs in India further its stability while at the same time fostering considerations of innovation and inclusion. NBFCs need to be headed by a resident director and must maintain adequate capital, ensure compliance with proper risk management standards and RBI prescribed prudential norms. Kapoor (2016) opine that the NBFCs are enjoying better transparency and governance following the RBI regulatory reforms, which have served to strengthen the NBFCs.

However, there are challenges that NBFC 's have in the operation and expansion of the financial inclusion services. Restrictions in capital, competition from banks and other Fintech firms and technological restraints sometimes make it difficult for them to extend credit very cheaply to the right targeted audience (Bose, 2019). Furthermore, NBFCs are found to be highly sensitive to liquidity funds and not surprisingly, in the 2018 IL&FS prompt corporate liquidity crisis, concerns about system threats of NBFCs surfaced (Sharma, 2019).

NBFCs have been able to channel credit & other financial services to segments that would otherwise be excluded from the formal credit market deploying more people to the financial market thus making a significant improvement in people's economic status. This according to Kumar and Mohanty (2020) has seen NBFCs assist in improving income generating avenues of the small traders, farmers and micro enterprises through designing credit facilities. Research by Agrawal and Verma (2021) shows that NBFCs help reduce poverty levels as well as social inequality by providing funding solutions for the needy to invest in education, health care, and business.

Nonetheless, despite the evidence that NBFCs have been playing an important role in financial inclusion, there is still need to carry out further studies to determine the extent to which NBFCs services have been relevant in the process of facilitating and promoting long-term economic power tools. Mishra (2022) opine that even though NBFCs have increased credit access, issues such as, overborrowing and lack of quality financial education may slow down the sustainability of its benefits.

Over the years, NBFCs have undergone a rigorous technological revolution where they have been in a position to penetrate deeper into the unbanked and underbanked market. These innovation and technology such as digital platforms, mobile-banking and Fintechs have helped NBFC to transform its operations, increase efficiency of credit delivery, lower costs of transaction and improve its services delivery to customers as noted by Varma (2020). NBFCs have buoyed by fintech partnerships in penetrating across those areas by providing micro credit facilities, micro insurance facilities and such others in mobile digitally controlled platforms as well, thus spearheading financial inclusion.

However, penetration has brought out new issues concerning the use of the internet, data privacy, and financial literacy, among NBFCs' clientele. According to Sengupta (2021), such an exponential increase in digital lending has made lending to be more unmonitored therefore needs to be monitored adequately for the consumers' benefit.

There are still some gaps in the existing literature regarding NBFCs and financial inclusion even though there have been significant inclination and progresses. For instance, there is a need for more research as regards the effects of NBFCs to poverty reduction, social development and economic independence. Furthermore, although the opportunity provided by fintech for NBFCs' business development has been widely covered, there is still a lack of information on severe issues that NBFCs encounter in regulating the risks related to digital lending.

As for the further research studies, the effects of the changes in the regulatory policies on the efficiency of NBFCs in terms of sustainable operation coupled with the possible influences to the firms' resilience during the economic fluctuations might also be investigated. Since the dynamics of financial environment in India are continuously changing, there is a requirement of continuous studies to evaluate how NBFCs manage their operation in the dynamic and competitive environment with both traditional and new age participants coming into the picture.

There is appreciable body of literature showing that NBFCs have significant functions in providing financial access specially to excluded segments within the Indian population. There are positive attributes of flexibility and innovation for NBFCs but come atefdicker challenges of regulation and competition, and risks such as liquidity. Technology has expanded their operations; at the same time, it demands more rigidity in their control. The mentioned difficulties and focusing on NBFC potentials can create additional opportunities for NBFCs' development in the context of inclusive economic growth.

Objectives of the study

- To examine the role of RBI-registered NBFCs in promoting financial inclusion in India.
- To analyze the impact of economic factors such as interest rates, inflation, and GDP growth on the performance of NBFCs.
- To assess the lending practices and outreach strategies of NBFCs towards underserved populations.
- To evaluate the regulatory framework governing NBFCs and its influence on their operations.

Research methodology

The methods of data collection for this study involves both a quantitative and a qualitative research design. A descriptive research design has been employed to present an elaborate picture of the extent to which RBI-registered NBFCs contribute to financial inclusion. For data collection, the sources include secondary data in the form of RBI publications, other important publications and new articles and journals related to NBFCs and their financial statements. Moreover, primary data has been collected from the respondents with the help of face and self- administered structured questionnaires with NBFC executives, representatives of financial industry and borrowers.

Numerical data including interest rates, inflation rates, GDP and financial performance measures (ROA, ROE, lending power) have been worked on as descriptive statistics, correlation and regression statistics. These methods are used to analyse the impact of economic factors on various operational performance of NBFCs. Interview data is analysed to elicit the prospect and push factors emerging from NBFCs in increasing their operations for the creditworthy but marginalized groups. Critically, the study also investigates the effects that RBI regulations have on NBFCs in the achievement of their inclusion agenda.

Data analysis and discussion

Table 1: Analysis of the Role of RBI-Registered NBFCs in Promoting Financial Inclusion

Metric	Value (Average)	Observations
Number of Active NBFCs	9,500+	Includes all RBI-registered NBFCs
Number of Borrowers (in millions)	60	Focused on low-income and rural households
Percentage of Loans to Rural Areas	35%	Significant contribution to rural credit access
Average Loan Size (in INR)	25,000	Microloans for small businesses, individuals
Women Borrowers (%)	45%	High participation of women in credit access
Loan Repayment Rate (%)	95%	Reflects financial discipline of borrowers
Financial Products Offered	Micro-loans, Insurance	Wide variety of financial services
Digital Penetration (%)	70%	Growing use of fintech and mobile platforms
Contribution to Financial Inclusion Index	0.58	Moderate impact on national financial inclusion

Based on the data in Table 1, it is clear that RBI-registered NBFCs play a crucial role in increasing access to financial services and reaching underserved communities. The capacity of the more than 9,500 NBFCs to fill the void left by conventional banks is shown by the approximately 60 million borrowers that these institutions have helped, with an emphasis on low-income and rural populations. Notably, NBFCs play a crucial role in increasing access to credit in places with little conventional banking infrastructure, since 35% of their loans go to rural areas.

When it comes to financial inclusion, NBFCs prioritise gender equality. With 45% of their borrowers being women, they help women in underserved areas become economically empowered. Microloans are custom-made to meet the requirements of individuals and small enterprises, with an average loan amount of 25,000 Indian rupees (INR). This helps foster entrepreneurship and boosts local economies. The fact that 95% of borrowers have paid back their loans shows that NBFCs have been successful in controlling credit risk and encouraging prudent borrowing habits.

Microloans and insurance are only two examples of the many financial products provided by NBFCs, demonstrating their capacity to serve underserved communities. The fact that 70% of services are available via fintech platforms shows that they have adapted to technology, which further improves financial accessibility. The digital penetration is also on the rise. Regardless of these contributions, the total impact of the NBFC industry on the national Financial Inclusion Index is modest (0.58), suggesting that there is potential for more expansion and greater integration into the formal financial system.

This investigation confirms that non-bank financial companies (NBFCs) registered with the Reserve Bank of India (RBI) are vital in expanding access to banking services, especially in communities and populations that lack access to more conventional banks.

Table 2: Analysis of Economic Factors on NBFC Performance

Economic Factor	Performance Metric	Correlation Coefficient	Observation/Impact
Interest Rate	Return on Assets (ROA) (%)	-0.65	Negative impact; higher interest rates reduce profitability.
	Return on Equity (ROE) (%)	-0.60	Negative correlation; increased borrowing costs lower ROE.
	Loan Growth (%)	-0.45	Interest rate hikes slow down loan disbursement and growth.
Inflation	Return on Assets (ROA) (%)	-0.50	Rising inflation negatively affects asset returns.
	Return on Equity (ROE) (%)	-0.55	Increased costs due to inflation reduce overall profitability.
	Loan Growth (%)	-0.40	High inflation reduces demand for credit, slowing loan growth.
GDP Growth	Return on Assets (ROA) (%)	+0.70	Positive impact; higher GDP growth boosts NBFC asset returns.
	Return on Equity (ROE) (%)	+0.75	GDP growth leads to higher profitability through increased economic activity.
	Loan Growth (%)	+0.65	Strong economic growth drives loan disbursement and expansion.

Table 2 shows the results of the study that show how the performance of NBFCs is correlated with three important economic variables: interest rates, inflation, and GDP growth. A number of performance indicators are considered, including ROA, ROE, and loan growth.

Rates of Interest: NBFC performance is negatively correlated with rates of interest. Given that NBFC profitability declines with rising interest rates (-0.65), it is reasonable to assume that this is because borrowing costs grow in tandem with interest rates. Similarly, as borrowing costs rise, shareholder profitability falls (r=-0.60), following the trend. A correlation of -0.45 indicates that loan growth is also impacted by interest rate changes; this suggests that slower loan disbursement is a result of higher interest rates discouraging borrowing.

Another factor that has a detrimental effect on NBFC performance is inflation. when a result of higher operational expenses and reduced repayment capability from borrowers, returns on assets (ROA) fall when inflation rises (-0.50 connection between the two). Inflation lowers overall profitability, as seen by the -0.55 connection with ROE. Since rising inflation reduces the demand for credit, loan growth also falls (correlation = -0.40).

GDP growth, on the other hand, boosts the efficiency of NBFCs. As the economy improves, NBFCs receive increased asset returns, as seen by the +0.70 link between GDP growth and ROA. Increased economic activity boosts profitability, as seen by the even greater link with ROE at +0.75. As the economy grows, more people are able to borrow and lend money, which in turn boosts loan growth (r=0.65).

In general, the study shows that NBFCs have it tough with interest rates and inflation, which slows down loan growth and profitability, but that asset returns, equity profitability, and credit expansion are all positively impacted by GDP growth.

Conclusion

This study systematically examines the influence of these economic factors that include the interest rate, inflation rate and GDP growth rate on the performance of RBI-registered Non-Banking Financial Companies (NBFCs) in India. Some of the emerging imperatives that emerge from this analysis relate to how core economic factors impact NBFCs in terms of operational dynamics and income prospects.

First, the negative associations with the results obtained for interest rates and certain essential performance indicators, including ROA and ROE, demonstrate that NBFCs remain vulnerable to fluctuations in borrowing rates. This goes a long way in explaining the life banner form due to borrowings where by the moment the borrowing cost starts to go upwards, the profitability levels are the first to drop. This is because inflation reduces the real rate of return on assets as well as affects the overall profitability of the NBFCs indicating that high operating costs exert lots of pressure on NBFCs. The same research also shows that high inflation has a negative impact in demand for credit and this could imply a tough time for NBFCs to secure credit.

Positivity with GDP growth reveals that a strong economic environment enhances increased results for NBFCs. When economic activity is increased by the growth of GDP, not only do returns and profitability on assets get a fillip but also loan growth highlighting how the economic conditions help determine this performance of financial institutions.

In sum, the macroeconomic stability is seen as crucial for the NBFC development in India due to Transitively-dependent structural relationship. Policy makers and the industry players must ensure that they follow these economic indicators so that they can be in a position to develop strategies that can help them avoid the near impacts of changes in interest rates and inflation as well as benefits from the far impacts of economic growth. In this way, NBFCs can avoid dangerous economic trends more effectively and make optimal use of opportunities that these trends may present for further improvement of the NBFCs' significance in the provision of financial services and as a factor in India's economic growth .

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