

Examination of Measures Taken by RBI to minimize Unauthorized Acceptance of Money Deposits by Unincorporated Entities: An Empirical Study in Karnataka State

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ARTICLE DETAILS

Article History

Published Online: 10 February 2019

Keywords

NBFCs, Reserve Bank of India, CAMEL Criteria, ASSOCHAM

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ABSTRACT

The study is conducted to ascertain the effectiveness of the measures taken by the Reserve Bank of India as regulators against the unauthorized acceptance of deposits of money by unincorporated entities. The data was collected using a survey method via structured questionnaire in Karnataka. A total no of 100 samples were collected through Simple random sampling method and their responses were analyzed using various Percentage analysis, Chi-square test and Independent sample t test; with the aid of Microsoft Excel and SPSS software. Findings offer insight into the current status of regulatory framework and form a foundation for valuable suggestions.

1. Introduction

NBFCs (Non-Banking Financial Companies) form a fundamental part of the Indian financial system. They play an important role in economic development and financial inclusion through channelizing the scarce financial resources in capital formation, thereby complementing banking sector in reaching out credit to the unbanked segments of society (more than 19% of the population according to ASSOCHAM-EY joint study), especially to micro, small and medium enterprises (MSMEs).

The contribution made by these NBFCs in the economic upswing by meeting the credit needs of the society is much appreciated. But there is also a need to keep an eye on their functioning, as some of the unregistered bodies have looted people's money who were innocent investors, thereby violating 45S of Reserve Bank of India Act, which states that accepting deposits by NBFCs is illegal. These unincorporated bodies are the pre-dominant cause of the multiplying fraudulent cases. They pose as NBFCs to invest money in MLM schemes with promises of heavy but mathematically improbable returns on investments, particularly when persons originally enrolled in a scheme induce others to join the same scheme. Given that NBFCs are set to increase their share in the overall credit pie in the next few years, stringent oversight becomes even more necessary. Nevertheless, no studies have been conducted concerning this area; despite the unconditional need to shift focus to mitigate public from these deceiving activities, more specifically in Karnataka. Therefore, it is highly imperative that the law enforcement agencies at the Central and State levels, work closely with each other to ensure early detection, investigation and further follow-up action against unscrupulous companies engaged in such practices. In an attempt to address this existing lacuna, the current study is initiated to understand and analyse the existing monitoring and regularizing mechanism with regard to such entities, confined within Karnataka.

2. Review of Literature

- Vinod Kothari in his research paper titled "Performance of NBFCs in 2016-2017" depicts the statistics regarding the number of NBFCs in India, growth, financial performance in terms of net profit, income/expenditure, return on equity/assets, cost/income ratio, including sectorial analysis of the same. It is mentioned that, 2016-17 could be labelled as the year in which NBFCs finally entered into the maturity phase of their lifespan and established a strong foothold in the country's financial eco-space. The ability to tap into niche markets and provide specialized services was the focal reason behind the growth in operations.
- The Associated Chambers of Commerce and Industry of India (ASSOCHAM) (2016) in association with Price Waterhouse Coopers in the research paper "Non-Banking Finance Companies: The changing Landscape" discusses about the market, growth, regulations, recent trends in funding sources of NBFCs in India. This paper explains about the contribution of NBFCs to the economy. It suggests that, as newer business model evolve for NBFCs, so should the regulations governing them for better functioning of the sector.
- NareshMakhijani (2014) writes on "Non-Banking Finance Companies: Time to Introspect" in 'Analytique'. NBFCs have been very advantageous over the banking system, in supplying credit to the underserved and unbanked areas given their reach and niche business model. However Reserve Bank of India has been keen on monitoring and supervising these entities, and during the course of time have introduced and suggested a number of changes in the existing regulatory norms governing NBFCs.
- Shiv Shakti (2014) in the journal titled International Journal of Multi-disciplinary and Academic Research (SSIJMAR) writes on Non-Banking Financial

Companies in India: Types, Needs, Challenges and Importance in Financial Inclusion. NBFCs have turned out to be engines of growth and integral part of Indian Financial system, enhancing competition, diversification in the financial sector, spreading risks, and complementing the functions of the banking sector. NBFCs have served a larger segment in supporting its audience financially, making it advantageous over banks. There are various types of NBFCs catering to different needs of people and reaching a vast circle. NBFCs have been known to the extent of financial inclusion it has created, thereby contributing to the economic development. NBFCs though have lighter regulatory norms, are subject to various challenges some of which are customer protection issues, camouflaging public deposits, etc. The study suggested on the need of improved corporate governance standards, capacity building, greater innovation, enhanced monitoring and regulatory convergence.

- ShailShakya (2014) published a working paper entitled "Regulation of Non-Banking Financial Companies in India: Some Visions & Revisions". Non-Banking Financial Companies are known for their higher risk making it are pioneer in their cash deployment, accessibility to the markets and others to count. NBFCs are known for their higher risk taking capacity making it disadvantageous compared to banks. Despite being an institution of attraction for the investors, NBFCs have played a significant role in the financial system.
- Thilakam and Saravanan (2014) writes on "CAMEL Analysis of NBFCs in Tamil Nadu" in 'International Journal of Business and Administration Research Review'. NBFC industry has gone drastic change over a decade, and the growth in that particular sector is phenomenal. The change is pretty volatile and is influenced by the market dynamics, its regulatory environment and the public interests. They have been complementing the role of the banks, in mobilizing funds and making it available for investment purposes. CAMEL criteria was used, in order to evaluate the soundness of NBFC sector in Tamil Nadu, based on which suggestions were offered to overcome the difficulties face by selected NBFCs in their development.

3. Research Methodology

To achieve the research objectives, the combination of exploratory and descriptive research design was adopted. Using a structured questionnaire, the primary data was collected by survey method. The sample of the study were various traders, micro, small, medium vendors and household people across Karnataka. Simple random sampling method was used to choose the samples. A total no of 100 samples were collected through Simple random sampling method and their responses were analyzed using various Percentage analysis, Chi-square test and Independent sample t test; with the help of Microsoft Excel and SPSS software. Charts and tables were also used for pictorial representation. Data was utilized to understand recent trends of fraudulent activities that

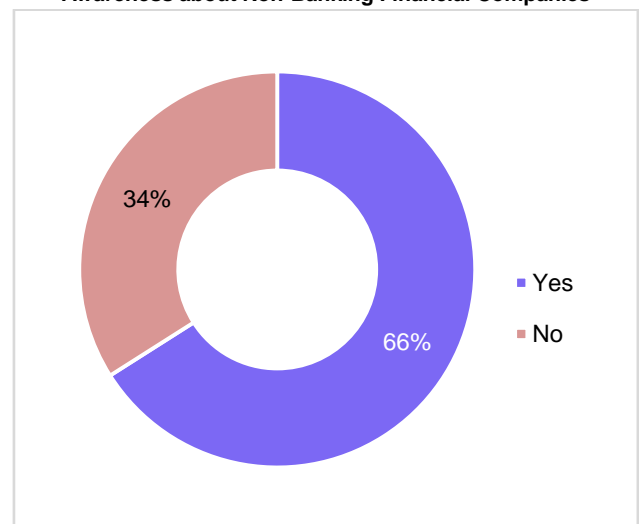
the unregistered Non-banking financial companies indulge in. The secondary data was collected through various sources like Government Publications, Reports, Statistical and historical documents, Public records, Research studies and RBI Bulletins. With Reserve Bank of India, coming up with various regulations to supervise and control the operations of the NBFCs, there are various instances, when the regulations are being violated and not being noted as well. The secondary sources helped to comprehend the functioning of the unregistered entities, their pattern of collecting deposits by analyzing the past cases reported with the regulatory authorities.

4. Objectives

- To examine the measures taken by the Reserve Bank of India as regulators against the unauthorized acceptance of deposits of money by unincorporated entities,
- To analyze the public's level of understanding about NBFCs in India,
- To study the state of public awareness in the light of unauthorized acceptance of deposits of money and
- To suggest the measures of increasing the awareness among depositors and investors to prevent them from becoming victims of such fraudulent cases.

5. Data Analysis and Interpretation

Chart-1
Awareness about Non-Banking Financial Companies

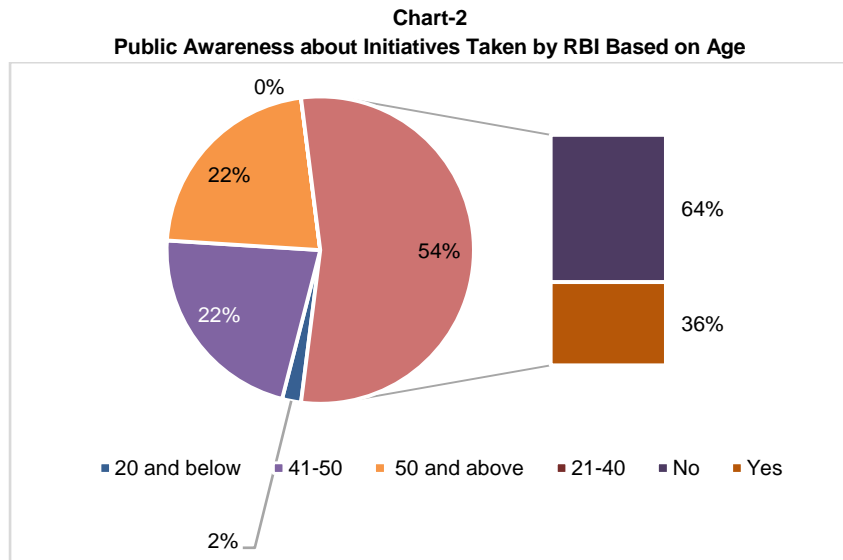


It can be seen from the above chart that, majority of the respondents i.e., 66% are aware about the Non-Banking Financial Companies and the rest 34% are not aware.

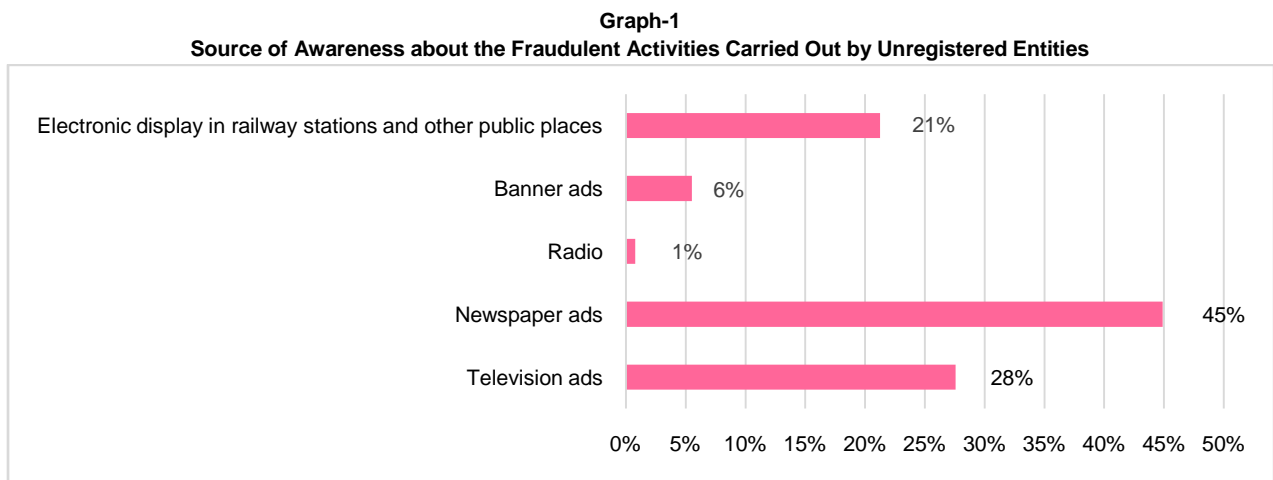
Table-1
Public Awareness about Initiatives Taken by RBI to Educate the Public about Unincorporated Entities and Their Fraudulent Mechanism

	No of respondents	Percentage
Yes	43	43
No	57	57

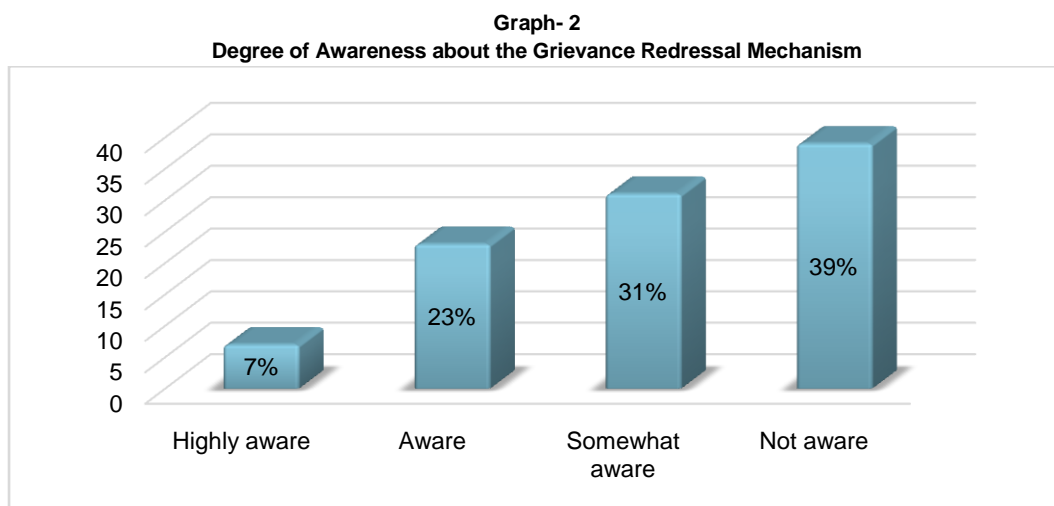
The table shows that, majority of the respondents i.e., taken by RBI, the balance 43% are aware of the same. about 57% are not aware of the public awareness initiatives



It is understood from the above chart that, 54% of respondents fall under the millennial category, and among them only 36% are informed of the public awareness initiatives taken by RBI and the rest 64% are not.



It is seen from the above graph that, Newspaper advertisement is considered to be the dominant source of public awareness representing 45% of the population, followed by television 28%, e-display in railway stations and other public places 21%, banner ads 6% and radio 1%.



It is inferred from the above graph that, 7% of the respondents are highly aware about the grievance redressal mechanisms, 23% are just aware, 31% are somewhat aware and 39% are not at all aware.

Chi-Square Test

Objective 1: To find the association between gender and RBI initiatives to educate public about unincorporated entities

and their fraudulent mechanism.

Ho₁: There is no association between gender and RBI initiatives to educate public about unincorporated entities and their fraudulent mechanism.

Ha₁: There is an association between gender and RBI initiatives to educate public about unincorporated entities and their fraudulent mechanism.

Table 2
Chi-Square Test to Analyze the Association Between Gender and RBI Initiatives to Educate Public about Unincorporated Entities and Their Fraudulent Mechanism

	Value	Asymp. Sig. (2-sided)
Pearson Chi-Square	.711 ^a	.399
N of Valid Cases	100	

P Value:0.399

Inference: We fail to reject null hypothesis, it is inferred that there is no association between gender and RBI initiatives to educate public about unincorporated entities and their fraudulent mechanism. At 5% significance level, the p value for the hypothesis is greater than 0.05. Hence we accept the null hypothesis.

Objective 2: To analyze the association between returns expected and investment decision.

Ho₂: There is no association between returns expected and investment decision.

Ha₂: There is an association between returns expected and investment decision.

Table 3
Chi-square test to Analyse the Association Between Returns Expected and Investment Decision

	Value	Asymp. Sig. (2-sided)
Pearson Chi-Square	4.964 ^a	.291
N of Valid Cases	100	

P value:0.291

Inference: We fail to reject null hypothesis, it is inferred that there is no association between returns expected and investment decision. At 5% significance level, the p value for the hypothesis is greater than 0.05. Hence we accept the null hypothesis.

Ho₃: Male and female investors have the same opinion on investment in NBFC's

Ho_{3.1}: Male and female investors have the same opinion on NBFC to be safe platform to invest money.

Ho_{3.2}: Male and female investors have the same opinion on conducting reliability check before investing.

Ho_{3.3}: Male and female investors have the same opinion on differentiating registered and unregistered entities before investing,

Independent Sample Test

Objective: To understand the opinion of male and female investors on investment in NBFC's

Table4
Independent Sample Test Showing Group Statistics to Analyze the Opinion of Male and Female Investors on Investment in NBFC's

	Gender	N	Mean	Std. Deviation	Std. Error Mean
NBFCs are a safe platform to invest money:	Male	58	3.31	1.245	.164
	Female	42	3.17	1.057	.163
I conduct reliability check on the NBFC before investing?	Male	55	2.05	1.079	.145
	Female	39	1.87	.767	.123
I know to differentiate between a registered and unregistered entity before investing?	Male	58	2.28	1.348	.177
	Female	40	2.58	1.196	.189

Table 5
Levene's Test Showing Group Statistics to Analyze the Opinion of Male and Female Investors on Investment in NBFC's

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	T	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
NBFCs are a safe platform to invest money:	Equal variances assumed	3.0	.084	.606	98	.54	.144	.237	-.327	.614
	Equal variances not assumed			.622	95.4	.53	.14	.231	-.315	.602
I conduct reliability check on the NBFC before investing?	Equal variances assumed	1.9	.165	.907	92	.36	.18	.201	-.217	.583
	Equal variances not assumed			.960	91.9	.34	.18	.190	-.195	.561
I know to differentiate between a registered and unregistered entity before investing?	Equal variances assumed	.152	.698	-1.1	96	.26	-.29	.265	-.825	.226
	Equal variances not assumed			-1.1	90.0	.25	-.29	.259	-.814	.215

Inference: From the Levene's test, it can be inferred that, we fail to reject null hypothesis. Male and female investors have the same opinion on investment in NBFCs. At 5% significance level, the p value for all the three sub-hypothesis is greater than 0.05. Hence we accept the null hypothesis.

6. Findings of the Study

The study showed that lack of awareness and financial illiteracy were the primary reasons for defraud by unincorporated entities. The study revealed that majority (66%) of the population were aware about the functioning of Non-Banking Financial Companies and chit fund was the dominantly known investment scheme. However, a major part of the population (51%), have invested their money in form of deposits. The results reveal that safety (44%) was the principle factor that guides public's investment decision, followed by returns (39%). 77% of the safety conscious people, do not invest through NBFCs. About (54%) of the population expect less than 12% of returns for their investment against the pre-conceived notion that people expect abnormally high returns on their investment. Hence, it was inferred that, the level of returns expected by public from investing does not completely affect their investment decision. A large part (37%) of the population agrees that they conduct reliability check before investing. Only a small proportion of the population (13%) have been defrauded by unincorporated NBFCs. And among those who had conducted reliability check before investing, only (14%) have been defrauded. A mere (37%) know to differentiate between a registered and unregistered entity before investing and relatively about (79%) were not aware of any unregistered entities operating in their vicinity. Even if people have knowledge on how to differentiate between registered and unregistered bodies, they are unable to spot the unscrupulous entities in their vicinity.

A major slice of the population (57%) was not aware of the public awareness initiatives taken by RBI and those who were aware consider newspaper advertisements (45%) as their prime source of awareness. Among the millennial population, only 36% were informed about the initiatives taken by RBI. A

greater part (39%) were not at all aware about the grievance redressal mechanisms, in case of being encountered by fraudulent activities. Primarily the millennial category of population was not informed about of the public awareness initiatives, because RBI has been following a conventional channel of creating awareness.

It was further inferred that majority of the fraudulent cases happen in the rural areas and relationally financial illiteracy has been the major reason for it. People lack basic financial literacy ultimately making them unaware about the dangers of investing and the credible sources where they should invest. They get swayed by the fact that NBFCs cater to the customer needs at high speed and level of customer orientation that the entities portray. In addition, the regulatory arbitrage has been indirectly encouraging the growth of these unincorporated entities. Considering all the central findings, the study implies that there is a need to fine tune RBI's policies by building robust detection and monitoring mechanism and also to lay more focus on creating awareness among the public.

7. Recommendations

RBI has to make the existing outreach program and awareness mechanism more active and effective. In addition, the study has suggested the following inclusions to the existing initiative stream.

Regulations

A robust regulatory framework is essential for an orderly growth and development of financial market or segment. Protecting depositor's interest is important but equally important is a sound NBFC network. Though, it is not possible to completely shield depositors from all risks, with relevant public awareness initiatives, depositors can be protected from the activities of unscrupulous entities. The deposit accepting NBFC has to declare its compliance with RBI regulations and the depositor also is required to confirm of having read the declaration. The depositors can be mitigated only through a general cautionary advice in form of public awareness

initiatives that RBI should carry forward.

Keeping the sensitive nature of the sector in view, vigorous policy measures have to be taken to protect the depositors as a whole and stabilize NBFC sector. The research suggests that the police department, can significantly contribute to the supervisory efforts. With its presence at all locations in rural and urban area, detecting and mitigation of fraudulent activities can be done efficiently. Continuous surveillance by the police department, can aid in knowing the functioning of various NBFCs and mainly in identifying the unscrupulous ones. In addition to this, the role of auditors can be made more extensive. RBI in public interest can create a panel of Chartered Accountants, who could be asked to conduct periodic reviews of the NBFCs through an enhanced audit program.

Presently NBFCs are regulated by RBI, Ministry of Corporate Affairs, Securities Exchange Board (SEBI), NHB, IRDA, etc. This multiple regulatory system creates a lot of confusion and ultimately makes it difficult for public to differentiate between registered and unincorporated entities. If all NBFCs are brought under the umbrella of RBI, it would substantially improve its functioning and gives more clarity to the public on where to deposit and where not to. There is an unconditional need for a single capsule system.

Formal Financial Education

From the findings, it is evident that more focus should be shifted towards financial literacy area, in order to make people more alert and educated about the existing fraudulent mechanisms thereby protecting them from becoming victims of such activities performed by unincorporated entities. As per the global survey (Standard & Poor's Financial Services LLC), in India about 76% of its adult population does not understand even the basic financial concepts.

The research suggests, an exclusive Financial Education and Literacy Commission be formed in collaboration with the Department of Education, thereby emphasizing on the need to offer Financial Literacy as part of the curriculum in schools,

which should be extended to other curriculums apart from CBSE, like CICSE, Matriculation and State Board and in colleges as well.

Detection Program

The research recommends on initiating a unique program by RBI, which provides incentives to individuals (public) who report possible violations of Protection of Interest of Depositors Act. If in case, people get to know about the functioning of an unregistered/unincorporated entity in their vicinity, or an NBFC not adhering to the policies/norms, can report to the Detection committee of RBI. The commission is committed to protecting finder's identities. In turn, they get monetary rewards based on how originality of the information.

The study infers that the number of fraudulent activities committed by the unincorporated entities can be reduced adversely through financial literacy among public and efficient public awareness initiatives. Amid growing cases of innocent people being cheated by multi-level marketing (MLM) firms, Direct Selling companies, etc.; through various Ponzi schemes, Pyramid schemes, chit frauds, etc., there is an unquestioning need for Reserve Bank of India to immediately act against companies, that are not registered as non-banking financial companies (NBFCs) but are floating financial schemes and committing frauds; for the benefit of the public and the economic progress.

8. Conclusion

The study found that there is no association between gender and RBI initiatives to educate public about unincorporated entities and their fraudulent mechanism. The researchers found that there is no association between returns expected and investment decision. Male and female investors were found to have the same opinion on NBFC to be safe platform to invest money. It was further observed that male and female investors have the same opinion on conducting reliability check before investing. Also, male and female investors had the same opinion with regards to differentiating registered and unregistered entities before investing.

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