

STRATEGIC PROVISIONING AND ASSET QUALITY TRANSFORMATION IN INDIAN PUBLIC SECTOR BANKS

Mrs. CMA V Subha

Reg.No. 21122011012006

Ph.D Research Scholar

PG and Research Department of Commerce

A.P.C.Mahalaxmi College for Women, Thoothukudi, TamilNadu

Affiliated to Manonmaniam Sundaranar University, Tirunelveli – 627 012

Email id: subhavishy68@gmail.com

Dr. R. Samundeswari

Assistant Professor

Department of Commerce

A.P.C.Mahalaxmi College for Women, Thoothukudi, Tamilnadu

Affiliated to Manonmaniam Sundaranar University, Tirunelveli – 627 012

Email id: samundeswari@apcmcollege.ac.in

Abstract

This report provides a comprehensive analysis of Non-Performing Asset (NPA) provisions for three major Indian public sector banks—Canara Bank, Indian Bank, and Indian Overseas Bank (IOB)—spanning fiscal years (FY) 2021 to 2025. The study reveals a consistent and significant improvement in asset quality across all institutions, evidenced by a substantial reduction in both Gross and Net NPA ratios. A primary driver of this positive trajectory is the strategic and prudent approach to provisioning. The sustained improvement in asset quality and the maintenance of high Provision Coverage Ratios (PCRs) across these banks enhance the stability and resilience of the Indian financial system.

1. Introduction: Decoding Non-Performing Assets and Provisions in Indian Banking

The health of a nation's banking sector is intrinsically linked to its economic stability and growth. Within this critical framework, Non-Performing Assets (NPAs) emerge as a key indicator of financial well-being, representing a significant challenge that necessitates diligent management.

1.1 Definition and Classification of Non-Performing Assets (NPAs)

Non-Performing Assets are defined as loans or advances where the borrower has failed to make scheduled interest or principal payments for a specified period, typically exceeding 90 days. Once a loan is classified as an NPA, it ceases to generate income for the bank, directly impacting profitability and liquidity. Historically, the Indian banking sector, particularly its public sector banks, has contended with elevated levels of stressed assets, which have significantly hindered their financial performance and overall stability.

The Reserve Bank of India (RBI) provides a structured classification system for NPAs to ensure consistency in risk assessment and alignment with international standards, such as those recommended by the Basel Committee on Banking Supervision (BCBS). These classifications include:

- ❖ **Sub-standard assets:** Loans or advances that have remained as NPAs for a period of up to 12 months.
- ❖ **Doubtful assets:** Assets that have remained in the sub-standard category for more than 12 months.

- ❖ **Loss assets:** Assets that are considered uncollectible and are deemed to have little or no recovery value, thereby requiring full provisioning.

1.2 The Fundamental Role and Significance of Provisions

In the context of managing these non-performing assets, provisions serve as mandatory allocations of funds set aside by banks to cover potential losses arising from such assets. This practice acts as a crucial financial buffer, ensuring that banks possess adequate capital to absorb potential credit defaults without jeopardizing their solvency or the funds of their depositors. The robustness of a bank's provisioning is often measured by its Provision Coverage Ratio (PCR), which quantifies the proportion of bad loans covered by these provisions. A higher PCR signifies a bank's strong financial prudence and its enhanced capacity to mitigate risks associated with asset quality issues.

Beyond mere regulatory compliance, robust provisioning is a fundamental aspect of sound financial management. It directly influences a bank's ability to withstand economic downturns and its capacity for future lending and expansion.

1.3 Rationale Behind RBI's Mandatory High NPA Provisioning Norms

The RBI mandates high NPA provisioning for several crucial reasons:

- ❖ **Protecting Financial Stability:** By requiring banks to set aside a portion of their profits to cover potential losses from NPAs, the RBI aims to prevent a build-up of bad loans that could destabilize the financial system. This practice helps banks maintain a strong financial position, thereby reducing the risk of bank failures and contributing to overall systemic stability.
- ❖ **Maintaining Public Trust:** High NPA provisioning ensures that banks do not become overly reliant on unsustainable lending practices. By enforcing a more conservative approach, the RBI helps maintain public trust in the banking sector, demonstrating a commitment to responsible lending and prudent financial management.
- ❖ **Preventing a Crisis:** The accumulation of unmanaged bad loans can lead to a systemic crisis. By requiring banks to set aside funds for potential losses, the RBI proactively works to prevent a situation where banks are unable to meet their obligations, thereby averting wider financial distress.
- ❖ **Alignment with International Standards:** The RBI's NPA provisioning norms are aligned with international best practices, such as the Basel III framework. This ensures that Indian banks are comparable to their global counterparts and adhere to a high level of regulatory rigor, enhancing their credibility in the international financial landscape.
- ❖ **Promoting Responsible Lending:** Provisioning incentivizes banks to exercise greater caution in their lending practices. This promotes a culture of responsible lending, which in turn helps reduce the risk of future NPAs and contributes to the long-term health of the banking system.
- ❖ **Facilitating Write-offs and Improving Asset Quality**

Provisions serve as a financial buffer, allowing banks to absorb losses from loans that are unlikely to be recovered. When such loans are written off, the impact is mitigated by prior provisions, directly reducing the Gross NPA ratio and presenting a clearer picture of asset quality.
- ❖ **Strategic Balance Sheet Management**

Beyond regulatory compliance, provisioning has become a strategic tool for banks. Some banks, have increased provisions even as new NPAs decline, deliberately building buffers against future risks and exceeding minimum regulatory standards. This

proactive approach demonstrates sophisticated capital management and enhances market confidence.

2. Bank-Specific Asset Quality and Provisioning Analysis (FY2021-FY2025)

This section provides a detailed analysis of the asset quality and provisioning strategies of three major Indian public sector banks: Canara Bank, Indian Bank, and Indian Overseas Bank (IOB) over the fiscal years FY2021 to FY2025.

2.1 Canara Bank: A Case Study in Strategic Provisioning

The bank's asset quality metrics show a clear positive trend. The Gross NPA percentage for Canara Bank notably decreased from 8.93% in March 2021 to 2.94% in March 2025. Concurrently, the Net NPA percentage fell from 3.8% to a much healthier 0.70% over the same period. This substantial reduction in non-performing assets underscores the bank's success in managing and recovering bad loans, contributing to a progressively healthier loan book and reflecting strengthened risk management capabilities.

Canara Bank's Provision Coverage Ratio (PCR) has consistently improved, reaching 92.70% in March 2025. This high PCR, exceeding 90%, is a hallmark of financial prudence, signifying that a substantial majority of the bank's non-performing assets are already covered by funds set aside for potential losses. This significantly reduces the risk of future unexpected shocks impacting profitability and capital adequacy, enhancing investor confidence.

Provisions for NPAs alongside other statutory and general provisions, amounting to around ₹17,000 Crore annually. However, for the more recent fiscal years (FY2024 and FY2025), more granular data specifically for "provisions for Non-performing assets" became available, offering clearer insight into NPA-specific allocations, which were around ₹9,000-9,500 Crore.

Table 1: Canara Bank - Annual Provisions for Non-Performing Assets (FY2021-FY2025)

Fiscal Year (FY)	Type of Provision	Provisions (₹ Crore)	Gross NPA Ratio (%)	Net NPA Ratio (%)	Provision Coverage Ratio (PCR) (%)
2025	Specific Provisions	9,586.44	2.94	0.70	92.70
2024	Specific Provisions	9,005.22	4.23	1.27	89.10
2023	Provisions & Contingencies	17,111.50	5.35	1.73	88.73
2022	Provisions & Contingencies	17,502.60	7.5	2.7	89.22
2021	Provisions & Contingencies	17,170.10	8.93	3.8	88.73

Source: Secondary data

Strategic Provisioning Decisions:

A notable aspect of Canara Bank's strategy is the slight increase in specific NPA provisions from ₹9,005.22 Crore in FY2024 to ₹9,586.44 Crore in FY2025, even as its Gross NPA ratio continued its decline from 4.23% to 2.94%. This might initially appear counterintuitive, as a reduction in bad loans would typically suggest a decreased need for new

provisions. However, this phenomenon points to a strategic and potentially more conservative provisioning approach.

2.2 Indian Bank: Leading the Way in Asset Quality Clean up

The bank's Gross NPA percentage significantly decreased from 8.47% in March 2021 to an impressive 3.09% in March 2025. Concurrently, its Net NPA percentage saw an even more drastic reduction, falling from 2.27% to a very low 0.19% over the same period. This substantial improvement underscores the bank's aggressive and effective bad loan resolution efforts and stringent credit monitoring mechanisms.

Indian Bank's Provision Coverage Ratio (PCR) has reached an exceptionally strong 98.10% as of March 2025. This near-total coverage provides a robust buffer against future contingencies and significantly enhances investor confidence, signifying a highly conservative risk management stance.

Table 2: Indian Bank - Annual Provisions & Contingencies (FY2021-FY2025)

Fiscal Year (FY)	Type of Provision	Provisions (₹ Crore)	Gross NPA Ratio (%)	Net NPA Ratio (%)	Provision Coverage Ratio (PCR) (%)
2025	Provisions & Contingencies	8,106.60	3.09	0.19	98.10
2024	Provisions & Contingencies	8,809.00	3.95	0.43	96.34
2023	Provisions & Contingencies	10,017.10	5.95	0.90	85.7
2022	Provisions & Contingencies	8,791.50	8.5	2.3	74.9
2021	Provisions & Contingencies	7,975.70	8.47	2.27	68.5

Source: Secondary data

The declining trend in "Provisions & Contingencies" from FY2023 to FY2025 (from ₹10,017.10 Crore to ₹8,106.60 Crore) directly correlates with the improving asset quality. This implies a reduced need for fresh provisioning due to a cleaner loan book. As Indian Bank's Gross and Net NPAs have significantly decreased, the inherent risk associated with its loan portfolio has diminished. This directly translates into a lower requirement for setting aside funds for potential new bad loans, which are captured under the "Provisions & Contingencies" line item. The observed reduction in these provisions, despite the overall growth in the bank's business, suggests that the improvement in asset quality is directly contributing to lower provisioning costs. This, in turn, frees up capital and positively impacts the bank's profitability, as evidenced by its reported record profits. This illustrates a direct, tangible benefit of successful NPA management: lower provisioning costs translate directly into higher reported profits, demonstrating a virtuous cycle where improved asset quality leads to enhanced financial performance.

2.3 Indian Overseas Bank (IOB): A Remarkable Turnaround Story

The Gross NPA percentage for IOB experienced a significant decline from 11.69% in March 2021 to a much healthier 2.14% in March 2025. Similarly, its Net NPA percentage plummeted from 3.58% to a low of 0.37% over the same period. This steep improvement

signifies a highly successful cleanup of its loan book and robust efforts in bad loan recovery, showcasing effective strategic interventions and operational improvements in managing credit risk.

IOB maintains a very high Provision Coverage Ratio (PCR) of 97.30% in March 2025, signifying strong financial resilience and a well-cushioned balance sheet against credit risks. This exceptionally strong PCR means that almost all of IOB's existing non-performing assets are adequately covered by provisions, significantly reducing the bank's vulnerability to future credit losses.

Table 3: Indian Overseas Bank (IOB) - Annual Provisions for Non-Performing Assets (FY2021-FY2025)

Fiscal Year (FY)	Type of Provision	Provisions (₹ Crore)	Gross NPA Ratio (%)	Net NPA Ratio (%)	Provision Coverage Ratio (PCR) (%)
2025	Total Provisions	3,313.00	2.14	0.37	97.30
2024	Provisions & Contingencies	4,108.30	3.10	0.57	96.85
2023	Provisions & Contingencies	3,843.30	7.44	1.83	92.63
2022	Provisions & Contingencies	4053.44	9.82	2.65	91.66
2021	Provisions & Contingencies	5063.68	11.69	3.58	90.34

Source: Secondary data

Reduction in "Provisions & Contingencies" from ₹4,108.3 Crore in FY2024 to ₹3,313 Crore in FY2025, is a direct consequence of IOB's improving asset quality. As the percentage of non-performing assets on its books significantly diminishes, the bank is inherently required to set aside less capital for potential new defaults. This reduction in the provisioning burden directly contributes to improved profitability, allowing more of the bank's operating income to flow to the bottom line. This demonstrates a clear cause-and-effect relationship where successful asset quality management directly enhances financial performance.

IOB's journey is particularly compelling given its high starting NPA levels in FY2021. The bank's ability to achieve such a dramatic reduction in NPAs, reaching levels comparable to or even better than its peers by FY2025, highlights a "catch-up" effect. IOB's success demonstrates that even banks with substantial legacy asset quality issues can achieve remarkable turnarounds through effective strategic interventions and operational improvements, leading to a significant positive impact on their financial health.

3. Factors Behind Non-Linear Provisioning Patterns

Non-linear trends in provisioning, even as NPA ratios decline, reflect sophisticated balance sheet management:

- ❖ **Strategic Buffering:** Banks may increase or maintain high provisions to strengthen their Provision Coverage Ratio (PCR), even when new NPAs are falling. This deliberate strategy, as seen with Canara Bank, aims to build robust buffers for unforeseen risks and to exceed regulatory requirements, signalling a focus on long-term resilience and market confidence.

- ❖ **Effect of Write-offs and Recoveries:** Net provisioning figures are shaped by more than just new provisions. Write-offs remove bad loans from the books, but these are often already provisioned for in prior periods. Recoveries from such loans allow banks to write back provisions, boosting current profits. As a result, reported provisions reflect a mix of new provisions, reversals, and recoveries, leading to fluctuations that may not directly align with changes in asset quality

4. Synergistic Drivers of Asset Quality Improvement

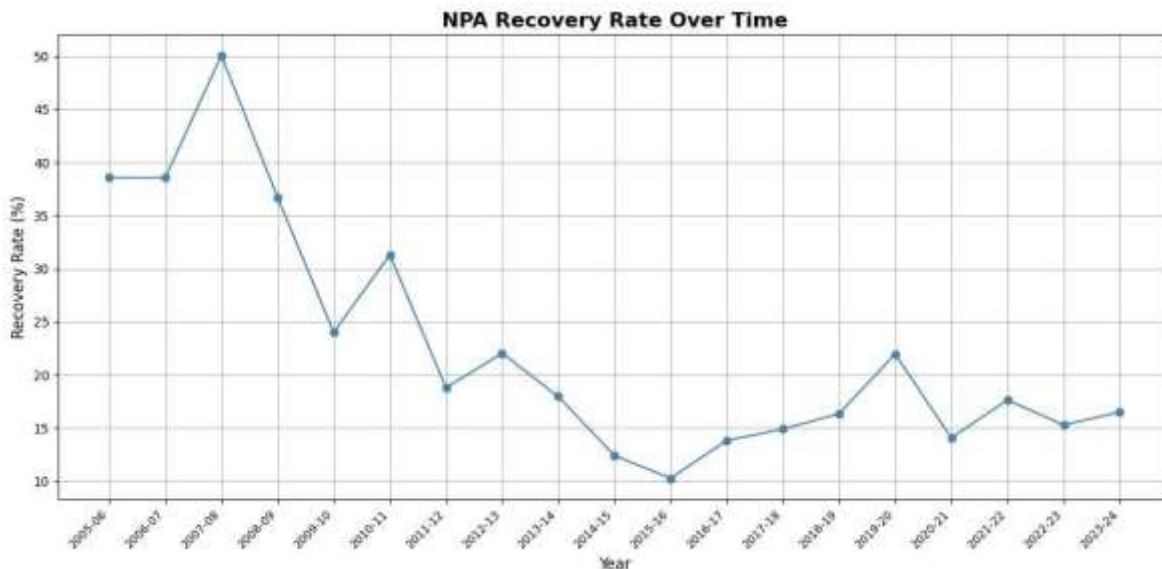
The positive trends observed across these banks are not attributable to a single factor but rather a powerful synergy of regulatory, legal, and internal reforms.

- ❖ **Sustained Regulatory Push from RBI:** The Reserve Bank of India (RBI) has consistently emphasized and enforced stringent norms for asset quality recognition and provisioning, compelling banks to clean up their balance sheets. This sustained regulatory pressure has provided a crucial impetus for the sector-wide cleanup.
- ❖ **Improved Recovery Mechanisms:** Enhanced legal and institutional frameworks, such as the Insolvency and Bankruptcy Code (IBC) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, have significantly improved the efficiency of stressed asset resolution and recovery. These frameworks provide banks with more effective tools to recover dues from defaulting borrowers.

5. Broader Implications for the Banking Sector and Economy: The Compromises Beneath the Cleanup

The sustained improvement in asset quality and strong provisioning levels across major public sector banks in India have significant broader implications for both the Indian banking sector and the national economy. However, a critical examination reveals certain compromises inherent in the cleanup process, particularly regarding the nature of balance sheet improvements.

Chart-1



Source: Trends and Progress of Banking in India, Reserve Bank of India

The above chart reveals the fact that the percentage of recovery is falling very drastically. A critical examination of the cleaning up process exposes the compromises beneath the Cleanup.

- ❖ **Heavy Reliance on Provisioning:** The decline in Gross and Net NPA ratios is largely

due to aggressive provisioning, where banks set aside significant capital to cover bad loans. While this enables NPA write-offs and cleaner balance sheets, it ties up resources that could otherwise support growth and lending.

- ❖ **Opportunity Cost:** Funds reserved for provisions represent capital that cannot be used for new loans or investments, limiting banks' ability to drive economic expansion and directly impacting profitability.
- ❖ **Underlying Systemic Issues:**
 - **Weak Credit Assessment:** India's low credit-to-GDP ratio of 56% and high NPA levels highlight flaws in credit evaluation, indicating that the root problem is not just legacy bad loans but also ongoing poor lending practices.
 - **Ever-greening of Loans:** Issuing new loans to repay old ones obscures the true extent of stressed assets, delaying real resolution and weakening capital strength.
 - **Concentration Risk:** Credit is disproportionately directed to large corporates, making banks vulnerable to single large defaults, as noted by Thomas Franco former general secretary of the All India Bank Officers' Confederation (AIBOC). This structural weakness persists despite balance sheet clean-ups.
 - **High PSB Provisioning:** Public Sector Banks' high provisioning, while necessary, can limit transparency and reduce funds available for inclusive lending.
- ❖ **Superficial Balance Sheet Improvement:** While write-offs reduce reported NPAs, the losses have already been absorbed through prior provisions. Thus, the apparent improvement is often more about accounting than actual recovery or better asset quality. True progress requires sustained reduction in new NPAs and effective recovery, not just accounting adjustments.
- ❖ **Prudence Paradox:** High provisioning enhances stability but constrains banks' ability to support immediate economic growth. The capital locked in provisions, though vital for risk absorption, limits aggressive lending and investment, making the balance sheet look better without fundamentally addressing the causes of NPAs or maximizing growth potential.

Key Findings

The analysis of NPA provisioning in Canara Bank, Indian Bank, and Indian Overseas Bank from FY2021 to FY2025 shows a strong improvement in asset quality, with significant drops in Gross and Net NPA ratios. All three banks have maintained high Provision Coverage Ratios, reflecting prudent risk management and enhanced capacity to absorb future losses. Robust provisioning has been central to NPA reduction, but it comes with an opportunity cost—diverting capital from productive lending to loss absorption. While balance sheets now look cleaner, much of this improvement is due to aggressive provisioning and write-offs, not just better recoveries or legal reforms. The sector is moving towards greater stability and resilience, but the reliance on provisioning highlights the need for deeper reforms to ensure sustainable growth.

Recommendations

- ❖ **Beyond Provisioning—Structural Reforms:** Focus on strengthening credit appraisal norms, implementing risk-based sectoral exposure limits, and promoting faster, out-of-court restructuring for stressed assets.
- ❖ **Operational Autonomy for PSBs:** Grant public sector banks more autonomy to improve agility in NPA management and optimize capital deployment.
- ❖ **Diversify Credit Flows:** Reduce risk concentration by capping credit exposure to single

corporates and encouraging market-based funding for large borrowers.

- ❖ **Balanced Capital Allocation:** Strive for an optimal balance between maintaining strong provisioning buffers and deploying capital for productive lending and growth.
- ❖ **Enhance Recovery Mechanisms:** Strengthen legal frameworks like IBC and SARFAESI to expedite asset recovery and reduce prolonged provisioning.
- ❖ **Proactive Risk Management:** Invest in advanced credit appraisal and early warning systems for timely identification and resolution of potential NPAs

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