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A Study on Credit Appraisal Practice for Micro, Small and Medium Enterprises Lending and Their Impact on Npa Trends of State Bank of India (2019-2025)

Km Sristi Kesari[1], Prof. Subarna Sarkar[2]

[1]Research Scholar, Commerce, Prof. Rajendra Singh Rajju Bhaiyya University Naini Prayagraj
[2]Professor, Commerce, Hemwati Nandan Bahuguna college Naini Prayagraj

Abstract
Micro, Small and Medium Enterprises (MSMEs) are one of the important pillars of the Indian economy. This industry plays a significant role in the Indian economy by contributing to GDP (30%), generating maximum employment, upgrading people's lifestyles, practically applying culture, skill and technology, and leading in export promotion. Even so, this industry is facing several problems, such as financial difficulties, technological usage issues, unregulated markets, and lack of marketing skills. Among these, the biggest problem is the non-availability of adequate and timely credit. Since they depend on banks for credit, banks screen and evaluate them before extending credit. This is done to minimise the risk of credit defaults. Through this paper, we will analyse the credit appraisal practices of the State Bank of India (SBI). We will examine the asset quality of the bank, focusing on how much of the loans given by the bank have turned into an NPA (Non-Performing Asset). Secondary data sources have been used in this paper, such as: RBI Reports, SBI Annual Reports, peer-reviewed journals, and articles. Broadly, it is concluded that the NPA ratio of loans given to the MSME sector by SBI has dropped from 9–10% in March 2021 to 3.3–3.6% in 2025. Changes and improvements have been made by SBI from time to time in its credit appraisal practices so that it becomes easier for MSMEs to obtain loans. This includes CGTMSE, a digital data-driven credit assessment model, tighter underwriting standards, and credit discipline.

Keywords: Credit Appraisal, NPA trends in State Bank of India, Credit Risk Management, CGTMSE.

1. Introduction

The banking sector plays a central role in shaping the growth of any economy. Banks act as a bridge between people who save money and those who need money to start or expand businesses. By collecting small deposits from the public and converting them into large-scale loans, banks ensure that idle money is used productively. They provide the necessary capital for agriculture, industry, trade, and services, which directly supports job creation and income generation. Apart from lending, banks also manage the payment system of the country through digital and traditional channels, making transactions faster and more reliable.

In India, banks are also the main channel through which government policies and welfare schemes reach the common people. With the rise of digital banking, the reach and efficiency of banks have increased significantly in the last decade. Thus, the health of the economy is closely linked to the health of its banking system, and the quality of a bank's loan book is one of the clearest indicators of that health.

Within this broader lending activity, credit to Micro, Small and Medium Enterprises (MSMEs) occupies a special place. MSMEs are widely regarded as the backbone of the Indian economy: they contribute close to a third of the country's Gross Domestic Product, employ well over a hundred million people, and account for a significant share of India's exports. Yet, the same enterprises are frequently described as "credit-starved", since many of them operate informally, lack audited financial statements, and are unable to offer the collateral that conventional appraisal systems demand. The manner in which a bank appraises an MSME loan proposal - the depth of financial analysis, the weight given to collateral versus cash flow, and the extent to which technology and external data sources are used - therefore has a direct bearing on both credit access for MSMEs and the eventual quality of the bank's assets.

Non-Performing Assets (NPAs) represent loans on which the borrower has stopped servicing interest or principal for a specified period, and are the most visible symptom of weaknesses in credit appraisal, monitoring, and recovery. A rising NPA ratio erodes a bank's profitability, restricts its ability to lend further, and can, at a systemic level, threaten financial stability, as was witnessed during India's twin balance sheet crisis of the mid-2010s. Since then, the Reserve Bank of India and the Government of India have introduced a series of reforms - the Insolvency and Bankruptcy Code, asset quality reviews, recapitalisation of Public Sector Banks (PSBs), and more recently, technology-driven credit assessment frameworks - aimed at strengthening credit appraisal and reducing the build-up of bad loans.

The State Bank of India (SBI), being the country's largest lender with the widest MSME loan portfolio among PSBs, offers a particularly useful case for studying how credit appraisal practices have evolved and how these changes are reflected in NPA trends. This paper undertakes an analytical study of SBI's credit appraisal framework for MSME lending during the period 2019-2025, a period marked by the COVID-19 pandemic, the roll-out of the Emergency Credit Line Guarantee Scheme (ECLGS), and the launch of a new digital Credit Assessment Model for MSMEs under the Union Budget 2024-25.

1.1 Statement of the Problem

Despite several policy interventions, MSME lending in India has historically carried a higher NPA ratio than most other retail and corporate loan segments. It is therefore important to examine whether, and to what extent, changes in credit appraisal practices at a large public-sector bank such as SBI have contributed to the observed decline in MSME NPAs, and to identify which appraisal-related factors continue to pose risks.

1.2 Objectives of the Study

1. To study the credit appraisal practices followed by SBI for MSME lending between 2019 and 2025.
2. To analyse the trend of Gross and Net NPAs of SBI and of the MSME sector as a whole during this period.
3. To examine the relationship between changes in credit appraisal methods (including digitisation and the CGTMSE mechanism) and the observed NPA trends.
4. To identify the challenges that remain in MSME credit appraisal and to suggest measures for further improvement.

1.3 Scope and Limitations of the Study

The study is confined to the MSME lending portfolio of the State Bank of India and covers the period from 2019 to 2025. The study relies entirely on secondary data; no primary survey of bank officials or borrowers was conducted. Bank-wise, MSME-specific data disclosed separately by SBI is limited in the public domain; hence, sector-level RBI and Government of India data (which include SBI as the largest constituent of the Public Sector Banks group) have been used to supplement bank-specific figures where necessary. This is stated transparently wherever such sector-level data has been used in place of SBI-specific figures.

2. Review of Literature

A substantial body of research has examined MSME financing and NPA management in Indian banks, and this section reviews the studies most relevant to the present paper.

Studies on MSME financing in India have long highlighted that inadequate access to credit, particularly for micro enterprises, remains among the most significant constraints on the growth of the sector, and that traditional collateral-based credit appraisal systems are poorly suited to the informal nature of many small businesses (Journal of Marketing & Social Research, 2025). A large share of Indian MSMEs continues to operate outside the formal financial system, which widens the financing gap for enterprises that lack collateral, a credit history, or formal registration (Journal of Marketing & Social Research, 2025). This literature has also pointed to sector-specific imbalances, with manufacturing MSMEs typically receiving proportionately greater institutional support than service-oriented enterprises, even though the latter account for a growing share of employment, and has noted that the expansion of fintech-based digital lending, while widening credit outreach, has not yet been fully inclusive across regions, gender, and levels of digital literacy (Journal of Marketing & Social Research, 2025).

Bank-specific studies on NPA management provide useful benchmarks for the present research. An analysis of SBI's NPA management and credit risk indicators found a consistent decline in the bank's net NPA ratio over the period studied, attributing the improvement to more effective credit risk management practices (Management research journal, 2025). A related comparative study of NPA impact on profitability across public and private banks between 2019 and 2023 observed that public sector banks, including SBI, continued to carry higher gross and net NPA percentages than private banks such as Axis Bank and Kotak Mahindra Bank, even though SBI showed improvement in Return on Assets alongside a falling net NPA ratio during the period (Management research journal, 2025).

A broader multi-bank study of NPA dynamics and recovery strategies across five public sector banks - Bank of India, Central Bank of India, Indian Overseas Bank, SBI, and UCO Bank - used time-series analysis of Gross and Net NPA to Total Assets ratios, Provisioning Coverage Ratios, and recovery data drawn from annual reports and RBI's Financial Stability Reports, and emphasised the role of recovery mechanisms such as the Insolvency and Bankruptcy Code alongside internal credit appraisal reforms in shaping asset quality outcomes (IJRASET, 2025).

On the policy and institutional side, the Credit Guarantee Fund Trust for Micro and Small Enterprises has been documented as a central mechanism enabling collateral-free lending to MSMEs, under which the lending institution continues to apply its own internal credit appraisal mechanism before the loan is sanctioned, after which guarantee coverage is obtained separately (Credit Guarantee Fund Trust for Micro and Small Enterprises, n.d.). More recently, the Union Government's Budget 2024-25 announcement of a new, digitally driven Credit Assessment Model for MSMEs has been reported extensively, with the model relying on digital footprints such as Goods and Services Tax data, bank statement analysis, and credit bureau records rather than solely on collateral or turnover, with the explicit aim of building in-house appraisal capability within Public Sector Banks and reducing turnaround time for loan decisions (Ministry of Finance, 2025; Devdiscourse, 2025).

Taken together, the literature suggests two broad conclusions that inform the present study: first, that traditional, collateral-heavy credit appraisal has been a persistent constraint on MSME credit access and asset quality; and second, that the more recent shift toward digital, data-driven appraisal combined with guarantee-backed lending mechanisms is associated with an observable improvement in NPA outcomes, though bank-wise and sector-wise data must be interpreted with some caution given differences in reporting periods and definitions across sources.

3. Research Methodology

3.1 Research Design

The study adopts a descriptive-cum-analytical research design. It describes the credit appraisal practices followed for MSME lending and analyses secondary data on NPA trends to draw inferences about the relationship between appraisal practices and asset quality outcomes.

3.2 Data Collection

The study is based entirely on secondary data collected from the following sources:

- Reserve Bank of India publications, including the Report on Trend and Progress of Banking in India and Financial Stability Reports.
- Press releases and replies to Parliament by the Ministry of Finance, Government of India, and the Ministry of Micro, Small and Medium Enterprises.
- State Bank of India's quarterly and annual financial results as reported in the financial press.
- Peer-reviewed and practitioner journal articles on NPA management and MSME credit appraisal.
- Reports of rating agencies such as CRISIL and coverage in reputed financial dailies including Business Standard.

3.3 Period of the Study

The study covers the period from 2019 to 2025, a period that includes the pre-pandemic base year, the COVID-19 disruption and the associated regulatory relief measures, and the subsequent recovery and digitisation phase in MSME credit appraisal.

3.4 Tools of Analysis

Simple statistical tools - trend analysis, percentages, and year-on-year comparison of Gross NPA ratio, Net NPA ratio, and slippage ratio - have been used to interpret the secondary data collected. Findings from existing studies have been synthesised with the quantitative trend data to arrive at the conclusions of this paper.

4. Data Analysis and Interpretation

4.1 NPA Trends: SBI and the MSME Sector (2019-2025)

The table below summarises the trend in key NPA indicators drawn from RBI and Government of India data. Figures marked as trend descriptions rather than precise numbers indicate periods for which bank-specific, MSME-only figures are not separately disclosed in the public domain; in such cases, the direction of movement reported in official sources has been indicated.

Year (as on 31 March)	MSME Sector Gross NPA Ratio (SCBs) (%)	SBI Gross NPA Ratio (%)	SBI Net NPA Ratio (%)	PSB Slippage Ratio (%)
2019	N/A*	7.53	3.01	N/A*
2021	8.70 – 9.87	~4.98	~1.50	~8.35 (2018 base)

2023	Declining trend	Declining trend	Declining trend	Declining trend
2024	4.50	Improving	Improving	Improving
2025 (Mar/Sept)	3.27 – 3.60	Improving	0.47	0.81 (Sept 2025)

**Data for 2019 pertains to SBI's overall standalone Gross/Net NPA ratio (not MSME-specific), reported at 7.53 per cent and 3.01 per cent respectively for Q4 FY19, down from 10.91 per cent and 5.73 per cent a year earlier (Business Standard, 2019).*

According to a Government of India reply in Parliament, the gross NPA ratio in MSME loans across Scheduled Commercial Banks fell from 9.87 per cent in March 2021 to 3.27 per cent by September 2025, while the slippage ratio for Public Sector Banks - a measure of new loans turning bad - fell from 8.35 per cent in March 2018 to 0.81 per cent in September 2025 (KNN India, 2025). A separate CRISIL assessment, cited in the financial press, placed the MSME gross NPA ratio at 8.7 per cent as of March 2021, declining to 3.6 per cent by March 2025 (Business Standard, 2025, October 6). The overall Gross NPA ratio for all Scheduled Commercial Banks stood at 2.1 per cent and the Net NPA ratio at 0.5 per cent as of September 2025, according to RBI's Report on Trend and Progress of Banking in India, with about 42.8 per cent of the reduction in Gross NPAs during 2024-25 attributed to recoveries and upgradations (Business Standard, 2025, December 29). A bank-specific study of SBI's NPA management similarly reported a consistent decline in the bank's Net NPA ratio, from around 1.5 per cent to 0.47 per cent, over the period it examined (Management Research Journal, 2025).

The consistency across these independent sources - RBI, Parliament replies, CRISIL, and academic studies - in showing a sustained decline in MSME and overall NPA ratios between 2019 and 2025 strengthens confidence in the broad trend, even though the exact percentage figures differ slightly owing to differences in the base period, the segment definition used (MSME-only versus overall retail/PSB), and the reporting date.

4.2 Changes in Credit Appraisal Practices

Several structural changes in credit appraisal practice can be linked to the improvement in asset quality documented above:

(a) **Credit Guarantee-backed lending:** Under the CGTMSE mechanism, the lending bank continues to apply its own internal credit appraisal based on the viability of the business proposal; the guarantee cover from CGTMSE is obtained only after the loan has been sanctioned, and does not substitute for appraisal of repayment capacity (CGTMSE, n.d.). This has allowed banks, including SBI, to extend collateral-free credit to MSMEs while still applying standard underwriting discipline.

(b) Digital, data-driven appraisal: The New Credit Assessment Model, launched following the Union Budget 2024-25, represents the most significant recent change in MSME credit appraisal at Public Sector Banks. The model uses digitally verifiable data - name and PAN authentication, GST returns, bank statement analysis, income tax returns, and credit bureau records - to generate automated, objective credit decisions for both existing and new-to-bank MSME borrowers, replacing paperwork-heavy and subjective appraisal with data-driven scoring (Ministry of Finance, 2025; Dev discourse, 2025). SBI has been the largest contributor by value under this scheme, having received over 169,000 applications and sanctioned over 86,000 loans in the first seven months of its roll-out in FY26, out of a total of roughly ₹28,724 crore sanctioned across all Public Sector Banks in the same period (Business Standard, 2025, December 26).

(c) Faster turnaround and standardised timelines: Regulatory guidance now requires banks to communicate credit decisions on MSE loans up to ₹25 lakh within 14 working days and to furnish borrowers with an indicative document checklist at the time of application, reducing the scope for delay and subjective back-and-forth that previously characterised MSME appraisal (Ministry of Micro, Small and Medium Enterprises / Ministry of Finance, 2025).

(d) Recovery-linked appraisal discipline: The improvement in asset quality has not come from appraisal alone; recoveries and upgradations accounted for close to 43 per cent of the reduction in Gross NPAs during 2024-25, reflecting the combined effect of the Insolvency and Bankruptcy Code, the SARFAESI Act, and internal recovery mechanisms working alongside stronger appraisal at the entry point (Business Standard, 2025, December 29).

4.3 Residual Areas of Risk

Notwithstanding the overall improvement, rating agency assessments caution that MSME and unsecured retail segments could see renewed mild stress, particularly in export-oriented sectors facing external demand slowdowns, and due to the effect of loan seasoning following a period of rapid credit growth (Business Standard, 2025, October 6). This suggests that the gains from improved appraisal practices need to be reinforced with continued monitoring rather than viewed as a permanent resolution of MSME credit risk.

5. Findings of the Study

1. The Gross NPA ratio of the MSME segment across Scheduled Commercial Banks has declined sharply between 2019 and 2025, from a range of approximately 8.7-9.9 per cent in March 2021 to approximately 3.3-3.6 per cent by 2025, reflecting a broad improvement in MSME asset quality during the period of study.
2. SBI's own asset quality indicators improved substantially over the same period, with reported Net NPA ratios falling from levels above 3 per cent around 2019 to below 0.5 per cent in more recent disclosures, consistent with the sector-wide trend.
3. The Public Sector Bank slippage ratio - the rate at which standard loans turn into NPAs - fell from 8.35 per cent in March 2018 to 0.81 per cent by September 2025, indicating that improved credit appraisal at the point of sanction, rather than recovery alone, has played a major role in containing fresh NPA formation.
4. The CGTMSE mechanism has enabled collateral-free lending to MSMEs without diluting appraisal standards, since guarantee coverage is obtained only after the bank's own credit appraisal process approves the loan.
5. The 2024-25 digital Credit Assessment Model marks a structural shift from subjective, collateral-based appraisal to objective, data-driven appraisal using GST, bank statement, and credit bureau data, and SBI has been the largest Public Sector Bank participant in this scheme by both applications and value sanctioned.
6. A meaningful share of the reduction in NPAs (around 43 per cent in 2024-25) is attributable to recoveries and upgradations rather than appraisal alone, indicating that appraisal reform and recovery mechanisms have worked in tandem.
7. Residual risk persists in export-oriented MSME segments and in unsecured retail lending, both flagged by rating agencies as segments to watch going into 2026.

6. Suggestions

1. SBI and other Public Sector Banks should continue to expand the coverage of the digital Credit Assessment Model to a wider range of MSME loan sizes and sectors, so that appraisal objectivity is not confined to larger or more formal borrowers.
2. Given the residual risk flagged in export-oriented MSME segments, appraisal models should incorporate external trade and demand-side indicators specific to export-linked units, rather than relying solely on historical financial and transactional data.
3. Periodic, bank-wise disclosure of MSME-specific (rather than only overall) Gross and Net NPA ratios would greatly assist researchers, regulators and investors in assessing the sector-specific performance of individual banks such as SBI.
4. Continued investment in staff training for interpreting digital footprint-based credit scores is necessary so that automated decisioning is used to complement, rather than replace, informed credit judgement in complex cases.
5. Recovery infrastructure (IBC and SARFAESI-based mechanisms) should continue to be strengthened, since a significant share of the recent improvement in asset quality has come from recoveries and upgradations rather than appraisal alone.

7. Conclusion

This study set out to examine how credit appraisal practices for MSME lending at the State Bank of India have evolved between 2019 and 2025, and how these changes relate to observed NPA trends. The evidence gathered from RBI publications, Government of India disclosures, rating agency assessments, and academic literature converges on a consistent picture: MSME asset quality across Indian banks, including SBI, has improved markedly over this period, with Gross NPA ratios in the MSME segment falling from close to double digits in 2021 to the mid-single digits by 2025, and with the Public Sector Bank slippage ratio falling to historic lows. This improvement coincides with, and is plausibly linked to, a shift in credit appraisal practice - from appraisal built primarily around collateral and subjective judgement, toward one that increasingly uses digitally verifiable financial data, credit bureau records, and guarantee mechanisms such as CGTMSE to assess MSME creditworthiness more objectively and more quickly. At the same time, the data show that recoveries and upgradations, supported by the Insolvency and Bankruptcy Code and related recovery mechanisms, have also contributed substantially to the reduction in NPAs, so that improved appraisal and improved recovery should be seen as complementary rather than as alternative explanations. Going forward, sustaining these gains will require continued vigilance in segments - particularly export-oriented MSMEs and unsecured retail credit - where rating agencies have flagged the possibility of renewed stress, as well as greater transparency in bank-wise, MSME-specific NPA disclosure to enable more precise research on individual banks such as SBI.

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