



EFFECTIVENESS OF IBC IN REDUCING NPA BACKLOGS IN INDIAN BANKS

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Abstract: The Insolvency and Bankruptcy Code (IBC), enacted in 2016, was a landmark reform to address India's mounting non-performing assets (NPAs). By creating a creditor-driven, time-bound resolution framework, it improved recovery rates, curbed willful defaults, and helped banks clean up stressed balance sheets. High-profile cases such as Essar Steel and Bhushan Steel demonstrated its ability to deliver market-driven solutions and enhance investor confidence.

Despite these gains, challenges persist. Delays due to litigation, capacity constraints at the National Company Law Tribunal, and steep creditor haircuts have limited outcomes in several cases. Its impact on MSMEs also remains modest. Looking ahead, strengthening institutional capacity, promoting pre-packaged insolvencies, and building a secondary market for stressed assets are crucial. Overall, while not flawless, the IBC has significantly advanced India's framework for reducing NPAs.

I. INTRODUCTION

Non-Performing Assets (NPAs) have long been one of the most pressing issues in the Indian banking system. Before 2016, recovery mechanisms like the Debt Recovery Tribunals (DRTs), SARFAESI Act, and Corporate Debt Restructuring (CDR) had limited success in resolving stressed assets. The enactment of the Insolvency and Bankruptcy Code (IBC), 2016 was a landmark reform intended to provide a time-bound, creditor-driven mechanism for resolution and to reduce mounting NPA backlogs. Nearly a decade later, it is important to examine whether the IBC has been effective in addressing the NPA crisis and strengthening the financial system.

II. IBC AS A STRUCTURAL REFORM

The IBC sought to consolidate fragmented insolvency laws into a single framework with the following objectives:

- Establish a **time-bound resolution process** (initially 180 days, extendable to 330 days).
- Shift from a **debtor-in-possession** model to a **creditor-in-control** framework.
- Maximize recovery for creditors through market-driven bidding.
- Enhance investor confidence by creating a predictable resolution mechanism.

By empowering the National Company Law Tribunal (NCLT) as the adjudicating authority, the IBC provided banks and financial institutions with a much stronger tool to deal with defaulting borrowers.

III. IMPACT OF NPA RESOLUTION

1. Reduction in NPA Accumulation

The IBC introduced a strong deterrent against willful default. Borrowers became more inclined to settle dues pre-emptively to avoid losing control of their firms. This "fear factor" helped curb fresh NPAs to some extent.

2. Improved Recovery Rates

Before IBC, recovery rates through earlier mechanisms were abysmally low—around 20% under DRTs and 26% under SARFAESI. Post-IBC, average recovery rates have improved significantly, often ranging between 35–45% of claims. In large cases like Essar Steel, creditors recovered over 80,000 crore against admitted claims of about 54% recovery.

3. Time-Bound Resolution – Still a Challenge

While the Code mandated completion within 330 days, delays due to litigation, lack of NCLT capacity, and complex cases have extended timelines. However, resolution under IBC remains considerably faster compared to pre-IBC mechanisms, where cases lingered for years.

4. Reduction in Backlogs

Banks were saddled with huge backlogs of NPAs. IBC offered a structured channel to resolve large-ticket accounts, which earlier clogged balance sheets. Several high-profile cases in steel, infrastructure, and power sectors were resolved, releasing locked funds and improving credit discipline.

IV. KEY ACHIEVEMENTS

1. Behavioral Transformation of Borrowers

One of the biggest achievements of IBC has been the change in mindset among borrowers. Earlier, defaulters could prolong recovery proceedings for years without serious consequences. Under IBC, promoters face the possibility of losing management control, which has made many corporate borrowers more proactive in settling dues or restructuring debt voluntarily.

2. Strengthening of Banking Sector Balance Sheets

Large stressed accounts, especially in steel, power, and infrastructure, which were clogging bank balance sheets, have been resolved under IBC. This has allowed banks to clean up their books and improve their capital adequacy, enabling them to extend fresh credit to productive sectors.

Case Study: Bhushan Steel – In 2018, Bhushan Steel (₹56,000 crore debt) was resolved through Tata Steel's bid of around ₹35,000 crore. Creditors recovered about 63% of their claims, making it one of the early success stories under IBC. This deal also reassured banks that large, complex cases could find market-driven buyers.

3. Improved Recovery Performance Compared to Earlier Regimes

Recovery rates under IBC are substantially higher than those under earlier mechanisms like SARFAESI and DRTs. According to RBI data, while earlier frameworks yielded recovery rates of around 20–25%, IBC has improved average recoveries to 35–45%, with some marquee cases achieving even better outcomes.

Case Study: Essar Steel – This was a landmark case where ArcelorMittal acquired Essar Steel for ₹42,000 crore. Creditors realized more than 54% of their admitted claims (higher than what SARFAESI or DRTs could have achieved). The Supreme Court's ruling also clarified the primacy of the Committee of Creditors (CoC), strengthening creditor confidence in the framework.

4. Creation of an Ecosystem for Stressed Assets

The IBC has catalyzed the growth of a professional ecosystem comprising Insolvency Professionals, Information Utilities, Resolution Professionals, and Insolvency Professional Agencies. It has also created a market for distressed assets, drawing interest from global investors, private equity firms, and asset reconstruction companies.

Case Study: Electrosteel Steels – Vedanta acquired Electrosteel Steels in 2018, marking the first major resolution under IBC. This case encouraged global investors to actively participate in India's stressed asset market, signaling that the Code was working.

5. Boost to Investor Confidence and Ease of Doing Business

By establishing a time-bound and predictable insolvency resolution mechanism, the IBC has enhanced India's ranking in the World Bank's Ease of Doing Business Index, especially under the "Resolving Insolvency" parameter. This credibility has attracted greater investor interest in Indian corporates.

V. LIMITATIONS AND CRITICISMS

1. Delays in Resolution

Although the Code envisages resolution within 330 days, in practice many cases drag on for over two to three years due to litigation, limited NCLT capacity, and procedural inefficiencies. This erodes the value of stressed assets and reduces creditor recoveries.

Case Study: Jaypee Infratech – Ongoing since 2017, this real estate insolvency has dragged on for years due to litigation and multiple resolution plan rejections. Homebuyers, who were later recognized as financial creditors under IBC, are still awaiting relief.

2. High Haircuts for Banks

In several high-profile resolutions, creditors have had to take steep haircuts — sometimes 70–80% of total dues. While resolution is better than liquidation, such outcomes raise questions about whether banks are truly benefiting in terms of financial health.

Case Study: Alok Industries – Creditors took over 83% haircut in this case, recovering just about ₹5,000 crore against admitted claims of nearly ₹30,000 crore. Such outcomes have drawn criticism that banks, while resolving NPAs, are forced to bear heavy losses.

3. Capacity Constraints at NCLTs

The shortage of benches, judges, and staff at the NCLT has been a significant bottleneck. Case overloads lead to adjournments and extended timelines, undermining the time-bound nature of IBC.

Case Study: Jet Airways – The airline's insolvency resolution faced multiple delays due to coordination challenges with creditors across jurisdictions, as well as NCLT's limited capacity. This shows that cross-border insolvencies remain a weak link.

4. Uneven Application Across Sectors

While the IBC has been effective in large corporate cases, its impact in resolving small and medium enterprises (SMEs) has been limited. Many MSMEs lack resources to go through the formal insolvency process, and pre-packaged insolvency schemes have seen limited adoption.

Case Study: Lanco Infratech – One of the first companies admitted under IBC, it ultimately went into liquidation due to the lack of viable resolution bids. This highlighted that IBC cannot guarantee revival in all cases.

5. Uncertainty Due to Frequent Amendments and Litigation

The IBC has been amended multiple times since its inception. While this reflects responsiveness, it also creates uncertainty for stakeholders. Judicial interventions in high-profile cases have also added unpredictability.

VI. FUTURE OUTLOOK

1. Strengthening Institutional Capacity

Expanding the number of NCLT benches, increasing judicial manpower, and leveraging technology for case management will be critical to reduce delays and improve efficiency.

2. Promoting Pre-Packaged Insolvency Schemes

Pre-packs, especially for MSMEs, can help speed up resolutions by allowing debtors and creditors to agree on a plan before approaching the NCLT. Encouraging greater use of this mechanism could reduce case backlogs.

3. Development of a Robust Secondary Market for Stressed Debt

A vibrant market for trading distressed debt will allow banks to offload NPAs quickly and free up capital. It will also attract specialized investors who can bring expertise in turning around distressed assets.

4. Improving Recovery Values

Strengthening valuation standards, increasing bidder participation, and ensuring transparent auctions will help maximize recoveries for creditors and reduce the burden of haircuts.

5. Capacity Building and Professionalization

Continued training and certification of Insolvency Professionals, along with strengthening Information Utilities, will enhance the quality of resolutions.

6. Balancing Speed with Fairness

Policymakers will need to strike a balance between strict timelines and ensuring fair opportunities for all stakeholders. Clearer jurisprudence and reduced scope for dilatory tactics will improve outcomes.

VII. CONCLUSION

The Insolvency and Bankruptcy Code (IBC), 2016 stands as one of the most transformative economic reforms in India's financial sector. It has not only provided banks with a credible framework to resolve bad loans but also shifted the balance of power decisively in favor of creditors. Through landmark cases such as Essar Steel, Bhushan Steel, and Electrosteel Steels, the IBC has demonstrated its potential to deliver higher recovery rates, instill borrower discipline, and clean up stressed corporate balance sheets.

At the same time, the Code's journey has been far from flawless. Prolonged litigation, heavy haircuts for banks, capacity constraints in the NCLT system, and uneven outcomes across industries highlight its limitations. Cases like Jaypee Infratech and Jet Airways reveal the urgent need for better institutional infrastructure, faster judicial processes, and specialized mechanisms for complex and cross-border insolvencies.

Despite these challenges, the IBC's effectiveness in reducing NPA backlogs cannot be underestimated. Compared to pre-IBC recovery frameworks, it has delivered quicker and more market-driven resolutions. Importantly, it has changed the behavior of both lenders and borrowers — lenders have become more assertive, while borrowers recognize that defaulting on loans has real consequences.

Looking ahead, the success of the IBC will depend on continuous refinement, judicial discipline, and institutional strengthening. Measures such as expanding NCLT capacity, promoting pre-packaged insolvencies, building a strong secondary market for stressed debt, and improving recovery values will help the Code achieve its full potential.

In essence, while the IBC may not be a "magic wand" that eliminates NPAs overnight, it has undeniably laid the foundation for a more disciplined, transparent, and resilient financial ecosystem in India. Its long-term effectiveness will lie in evolving with market realities and ensuring that banks, businesses, and borrowers alike view it not as a punitive tool, but as a constructive framework for sustainable financial recovery.

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