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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

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ANALYSIS OF CAPITAL ADEQUACY OF PRIVATE SECTOR INDIAN BANKS

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ABSTRACT

In the present study, an attempt is made to analyze the present position of capital adequacy of selected private sector Indian banks. First section includes a brief review of some of the earlier studies. Second section covers the scope, objectives, hypothesis and research methodology. In third section, an attempt is made to analyze the capital adequacy of selected banks namely ICICI Banking Corporation Ltd (ICICI), Indusind Bank Ltd (Indusind), AXIS Bank Ltd (AXIS) and HDFC Bank Ltd (HDFC) in India by using CAMEL Model ratios for a period of 2000-01 to 2010-11. Fourth section covers the conclusion and limitations of the study. To achieve the objectives of the study, the use is made of secondary data collected mainly from Report on Trends and Progress of Banking in India, Performance Highlights of Private Banks in India, various journals such RBI Bulletin, IBA Bulletin, etc. To test the statistical significance of the results, one-way ANOVA technique has been used. The results of the study reveal that there is no significant difference in the capital adequacy ratio and the ratio of government securities to total investments in the selected banks; therefore, null hypothesis is accepted. On the other hand, a significant difference is found in the ratio of advances to total assets, government securities to total investments and debt-equity ratio in the selected banks; therefore, null hypothesis is rejected.

KEYWORDS

Capital Adequacy, Net NPA to Net Advances, Investment to Total Assets, Net NPA as percentage to Total Assets.

INTRODUCTION

The face of banking in India is changing rapidly. The enhanced role of the banking sector in the Indian economy, the increasing levels of deregulation along with the increasing levels of competition have facilitated globalization of the Indian banking system and placed numerous demands on banks. Operating in this demanding environment has exposed the banks to various challenges and risks. In the process of providing financial services, they assume various kinds of financial risks. The quality, consistency and transparency of the capital base are one of the primary objectives of any banking institution. It is only through higher levels of loss absorbing capital that the banking sector will be in a stronger position to shield the economy from future shocks. The thrust of bank's work is to improve the level and proportion of the core elements of Tier 1 capital, namely common equity and retained earnings. Under the existing standard, banks could hold as little as 2 percent of risk-weighted assets as common equity. It is even less if you consider the need for additional regulatory adjustments. The Reserve Bank of India acts as a centralized body monitoring any discrepancies and shortcoming in the system. It is the foremost monitoring body in the Indian financial sector. It is generally accepted that greater financial system depth, stability and soundness contribute to economic growth. But beyond that, for growth to be truly inclusive requires broadening and deepening the reach of banking by improving earning quality of banking sector. A wider distribution and access of financial services helps both consumers and producers raise their welfare and productivity. Such access is especially powerful for the poor as it provides them opportunities to build savings, make investments, avail credit, and more important, insure themselves against income shocks and emergencies. Though the Indian financial system has made impressive strides in resource mobilization, geographical and functional reach, financial viability, profitability and competitiveness, vast segments of the population, especially the underprivileged sections of the society, have still no access to formal banking services. The Reserve Bank is, therefore, considering the proposal for providing licenses to a limited number of new banks. A larger number of banks would foster greater competition, and thereby reduce costs and improve the quality of service. More importantly, it would promote financial inclusion and ultimately support inclusive economic growth, which is a key focus of public policy. The success in the global scenario can be attained only if banks maintain competitive edged in their higher levels of capital adequacy to empower them with loss absorbing capital that the banking sector will be in a stronger position to shield the economy from future shocks.

Induced by the forgoing revelations, an attempt is made to analyze the capital adequacy of selected private sector banks in India, which is divided into four sections. First section includes a brief review of some of the earlier studies. Second section covers the scope, objectives, hypotheses and research methodology of the study. In third section, an attempt is made to analyze the capital adequacy of private sector Indian banks. Fourth section covers the conclusion and limitations of the study.

SECTION-I: LITERATURE REVIEW

The articles published on different facets of Indian banking reforms are restrictive in nature and have been found wanting in terms of the assessment of the impact of the reforms on the banking sector. Reddy and Yuvaraja (2001) were of the view that the adoption of international capital adequacy standards, deregulation of interest rates and entry of private and foreign banks underlined that the speed and sequencing of the financial sector reforms should be as per the requirements of the Indian economy. Rao (2002) concluded that the international regulations are forcing the Indian banks to adopt better operational strategies and upgrade the skills. The system requires new technologies, well-guarded risk and credit appraisal system, treasury management, product diversification, internal control, external regulation as well as skilled human resources to achieve the international excellence and to face the global challenges. Muniappan (2003) focused on two areas - firstly, challenges faced by the Indian banks and secondly, the management of these challenges. Every aspect of the banking industry, be it profitability, NPA management, customer service, risk management, HRD etc., has to undergo the process of transformation of aligning with the international best practices. He concluded that the future of Indian banking system needs a long-term strategy, which should cover areas like structural aspects, business strategies, prudential control systems, integration of markets, technology issues, credit delivery mechanism and information sharing, etc. Ghosh and Das (2005) highlighted the ways how market forces may motivate banks to select high capital adequacy ratios as a means of lowering their borrowing costs. If the effect of competition among banks is strong, then it may overcome the tendency for bank capitalization. If systemic effects are strong, regulation is required. Empirical tests for the Indian public sector banks during the 1990s demonstrated that better capitalized banks experienced lower borrowing costs. Sharma and Nikadio (2007) presented an analytical review of the capital adequacy regime of the banking sector in India and concluded that in the regime of Basel I, Indian banking system performed reasonably well, with an average CRAR of about 12 per cent, which was higher than the internationally accepted level of 8 per cent as well as India's own minimum regulatory requirement of 9 per cent. Ghosh and Ghosh (2011) emphasized on management of non-performing assets in the perspective of the public sector banks in India under strict asset classification norms, use of latest technological platform, recovery procedures and other bank specific indicators in the context of stringent regulatory framework of the Reserve Bank of India and concluded that the reduction of non-performing assets is necessary for improving the profitability of banks and to comply with the capital adequacy norms as per the Basel Accord(s). Thiagarajan, Ayyappan and Ramachandran (2011) analyzed the role of market discipline on the behaviour of commercial banks with respect to their capital adequacy and concluded that the commercial banks are well capitalized and the ratio is well over the regulatory minimum requirement. The private sector banks show a higher percentage of Tier-I capital over the public sector banks. However the public sector banks show a higher level of Tier-II capital. The study also indicated that the Non-Performing Assets influenced the cost of deposits for both public and private sector banks in a significant manner. The return on equity had a significant positive influence on the cost of deposits for private sector banks. The public sector banks can reduce the cost of deposits by increasing their Tier-I capital.

SECTION-II: SCOPE, OBJECTIVES, HYPOTHESES AND METHODOLOGY

SCOPE OF THE STUDY

This study covers four private sector Indian banks namely ICICI Banking Corporation Ltd (ICICI), Indusind Bank Ltd (Indusind), AXIS Bank Ltd (AXIS) and HDFC Bank Ltd (HDFC).

OBJECTIVES OF THE STUDY

The present study aims to analyze the present position of capital adequacy of selected private sector Indian banks.

RESEARCH HYPOTHESIS

H01: There is no significant difference in the capital adequacy ratio of the selected private sector Indian banks.
H02: There is no significant difference in the debt-equity ratio of the selected private sector Indian banks..
H03: There is no significant difference in the advances to total assets of the selected private sector Indian banks.
H04: There is no significant difference in the government securities to total investments of the selected private sector Indian banks.

RESEARCH METHODOLOGY

To achieve the objective of the study, the use is made of secondary data for a period of eleven years i.e. from 2000-01 to 2010-11, collected mainly from Report on Trends and Progress of Banking in India, Performance Highlights of Private Sector Banks in India, various journals such as RBI Bulletin, IBA Bulletin and ICFAI Journal of Bank Management. To test the statistical significance of the results, one-way ANOVA technique has been used to arrive at the conclusion.

SECTION-III: ANALYSIS OF CAPITAL ADEQUACY

It is important for a bank to maintain depositors' confidence and preventing the bank from going bankrupt. Capital is seen as a cushion to protect the depositors and promote the stability and efficiency of financial system. Capital adequacy reflects the overall financial condition of the banks and also the ability of the management to meet the need for additional capital. It also indicates whether the bank has enough capital to absorb unexpected losses. Capital adequacy ratios act as indicators of bank leverage. The following ratios are used to measure the capital adequacy:

3.1 CAPITAL ADEQUACY RATIO

The banks are required to maintain the capital adequacy ratio as specified by RBI from time to time. As per the latest RBI norms, the banks in India should have a CAR of 9 per cent. It is arrived at by dividing the sum of Tier-I and Tier-II capital by aggregate of risk weighted assets (RWAs). The higher the CAR, the stronger is considered a bank as it ensures high safety against bankruptcy. Tier-I capital includes equity capital and free reserves. Tier-II capital comprises of subordinate debt of 5-7 years tenure, revaluation reserves, general provisions and loss reserves, hybrid debt capital instruments and undisclosed reserves and cumulative perpetual preference shares.

TABLE 1: CAPITAL ADEQUACY RATIO

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	11.57	15.00	09.00	11.09
2001-2002	11.44	12.51	10.65	13.93
2002-2003	11.10	12.13	10.09	11.12
2003-2004	10.36	12.75	11.21	11.66
2004-2005	11.78	11.62	12.66	12.16
2005-2006	13.35	10.54	11.08	11.41
2006-2007	11.69	12.54	11.57	13.08
2007-2008	14.92	11.91	13.73	13.60
2008-2009	15.92	12.33	N.A.	15.09
2009-2010	19.41	15.33	15.80	17.44
2010-2011	19.54	15.89	12.65	16.22
ANOVA Value	F- 2.24	P-value- 0.09		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

Table -1 shows the capital adequacy ratio of the banks under study. It ranges from 10.36 to 19.54 in case of ICICI, from 10.54 to 15.89 in case of Indusind, from 9.00 to 13.73 in case of AXIS and from 11.09 to 17.44 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is no significant difference in the capital adequacy ratio in the selected banks; therefore, null hypothesis is accepted.

3.2 ADVANCES TO TOTAL ASSETS

The ratio of the advances to total assets indicates a bank's aggressiveness in lending, which ultimately results in better profitability. Higher ratio of advances to total assets is preferred to a lower one. The value of total assets is excluding the revaluation of all the assets.

TABLE 2: ADVANCES TO TOTAL ASSETS

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	33.54	45.40	42.31	27.63
2001-2002	44.61	51.45	35.55	27.45
2002-2003	49.88	54.01	36.61	38.64
2003-2004	49.59	51.78	38.77	41.94
2004-2005	54.52	57.61	41.34	49.71
2005-2006	58.14	52.83	44.87	47.70
2006-2007	56.83	52.97	50.34	51.45
2007-2008	56.43	55.01	54.45	47.63
2008-2009	59.48	46.34	40.39	34.61
2009-2010	49.86	58.10	57.76	56.56
2010-2011	53.26	57.34	58.67	57.68
ANOVA Value	F-3.46	P-value-0.02		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-2, the ratio of the advances to total assets ranges from 33.54 to 59.48 in case of ICICI, from 45.40 to 58.10 in case of Indusind, from 35.55 to 58.67 in case of AXIS and from 27.45 to 57.68 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is a significant difference in the ratio of advances to total assets in the selected banks; therefore, null hypothesis is rejected.

3.3 GOVERNMENT SECURITIES TO TOTAL INVESTMENTS

The proportion of investment in government securities to total investments is a very important indicator, which shows the risk-taking ability of the bank. It indicates a bank's strategy as being high profit-high risk or low profits-low risk. It also gives a view as to the availability of alternative investment opportunities. Government securities are generally considered as the most safe debt instrument, which as a result, carries the lowest return. Since government securities are risk-free, therefore higher the government securities to investment ratio, the lower the risk involved in a bank's investments and vice versa.

TABLE 3: GOVERNMENT SECURITIES TO TOTAL INVESTMENTS

Years	ICICI	Indusind	AXIS	HDFC
2000-2001	49.72	73.24	57.89	47.76
2001-2002	63.31	78.65	55.04	44.11
2002-2003	72.04	79.68	59.28	47.48
2003-2004	69.96	94.93	64.88	59.88
2004-2005	68.31	83.68	52.81	58.02
2005-2006	71.66	84.72	54.77	69.14
2006-2007	74.15	82.31	61.09	73.76
2007-2008	67.76	81.99	59.87	64.11
2008-2009	61.59	77.87	59.85	88.68
2009-2010	56.71	81.92	61.09	87.10
2010-2011	48.27	73.96	61.39	75.64
ANOVA Value	F-11.23		P-value-1.76	df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-3, the ratio of government securities to total investments ranges from 48.27 to 74.15 in case of ICICI, from 73.24 to 94.93 in case of Indusind, from 52.81 to 64.88 in case of AXIS and from 44.11 to 88.68 in case of HDFC during the period under study. The results of one-way ANOVA reveal that there is no significant difference in the ratio of government securities to total investments in the selected banks; therefore, null hypothesis is accepted.

3.4 DEBT- EQUITY RATIO

This ratio indicates the degree of leverage of a bank. It indicates how much of the bank business is financed through debt and how much through equity. This is calculated as the proportion of outside liabilities to net worth. Outside liabilities includes total borrowings, deposits and other liabilities. Net worth includes equity capital and reserves & surplus. Higher ratio indicates less protection for the creditors and depositors in the banking system and vice versa.

TABLE 4: DEBT-EQUITY RATIO

Year	ICICI	Indusind	AXIS	HDFC
2000-2001	14.04	14.89	34.71	16.09
2001-2002	14.78	17.16	22.38	11.24
2002-2003	13.67	15.44	20.36	12.46
2003-2004	13.98	17.85	20.25	14.72
2004-2005	12.00	17.84	14.67	10.27
2005-2006	8.61	19.35	16.23	12.55
2006-2007	12.97	18.80	20.59	13.18
2007-2008	7.54	16.24	11.50	10.58
2008-2009	6.60	15.60	13.46	11.49
2009-2010	6.04	13.77	10.26	9.34
2010-2011	6.37	10.29	11.78	9.93
ANOVA Value	F-7.00	P-value- 0.00		df-3

Source: Performance Highlights of Private Sector Banks, IBA, Mumbai.

As is evident from the Table-4, the debt-equity ratio ranges from 6.04 to 14.78 in case of ICICI, from 10.29 to 19.35 in case of Indusind, from 10.26 to 34.71 in case of AXIS, and from 9.34 to 16.09 in case of HDFC during the period under study. The results of One-Way ANOVA reveal that there is a significant difference in the debt-equity ratio in the selected banks; therefore, null hypothesis is rejected.

SECTION-IV: CONCLUSION AND LIMITATIONS

To sum up, there is no significant difference in the capital adequacy ratio and the ratio of government securities to total investments in the selected banks; therefore, null hypothesis is accepted. On the other hand, a significant difference is found in the ratio of advances to total assets, government securities to total investments and debt-equity ratio in the selected banks; therefore, null hypothesis is rejected. The results obtained from the present study will be helpful to the policy makers, depositors, investors and other stakeholders to take decisions about the capital adequacy of the selected private sector banks in India. As the present study covers the analysis of four private sector banks for a period of eleven years only, therefore the results drawn cannot be applied to the banking sector as whole.

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