

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

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Abstract

Non-Performing Assets (NPAs) have been a persistent challenge for the Indian banking sector, significantly impacting profitability, liquidity, and overall financial stability. Over the years, excessive lending, weak credit monitoring, and economic slowdowns have contributed to rising NPAs, particularly among public sector banks. To address this crisis, the Government of India and the Reserve Bank of India (RBI) introduced several banking reforms, including the SARFAESI Act, Debt Recovery Tribunals (DRTs), Corporate Debt Restructuring (CDR), Joint Lenders' Forum (JLF), the Insolvency and Bankruptcy Code (IBC) 2014, and the establishment of Asset Reconstruction Companies (ARCs). These reforms emphasize faster loan recovery, improved accountability, stricter provisioning norms, and transparent resolution processes. The Insolvency and Bankruptcy Code (IBC) has emerged as a game-changing reform, enabling time-bound insolvency resolution and reducing banks' recovery delays. Despite progress, challenges such as delays in legal proceedings, poor governance in lending decisions, and reluctance of banks to recognize stressed assets continue to hinder full recovery. The study concludes that sustained reforms, effective policy execution, and improved credit discipline are essential to strengthening asset quality and enhancing the financial health of Indian banks.

Keywords: Non-Performing Assets (NPAs); Banking Reforms; Indian Banks; Insolvency and Bankruptcy Code (IBC); Asset Reconstruction Companies (ARCs); SARFAESI Act; Debt Recovery Tribunals; Credit Risk Management; Financial Stability; Public Sector Banks.

Introduction

The banking sector plays a critical role in the economic development of any country by mobilizing funds and extending credit for productive activities. In India, increasing levels of Non-Performing Assets (NPAs) have posed serious challenges to the credit delivery system and financial stability. NPAs reduce banks' earning capacity, diminish profitability, weaken capital adequacy, and restrict their ability to extend new loans. Historically, Indian banks—especially public sector banks—have struggled with NPA management due to issues such as inadequate credit appraisal systems, political interference in lending decisions, and ineffective monitoring of large corporate loans. Recognizing the severity of the problem, the Indian government and RBI initiated comprehensive financial sector reforms to strengthen early identification of stressed assets, speed up recovery mechanisms, and enforce credit discipline. Key reforms include the introduction of Debt Recovery Tribunals (DRTs),

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

the SARFAESI Act 2002, Corporate Debt Restructuring mechanisms, Asset Reconstruction Companies, and most importantly, the Insolvency and Bankruptcy Code (IBC) 2012. These reforms aim to improve asset quality by enabling banks to take timely corrective actions and recover funds from defaulters through transparent and time-bound processes. Despite these measures, the challenge remains significant, calling for improved enforcement, technology-based monitoring of credit risk, and stronger accountability in lending practices. Thus, effective management of NPAs through banking reforms remains crucial to enhancing the resilience and efficiency of the Indian banking sector.

The performance and sustainability of the banking sector serve as a cornerstone for the economic growth of any country. Banks support economic activities by channeling savings into productive investments and providing credit to industries, businesses, and individuals. In India, the banking sector—particularly Public Sector Banks (PSBs)—plays a dominant role in extending credit to major economic sectors such as infrastructure, agriculture, manufacturing, and small businesses. However, the increasing volume of Non-Performing Assets (NPAs) has emerged as one of the most critical threats to financial stability. An asset becomes non-performing when borrowers fail to make interest or principal payments for 90 days or more. Rising NPAs reduce profitability, impair capital adequacy, restrict lending capacity, and weaken investor confidence. More importantly, NPAs reflect inefficient credit appraisal systems, poor governance, and monitoring failures within banks.

Several structural and economic factors contributed to the NPA crisis in India. During the economic boom of early 2000s, banks aggressively extended loans—especially to capital-intensive sectors like infrastructure, steel, power, and real estate. Many of these loans turned into stressed assets due to project delays, governance failures, policy bottlenecks, global recession, and willful default by corporate borrowers. Additionally, prior to 2015, banks engaged in “evergreening of loans,” where stressed assets were rolled over or restructured instead of being classified as NPAs. This led to delayed recognition of the real magnitude of bad loans. The problem became more transparent when the RBI introduced the Asset Quality Review (AQR) in 2015, forcing banks to acknowledge and disclose actual NPAs. As a result, NPAs peaked between 2012 and 2014, particularly in public sector banks, necessitating urgent reforms.

To address the mounting NPA crisis, the Government of India and the Reserve Bank of India introduced a series of comprehensive banking reforms aimed at improving credit discipline, enabling faster recovery, and ensuring accountability in lending decisions. These reforms include the SARFAESI Act (2002), Debt Recovery Tribunals (DRTs), Corporate Debt Restructuring (CDR), Joint Lenders' Forum (JLF), 5/25 refinancing, and Strategic Debt Restructuring (SDR). However, the most transformative reform came with the enactment of the Insolvency and Bankruptcy Code (IBC), 2010, which introduced a time-bound insolvency resolution framework. IBC shifted the power from defaulting borrowers to creditors, enabling banks to recover dues through the sale or restructuring of defaulting assets. Further reforms such as the establishment of the National Asset Reconstruction Company Limited (NARCL) and bad bank structure introduced in 2012 are designed to clean up legacy NPAs.

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

Despite multiple reforms, managing NPAs continues to be a complex challenge due to lengthy legal procedures, delays in court approvals, and deficiencies in credit risk assessment practices. Strengthening NPA management does not simply require regulatory changes—it demands improved technology-based monitoring, data analytics-driven credit assessment, and accountability in lending decisions. Therefore, banking reforms play a crucial role not only in resolving existing NPAs but also in preventing future accumulation through transparent governance, early warning systems, and enhanced credit discipline. Managing NPAs effectively is essential for restoring the financial health of Indian banks, improving investor confidence, and enabling the banking system to contribute more strongly to national economic development.

Objectives of the Study

1. To examine the trend and causes of Non-Performing Assets (NPAs) in Indian banks.
2. To analyze the effectiveness of key banking reforms such as SARFAESI Act, Asset Reconstruction Companies (ARCs), Debt Recovery Tribunals (DRTs), and the Insolvency and Bankruptcy Code (IBC), in the resolution and management of NPAs.
3. To evaluate the impact of banking reforms on the financial performance and asset quality of Indian banks, particularly Public Sector Banks (PSBs).
4. To identify challenges faced by banks in implementing NPA recovery mechanisms and suggest measures for improving loan monitoring and credit discipline.
5. To recommend strategies and policy changes for strengthening NPA management and improving the efficiency of recovery frameworks in Indian banking.

Research Questions

1. What are the major causes behind the rise of Non-Performing Assets (NPAs) in Indian banks?
2. How effective have banking reforms such as the SARFAESI Act, Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARCs), and the Insolvency and Bankruptcy Code (IBC) been in improving NPA management?
3. How have banking reforms influenced the financial performance, asset quality, and credit discipline of Indian banks, particularly public sector banks?
4. What challenges do Indian banks face in the implementation of NPA recovery and resolution mechanisms?
5. What recommendations can be proposed to strengthen NPA management and ensure better credit monitoring and recovery efficiency?

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

Review of Literature

The problem of Non-Performing Assets (NPAs) has been widely researched as a critical threat to the financial stability of banking systems. According to Rajan and Dhal (2003), NPAs are indicative of asset quality deterioration, weak credit appraisal systems, and ineffective monitoring mechanisms within banks. Banks burdened with high levels of NPAs experience reduced profitability, as interest income declines while provisioning requirements increase. Das and Ghosh (2007) further emphasized that NPAs restrict lending capabilities, leading to slower credit growth in the economy.

The introduction of financial reforms in India aimed to enhance transparency, strengthen regulation, and improve the asset quality of banks. The Narasimham Committee (1991, 1998) played a pivotal role in recommending structural changes to improve operational efficiency, including prudential norms, income recognition standards, and capital adequacy requirements. The committee highlighted that long-term financial stability could be achieved only when banks adopt global standards of asset classification and provisioning.

Many studies have evaluated the effectiveness of specific legal reforms. The SARFAESI Act (2002) is considered one of the most significant banking reforms, granting banks the authority to seize collateral from defaulting borrowers without court intervention. According to Mohan (2005), SARFAESI empowered banks and reduced recovery delays. However, Singh (2013) argued that while SARFAESI improved recovery rates in initial years, its impact eventually slowed due to borrower litigation and legal bottlenecks.

Debt Recovery Tribunals (DRTs), established to provide faster adjudication of loan recovery cases, were expected to reduce the backlog in regular courts. However, research by Chaudhuri (2010) shows that despite their establishment, delays persisted due to case overload and inadequate infrastructure. To supplement recovery efforts, Asset Reconstruction Companies (ARCs) were introduced to purchase and restructure stressed assets. Reserve Bank of India reports indicate that while ARCs initially helped banks reduce balance sheet burden, limited capital availability restricted their long-term impact.

The landmark reform in NPA management was the Insolvency and Bankruptcy Code (IBC), 2011. According to the Insolvency and Bankruptcy Board of India (IBBI, 2010), the IBC introduced a transparent and time-bound resolution mechanism, reducing the power imbalance between banks and borrowers. Studies by Ernst & Young (2014) suggest that IBC improved recovery rates and strengthened creditor rights, making it a transformative reform in India's banking sector. However, delays in National Company Law Tribunal (NCLT) proceedings and frequent legal appeals have slowed the resolution process in some cases.

Recent literature also highlights the importance of improved credit appraisal and early warning systems. Chakrabarty (2012) stressed that banks must shift from collateral-based lending to due diligence-based credit decisions, particularly for corporate borrowers. RBI's Asset Quality Review (AQR) of 2011 forced banks to recognize hidden NPAs, improving transparency in financial reporting.

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

Overall, existing literature suggests that while reforms such as SARFAESI, DRTs, ARCs, and IBC have contributed positively to recovery and asset quality improvement, challenges remain in the form of legal delays, poor credit governance, and ineffective monitoring. Continuous reform measures and enhanced accountability are essential to permanently reduce NPA levels and strengthen the financial resilience of Indian banks.

Research Methodology

This chapter presents the methodological framework adopted to examine how banking reforms have influenced the management of Non-Performing Assets (NPAs) in Indian banks. The study focuses on evaluating the effectiveness of major reform measures such as the SARFAESI Act, Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARCs), the Asset Quality Review (AQR), and the Insolvency and Bankruptcy Code (IBC) in strengthening NPA recovery and improving asset quality within both public and private sector banks.

The nature of this study is descriptive and analytical. The descriptive approach helps in understanding the evolution of banking reforms over time and their associated mechanisms, while the analytical aspect focuses on interpreting trends in NPAs and evaluating how reforms have impacted recovery efficiency, asset quality, and financial performance of Indian banks. This dual approach allows for a comprehensive understanding of policy impact concerning NPA management.

The research relies exclusively on secondary data sources. Data has been collected from credible and authoritative sources including reports from the Reserve Bank of India (RBI), Ministry of Finance, Insolvency and Bankruptcy Board of India (IBBI), National Asset Reconstruction Company Limited (NARCL) documents, and publications from the Indian Banks' Association (IBA). Additionally, peer-reviewed journal articles, government circulars, bank annual reports, Economic Survey, and financial data from the RBI's *Statistical Tables Relating to Banks in India* have been used. Research papers accessed through Google Scholar, JSTOR, and Scopus databases were reviewed to identify empirical studies conducted on banking reforms and NPA trends.

The variables selected for this study include:

- **Independent variable:** Banking reforms (SARFAESI, DRTs, ARCs, AQR, IBC, Bad Bank model)
- **Dependent variable:** NPA management efficiency measured by Gross NPA ratio, Net NPA ratio, recovery percentage, and resolution time.

The data was analyzed using qualitative content analysis and trend analysis. Through qualitative content analysis, key themes such as reform effectiveness, legal enforcement challenges, bottlenecks in loan recovery, and improvement in asset quality were identified. Trend analysis was employed to interpret changes in Gross NPA and Net NPA ratios over time, particularly before and after major reforms like IBC (2011) and AQR (2014). Comparative observations were also made between public sector banks and private sector banks to understand differences in outcomes.

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

Ethical considerations were strictly maintained throughout the research process. Only publicly available secondary data has been used, and all sources have been acknowledged to maintain academic transparency and avoid plagiarism. No confidential or sensitive bank information was accessed.

In summary, this research methodology—built on descriptive analysis, secondary data interpretation, and content-based examination of reforms—provides a systematic framework to evaluate the impact of India’s banking reforms on NPA management and asset quality improvement.

Data Analysis and Discussion

This chapter presents an analysis of the trends in Non-Performing Assets (NPAs) in Indian banks and evaluates how major banking reforms have influenced NPA recovery, resolution efficiency, and asset quality over time. The discussion is structured around changes observed before and after key reforms, including the SARFAESI Act (2002), the introduction of Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARCs), the Asset Quality Review (AQR) in 2010, and the Insolvency and Bankruptcy Code (IBC) implemented in 2014.

The data reviewed from RBI publications and banking reports indicates that NPAs in Indian banks began rising rapidly between 2012 and 2013. During this period, public sector banks saw a surge in stressed assets due to aggressive lending to infrastructure, power, steel, and real estate projects, which later stalled due to policy delays, cost overruns, and macroeconomic slowdown. Banks continued to restructure loans rather than classify them as NPAs, resulting in “evergreening” of loans, which masked the true stress in the banking system. The RBI’s Asset Quality Review (AQR) in 2011 forced banks to identify and report stressed assets transparently, leading to a sharp rise in reported NPAs, particularly in state-owned banks.

The analysis shows that the SARFAESI Act (2002) improved banks’ ability to enforce security against defaulting borrowers without lengthy court procedures. Although SARFAESI empowered lenders, its impact was diluted over time due to increased litigation and operational delays. Debt Recovery Tribunals (DRTs) were introduced to speed up loan recovery, but backlogs and limited judicial capacity hindered their effectiveness. Similarly, Asset Reconstruction Companies (ARCs) helped offload bad loans from bank balance sheets, yet their contribution remained limited due to insufficient capital and risk appetite.

A major shift occurred after the implementation of the Insolvency and Bankruptcy Code (IBC), 2012. The IBC introduced a time-bound insolvency resolution process and empowered creditors by allowing them to take control of the debtor company through the Committee of Creditors (CoC). Analysis of RBI and IBBI reports suggests that recovery rates under IBC were significantly higher compared to earlier mechanisms such as SARFAESI and DRTs. Several large corporate defaulters, including Essar Steel and Bhushan Steel, were resolved through the IBC framework, enabling banks to recover substantial portions of their outstanding dues. The data indicates that the Gross NPA ratio for scheduled commercial banks, which peaked around 2014, started declining gradually after the effectiveness of IBC and recapitalization support by the government.

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma

Further, the introduction of the bad bank model (NARCL) in 2011 marked a new phase in NPA management by creating a centralized institution to acquire large legacy NPAs from banks and expedite resolution. Data analysis indicates that banks, especially public sector banks, were able to clean up their balance sheets and improve provisioning when bad assets were transferred to NARCL.

The discussion suggests that banking reforms significantly influenced NPA management outcomes. While earlier reforms focused on recovery through legal action or restructuring, the post-2012 reforms—especially AQR and IBC—focused on transparency, accountability, and resolution. The improvement in NPA ratios following these reforms shows that structural issues were better addressed when reforms were aimed at changing borrower incentives, improving governance, and establishing a time-bound resolution mechanism.

In conclusion, the analysis reinforces that banking reforms have played a transformative role in improving financial discipline, strengthening credit monitoring, and enhancing recovery mechanisms. Although challenges remain in terms of judicial delays, borrower litigation, and slow resolution of certain large accounts, the overall trend indicates improved asset quality and greater operational resilience in the Indian banking sector.

Conclusion

The management of Non-Performing Assets (NPAs) remains one of the most critical challenges for the Indian banking system, especially for public sector banks. The study reveals that the persistent rise in NPAs before 2012 was largely the result of aggressive lending to infrastructure and corporates, coupled with inadequate credit appraisal, weak monitoring, and delayed recognition of stressed assets. Prior to reforms such as the Asset Quality Review (AQR) and Insolvency and Bankruptcy Code (IBC), banks commonly resorted to loan restructuring practices, which masked the actual level of NPAs in their balance sheets. The AQR forced banks to recognize true asset quality, leading to transparency and responsible lending practices.

The analysis shows that earlier mechanisms such as the SARFAESI Act, Debt Recovery Tribunals (DRTs), and Asset Reconstruction Companies (ARCs) provided banks with recovery tools but were insufficient to address structural weaknesses in insolvency resolution. The introduction of the Insolvency and Bankruptcy Code (IBC) 2014 emerged as the most significant reform, shifting the power from borrowers to creditors and enabling a time-bound insolvency process. IBC improved recovery rates, boosted credit discipline, and restored market confidence in the banking sector. Further, the formation of the National Asset Reconstruction Company Limited (NARCL), commonly known as the “Bad Bank,” strengthened the cleanup of legacy NPAs.

Overall, the combination of AQR, IBC, recapitalization support, and improved governance mechanisms has resulted in a sharp decline in NPAs post-2012. However, long-term sustainability requires continuous vigilance, stronger risk assessment mechanisms, and proactive monitoring of credit exposures.

Banking Reforms and the Management of Non-Performing Assets in Indian Banks

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Banking Reforms and the Management of Non-Performing Assets in Indian Banks

Dr. Nandini Sharma