

Non-Performing Assets in the Indian Banking Sector

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Abstract: *The accumulation of Non-Performing Assets (NPAs) has historically posed a severe threat to the stability and profitability of the Indian banking sector. This research paper examines the trajectory of NPAs from the peak of the crisis in 2018 to the robust recovery phase observed in 2025–2026. Utilizing a descriptive and analytical methodology based on secondary data from the Reserve Bank of India (RBI) and other institutional reports, the study analyzes the internal and macroeconomic triggers of bad loans. It further evaluates the efficacy of regulatory interventions, notably the Insolvency and Bankruptcy Code (IBC) and enhanced provisioning norms.*

The findings indicate a historic turnaround, with the Gross NPA (GNPA) ratio of Scheduled Commercial Banks falling to a multi-decade low of 2.15% and Net NPAs dropping to 0.5%. The paper concludes that while systemic risks have been largely mitigated through structural reforms and recapitalization, ongoing vigilance particularly in the MSME sector—and the integration of advanced credit monitoring technologies remain essential to sustain long-term financial stability.

Keywords: The accumulation of Non-Performing Assets (NPAs) has historically posed a severe threat to the stability and profitability of the Indian banking sector. This research paper examines the trajectory of NPAs from the peak of the crisis in 2018 to the robust recovery phase observed in 2025–2026. Utilizing a descriptive and analytical methodology based on secondary data from the Reserve Bank of India (RBI) and other institutional reports, the study analyzes the internal and macroeconomic triggers of bad loans.

I. INTRODUCTION

A robust banking sector is the backbone of any developing economy, and in India, banks are the primary agents of financial intermediation. However, the efficiency and profitability of this sector are heavily dependent on the quality of its assets. When loans are not repaid, they turn into Non-Performing Assets (NPAs), creating a severe bottleneck for economic growth.

According to the Reserve Bank of India (RBI), an asset becomes non-performing when it ceases to generate income for the bank. Specifically, a loan or advance is classified as an NPA if the principal or interest payment remains overdue for a period of more than 90 days.

NPAs are further classified into three distinct categories based on the duration for which the asset has remained non-performing:

- * Sub-standard Assets: Assets that have remained NPAs for a period less than or equal to 12 months.
- * Doubtful Assets: Assets that have remained in the sub-standard category for a period of 12 months.
- * Loss Assets: Assets where the loss has been identified by the bank or internal/external auditors, but the amount has not been written off wholly.

The accumulation of NPAs has a cascading effect on the economy. For banks, high NPAs mean higher provisioning requirements, which directly erode their profitability and deplete their capital base. This leads to a "credit crunch," where banks become risk-averse and reduce lending to critical sectors like infrastructure, agriculture, and manufacturing. Over the last decade, the Indian banking sector—particularly Public Sector Banks (PSBs)—faced a severe NPA crisis, prompting structural reforms, massive recapitalization, and strict regulatory oversight by the government and the RBI.



II. RESEARCH METHODOLOGY

2.1 Introduction

This chapter outlines the systematic procedure used to analyze the trends and impact of NPAs in the Indian banking sector. It details the research design, data sources, sampling techniques, and statistical tools employed to achieve the study's objectives.

2.2 Research Design

The study adopts a Descriptive and Analytical Research Design.

Descriptive: It seeks to describe the current status and trends of NPAs in Public and Private sector banks.

Analytical: It uses historical data to analyze the relationship between NPAs and variables like bank profitability (ROE/ROA) or macroeconomic factors (GDP growth).

2.3 Objectives of the Study

To analyze the trends of Gross and Net NPAs in Indian banks over the last 10 years.

To compare the NPA management efficiency of Public Sector Banks (PSBs) vs. Private Sector Banks.

To identify the key determinants (internal and external) leading to asset quality deterioration.

2.4 Data Collection Methods

Since NPAs are highly regulated financial data, most research in this field relies on Secondary Data. Sources: * Annual Reports of selected banks.

RBI's "Report on Trend and Progress of Banking in India." RBI Database on Indian Economy (DBIE).

Statistical Tables Relating to Banks in India.

Period of Study: (e.g., A 10-year period from FY 2015-16 to FY 2025-26).

2.5 Sampling Technique

Due to the large number of banks in India, a Purposive or Judgmental Sampling method is often used.

Population: All Scheduled Commercial Banks (SCBs) in India.

Sample Size: (e.g., Top 5 Public Sector Banks and Top 5 Private Sector Banks based on market capitalization or total assets).

2.6 Selection of Variables

To measure NPAs effectively, the following variables are typically selected:

Dependent Variables: Gross NPA Ratio (%), Net NPA Ratio (%), and Provision Coverage Ratio (PCR).

Independent Variables: Return on Assets (ROA), Net Interest Margin (NIM), Capital Adequacy Ratio (CAR), and Credit-to-Deposit Ratio.

III. REVIEW OF LITERATURE

The issue of Non-Performing Assets has been extensively studied to understand its macroeconomic and microeconomic triggers. Historically, researchers have categorized the causes of NPAs into bank-specific factors (internal) and macroeconomic factors (external).

Internal Factors and Credit Management:

Studies highlight that poor credit management policies, deliberate loan defaults, and sanctioning of loans without adequately analyzing the risk-bearing capacity of borrowers are primary internal causes of NPAs. A lack of frequent interaction with borrowers, inadequate post-disbursement monitoring, and manipulation of financial statements by borrowers also heavily contribute to the pile-up of bad loans.



External and Macroeconomic Triggers:

From a macroeconomic perspective, the literature points to periods of economic slowdown, delayed regulatory clearances for infrastructure projects, and industrial sickness as major external contributors. The global financial crisis of 2008 and subsequent aggressive lending by Indian banks without adequate risk assessment laid the groundwork for the massive NPA spike that peaked around 2018.

The trajectory of NPAs in India is intrinsically linked to phases of economic regulation and liberalisation.

The literature commonly divides this evolution into distinct eras:

Pre-Reform and Initial Reform Phase (Pre-1991 to 2000)

(Reddy, 2017) describes the pre-reform period as characterized by 'social banking,' where credit was directed toward priority sectors often regardless of commercial viability, leading to high (though opaque) levels of stress. The post-1991 period, analyzed by (Kohli, 2018), saw the introduction of prudential norms. While this initially led to a sharp increase in recorded NPAs (as hidden stress was recognized), it forced transparency. The subsequent establishment of Debt Recovery Tribunals (DRTs) in 1993 was the first major legislative attempt at resolution.

The Credit Boom and the Twin Balance Sheet Crisis (2000–2015)

The mid-2000s marked a period of rapid economic growth and aggressive credit expansion by Indian banks. Literature analyzing this phase, particularly the landmark RBI Financial Stability Reports (2014, 2015), points to a systemic concentration of credit in long-gestation infrastructure projects (power, roads, steel). (Acharya, 2017) coined the term "Twin Balance Sheet (TBS) Crisis" to describe this period: overleveraged corporate balance sheets (unable to pay) resulting in stressed bank balance sheets (unable to lend).

A critical segment of the research focuses on identifying the drivers of asset quality deterioration. Scholars categorized these causes into two main streams:

Internal/Microeconomic (Bank-Specific) Factors

These factors relate to the internal operations, credit culture, and governance of individual banks. A significant consensus exists (Kumar and Singh, 2018; Das, 2019) regarding the primary internal drivers in India:

Deficient Credit Appraisal: Studies consistently point to an overreliance on collateral rather than a critical assessment of the borrower's future cash flows and project viability. This was particularly evident in the infrastructure lending boom.

Inadequate Monitoring: (Gupta, 2020) argues that post-sanction supervision and monitoring of end-use of funds are often weak, failing to detect early warning signs of stress.

Weak Governance in Public Sector Banks (PSBs): Comparative studies (Verma, 2021) frequently highlight that PSBs have structurally higher NPAs than private counterparts. This is attributed to issues in governance, political interference in lending (directed credit), and a culture that may prioritize loan volume growth over asset quality.

External/Macroeconomic (Systemic) Factors

These drivers are external to the bank's operational control and affect the entire economy or specific sectors. (RBI Occasional Papers, 2019) and other econometric studies establish strong correlations between:

GDP Growth Deceleration: A slowing economy reduces corporate revenues, making debt servicing difficult across the board.

Sector-Specific Shocks: The literature heavily documents how regulatory delays in land acquisition, environmental clearances, and cancellation of coal blocks disproportionately impacted the power and infrastructure sectors, turning massive loans into NPAs.

Global Shocks: Fluctuations in commodity prices (e.g., steel) and global interest rate cycles can drastically alter the viability of export-oriented and leveraged companies.



Willful Defaults and Frauds: More recent literature (Sharma, 2022) addresses the specific challenge of "willful defaulters"—borrowers who have the capacity to repay but choose not to—and the increasing incidence of high-value banking frauds, which contribute significantly to the total NPA stock.

IV. DATA ANALYSIS & INTERPRETATION:

The current data reflects a remarkable turnaround in the asset quality of the Indian banking sector. After peaking at 11.18% in March 2018, the Gross Non-Performing Assets (GNPA) ratio has seen a continuous downward trajectory.

Latest Data Trends (2025–2026):

- * Historic Lows: As of September 2025, the GNPA ratio of Scheduled Commercial Banks (SCBs) reached a multi-decade historic low of 2.15%.
- * Net NPAs: The Net NPA (NNPA) ratio, which subtracts provisions from the gross NPAs, dropped to an impressive 0.5%, reflecting exceptionally strong provision buffers maintained by the banks.
- * Sector-wise Breakdown:
 - * Public Sector Banks (PSBs): 2.50%
 - * Private Sector Banks (PVBs): 1.73%
 - * Foreign Banks: 0.80%

V. INTERPRETATION

The data clearly illustrates that the asset quality of Indian banks has strengthened drastically. Public Sector Banks, which historically carried the bulk of the NPA burden (with GNPA ratios exceeding 14% at the peak of the crisis), have shown the most significant recovery. The slippage ratio—which measures the fresh accretion of NPAs—improved to 0.8% for PSBs in September 2025, lower than the 1.8% recorded for Private Sector Banks.

This decline in gross NPAs has led to reduced provisioning requirements, directly boosting bank profitability. For instance, PSBs reported an aggregate net profit of ₹1.78 lakh crore in FY 2024-25, a massive shift from the heavy losses reported in 2017-18. The interpretation of this data suggests that the implementation of Early Warning Systems (EWS), the effectiveness of the IBC, and rigorous credit underwriting have successfully insulated the banking system against large-scale credit defaults, fostering a healthy environment for business growth and credit expansion.

VI. CONCLUSION

The journey of the Indian banking sector from the brink of a systemic crisis in 2018 to a position of global strength in 2026 is a testament to resilient policy-making and disciplined banking.

This research paper concludes that Non-Performing Assets, while inevitable in any lending business, are no longer a threat to India's financial stability.

The drastic reduction in GNPA to 2.15% and the historic high in bank profitability signify that the "cleanup" phase is over. However, the lessons of the past must not be forgotten.

The banking sector must remain vigilant against "aggressive lending" and continue to prioritize asset quality over mere balance sheet expansion. With the robust framework of the IBC, the oversight of the RBI, and the integration of advanced financial technology, the Indian banking sector is well-positioned to support the nation's goal of becoming a multi-trillion dollar economy.

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