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ANALYSIS OF CAPITAL ADEQUACY OF LEADING 5 NON-BANKING FINANCIAL COMPANIES IN INDIA

Mr. B.Naveen Kumar[1], Dr. R. Kavitha[2], Ms.S. Sathiya[3]
[1]Student, [2]Associate Professor, [3]Assistant professor
Sakthi Institute of Information and Management Studies, Pollachi

ABSTRACT

This research analyses the financial performance of five leading Non-Banking Financial Companies (NBFCs) in India LIC Housing Finance, Bajaj Finance, Shriram Finance, Cholamandalam Investment and Finance Company, and L&T Finance over a ten-year period from 2014 to 2024, focusing on their Capital Adequacy Ratio (CAR). CAR is a key indicator of an institution's ability to manage financial risks. The study employs statistical techniques like mean and standard deviation to assess CAR trends. Findings reveal significant variations: Bajaj Finance demonstrated strong growth in CAR, while LIC Housing Finance remained stable. In contrast, Cholamandalam and L&T Finance faced challenges with variable CARs, and Shriram Finance showed minor fluctuations but complied with regulatory requirements. The study emphasizes the importance of effective capital management for NBFCs and offers insights for policymakers, stakeholders, and investors regarding the sector's resilience and strategies for improvement.

KEY WORDS: *Non-Banking Financial Institutions, Capital Sufficiency Ratio, Financial Results, Economic Resilience, Risk Control*

1. INTRODUCTION

A Non-Banking Financial Corporation (NBFC) is a financial entity that offers a variety of banking services without possessing a banking license. NBFCs are essential to the financial landscape, addressing the varied requirements of individuals, small enterprises, and large corporations. They serve as a link between the formal banking system and those without access to banking services, thereby enhancing the availability of financial products and services. In contrast to conventional banks, NBFCs are not permitted to accept demand deposits, which means they cannot provide checking or savings accounts that allow for immediate withdrawals by the public.

Non-Banking Financial Companies (NBFCs) hold a crucial position within the financial sector by supplementing the offerings of conventional banks. They address the deficiencies in the financial system, thereby enabling a wider array of customers to obtain the financial products and services they require. Through the encouragement of innovation, the advancement of financial inclusion, and the facilitation of economic development, NBFCs remain a vital component of the financial ecosystem.

2. REVIEW OF LITERATURE

V. Suresh, Gummadi Sai Sivaji, Gurajala Pramod Kumar (2024) "A Study of The Non-Banking Finance Companies in India" Public Sector Banks (PSBs), which account for 70% of the assets within the banking system, experienced a peak in gross non-performing assets (NPAs) at 14.6% in March 2018. Although net NPAs decreased to 8.5%, instances of financial irregularities continued to be a concern. The TBS crisis resulted in a decline in bank lending to the business sector during the years 2016 and 2017, with a significant pivot towards lending to non-banking financial companies (NBFCs) and consumers. Between 2015 and 2019, loans extended to individuals and NBFCs increased by 17%, whereas industrial lending saw a growth of less than 3%. The demonetization initiative in November 2016 catalysed investments in mutual funds, leading to an annualized growth rate of 22.1% in assets under management (AUM) from 2012 to 2017. The NBFC crisis of 2018 further constricted the loan market, adversely affecting industries that depended on NBFC credit. As a result, sales of passenger cars plummeted from 244,279 units in September 2018 to 162,435 units in August 2019, and the GDP contracted from 6.1% in 2018-2019 to 4.2% in 2019-2020.

Khatri, R., & Modi, A. (2022). Performance of NBFCS: A pre and post COVID analysis. The pandemic has restricted the growth of the sector during the past 2 years, which saw a notable downfall in profits of 14.44% compared to the pre covid periods. This dragged the profitability ratios down as well. The increase in cost to income ratio by around 5.7% further added to the decrease in profitability of the NBFCs. The fact that in spite of

the economy dipping by almost 27% the growth in NBFCs has been plateaued at about 8% shows that it is on the path of growth.

Rajeswari Sengupta, Lei Son, and Harsh Vardhan (2022) "A Study of the Non-Banking Finance Companies in India" The TBS crisis resulted in a notable reduction in bank credit extended to the commercial sector, particularly during the years 2016-17, with public sector banks exhibiting the most significant withdrawal of credit. Although there was a decline in bank credit to the industrial sector, banks began to increase their lending to non-banking financial companies (NBFCs) and consumers following 2014-15. From 2015 to 2019, bank credit to NBFCs and consumers experienced an average growth rate of 17%, whereas credit to the industrial sector grew by less than 3%. Additionally, mutual funds gained prominence in the credit market, with their assets under management expanding at a compound annual growth rate (CAGR) of 22.1% from 2012 to 2017. The combination of decreasing interest rates and abundant liquidity contributed to a significant reduction in the funding costs for NBFCs, thereby enabling their substantial growth.

Dr. Rita Khatri, Prof. Arti Modi (2022) "Performance of NBFCS: A pre and post COVID analysis" Non-Banking Financial Companies (NBFCs) have enhanced their operational quality in the context of a decline in asset quality within the banking sector, increasing their share of total banking assets to 33.335% by 2022, up from 22-23% in March 2015. The Reserve Bank of India (RBI) has introduced a new scale-based regulatory framework that categorizes NBFCs into four tiers according to their risk profile, operational activities, and size. In the aftermath of the COVID-19 pandemic, NBFCs are anticipated to experience growth due to regulatory reforms, improved risk management practices, and increased confidence from stakeholders. CRISIL projects an enhancement of 150-200 basis points in the ratio of non-performing loans, attributed to extended timelines and a resurgence in economic activity.

Khan, Ahmad, and Shireen (2021) provide insights into the operational efficiency of microfinance institutions, comparing NBFCs with non-NBFC MFIs. Their findings indicate that factors such as ownership structure and size influence financial outcomes. Utilizing methodologies like bootstrap data envelopment analysis (DEA) could yield a comprehensive assessment of the financial performance and risk management strategies of the top NBFCs. This comparative analysis is crucial for identifying strengths and weaknesses in their performance metrics.

3. OBJECTIVES

An examination and comparison of the Capital Adequacy Ratio (CAR) trends for five leading financial institutions LIC Housing Finance, Bajaj Finance, Shriram Finance, Cholamandalam Investment and Finance Company, and L&T Finance will be conducted from 2014 to 2024.

4.RESEARCH METHODOLOGY

Required data for the study have been collected from the secondary sources like annual reports, Magazines, journals and websites.

This analysis has been used statistical metrics like mean and standard deviation to evaluate their ability to handle financial risks and ensure economic stability.

5. NON-BANKING FINANCIAL CORPORATION

A Non-Banking Financial Corporation (NBFC) is defined as a company established under the Companies Act of either 2013 or 1956. As per section 45-I (c) of the Reserve Bank of India (RBI) Act, a Non-Banking Company that operates as a financial institution qualifies as an NBFC. Additionally, it is required that the NBFC is involved in activities such as providing loans and advances, as well as acquiring stocks, equities, debts, and other marketable securities issued by the government, local authorities, or similar entities.

Non-banking financial companies (NBFCs) engage in lending and investment activities similar to banks; however, there are several key distinctions between the two. These include:

- NBFCs are not permitted to accept demand deposits.
- NBFCs do not participate in the payment and settlement system and are unable to issue cheques drawn on themselves.
- Unlike banks, depositors of NBFCs do not have access to the deposit insurance facility provided by the Deposit Insurance and Credit Guarantee Corporation.

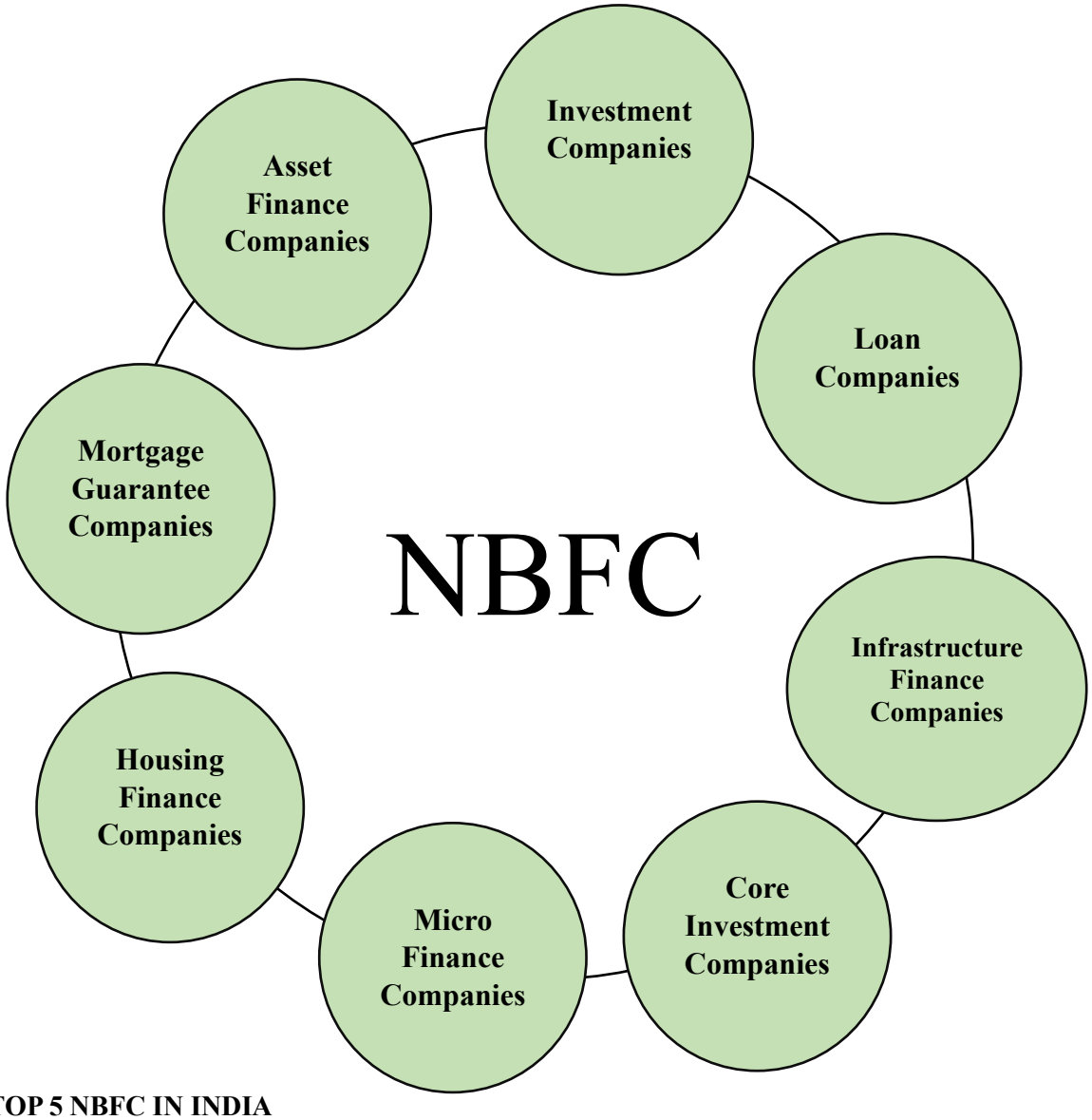
A non-banking financial company (NBFC), specifically classified as a residuary non-banking company, refers to an entity that primarily engages in the acceptance of deposits through various schemes or arrangements.

Exclusions from this classification include businesses whose main activities are:

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- Agricultural operations
- Industrial operations
- Trading in goods, excluding securities
- Transactions involving immovable property, including the provision of services

6. TYPES OF NBFC IN INDIA



7. TOP 5 NBFC IN INDIA

i. LIC Housing Finance Limited

LIC Housing Finance Limited (LICHFL) remains committed to its goal of providing accessible housing finance while playing a significant role in the economic development of India. The organization has broadened its outreach, enhanced operational effectiveness, and adopted digital innovations to improve the customer experience.

ii. Bajaj Finance Ltd

Bajaj Finance Ltd. (referred to as 'BFL', 'Bajaj Finance', or 'the Company') is a subsidiary of Bajaj Finserv Ltd. It operates as a deposit-taking Non-Banking Financial Company (NBFC-D) and is registered with the Reserve Bank of India (RBI), classified as an NBFC-Investment and Credit Company (NBFC-ICC). BFL specializes in lending and accepting deposits, boasting a diverse lending portfolio that serves retail, small and medium-sized enterprises (SMEs), and commercial clients, with a notable presence in both urban and rural regions of India. The Company accepts deposits from the public and corporate entities while providing a wide range of financial service products to its clientele.

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iii. Shriram Finance

Founded in 1974, Shriram Group has emerged as a significant entity in the Indian financial services industry. The group's primary strength lies in its pioneering efforts in truck financing and the chit fund business. By addressing the financial needs of the general populace, Shriram Group has developed into a leading financial services conglomerate.

iv. Cholamandalam Investment and Finance Company

Cholamandalam Investment and Finance Company Limited (Chola) was established in 1978 as the financial services division of the Murugappa Group. Initially, Chola focused on equipment financing but has since evolved into a comprehensive provider of financial services. Today, it offers a wide range of products, including vehicle finance, home loans, loans against property, SME loans, Secured Business Personal Loans (SBPL), Consumer & Small Enterprises Loans (CSEL), loans against securities, and various other financial solutions.

v. L&T Finance

L&T Finance Limited, previously referred to as L&T Finance Holdings Limited, is headquartered in Mumbai and stands as one of India's prominent Non-Banking Financial Companies. The firm has established a robust presence in the lending sector, addressing the varied financing requirements of both served and underserved clientele. L&T Finance provides a range of financial products, including Personal loans, Two-Wheeler loans, home loans, Rural Business loans, Farm loans, and SME loans. Our commitment at L&T Finance is to deliver tailored financial solutions that align with the distinct needs of our customers.

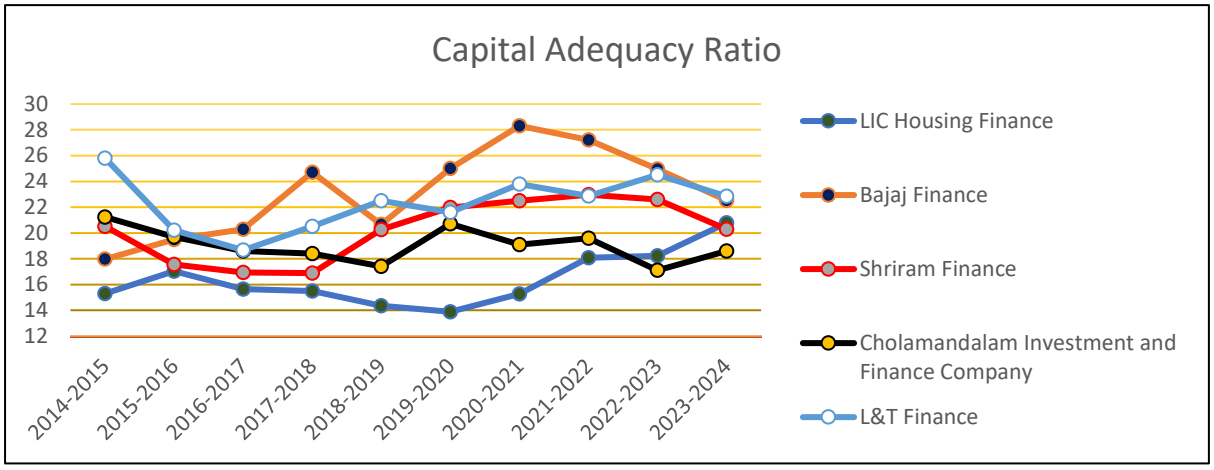
8. ANALYSIS AND DISCUSSION

The Capital Adequacy Ratio (CAR) assesses a bank's capacity to manage risks such as credit and operational risks while fulfilling its obligations. In essence, it serves as a protective 'buffer' against potential losses, safeguarding both depositors and lenders. Regulatory authorities establish and oversee minimum CAR thresholds to uphold confidence in the banking sector and ensure its stability. A robust CAR indicates that a bank is equipped to absorb losses without compromising its financial responsibilities, thereby mitigating risks associated with defaults or unforeseen economic difficulties.

Capital Adequacy ratio = (Tier 1 Capital + Tier 2 Capital + Tier 3 Capital)

Years / Companies	LIC Housing Finance	Bajaj Finance	Shriram Finance	Cholamandalam Investment and Finance Company	L&T Finance
2014-2015	15.3	17.97	20.52	21.24	25.81
2015-2016	17.04	19.5	17.56	19.7	20.21
2016-2017	15.64	20.3	16.94	18.6	18.67
2017-2018	15.49	24.71	16.89	18.4	20.51
2018-2019	14.36	20.66	20.27	17.4	22.5
2019-2020	13.89	25.01	21.99	20.7	21.6
2020-2021	15.28	28.31	22.5	19.1	23.8
2021-2022	18.08	27.22	22.97	19.6	22.88
2022-2023	18.23	24.97	22.61	17.1	24.52
2023-2024	20.78	22.52	20.3	18.6	22.84
Mean	16.409	23.117	20.255	19.044	22.334
SD	2.11072	3.45221	2.37148	1.31649	2.14461

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The chart depicts the Capital Adequacy Ratio (CAR) trends for LIC Housing Finance, Bajaj Finance, Shriram Finance, Cholamandalam Investment and Finance Company, and L&T Finance from 2014 to 2024.

Key Observations

i. Consistent Leaders and Trends

- LIC Housing Finance demonstrates stable CAR values with a steady upward trajectory from 2020 to 2024, indicating an enhanced capacity to absorb losses in recent years.
- Bajaj Finance boasts the highest average CAR at 23.117, characterized by notable year-on-year variations and a peak of 28.31 in 2020-2021, reflecting both financial strength and some volatility.
- Shriram Finance shows a moderate CAR with fewer fluctuations than Bajaj Finance, maintaining values around the 20 to 22 range in recent years.
- Cholamandalam Investment and Finance has the lowest standard deviation at 1.31649, indicating minimal fluctuations over time, although its CAR has slightly declined in recent years, signalling a potential area for concern.
- L&T Finance showcases robust performance with a high average CAR of 22.334, exhibiting relative stability and consistently elevated values.

ii. Volatility and Risk

Standard Deviation (SD) measures variability. Bajaj Finance exhibits the highest SD at 3.45221, indicating significant fluctuations in its CAR values, whereas Cholamandalam Investment and Finance shows the lowest SD, implying a more stable performance.

iii.Overall Trend

In general, companies tend to experience variations over the years, yet they demonstrate stable or positive trends in the more recent years, particularly post-2020. This may indicate their efforts to enhance financial stability in response to evolving economic circumstances.

iv.For the 2023-2024 performance period

LIC Housing Finance and Bajaj Finance have experienced a minor reduction in their Capital Adequacy Ratio (CAR) from previous highs, yet they continue to demonstrate robust performance. Conversely, Cholamandalam Investment and Finance is witnessing a drop in CAR, which necessitates monitoring. Meanwhile, Shriram Finance and L&T Finance seem to uphold consistent CAR levels.

v. Comparison

LIC Housing Finance exhibits the lowest average Capital Adequacy Ratio (CAR) at 16.409, suggesting a smaller buffer in comparison to its competitors. In contrast, Bajaj Finance and L&T Finance excel in financial stability and their capacity to absorb risk.

vi. Stakeholder Insights

Investors: Bajaj Finance and L&T Finance may present a more appealing option due to their elevated and consistent Capital Adequacy Ratios (CAR), indicating a strong ability to manage risks.

Regulators: The downward trend observed in Cholamandalam Investment and Finance's CAR may require close observation to guarantee compliance with regulatory standards.

Companies: LIC Housing Finance should consider improving its CAR to boost its competitive edge and enhance investor trust.

9.CONCLUSION

The analysis of CAR trends highlights the varied financial strategies and levels of resilience among the examined NBFCs. Institutions such as LIC Housing Finance and Bajaj Finance have shown strong capital management, whereas others like Cholamandalam and L&T Finance have struggled to maintain stable ratios. These results underline the necessity for NBFCs to find a balance between growth and capital adequacy, particularly in fluctuating economic environments. This analysis can be utilized by policymakers and stakeholders to evaluate the stability of the sector and to implement strategies aimed at enhancing financial frameworks. Future studies may investigate the root causes of CAR variations and their long-term effects.

This examination stresses the critical role of capital adequacy in ensuring financial stability, noting that Bajaj Finance has significantly improved its CAR, while LIC Housing Finance has remained steady. The observed variations in Shriram Finance and Cholamandalam Investment highlight the ever-changing landscape of financial markets. For investors and policymakers, these findings offer valuable insights for assessing the resilience of these firms and their ability to navigate economic challenges.

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