



INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

Capital Adequacy And Financial Stability: An Empirical Study Of Small Finance Banks In India

Dr.M.Parameshwari

Assistant Professor,

PG and Research Department of Commerce,
Gobi Arts & Science College,
Karattadipalayam, Gobichettipalayam,
Phone: 04285 - 240147, 240741.

Mr.V.Anandhakumar

Ph.D Research Scholar,

PG and Research Department of Commerce,
Gobi Arts & Science College,
Karattadipalayam, Gobichettipalayam,
Phone: 04285 - 240147, 240741.

ABSTRACT

Capital adequacy means that banks keep enough capital money to protect themselves from losses and stay safe. Using data from different small finance banks, this research examines how having more or less capital changes the number and type of loans small finance banks provide. The study finds that small finance banks with more capital are careful when giving loans and manage risks better also small finance banks with less capital may give fewer loans, which can affect economic growth. This study shows that having strong rules about how much capital banks must keep is very important.

Keywords: Capital Adequacy Ratio (CAR), Bank Lending, Financial Stability, Bank Capital.

INTRODUCTION

Banks are the main institutions that provide loans to people and businesses. Lending money helps the economy grow by allowing new businesses to start and existing ones to expand. But banks face risks when borrowers fail to repay loans. To protect themselves and their customers, banks must keep enough capital as a safety cushion. This is called capital adequacy.

Capital adequacy means the bank has enough funds to cover possible losses and continue its operations without trouble. Regulators set capital requirements to make sure banks stay safe and stable. These rules help prevent bank failures that can hurt the economy. This study focuses on how capital adequacy affects banks' lending behavior. It explores whether banks with higher capital are more careful in lending or if capital limits their ability to provide loans. Understanding this relationship is important for regulators, banks, and the economy.

METHODOLOGY

This study uses secondary data obtained from published reports of respective selected small finance bank in India.

ANALYTICAL TOOL USED

To examine the capital adequacy of the selected small finance banks using Mean, standard deviation, co-efficient of variation, compound annual growth rate, range, minimum values, maximum value, ratios.

SELECTION OF SAMPLE AND SIZE

This study relies on secondary data obtained from the published annual reports of small finance banks in India. The data cover the period from 2016-2017 to 2023-2024. Annual reports were selected as the primary data source because they provide audited and reliable financial information, ensuring accuracy and comparability across small finance banks. The use of secondary data from annual reports was considered appropriate as it offers long-term, standardized, and consistent records, which are necessary for time series analysis of capital adequacy small finance banks in India.

OBJECTIVE OF THE STUDY

1. To examine and compare the Capital to Risk-Weighted Assets Ratio (CRAR) of various Small Finance banks in India.

STATEMENT OF THE PROBLEM

The strength and safety of any bank depend on the amount of capital it holds, as this capital protects depositors and helps the bank absorb unexpected losses. Regulators, through Basel norms and national guidelines, require banks to maintain a minimum Capital Adequacy Ratio (CAR/CRAR) to ensure stability. But in reality, banks face many challenges in calculating and maintaining this ratio. The increasing complexity of financial products, rising risks, and stricter rules make compliance difficult. Large banks often manage more easily, but smaller banks struggle to raise capital, which affects their lending capacity, profitability, and competitiveness. At the same time, holding too much capital may reduce returns to shareholders.

From this problem, this paper finds out how banks calculate and maintain their capital adequacy, what difficulties they face in meeting the requirements, and how the level of capital adequacy impacts lending, profitability, and financial stability.

REVIEW OF LITERATURE

Rami Obeid (2023), study examines the factors that affect the Capital Adequacy Ratio (CAR) in banks across seven Arab countries. It finds that bank size, non-performing loans, and economic growth positively influence CAR, while profitability has a negative effect. Provisions do not have a significant impact. The paper recommends that Arab central banks strengthen Basel III implementation and improve banking supervision. These steps will help banks remain resilient and better manage risks.

Md Shah Naoaj (2023), study finds that the Capital Adequacy Ratio (CAR) of banks increases with liquidity risk and economic growth but decreases with bank size, leverage, and inflation. The Tier 1 capital ratio grows with more employees, profits, economic growth, and inflation but falls as bank size increases. These factors influence bank stability and risk management. The study suggests policymakers consider these factors when making banking rules. This will help keep banks safe and the financial system stable.

Rakesh Kumar (2016), Conclude the study As Performance of banks depends upon various factors. In this paper, performance is known by taking into account capital adequacy ratio, NPA, Profit per employee and Business per employee. In foreign sector banks, performance is better in terms of all these indicators as compare to other sector banks. NPA exists to the small extent in public and private sector bank but in some foreign sector banks it is near about zero which shows their sound business practices. In Capital adequacy ratio, only Dhanlaxmi bank shows declining trend yet others sector bank it is satisfactory.

Larojan and Chandrasegaran(2020), study examined the relationship between capital adequacy requirements and the profitability of the banking industry in Sri Lanka using quarterly time series data from 2008 (Q1) to 2019 (Q3). The findings revealed that the Domestic Capital Adequacy Ratio (DCAR) had a positive and significant relationship with Domestic Net Interest Income to Assets (DNIIAA), while the Domestic Tier 1 Capital to Assets Ratio (DT1CTAR) showed a negative and significant relationship with DNIIAA. In addition, Domestic Asset Quality (DAQ) had a negative and significant relationship with Domestic Net Interest Margin (DNIM). Based on these results, it is recommended that banking regulators ensure the gains of recent banking reform processes are sustained. The Central Bank of Sri Lanka (CBSL) should strengthen measures aimed at tightening risk management practices in the industry, with strategic monitoring and evaluation of capital adequacy requirements for long-term stability. By enhancing the capital base and adopting effective risk mitigation techniques, the Sri Lankan banking sector will be better positioned to consistently meet capital adequacy requirements and improve financial resilience.

TO EXAMINE AND COMPARE THE CAPITAL TO RISK-WEIGHTED ASSETS RATIO (CRAR) OF VARIOUS SMALL FINANCE BANKS IN INDIA

CAPITAL ADEQUACY

Capital Adequacy Theory explains the importance of maintaining sufficient capital in banks to absorb losses, protect depositors, and ensure financial stability. It is based on the principle that a bank's capital acts as a cushion against risks such as credit risk, market risk, and operational risk. According to this theory, regulators set minimum capital requirements—measured through ratios like the Capital Adequacy Ratio (CAR/CRAR)—to make sure banks remain solvent even during financial stress. The theory further highlights that while higher capital improves safety and reduces the probability of bank failure, it may also reduce profitability since shareholders' returns can be diluted. This creates a balance between stability and efficiency, where banks must hold enough capital to safeguard against unexpected losses but also manage it effectively to sustain growth and competitiveness. The Basel Accords are practical applications of this theory, providing international standards for how much capital banks should maintain in relation to their risk-weighted assets.

CAPITAL ADEQUACY RATIO FORMULA

$$\text{CAPITAL ADEQUACY RATIO} = \frac{\text{TOTAL CAPITAL}}{\text{RISK-WEIGHTED ASSETS RATIO}} \times 100$$

CAPITAL ADEQUACY (CRAR (%))				
PERIOD	AU SEB	CAPITAL SEB	SURYODAY SEB	UTKARSH SEB
2016-2017	23.04	22.95	53.62	25.87
2017-2018	19.31	19.66	37.94	17.40
2018-2019	19.31	17.47	36.00	24.14
2019-2020	21.99	19.11	29.57	22.19
2020-2021	23.37	19.80	51.47	21.88
2021-2022	20.99	18.63	37.86	21.59
2022-2023	23.59	18.87	33.72	20.64
2023-2024	20.06	27.39	28.41	22.57
Mean	21.46	20.49	38.57	22.04
Std. Deviation	1.79	3.21	9.32	2.48
Range	4.28	9.92	25.21	8.47

Minimum	19.31	17.47	28.41	17.4
Maximum	23.59	27.39	53.62	25.87
CAGR	-1.96	2.56	-8.67	-1.93
CV	8.33	15.65	24.16	11.26

Source: Annual Report of the Respective Small Finance Banks in India

The analysis of Capital Adequacy Ratios (CRAR) shows clear differences among the four Small Finance Banks. **AU SFB** maintained a strong and stable capital position with a mean CRAR of 21.46%, very low variability (SD 1.79), and a narrow range (19.31%–23.59%). Although it recorded a slight negative CAGR of –1.96%, its consistency and low CV of 8.33% reflect effective capital management.

Capital SFB reported a mean CRAR of 20.49% with moderate variability (SD 3.21) and a wide range (17.47%–27.39%). Despite fluctuations, it achieved a positive CAGR of 2.56%, indicating improving capital adequacy over time, though its CV of 15.65% suggests less stability than AU SFB.

Suryoday SFB stood out with the highest mean CRAR of 38.57%, but also the highest variability (SD 9.32), widest range (28.41%–53.62%), and the steepest negative CAGR of –8.67%. This shows that although its capital levels were initially very strong, they declined sharply with high volatility, raising concerns over long-term sustainability.

Utkarsh SFB maintained a mean CRAR of 22.04% with moderate variability (SD 2.48) and a range of 17.40%–25.87%. It recorded a small negative CAGR of –1.93% and a CV of 11.26%, indicating relatively stable performance with a slight downward trend. Overall, AU SFB emerged as the most consistent performer, Capital SFB showed improvement despite fluctuations, Suryoday SFB displayed strength but with instability, and Utkarsh SFB reflected moderate stability with a gradual decline.

FINDINGS

The study on Capital Adequacy Ratio (CRAR) across selected Small Finance Banks highlights notable differences in stability, growth, and variability.

AU Small Finance Bank consistently maintained a strong capital position with the least variability, reflecting effective capital management despite a slight declining trend.

Capital Small Finance Bank recorded a moderate mean CRAR but demonstrated improvement over time with a positive CAGR, although higher variability shows uneven performance.

Suryoday Small Finance Bank reported the highest average CRAR, but its sharp negative CAGR and wide fluctuations indicate instability and declining capital strength over the study period.

Utkarsh Small Finance Bank showed relatively steady performance with a comfortable mean CRAR, moderate variability, and only a slight negative trend.

CONCLUSION

From the analysis, AU SFB Ltd and Utkarsh SFB Ltd show the most stable and sustainable capital adequacy positions with consistent CRAR levels and manageable variability. Although Suryoday SFB Ltd has the highest average CRAR, its steep decline and volatility could threaten its future capital stability. Capital SFB Ltd is improving, but its capital adequacy remains lower on average and more volatile than AU and Utkarsh.

SUGGESTIONS

Suryoday SFB Ltd should investigate the causes of its volatility and declining CRAR. It may need to strengthen capital buffers or improve risk management to ensure sustainable growth. AU SFB Ltd and Utkarsh SFB Ltd should maintain their current capital management strategies but monitor for any further declines to prevent potential risks. Capital SFB Ltd should focus on reducing volatility and continuing efforts to improve capital adequacy steadily. All banks should regularly review risk-weighted assets and capital planning to align with regulatory requirements and economic conditions, ensuring long-term solvency.

REFERENCES

1. <https://www.aubank.in/>
2. <https://www.capitalbank.co.in/>
3. <https://www.suryodaybank.com/>
4. <https://www.utkarsh.bank/>
5. Rami Obeid (2023), Determinants of Capital Adequacy Ratio in the Banking Sector: Evidence from the Arab Region, International Journal of Business and Management; Vol. 18, No. 5; 2023 ISSN 1833-3850 E-ISSN 1833-8119.
6. Md Shah Naoaj (2023), Exploring the Determinants of Capital Adequacy in Commercial Banks: A Study of Bangladesh's Banking Sector, European Journal of Business and Management Research, ISSN: 2507-1076.
7. Rakesh Kumar(2016), Performance of Indian Banking Sector With Reference To Capital Adequacy Ratio Under Basel Norms - A Study Of Selected Banks, International Journal Of Advance D Research(IJAR), 4(8), 1851-1856, ISSN: 2320-5407.
8. Larojan, Chandrasegaran. (2020), Capital Adequacy Requirements and Profitability: An Empirical Study on Banking Industry in Sri Lanka. In: Journal of Economics and Business, Vol.3, No.2, 589-601. ISSN 2615-3726