Effect of RBI's Monetary Policy on NPAS and Profitability of Scheduled Commercial Banks in India

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ABSTRACT: The banking sector plays a crucial role in the economic development of India, and its performance is significantly influenced by the monetary policy decisions of the Reserve Bank of India (RBI). This study aims to examine the impact of RBI's monetary policy on the profitability and Non-Performing Assets (NPAs) of scheduled commercial banks in India. The research focuses on understanding how changes in policy rates affect lending behavior, asset quality, and overall financial performance of banks. Primary data were collected from bank officials through a structured questionnaire, and appropriate statistical tools, including the chi-square test, were used for analysis. The findings reveal that a majority of respondents perceive a strong relationship between monetary policy changes and bank profitability, as well as between policy rates and NPAs. The study also highlights operational challenges faced by banks in effectively transmitting monetary policy decisions, particularly during periods of monetary tightening. Additionally, the research emphasizes the importance of risk management practices, technological efficiency, and staff training in mitigating the adverse effects of policy changes. The chi-square test results confirm that RBI's monetary policy has a significant effect on both profitability and asset quality of banks, leading to the acceptance of the alternative hypothesis. The study concludes that effective policy transmission, proactive risk management, and supportive regulatory measures are essential to ensure financial stability and sustainable performance of the Indian banking sector.

KEYWORDS: Monetary Policy, RBI, Bank Profitability, Non-Performing Assets, Scheduled Commercial Banks

I. INTRODUCTION

The construction industry is a major contributor to economic growth, supporting infrastructure development, urbanization, and employment generation. It includes a wide range of activities, from small residential buildings to large infrastructure projects such as roads, bridges, and airports. Despite its importance, the industry is highly exposed to risks due to uncertain project environments, fluctuating costs, delays, and strict regulatory requirements. These uncertainties can seriously affect project profitability and financial stability. Therefore, effective Financial Risk Management (FRM) is essential to protect investments, ensure timely project completion, and maintain sustainable business performance.

Financial Risk Management in construction refers to the systematic process of identifying, analyzing, and controlling financial uncertainties that may negatively impact project outcomes. These risks may arise due to cost escalations, funding shortages, delayed payments, contractual disputes, or changing market conditions. Effective FRM helps reduce potential losses, improves financial stability, and supports informed decision-making throughout the project lifecycle.

The construction industry plays a crucial role in economic development by creating infrastructure that supports trade, transportation, and urban growth. It also generates employment for skilled and unskilled workers, engineers, and project managers. Construction projects require large financial investments, and even minor disruptions can lead to significant financial losses. Hence, sound financial

planning and risk management are vital not only for individual firms but also for the overall economy.

Construction projects are unique in nature because they are complex, large-scale, and temporary. Each project has specific objectives, timelines, and resource requirements. Factors such as weather conditions, labor availability, material supply, and design changes introduce uncertainty in cost and scheduling. Due to this non-repetitive nature, financial planning must be customized for each project, making financial risk management more challenging.

Several financial challenges commonly affect construction projects. Cost overruns often occur due to inflation, poor estimation, or unexpected changes in scope. Project delays may result in penalties and increased expenses. Funding risks arise from inadequate cash flow or delayed disbursement of funds. Contractual disputes related to scope changes or payment terms can also lead to legal and financial liabilities. These challenges highlight the need for effective financial risk identification and control.

Risk in construction refers to the possibility of events that may negatively impact project objectives, costs, or timelines. Financial risks include cash flow shortages, interest rate fluctuations, and cost uncertainty. Other risks include operational risks from inefficiencies, market risks due to price volatility, legal and regulatory risks from non-compliance, and political risks arising from policy changes. Proper management of these risks is essential to ensure smooth project execution.

Financial Risk Management aims to protect assets, maintain liquidity, maximize profits, and ensure regulatory compliance. It improves decision-making, optimizes resource allocation, reduces cost overruns, and enhances credibility among investors and stakeholders. Effective FRM involves identifying risks through expert judgment, historical data analysis, financial ratio analysis, and risk registers.

Risk assessment uses qualitative and quantitative techniques to evaluate the likelihood and financial impact of risks. Mitigation strategies include risk avoidance, risk reduction through planning and cost control, risk transfer through insurance and contracts, and risk retention for minor risks. Modern tools such as financial modeling, budgeting, hedging, contingency planning, ERP systems, and financial analytics further strengthen FRM practices.

Despite its importance, implementing FRM in construction faces challenges such as project complexity, limited financial expertise, unpredictable external factors, and data limitations. Overcoming these challenges requires improved financial planning, use of technology, and skilled risk management practices to ensure project success and long-term financial stability.

II. LITERATURE REVIEW

Kumar and Singh (2020) studied how RBI's monetary policy decisions affected the profitability of Indian scheduled commercial banks. They analyzed secondary data from RBI publications and annual reports of major private and public sector banks over a six-year period. Their study showed that whenever the RBI increased the repo rate, lending became more costly, which reduced credit demand and net interest income for banks. They also found that higher policy rates increased overdue loans because borrowers struggled with repayment at high interest levels. The authors concluded that monetary tightening created a negative effect on profitability while monetary easing helped improve credit flow and returns. They suggested that banks must improve risk assessment to reduce NPA formation during rate hikes.

Sharma (2020) investigated the link between RBI's policy rate changes and the stressed asset levels of scheduled commercial banks. Using panel data analysis of 25 banks, the study found that increases in repo rate and CRR led to higher loan defaults, especially in sectors like infrastructure and power. The research highlighted that public sector banks were more affected due to higher exposure to large corporate loans. It was observed that policy tightening reduced profitability indicators like ROA and ROE due to higher provisioning requirements. The author suggested that effective credit monitoring and restructuring support were needed during strict monetary periods.

Patil and Jadhav (2021) focused on the transmission of monetary policy to bank lending and profitability in India. They examined RBI's monetary interventions from 2014 to 2020 and evaluated their impact on retail and corporate lending. Results showed that strict policy rates reduced loan growth and delayed loan approvals due to increased borrower risk. They also found that profitability remained stable in some private banks, but public banks experienced a decline due to higher operational inefficiencies. The study concluded

that monetary policy transmission was uneven across the banking sector and needed structural reforms.

Banerjee (2021) carried out a study on how asset quality was affected by monetary tightening. The research used NPA data before and after monetary policy adjustments and revealed that rising repo rates and liquidity restrictions resulted in increased NPAs in industries facing low cash flow. The study stated that borrowers delayed loan repayment when their borrowing cost increased sharply. The author concluded that banks must balance lending growth and strict credit standards during high-interest cycles to prevent asset quality deterioration.

Problem Definition

The banking sector in India is vital for economic growth, and its performance is strongly influenced by the Reserve Bank of India's (RBI) monetary policy. Changes in policy rates affect lending, borrowing costs, bank profitability, and the level of Non-Performing Assets (NPAs). While many studies examine profitability and NPAs separately, limited research focuses on the combined impact of RBI's monetary policy on both asset quality and profitability of scheduled commercial banks. This study aims to examine how RBI's policy decisions influence NPAs and profitability and how banks manage these effects to ensure financial stability and sustainable performance.

Research Objective

1. To examine how RBI's monetary policy influences the profitability of scheduled commercial banks in India.
2. To analyze the effect of changes in policy rates on Non-Performing Assets (NPAs) of banks.
3. To study the perceptions of bank managers and officials regarding the transmission of monetary policy to lending, credit, and asset quality.
4. To identify the challenges faced by banks in maintaining profitability and controlling NPAs under varying monetary policy conditions.
5. To provide suggestions for improving bank performance and risk management in response to RBI's monetary policy decisions.

Hypothesis Statement

Null Hypothesis (H_0):

RBI's monetary policy has no significant effect on the profitability and Non-Performing Assets (NPAs) of scheduled commercial banks in India.

Alternative Hypothesis (H_1):

RBI's monetary policy has a significant effect on the profitability and Non-Performing Assets (NPAs) of scheduled commercial banks in India

Research Methodology

A) **Research Design:** A definite plan for obtaining a sample from sampling frame will be called the sample design. It refers to the technique or the procedure a researcher adopts in selecting some sampling units**.**

B) **Data Sources And Methods**

Data for this study was collected from two main sources: primary data and secondary data. Both sources were used to ensure comprehensive and reliable research findings.

Primary Sources:-

The primary data for this study will be collected directly from people working in different scheduled commercial banks in India. The researcher will use a questionnaire and personal interviews to get their opinions.

Secondary Data:-

The secondary data for this study will be collected from already available sources like RBI reports, bank annual reports, financial journals, research papers, newspapers, and official websites.

C. Data Analysis Techniques:

Percentage Analysis: To determine the distribution of responses across survey questions.

Tables and Graphs (Bar Charts, Pie Charts): For visual representation and clarity of data trends.

D. Sampling Design

Universe: The universe of this study will be commercial banks in Amravati city.

Population: Commercial banks in Amravati city.

Sample Unit: Commercial banks employees in Amravati city.

Sample Size: A total of 10 scheduled commercial banks will be selected for the study. From each bank, 10 respondents (such as managers, credit officers, and finance staff) will be chosen.

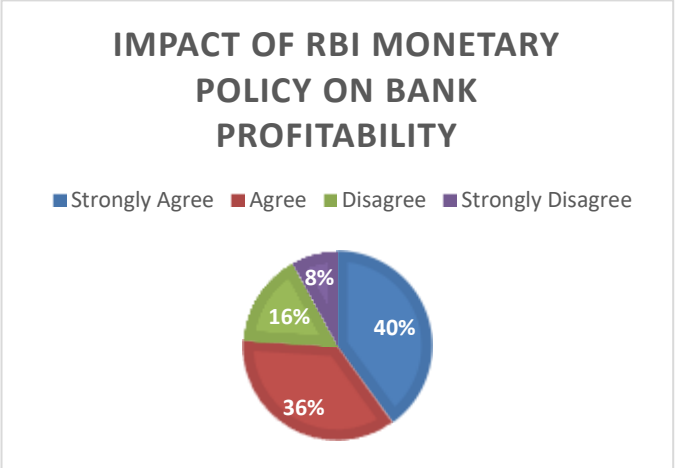
E. Sampling Technique: To collect the data from the respondents the research will use simple random sampling technique.

Data Analysis and Interpretation

TABLE 1 Impact of RBI Monetary Policy on Bank Profitability

Response	No. of Respondents	Percentage (%)
Strongly Agree	20	40
Agree	18	36
Disagree	8	16
Strongly Disagree	4	8
Total	**50**	**100**

Graph No 1 Graphical Representation of Impact of RBI Monetary Policy on Bank Profitability

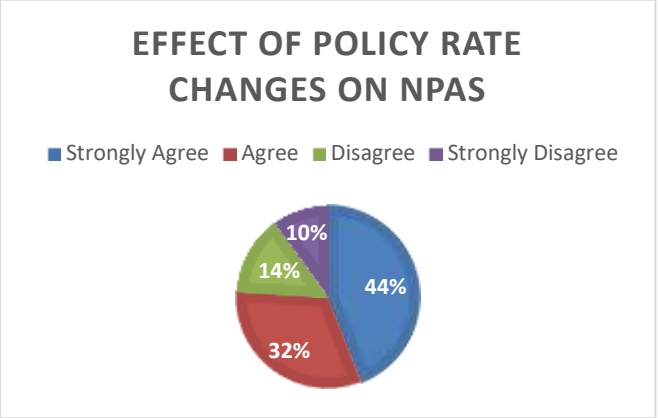


Interpretation :- From the above table, it is interpreted that 40% respondents strongly agree and 36% respondents agree that RBI's monetary policy directly influences bank profitability. However, 16% respondents disagree and 8% respondents strongly disagree, indicating that a majority perceive a significant impact of monetary policy on profitability.

Table No. 2 Analysis of Effect of Policy Rate Changes on NPAs

Response	No. of Respondents	Percentage (%)
Strongly Agree	22	44
Agree	16	32
Disagree	7	14
Strongly Disagree	5	10
Total	**50**	**100**

Graph No. 2 Graphical Representation of Effect of Policy Rate Changes on NPAs

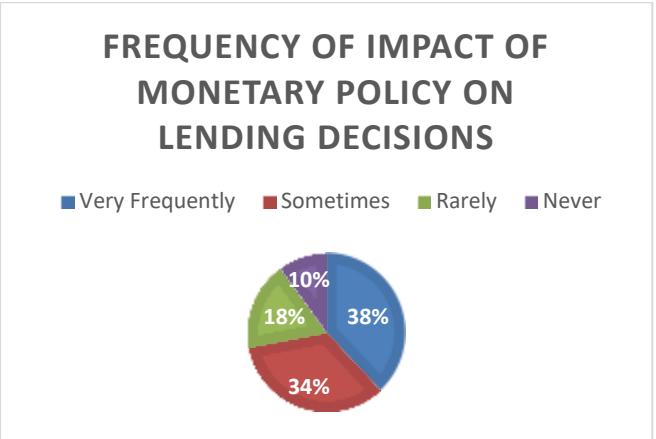


Interpretation :- The table shows that 44% respondents strongly agree and 32% respondents agree that changes in policy rates significantly affect NPA levels. Meanwhile, 14% respondents disagree and 10% respondents strongly disagree, suggesting that most bank officials acknowledge a strong relationship between policy rates and NPAs.

Table No 3 Analysis of Frequency of Impact of Monetary Policy on Lending Decisions

Response	No. of Respondents	Percentage (%)
Very Frequently	19	38
Sometimes	17	34
Rarely	9	18
Never	5	10
Total	**50**	**100**

Graph No. 3 Graphical Representation of Frequency of Impact of Monetary Policy on Lending Decisions

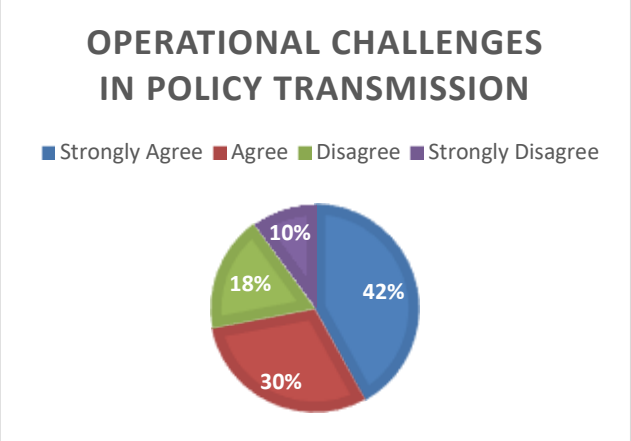


Interpretation :- It is observed that 38% respondents state that RBI's monetary policies impact lending decisions very frequently, while 34% respondents feel it happens sometimes. On the other hand, 18% respondents say rarely and 10% respondents say never, indicating that monetary policy plays a frequent role in lending decisions.

Table No 4. Analysis of Operational Challenges in Policy Transmission

Response	No. of Respondents	Percentage (%)
Strongly Agree	21	42
Agree	15	30
Disagree	9	18
Strongly Disagree	5	10
Total	**50**	**100**

Graph No. 4. Graphical Representation of Operational Challenges in Policy Transmission

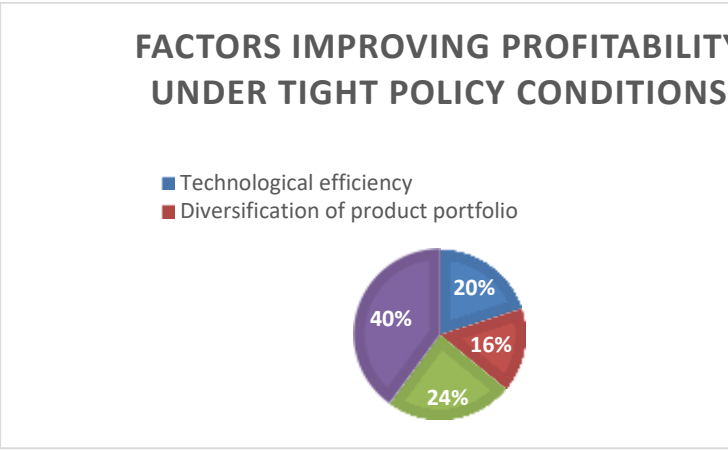


Interpretation :- The table indicates that 42% respondents strongly agree and 30% respondents agree that banks face operational challenges in implementing monetary policy transmission. However, 18% respondents disagree and 10% respondents strongly disagree, showing that challenges are widely experienced by bank officials.

Table No 5. Analysis of Factors Improving Profitability Under Tight Policy Conditions

Response	No. of Respondents	Percentage (%)
Technological efficiency	10	20
Diversification of product portfolio	8	16
Improved risk assessment	12	24
All of the above	20	40
Total	**50**	**100**

Graph No. 5. Graphical Representation of Factors Improving Profitability Under Tight Policy Conditions



Interpretation :- From the above table, it is interpreted that 40% respondents believe all factors together help improve profitability even under tight monetary policy. Further, 24% respondents prefer improved risk assessment, 20% respondents technological efficiency, and 16% respondents diversification of product portfolio, highlighting the importance of a combined strategy.

Findings:-

The study shows that RBI's monetary policy has a strong impact on bank profitability and NPAs. About 76% respondents agreed that RBI's monetary policy directly affects bank profitability. Regarding NPAs, 76% respondents felt that changes in policy rates significantly influence NPA levels. In terms of lending decisions, 72% respondents stated that RBI's monetary policy regularly impacts their branch's lending activities. Operational challenges were also evident, as 72% respondents agreed that banks face difficulties in effectively implementing monetary policy transmission. Finally, 40% respondents believed that a combination of technology, diversification, and improved risk assessment helps banks maintain profitability even during periods of tight monetary policy.

Conclusions:-

From the study, it can be concluded that RBI's monetary policy plays a significant role in influencing both profitability and asset quality of scheduled commercial banks in India. Most bank officials strongly believe that changes in policy rates affect lending activity, borrower repayment capacity, and NPA levels. Tight monetary policy increases pressure on borrowers, which may lead to higher NPAs and reduced profitability. The chi-square test results also confirm that the impact of RBI's monetary policy on bank performance is statistically significant. Therefore, the alternative hypothesis is accepted, proving that

RBI's monetary policy has a meaningful effect on bank profitability and NPAs. Effective policy transmission and risk management are essential for maintaining financial stability in the banking sector.

Suggestions:-

Banks should strengthen their risk assessment and credit appraisal systems, especially during periods of monetary tightening, to control the rise in NPAs. Regular training programs should be provided to bank staff so they can better understand RBI's monetary policy changes and implement them efficiently at the branch level. Banks should also make greater use of digital tools and technology to monitor loan accounts and detect early warning signals. Diversification of income sources, such as fee-based services, can help reduce dependence on interest income and protect profitability. Additionally, RBI should continue to support banks through clear policy communication, faster restructuring approvals, and capacity-building initiatives to ensure smooth policy transmission and long-term banking stability.

III. REFERENCES

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