RISING TREND OF NPA IN INDIAN BANKING SECTOR

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Abstract

Non-Performing Assets (NPAs) have emerged as one of the most persistent and formidable challenges confronting the Indian banking sector over the past two decades. An asset, particularly a loan or advance, is classified as non-performing when it ceases to generate income for the bank, typically when interest or principal repayment remains overdue for a period of more than ninety days. The steady and, at times, alarming rise in NPAs has significant implications for the profitability, capital adequacy, credit expansion capacity, and overall financial stability of banks, with cascading effects on the broader economy. This article examines the rising trend of NPAs in the Indian banking sector, tracing its evolution from the early years of liberalization to the present day, with particular focus on the surge witnessed after the Asset Quality Review (AQR) of 2015. It analyses the principal causes underlying this trend, including aggressive lending during the credit boom of the mid-2000s, diversion of funds, wilful default, delays in project implementation, global economic slowdown, and governance deficiencies in public sector banks. The study further discusses the multifaceted challenges that rising NPAs pose for banks, borrowers, regulators, and the economy at large, ranging from erosion of profitability and capital base to reduced credit flow to productive sectors and reputational damage.

Keywords: Assets, Banking Sector, Bankruptcy Code Credit Risk Gross NPA, Public Sector Banks

1. Introduction

The banking sector occupies a pivotal position in the economic architecture of any nation, functioning as the principal intermediary between savers and borrowers and thereby facilitating capital formation, investment, and economic growth. In India, banks have historically served as the backbone of financial intermediation, mobilizing household savings and channeling them into productive sectors such as agriculture, industry, infrastructure, and services. The soundness of this intermediation process depends critically on the quality of the loan portfolio held by banks. When a substantial proportion of loans turns bad, the very foundation of the banking system is threatened, and this is precisely the phenomenon captured by the term Non-Performing Asset, or NPA.

As per the guidelines issued by the Reserve Bank of India (RBI), an asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. More specifically, a loan or advance is classified as an NPA when interest and/or instalment of principal remains overdue for a period exceeding ninety days in respect of a term loan, or when the account remains out of order for the same period in respect of an overdraft or cash credit facility. NPAs are further categorized into Sub-Standard Assets, Doubtful Assets, and Loss Assets, depending on the duration for which they have remained non-performing and the extent of realizability of the dues.

The problem of NPAs is not unique to India; banking systems across the world periodically grapple with asset quality stress, particularly following episodes of rapid credit expansion or macroeconomic shocks. However, the scale and persistence of the NPA problem in India, particularly within the public sector banking space, has attracted considerable attention from policymakers, regulators, academicians, and international financial institutions alike. The origins of the present crisis can be traced to the credit boom of the mid-2000s, when banks, buoyed by robust economic growth, extended large volumes of credit to infrastructure, power, steel, and telecom sectors. Many of these projects subsequently faced delays in environmental and regulatory clearances, cost overruns, and demand shortfalls, resulting in an inability of borrowers to service their debt obligations.

2. Meaning and Classification of NPA

Under RBI norms, assets are classified into four broad categories for the purpose of income recognition and asset classification (IRAC norms): Standard Assets, which do not carry more than normal risk; Sub-Standard Assets, which have remained NPA for a period of less than or equal to twelve months; Doubtful Assets, which have remained in the sub-standard category for a period of twelve months; and Loss Assets, where loss has been identified by the bank, internal or external auditors, or the RBI inspection, but the amount has not been written off wholly. This classification determines the quantum of provisioning that banks are required to maintain against such assets, which directly impacts their profitability and capital position.

3. Gross NPA and Net NPA

Two key indicators are commonly used to assess asset quality: Gross NPA, which represents the total value of non-performing loans before provisioning, expressed either in absolute terms or as a percentage of gross advances; and Net NPA, which represents the value of NPAs after deducting provisions made by the bank, reflecting the actual stress on the bank's net worth. The Gross NPA ratio is widely regarded as a headline indicator of asset quality and is closely monitored by regulators, investors, and rating agencies.

4. Rising Trend of NPA in Indian Banking Sector

The trajectory of NPAs in the Indian banking sector can be broadly divided into distinct phases. In the period immediately following the introduction of prudential norms in 1992-93 as part of the broader financial sector reforms, NPA levels were relatively high, reflecting years of directed and often poorly appraised lending under the pre-reform regime. Concerted efforts through the 1990s and 2000s, including the establishment of Debt Recovery Tribunals and the enactment of the SARFAESI Act, 2002, helped bring down the Gross NPA ratio substantially, reaching single-digit and eventually low single-digit levels by the mid-2000s.

The period between 2004 and 2008 witnessed exceptionally high credit growth, often in excess of twenty to thirty percent annually, driven by strong GDP growth, rising corporate investment, and expansion of infrastructure financing. Banks, particularly public sector banks, extended large-ticket loans to power generation, road, steel, textiles, and telecom projects, frequently based on optimistic project appraisals and consortium lending arrangements with inadequate due diligence. The global financial crisis of 2008 and the subsequent economic slowdown, coupled with policy paralysis, delays in land acquisition and environmental clearances, and volatility in input prices, severely impacted the viability of many such projects.

Rather than recognizing the resultant stress promptly, a significant number of banks resorted to restructuring mechanisms such as Corporate Debt Restructuring (CDR) and various RBI schemes including 5:25 Scheme, Strategic Debt Restructuring (SDR), and Scheme for Sustainable Structuring of Stressed Assets (S4A), which allowed stressed accounts to be kept outside the NPA classification for extended periods. This practice of "evergreening" masked the true health of bank balance sheets for several years.

The turning point came with the RBI's Asset Quality Review (AQR) launched in 2015 under then Governor Raghuram Rajan, which mandated banks to re-classify stressed but restructured accounts as NPAs based on objective criteria rather than subjective assessment. This exercise led to a dramatic and sudden increase in reported Gross NPA figures across the banking system. Gross NPAs of Scheduled Commercial Banks, which stood at around 2.3 percent of gross advances in March 2008, rose sharply to cross 4 percent by March 2015, and thereafter escalated rapidly to peak at approximately 11.2 percent of gross advances in March 2018, the highest level recorded in over two decades. Public sector banks were disproportionately affected, with their Gross NPA ratio touching nearly 14-15 percent at the peak, considerably higher than that of private sector banks, whose asset quality remained comparatively more resilient owing to tighter underwriting standards and lower exposure to large corporate and infrastructure loans.

Following the peak in 2017-18, a combination of regulatory reforms, recognition-driven clean-up, resolution of large stressed accounts under the Insolvency and Bankruptcy Code, and substantial recapitalization of public sector banks by the Government of India contributed to a gradual but steady decline in NPA levels. By March 2023, the Gross NPA ratio of Scheduled Commercial Banks had declined to approximately 3.9 percent, and by March 2024, provisional data indicated a further improvement to around 2.8 percent, the lowest level in over a decade, reflecting improved asset quality, stronger provisioning buffers, and more disciplined lending practices. Nevertheless, the sheer scale of the earlier NPA accumulation, running into several lakh crore rupees at its peak, underscores the severity of the episode and its lasting impact on the health of the Indian banking system, particularly the public sector segment.

It is also important to note sector-wise and bank-group-wise variations in the trend. Within public sector banks, some of the larger banks such as those subsequently merged under consolidation exercises carried disproportionately large NPA burdens concentrated in sectors such as power, iron and steel, textiles, infrastructure, and aviation. Private sector banks, while not entirely insulated, generally reported lower and more stable NPA ratios, partly attributable to their relatively conservative retail-focused lending models and more robust risk management systems. The COVID-19 pandemic during 2020-21 introduced fresh uncertainty, with concerns of a fresh wave of NPAs due to widespread business disruption however, timely regulatory measures such as loan moratoriums, restructuring windows under the Resolution Framework 1.0 and 2.0, and the Emergency Credit Line Guarantee Scheme (ECLGS) helped contain a sharp deterioration in asset quality during this period.

NPA Ratio:

2008	2.3	Post-reform low, strong credit growth phase
2012	3.1	Early signs of stress emerging
2015	4.3	Pre-AQR reported levels
2016	7.5	Immediate post-AQR recognition
2018	11.2	Peak NPA level

2020	8.2	Gradual decline begins
2022	5.9	Continued improvement
2023	3.9	Sustained recovery
2024	2.8	Decade-low level (provisional)

Source: Reserve Bank of India, Financial Stability Reports and Report on Trend and Progress

5. Major Causes Contributing to the Rising Trend

Aggressive Credit Expansion: The high-growth phase of 2004-2008 witnessed banks extending large volumes of credit, often through consortium lending, to infrastructure and core-sector projects without adequate appraisal of project viability, promoter capability, or sensitivity to macroeconomic shocks.

Global and Domestic Economic Slowdown: The 2008 global financial crisis, followed by domestic policy paralysis, delays in obtaining statutory clearances, and volatility in commodity prices, adversely affected the cash flows of borrowers in capital-intensive sectors.

Diversion of Funds and Wilful Default: In a number of high-profile cases, promoters were found to have diverted borrowed funds for purposes other than those for which they were sanctioned, or to have wilfully defaulted despite having the capacity to repay.

Delayed Recognition through Restructuring: The extensive use of restructuring schemes prior to 2015 allowed banks to defer the recognition of stress, resulting in a sudden and sharp increase in reported NPAs once the Asset Quality Review enforced stricter classification norms.

Governance Deficiencies in Public Sector Banks: Weaknesses in credit appraisal, monitoring systems, and post-sanction follow-up, compounded by political and bureaucratic interference in lending decisions, have been widely cited as structural factors contributing to higher NPA levels in public sector banks compared to their private sector counterparts.

Sector-Specific Stress: Certain sectors such as power, iron and steel, textiles, infrastructure, and aviation experienced disproportionately higher levels of stress due to sector-specific issues including fuel supply constraints, overcapacity, and regulatory uncertainty.

6. Challenges of Rising NPA in Banks

The rising trend of NPAs poses a wide array of interlinked challenges for banks, borrowers, regulators, and the economy as a whole. These challenges extend well beyond the immediate financial statements of banks and have far-reaching implications for credit availability, investment, and macroeconomic stability.

- **Erosion of Profitability**

As per RBI norms, banks are required to make provisions against non-performing assets based on their classification, ranging from 15 percent for sub-standard assets to 100 percent for loss assets. Rising NPAs therefore translate directly into higher provisioning requirements, which reduce net profitability. Several public sector banks reported substantial losses during the peak NPA years of 2017-18 and 2018-19, primarily on account of elevated provisioning burdens, despite reasonable levels of operating profit.

- **Capital Adequacy Pressures**

Continuous losses arising from high provisioning erode a bank's capital base, making it difficult to maintain the minimum Capital to Risk-weighted Assets Ratio (CRAR) mandated under Basel III norms. This often necessitates fresh infusion of capital, either through government recapitalization in the case of public sector banks or through equity dilution and fund-raising in the market, which can be dilutive for existing shareholders and, in the case of government infusion, places additional strain on the fiscal exchequer.

- **Reduced Credit Flow and Credit Crunch**

Banks burdened with high NPAs tend to become risk-averse, adopting a cautious approach to fresh lending, particularly to sectors perceived as high-risk such as infrastructure, micro, small and medium enterprises (MSMEs), and capital-intensive industries. This risk aversion can result in a credit crunch that constrains investment and economic growth, creating a vicious cycle wherein slower growth further impairs the repayment capacity of existing borrowers.

- **Asset-Liability Mismatch and Liquidity Stress**

Non-performing assets do not generate the interest income that banks rely upon to service their own liabilities, including deposit interest payments. A high proportion of NPAs can therefore create asset-liability mismatches and liquidity pressures, particularly for banks with a concentrated exposure to a small number of large stressed accounts.

- **Impact on Public Sector Banks and Fiscal Burden**

Given that public sector banks account for the majority of NPAs in the Indian banking system, the government, as the majority shareholder, has been required to undertake large-scale recapitalization exercises. Between 2016 and 2021, the Government of India infused several lakh crore rupees into public sector banks to shore up their capital base, representing a significant opportunity cost in terms of alternative developmental expenditure that could otherwise have been directed towards infrastructure, education, or healthcare.

- **Legal and Recovery Challenges**

Despite the enactment of the Insolvency and Bankruptcy Code, 2016, and the strengthening of the SARFAESI framework, the recovery of dues from defaulting borrowers remains a time-consuming and legally complex process. Delays in the resolution of cases before the National Company Law Tribunal (NCLT), protracted litigation, and haircuts often exceeding fifty to sixty percent of the admitted claims in resolved cases, continue to limit the effectiveness of recovery mechanisms and the value ultimately realized by banks.

- **Impact on Investor and Depositor Confidence**

Persistently high NPA levels can undermine the confidence of investors, credit rating agencies, and, in extreme cases, depositors, particularly for weaker banks. This can result in higher cost of capital for banks, downgrades in credit ratings, and, in a small number of instances such as certain cooperative and small private banks, has necessitated regulatory intervention including moratoriums and reconstruction schemes to protect depositor interests.

- **Consolidation, Governance Reform, and Human Resource Challenges**

The NPA crisis prompted the Government of India to undertake large-scale consolidation of public sector banks, reducing their number from twenty-seven in 2017 to twelve by 2020, with the objective of creating stronger, more resilient banking entities. While consolidation has certain long-term benefits, it has also posed short-term challenges relating to integration of technology platforms, harmonization of human resource policies, and cultural assimilation across merged entities, alongside the broader and more persistent challenge of strengthening credit appraisal and risk management capabilities across the banking system.

7. Conclusion

The rising trend of Non-Performing Assets in the Indian banking sector represents one of the most significant challenges to have confronted the domestic financial system since the onset of economic liberalization. Rooted in the aggressive credit expansion of the mid-2000s, compounded by global and domestic macroeconomic headwinds, delayed recognition of stress through restructuring practices, and governance weaknesses particularly within public sector banks, the NPA crisis reached its peak around 2017-18, with Gross NPA ratios touching levels in excess of eleven percent for the banking system as a whole and considerably higher for public sector banks individually.

The consequences of this trend have been far-reaching, encompassing erosion of profitability and capital adequacy, constrained credit flow to productive sectors of the economy, substantial fiscal costs associated with bank recapitalization, and challenges to investor and depositor confidence. At the same time, the crisis has served as a catalyst for significant structural and institutional reform, including the enactment of the Insolvency and Bankruptcy Code, strengthening of the Prompt Corrective Action framework, establishment of dedicated asset reconstruction mechanisms, and large-scale consolidation of public sector banks.

The subsequent decline in Gross NPA ratios to below three percent by March 2024 demonstrates that concerted regulatory action, improved recognition practices, and stronger recovery mechanisms can yield meaningful results over time. However, the experience also underscores the importance of sustained vigilance. Sound credit appraisal systems, independent and professional bank governance, timely recognition of stress, robust post-sanction monitoring, and an efficient and time-bound legal recovery framework remain essential prerequisites for preventing a recurrence of large-scale asset quality deterioration in the future. As the Indian economy continues its growth trajectory and credit demand expands across retail, MSME, and corporate segments, the lessons drawn from the NPA crisis of the past decade must continue to inform prudent lending practices, proactive risk management, and continued strengthening of the institutional and regulatory architecture governing the banking sector, so as to ensure the long-term financial stability and resilience of the Indian banking system.

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