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A Study on the Impact of Non-Performing Assets (NPAs) on the Financial Performance of Public Sector Banks in India

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Abstract: *The banking and financial institutions sector is a vital component of the Indian financial system, contributing significantly to economic growth, employment generation, and financial inclusion. Public Sector Banks (PSBs) hold a dominant share in India's banking industry; however, their performance has been adversely affected by the persistent problem of Non-Performing Assets (NPAs). Rising NPAs reduce profitability, weaken capital adequacy, and restrict the lending capacity of banks. This study examines the impact of NPAs on the financial performance of selected public sector banks in India using secondary data collected from RBI reports and annual reports of banks. Financial performance is analyzed using ratios such as Return on Assets (ROA), Net Profit Margin, and Capital Adequacy Ratio (CAR). The study finds a significant negative relationship between NPAs and profitability, highlighting the need for effective credit risk management and recovery mechanisms.*

Keywords: *financial institutions*

I. INTRODUCTION

Banking and financial institutions play a crucial role in the development of an economy by mobilizing savings, providing credit, facilitating trade, and supporting industrial and agricultural growth. In India, the banking sector is dominated by public sector banks, which are instrumental in implementing government policies related to priority sector lending and financial inclusion. Despite their importance, PSBs have faced serious challenges in recent years, particularly due to the rapid increase in Non-Performing Assets (NPAs).

NPAs adversely affect banks by reducing interest income, increasing provisioning requirements, and eroding capital. High levels of NPAs also weaken investor confidence and limit banks' ability to extend fresh credit to productive sectors. Therefore, analyzing the impact of NPAs on the financial performance of public sector banks is essential for ensuring the stability and efficiency of the Indian banking system.

II. CONCEPTUAL FRAMEWORK

2.1 Banking and Financial Institutions

Banking institutions accept deposits from the public and provide loans and advances to individuals, businesses, and governments. Financial institutions also include Non-Banking Financial Companies (NBFCs), insurance companies, mutual funds, and development banks, all of which contribute to financial intermediation and economic development.

2.2 Non-Performing Assets (NPAs)

According to the Reserve Bank of India (RBI), a loan or advance is classified as a Non-Performing Asset when interest or principal remains overdue for more than 90 days. NPAs are further classified into
sub-standard assets, doubtful assets, and loss assets based on the duration and recoverability of the loan. High NPAs indicate poor asset quality and inefficiencies in credit appraisal and monitoring systems.

2.3 Financial Performance of Banks

Financial performance refers to the ability of a bank to generate profits while maintaining liquidity and solvency. Key indicators used to assess bank performance include Return on Assets (ROA), Return on Equity (ROE), Net Interest Margin, Net Profit Margin, and Capital Adequacy Ratio (CAR).

III. REVIEW OF LITERATURE

Several researchers have examined the problem of NPAs in the Indian banking sector. Studies have consistently reported a negative relationship between NPAs and bank profitability. Research indicates that high NPAs lead to increased provisioning and reduced net profits. Other studies emphasize that economic slowdown, ineffective recovery mechanisms, and poor credit risk assessment are major contributors to rising NPAs. The literature highlights the importance of regulatory reforms and strong risk management practices to control NPAs and improve bank performance.

IV. RESEARCH METHODOLOGY

4.1 Objectives of the Study

1. To analyze the trend of Non-Performing Assets in public sector banks in India.
2. To examine the financial performance of selected public sector banks.
3. To study the impact of NPAs on the profitability of public sector banks.
4. To suggest measures for improving asset quality and financial performance.

4.2 Hypothesis

H0: There is no significant relationship between NPAs and the financial performance of public sector banks. H1: There is a significant negative relationship between NPAs and the financial performance of public sector banks.

4.3 Research Design and Data Collection

The study is descriptive and analytical in nature and is based on secondary data. Data has been collected from annual reports of selected public sector banks, RBI publications, journals, and reliable financial websites. The sample includes banks such as State Bank of India, Punjab National Bank, and Bank of Baroda.

4.4 Tools of Analysis

The data has been analyzed using ratio analysis, trend analysis, and comparative analysis. These tools help in understanding the relationship between NPAs and profitability indicators such as ROA.

V. DATA ANALYSIS AND FINDINGS

The analysis reveals that public sector banks with higher Gross and Net NPAs report lower profitability. An increase in NPAs leads to higher provisioning requirements, which reduces net profits. The study also finds that high NPAs put pressure on capital adequacy, affecting the long-term stability of banks. Overall, NPAs have a significant adverse impact on the financial performance of public sector banks.

VI. SUGGESTIONS

- Strengthening credit appraisal and monitoring systems.
- Early identification and resolution of stressed assets.
- Effective implementation of the Insolvency and Bankruptcy Code (IBC).
- Improving corporate governance and accountability in public sector banks.
- Use of technology and data analytics for credit risk assessment.

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VII. CONCLUSION

The study concludes that Non-Performing Assets pose a serious challenge to the performance and stability of public sector banks in India. High NPAs adversely affect profitability, capital adequacy, and lending capacity. Reducing NPAs through effective risk management, regulatory support, and efficient recovery mechanisms is essential for strengthening the Indian banking system and ensuring sustainable economic growth.

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