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Economic Survey 2025-Banking Sector Stability, Insolvency Outcomes and the Imperative for Course Correction & Challenges for MSMEs



EXECUTIVE SUMMARY

The Economic Survey 2025 presents a banking system that has regained strength after a prolonged period of stress, marked by improved asset quality, stronger capital buffers and sustained profitability. Institutional reforms, particularly the Insolvency and Bankruptcy Code, 2016, have contributed to restoring credit discipline and reducing legacy non-performing assets. At the same time, the Survey's data and recent insolvency trends point to structural gaps in the resolution ecosystem—most notably prolonged timelines, uneven recovery outcomes, limited enterprise revival, and significant value erosion in liquidation cases.

This write-up examines these developments in an integrated manner, drawing linkages between banking sector performance, insolvency outcomes, and the broader objective of economic growth and entrepreneurship. It highlights how IBC, while effective as an enforcement and recovery tool, has increasingly become the default response to financial stress, even where early restructuring or out-of-court solutions could have preserved value. Particular attention is given to MSMEs, which remain highly vulnerable due to their dependence on larger industries, limited access to formal credit, and the procedural and cost burdens of insolvency frameworks, including emerging proposals such as CIIRP.

The analysis underscores the need for the next phase of reform to move beyond recovery metrics and focus on timeliness, commercial viability, and enterprise preservation. Strengthening pre-insolvency restructuring mechanisms, improving institutional capacity, and building confidence in commercial decision-making outside the IBC framework are critical to ensuring that insolvency law supports, rather than undermines, sustainable economic growth.

BANKING SECTOR, INSOLVENCY RESOLUTION AND RECOVERY: CONSOLIDATION ACHIEVED, REFORM IMPERATIVE AHEAD

The recent trajectory of India's banking sector, as reflected in the *Economic Survey 2025–26*¹, presents a system that has largely completed its balance sheet repair phase and entered a period of stability, profitability and credit expansion. At the same time, experience under the Insolvency and Bankruptcy Code, 2016 presents a more nuanced reality. While the Code has clearly strengthened enforcement discipline and improved creditor confidence, outcomes in terms of value-maximizing resolution and enterprise revival have been uneven, largely constrained by structural delays, procedural layering, and institutional capacity gaps. This gap is particularly visible in the MSME sector. Despite repeated policy statements recognizing MSMEs as the backbone of employment and economic activity, they continue to receive no meaningful insulation from insolvency triggers. On the contrary, their vulnerabilities are likely to intensify under the proposed Creditor-Initiated Insolvency Resolution Process (CIIRP), which removes the safeguard of judicial scrutiny at the stage of initiation of the process and add litigation challenges and related cost at entry stage and exposes MSMEs to creditor-driven processes at a time when their financial stress is often cyclical, operational, and recoverable outside formal insolvency.

The Economic Survey reflects a clear improvement in the asset quality of the banking sector, with gross and net NPAs declining to multi-year lows, supported by recoveries, write-offs and stronger credit discipline. The Survey acknowledges that mechanisms such as the Insolvency and Bankruptcy Code (IBC) have contributed to this clean-up by enabling time-bound resolution and recoveries in large, stressed accounts, particularly in cases where resolution plans were successfully implemented.

At the same time, the Survey implicitly recognizes the limitations of the IBC as a recovery tool, while recoveries under resolution have been materially higher than liquidation values, overall recovery as a percentage of admitted claims remains modest, and prolonged timelines continue to erode value. The improvement in NPA ratios, therefore, owes as much to balance-sheet repair, prudent lending and economic recovery as it does to insolvency outcomes, underscoring the need to view IBC as one element within a broader recovery and credit-management framework rather than a standalone solution.

BANKING SECTOR: STABILITY RESTORED AND INTERMEDIATION RE-ORIENTED

The Survey records a decisive improvement in asset quality and recovery performance of Scheduled Commercial Banks (SCBs). Recovery rates in NPAs have nearly doubled since FY18 (13.2) to 26.2% in FY 25, while fresh slippage moderated

¹ <https://www.indiabudget.gov.in/economicsurvey/doc/echapter.pdf>

sharply 7.1% in FY 18 to 1.4% in FY 25), reflecting stronger underwriting discipline and macroeconomic resilience. Profitability metrics, return on assets, capital buffers and provisioning capacity indicate that banks today are better positioned to absorb stress and support credit growth.

However, the composition of credit growth reveals an important structural shift. Bank lending has increasingly gravitated towards retail, MSMEs and asset-backed exposures, while large corporates are progressively accessing market-based financing through bonds, foreign borrowings and non-bank channels. The rapid growth of non-bank sources of finance and corporate bond issuances underscores the reduced dependence of large enterprises on bank credit, even as MSMEs continue to rely predominantly on banks for funding.

Key Banking Sector Indicators – Economic Survey 2025–26

Indicator	FY18	FY24	FY25	FY26 (as on Sept/ Dec 2025)	Observation / Trend
Recovery rate in NPAs of SCBs	13.2%	28.3%	26.2%	26.2% (FY25 level)	Recovery rate has approximately doubled since FY18, reflecting improved resolution and recovery environment.
Slippage ratio of SCBs (fresh NPAs as % of standard advances)	7.1%	–	1.4%	1.3%	Sharp decline in slippage indicates stronger appraisal and improved asset quality.
Recovery rate through IBC	–	28.3%	36.6%	–	Improvement in IBC recovery reflects better outcomes in large ticket stressed assets.
Recovery rate through SARFAESI	–	25.4%	31.5%	–	SARFAESI continues to complement insolvency framework in recovery efforts.
Profit After Tax (SCBs) – YoY growth	–	–	+16.9%	+3.8% (YoY as of Sept 2025)	Strong profitability is supported by lower NPAs and steady credit growth.
Return on Equity (RoE) – SCBs	–	13.8% (Mar 2024)	13.6% (Mar 2025)	12.5% (Sept 2025)	Marginal moderation, but RoE remains structurally stronger than pre-COVID levels.
Return on Assets (RoA) – SCBs	–	1.4%	1.4%	1.3% (Sept 2025)	Stability in RoA indicates sustained balance-sheet strength.
YoY growth in outstanding bank credit	–	11.2% (Dec 2024)	–	14.5% (Dec 2025)	Credit growth has strengthened, with December 2025 marking the highest YoY growth in FY26 so far.
Outstanding bank credit (₹ lakh crore)	–	–	–	195.3 (Nov 2025)	Reflects expansion in banking system balance sheet alongside improving asset quality.

KEY TAKEAWAY

The Economic Survey highlights a structural improvement in asset quality, recovery performance and profitability of Scheduled Commercial Banks, supported by declining slippages, higher recoveries under IBC and SARFAESI, and renewed momentum in credit growth.

IBC: ENFORCEMENT CREDIBILITY ACHIEVED, REVIVAL OUTCOMES LIMITED

The IBC has fundamentally altered the creditor–debtor landscape by providing a time-bound enforcement mechanism. It has strengthened creditor rights, improved recoveries compared to pre-IBC regimes and introduced discipline in credit markets. Recovery rates under approved resolution plans have consistently exceeded liquidation values, validating the Code’s core design.

Over the past nine years, IBC has contributed to a discernible behavioural change among borrowers and lenders. The credible threat of loss of control upon default has altered repayment incentives, leading to earlier engagement with lenders and improved settlement behaviour even outside the formal insolvency framework. This is reflected in the improvement in recovery rates under the IBC from approximately **15–20 per cent in the pre-IBC regime to about 30–32 per cent**, alongside a significant reduction in resolution timelines from **6–8 years earlier to about 2.5–3 years** in resolved cases. Secured creditors have experienced materially higher recoveries, reinforcing the primacy of credit contracts and the enforcement of creditor rights.

The Code has also demonstrated its value in cases where resolution has been feasible. As of September 2025, 57 per cent of concluded CIRPs resulted in going-concern outcomes, either through approved resolution plans, appeal/review settlements, or withdrawals under section 12A, while 43 per cent culminated in liquidation. Importantly, where resolution plans were implemented, creditors realized nearly ₹3.99 lakh crore.

At the same time, the Survey candidly acknowledges the limitations that have emerged in practice. Institutional constraints, most notably capacity shortages at the NCLT and among Resolution Professionals, have resulted in proceedings stretching well beyond the statutory framework. Despite a mandated outer limit of 330 days, **actual average completion time stood at 713 days overall and 853 days for cases closed in FY25**, reflecting a deviation of over 150 per cent from the prescribed timeline. Prolonged pendency has contributed to value erosion, employee attrition, loss of customers, and breakdown of supplier relationships, particularly in asset-light and service-oriented sectors.

The behavioural impact of IBC is also visible in ex-ante credit behaviour. Empirical evidence cited in the Survey, including the IIM Bangalore study², shows a measurable improvement in credit discipline: a decline in overdue corporate loan ratios from 8 per cent in 2018 to about 5 per cent in 2024, faster transitions of accounts from default to normal status, and a reduction of approximately 0.96 percentage points in net NPA accretion attributable to the implementation of IBC. These effects suggest that the Code’s influence extends beyond cases formally admitted into CIRP, functioning as a deterrent against strategic default.

Nevertheless, the Survey recognizes that IBC remains a work in progress. The high proportion of liquidations, low recovery in liquidation cases, underutilization of Pre-Packaged Insolvency Resolution Processes (**PIRP**), and capacity bottlenecks underscore the need for process simplification, institutional scaling, and complementary restructuring mechanisms outside the IBC. The next phase of insolvency reform, as envisaged in the IBC Amendment Bill, 2025, therefore rightly emphasizes procedural streamlining, cross-border insolvency, and capacity augmentation seeking to preserve enterprise value while retaining the discipline introduced by the Code.

² <https://ibbi.gov.in/uploads/whatsnew/1af62766c26f90a284c1fa996faa6e97.pdf>

Key Performance Indicators of IBC (as per Economic Survey 2025-26)

Indicator	Position / Outcome
Improvement in recovery rates (pre-IBC vs IBC)	From about 15–20% (pre-IBC) to about 30–32% under IBC
Average resolution timeline	Reduced from 6–8 years to around 2.5–3 years in resolved cases
CIRPs concluded with going-concern outcomes	Around 57% of concluded CIRPs
CIRPs ending in liquidation	Around 43% of concluded CIRPs
Realization under resolution plans	Around ₹3.99 lakh crore
Recovery vs liquidation value	Around 170% of liquidation value
Recovery vs fair value	Around 94% of fair value
Average time for CIRP completion (overall)	Around 713 days
Average time for CIRPs closed in FY25	Around 853 days
Statutory outer limit for CIRP	330 days
Reduction in overdue corporate loan ratio	From Around 8% (2018) to 5% (2024)
Reduction in Net NPA accretion (IBC impact)	Around 0.96 percentage points
PPIRP admissions since 2021	Very limited (14 admissions over four years)
Key institutional constraint	NCLT pendency (Around 60,000 cases), RP capacity gaps

VALUE STRUCK IN RECEIVABLES

However, it is also seen that large components of creditor value, particularly receivables, book debts and claims against group entities, remain unrealized. Avoidance transactions, though increasingly pursued, are frequently mired in prolonged litigation with modest economic outcomes. As a result, while recovery *rates* have improved, recovery *depth* and enterprise preservation have not kept pace.

The experience thus far suggests that the IBC has functioned more effectively as a **judicially anchored recovery backstop** than as a comprehensive framework for business turnaround, with successful revivals concentrated in a limited number of large, operationally viable enterprises.

MSME PRE-PACK INSOLVENCY PROCESS

This case originates from a 2017 banking consortium fraud involving Gujarat-based Sterling Biotech Ltd. and its The limited uptake of the MSME pre-pack framework is not attributable to a single factor but reflects a misalignment between legal design and on-ground insolvency behaviour. While the framework was introduced with the objective of providing a debtor-in-possession, time-bound solution, its architecture continues to be creditor and NCLT approval heavy which require indulgence of NCLT at each and every stage. Pre-pack as the concept goes and the way it is being implemented in the jurisdictions from where IBC is inspired, it works with minimum judicial involvement, but the Pre-Pack offers in India no such benefits.

In practice, the MSME pre-pack framework is burdened with additional procedural layers without offering any material advantage over the existing CIRP or even bilateral restructuring mechanisms. The scope for commercial negotiation is significantly narrower. Any meaningful haircut to financial creditors is linked to a compulsory dilution of promoter stake, while any reduction in claims of other creditors triggers a public invitation for competing resolution plans, effectively importing CIRP-like uncertainties into what was intended to be a streamlined process.

At the same time, the entire cost of the pre-pack process, valuation, process advisory, resolution professional fees, and NCLT filings etc, is borne by the MSME itself, unlike a normal CIRP where costs are typically borne or shared by financial creditors. This cost asymmetry is critical for smaller enterprises already under financial stress.

Further, where the MSME account is not classified as fraud or wilful default, promoters are otherwise eligible to submit resolution plans under the regular CIRP framework without being subject to the additional constraints embedded in the pre-pack regime. From the perspective of both time and flexibility, a normal CIRP therefore often offers greater negotiating space and fewer structural limitations than a pre-pack.

In many cases, if the promoter's proposal fits within the bank's One-Time Settlement (**OTS**) guidelines, it is commercially and procedurally more efficient for both MSMEs and lenders to resolve the stress through an OTS, without the judicial delays, procedural rigidity, and mandatory payment sequencing imposed under the pre-pack insolvency framework.

As currently structured, the pre-pack process narrows options for both MSMEs and banks, rather than expanding them, which explains its limited adoption despite its stated objectives.

WHAT NEEDS TO BE DONE TO MAKE THE PRE-PACK SYSTEM WORK BETTER FOR MSMEs

For the pre-pack framework to work meaningfully for MSMEs, it requires substantive re-calibration rather than incremental or cosmetic changes. As presently structured, the process adds layers without expanding commercial options, making it unattractive for both borrowers and lenders.

First, the framework must restore commercial flexibility. The current design artificially constrains negotiations by linking haircuts to mandatory promoter dilution and by triggering public invitation of plans even for limited adjustments to creditor claims.

Second, cost allocation needs correction. Requiring MSMEs to bear the entire cost of the process, valuation, RP fees, and NCLT proceedings, undermines the very objective of a "lighter" insolvency mechanism.

Third, the procedural architecture must be simplified. MSME distress is usually a liquidity or demand shock. A process involving multiple filings, repeated confirmations, and judicial oversight at several stages defeats the purpose of early intervention. A reduced judicial footprint with clearly defined limited checkpoints is essential.

Finally, the framework must align with existing bank restructuring tools rather than compete with them. Where a base plan broadly fits within a lender's OTS or restructuring policy, pushing the account into a pre-pack, with its additional statutory constraints and timelines, serves little purpose. Unless the pre-pack offers clear advantages over OTS and regular CIRP in terms of flexibility, cost, and certainty, it will continue to remain underutilized.

BEHAVIORAL AND INSTITUTIONAL CONSEQUENCES

The growing reliance on IBC as a default recovery mechanism has had broader systemic implications. For banks, insolvency proceedings often serve as a shield against ex-post scrutiny by vigilance and investigative agencies, encouraging defensive filings even in cases better suited for restructuring or negotiated settlement. For promoters, insolvency carries severe reputational, regulatory and personal consequences, reinforcing resistance and delay rather than early engagement.

These dynamic risks crowding NCLTs with cases that have little prospect of revival, diluting institutional capacity and undermining the Code's core objective of value preservation. It also risks discouraging entrepreneurship, particularly in MSMEs, where temporary stress is often conflated with insolvency.

THE LIMITS OF INSOLVENCY-LED RESOLUTION FOR MSMEs

Despite targeted policy support and the introduction of the Pre-Packaged Insolvency Resolution Process (**PPIRP**), MSMEs continue to remain ill-served by formal insolvency mechanisms under the IBC. The pre-pack framework, far from offering a simplified or expedited route, introduced additional procedural layers mandatory creditor approvals on the base plan, prior consent on the appointment of the Resolution Professional, multiple applications before the NCLT, public bidding triggers, potential transfer of management to the RP, and full cost-bearing by the MSME, without delivering any commensurate benefit over a normal CIRP. The requirement of judicial intervention at almost every stage, including admission, approval of the base plan, and implementation, rendered the process cost-intensive, time-consuming, and commercially unattractive for MSMEs. The negligible uptake of PPIRP over more than four years is itself indicative of its structural and design failures.

The proposed Creditor-Initiated Insolvency Resolution Process (CIIRP) risks replicating and potentially aggravating these shortcomings. While positioned as a creditor-driven alternative, CIIRP envisages extensive involvement of the Adjudicating Authority at multiple stages, including commencement, moratorium, constitution of the committee of creditors, approval of resolution plans, avoidance applications, objections, and possible conversion into a full CIRP. Each such judicial touchpoint creates scope for intervention, challenges, and interlocutory litigation by promoters and other stakeholders, an experience already well documented under the existing CIRP framework. For MSMEs, which are particularly sensitive to time, cost, and uncertainty, such procedural density is likely to prove fatal rather than facilitative.

The irony lies in the assumption that CIIRP would reduce litigation, when in reality it multiplies procedural stages that invite challenge. Provisions such as automatic conversion into CIRP upon alleged non-cooperation by promoters overlook ground realities, where resolution professionals are routinely compelled to approach NCLTs for directions, and promoters frequently resort to litigation to delay or derail proceedings. If most CIIRP cases are ultimately expected to migrate into CIRPs, the rationale for introducing a parallel hybrid mechanism, adding further layers of process and uncertainty, remains questionable. Experience under earlier hybrid regimes such as BIFR, CDR, and even SARFAESI demonstrates that such designs tend to institutionalize litigation while undermining timely resolution.

For MSMEs, therefore, early restructuring, cash-flow support, receivable realization, and negotiated settlements outside the IBC framework remain economically superior to formal insolvency. Strengthening pre-insolvency mechanisms under RBI regulations, contractual restructuring tools, and sector-specific workout frameworks is critical, not merely as alternatives, but as complements that preserve enterprise value, minimize judicial intervention, and prevent avoidable value destruction. What is required is a genuine, streamlined, out-of-court, creditor-driven restructuring framework with certainty of timelines and minimal adjudicatory involvement, rather than over-engineered or hybrid insolvency processes that risk deepening delays and litigation. The system can ill afford another half-measured experiment; the focus must remain on consolidating and strengthening the existing CIRP architecture while addressing its known bottlenecks through institutional capacity building and process discipline.

CHALLENGES FACED BY MSMEs

MSMEs face a structural “credit handicap” because their cash flows are volatile, financial reporting is often thin, and collateral is limited, so lenders tend to price them for risk, rely on personal guarantees, and keep limits tight, especially for working capital. This constraint is aggravated by MSMEs’ dependence on large industry, a very large part of MSME liquidity is effectively “parked” in receivables from bigger buyers (including PSUs), and payment delays quickly translate into overdue, loss of drawing power, and a spiral of penal interest and downgraded ratings, forcing otherwise viable units into distress.

The Government’s MSME Samadhaan /MSEFC architecture itself exists because delayed payments are a recurring, system-wide problem under the MSMED framework, and it remains a key chokepoint for MSME survival.

Delayed payments to Micro, Small, and Medium Enterprises in India, a major component of the banking sector's working capital financing, as per Business World report published on Nov 27, 2025, an amount to over Rs 7.34 lakh crore as of March 2024. This locked-up capital represents more than **4.6 per cent of India's Gross Value Added (GVA)**³. This report of

³ <https://www.businessworld.in/article/despise-reforms-india-s-msme-delayed-receivables-still-exceed-4-6-of-gva-581337>

Business World also highlights that *“since its inception, the MSME Samadhaan portal has received over two lakh applications seeking recovery of delayed payments, amounting to Rs 50,155.7 crore as of 31 March. Among the defaulters, state governments emerged as the largest contributors to pending dues, with 12,373 cases involving Rs 6,713.8 crore. Central public sector undertakings (PSUs) followed, responsible for Rs 5,660.9 crore across 7,331 applications. Individual proprietors were next, with unpaid dues totalling Rs 4,518.1 crore.”*

Magnitude of Stressed Receivables: While down from Rs 10.7 lakh crore in 2022, the value of overdue receivables remains high, severely impacting the working capital and liquidity of MSMEs⁴.

Sectoral Impact: MSMEs often rely on bank-financed working capital to bridge the gap between production and payment collection. High delayed payments create a "working capital crisis," forcing businesses to use high-interest loans, which can lead to default.

Samadhaan Portal Data: As of April 2025, over 2.31 lakh applications for delayed payments were filed, with a total value of Rs 26,414 crore, though this represents only a fraction of the total outstanding dues.

Banking Regulation: For larger borrowers, the [Reserve Bank of India \(RBI\)](#) mandates that book-debt finance (receivables) should not exceed 75% of the sanctioned fund-based working capital limits.

In addition to delayed payments, the broader working capital gap (total funding need minus what is available) for MSMEs has been estimated at INR 20–25 lakh crore.

AGAINST THIS BACKDROP, THE POLICY PRIORITY SHOULD BE SUPPORT TO KEEP MSMEs ALIVE RATHER THAN PUSHING THEM INTO IBC/CIIRP-TYPE TRACKS:

- *enforceable time-bound payment discipline by large buyers (including stronger consequences for non-compliance),*
- *scale-up of receivable financing (TReDS/factoring) so MSME book-debts convert into cash early,*
- *wider and faster credit guarantee + cash-flow based lending for working capital, and*
- *an out-of-court, banker-led restructuring/workout channel with standard templates and safe-harbours for bona fide decisions, because MSMEs need speed and liquidity, not process-heavy resolution with multiple intervention points and litigation risk.*

The Economic Survey's own narrative around robust MSME credit growth underscores MSMEs' reliance on bank credit and the macro importance of keeping this segment liquid and functioning.

THE CASE FOR RESOLUTION OUTSIDE IBC

The cumulative evidence points to the need for a **more differentiated resolution architecture**, where insolvency is reserved for genuine cases of non-viability, and commercially resolvable stress is addressed through non-judicial mechanisms. Such an approach would:

- *Preserve enterprise value through early intervention.*
- *Reduce congestion and delays in NCLTs.*
- *Encourage consensual restructuring without stigma.*
- *Protect bona fide banking decisions from retrospective scrutiny.*
- *Foster a culture of risk-taking and entrepreneurship consistent with a growing economy.*
- *Provide compulsory mediation for MSME before admission into IBC process.*

Dedicated frameworks for closure of non-viable entities, fast-track monetisation of receivables, and resolution of group-level claims could significantly enhance recovery outcomes without over-burdening insolvency institutions.

⁴ <https://credible.in/insights-by-credible/business-insights/working-capital-crisis-unfolding/#:~:text=Taking%20stock%20of%20the%20issue,The%20impact%20on%20businesses>

Concluding Assessment

The Economic Survey 2025–26 reflects a banking system that is markedly more resilient, profitable, and better capitalized than it was a decade ago. Improvements in asset quality, recovery rates and credit discipline underscore the impact of sustained regulatory reforms, among which the Insolvency and Bankruptcy Code has been a critical institutional anchor. The IBC has helped impose consequences for default, reduced strategic non-payment, and improved predictability in insolvency outcomes, contributing meaningfully to the clean-up of bank balance sheets.

However, the evidence also suggests that the reform journey has reached an inflection point. While enforcement and recovery have strengthened, delays, procedural layering and value erosion within formal insolvency processes risk undermining economic efficiency. The experience with PIRP, and the proposed expansion through CIIRP, highlight a deeper concern: process-heavy, tribunal-centric mechanisms are ill-suited for preserving enterprise value, particularly for MSMEs and operating businesses dependent on speed, liquidity and commercial negotiation. Insolvency, by design, is a last-resort tool; its increasing use as a default pathway for stressed but viable businesses reflects gaps in pre-insolvency frameworks rather than failures of entrepreneurship.

The next phase of reform must therefore pivot from *recovery-centric enforcement* to *time-sensitive resolution*. IBC must remain the backbone of the insolvency architecture, but not a substitute for early restructuring, receivables realization, or commercially driven workouts outside the courtroom. A balanced ecosystem combining a credible insolvency threat with robust pre-insolvency restructuring tools, market-based resolution mechanisms, and institutional confidence in bona fide commercial decisions, is essential. Such an approach will better preserve enterprise value, protect entrepreneurial risk-taking, and ensure that the gains achieved in banking sector stability translate into durable, growth-supportive financial intermediation.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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