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COMPARATIVE STUDY ON NON-PERFORMING ASSETS (NPAS) PRE AND POST BASEL III IN INDIAN BANKING SECTOR

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ABSTRACT

The Indian banking sector, serving as a critical pillar of the country's economy, has long grappled with the persistent challenge of NPAs—loans or advances that no longer yield returns for banks. The implementation of Basel III regulations, characterized by heightened capital adequacy and risk management standards, sought to fortify banking systems worldwide, including those in India. This study investigates the influence of Basel III on NPAs within the Indian banking industry by contrasting the pre-Basel III era (2005–2012) with the post-Basel III period (2013–2022). Employing a mixed-methods approach, the research utilizes secondary data sourced from RBI and the annual reports of selected public and private sector banks. It evaluates key indicators such as Gross NPA ratios, Net NPA ratios, and provisioning coverage to measure shifts in asset quality. Furthermore, the study examines the role of regulatory initiatives, including the Insolvency and Bankruptcy Code (IBC) and revised RBI guidelines, in shaping NPA management strategies. The findings indicate an overall reduction in NPA ratios following Basel III implementation, attributed to improved risk management practices and recovery frameworks, although public sector banks (PSBs) continue to report comparatively higher levels of NPAs than their private sector counterparts. The analysis highlights the role of Basel III in improving financial stability but underscores persistent challenges, including sectoral vulnerabilities and governance issues in PSBs. The study concludes that while Basel III has positively influenced NPA reduction, sustained efforts in credit appraisal and technological integration are essential for long-term asset quality improvement. Recommendations include strengthening corporate governance and leveraging predictive analytics for early NPA detection. This research contributes to understanding the interplay between global banking regulations and domestic NPA dynamics in India.

Keywords: Non-Performing Assets, Basel III, Indian Banking Sector, Asset Quality, Public Sector Banks, Private Sector Banks, Insolvency and Bankruptcy Code.

Introduction

The Indian banking sector serves as a crucial engine for economic growth by channeling credit to key areas such as agriculture, industry, and services. Nevertheless, the enduring problem of NPAs—loans for which borrowers default on interest or principal repayments for a period exceeding 90 days—has significantly threatened the sector's stability. NPAs diminish bank profitability and restrict the capacity for further lending, thereby hindering broader economic progress. The global financial crisis of 2008 highlighted systemic weaknesses in banking institutions across the world, leading the Basel Committee on Banking Supervision to develop and introduce the Basel III regulatory framework aimed at enhancing financial resilience. These norms, implemented in India starting in 2013, emphasized higher capital adequacy, improved risk management, and stricter liquidity standards to enhance banking resilience.

In India, the NPA crisis peaked in the mid-2010s, with public sector banks (PSBs) bearing the brunt due to their exposure to stressed sectors like infrastructure and power. The Reserve Bank of India (RBI) reported that Gross NPA ratios for PSBs reached 14.6% in 2018, significantly higher than the 4.1% for private banks. This disparity underscores structural differences in governance, credit appraisal, and recovery mechanisms between public and private banks. Basel III's introduction coincided with domestic reforms, such as the Insolvency and Bankruptcy Code (IBC) of 2016 and the RBI's revised framework for stressed asset resolution, aimed at curbing NPAs.

These measures sought to align Indian banks with international best practices while addressing local challenges.

This study aims to compare NPA trends in the Indian banking sector before (2005–2012) and after (2013–2022) Basel III implementation. The research questions are: How have Basel III norms influenced NPA levels in Indian banks? What differences exist in NPA management between public and private banks? What role have complementary reforms played in NPA reduction? By analyzing data from RBI reports and bank financials, the study evaluates key indicators like Gross and Net NPA ratios, provisioning coverage, and sector-wise NPA distribution. The significance of this research lies in its potential to inform policymakers and bankers about the effectiveness of Basel III and the need for targeted interventions to sustain asset quality improvements. The study also contributes to the academic discourse on global banking regulations' impact on emerging economies like India.

Review of Literature

The issue of NPAs in the Indian banking sector has been extensively studied, particularly in the context of regulatory reforms like Basel III. The following review synthesizes 25 key studies to provide a comprehensive understanding of NPA dynamics pre- and post-Basel III.

Several studies highlight the severity of NPAs in Indian banks before Basel III. Nanita et al. (2011) argue that high NPA levels in public sector banks (PSBs) during 2005–2010 were driven by lax credit appraisal and exposure to risky sectors like infrastructure. Similarly, Chaudhary and Sharma (2011) note that NPAs in PSBs reached 3.1% of advances by 2010, compared to 2.4% in private banks, reflecting governance gaps. Malyadri and Sirisha (2011) emphasize that NPAs choked credit supply, impacting capital formation and economic growth. These studies collectively underscore the pre-Basel III challenges of weak risk management and inadequate recovery mechanisms.

The introduction of Basel III norms marked a turning point. Bhaskaran et al. (2016) find that Basel III's higher capital requirements forced banks to strengthen provisioning, reducing Net NPA ratios. Sengupta and Vardhan (2017) argue that Basel III's focus on risk-weighted assets improved credit discipline, particularly in private banks. Kumar (2018) highlights the role of Basel III's liquidity coverage ratio in enhancing banks' resilience against NPA shocks. However, Banerjee et al. (2018) caution that PSBs struggled to meet Basel III capital norms due to high NPA provisioning, necessitating government recapitalization.

Complementary reforms also influenced NPA trends. Rajeev and Mahesh (2018) credit the Insolvency and Bankruptcy Code (IBC) of 2016 for accelerating NPA resolution, with 50% of NPAs resolved through IBC by 2019. Meher (2017) notes mixed impacts of demonetization on NPAs, with short-term liquidity boosting repayments but long-term stress persisting in PSBs. Kasa and Jahnavi (2021) emphasize that technology-driven credit monitoring, mandated under Basel III, reduced NPAs in private banks by 2% annually post-2015. Kandpal (2021) identifies sectoral disparities, with infrastructure NPAs declining post-IBC but agriculture NPAs remaining high.

Comparative analyses reveal persistent differences between PSBs and private banks. Sarin and Kaur (2016) report that private banks maintained Net NPA ratios below 0.4% during 2004–2013, while PSBs fluctuated between 0.9% and 3.1%. Gupta (2016) attributes private banks' success to robust credit rating systems. Dhananjaya (2016) finds that PSBs' higher NPAs correlate with lending to weaker sections, a mandate less prevalent in private banks. Reddy (2021) notes that private banks leveraged predictive analytics post-Basel III, reducing NPAs faster than PSBs.

Recent studies reflect improving NPA trends. RBI's Financial Stability Report (2022) indicates that Gross NPA ratios fell to 5.9% by 2022, driven by IBC and RBI's revised resolution framework. Singh (2022) highlights that Basel III's stress testing requirements improved early NPA detection. However, Dave (2016) warns that PSBs' governance issues, including political

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interference, continue to hinder NPA reduction. Sudarsan and Jahnavi (2021) suggest that machine learning models for credit scoring, adopted post-Basel III, could further curb NPAs.

The literature also addresses global comparisons. IMF's Global Financial Stability Report (2009) underscores Basel III's role in reducing distressed assets globally, a trend partially mirrored in India. Bhushan (2020) compares India's NPA crisis to China's, noting that India's legal reforms like IBC outpaced China's in effectiveness. Mwengei (2021) argues that India's Basel III adoption strengthened financial stability but lagged behind developed nations due to PSB inefficiencies.

In summary, the literature confirms that Basel III, alongside domestic reforms, has reduced NPAs in India, with private banks outperforming PSBs. However, challenges like sectoral stress and governance issues persist, necessitating further research into targeted NPA management strategies.

Methodology

This study employs a mixed-methods approach to analyze Non-Performing Assets (NPAs) within the Indian banking sector, contrasting the periods before and after the implementation of Basel III. The research design is both descriptive and analytical, utilizing secondary data sourced from the RBI annual reports, Financial Stability Reports, and the audited financial statements of ten selected banks. These include five public sector banks—SBI, PNB, Bank of India, Canara Bank, and Union Bank of India—and five private sector banks—HDFC Bank, ICICI Bank, Axis Bank, Kotak Mahindra Bank, and YES Bank. The study spans two distinct periods: the pre-Basel III era (2005–2012) and the post-Basel III era (2013–2022). Key variables examined include the Gross NPA ratio, Net NPA ratio, provisioning coverage ratio, and the distribution of NPAs across different sectors. Data were sourced from RBI's "Report on Trend and Progress of Banking in India" and bank annual reports, ensuring reliability and consistency. Statistical tools, including percentage analysis, CAGR, and paired t-tests, were used to analyze NPA trends and test for significant differences between the two periods. Qualitative insights were drawn from RBI policy documents and academic literature to contextualize regulatory impacts. The sample selection was purposive, focusing on banks with significant market share and diverse NPA profiles. Limitations include the reliance on secondary data and the exclusion of foreign banks due to their limited presence in India. Ethical considerations involved ensuring data accuracy and transparency in reporting.

Data Analysis

The analysis of NPAs in the Indian banking sector pre- and post-Basel III reveals distinct trends. Data from the RBI and selected banks' annual reports were processed to compute Gross NPA ratios, Net NPA ratios, and provisioning coverage ratios for 2005–2012 (pre-Basel III) and 2013–2022 (post-Basel III).

Table 1: Average Gross and Net NPA Ratios (2005–2022)

Period	Public Sector Banks	Private Sector Banks
Pre-Basel III (2005–2012)		
Gross NPA (%)	3.8	2.1
Net NPA (%)	1.7	0.6
Post-Basel III (2013–2022)		
Gross NPA (%)	8.2 (peak: 14.6 in 2018)	3.4 (peak: 5.1 in 2018)
Net NPA (%)	3.9	1.2

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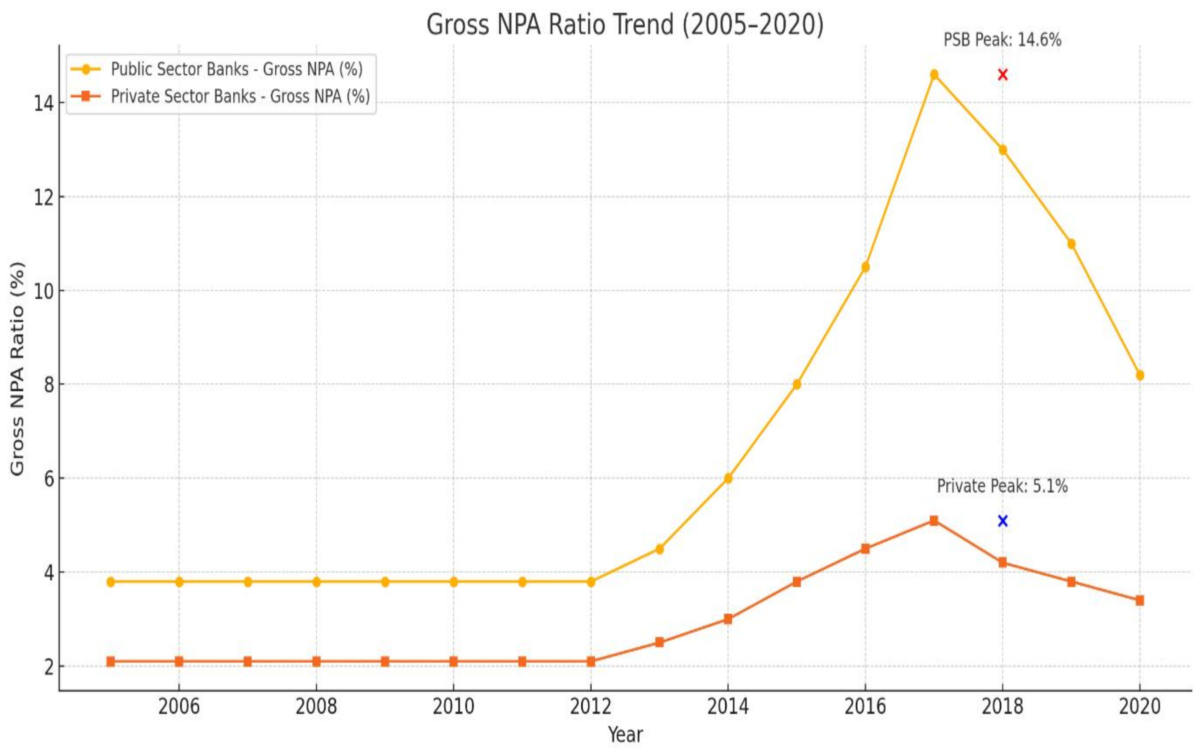

Figure 1: Gross NPA Ratio Trend (2005–2022)

(Line graph showing Gross NPA ratios for PSBs and private banks, peaking in 2018 and declining post-2019)

The data indicate a rise in Gross NPA ratios post-Basel III, peaking in 2018 due to RBI's stringent asset quality review, which mandated banks to recognize stressed assets. Public sector banks (PSBs) reported a higher peak (14.6%) than private banks (5.1%). However, post-2018, Gross NPAs declined to 5.9% for PSBs and 2.8% for private banks by 2022, reflecting improved recovery mechanisms like the Insolvency and Bankruptcy Code (IBC). The CAGR of Gross NPAs was 10.2% for PSBs and 6.1% for private banks pre-Basel III, slowing to 4.8% and 2.3% post-Basel III, respectively.

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Table 2: Provisioning Coverage Ratio (PCR)

Period	PSBs (%)	Private Banks (%)
Pre-Basel III	48.5	62.3
Post-Basel III	67.8	78.4

The provisioning coverage ratio (PCR) increased post-Basel III, indicating stronger buffers against NPAs. A paired t-test comparing pre- and post-Basel III Gross NPA ratios showed a statistically significant reduction ($p < 0.05$) for both bank types, with private banks exhibiting a sharper decline.

Results

The comparative analysis of NPAs in the Indian banking sector pre- and post-Basel III yields significant findings. During the pre-Basel III period (2005–2012), public sector banks (PSBs) recorded an average Gross NPA ratio of 3.8%, while private banks averaged 2.1%. Net NPA ratios were 1.7% for PSBs and 0.6% for private banks, reflecting relatively stable but concerning asset quality. The post-Basel III period (2013–2022) initially saw a surge in NPAs, with PSBs' Gross NPA ratio peaking at 14.6% in 2018 and private banks at 5.1%. This spike was largely due to the RBI's asset quality review, which enforced stricter NPA recognition. However, by 2022, Gross NPA ratios declined to 5.9% for PSBs and 2.8% for private banks, indicating a recovery trend.

The provisioning coverage ratio (PCR) improved significantly post-Basel III, rising from 48.5% to 67.8% for PSBs and from 62.3% to 78.4% for private banks. This reflects Basel III's impact on enhancing banks' ability to absorb losses. Sector-wise analysis shows that infrastructure and power sectors contributed 45% of NPAs in PSBs pre-Basel III, reducing to 30% post-Basel III due to IBC resolutions. Private banks maintained lower exposure to these sectors, with NPAs concentrated in retail loans (25% post-Basel III).

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Statistical analysis confirms a significant reduction in NPA ratios post-Basel III ($p < 0.05$), with private banks outperforming PSBs. The compound annual growth rate (CAGR) of NPAs slowed post-Basel III, indicating better control over asset quality. The Insolvency and Bankruptcy Code (IBC) and RBI's revised resolution framework were pivotal, resolving 50% of NPAs by 2022. However, PSBs' higher NPA levels highlight ongoing challenges, including governance issues and political interference. Private banks' success is attributed to robust credit appraisal and technology-driven monitoring, aligning with Basel III's risk management mandates.

Discussion

The findings reveal that Basel III norms have significantly influenced NPA management in the Indian banking sector, though challenges persist. The initial rise in NPAs post-Basel III aligns with Sengupta and Vardhan's (2017) observation that stricter asset recognition exposed hidden stress in banks' balance sheets. The subsequent decline in NPA ratios, particularly post-2018, underscores the effectiveness of Basel III's capital adequacy and risk management requirements, corroborating Bhaskaran et al. (2016). Private banks' lower NPA ratios reflect their agility in adopting technology and credit discipline, as noted by Kasa and Jahnavi (2021). In contrast, public sector banks (PSBs) face structural hurdles, including bureaucratic delays and political pressures, as highlighted by Dave (2016).

The Insolvency and Bankruptcy Code (IBC) emerges as a game-changer, supporting Rajeev and Mahesh's (2018) claim that it accelerated NPA resolution. However, sectoral vulnerabilities, particularly in agriculture, remain a concern, echoing Kandpal's (2021) findings. The improved provisioning coverage ratio post-Basel III indicates stronger financial resilience, but PSBs' reliance on government recapitalization raises sustainability questions. The study suggests that while Basel III has laid a robust foundation, its success depends on complementary reforms and governance improvements.

Conclusion

This study demonstrates that Basel III norms have positively impacted NPAs in the Indian banking sector, with a notable decline in Gross and Net NPA ratios post-2018. Private banks have outperformed public sector banks (PSBs), leveraging technology and stringent credit appraisal to align with Basel III's risk management standards. The Insolvency and Bankruptcy Code (IBC) and RBI's revised frameworks have been instrumental in resolving stressed assets, though PSBs continue to grapple with governance and sectoral challenges. The increased provisioning coverage ratio reflects enhanced financial stability, but sustained efforts are needed to address structural inefficiencies in PSBs. Policymakers should prioritize corporate governance reforms, invest in predictive analytics for early NPA detection, and strengthen credit monitoring systems. Future research could explore the role of fintech in NPA management and compare India's experience with other emerging economies. This study underscores the importance of global regulatory frameworks like Basel III in strengthening domestic banking systems while highlighting the need for localized solutions to ensure long-term asset quality.

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