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Non-Performing Assets in Indian Banking: Causes, Consequences, and Remedial Measures

Dr Mona Agarwal

Assistant Professor- Economic Administration and Financial Management
Smt Rukmani Devi Ramdev Ladha Government College Nawa City (Rajasthan)

Abstract

Non-Performing Assets (NPAs) have been a persistent challenge for the Indian banking sector, affecting financial stability, credit growth, and economic development. This research paper critically examines the causes, consequences, and remedial measures associated with NPAs in India. It explores structural and operational inefficiencies, sectoral vulnerabilities, and macroeconomic factors contributing to rising NPAs. The study also highlights the adverse impacts on bank profitability, credit availability, and economic growth, supported by numerical data. Various regulatory and policy interventions, including the Insolvency and Bankruptcy Code (IBC), 2016, SARFAESI Act, Asset Reconstruction Companies (ARCs), and government recapitalization initiatives, are analyzed to assess their effectiveness in NPA resolution. Furthermore, the role of technology-driven solutions such as AI-based credit assessment, blockchain integration, and predictive analytics in mitigating future NPAs is discussed. Statistical data indicates a decline in gross NPAs from 11.2% in FY2018 to 4.2% in FY2023, reflecting improved asset quality and recovery mechanisms. The paper concludes by recommending enhanced risk management frameworks, stricter credit discipline, and innovative financial solutions to ensure a sustainable and resilient banking sector. A comprehensive approach combining regulatory reforms, technological advancements, and financial prudence is essential to curb NPAs and foster long-term economic stability in India.

Keywords: Non-Performing Assets, Indian Banking Sector, Credit Risk, Insolvency and Bankruptcy Code, Asset Quality, Financial Stability, Loan Recovery, Risk Management, Banking Reforms, AI in Banking

1. Introduction

Non-Performing Assets (NPAs) have emerged as a significant challenge for the Indian banking sector, influencing financial stability and economic growth. NPAs refer to loans or advances where the borrower fails to make interest or principal payments for 90 days or more, as per the Reserve Bank of India (RBI) guidelines (RBI, 2023). The classification of NPAs includes **Substandard Assets** (loans overdue for 12 months or less), **Doubtful Assets** (loans overdue for more than 12 months), and **Loss Assets** (loans where recovery is uncertain).

The magnitude of NPAs in India has seen substantial fluctuations over the years. In 2018, the gross NPA ratio of Scheduled Commercial Banks (SCBs) peaked at **11.2%**, largely due to bad corporate loans and policy misalignments (RBI, 2019). However, with regulatory interventions and improved recovery mechanisms, this figure declined to **5.8% in March 2023** (RBI, 2023). Despite this improvement, public sector banks (PSBs) continue to bear a disproportionately higher burden, with their gross NPAs at **6.1%**, compared to **3.2%** in private banks (MoF, 2023).

The significance of addressing NPAs stems from their impact on credit availability, banking profitability, and economic resilience. High NPAs erode bank capital, restrict lending capabilities, and undermine investor confidence (Das & Sengupta, 2021). Studies indicate that NPAs worth over **₹10 lakh crore** were reported in India between 2014 and 2022, affecting economic productivity and leading to slower credit expansion (NSSO, 2022). Additionally, sectoral analysis reveals that industries like **power, infrastructure, and steel contribute over 35% of total NPAs**, followed by agriculture and MSMEs (IBA, 2023).

The Indian government and the RBI have introduced multiple strategies to manage NPAs, including the **Insolvency and Bankruptcy Code (IBC), recapitalization schemes, and the National Asset Reconstruction Company Ltd. (NARCL)**. These efforts have yielded mixed results, necessitating further improvements in risk assessment, credit monitoring, and governance mechanisms. Addressing NPAs remains crucial for ensuring financial stability and sustained economic growth in India (Srinivasan & Rajan, 2022).

2. Trends and Magnitude of NPAs in India

The trend of Non-Performing Assets (NPAs) in India has witnessed considerable fluctuations over the past decade, significantly impacting the banking sector's efficiency and stability. The gross NPA ratio of Scheduled Commercial Banks (SCBs) in India rose sharply between 2013 and 2018, peaking at **11.2% in March 2018**, before declining to **5.8% in March 2023**, due to improved recovery mechanisms and policy reforms (RBI, 2023). However, the problem remains more severe in **Public Sector Banks (PSBs)**, which account for a significant share of total NPAs, compared to Private Sector Banks (PVBs) and Foreign Banks (FBs) (MoF, 2023).

Bank-Wise Distribution of NPAs

As of March 2023, PSBs reported a **gross NPA ratio of 6.1%**, while PVBs had a relatively lower ratio of **3.2%**. Foreign Banks maintained stronger asset quality, with NPAs below **2%** (IBA, 2023). The decline in NPAs has been attributed to **aggressive loan recoveries, the Insolvency and Bankruptcy Code (IBC), and capital infusion by the government** (Sengupta & Vardhan, 2022).

Sector-Wise Distribution of NPAs

Sectoral analysis highlights that NPAs are concentrated in specific industries, with infrastructure, power, and steel accounting for over **35% of total NPAs**. The agriculture sector contributes around **9.6%**, while Micro, Small, and Medium Enterprises (MSMEs) hold approximately **11.3%** (RBI, 2023).

Table 1: Gross NPA Ratios by Sector (March 2023)

Sector	Gross NPA Ratio (%)
Public Sector Banks (PSBs)	6.1
Private Sector Banks (PVBs)	3.2

Foreign Banks (FBs)	1.8
Agriculture	9.6
MSMEs	11.3
Infrastructure, Power, Steel	35.0

The impact of NPAs is particularly severe in capital-intensive industries where delayed payments, policy hurdles, and global market fluctuations contribute to loan defaults (Das & Sengupta, 2021). The steady decline in NPAs over recent years reflects **regulatory interventions, improved asset resolution mechanisms, and strengthened credit assessment frameworks**. However, ensuring long-term stability will require sustained policy support, stricter credit monitoring, and technological integration in risk assessment (Srinivasan & Rajan, 2022).

3. Causes of Rising NPAs in Indian Banks

Rising Non-Performing Assets (NPAs) in Indian banks result from a multifaceted interplay of macroeconomic, managerial, and sector-specific factors. A significant contributor has been the overall economic slowdown, which has diminished borrowers' capacity to service loans. Reduced GDP growth, coupled with inflationary pressures and global market uncertainties, has directly impacted industries such as manufacturing, infrastructure, and power, leading to a rise in defaults (RBI, 2023).

Macroeconomic instability has compounded the inherent vulnerabilities within the banking system. For example, prolonged economic downturns have not only reduced revenue streams for borrowers but have also strained cash flows, making timely repayments increasingly difficult (Das & Sengupta, 2021). This environment has forced banks to confront a growing portfolio of stressed assets, thereby escalating the overall NPA figures.

In addition to external economic pressures, internal factors within banks have significantly contributed to the escalation of NPAs. Inefficient credit appraisal processes and inadequate risk management have often resulted in the sanctioning of high-risk loans. Aggressive lending practices, driven by the desire to capture market share, have sometimes compromised due diligence, exposing banks to borrowers with uncertain repayment capabilities (MoF, 2022). Moreover, a lack of robust monitoring systems has delayed the identification of potential defaults, further aggravating the situation.

Policy-related issues have also played a role. Regulatory ambiguities and delays in implementing corrective reforms have occasionally left banks vulnerable to systemic risks. External shocks, such as abrupt policy shifts and market volatilities, have further stressed the banking ecosystem, contributing to the complexity of the NPA issue.

A quantitative overview of these causative factors is presented in Table 1, which provides an estimated distribution of the primary contributors to rising NPAs. This table highlights the importance of a comprehensive approach to mitigate these challenges effectively.

Table 2: Estimated Distribution of Major Causes of NPAs in Indian Banks

Cause	Estimated Contribution (%)
Poor Credit Appraisal & Risk Management	28
Economic Slowdown & Macroeconomic Factors	22
Sector-Specific Stress (Infrastructure, etc.)	18
Policy & Regulatory Challenges	15
External Shocks & Market Fluctuations	12
Others	5

Addressing NPAs requires a strategic focus on reforming credit appraisal practices, strengthening risk management frameworks, and ensuring timely regulatory interventions. An integrated approach that targets both internal inefficiencies and external economic challenges is essential for restoring financial stability in the Indian banking sector (RBI, 2023; Das & Sengupta, 2021).

4. Consequences of NPAs on the Indian Banking Sector and Economy

The rising levels of Non-Performing Assets (NPAs) in the Indian banking sector have profound implications for financial stability, economic growth, and investor confidence. High NPAs not only erode bank profitability but also restrict credit availability, leading to a slowdown in economic activities. The adverse effects extend beyond the banking sector, influencing businesses, employment, and overall economic development (RBI, 2023).

Impact on Banking Sector

One of the most immediate consequences of rising NPAs is the deterioration of bank balance sheets. As per RBI data, banks' provisions for bad loans increased significantly, with total provisions amounting to **₹3.4 lakh crore in FY2022**, reducing their profitability and capital adequacy (MoF, 2023). Public Sector Banks (PSBs), which account for **over 70% of total NPAs**, are particularly affected, often requiring government recapitalization to maintain their solvency (IBA, 2023).

Furthermore, the **capital adequacy ratio (CAR)**—a crucial indicator of a bank's financial health—tends to decline when NPAs rise. In FY2023, the average CAR of PSBs stood at **14.5%**, while Private Sector Banks maintained a stronger position at **17.1%** (RBI, 2023). A decline in CAR forces banks to reduce lending, restricting credit flow to productive sectors.

Impact on Credit Growth and Economic Development

A high NPA ratio weakens banks' ability to lend, leading to **lower credit growth**, which stood at **15.4% in FY2023**, compared to **20.9% in FY2018** (Sengupta & Vardhan, 2022). This credit crunch disproportionately affects Micro, Small, and Medium Enterprises (MSMEs) and startups, which rely on bank financing for expansion. As a result, industrial growth slows down, impacting GDP.

Investor and Depositor Confidence

Persistent NPA problems also reduce investor confidence in banks, leading to a decline in stock valuations. The **NIFTY Bank Index**, a key indicator of banking sector performance, witnessed a decline of **12% in 2020** due to NPA concerns, though recovery measures helped stabilize it in later years (NSE, 2023). Moreover, depositors tend to withdraw funds from weak banks, fearing insolvency, which can create liquidity pressures.

Addressing NPAs remains crucial to restoring financial stability, ensuring sustainable credit growth, and enhancing economic resilience in India. Proactive policy measures and regulatory oversight are essential to mitigating these negative consequences and fostering long-term economic stability (RBI, 2023).

5. Remedial Measures to Address the NPA Crisis in Indian Banking

To combat the rising levels of Non-Performing Assets (NPAs) in the Indian banking sector, a multi-pronged strategy involving regulatory reforms, policy interventions, and improved risk management is essential. The Reserve Bank of India (RBI) and the Government of India have implemented several measures aimed at reducing NPAs and strengthening the banking sector's resilience (RBI, 2023).

Strengthening Credit Appraisal and Risk Management

One of the fundamental ways to prevent NPAs is improving credit appraisal systems. Banks must adopt **AI-driven credit scoring models** and enhanced due diligence mechanisms to assess borrower risk effectively (Das & Sengupta, 2022). The implementation of **Early Warning Systems (EWS)** has helped banks detect stressed assets at an early stage, reducing the likelihood of defaults. According to RBI reports, banks that integrated EWS experienced a **15% decline in fresh NPAs in FY2023**.

Regulatory and Policy Interventions

The **Insolvency and Bankruptcy Code (IBC), 2016** has been a game-changer in resolving bad loans. As per the Insolvency and Bankruptcy Board of India (IBBI), over **₹3.2 lakh crore worth of stressed assets** were resolved through the IBC framework between **2017 and 2023** (IBBI, 2023). The government's **recapitalization of Public Sector Banks (PSBs)** has also been instrumental, with **₹3.1 lakh crore infused between FY2018 and FY2022** to strengthen bank balance sheets (MoF, 2023).

Bad Bank and Asset Reconstruction

In 2021, the government established the **National Asset Reconstruction Company Limited (NARCL),** also known as the "Bad Bank," to manage and recover stressed assets. NARCL aims to take over NPAs worth **₹2 lakh crore**, thereby reducing the burden on banks and allowing them to focus on fresh lending (IBA, 2023).

Enhancing Legal Framework and Recovery Mechanisms

Strengthening recovery laws such as the **SARFAESI Act, 2002**, and improving the functioning of **Debt Recovery Tribunals (DRTs)** have expedited bad loan resolution. Recovery rates under SARFAESI have improved, with **₹77,000 crore recovered in FY2023**, up from **₹52,000 crore in FY2019** (RBI, 2023).

Tackling NPAs requires a sustained approach integrating technological advancements, regulatory reforms, and improved governance within banks. A combination of proactive measures, such as strengthening risk management and enhancing recovery mechanisms, can help ensure a more stable and resilient banking sector in India (Das & Sengupta, 2022).

6. Future Outlook: Strategies for Sustainable Banking and NPA Management

As India aims for a resilient banking sector, sustainable strategies to manage and prevent Non-Performing Assets (NPAs) are crucial. With advancements in financial technology, regulatory reforms, and improved governance, the future of banking in India can be strengthened to mitigate the risks associated with bad loans (RBI, 2023).

Leveraging Technology for NPA Prevention

The adoption of **Artificial Intelligence (AI) and Machine Learning (ML)** in credit risk assessment is expected to enhance banks' ability to identify potential defaulters. AI-driven models can analyze borrower history, industry trends, and market risks to provide real-time risk profiling (Das & Sengupta, 2023). In fact, **banks using AI-based credit scoring reported a 20% reduction in default rates in FY2023** (IBA, 2023). Additionally, **blockchain technology** can improve transparency in loan disbursals and repayments, reducing fraudulent lending.

Strengthening the Insolvency and Recovery Framework

The **Insolvency and Bankruptcy Code (IBC)** has played a significant role in bad loan resolution. However, the average resolution time under IBC currently stands at **411 days**, which is still longer than the **180-day** target set by the RBI (IBBI, 2023). Streamlining IBC proceedings, increasing the number of **National Company Law Tribunal (NCLT)** benches, and integrating digital case management systems can accelerate loan recovery processes.

Encouraging Responsible Lending Practices

Banks must adopt **stringent due diligence norms** and **sector-specific lending policies** to prevent asset quality deterioration. In FY2023, RBI mandated a higher **loan-to-value (LTV) ratio limit of 75%** for high-risk sectors like real estate and infrastructure (RBI, 2023). Moreover, credit risk diversification—such as reducing overexposure to single sectors—can mitigate systemic risks.

Public-Private Partnerships (PPP) and Financial Inclusion

Collaboration between the government, private sector, and fintech firms can expand financial access while ensuring responsible lending. The **Jan Dhan-Aadhaar-Mobile (JAM) framework** has significantly enhanced credit access, bringing **500 million unbanked individuals into the formal financial system** (MoF, 2023). Going forward, targeted credit expansion for MSMEs and startups with risk-sharing mechanisms can foster economic growth without increasing NPAs.

A future-proof banking system requires continuous innovation, regulatory agility, and responsible credit allocation. By leveraging technology, strengthening legal frameworks, and adopting risk-mitigation strategies, India can build a sustainable banking environment resilient to future NPA challenges (Das & Sengupta, 2023).

Conclusion

The issue of Non-Performing Assets (NPAs) remains a significant challenge for the Indian banking sector, affecting financial stability and economic growth. A combination of structural inefficiencies, poor credit assessment, and external economic shocks has contributed to the rising NPA levels over the years. However, concerted efforts by regulatory bodies, the government, and financial institutions have led to notable improvements in asset quality and recovery mechanisms.

Regulatory interventions such as the **Insolvency and Bankruptcy Code (IBC), 2016**, the **SARFAESI Act**, and the establishment of **the National Asset Reconstruction Company Limited (NARCL)** have strengthened the banking sector's ability to manage bad loans. Data indicates that **gross NPAs in Indian banks declined from 11.2% in FY2018 to 4.2% in FY2023**, signaling progress in addressing asset quality issues (RBI, 2023).

Technology-driven solutions, including **AI-based credit assessment models, blockchain integration, and early warning systems**, have shown promising results in reducing loan defaults. Banks that have integrated **predictive analytics** reported a **15-20% reduction in fresh NPAs**, demonstrating the potential of data-driven credit risk management (IBA, 2023).

Looking ahead, the banking sector must focus on **strengthening risk management frameworks, improving credit discipline, and promoting financial inclusion** to ensure long-term sustainability. The adoption of responsible lending practices, sectoral diversification, and enhanced legal enforcement will be key to minimizing future NPAs. Additionally, greater **public-private collaboration** and the expansion of formal credit channels can support economic growth while maintaining asset quality.

In conclusion, while the Indian banking sector has made significant strides in tackling NPAs, a proactive and adaptive approach is required to sustain these improvements. By leveraging regulatory reforms, technological advancements, and strategic policy measures, India can build a **more resilient, transparent, and efficient banking system**, ensuring financial stability and sustained economic development (Das & Sengupta, 2023).

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