ISSN: 2278-4632
Vol-14, Issue-10, No.03, October: 2024

CAPITAL ADEQUACY OF INDIAN BANKS IN RELATION TO BANK SPECIFIC FACTORS: OVERVIEW

Onkar Arora, Research Scholar, Department of Commerce, Shri Khushal Das University, Hanumangarh
Prof. (Dr.) Rishi kantAgnihotri, Professor, Department of Commerce, Shri Khushal Das University, Hanumangarh

INTRODUCTION :

Banks and other similar financial institutions provide a vast array of goods and services to its customers, including banking. Financial institutions that take deposits and lend them out are known as banks. Banks also often deal with financial transactions, such as the transfer of funds. Not all financial institutions are banks; in fact, some non-banking firms do offer banking services. Among these non-banking firms, you could find a handful that work as banks. Banks utilize in-house systems to monitor the daily inflow and outflow of customer funds from their accounts and investments. Additionally, these systems provide services for managing financial flow. One term for a system that banks offer is a banking system. In addition to being easy to use, Indian banks should be strong enough to withstand and even thrive in the face of internal and external challenges, such as those posed by new technologies. Why? Because right now, India's economy is going through a period of phenomenal expansion. The Indian banking industry has come a long way in its 30 years of existence. Within India's present economic framework, the banking industry stands head and shoulders above the others.

REVIEW OF LITERATURE :

Devendra Vyas authored the study in 2022. A comparison and contrast of the Capital Adequacy of ICICI, AXIS, HDFC, and KOTAK MAHINDRA Banks is shown below. The objectives of the study were attained mostly via the use of secondary data that was collected from yearly reports submitted by the institutions that were stated earlier. The research covered a period of ten years, beginning in 2004-2005 and ending in 2013-2014. An analysis of variance (ANOVA) was performed in order to determine the significance of the findings. The outcomes of the study suggest that the Capital Adequacy ratio of the private sector banks that were sampled did not change much, which lends credence to the idea that the null hypothesis should be accepted.

Sampson Atuahene, Kong Yusheng, Geoffrey Benturn-Micah, and Abigail Aboagye have published their findings in the year 2021. Investigation is being done into the relationship between bank capital and financial performance. In order to conduct the statistical analysis, a model with fixed effects was utilized. The time series data obtained from universal banks that were listed in Ghana during the years 2008 and 2017 were accounted for. We came to the conclusion that the total asset base, when used as a performance metric, has a correlation that is both positive and substantial with bank capital as well as net profit after taxes. We conducted more statistical research, and one of the findings that we came to was that the proportion of a bank's outstanding loans to the amount of credit it had extended had a substantial and negative impact on the bank's performance. The most essential thing to take away from this study is the necessity of increasing the vigilance of monitoring the capital adequacy of banks in order to make certain that banks are operating at their full potential.

Mohan and Ray (2017) looked into the structure and developments of the Indian financial industry. From 1950 to 2015, they trace the evolution of the Indian financial sector in their study. The number of private sector new entrants has ratcheted up competition in the banking industry, although public sector banks still have the bigger market share. Recent trends at commercial banks raise some troubling new developments, even if these institutions have seen improvements in critical financial metrics generally, especially in capital adequacy, asset quality, and profitability. While there has been progress in increasing access to financial services through a number of programs, this study's

ISSN: 2278-4632
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results show that much more effort is required.
RamaswamyShanmugam, Rajveer S. Rawlin, and MuddamMounika wrote the book. The year (2017) The authors used the CAMEL measures' Compound Annual Growth Rate (CAGR) to compare various financial companies. When looking at capital adequacy, asset quality, and earnings quality, the IndusInd Bank was the best of the banks that were included in the study's sample group. Overall, both HDFC Bank and Axis Bank were ranked top; however, when it came to management performance, HDFC Bank was placed first. In terms of total liquidity, Axis Bank came out on top. Overall, IndusInd Bank was deemed the best bank according to the CAMEL assessment. The CAMEL rating is useful because it gives regulators, investors, and bank management something to measure their institutions against. Researchers in India highlighted the need of using up-to-date data while comparing the performance of various public-sector banks.

NEED OF THE BANKS:

Before the establishment of banks, the majority of the day-to-day activities of the economy were handled by moneylenders and private persons. Banks did not come into existence until the 18th century. During that span of time, the interest rates consistently hovered around exceptionally high levels. Both the public's money and the terms of loans were not safeguarded, and there was no uniformity in the lending process. In order to find answers to problems of this sort, a system of organized banking was established, and following its implementation, it came under the full authority and supervision of the government. The fact that these functions exist is evidence of not just the relevance of the Bank as an institution but also the need of having the Bank.

1. To ensure that the clients' savings are protected at all times.
2. To exercise dominion over the available amounts of money and credit.
3. Raise the amount of money that is saved in a timely and effective manner to inspire public trust in the operation of the financial system.
4. Order to prevent a small number of persons and organizations from concentrating their control over the financial system.
5. To ensure that all different sorts of consumers are subject to the same standards and conditions (such as interest rate, length of loan, etc.).

IMPORTANCE OF CAPITAL ADEQUACY IN PERFORMANCE OF BANKS:

There is a direct correlation between the degree of capital adequacy and the performance of banks. This is due to the fact that it automatically influences the asset generation of banks, whether it be fund-based or fee-based. This is due to the fact that it establishes the total quantity of funds that are accessible for the purpose of providing loans and advances to customers, which in turn influences the level and degree of risk accumulation. Providing a protective barrier for banks against unexpected losses is one of the roles that capital sufficiency plays, according to Gardner (1981). This is in addition to the fact that capital sufficiency provides a range of other functions. In accordance with this point of view, the primary function of capital is to safeguard depositors and other creditors of banks from losses, which ultimately results in the banks benefiting during the liquidation stage. According to Graham (1985), in order for the capital base to expand in tandem with an increase of depositors, it is necessary to do both of these things concurrently. He affirmed the significant role that managerial discipline plays in the distribution of funds, which is a crucial part of the process. In addition, the researcher mentioned that there is an additional viewpoint, which considers capital to be a tool that has the ability to prevent banks from engaging in excessive trading and to prevent management from engaging in malpractices. According to Graham (1989), adequate capital has an effect on the profitability of banks.

OBJECTIVES OF THE STUDY:

1. To study growth and development of banking scenario in India

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2. To study importance of banks for economic development in India
3. To study Basel norms for Capital Adequacy in Indian Banks
4. To study Capital Adequacy Regulation in India for banks
5. To study impact of capital adequacy on various financial performance of Indian banks

HYPOTHESIS OF THE STUDY:

H1: There is a positive impact of capital adequacy on overall performance across public and private sector banks.

H2: There is a positive difference between capital adequacy and overall performance among private and public sector banks

CAPITAL ADEQUACY OF INDIAN COMMERCIAL BANKS:

Section: Evolution Of BIS Capital Adequacy Standard:

One of the most dependable ways to safeguard the stability of financial institutions is to maintain a significant stockpile of capital, which regulators have known about for as long as regulators have been keeping tabs on the banking industry. One of the most reliable ways to guarantee that financial institutions are trustworthy is to check that they have enough to cover their expenses. After being held personally liable up to the year 2022, the owners of Scottish banks were granted permission to transition to a limited liability corporation status. Given the prior mention of security issues, this action was taken. Meanwhile, in 2023, the US government enacted the National Banking Act, which mandated that all national banks adhere to a system of double liability and created a national banking system. The U.S. government gave its approval to this measure. It was determined that this step would be required to maintain the stability of the international monetary system, thus it was taken. Stockholders risk losing two times their initial investment should the bank's asset worth plummet to zero.

The implications of Basel on India's Capital Adequacy Regulation are discussed in Section.

Concerns over the fair amount of capital that commercial banks may maintain were, for the most part, dismissed throughout the time period previous to the adoption of reforms. Nevertheless, in 2011, the Committee on Financial System proposed that commercial banks should be subject to capital adequacy regulation in a manner that is akin to the proposals that were presented by BCBS during the same year. This suggestion was made in the same year. During the course of the reform process, the Reserve Bank of India (RBI) implemented two distinct types of laws that dealt with capital. The following are the following laws:

Requirements for a Minimum Amount of Net Worth:

When new banks were being established, the Reserve Bank of Australia announced additional criteria that had to be adhered to. These criteria were published in the beginning of 2013. In accordance with the recommendations, the minimum amount of capital that was required for the establishment of new banks was raised to one hundred crores. For the purpose of adhering to the requirements, this act was carried out. The criteria were amended in January of 2021, and one of the alterations that entailed an increase in the minimum net worth level was one of the adjustments that took place. In addition, the requirements continued to be revised. After the amended regulations were put into effect, the minimum initial paid-up capital that is required to establish a new bank was increased to a total of two hundred crores of rupees. This was done in order to satisfy the requirements of the revised laws. In order to fulfill the criteria, the initial capital must be increased to a total of 300 crores of rupees during the first three years of the company's existence. This expansion is necessary in order to meet the standards. Furthermore, the laws stipulate that the promoter's contribution must be kept at a minimum of forty percent of the paid up capital on a continuous basis. This is a requirement that must be consistently met. Additionally, this payment will be locked in for a period of five years commencing on the day that the bank is licensed to operate at the financial institution.

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2. Capital to Risk Weighted Asset Ratio: Commercial banks in India were given a deadline of eight months by the Reserve Bank of India (RBI) in April 2012 to reach an eight percent capital to risk weighted asset ratio, following recommendations made by the Committee on Financial System (2011). International financial institutions were given till the end of March to complete the tasks outlined in the CRAR. All banks were given until March 2016 to comply with the rule, except for Indian commercial banks having an overseas presence, which had until the end of March 2015 to become compliant.

Commercial banks have been advised to study the Basel

Released by BCBS in January 2016, the framework on capital for market risks would help them get ready to adopt global norms in this area when the RBI announces a suitable date. In India, the framework was released.

Classification of Capital Fund:

For the purpose of evaluating capital sufficiency, the Reserve Bank of India (RBI) divided the funds of scheduled commercial banks into two independent categories: Tier I capital and Tier II capital. There is a difference between the two types of classifications. Tier I capital will encompass a number of different things. Capital reserves that represent the surplus from the secure sale of assets, paid-up capital, statutory reserves, and other stated free reserves are all part of this. The phrase "tier I capital" is sometimes known as "core capital." Initial Tier I capital is the remaining amount after deducting stock, investments in subsidiaries, intangible assets, and losses. This is completed prior to reaching the ultimate result. Help that is both permanent and easily available is what a bank calls Tier I capital, and it's there in case they foresee losses. At the very least, half of the total capital need to go into Tier I. This should serve as the bare minimal distribution.

Tier II capital consists of components that are both readily available and have a shorter lifespan. Some of the parts that make up this structure include subordinated debt, general provisions and loss reserve, revaluation reserves, hybrid debt, capital instruments, and cumulative perpetual preferential shares. Some have called for a cap that would restrict the amount of Tier II items to no more than 100% of the entire number of Tier I components.

The process of assigning a risk weight was an integral part of the system. Calculating the capital adequacy intervals of risk-weighted assets is required under this system's requirements. This is because larger capital reserves will be required of institutions with a greater risk asset profile. For the system to calculate capital adequacy, it had to take into account both balance sheet and non-balance sheet aspects. To meet the need for capital sufficiency, this was done. In addition to making sure the balance sheet was appropriate, doing so would increase risk sensitivity and risk management skills. With respect to the items that make up the balance sheet, the items that aren't there are each multiplied by their face value, by a credit conversion factor, and then by the weights given to the relevant counterparts in the funded risk assets. The method is carried out until the objects' total worth is determined.

BANK CAPITAL ADEQUACY : AN ECONOMETRIC STUDY :

It would be interesting to learn how capital adequacy varies across commercial banks depending on factors such as size, the frequency of nonperforming assets (NPA), or the profitability of the respective banks. Although it is patently obvious that re-capitalization decisions and regulatory standards play a significant part in determining the capital adequacy of Indian commercial banks, it would be interesting to learn how these factors change. Using panel data for the years 2016–2017 through 2020–2021, an econometric analysis is performed on twenty commercial banks that are a part of the public sector and ten commercial banks that are a part of the private sector. The study is carried out so that the results may be more accurately interpreted. It is done in this manner in order to accomplish the goal that has been established. The time series of the year contains an intersection that may be found inside it. The acronym "Uit" is an abbreviation that stands for "disturbance term."

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A breakdown of the scenario revealed that there were three primary factors that had a role in its development.

1. Log of total assets as a proxy for bank size
2. Operating profit/working funds (Operating Profit Ratio)
3. Net NPA / Net Advances .

The results are provided in Tables.

Table: Characteristics of the Model Regarding the Adequacy of Capital and the Size of the Bank

Explanatory variable	Log of total assets
Dependent variable	Tier 1 CRAR
Model size	149
Parameters	4
Degree of Freedom	145
R^2	0.07259
Adj R^2	0.05340
Durbin Watson statistic	1.01044

Source:Author' Own Calculation

Table: The Sufficient Stock of Bank Capital and the Reduction in the Size of Banks as a Direct Result

Particulars	Coefficient	Standard. Error.	P- Value
Common Intercept	17.993	2.872	0.0000
Bank Specific Intercept	-0.005	0.037	0.894
Time Series Intercept	0.098	0.237	0.631
Log of Total Assets	-1.004	0.300	0.001

Source : Author' Own Calculation

FINDINGS :

Additionally, this thesis found that banks in India have completed a full recovery from the financial crisis, and a major number of private banks are presently on a path of positive profitability trends mixed with sufficient liquidity. This is a noteworthy finding.In terms of the ratio of their inputs to their outputs, the public banks were functioning at a very high level of productive efficiency. And in the case of independent variables research of the CAMEL rating, which is a reflection of the financial health of the banks, it was found that all of the banks had a solid capital adequacy ratio. This was observed in the case of the CAMEL rating. When it comes to public banks, a high Capital Adequacy Ratio implies that there is a restricted quantity of money that are accessible for use in commercial applications. This is due to the fact that the majority of the funds have been reserved in the form of Capital Adequacy. However, unexpected results were discovered when PSB were found to have greater NPA even after a decrease in the circulation of funds. Furthermore, when earnings ratios were examined across different sectors, it was discovered that all sectors were deemed to be generally good. In addition, poor management can result in inappropriate lending decisions, which can be observed by the Asset Quality and Management Efficiency ratio. This can lead to bad loans with negative consequences. In light of these ratios, we are able to observe this particular aspect. It

ISSN: 2278-4632
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was also observed in the study that foreign banks might not be accepted at face value for direct comparison with other banks. This was discovered when the performance of all three sectors was examined. This is because these foreign banks are more focused on the investing side of banking as opposed to the lending side of banking. This is the reason why this is the case.

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