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A Comprehensive Analysis of Non-Performing Assets in Indian Banking: Causes, Challenges, Regulatory Reforms, and Future Prospects

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ABSTRACT

Non-Performing Assets (NPAs) have remained one of the most persistent structural challenges in Indian banking, with important implications for profitability, capital adequacy, credit growth, and financial stability. The issue has evolved through a combination of weak credit appraisal, corporate governance failures, sectoral concentration, project delays, macroeconomic slowdown, and delayed recovery mechanisms. Historically, public sector banks have borne a much larger burden than private sector banks because of legacy corporate exposure, policy-driven lending, and slower institutional response, whereas private banks have generally maintained better asset quality through stronger underwriting and more agile risk management. In response, regulators and policy makers have introduced major reforms such as the Asset Quality Review (AQR), SARFAESI, the Insolvency and Bankruptcy Code (IBC), recapitalization of public sector banks, and the creation of NARCL to deal with legacy stressed assets. According to RBI's Financial Stability Report and related official disclosures, the gross NPA ratio of scheduled commercial banks fell to a 12-year low in 2024, reflecting notable progress in asset-quality clean-up. This article presents a comprehensive analysis of NPAs in Indian banking by examining their concept, causes, challenges, regulatory reforms, literature review, and future prospects. The paper concludes that while India has made meaningful improvements, sustainable NPA reduction will require preventive credit governance, stronger monitoring, better use of analytics, and disciplined lending practices.[2][4][5][1]

Keywords: Non-Performing Assets, Indian Banking, Public Sector Banks, Private Sector Banks, IBC, SARFAESI, NARCL, Financial Stability

1. Introduction

The banking system is the foundation of financial intermediation because it channels household savings into productive investment and supports economic growth. When bank loans become non-performing, this intermediation weakens, credit supply slows down, and banks' profitability and capital position deteriorate. In the Indian context, NPAs have remained a major issue because banks have historically financed infrastructure, industry, agriculture, MSMEs, and household consumption on a large scale.

According to Reserve Bank of India norms, a loan is classified as non-performing when interest or principal remains overdue for 90 days or more. This makes NPAs a core indicator of credit risk and banking-sector stress. The Indian NPA problem became especially visible in the 2010s, when aggressive lending, delayed project completion, infrastructure bottlenecks, and weak corporate governance led to a sharp rise in stressed loans. Public sector banks were disproportionately affected because of legacy exposures, slower decision-making, and policy-linked lending, whereas private banks generally maintained tighter underwriting standards and faster response systems.[4][5][1][2]

The issue is important not only for banks but also for the wider economy. High NPAs reduce lending capacity, increase provisioning burdens, weaken investor confidence, and can eventually affect employment and investment. The post-reform period has seen visible improvement, but the issue remains relevant because new forms of stress can emerge from sectoral shocks, unsecured retail lending, and global uncertainty. Therefore, a comprehensive academic analysis of NPAs remains essential for researchers, regulators, and banking practitioners.

2. Literature Review

The literature on NPAs in Indian banking has developed around three broad themes: causes, resolution mechanisms, and bank-group differences.

Chawla and Rani (2022) analyzed NPA resolution from the banker's perspective and found that it involves multiple internal dimensions such as monitoring quality, organizational efficiency, managerial coordination, and timely intervention. Their study used exploratory and confirmatory factor analysis and identified 21 dimensions and 7 significant factors related to effective NPA resolution. This study is important because it shows that recovery is not only a legal problem but also an internal organizational challenge.[3]

A 2024 literature review on NPAs in Indian banking observed that the issue remains structural despite reforms. The review emphasized that NPAs have been influenced by liberalization, rapid credit growth, weak appraisal standards, and macroeconomic fluctuations. It also noted that the

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COVID-19 period created additional pressure on bank asset quality. This suggests that even when the system improves, it remains vulnerable to external shocks.[6]

Another line of research examines NPA trends in relation to RBI's evolving regulatory stance. Studies have highlighted the importance of Asset Quality Review, IBC, SARFAESI, and Prompt Corrective Action in forcing the recognition of stressed assets and accelerating resolution. These studies argue that transparency in recognition is a necessary first step before recovery can happen.[7]

Recent comparative work on Indian banks shows that public sector banks have historically recorded higher NPAs than private sector banks, although the gap has narrowed due to reforms and recovery efforts. A 2025 paper reported that gross NPAs in Indian banks declined from 11.2% in FY2018 to 4.2% in FY2023, showing strong improvement in balance-sheet quality. Taken together, the literature suggests that NPAs are caused by a mix of borrower-side weakness, bank-side failure, and regulatory or institutional delays. It also shows that future improvement will require both preventive and corrective measures.[5][8][9][3][6][7]

3. Concept and Classification of NPAs

An asset becomes non-performing when it ceases to generate income for the bank for a specified period. In India, the key threshold is 90 days overdue for interest or principal. NPAs are generally classified into three categories:[1][5]

- **Substandard assets:** assets that have remained NPA for a relatively short time.
- **Doubtful assets:** assets that have remained non-performing for a longer period.
- **Loss assets:** assets where recovery is considered highly unlikely.

This classification is important because it determines provisioning requirements and indicates the severity of credit risk. The longer a loan remains unresolved, the lower the chances of recovery and the greater the pressure on the bank's balance sheet.

4. NPA Trends and Comparative Data

Table 1. Comparative NPA Position in Indian Banks

Bank Category	Peak Gross NPA	Gross NPA (Sep. 2024)	Net NPA (Sep. 2024)	Broad Trend
Public Sector	14.58%	3.12%	0.71%	Sharp rise until 2018, followed

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Banks (PSBs)	(Mar. 2018)			by a significant decline due to AQR, IBC, recapitalisation, and strengthened recovery mechanisms.
Private Sector Banks (PVBs)	5.50% (approx. Mar. 2018)	1.80%	0.40%	Comparatively lower NPA levels throughout the period, with greater stability and stronger credit risk management.

Source: RBI and Government of India disclosures, 2024.[2][4][1]

Table 2. Major Regulatory Reforms in NPA Management

Reform	Main Purpose	Effect
Asset Quality Review	Force recognition of hidden stress	Improved transparency
SARFAESI Act	Enable secured asset recovery	Faster enforcement
Insolvency and Bankruptcy Code	Time-bound insolvency resolution	Better creditor discipline
Recapitalization	Strengthen public sector banks	Restored lending capacity
NARCL	Manage legacy stressed assets	Specialized resolution mechanism

Source: RBI, Ministry of Finance, and banking reform literature.[4][5][1]

Table 3. Public vs Private Sector Banks

Aspect	**Public Sector Banks**	**Private Sector Banks**
Credit appraisal	Historically weaker	Generally stronger
Governance	Slower and policy-driven	Faster and more autonomous
Gross NPA level	Higher	Lower
Recovery speed	Slower	Faster
Risk management	Improving but uneven	More proactive

Source: Comparative banking studies and RBI trend reports.[8][9][2]

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The comparative data indicates that public sector banks were hit more severely during the NPA crisis. RBI data and official commentary show that the GNPA ratio of scheduled commercial banks fell to around 2.8% by March 2024, while the NNPA ratio fell to 0.6%, the lowest in many years. This confirms that reforms have had a measurable effect, though stress has not disappeared completely.[1][2]

5. Causes of NPAs

The causes of NPAs in Indian banking are multi-dimensional and mutually reinforcing.

5.1 Macroeconomic slowdown

When GDP growth slows, industrial output declines, and firm cash flows weaken. In such circumstances, borrowers find it difficult to service debt. This is especially serious in capital-intensive sectors with long project gestation periods.

5.2 Weak credit appraisal

One of the biggest causes of NPAs is poor credit appraisal. In many cases, banks extended credit without adequately assessing project feasibility, promoter track record, sectoral risk, or cash-flow realism. Excessive optimism and weak due diligence created future stress.[3]

5.3 Project delays and cost overruns

Infrastructure and industrial projects often face land acquisition issues, environmental clearances, legal disputes, and execution delays. These problems increase project cost and weaken the borrower's repayment ability.

5.4 Corporate governance failures

Diversion of funds, related-party transactions, weak board oversight, and borrower misconduct have all contributed to bad loans. Governance failure is therefore a key structural cause of NPAs.

5.5 Sectoral concentration

Banks' exposure to stressed sectors such as power, steel, telecom, and real estate has made the NPA problem more severe. When one major sector weakens, multiple lenders are affected simultaneously.

5.6 Weak post-disbursement monitoring

Even when loans are correctly sanctioned, a lack of continuous monitoring can allow early warning signs to go unnoticed. In many cases, stress becomes visible only after the account has already turned non-performing.

6. Challenges for Banks

NPAs create a wide range of financial and operational difficulties.

6.1 Profitability pressure

A non-performing loan stops generating interest income and requires higher provisioning. This reduces profitability and weakens return on assets and return on equity.

6.2 Capital erosion

As bad loans rise, banks need more capital to absorb potential losses. This reduces lending capacity and often forces recapitalization, especially in public sector banks.

6.3 Credit squeeze

Banks with high NPAs become conservative in lending, reducing credit flow to industry, MSMEs, and households. This slows investment and growth.

6.4 Management distraction

Banks with large stressed portfolios spend too much managerial energy on recovery, litigation, and restructuring. As a result, attention shifts away from growth, customer service, and innovation.

6.5 Reputation risk

Persistent NPA problems can damage public confidence in the banking system, especially if accompanied by governance failures or delayed disclosure.

7. Regulatory and Institutional Reforms

India has introduced a series of reforms to address NPAs more effectively.

- **Asset Quality Review (AQR):** Forced banks to recognize hidden stress and clean up balance sheets.[7]
- **SARFAESI Act:** Enabled banks to enforce security interests and recover dues more efficiently.

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- **Insolvency and Bankruptcy Code (IBC):** Created a time-bound resolution process and improved creditor discipline.[5][1]
- **Recapitalization of public sector banks:** Restored balance-sheet strength and lending capacity.
- **NARCL:** Created a specialized vehicle for dealing with legacy stressed assets.[4][5]

These reforms have made the banking system more transparent and recovery-oriented. RBI's Financial Stability Report and official releases show a substantial decline in GNPA and NNPA levels by 2024, with GNPA falling to a 12-year low. This improvement is significant because it indicates that policy intervention can reshape asset-quality outcomes when implemented consistently.[2][1]

8. Discussion

The Indian NPA story shows a clear shift from crisis to recovery. Public sector banks were the major victims of the earlier phase because of legacy exposure, slower governance, and policy-linked lending. Private sector banks also faced stress, but they were better able to control risk through more disciplined underwriting and faster action.[9][8]

The fall in gross NPA ratios demonstrates the effectiveness of reforms, but it should not lead to complacency. A lower ratio can coexist with hidden vulnerabilities if write-offs, restructuring, or rapid credit growth mask underlying stress. RBI data from 2024 suggest that asset quality improved sharply, but future risk must still be monitored closely.[1][2]

The literature also makes it clear that NPA control is not just about post-default recovery. It begins much earlier—with loan appraisal, sector selection, governance checks, and continuous borrower monitoring. The banker-perspective study by Chawla and Rani is especially useful because it shows that effective resolution depends on organizational quality and process discipline inside banks. Thus, the future of NPA management lies in prevention plus resolution, not resolution alone.[3]

9. Future Prospects

The future of NPAs in India will depend on how well banks combine regulation, technology, and governance.

9.1 Technology-driven risk management

AI, machine learning, and predictive analytics can improve borrower screening and detect early warning signs. Banks can use data patterns to identify stress before it becomes severe.[5]

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9.2 Stronger governance

Public sector banks need improved autonomy, accountability, and professional risk culture. Better governance can reduce the gap between public and private bank asset quality.

9.3 Diversified lending

Banks should avoid heavy concentration in vulnerable sectors. A more balanced portfolio can reduce systemic risk.

9.4 Continued resolution reforms

Fast-track insolvency, specialized recovery tribunals, and efficient asset reconstruction structures will remain important for future stability.

9.5 Better financial discipline

Borrowers must be made more accountable for fund diversion, non-disclosure, and wilful default. Credit discipline is essential for sustainable banking.

10. Conclusion

NPAs remain a central issue in Indian banking because they directly affect bank profitability, capital adequacy, credit growth, and systemic confidence. The literature shows that the problem emerges from a combination of weak appraisal, macroeconomic stress, corporate governance failures, project delays, and institutional inefficiencies. Public sector banks have historically been more affected, but recent reforms have significantly improved asset quality and recovery outcomes.[6][2][3][4][1]

The regulatory response through AQR, SARFAESI, IBC, recapitalization, and NARCL has helped make the system more transparent and more effective in resolving legacy stress. However, sustainable reduction in NPAs will require more than legal reform alone. It will demand better lending discipline, data-driven credit assessment, stronger governance, and continuous monitoring. If these reforms are maintained, India’s banking sector can become more resilient, efficient, and supportive of long-term economic growth.[7][5]

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