

United International Journal of Multidisciplinary Research

ISSN: 3048-6726(UIJMR)Impact Factor: 6.934 (SJIF)

An International Peer-Reviewed and Refereed Multidisciplinary Journal

www.ujmr.in Vol-3, SpecialIssue-2,2026

Non-Performing Assists in Public Sector Banks in India—A Study

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Abstract

Public Sector Banks (PSBs) hold a crucial position in the Indian economy by mobilizing savings, fostering financial inclusion, supporting priority sectors, and enabling balanced regional development. Despite their substantial contributions, PSBs have encountered ongoing challenges due to the rise of Non-Performing Assets (NPAs), which have negatively impacted their profitability, capital adequacy, and lending capabilities. This paper explores the function of Public Sector Banks within the Indian economy, assesses the effects of NPAs on their performance, reviews the trends of gross NPAs in PSBs, and evaluates the strategies implemented to manage and mitigate NPAs. The study underscores the significant enhancement in asset quality observed in recent years, demonstrating the success of reforms such as the Insolvency and Bankruptcy Code (IBC), bank recapitalization, asset quality reviews, and governance reforms. The results suggest that ongoing policy support and sound banking practices are vital for fortifying PSBs and ensuring enduring financial stability and economic growth.

Key Words: Public Sector Banks, Indian Economy, and Non-Performing Assets.

Introduction:

Public Sector Banks (PSBs) constitute the foundation of India's banking framework, playing an essential role in economic advancement, financial stability, and inclusive growth. The majority ownership by the Government of India allows these banks to operate under a dual mandate—engaging in commercial banking activities while also addressing social and developmental obligations. Their vast branch network, especially in rural and semi-urban regions, facilitates the mobilization of savings, provision of credit to priority sectors, and promotion of balanced regional development.

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www.ujmr.in Vol-3, SpecialIssue-2,2026

PSBs are characterized as banks where the Government of India possesses over 50 percent of the shareholding. Notable examples include the State Bank of India (SBI), Punjab National Bank, Bank of Baroda, Canara Bank, Union Bank of India, Indian Bank, and Bank of Maharashtra. Since the period of nationalization, PSBs have played a crucial role in broadening access to institutional banking for agriculture, small industries, and marginalized communities, ensuring that financial services reach even the most underserved segments of society.

In addition to traditional banking, PSBs act as vital instruments for public policy and economic development. They execute government welfare and financial inclusion programs, such as Direct Benefit Transfers, Jan Dhan accounts, and credit schemes for MSMEs and self-employment. By sustaining credit flow during economic down turns and

backing priority sectors, PSBs make significant contributions to capital formation, job creation, and overall economic growth.

Nonetheless, Public Sector Banks encounter a significant challenge in the form of Non-Performing Assets (NPAs), which are loans where borrowers fail to repay the principal or interest within the designated timeframe. Elevated NPAs diminish profitability, deplete capital, restrict lending capacity, and heighten reliance on government recapitalization. Consequently, increasing NPAs not only impact the operational efficiency of PSBs but also present risks to the stability and growth of India's financial system and the broader economy.

Significance of the Study:

The research improves comprehension of the function of Public Sector Banks within the Indian economy and investigates the influence of Non-Performing Assets (NPAs) on their financial performance. Through the analysis of trends in gross NPAs, it offers insights into the efficacy of recent banking reforms. The results are beneficial for students, researchers, policymakers, and banking professionals, and they add to the existing literature by connecting banking sector reforms with economic growth and financial stability.

Objectives of the Study: The following are the main objectives of the study

1. To investigate the function of Public Sector Banks (PSBs) within the Indian economy and their role in fostering economic growth and promoting financial inclusion.
2. To assess the effects of Non-Performing Assets (NPAs) on the financial performance and stability of Public Sector Banks.

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3. To examine the trends and current status of Gross NPAs in Public Sector Banks in India over recent years.

4. To review the initiatives undertaken by the Government of India and the Reserve Bank of India (RBI) aimed at managing and mitigating NPAs in Public Sector Banks.

Scope and Methodology:

This study is characterized by its descriptive and analytical approach. It relies solely on secondary data obtained from trustworthy sources, including reports from the Reserve Bank of India (RBI), publications from the Government of India, annual reports from Public Sector Banks, Economic Surveys, academic journals, research articles, and official websites. The data gathered have been examined using basic statistical methods, percentages, and trend analysis to assess the role of Public Sector Banks (PSBs), the effects of Non-Performing Assets (NPAs), and the efficacy of measures implemented for NPA management.

Role of Public Sector Banks in the Indian Economy

Public Sector Banks (PSBs) hold a crucial and essential role in the Indian economy.

Founded with the aim of providing broader access to banking services, these banks are predominantly government-owned and serve as significant tools of economic policy. Following the nationalization of banks, PSBs have been instrumental in increasing institutional credit, particularly to priority and underserved sectors. By integrating commercial banking functions with social and developmental goals, Public Sector Banks make substantial contributions to economic growth, financial inclusion, and regional equity. Their vast branch network, robust customer base, and participation in executing government welfare initiatives allow them to assist agriculture, industry, MSMEs, and social security programs, establishing them as a fundamental component of India's financial framework and economic progress.

□ Financial Intermediation: Public Sector Banks (PSBs) gather savings from households and institutions, directing these funds into productive sectors such as agriculture, industry, micro, small, and medium enterprises (MSMEs), and services, thus facilitating capital formation and fostering economic growth.

□ Agricultural and Rural Development: PSBs serve as the primary source of agricultural financing, providing loans for crop production, related activities, rural infrastructure, Self-Help Groups (SHGs), and Joint Liability Groups (JLGs), which enhance farm productivity and increase rural incomes.

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- **Support to MSMEs and Industry:** They extend working capital and term loans to MSMEs, large-scale industries, and infrastructure initiatives, thereby encouraging industrial expansion and creating substantial employment opportunities.
 - **Financial Inclusion:** Through initiatives such as the Pradhan Mantri Jan Dhan Yojana, Basic Savings Bank Accounts, and Direct Benefit Transfers, PSBs integrate unbanked individuals into the formal financial system, fostering inclusive economic growth.
 - **Implementation of Government Schemes:** PSBs function as essential implementing bodies for government initiatives like the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), Mudra Yojana, Stand-Up India, as well as pension and insurance programs, thereby bolstering social welfare and entrepreneurship.
 - **Employment Generation:** By financing agriculture, MSMEs, startups, and infrastructure projects, PSBs contribute to indirect employment creation, in addition to offering direct employment through their extensive branch networks.
 - **Balanced Regional Development:** With a robust presence in rural and semi-urban regions, PSBs play a crucial role in diminishing regional inequalities and fostering equitable economic development.
 - **Economic Stability:** In times of economic downturns and financial crises, PSBs maintain a steady flow of credit, fulfilling a stabilizing and counter-cyclical function within the Indian economy.

Impact of Non-Performing Assets on Public Sector Banks

Non-Performing Assets (NPAs) have become one of the most pressing issues confronting Public Sector Banks (PSBs) in India. An NPA is defined as a loan or advance for which the borrower has not repaid either the interest or the principal within a designated timeframe, leading to a loss of revenue for the bank. Given that PSBs represent a substantial portion of total bank lending in India, the rise in NPAs has considerably affected their financial stability and operational effectiveness. The increasing incidence of NPAs has negatively impacted the profitability, capital adequacy, and lending capacity of Public Sector Banks. Elevated levels of NPAs compel banks to allocate significant provisions, thereby diminishing their capacity to offer new credit and heightening their reliance on government recapitalization. As a result, the NPA issue not only undermines the strength of PSBs but also affects the overall stability and growth of the Indian financial system and economy.

- **Decline in Profitability:** The presence of high NPAs diminishes the interest income of Public Sector Banks, as loans that are non-performing cease to yield

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returns. Furthermore, banks must allocate substantial provisions for these bad loans, which considerably reduces net profits and, in certain instances, results in losses.

□ Erosion of Capital and Net Worth: The necessity for increased provisioning for NPAs diminishes the capital base of PSBs. This deterioration weakens their balance sheets and frequently requires capital injections from the government to uphold capital adequacy standards.

□ Reduced Lending Capacity: With a significant amount of funds tied up in non-performing assets, PSBs tend to be more cautious in granting new credit. This contraction in credit negatively impacts productive sectors such as agriculture, MSMEs, and industry, thereby hindering economic growth.

□ Operational Inefficiency: The management and recovery of NPAs demand considerable time, personnel, and resources. This diverts the attention of bank management from essential banking functions and diminishes overall operational efficiency.

□ Loss of Public and Investor Confidence: Persistently elevated NPAs undermine the credibility and market perception of PSBs. A decline in confidence among depositors and investors can adversely affect fund mobilization and market performance.

□ Increased Dependence on Government Support: As a result of capital erosion attributed to NPAs, PSBs frequently rely on government recapitalization. This reliance amplifies the fiscal burden on the government and restricts the operational autonomy of the banks.

□ Negative Impact on Financial Stability: High levels of NPAs weaken the banking system and can introduce risks to overall financial stability. Given that PSBs represent a substantial portion of banking assets in India, their distress has wider implications for the economy.

□ Delay in Economic Development: When PSBs are encumbered with NPAs, their capacity to support priority sectors and development initiatives is diminished, ultimately impacting job creation, investment, and inclusive economic growth.

Gross NPAs in the Public Sector Banks in India

Gross Non-Performing Assets (NPAs) serve as a crucial measure of the financial stability and asset quality of banks, especially Public Sector Banks (PSBs), which possess a substantial portion of India's banking assets. In this regard, there is need to study the last five years Gross NPAs from the financial year 2020-21 to 2024-25. The required data collected and presented in Table – 1.

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Table-1:GrossNPAsinthePublicSectorBanksinIndia

	FinancialYear	GrossNPAs	GrossNPARatio(%)
2024-25	3,39,541	3.47	
2022-23	4,28,197	4.97	
2021-22	5,40,958	7.28	
2020-21	6,16,616	9.11	

Source:RBIAnnualReportsofFinancialYear-2024-25.

The data in the table – 1 indicates that the Public Sector Banks (PSBs) have demonstrated significant enhancement in asset quality, as evidenced by a consistent decrease in grossNon-Performing Assets (NPAs) from 9.11% in March 2021 to 2.58% by March 2025. This declining trend illustrates the success of regulatory reforms, improved credit discipline, more effective recovery mechanisms, and proactive policy measures implemented by both the Government of India and the Reserve Bank of India.

The substantial decrease in gross NPA s among Public Sector Banks indic at esa Fortification of the Indian banking system and an increase in financial stability. The reduction in NPAs has bolstered the profitability, capital adequacy, and lending capacity of PSBs, allowing them to contribute to economic growth more efficiently. A sustained emphasis on prudent lending practices, strong governance, and the timely resolution of distressed assets will be crucial in maintaining this favourable trend and ensuring the long-term resilience of Public Sector Banks.

Measures Implemented to Manage NPA sin Public Sector Banks

Non-Performing Assets (NPAs) present a significant challenge to the stability and efficiency of Public Sector Banks (PSBs) in India. A substantial level of NPAs undermines bank balance sheets, diminishes profitability, limits credit expansion, and erodes public trust in the banking system. Given that PSBs represent a considerable portion of total banking assets and lending, the NPA issue has broader consequences for financial stability and economic development. In response to this challenge, the Government of India and the Reserve Bank of India have implement edvarious structural, regulatory, and institutional initiatives aimed at enhancing asset quality, fortifying recovery processes, and improving governance within PSBs. These initiatives are intended not only to address current stressed assets but also to avert the future rise of NPAs, thus ensuring a robust and sustainable banking framework.

□ Insolvency and Bankruptcy Code (IBC), 2016: The Insolvency and Bankruptcy Code(IBC) represent a significant reform aimed at tackling the issue of

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NPAs .It establishes a time-sensitive and transparent framework for the resolution of distressed assets by shifting control of defaulting companies from their promoters to creditors. Under the IBC, cases are required to be resolved within a designated timeframe, after which liquidation proceedings commence. This has led to improved recovery rates, reinforced credit discipline, and minimized delays in addressing substantial corporate NPAs.

□ **Bank Recapitalization:** The Government of India has initiated extensive recapitalization efforts for Public Sector Banks to restore their financial stability. The infusion of capital enables PSBs to comply with regulatory capital adequacy requirements, absorb losses stemming from NPAs, and return to regular lending operations. Recapitalization has bolstered balance sheets, increased confidence among depositors and investors, and allowed banks to contribute to economic growth.

□ **Asset Quality Review (AQR):** The Asset Quality Review conducted by the Reserve Bank of India has ensured a transparent and precise identification of stressed and non-performing assets. Banks were mandated to recognize and report bad loans that had previously been concealed or restructured. This resulted in a temporary rise in reported NPAs but fostered long-term financial discipline, accountability, and the credibility of PSBs.

□ **Bank Mergers and Governance Reforms:** The consolidation of Public Sector Banks through mergers has been aimed at forming larger, more robust, and efficient banking institutions. Mergers facilitate economies of scale, enhance risk diversification, strengthen management, and improve operational efficiency. In conjunction with mergers, governance reforms such as the establishment of professional boards, enhanced accountability, and performance-driven management have fortified risk management practices.

□ **SARFAESI Act and Debt Recovery Tribunals (DRTs):** The SARFAESI Act grants banks the authority to recover outstanding dues without the need for court intervention by seizing the secured assets of borrowers who default. Debt Recovery Tribunals(DRTs) offer a specialized framework for the swift adjudication and recovery of bank dues. Collectively, these mechanisms have enhanced recovery processes, minimized delays, and improved the overall efficiency of Non-Performing Asset (NPA) management.

□ **Improved Credit Appraisal and Monitoring Systems:** Public Sector Banks (PSBs) have fortified their credit appraisal processes by implementing advanced risk assessment tools, early warning systems, and ongoing monitoring of loan

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accounts. This proactive approach aids in the early identification of stress, thereby preventing the further accumulation of NPAs.

□ Use of Technology and Data Analytics: The increased utilization of technology, digital platforms, and data analytics has significantly enhanced loan tracking, fraud detection, and recovery processes. This advancement boosts operational efficiency and diminishes the chances of future NPAs.

The integration of legal reforms, regulatory oversight, capital support, and institutional fortification has markedly improved the capacity of Public Sector Banks to manage and mitigate NPAs. Although challenges persist, these initiatives have established a robust foundation for a healthier and more resilient banking system in India.

Conclusion:

Public Sector Banks hold a crucial and diverse position in the Indian economy by fostering financial inclusion, aiding priority sectors, and facilitating balanced regional development. Nevertheless, the issue of Non-Performing Assets (NPAs) has historically presented a significant obstacle to their profitability, capital adequacy, and lending capabilities. In recent years, the downward trend in Gross NPAs indicates the effectiveness of policy reforms, regulatory supervision, and institutional frameworks such as the Insolvency and Bankruptcy Code, bank recapitalization, governance enhancements, and refined credit appraisal processes. Ongoing initiatives to bolster risk management, transparency, and accountability are vital for ensuring the long-term stability and growth of Public Sector Banks, thereby augmenting the role in India's economic advancement.

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