

The Impact of Interest Rate Changes on The Financial Performance of Indian Companies

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Abstract:

Interest rates influence corporate financial performance through borrowing costs, investment decisions, consumer demand, cash-flow management, asset valuation and access to credit. This paper examines these channels in the context of Indian non-financial companies, with particular attention to the Reserve Bank of India (RBI) policy-rate cycle from the COVID-19 period through 2025. The study uses secondary data from RBI publications and findings from recent empirical literature on Indian firms. The evidence shows that monetary tightening can increase interest expense, reduce debt-servicing capacity and postpone investment, while monetary easing can reduce financing costs and support investment and demand. However, the effect is heterogeneous: firms with high leverage and greater dependence on floating-rate debt are more exposed than firms with strong internal cash generation or fixed-rate funding. Recent Indian evidence based on thousands of non-financial firms confirms that price- and quantity-based monetary policy significantly affects corporate investment and that firm-specific characteristics condition the strength of transmission. The paper concludes that interest-rate changes should be assessed together with leverage, debt maturity, interest coverage, liquidity and sectoral demand rather than treated as a single determinant of profitability.

Keywords — Interest Rate, RBI Repo Rate, Corporate Finance, Financial Performance, Profitability, Leverage, Investment, Indian Companies, Monetary Policy

I. INTRODUCTION

Interest rate is one of the most important macroeconomic variables affecting corporate financial decisions. In India, the Reserve Bank of India uses the policy repo rate as a major monetary-policy instrument. Changes in the policy rate influence money-market conditions and, with a time lag and varying degree of pass-through, bank lending rates and other market financing costs. RBI evidence shows that monetary transmission operates through changes in deposit and lending rates, while the increasing use of external benchmarks has strengthened the connection between policy rates and floating-rate loans [1], [2].

For companies, a change in interest rates matters because debt is a major source of external finance. When rates rise, the interest component of finance costs may increase, especially for firms with floating-rate loans or debt that must be

refinanced. Higher financing costs can reduce profit after tax and interest coverage and may make marginal investment projects less attractive. At the same time, tighter monetary conditions can weaken aggregate demand, which may affect sales and operating cash flows. Conversely, lower interest rates can reduce financing costs and support investment, although the benefit depends on credit availability and the demand environment.

The Indian experience after the pandemic provides a useful setting for studying these effects. The policy repo rate was maintained at 4.00 per cent during the accommodative phase and was subsequently increased by a cumulative 250 basis points between May 2022 and February 2023 to 6.50 per cent. The rate remained at 6.50 per cent through much of 2023-24 before being reduced in 2025; RBI data show 6.25 per cent in

February 2025, 6.00 per cent in April 2025 and 5.50 per cent in June 2025 [3]–[5].

This paper therefore studies how changes in interest rates can influence the financial performance of Indian companies and identifies the firm-level characteristics that can strengthen or weaken the transmission.

II. OBJECTIVES OF THE STUDY

The main objectives of the study are: (1) to explain the relationship between interest-rate changes and corporate financial performance; (2) to examine the transmission channels through which RBI policy rates affect Indian companies; (3) to assess the likely effects on profitability, investment, liquidity and debt-servicing capacity; (4) to examine evidence from recent studies on Indian firms; and (5) to identify firm-specific and sector-specific factors that influence the magnitude of the impact.

III. REVIEW OF LITERATURE

Bandyopadhyay and Barua examined capital structure and corporate performance using a panel of 1,594 Indian manufacturing firms over 1998–2011. Their findings indicate that macroeconomic conditions influence financing decisions and, consequently, corporate performance; they also identify debt financing and firm characteristics as important determinants [6].

A study by Bagow and Altaf uses 3,782 non-financial Indian firms and 45,238 observations for 2000–2023. It reports that both price-based and quantity-based monetary policy significantly affect corporate investment, while firm-specific factors constrain or shape the transmission across manufacturing and non-manufacturing sectors [7].

Panda, Nanda and Hegde investigate the transmission of monetary-policy impulses to manufacturing-firm profitability through short- and long-term corporate financing decisions, using Indian manufacturing firms for 2008–2020. Their research highlights the role of financial flexibility in determining how monetary-policy changes reach firm profitability [8].

Raghuvanshi and Ahmad provide more recent firm-level evidence and report that financially fragile firms bear a larger cost of monetary

tightening, while low leverage and greater market power weaken monetary-policy transmission [9]. This supports the view that the same interest-rate shock can have different consequences for different companies.

Overall, the literature suggests that interest rates matter for Indian corporate decisions, but the effect is not uniform. Leverage, liquidity, firm size, market power, debt structure, sectoral conditions and financial flexibility influence the intensity and timing of the impact.

IV. RESEARCH METHODOLOGY

Research Design: The study follows a descriptive and analytical research design based on secondary data. The analysis focuses on the mechanism linking changes in interest rates to corporate financial indicators rather than estimating a new firm-level econometric model.

Data Sources: Major macroeconomic observations are drawn from RBI annual reports, monetary-policy releases and statistical supplements. Supporting evidence is taken from peer-reviewed and research publications on Indian firms. The National Stock Exchange (NSE) corporate-filings platform is also identified as a source for company-level financial statements and ratios when a firm-specific extension is undertaken [10].

Study Period: The macroeconomic discussion primarily covers the 2020–2025 period, which captures the low-rate pandemic phase, the 2022–2023 monetary tightening cycle and the subsequent easing observed in 2025.

Key Financial Indicators: The study considers interest expense, profit after tax, operating profit, interest coverage ratio, debt-equity ratio, return on assets, return on equity, liquidity and capital expenditure as relevant measures of financial performance. Interest Coverage Ratio may be expressed as EBIT divided by interest expense, while ROA and ROE measure returns relative to assets and shareholders' equity.

Analytical Approach: The paper uses trend interpretation, literature synthesis and a transmission-channel framework. The direction of impact is interpreted cautiously because company performance is simultaneously affected by

inflation, exchange rates, commodity prices, demand, taxation, business cycles and firm-specific decisions.

TABLE I
MAJOR RBI POLICY REPO RATE MOVEMENTS

Period/Date	Repo Rate (%)	Policy Movement
2020–2021	4.00	Accommodative / low-rate phase
May 2022	4.40	First increase after the low-rate phase
Jun 2022	4.90	Tightening continued
Aug 2022	5.40	Tightening continued
Sep 2022	5.90	Tightening continued
Dec 2022	6.25	Tightening continued
Feb 2023	6.50	Cumulative increase of 250 bps since May 2022
Feb 2025	6.25	25 bps reduction
Apr 2025	6.00	25 bps reduction
Jun 2025	5.50	50 bps reduction

Source: Compiled from RBI annual reports, weekly statistical supplements and monetary-policy releases [3]–[5].

V. INTEREST-RATE TRANSMISSION TO COMPANIES

A. Borrowing Cost Channel: A rise in interest rates increases the cost of new borrowing and can raise interest expense on floating-rate or refinanced debt. If operating income remains unchanged, higher interest expense reduces profit before tax and profit after tax. The effect is stronger for firms with high debt relative to operating earnings.

B. Investment Channel: Higher financing costs raise the hurdle rate for new projects. Projects with relatively low expected returns may be delayed, resized or rejected. Indian firm-level research finds that monetary policy significantly affects corporate investment [7]. The investment response can also affect future capacity, productivity and cash flows.

C. Cash-Flow and Liquidity Channel: When debt servicing becomes more expensive, a larger

share of operating cash flow may be committed to interest and principal payments. This can reduce funds available for working capital, dividends, acquisitions and capital expenditure. Research on Indian firms also finds that monetary-policy shocks affect corporate liquid-asset holdings, showing the importance of liquidity management [11].

D. Demand Channel: Monetary tightening can reduce interest-sensitive consumption and investment elsewhere in the economy. Companies may therefore face weaker demand for products and services in addition to higher financing costs. The size of this effect varies substantially by sector.

E. Asset Valuation and Market Channel: Interest rates influence discount rates used in valuation. A higher discount rate can reduce the present value of expected future cash flows, particularly for companies whose valuation depends heavily on long-term growth expectations. Changes in bond yields can also affect corporate borrowing spreads and refinancing conditions.

F. Exchange-Rate and Input-Cost Channel: Interest-rate changes can interact with capital flows and the exchange rate. For companies with substantial imported inputs or foreign-currency liabilities, exchange-rate movements can amplify or offset the direct effect of domestic interest rates. Therefore, the final impact on financial performance is multidimensional.

VI. IMPACT ON FINANCIAL PERFORMANCE

Profitability: The most direct accounting effect of higher interest rates is an increase in finance cost for affected borrowers. If sales and operating margins remain constant, net profit is likely to decline. The effect is comparatively limited for firms with low leverage, large cash balances or predominantly fixed-rate debt.

Interest Coverage and Solvency: Interest Coverage Ratio ($ICR = EBIT / \text{Interest Expense}$) tends to deteriorate when interest expense rises without a proportional increase in EBIT. A lower coverage ratio can reduce financial flexibility and

increase refinancing risk. Highly leveraged firms are therefore more exposed to tightening cycles.

Return on Equity: Higher interest expense can reduce net income and, consequently, ROE, although leverage can complicate interpretation. A company may have high ROE because of leverage during favourable conditions, but the same leverage can magnify pressure on earnings during a tightening cycle.

Return on Assets: Higher interest costs reduce net income, which can lower ROA. However, the effect is not mechanically identical across firms because asset utilisation, operating margins and capital intensity also change with the business cycle.

Capital Expenditure: Companies may postpone expansion when the cost of external finance rises. Evidence for India indicates that monetary policy has a significant effect on corporate investment and that firm-level characteristics condition the response [7].

Working Capital: Higher rates can increase the cost of financing inventory and receivables. Companies with long working-capital cycles may experience greater pressure on cash flows, particularly when customer demand slows.

Shareholder Value: Interest rates affect both earnings expectations and discount rates. Consequently, changes in rates can influence market valuation even before the full accounting effect appears in financial statements. The direction and size of market response depend on expected future earnings, leverage, risk and sector conditions.

VII. SECTOR-WISE EFFECTS

Interest-rate sensitivity differs across Indian industries. Capital-intensive sectors such as infrastructure, construction, real estate, automobiles and selected manufacturing activities can be more exposed because projects often require substantial external finance. A higher rate can increase project costs and reduce affordability for interest-sensitive customers.

Consumer-facing sectors can be affected indirectly when higher borrowing costs reduce household or business spending. In contrast, companies with strong cash generation and lower

financial leverage may experience a smaller direct increase in financing costs.

Financial institutions require separate interpretation. For banks and other lenders, changes in interest rates affect both asset yields and funding costs, so the effect on profitability cannot be inferred simply from the direction of the policy rate. This paper therefore focuses primarily on non-financial companies when discussing corporate borrowing and operating performance.

VIII. FINDINGS AND DISCUSSION

First, the Indian monetary-policy cycle demonstrates a clear change in financing conditions. RBI raised the policy repo rate cumulatively by 250 basis points between May 2022 and February 2023, while corporate bond yields also hardened during 2022–23 [3]. This provides an economically plausible environment in which debt-dependent companies would face higher financing costs.

Second, monetary transmission is incomplete and time-varying. RBI notes that changes in the policy rate transmit to bank lending and deposit rates with varying pass-through, while external benchmark-linked lending has strengthened transmission [2]. Consequently, the effect on an individual company's interest expense depends on loan pricing, reset frequency and refinancing timing.

Third, firm heterogeneity is central. Recent Indian research using 3,782 non-financial firms finds significant monetary-policy effects on investment and emphasises firm-specific factors [7]. Another recent study reports that financially fragile firms bear a greater cost of tightening [9]. Thus, the same rate increase does not produce the same financial outcome for every company.

Fourth, interest rates affect performance through multiple channels simultaneously. A company may experience higher interest expense, weaker demand and delayed investment at the same time. Conversely, lower rates can support borrowing, investment and demand, but only when credit is available and projects have adequate expected returns.

Fifth, the relationship should not be interpreted as a simple one-to-one causal rule. Corporate earnings are also influenced by inflation, commodity prices, exchange rates, productivity, competition, fiscal measures and management decisions. Therefore, an observed fall in profitability during a high-rate period cannot automatically be attributed entirely to interest rates.

TABLE II
EXPECTED DIRECTION OF KEY EFFECTS

Financial Area	When Interest Rates Rise	When Interest Rates Fall
Interest Expense	Generally increases for floating/refinanced debt	Generally decreases for affected debt
Net Profit	Pressure through higher finance cost	Potential support through lower finance cost
Investment	Projects may be delayed or reduced	Financing conditions may support investment
Interest Coverage	May weaken if EBIT is unchanged	May improve if interest expense falls
Liquidity	Greater debt-service pressure	Potentially greater financing flexibility
Demand	May weaken in interest-sensitive segments	May strengthen in interest-sensitive segments
Valuation	Higher discount rate can pressure present value	Lower discount rate can support present value

Note: The table presents general transmission directions, not a prediction for every company. Actual effects depend on debt structure, pricing power, demand, cash holdings and other macroeconomic variables.

IX. MANAGERIAL IMPLICATIONS

Indian companies can reduce exposure to interest-rate volatility by monitoring debt maturity, the share of floating-rate borrowing, interest coverage and refinancing requirements. Maintaining adequate liquidity and matching the maturity of debt with project cash flows can reduce refinancing pressure.

Treasury and finance teams should evaluate projects under multiple interest-rate scenarios rather than using one fixed cost-of-capital assumption. Companies with substantial variable-rate exposure may consider appropriate interest-rate risk-management instruments, subject to cost, accounting treatment and governance requirements.

Management should also distinguish between temporary changes in borrowing cost and

structural changes in demand. A rate increase that is expected to be short-lived may require a different capital-expenditure response from a prolonged tightening cycle. Sector conditions and competitive pricing should therefore be incorporated into financial planning.

X. LIMITATIONS OF THE STUDY

The study is based mainly on secondary evidence and does not estimate a new firm-level panel regression. It therefore identifies mechanisms and synthesises existing empirical results rather than claiming a single causal coefficient for all Indian companies. The analysis also does not separately estimate the effect for each industry or distinguish all forms of fixed-rate, floating-rate, domestic and foreign-currency debt. Future research can use annual or quarterly financial statements of selected listed firms and estimate panel models controlling for leverage, size, liquidity, sector, inflation and GDP growth.

XI. CONCLUSION

Interest-rate changes are an important determinant of the financial environment faced by Indian companies. The strongest direct effect is usually observed through the cost of debt, while indirect effects occur through investment, demand, liquidity, valuation and refinancing conditions. The Indian tightening cycle of 2022–2023 and subsequent easing in 2025 provides a clear macroeconomic setting for observing these transmission mechanisms [3]–[5].

The evidence reviewed in this paper indicates that corporate investment and financing decisions respond to monetary policy, but the magnitude of the response depends on firm-specific characteristics. Companies with higher leverage, weaker liquidity or greater exposure to floating-rate and short-maturity debt can face greater pressure during tightening. Companies with stronger internal cash generation and financial flexibility may experience a smaller direct effect. Accordingly, the financial performance of Indian companies should be evaluated by combining interest-rate movements with leverage, interest coverage, liquidity, operating profitability and sectoral demand conditions.

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