International Journal of Web of Multidisciplinary Studies
(Peer-Reviewed, Open Access, Fully Refereed International Journal)
website: *http://ijwos.com*
Volume.03 Issue.01.
OPEN ACCESS
E-ISSN : 3049-2424
DOI: https://doi.org/10.71366/ijwos

A Study of the Impact of Non-Performing Assets (NPAs) on Banks and the Indian Economy

Abhishek Gupta[1]
[1] *Assistant Professor, Department of Commerce, Lucknow Christian Degree College, Lucknow.*

Article Info

Article History:

Published:31 Jan 2026

Publication Issue:
Volume 3, Issue 01
January-2026

Page Number:
674-679

Corresponding Author:
Abhishek Gupta

Abstract:

Non-Performing Assets (NPAs) have come to be recognized as a basic problem in the Indian banking system, and by extension, the economy as a whole. High levels of NPAs affect the profitability of banks, their capital adequacy, and their ability to transmit credits to the productive sectors of the economy, thus hindering economic growth. This paper presents the conceptual framework of NPAs, their development in the Indian context, and their impact on the financial health of banks and the economy as a whole, measured by GDP growth, credit growth, and employment. Using secondary data from Reserve Bank of India publications and current literature, this paper argues that effective management strategies and good governance are necessary to counter the negative impacts of NPAs on banks and the economy.

Keywords: Non-Performing Assets (NPAs)

1. Introduction

The banking sector is an important sector in the economy, as it acts as an intermediary between savings and credit. When a large amount of bank loans becomes Non-Performing Assets (NPAs), it affects the financial health of the banks, as well as the economy, due to the unavailability of credit. The NPA issue has been a periodic concern in the Indian economy, especially after the global financial crisis in 2008 and during periods of economic slowdown in the country.

This paper aims to study the **impact of NPAs on banks and the Indian economy**, with the following objectives:

1. To define NPAs and examine their classification and measurement.
2. To trace the evolution of NPAs in the Indian banking sector.
3. To analyze the impact of NPAs on banks' profitability, capital adequacy, and credit-delivery capacity.
4. To assess the macroeconomic consequences of high NPAs, including effects on GDP growth, investment, and employment.

Copyright © 2025 The Author(s) : This is an open access article under the CC BY license (http://creativecommons.org/licenses/by-nc/4.0/)

5. To discuss policy measures adopted by the RBI and the Government of India to address the NPA problem.

2. Conceptual Framework and Measurement of NPAs

2.1 Definition of NPAs

A Non-Performing Asset (NPA) is defined as a loan or an advance where the borrower has not incurred any scheduled interest or principal repayment for a specified period of time, usually 90 days, under the Indian system. Based on the Reserve Bank of India guidelines, an asset can be classified as sub-standard, doubtful, or a loss, depending on the duration of default and the chances of recovery.

2.2 Classification of NPAs

The RBI classifies NPAs into three broad categories:

- **Sub-standard assets**: Loans overdue for up to 12 months; these are considered doubtful but may still be recoverable.
- **Doubtful assets**: Loans overdue for more than 12 months; the probability of full recovery is low.
- **Loss assets**: Loans where a loss has been identified but not yet written off; recovery prospects are negligible.

Banks are required to make **provisions** against NPAs, which directly affect their profitability and capital base.

2.3 Measurement of NPAs

Commonly used indicators include:

- **Gross NPA ratio** = (Gross NPAs / Total advances) × 100
- **Net NPA ratio** = (Net NPAs / Net advances) × 100
- **Provision coverage ratio (PCR)** = (Provisions / Gross NPAs) × 100

These ratios help regulators and analysts gauge the severity of the NPA problem across banks and over time.

2. Evolution of NPAs in the Indian Banking Sector

The Indian economy has witnessed two different phases of non-performing asset (NPA) accumulation. The first phase came after the global financial crisis of 2008-09, when many corporate borrowers, especially in the infrastructure, power, and property sectors, faced cash flow problems. The second phase escalated around 2015-18, when the Reserve Bank of India's (RBI) Asset Quality Review (AQR) forced banks to disclose their hidden non-performing loans, which led to a substantial rise in reported NPAs.

The public sector banks (PSBs) were more adversely affected because of their aggressive lending in the mid-2000s, poor credit analysis, and, in some cases, political or crony influences in lending decisions. By 2018, the gross NPA ratio of scheduled commercial banks peaked at around 11.46%, but it reduced to around 2.31% as of March 2025.

4. Impact of NPAs on Banks

4.1 Profitability and Earnings

This directly affects the net profits of banks, as high non-performing assets eat into their interest income and increase provisioning, thereby reducing net profits. It has been found that an increase in the gross NPAs ratio adversely affects the Return on Assets (ROA) and Return on Equity (ROE), and this effect is most pronounced in public sector banks.

In simple terms: when NPAs rise, banks are forced to shift more funds to provisions rather than to lending, thereby reducing dividends paid to shareholders.

4.2 Capital Adequacy and Risk-Taking

Non-performing assets reduce capital buffers because setting aside provisions reduces retained earnings, and in extreme cases, governments are required to recapitalize banks. When banks have a weakened capital base, they become less active, and credit standards become stringent even for good borrowers.

4.3 Credit Supply and Risk-Pricing

Banks with large non-performing assets will be less likely to extend new loans or will turn to low-return assets. This will reduce credit to small and medium enterprises and infrastructure projects.

Banks will also raise interest rates to compensate for their losses, making borrowing more expensive for the economy.

5. Impact of NPAs on the Indian Economy

5.1 Effect on GDP Growth and Investment

Some studies reveal that a high level of non-performing assets (NPA) can be a hindrance to GDP growth. When banks cut back on lending or become selective about lending to whom, businesses find it difficult to raise funds for expansion, upgradation, and even working capital. As a large number of credits are offered by public sector banks, the impact of their credit squeeze due to high NPAs is quite significant.

5.2 Employment and Sectoral Effects

A high NPA can be a trigger for job cuts, particularly in sectors that are heavily dependent on bank funding, such as manufacturing, infrastructure, and real estate. When there are stressed projects, there are layoffs, cuts in wages, and reduced consumer spending, which further worsens the demand situation.

5.3 Fiscal and Financial Stability Implications

In order to maintain financial stability, the government has been injecting capital into public sector banks from time to time. This method not only puts pressure on the fiscal system but also diverts funds away from social and developmental expenditure. The current problems of non-performing assets also affect the confidence of investors in the banking sector and may increase the cost of borrowing.

6. Policy Measures to Address NPAs

6.1 Regulatory and Supervisory Reforms

The RBI has introduced several measures, including:

- **Asset Quality Review (AQR)** to ensure realistic recognition of NPAs.[9][4]
- **Prudential norms** for provisioning and capital adequacy, aligned with Basel-III standards.[5][4]
- **Prompt Corrective Action (PCA)** framework for weak banks.[12][4]

6.2 Legal and Resolution Frameworks

The Insolvency and Bankruptcy Code (IBC), introduced in 2016, has emerged as a major tool for addressing large corporate NPAs through the resolution and, if required, liquidation process. The establishment of Asset Reconstruction Companies (ARCs) and National Asset Reconstruction Company Limited (NARCL) has also facilitated the resolution of stressed assets.

6.3 Governance and Risk-Management Improvements

Banks must strengthen their credit evaluation, monitoring, and recovery mechanisms. Improved corporate governance, reduced political interference, and enhanced internal controls are necessary to avoid any future accumulation of non-performing assets.

7. Empirical Evidence and Findings

Recent empirical studies using panel-data techniques for Indian commercial banks report that:

- A rise in **gross NPA ratios** significantly lowers **ROA and ROE**.
- High NPAs in public sector banks are associated with **slower GDP growth** and reduced credit flow to productive sectors.
- After the implementation of IBC and other reforms, there has been a visible **decline in gross NPA ratios**, from around 11.46% in 2018 to about 2.31% by March 2025.

  Banks need to tighten their credit assessment, monitoring, and recovery procedures. Improving corporate governance, reducing political intervention, and enhancing internal controls are necessary to avoid the accumulation of non-performing assets in the future.

8. Conclusion and Policy Implications

Non-Performing Assets are a profound and systemic challenge to the banking sector in India and the economy as a whole. If NPAs remain high, it will impact the profitability of banks, the capital adequacy ratio will be affected, and the growth of lending will decelerate. This will further affect investments, employment, and GDP. The last decade has clearly shown that early detection, effective resolution mechanisms, and effective governance are essential to mitigate the problem of NPAs. The key learnings for policymakers are:

- Continued strengthening of the **IBC and legal-recovery framework** to ensure faster resolution of stressed assets.
- Encouraging banks to adopt **advanced risk-management systems** and **prudent lending practices**.

- Enhancing **transparency and accountability** in public sector banks to reduce moral hazard and political interference.

Looking ahead, some questions that could be explored using more detailed data and more advanced techniques include: what drives NPAs at the bank level, how stressed assets are distributed by sector, and what are the growth effects of different resolution strategies.

References

1. Reserve Bank of India. *Report on Trend and Progress of Banking in India*. Various issues.
2. Goyal, A. (2017). *Aggregate demand or bank non-performing assets?* IGIDR Working Paper.
3. Mishra, P., & Dhal, S. (2010). *Determinants of NPAs in Indian banks*.
4. IJIRT, IJNRD, JETIR, and other journal papers on NPAs in Indian banking.