

REVIEW OF LITERATURE: CAPITAL ADEQUACY NORMS AND ITS OPERATIONAL EFFECT ON BANKING SECTOR

Dr. Surbhi Mathur*

ABSTRACT

This paper is a review of the major recommendations of Narasimham Committee I & II relate to Capital Adequacy Ratio, Income Recognition, Asset Classification, Deregulation of Interest Rates, Reduction in Statutory Liquidity Ratio and Cash Reserve Ratio, Priority Sector Lending Norms, Merger of Public Sector Banks, Prudential Regulation such as safe guards to prevent the misuse of funds, cover minimum capital and liquidity requirements, Integration of Financial Market and so on. All these Reforms have resulted in a rapid change in the banking activities at National and International Level. These norms have affected the income measurement in banks and thus their profits. The introduction of the Prudential Norms to strengthen the bank balance sheet and enhance transparency is considered, as a milestone in the financial sector reforms. In the recent past, the profits of the commercial banks have been eroded to a greater extent, as they were not able to immediately adjust to the prudential norms recommended by the Narasimham committee. Hence, there is a need to review on these aspects.

KEYWORDS: *Capital Adequacy Ratio, Income Recognition, Asset Classification, Deregulation of Interest Rates.*

Introduction

Banking industry provides support to economy in general and industries in specific in the time of recessions and economic crisis. But, when banks are at the heart of economic recession or banks are the cause of financial crisis like the recent past financial crisis, it makes the situation worse for economic recovery. So, it is of great importance to keenly observe the performance of the banks and their compliance with the regulatory requirements. The financial system, the bank in particular, is exposed to a variety of risks that are growing more complex. In order to cope with the complexity and a mix of risk exposure to the banking system, it is of great importance to evaluate the overall performance of banks by implementing a regulatory banking supervision framework. In the recent past, the profits of the commercial banks have been eroded to a greater extent, as they were not able to immediately adjust to the prudential norms recommended by the Narasimham committee. Later, they started recovering by taking measures to arrest non-performing assets (NPAs). As the norms of the committee have an effect on the income measurement in banks and their profits, it is befitting to review on their effect on the profits of the banks in order to suggest ways and means to improve the overall performance of the banks.

Review Related to Development and Performance Measures

- **Alfriend (1988)** pointed out that a weakness of the minimum capital standards was that they failed to acknowledge the heterogeneity of bank assets and as a result, banks had an incentive to shift their portfolios from low-risk to high-risk assets.
- **V.A. Lalitha** in her dissertation entitled "Deployment of funds by commercial banks - A case study of Andhra bank" critically analyzed the growth in deposits and advances of scheduled commercial banks, working funds of Andhra bank in relation to other banks, asset structure and its components, profitability of Andhra bank and suggested measures for improvement of profits in general.

* Assistant Professor, Kanodia PG Mahila Mahavidhyalaya, JLN Marg, Jaipur, Rajasthan.