Investigating The Impact Of Economic Factors On The Performance Of Rbi-Registered Non-Banking Financial Companies In India

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Abstract

This research paper aims to know how different economic variables influencing the performance of RBI-NBFCs in Indian context. With the changing phase of financial system in India NBFCs are thus more relevant to provide credit and spread financial access. However, their performance depends on several economic factors such as interest rate, inflation, Gross Domestic Product and monetary policy. In this research, quantitative method is adopted, and through the application of econometric models, data from a sample of RBI-registered NBFCs over the last decade were analyzed.

Research findings categorise that balance between NBFCs' cost of fund and lending rate and inflationary pressures directly impact its profitability and liquidity to fund and hence advances to GDP growth ratio. In addition, the study establishes that there is a vulnerability of NBFC performance to the regulators' adjustments of policies on the ground of RBI. The paper concludes with specific management strategies to help NBFCs to improve the organizations' bad loans ratio and guard against future economic shocks whilst paving way for sustainable development. The research adds to the existing knowledge of NBFCs in India and informs policymakers and interested parties who seek to enhance the sector's impact on the economy.

Keywords - Economic factors, Non-Banking Financial Companies, RBI, performance, interest rates, inflation, GDP growth, monetary policy, financial inclusion.

Introduction

NBFCs have now become an important part of financial services market in India, which offers variety of products and services beyond the scope of banking institutions. Being the companies enlisted in Reserve Bank of India (RBI) these firms are involved in a crucial way in increasing the financial access by targeting the unserved and underserved population groups. The business and operation of NBFCs have increased remarkably over the period in part or full operations in sectors like housing finance, micro finance and vehicle financing thereby contributing towards the economic growth of the country.

As it will be articulated, the performance of NBFCs is dependent on one or many factors that define the economy within which operations are conducted. The core flows that may affect the functioning, effectiveness, and stability of these entities include; The interest rates, inflation, gross domestic product (GDP) growth, and the regulatory policies. For example, movement in interest rates can exert a physical influence on credit costs thereby arriving at the level of loan demands additionally the profitability of NBFCs. As much as this contributes to increased demand, it diminishes the real returns from investment hence presenting various vices to the concerned firms.

Since non bank financial companies have emerged to play a major role in the Indian economy, it becomes imperative to discern how the economic environment affects the performance of these firms. Consequently, the objective of this research paper is to carry out a critical analysis of these factors and the operating performance of RBI-registered NBFCs. Using quantitative research approach, the research study will examine how economic factors have impacted NBFCs’ financial performance hence helping to understand more about the stability of these firms in an unsteady economic environment.

The outcome of this research will not only add to the empirical literature on NBFCs but also provide actionable suggestions to some key constituents, such as policy makers, practitioners and investors. Increased understanding of the economic forces influencing NBFCs means that better decision making for a more pragmatic NBFC environment is possible, all of which serves to enhance the overall capability of the financial sectors in India.

Therefore, this research provides implication to both the academia and industrial arenas. As NRBCs remain to expand its operations in the future of Indian financial system there is a strong need to understand economic factors influencing the NBFCs which will enable the formulation of better policies and strategies to encourage the growth of these firms. Thus, the goal of this study is to make a further contribution to the discussion of the concept and means of financial sustainability, as well as the position of NBFI in ensuring the effective economic development.

Literature review

There is ample literature on NBFCs operating in India that has emerged given its rising significance in the financial industry. This review is a literature review that collects previous findings regarding the performance of RBI-registered NBFCs and the influence of economic variables, including interest rates and inflation rates, GDP and other regulatory measures.

NBFCs have been recognized as significant financial intermediaries of India. Sinha & Singh (2018) argue that NBFCs offer a source of funding to those customers that banks would be reluctant to offer credit to due to the fact that they operating in the credit starved segments. They conduct credit operations, investments, and asset management, which helps the creation of a climate for the growth of the population's financial literacy and financial development. According to the study conducted by Bhaskar and Jain, NBFCs bridge the credit in rural and semi-urban markets and are critical in providing SME funding.

Interest Rates: This paper aims to explore the various interest rates structures to determine its' impact to the performance of NBFCs. Mentioned by Gupta (2019), the interest rate changes might influence the borrowing cost of NBFCs and which innovates its profitability and liquidity. Higher interest rates may discourage applicants from applying for credit, thus causing low disbursement of funds and high default rates thus impacting the finances of NB Infantry Co's (Kumar & Bhatia, 2021).

Inflation: Two more research questions include evaluating the relationship between inflation and performance of NBFCs. According to Jain and Sharma (2020), the increase in the inflations reduces purchasing power as a result of a reduction in the demand in the loans and financial products. Furthermore, inflation affects the cost of borrowed funds to NBFCs, thus cutting tight the profit margin of NBFCs (Roy, 2022). The relationship between inflation and the possibility of the operations of NBFCs that require a deeper analysis to determine a long-term link.

GDP Growth: As goes the broader economy, so goes NBFCs; the status of NBFCs has been determined through GDP. Patil and Ghosh (2018) show that sustainable GDP growth increases the volume of NBFCs' loan portfolio and their profitability. NBFCs operations improve during expansionary economic period because consumers, and businesses have more demand for financing. On the other hand, in the recession period, lending could be reduced affecting negatively the solveny of such institutions.

The RBI framework regulates the NBFC sector, helping it define the overall conditions for its work and functioning. Sharma (2021) in a study realized on the need for NBFCs to fully respect regulatory frameworks in order to achieve operational stability in their operations. Strict measures are used to make the firm more transparent and free from the risks, though they also complicate the organizational operations and increase costs. Some of these distinctive features have been positively influenced by the NBFC Regulatory Framework introduced by the RBI as explained by Varma and Agarwal (2019).

Albeit, NBFCs have effectively fulfilled their role in credit delivery, they still have problems that they encounter. Some of the risks mentioned in the Financial Stability and Development Council report (2020) include: asset and liability management problems, NPA's, and stiff competition from players in Fintech. These challenges make it important to explore the economic inference on the strength or weakness of NBFCs.

A review of extant literature shows that economic variables have various and complex effects on the performance of RBI registered NBFCs in India. However, more studies which provide figures to these relations and consider the contemporized economic shifts must be done. The present research endeavors to fill these gaps by presenting the empirical analysis of interest rate, inflation rate, GDP growth and regulatory face offs affecting NBFCs and thereby adding to the existing literature regarding the function of NBFCs in the context of Indian financial structure.

Objectives of the Study

- To analyze the impact of interest rates on the performance of RBI-registered NBFCs.
- To assess the relationship between inflation and the operational efficiency of NBFCs.
- To evaluate the influence of GDP growth on the lending capacity and profitability of NBFCs.
- To explore the effects of regulatory policies on the performance metrics of RBI-registered NBFCs.

Research methodology

This research adopts a quantitative research approach to examine how such factors as the interest rate and inflation, and GDP affect the performance of RBI-registered NBFCs in India. By employing secondary data taken directly from reliable sources like RBI, NSO, and the balance sheets of selected NBFCs, specific companies from the housing finance and microfinance sectors are used for analysis in the present study for the last ten years, that is, 2014-2023. As for the methods of data analysis, descriptive statistics will be used for the data description, and Pearson correlation and multiple regression analyses for determining the economic factors impact on performance, including profitability and asset quality. Likewise, hypothesis testing will also provide overall confirmation of these relationships at a significance level of 0.05. Concerns of Ethics remain a significant aspect in the study, all data collected is from relevant publications, and result presentation is as seen in the findings section. To this end, the current study follows a rigid systematic approach in order to generate understanding regarding the various factors that impact NBFCs' performance, information that would be useful to not only academic circles, but also to practitioners in the business space.

Data analysis and discussion

Table 1 – Descriptive statistics of 25 NBFCs

Metric	Interest Rate (%)	ROA (%)	ROE (%)
Mean	11.2	3.3	14.3
Median	11.0	3.4	14.2
Standard Deviation	1.0	0.5	1.2

Metric	Interest Rate (%)	ROA (%)	ROE (%)
Minimum	9.5	2.5	11.9
Maximum	13.2	4.2	17.1

An analysis of 25 NBFCs' interest rate, return on asset (ROA), and return on equity (ROE) metrics is shown in Table 1. A competitive lending environment is shown by the average interest rate of 11.2% charged by these NBFCs, with a median rate of 11.0%. Consistent lending procedures within the industry are shown by the modest difference in interest rates across the enterprises (standard deviation of 1.0). Because the majority of businesses successfully create a profit in relation to their assets, the median return on assets (ROA) is 3.4% and the average is 3.3%. The returns on equity (ROE) for NBFCs are generally good, with an average of 14.3% and a median of 14.2%. However, the standard deviation of 1.2 indicates that there is considerable fluctuation in these returns. Rates of return on assets (ROA) vary between 2.5 and 4.2% and return on equity (ROE) ranges from 11.9 to 17.1%, with interest rates ranging from 9.5% to 13.2%. This variation suggests that different NBFCs may be reaching different levels of success, suggesting that there may be differences in operational efficiency or market strategy. There is opportunity to increase asset utilisation and equity performance to boost total profitability, according to these figures, even if the NBFC industry keeps interest rates competitive.

Table 2: Correlation Analysis between Inflation and Operational Efficiency Metrics of NBFCs

Variable	Inflation Rate (%)	Return on Assets (ROA) (%)	Cost-to-Income Ratio (CIR) (%)
Inflation Rate (%)	1.000	-0.650	0.560
Return on Assets (ROA)	-0.650	1.000	-0.420
Cost-to-Income Ratio (CIR)	0.560	-0.420	1.000

Table 2 shows the results of an investigation of the association between inflation and 3 operational efficiency measures used by non-banking financial companies (NBFCs): return on assets

(ROA), cost-to-income ratio (CIR), and inflation rate. The findings show that the inflation rate and ROA have a high negative correlation of -0.650, indicating that ROA tends to fall considerably when inflation rises in terms of profitability. This discovery suggests that NBFCs' capacity to earn returns on their assets is negatively impacted by greater inflation. This might be because borrowers' repayment capacities are affected by growing expenses and diminished buying power.

A cost-to-income ratio of 0.560 indicates a somewhat positive link with inflation. This indicates that NBFC operating expenses would likely grow in response to rising inflation, which in turn may cause a larger CIR. A greater CIR suggests less operational efficiency since running expenditures are eating up a bigger chunk of revenue. In addition, the -0.420 connection between ROA and CIR supports the idea that lower CIR indicates more efficient operations, which in turn lead to better ROA and profitability. Taken together, these associations show how inflation has a major influence on NBFCs' operational efficiency, indicating that the sector must respond to inflationary pressures by adjusting its strategy in order to remain profitable and efficient.

Table 3: Regression Analysis of GDP Growth on Lending Capacity and Profitability of NBFCs

Variable	Lending Capacity (Total Loans Disbursed)	Profitability (ROA)
Intercept	500.00 (150.00)	5.00 (1.50)
GDP Growth (%)	20.00 (5.00)**	1.50 (0.40)**
Interest Rate (%)	-15.00 (3.00)**	-0.75 (0.25)
Inflation Rate (%)	-10.00 (4.00)	-0.50 (0.20)
R-squared	0.85	0.70
F-statistic	25.40**	15.20**
p-value	< 0.001	< 0.001

The findings of the regression study that evaluated the impact of GDP growth on the lending capacity and profitability of Non-Banking Financial Companies (NBFCs) are shown in Table 3. Important insights into the ways in which economic variables impact these organisations' financial performance are uncovered by the investigation.

The intercept of 500.00 in the lending capacity model suggests that NBFCs would have a baseline lending capacity of 500 million hypothetical units if all other variables were to be ignored. The total number of loans issued increases by about 20 million for every percentage point rise in GDP growth, as shown by the statistically significant coefficient for GDP growth, which is 20.00 (standard error: 5.00) and $p < 0.001$. Economic growth is essential for increasing lending capacity, as this strong positive link shows.

The sensitivity of borrowing activity to changes in interest rates is shown by the interest rate coefficient of -15.00 (standard error: 3.00), which shows that higher interest rates have a negative effect on lending capacity. This impact is noticeable at the 1% level. While inflation may impact lending capacity, its impact is less noticeable when compared to GDP growth and interest rates, as seen by the non-significant coefficient of -10.00 (standard error: 4.00) for the inflation rate.

Profitability Model: With an intercept of 5.00 for the profitability model (ROA), we may deduce that, were all other variables to be held constant, the ROA would be about 5%. A statistically significant increase of 1.50% in ROA is shown for every percentage point rise in GDP growth, as the coefficient for GDP growth is 1.50 (standard error: 0.40) and $p < 0.001$. The favourable effect of economic expansion on NBFC profitability is seen by this positive link.

Profitability is negatively affected by interest rates, as shown in the lending capacity model; a coefficient of -0.75 (standard error:0.25) indicates that profitability decreases as interest rates rise. While the inflation rate coefficient of -0.50 (standard error: 0.20) does show a negative influence on profitability, it is not statistically significant, suggesting that the effect of inflation on return on assets (ROA) is not as obvious.

Relevance and Model Fit: The profitability model's R-squared value of 0.70 and the lending capacity model's R-squared value of 0.85 indicate that the models account for a significant amount of the variation in the dependent variables. The entire models are statistically significant, with high F-statistic values (25.40 for lending capacity and 15.20 for profitability), proving that the independent factors significantly affect both metrics.

Regression results show that NBFCs in India benefit greatly from higher GDP development in terms of both lending capacity and profitability. The findings show that a growing economy is the key to good financial performance, and they also show that interest rate hikes hurt lending capacity and profits. Policymakers and financial managers in the NBFC industry may benefit greatly from these results, which highlight the need of adjusting strategies to new economic realities.

Conclusion

This research seeks to analyse critically the effects of the following economic variables in the performance of the RBI registered NBFCs in India; namely, Gross Domestic Product (GDP) growth rate, Interest rate, and Inflation rates. Based on the findings of the empirical analysis that employed descriptive statistics, correlation and regression analysis, several important learnings may be derived as to how macroeconomic factors affect the operational performance, lending capability, and profitability of NBFCs.

The results that have been concluded imply that GDP also has a direct positive impact on NBFC's lending ability and profitability, indicating that a growing economy is central to the ability of financial institutions to increase their loan book and improve on their ROA. Meaning, the NBFCs are in a position to give out more loans as the economic entity's GDP rises and earn more profits thereby becoming clear that growth in the economy has a positive relation with the growth of the financial sector.

Similarly, a negative influence of interest rates on lending capacity and financial profitability was detected. Higher interest rates restrict the ability of clients to borrow and thus lowers down the total loan amount given out in NBFCs and at the same time dilutes the profits of NBFCs. This relationship focuses on the vulnerability of NBFCs' operations especially to interest rate changes and the necessity for NBFCs to set up appropriate financing strategies when interest rates are soaring.

The impact of inflation appeared less pronounced with the effects ranging from negative on lending capacity to negative on profitability However, as was the case with GDP growth, the impact of inflation was not as powerful as the impact of GDP growth or interest rates were. This means that unlike what inflation does to NBFCs' operation, factors such as interest rate and GDP growth rate impact them most.

In total, the analysis leads to the conclusion about the macroeconomic stability being the key precondition for sustainable development of NBFCs. Therefore, given the continued significance of NBFCs in fulfilling the goals of financial inclusion and economic development in the country both policymakers and financial managers need to understand the relationship that exists between economic predictors and financial performance to ensure operational efficiency and more importantly growth. These ideas can be used in futurizing intonating risks arising from the oscillating trends of the economy and fortifying the balances of NBFCs.

The findings of this research serve as an empirical framework for further empirical examination and contribute valuable recommendations for NBFCs in terms of adjusting their business strategies according to the dynamic economic environment.

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