

INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE & MANAGEMENT

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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	EFFECTS OF EMPLOYEE RETENTION STRATEGIES ON ORGANISATIONAL COMPETITIVE ADVANTAGE IN THE HOTEL INDUSTRY IN MOMBASA COUNTY <i>HENRY MWASARU & WILLIAM KAZUNGU KINGI</i>	1
2.	A COMPARATIVE ANALYSIS OF SOURCES OF INCOME OF COMMERCIAL BANKS IN INDIA DURING 2009-2013 <i>NARASIMHA PRAKASH & DR. S. RAMESH</i>	5
3.	ASSESSMENT OF THE EFFECTIVENESS OF CASH MANAGEMENT INTERNAL CONTROLS IN THE ZIMBABWE RED CROSS SOCIETY CHAPTER <i>DR. B. NGWENYA & E. MUNYANYI</i>	12
4.	A COMPARATIVE ANALYSIS OF CONSUMER BEHAVIOR TOWARDS SELECTIVE MEN COSMETICS IN URBAN AND RURAL AREAS OF NASHIK REGION <i>VAIBHAV RAMESH BHALERAO & DR. ANAND DESHMUKH</i>	15
5.	FOOD SECURITY STATUS OF WOMEN GARMENTS' WORKERS IN SELECTED GARMENTS UNDER GAZIPUR DISTRICT OF BANGLADESH <i>SANZIDA ANANNA ZAMAN, MD. SAFIUL ISLAM AFRAD & FOYEZ AHMED PRODHAN</i>	20
6.	GROWTH AND PERFORMANCE OF SECONDARY MARKETS: A REVIEW OF EMERGING TRENDS <i>DR. P. B RAMA KUMAR & K. MADHAVA RAO</i>	25
7.	AN EMPIRICAL STUDY ON THE RELATIONSHIPS AMONG TRANSFORMATIONAL LEADERSHIP DIMENSIONS, JOB SATISFACTION AND ORGANIZATIONAL COMMITMENT OF BANK EMPLOYEES <i>FERIT ÖLÇER</i>	31
8.	IMPACT OF WORKING ENVIRONMENT AS A MOTIVATIONAL FACTOR FOR EMPLOYEES & ITS EFFECT ON THEIR PERFORMANCE: CASE STUDY OF SYNDICATE BANK OF INDIA <i>DR RAJEEV JOHRI & NEHA VASHISTHA</i>	40
9.	AN INVESTIGATION OF CONSUMER DECISION MAKING STYLE OF YOUNG ADULTS IN JAIPUR CITY IN RAJASTHAN <i>DR. RUBY JAIN & ARTI SHARMA</i>	45
10.	COMPOSITION OF INTERNATIONAL RESERVES AND ITS COLLISION ON EXCHANGE RATE AND GROSS DOMESTIC PRODUCT IN INDIA <i>SHANKAR. R & LAVANYA.M.R</i>	50
11.	CONSUMER BUYING BEHAVIOUR: AN EMPIRICAL STUDY ON PERSONAL COMPUTER <i>SANTPAL & PRADEEP</i>	54
12.	PERFORMANCE AND STRUCTURE OF CO-OPERATIVE BANKS IN AGRICULTURE CREDIT IN HARYANA <i>HARDEEP KAUR</i>	59
13.	BANK REGULATION AND RISK: A STUDY OF SBI AND ITS ASSOCIATE BANKS <i>ANKITA TOMAR</i>	63
14.	FINANCIAL INCLUSION: CHALLENGES AND OPPORTUNITIES IN INDIA <i>DR. S. HARI BABU</i>	68
15.	WHISTLE BLOWING: IS IT SO HARD IN INDIA? <i>PINKY ARORA</i>	72
16.	PERFORMANCE OF REGIONAL RURAL BANKS PRE AND POST AMALGAMATION: A STUDY OF HIMACHAL PRADESH <i>GAGAN DEEP</i>	76
17.	JOB SATISFACTION OF HIGHER SECONDARY SCHOOL TEACHERS IN PUDUCHERRY: AN EMPIRICAL ANALYSIS <i>DR. N. S. PANDEY & M. KAVITHA</i>	83
18.	CORPORATE GOVERNANCE PRACTICES AND ITS IMPACT ON DIVIDEND POLICY: A STUDY ON SRI LANKAN LISTED MANUFACTURING COMPANIES <i>KALAIARASI KANAPATHIPPILLAI & S. ANANDASAYANAN</i>	87
19.	IMPACT OF SOCIAL MEDIA ON TEENAGERS: A CASE STUDY <i>MOHAMMAD OSAMA</i>	93
20.	DEFINING SIZE STANDARD FOR SMALL AND MEDIUM ENTERPRISES TOWARDS ECONOMIC REVOLUTION IN NIGERIA <i>GODSPOWER GODWIN ITEMESH</i>	96
	REQUEST FOR FEEDBACK & DISCLAIMER	101

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BANK REGULATION AND RISK: A STUDY OF SBI AND ITS ASSOCIATE BANKS

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ABSTRACT

This paper analyses the data of tier-1, tier-2 and overall capital of SBI and its associate banks under basel-1 and basel-2 for the two years i.e. 2009 and 2010. Our basic premise is that as financial system is becoming more and more complex and banking system as a whole is getting exposed to new risks, there is likelihood that Indian banks are also getting exposed to some of these toxic assets. We also know that institutional mechanism is evolving year by year, therefore the capital adequacy requirements under progressive capital norms must ideally increase. However, the overall minimum capital to risk-weighted assets and minimum tier-1 capital requirement is the same under basel-1 and basel-2 i.e. 9% and 6%, respectively. In this paper, we are examining the capital norms from static point of view. From static point of view, we are examining the norms in their current form i.e. by taking the value of hypothesized mean difference as zero since minimum capital requirement is same in both basel-1 and basel-2.

KEYWORDS

bank, basel norms, risk, regulation.

INTRODUCTION

The rationale for closely regulating and supervising the banking institutions, all over the world, is the fact that the banks are "special". Sir Eddie George, the Governor of Bank of England had said on the subject banks being special: "they remain special in terms of the particular functions they perform - as the repository of the economy's immediately available liquidity, as the core payments mechanism, and as the principal source of non-market finance to a large part of the economy. And they remain special in terms of the particular characteristics of their balance sheets, which are necessary to perform those functions - including the mismatch between their assets and liabilities which makes banks peculiarly vulnerable to systemic risk in the traditional sense of that term." He is even more forthright in making it clear that treatment of banks cannot be on par with non-banks. "On the other hand, I am not persuaded that the special public interest in banking activity extends to non-banking financial institutions, though different functional public interests in many cases clearly do."¹

Therefore, the need for closely regulating the banks emanates from the need of protecting the interests of public at large and avoiding any systemic risks since failure of banks can have a disastrous effect on the economy as a whole. This is specifically because of the inevitable linkages that the banks have by virtue of the nature of their role in the financial system. Ensuring robustness of the banking system, therefore, becomes a prominent objective of the financial regulators. Institutional mechanisms like prudential norms of capital adequacy, asset classification, income recognition are not only evolving but are getting more and more stringent year by year. Prudential norms relating to capital adequacy are one of the most prominent aspects of regulation. This importance emerges from the central role that banks play in financial intermediation, the importance of bank capital for bank soundness and the efforts of the international community to adopt common bank capital standards.

As pointed out by Dr. Bimal Jalan, RBI's ex-Governor that banking is the only institution that invested other people's money. On capital of 10 rupees they can lend 100 rupees. Bankers must be conscious of this and follow prudential norms of the highest order so that the public money is not threatened. "Banking system's edifice is based on trust, and that should not be eroded"²

Basel accords laid the very foundation for strengthening the capital adequacy requirements in the banking system. During 1987, the "Basle Committee on Banking Regulations and Supervisory Practices", as it was then named, arrived at a consensus on 8% as the minimum capital adequacy ratio. After a period of consultation with the banks around the world, this framework was formally adopted in 1988 and was widely endorsed by the supervisory community, world-wide. This standard came to be commonly known as the Basel Accord or Basel I Framework.

It was amended in 1996 to cover market risks arising from banks' open positions in foreign exchange, traded debt securities, traded equities, commodities and options. In 1999, the Basel Committee on Banking Supervision released for comment a proposal to amend the Accord's original framework for setting capital charges for credit risk. In it, the Committee also proposed to develop capital charges for risks not taken into account by the present Accord, such as interest rate risk in the banking book and operational risk. The Accord has also been praised for the international convergence of capital standards and for the improvement of these standards in many countries. Its design, however, has been blamed for several distortions to the business of banking. Growing evidence both on these distortions and on a reduction in the Accord's effectiveness, together with a better understanding of its conceptual shortcomings, has led to proposals to redesign it.

The Basel Committee on Banking Supervision (BCBS), therefore, after a world-wide consultative process and several impact assessment studies, evolved a new capital regulation framework, called "International Convergence of Capital Measurement and Capital Standards: A Revised Framework", which was released in June 2004. The revised framework has come to be commonly known as 'Basel II' framework and seeks to foster better risk management practices in the banking industry. In India, the Reserve Bank of India (RBI) opted for the adoption of a cautious strategy, in that it decided that all banks will follow the standardised approach. Moreover, the focus will not be on Pillar 1, but on Pillars 2 and 3, which deal with banking supervision and market discipline.

The process of implementing Basel II norms in India is being carried out in phases. Phase I has been carried out for foreign banks operating in India and Indian banks having operational presence outside India with effect from March 31, 2008. In phase II, all other scheduled commercial banks (except Local Area Banks and RRBs) will have to adhere to Basel II guidelines by March 31, 2009. The minimum capital to risk-weighted asset ratio (CRAR) in India is placed at 9%, one percentage point above the Basel II requirement. All the banks have their Capital to Risk Weighted Assets Ratio (CRAR) above the stipulated requirement of Basel guidelines (8%) and RBI guidelines (9%). As per Basel II norms, Indian banks should maintain tier I capital of at least 6%. The Government of India has emphasized that public sector banks should maintain CRAR of 12%. For this, it announced measures to re-capitalize most of the public sector banks, as these banks cannot dilute stake further, as the Government is required to maintain a stake of minimum 51% in these banks. (Prasad & Veena, 2011)

This paper analyses the data of tier-1, tier-2 and overall capital of SBI and its associate banks under basel-1 and basel-2 for the two years i.e. 2009 and 2010. Our basic premise is that as financial system is becoming more and more complex and banking system as a whole is getting exposed to new risks, there is likelihood that Indian banks are also getting exposed to some of these toxic assets. We also know that institutional mechanism is evolving year by year, therefore the capital adequacy norms must ideally increase. However, the overall minimum capital to risk-weighted assets and minimum tier-1 capital requirement is the same under basel-1 and basel-2 i.e. 9% and 6%, respectively. In this paper, we are examining the capital norms from static point of view. From static point of view, we are examining the norms in their current form i.e. by taking the value of hypothesized mean difference as zero since minimum capital requirement is same in both basel-1 and basel-2.

¹ Cited from "Towards Globalisation in the Financial Sector in India" - Speech by Y.V. Reddy published in RBI Bulletin on Jan 13, 2004; available at link http://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=4961

² Cited from "Strengthening Indian Banking and Finance: Progress and Prospects" excerpts from remarks of Dr. Bimal Jalan, ex-Governor, Reserve Bank of India at the twenty-fourth Bank Economists' Conference at Bangalore on December 27, 2002; Available at link <http://www.bimaljalan.com/speech271202.html>

The paper is organized as follows. Review of literature is featured in Section I. Section II deals with the hypotheses of our study. Section III provides an insight into Data and Methodology followed by Section IV which is devoted to Analysis and Results. Section V deals with the Summary and Conclusions.

REVIEW OF LITERATURE

Following are the literature review of some significant work done in the field of capital adequacy norms and the risk.

Dionne (2003) examined that Banks are the financial institutions responsible for providing liquidity to the economy. This responsibility is, however, the main cause of their fragility. Banks' risks are regulated to protect liquidity in financial markets. The government is responsible for limiting the social costs related to the liquidation of investment projects and the reduction of consumption possibilities bank runs or systemic risk may cause. Current regulation of bank capital adequacy has its critics because it imposes the same rules on all banks. This seems particularly unsuitable when applied to credit risk which is the major source of a bank's risk (about 70%). Moreover, diversification of a bank's credit-risk portfolio is not taken into account in the computation of capital ratios. These shortcomings seem to have distorted the behaviour of banks and this makes it much more complicated to monitor them. In fact, it is not even clear that the higher capital ratios observed since the introduction of this new form of capital regulation necessarily lower risks. More fundamentally, it is not evident that current capital ratios have any economic meaning in terms of the true economic capital needed to protect against credit risk, particularly for loans risk. One explanation is the following: The regulator imposes capital ratios that do not correspond to the bank's optimal capital ratios; the bank then makes market adjustments by choosing other parameters which allow it to maximize shareholders' value while taking into account the level of regulated capital as a constraint. Many instruments for doing this are available to banks, such as substituting assets with different risk levels in a given class of capital.

Consequently, it might be appropriate to continue developing national regulation based on optimal deposit insurance (with individual insurance pricing and continuous auditing on individual risk) and to keep searching for other optimal complementary instruments for use against systemic risk, instruments suitably designed to fit the banking industry's peculiar structure. Other market discipline and governance instruments may be more efficient than the current capital requirement scheme for the banks' commitment problem associated to deposit insurance.

Santos (2000) reviews the theoretical literature on bank capital regulation and analyses.

Some of the approaches to redesigning the 1988 Basel Accord on capital standards. Santos observes that despite the progress in the research on banking since 1988, the year of the Basel Capital Accord, there is still no consensus on the optimal design of bank capital regulation. There are differences in opinion regarding the market failure that justify banking regulation. There are differences in the conclusions of the research on the optimal design of capital regulation, albeit explained by different modeling assumptions. In addition, there are still many relevant questions that remain unanswered. Notwithstanding these shortcomings, the research already undertaken, particularly that which builds on contemporary banking theory has produced some useful insights for the design of capital standards. In addition, raising the share of bank capital in the economy may be costly, as securities are not perfect substitutes. The research also shows that there is value in considering banks' informational advantage. In this case, incentive compatibility calls for a regulation that encompasses a menu of different regulatory instruments. Accordingly, in general, it will be advantageous to include in the menu instruments other than capital standards. Finally, a strand of that research points to the importance of capital standards in the implementation of the optimal governance of banks, as they can define the threshold for interference in management and for transfer of control from shareholders to the depositors' representative, the supervisory authority.

An analysis of the Basel Committee's proposal for a new capital adequacy framework reveals that some of these insights have made their way into the proposal, at least in a simplified form. This is evidenced in the replacement of the "one-size-fits-all" approach of the 1988 Accord with a more menu-like approach, offering banks different variants of the regulation. In contrast with the literature, however, the proposal's "menu" does not consider regulatory instruments other than capital standards. However, it is worth noting that in the case of some of the instruments suggested in the literature, such as those related to deposit insurance and the lender of last resort facility, their inclusion in the menu is beyond what supervisors can do on their own. Further evidence in the proposal of an insight of the literature is pillar two, the supervisory review process, which was introduced to enable early supervisory intervention. Here too, though, the proposal does not completely follow the literature, as it does not pre-specify both the trigger points and the corresponding forms of supervisory interference. Finally, in a few areas, such as the minimum capital requirement, it is still not possible to evaluate the new regulation because the Committee's proposal is silent about them.

Blum (1998) examined that in a dynamic framework, capital adequacy rules may increase a bank's riskiness. In addition to the standard negative effect of rents on risk attitudes of banks a further intertemporal effect has to be considered. The intuition behind the result is that under binding capital requirements an additional unit of equity tomorrow is more valuable to a bank. If raising equity is excessively costly, the only possibility to increase equity tomorrow is to increase risk today. This paper has shown that in a dynamic model with incentives for asset substitution, capital adequacy requirements may actually increase risks. If regulators are mainly concerned about reducing the insolvency risk of banks, introducing capital rules, therefore, may not be such a good idea. After all, one of the effects of such a regulation is the reduction of a bank's profits. If future profits are lower, a bank has a smaller incentive to avoid default. In addition to this, the 'leverage effect' of capital rules raises the value of equity to the bank. For every dollar of equity, more than one dollar can be invested in the profitable but risky asset. In order to raise the amount of equity tomorrow it may be optimal for a bank to increase risk today. While the effects illustrated in this paper are potentially important, it must be understood that the model used under the study is only an example rather than a general theory. In order to be able to make meaningful statements, one necessarily has to restrict the class of distributions under consideration. The distribution used in this model has two important properties: (i) an increase in risk leads to a higher probability of default, and (ii) the conditional expected return given no default rises as risk is increased. Whatever definition of risk one wants to use, as long as these two properties are satisfied, the results of this paper hold. The results of this paper are a reminder that one has to be careful when assessing the effectiveness of capital adequacy rules. The present model illustrates that by arguing in a purely static framework, important dynamic effects of the regulation are contrary to the ones intended.

HYPOTHESES

As earlier mentioned, our analysis is divided into two parts- static and dynamic analysis. In static analysis, we are performing the analysis by looking at the norms in their current form i.e. by assuming that there is no difference between tier-1, tier-2 and overall capital under basel-1 and basel-2. The rationale for making such hypotheses comes from the minimum capital requirement which is same under basel-1 and basel-2 i.e. 9% for overall capital and 6% for tier-1 capital.

The following hypotheses are tested in this paper-

- H_0^1 Null hypothesis 1- There is no significant difference between tier -1 capital of SBI and its associate banks under basel-1 and basel-2 in the year 2009.
 H_1^1 Alternate hypothesis 1- There is a significant difference between tier -1 capital of SBI and its associate banks under basel-1 and basel-2 in the year 2009.
- H_0^2 Null hypothesis 2- There is no significant difference between tier -2 capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2009.
 H_1^2 Alternate hypothesis 2- There is a significant difference between tier -2 capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2009.
- H_0^3 Null hypothesis 3- There is no significant difference between total capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2009.
 H_1^3 Alternate hypothesis 3- There is a significant difference between total capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2009.
- H_0^4 Null hypothesis 4- There is no significant difference between tier-1 capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2010.
 H_1^4 Alternate hypothesis 4- There is a significant difference between tier-1 capital of SBI and its associate banks under basel-1 and Basel -2 in the year 2010.
- H_0^5 Null hypothesis 5- There is no significant difference between tier-2 capital of SBI and its associate banks under basel-1 and basel-2 in the year 2010.
 H_1^5 Alternate hypothesis 5- There is a significant difference between tier-2 capital of SBI and its associate banks under basel-1 and basel-2 in the year 2010.
- H_0^6 Null hypothesis 6- There is no significant difference between total capital of SBI and its associate banks under basel-1 and basel-2 in the year 2010.
 H_1^6 Alternate hypothesis 6- There is a significant difference between total capital of SBI and its associate banks under basel-1 and basel-2 in the year 2010.
- H_0^7 Null hypothesis 7- There is no significant difference between tier-1 capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.
 H_1^7 Alternate hypothesis 7- There is a significant difference between tier-1 capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.

8. H_0^8 Null hypothesis 8- There is no significant difference between tier-2 capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.
 H_1^8 Alternate hypothesis 8- There is a significant difference between tier-2 capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.
9. H_0^9 Null hypothesis 9- There is no significant difference between total capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.
 H_1^9 Alternate hypothesis 9- There is a significant difference between total capital of SBI and its associate banks under basel-1 in the years 2009 and 2010.
10. H_0^{10} Null hypothesis 10- There is no significant difference between tier-1 capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.
 H_1^{10} Alternate hypothesis 10- There is a significant difference between tier-1 capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.
11. H_0^{11} Null hypothesis 11- There is no significant difference between tier-2 capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.
 H_1^{11} Alternate hypothesis 11- There is a significant difference between tier-2 capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.
12. H_0^{12} Null hypothesis 12- There is no significant difference between total capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.
 H_1^{12} Alternate hypothesis 12- There is a significant difference between total capital of SBI and its associate banks under basel-2 in the years 2009 and 2010.

DATA SOURCES AND METHODOLOGY

This section shall discuss the data sources, empirical exercises and methodological details.

SOURCES OF DATA

The data used in the study is secondary data. The study uses bank level data on Tier1, Tier2 and overall capital under Basel-1 and Basel-2 for the years 2009 and 2010 published in RBI's 'Statistical tables relating to banks in India'. We have limited our study to SBI and its associate Banks.

The empirical exercises that have been undertaken in the later section are-

1. t-test- paired two sample for means
2. Descriptive statistics like Mean, Range, Standard deviation, Coefficient of variation, kurtosis etc.

t TEST- PAIRED TWO SAMPLE FOR MEANS

Paired test can be used when there is a natural pairing of observations in the samples, such as when a sample group is tested twice — before and after an experiment. This analysis tool determines whether observations that are taken before a treatment and observations taken after a treatment are likely to have come from distributions with equal population means. This t-Test form does not assume that the variances of both populations are equal.

t-test- paired two sample for means can be applied on the fulfillment of certain conditions -

- The population from which the sample is drawn is (approximately) normally distributed.
- The two population variances are identical, whatever value they happen to have in other words, there is homogeneity of variances.
- The sample size is small (that is $n < 30$).
- The population standard deviation (S) is unknown.

Hypotheses for a Paired t-Test

The hypotheses to be tested in a paired t-test are similar to those used in a two-sample t-test. In this case, X_1 and X_2 refer to the means of the first and second pair in the case of matched subjects. The null hypotheses may be stated as H_0 and alternate hypothesis as H_1 .

Under this method, t-value is computed by assuming a level of significance and degrees of freedom. The decision of accepting the null hypothesis is then based on comparing the paired p-value (significance level) with the 0.05 level of significance or comparing the computed t- value with critical value. The decision rule:

Accept H_0 , if calculated p-value > 0.05 .

The value of t is computed as follows-

$$t_{n_1 + n_2 - 2} = \frac{X_1 - X_2}{S_{(X_1 - X_2)}}$$

Where;

X_1 = Sample mean value of variable-1.

X_2 = Sample mean value of variable-2.

$S_{(X_1 - X_2)}$ = Population standard deviation.

$$S_{(X_1 - X_2)} = \sqrt{[(n_1 - 1)s_1^2 + (n_2 - 1)s_2^2] / (n_1 + n_2 - 2)}$$

n_1 = size of variable1

n_2 = size of variable2

$n_1 + n_2 - 2$ = Degree of freedom.

In our study, we have formulated certain hypotheses and then t-test- paired two sample for means is applied to check the validity of our hypotheses.

DESCRIPTIVE STATISTICS ANALYSIS TOOL

The Descriptive Statistics Analysis tool generates a report of univariate statistics for data in the input range, providing information about the central tendency and variability of the data. The Descriptive Statistics Analysis tool provides report on statistical measures like Mean, Standard Error, Standard Deviation, Range etc., to facilitate comparison between different categories of capital under basel-1 and basel-2 for 2009 and 2010.

DATA ANALYSIS AND RESULTS

Data of Tier-1, Tier-2 and overall capital under Basel-1 and Basel-2 of SBI and its associate banks for the years 2009 and 2010 is analysed by computing the descriptive statistics like Mean, Range, Coefficient of Variation, Kurtosis, etc and t-test- Paired Sample for Means by formulating various hypothesis. Graphs are also used to show the comparisons of tier-1, tier-2 and overall capital of SBI and its associate banks under basel-1 and basel-2 for 2009 and 2010.

Let's first have a look at the descriptive statistics for the two years i.e. 2009 and 2010. Table1 and Table-2 shows the summary statement of Descriptive Statistics Analysis for the year 2009 and 2010, respectively.

TABLE-1: SUMMARY STATEMENT OF DESCRIPTIVE STATISTICS FOR THE YEAR 2009

	BASEL-1			BASEL-2		
	TIER-1	TIER-2	OVERALL	TIER-1	TIER-2	OVERALL
Mean	7.18	4.892857	12.07286	7.938571	5.401429	13.34
Standard Deviation	0.762	0.560408	0.899865	0.915741	0.580501	1.053344
Sample Variance	0.581	0.314057	0.809757	0.838581	0.336981	1.109533
Kurtosis	0.354524	-0.85909	-0.20063	-1.18034	0.173925	-0.13118
Skewness	0.849598	-0.23981	-0.47814	0.430773	-0.94726	-0.72892
Range	2.23	1.55	2.6	2.44	1.67	2.99
Minimum	6.3	4.03	10.58	6.94	4.39	11.53
Maximum	8.53	5.58	13.18	9.38	6.06	14.52
coefficient of variation	10.61668	11.45359	7.453621	11.53533	10.74717	7.896131

TABLE-2: SUMMARY STATEMENT OF DESCRIPTIVE STATISTICS FOR THE YEAR 2010

	BASEL-1			BASEL-2		
	TIER-1	TIER-2	OVERALL	TIER-1	TIER-2	OVERALL
Mean	7.804286	4.508571	12.31286	8.572857	4.932857	13.50571
Standard Deviation	0.362209	0.709846	0.642643	0.633133	0.703982	0.740987
Sample Variance	0.131195	0.503881	0.41299	0.400857	0.49559	0.549062
Kurtosis	0.644456	1.009987	5.204703	-0.30383	2.409013	2.614495
Skewness	0.944044	0.551386	2.243563	-0.05406	0.856907	0.813536
Range	1.06	2.22	1.82	1.86	2.32	2.48
Minimum	7.4	3.54	11.89	7.59	3.94	12.42
Maximum	8.46	5.76	13.71	9.45	6.26	14.9
coefficient of variation	4.641153	15.74436	5.219287	7.385318	14.27128	5.486471

MEAN AND COEFFICIENT OF VARIATION

From Table1 and Table2, it can be observed that the mean value of tier-1, tier-2 and total capital has increased from basel-1 to basel-2 in both the years i.e. 2009 and 2010. However, if we compare the data of 2009 with 2010, we see that except for tier-2 capital, the mean of other categories of capital i.e. Tier-1 and Overall Capital has increased from 2009 to 2010 in Basel-1 as well as in the Basel-2.

We found one interesting observation that although the mean of tier-2 capital has increased while moving from basel-1 to basel-2 in both the years i.e. 2009 and 2010 but the mean value is lower than the corresponding mean values of other categories of capital under basel-1 and basel-2 for the two years i.e. 2009 and 2010. This may be because that SBI group as a whole has not undertaken much of the off balance sheet activities since tier-2 capital depends upon particular risk exposure i.e. it is a risk weighted norm and it does not have a fixed minimum capital requirement. It also reflects that SBI and its associate banks have been conservative in their assets portfolio. the dynamic effect of capital norms is felt on tier-1 capital.

From Table-1 and Table-2, if we compare the coefficient of variation of Tier-1, Tier-2 and Overall capital under Basel-1 with the Tier-1, Tier-2, and Overall capital under Basel-2 in the two years i.e. 2009 and 2010, we see that the coefficient of variation for all categories of capital except for Tier-2 has increased under Basel-2. However, if we compare the data of 2009 with 2010, interestingly, coefficient of variation has fallen for all categories of capital except for tier-2 capital which is having a rising coefficient of variation.

Combining the analysis of Mean with the coefficient of variation, we can infer that while migrating from Basel-1 to Basel-2, SBI and its associate banks have increased the capital in all the categories. However, we observe that volatility has also increased under Basel-2 since coefficient of variation is higher while moving from Basel-1 to Basel-2 for all the categories of capital except for Tier-2.

Year wise comparisons shows that Tier-2 capital has fallen in 2010 than it was in 2009 under Basel-1 as well as in Basel-2 which points out a possibility that the Banks have become very conservative in their portfolio selection since both Basel-1 and Basel-2 does not mandate banks to keep a fixed minimum Tier-2 capital. On the other hand, the elements of Tier-2 capital include undisclosed reserves, revaluation reserves, general provisions and loss reserves, hybrid capital instruments, subordinated debt and investment reserve account which shows that amount of tier-2 capital is actually dependent on the kind of investments a bank has made. Data relating to coefficient of variation reveals that volatility has decreased from 2009 to 2010 in all categories of capital except for Tier-2 capital, which implies that there is uniformity amongst SBI and its associate banks in setting the capital norms.

Range- An analytical look at Table1 and Table2 depicts that the range of Tier-1, Tier-2, and Overall capital has increased while moving from Basel-1 to Basel-2 in 2009. Similarly, data for the year 2010 also shows the same trend except for Tier-2 capital.

Kurtosis- Table-1 and Table-2 shows that in 2009, all the categories of capital under both basel-1 and basel-2 are having a platykurtic distribution which means curve would be flatter with a wide peak depicting that there is uniformity in the banking system. In 2010 also, we see the similar trend except for overall capital under basel-1 which is having a leptokurtic distribution. Leptokurtic distribution corresponds to the high value of kurtosis implying the dominance of some banks in the SBI group.

Let's now have a look at the results of t-test- paired two sample for means wherein one variable is the data of tier-1, tier-2 and overall CRAR under basel-1 and the other variable is the data of tier-1, tier-2 and overall CRAR under basel-2. This analysis is being done for the two years i.e. 2009 and 2010.

TABLE-3: DATA FOR THE t-TEST- PAIRED TWO SAMPLE FOR MEANS FOR THE YEAR 2009

	Tier-1 capital		Tier-2 capital		Overall capital	
	Basel-1	Basel-2	Basel-1	Basel-2	Basel-1	Basel-2
Mean	7.18	7.94	4.89	5.40	12.07	13.34
Variance	0.581067	0.838581	0.314	0.3369	0.80976	1.1095
Observations	7	7	7	7	7	7
Pearson Correlation	0.963209		0.9555		0.91266	
Hypothesized Mean Difference	0		0		0	
Df	6		6		6	
t Stat	-7.33269		-7.85443		-7.7091	
P(T<=t) one-tail	0.000164		0.000113		0.00012	
t Critical one-tail	1.94318		1.94318		1.94318	
P(T<=t) two-tail	0.000329		0.000225		0.00025	
t Critical two-tail	2.446912		2.446912		2.44691	

TABLE-4: DATA FOR THE t-TEST- PAIRED TWO SAMPLE FOR MEANS FOR THE YEAR 2010

	TIER-1 CAPITAL		TIER-2		OVERALL	
	Basel-1	Basel-2	Basel-1	Basel-2	Basel-1	Basel-2
Mean	7.804286	8.572857	4.508571	4.932857	12.31286	13.50571
Variance	0.131195	0.400857	0.503881	0.49559	0.41299	0.549062
Observations	7	7	7	7	7	7
Pearson Correlation	0.900619		0.97149		0.74616	
Hypothesized Mean Difference	0		0		0	
Df	6		6		6	
t Stat	-5.89515		-6.64611		-6.29411	
P(T<=t) one-tail	0.000529		0.00028		0.000375	
t Critical one-tail	1.94318		1.94318		1.94318	
P(T<=t) two-tail	0.001058		0.00056		0.000749	
t Critical two-tail	2.446912		2.446912		2.446912	

Table-3 and Table-4 shows the results of t-test- paired two sample for means of tier-1, tier-2 and overall capital under Basel-1 with the tier-1, tier-2 and overall capital under Basel-2 for the years 2009 and 2010. Level of significance is taken at 5% and dof (Degrees of freedom = 5). Now, an analytical look at the tables shows that p- value is less than 0.05 for all the categories of capital which implies that results are highly significant. Therefore, we reject the null hypothesis and accept our alternate hypothesis i.e. Tier-1capital, Tier-2 capital and Overall capital under Basel-1 are significantly different from Basel-2 in both the years i.e. 2009 and 2010.

In this part, we have applied the t-test- paired two sample for means by taking one variable as the data of tier-1, tier-2 and overall CRAR, respectively for 2009 and the other variable as the data of tier-1, tier-2 and overall CRAR for 2010. This analysis has been done for both Basel-1 and Basel-2.

TABLE-5: DATA OF THE t-TEST- PAIRED TWO SAMPLE FOR MEANS UNDER BASEL-1 FOR BOTH THE YEARS 2009 AND 2010

	TIER-1		TIER-2		OVERALL	
	2009	2010	2009	2010	2009	2010
Mean	7.18	7.804286	4.892857	4.508571	12.07286	12.31286
Variance	0.581067	0.131195	0.314057	0.503881	0.809757	0.41299
Observations	7	7	7	7	7	7
Pearson Correlation	0.599594		-0.14642		-0.83446	
Hypothesized Mean Difference	0		0		0	
Df	6		6		6	
t Stat	-2.67533		1.051793		-0.42929	
P(T<=t) one-tail	0.018382		0.166699		0.34135	
t Critical one-tail	1.94318		1.94318		1.94318	
P(T<=t) two-tail	0.036764		0.333399		0.6827	
t Critical two-tail	2.446912		2.446912		2.446912	

TABLE-6: DATA OF THE t-TEST- PAIRED TWO SAMPLE FOR MEANS UNDER BASEL-2 FOR BOTH THE YEARS 2009 AND 2010

	TIER-1		TIER-2		OVERALL	
	2009	2010	2009	2010	2009	2010
Mean	7.938571	8.572857	5.401429	4.932857	13.34	13.50571
Variance	0.838581	0.400857	0.336981	0.49559	1.109533	0.549062
Observations	7	7	7	7	7	7
Pearson Correlation	0.780814		-0.33419		-0.4581	
Hypothesized Mean Difference	0		0		0	
Df	6		6		6	
t Stat	-2.90364		1.178972		-0.28457	
P(T<=t) one-tail	0.013603		0.14152		0.392768	
t Critical one-tail	1.94318		1.94318		1.94318	
P(T<=t) two-tail	0.027205		0.283039		0.785536	
t Critical two-tail	2.446912		2.446912		2.446912	

Table-5 and Table-6 shows the results of t-test- paired two sample for means of tier-1, tier-2 and overall capital for 2009 with the tier-1, tier-2 and overall capital for 2010 under Basel-1 and Basel-2, respectively. Level of significance is taken at 5% and dof (Degrees of freedom = 5). Now, an analytical look at the tables shows that p- value is less than 0.05 only for the tier-1 capital under Basel-1 and as well as Basel-2 which implies that result is significant. Therefore, we reject the null hypothesis and accept our alternate hypothesis i.e. Tier-1capital in 2009 is significantly different from tier-1 capital in 2010 under both Basel-1 as well as Basel-2.

However, tables also reveal that p-value is higher than 0.05 for tier-2 capital and overall capital in both the tables i.e. table5 for Basel-1 and table6 for Basel-2, implying that result is not significant. Therefore, we accept the null hypothesis which states that tier -2 capital and overall capital in 2009 is not significantly different from tier-2 capital and overall capital in 2010 under both Basel-1 and Basel-2.

From the above-mentioned results, we may infer that as institutional mechanism for stringent capital adequacy norms is evolving year by year, and we expect banks to strictly follow these norms as the time passes by. But the dynamic effect of such stringency is mostly felt on tier-1 capital because although mean values of tier-2 and overall capital have increased but these values are statistically insignificant.

SUMMARY AND CONCLUSIONS

Our basic premise in this paper is that as financial landscape is becoming more and more complex and banking system specifically is getting exposed to new risks, there is likelihood that Indian banks are also getting exposed to some of these toxic assets. We also know that institutional mechanism is evolving year by year, therefore the capital adequacy norms must ideally increase and become higher than they were in the past periods. However, the overall minimum capital to risk- weighted assets and minimum tier-1 capital requirement is the same under Basel-1 and Basel-2 i.e. 9% and 6%, respectively. From static point of view, we examined the norms in their current form i.e. by taking the value of hypothesized mean difference as zero since minimum capital requirement for tier-1 and overall capital is same in both Basel-1 and Basel-2.

We may summarise in the sense that while moving from Basel-1 to Basel-2, mean values of all categories of capital of SBI and its associate banks have increased in both 2009 and 2010. However, we also observed that volatility has also increased for the SBI group while shifting from Basel-1 to Basel-2.

One interesting observation which emanated from the study is that although the mean of tier-2 capital increased while moving from Basel-1 to Basel-2 in both the years i.e. 2009 and 2010 but the mean value was much lower than the corresponding mean values of other categories of capital under Basel-1 and Basel-2 for the two years i.e. 2009 and 2010. The reason maybe that SBI group as a whole has not undertaken much of the off balance sheet activities post global financial crisis since the level of tier-2 capital depends upon the particular risk exposure of a bank i.e. it is a risk weighted norm and it does not have a fixed minimum capital requirement. It also reflects that SBI and its associate banks have been conservative in their choice of asset basket. We may safely say that the dynamic effect of capital norms is felt on tier-1 capital.

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