



Comparative Analysis of Interest Rates Offered by the Banks in Sri Lanka

Madhusanka KTGP¹

Prabodanie RAR²

ABSTRACT

In Sri Lanka there are 25 licensed commercial banks and 9 licensed specialized banks. They offer different interest rates for their products such as fixed deposits (FDs), normal savings, pawning, housing loans, and etc. There is a competition among banks to attract customers by providing more advantages to the customers while gaining profits to the company. Customers go to the banks to save their money, to get loans, and to get money from pawning. Generally customers prefer higher interest rates for their savings and lower interest rates for their loans. Thus, it is important to identify the banks which give better interest rates to their customers. In that case, some customers are aware of these rates while some are not. Most of the customers do their transactions with the bank they usually interact with rather than going to banks that provide better interest rates for a particular product. A comparative analysis of interest rates offered by these banks will be beneficial for customers as well as the banks. Therefore, this cross-sectional research focuses on how the interest rates vary among the banks in Sri Lanka. Ten popular banks in Sri Lanka were taken into consideration and their interest rates were gathered for several products. By analyzing those data, the banks which are most beneficial to customers for various products were identified and conclusions were drawn up using the results of the analysis. Results indicate that some of the popular perceptions about the interest rates offered by public and private banks are actually incorrect.

KEYWORDS: Banking Sector, Interest Rate, Interest Spread

INTRODUCTION

The banking sector in Sri Lanka is monitored by the Bank Supervision Department of the Central Bank of Sri Lanka under the Banking Act No. 30 of 1988, Monetary Law Act and the Exchange Control Act.

Three types of financial institutions are permitted under Banking Act and the Finance Companies Act to operate in Sri Lanka.

They are,

1. Licensed Commercial Banks (LCBs)
2. Licensed Specialized Banks (LSBs)
3. Registered Finance Companies

¹Graduate, Department of Industrial Management, Faculty of Applied Sciences, Wayamba University of Sri Lanka

²Senior Lecturer, Department of Industrial Management, Faculty of Applied Sciences, Wayamba University of Sri Lanka

Banks offer different interest rates to the customers for products such as Fixed Deposits (FDs), Normal Savings, Pawning, Housing Loans, Personal Loans, Leasing, etc.

There is a competition between banks to attract customers by providing more advantages to them while gaining profits to the company.

This survey was focused on comparing the interest rates offered by 10 popular banks in Sri Lanka. Interest rates for 09 different products such as normal savings and fixed deposits were considered. The main objective was to identify which bank/s offer the best interest rate for each product. While addressing the main objective, some other secondary objectives that came across were:

- Finding out which bank/s can gain higher profits based on the 09 products considered

- Identifying whether the popular perceptions in the society are true with respect to the selected products.

LITERATURE REVIEW

Interest rate is used as a monetary policy instrument in most countries. In Sri Lanka interest rate decisions are taken by the Central bank of Sri Lanka and other banks have to set their interest rates obeying the government rules and regulations.

Sri Lanka has been experiencing a declining trend in market interest rates since the latter part of 2012. The benchmark interest rate in Sri Lanka was last recorded at 6.5% in March, 2015. Interest rate averaged 8.09% from 2003 until 2015, reaching an all-time high of 10.5% in February, 2007 and a record low of 6.5% in March, 2015. Although there is a declining trend in market interest rates the personal savings increased to 20% in 2013 from 16.9% in 2012 (Trading Economics, 2015). So it concludes that there is an attraction of customers for products that are offered by banks and this is the opportunity for banks to attract customers for their companies. Interest rates for products can be used as a key in that matter other than benefits.

When setting interest rates for products, banks must consider three factors such as real interest rate (time value of money), inflation and risk. Risk can be divided into two categories – business risk and financial risk (Hofstrand, 2013). It is obvious that if there is a high return there is a high risk. This means although customers go for the bank that has a higher interest rate there is a high risk too. Thus, it is customer's responsibility to select the product according to their requirements.

From the bank's point of view the interest spread is a key variable that determines the bank's profitability. According to the prior researchers, interest spread is described in several ways. It is defined as the difference between average

interest rate earned on interest earning assets (loans) and average interest rate paid on deposits (Jayaraman & Sharma, 2003).

High interest spread is causing high cost to borrowers and investors. On the other hand, it reduces the deposit income of the depositors. Bandaranayake (2014) highlights some inefficiency that exists in the state banks is adversely influencing the interest spread. As a result of that, industry paves the way for high profitability of private banks.

METHODOLOGY

In this research judgmental sampling technique was adopted for choosing the sample and bank popularity was taken as a major factor while selecting the sample. The primary data were mainly collected from the internet through websites of different banks and by visiting.

Interest rates were collected in the time period of 25th of December 2014 to 31st of January 2015 using the banks' websites. Since some interest rates were not displayed in the web sites those data were collected by asking the employees who work in those banks.

Since this research is about comparison of interest rates, data of 09 different products - Kids savings, Ordinary Savings, Senior Citizen Savings, FD 3 months, FD 6 months, FD 1 year, Pawning, Housing Loan and Personal Loan - were collected from 10 different banks – Bank of Ceylon, People's Bank, National Savings Bank, Commercial Bank, Sampath Bank, Hatton National Bank, Seylan Bank, National Development Bank, DFCC Vardhana Bank and HSBC Bank - in Sri Lanka.

DATA COLLECTION & ANALYSIS

■ Government Banks □ Private Banks

Kids Accounts

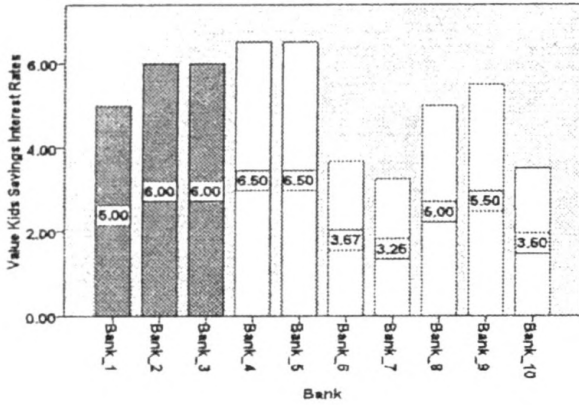


Figure 1: Kids Savings Interest Rates

For Kid's savings, the interest rates vary between 3.25 % and 6.5%. The mean interest rate is 5.092%. Comparing the government and private banks it seems most private banks' interest rates are lesser than those of government banks.

Ordinary Savings Accounts

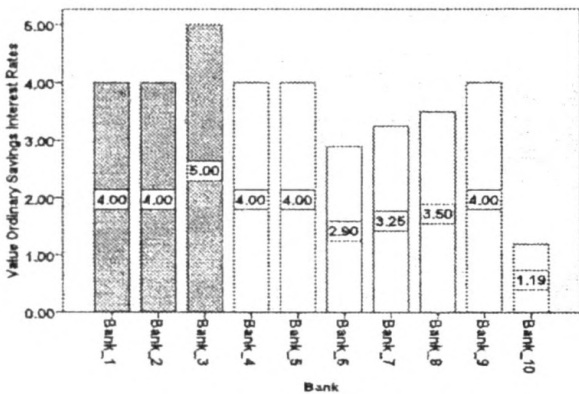


Figure 2: Ordinary Savings Interest Rates

For ordinary savings, 50% of the selected banks have the same rate (4.0%). The highest and the lowest are 5.00% and 1.19% respectively. With few exemptions, ordinary savings interest rate is quite stable around 4.0% among both private and public banks.

Senior Citizen Accounts

According to the Figure 3, the maximum rate for senior citizen accounts is

7% while the minimum is 2.7%. The variations are significant.

In figure 4, the interest rates offered for senior citizen accounts are presented together with ordinary savings rates offered by each bank. Except two private banks, other banks offer higher rate than ordinary savings accounts for senior citizen product.

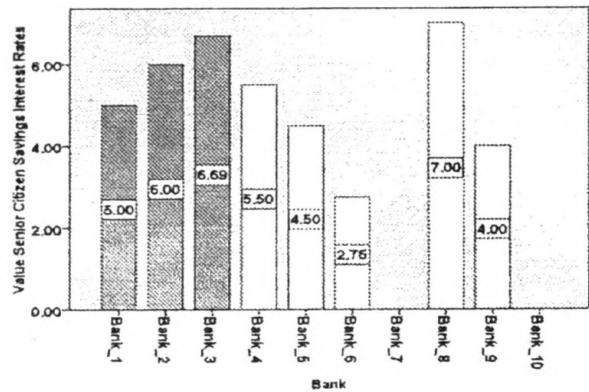


Figure 3: Senior Citizen Interest Rates

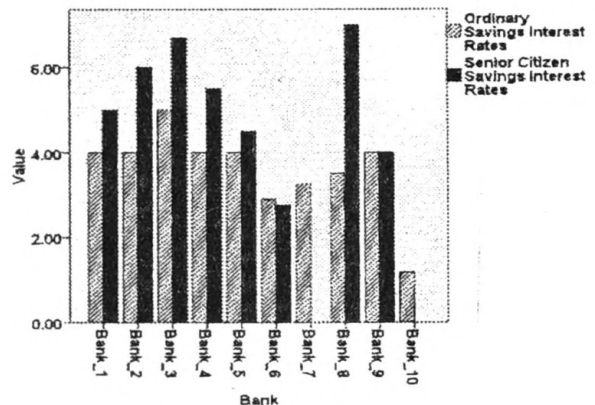


Figure 4: Comparison of Ordinary and Senior Citizen Savings Interest Rates

FD 3 Months

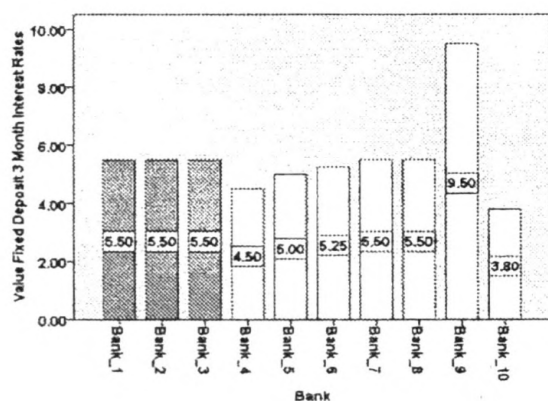


Figure 5: FD 3 Months Interest Rates

Most banks have equal rates for 3 month FD and highest rate is 9.5% and lowest is 3.8%. All government banks give same rate for this product and most private banks have approximately equal rates other than Bank 9.

FD 6 Months

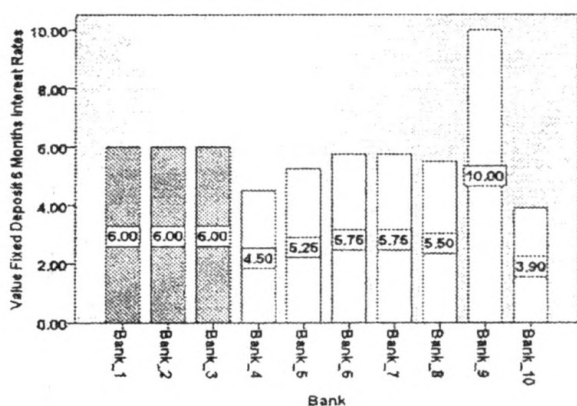


Figure 6: FD 6 Months Interest Rates

Bank 9 gives the highest rate which is 10.0% and the minimum rate is 3.9%. Government banks have the same rate and private banks have approximately equal rates other than Bank 9. Comparing two types of banks most private banks' rates are less than government banks.

FD 12 Months

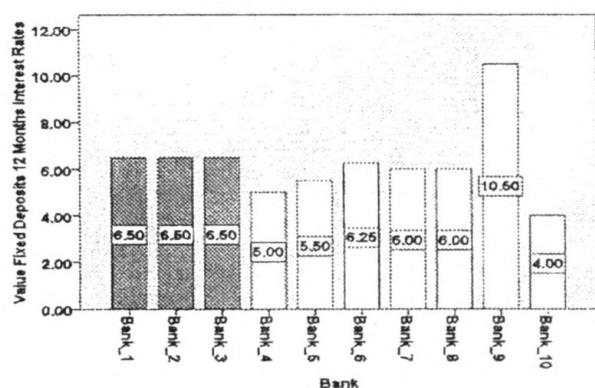


Figure 7: FD 12 Months Interest Rates

Same as the FD 3 months and 6 months, for this product also Bank 9 has maximum (10.5%) and Bank 10 has minimum rate (4.0%). Government bank rates are same and private banks have little difference between rates. But all of them

(except Bank 9) have lower rate than government banks.

Pawning

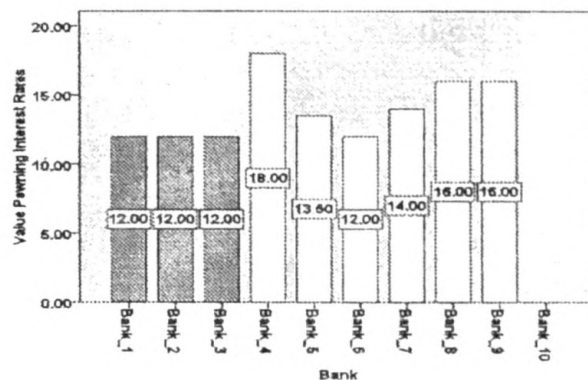


Figure 8: Pawning Interest Rate

All the government banks have an equal rate which is 12.0% and private banks have a higher rate than government banks for pawning. The highest is 18.0% which is offered by a private bank.

Housing Loan

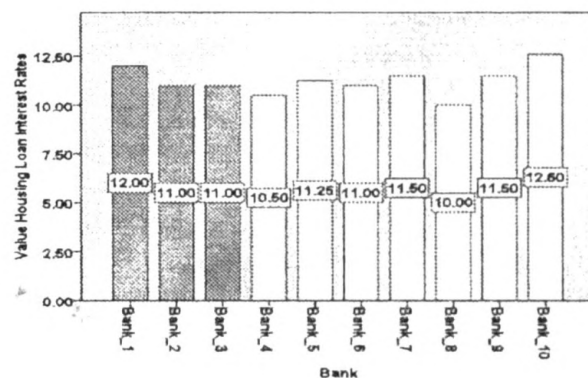


Figure 9: Housing Loan Interest Rate

Housing loan interest rates are varying within 10.0% - 12.6%. In government banks two banks have the same interest rate which is lower than the other bank (Bank 1). There is no much difference in rates and when comparing government and private banks some private banks have a higher rate than government banks while other banks have a lesser rate.

Personal Loan

Interest rates for personal loans are varying within 10.5% - 16.0% interest rate.

When considering government banks separately Bank 2 has the minimum rate and other two banks have the same rate. Most private banks have a higher rate than government banks for personal loans.

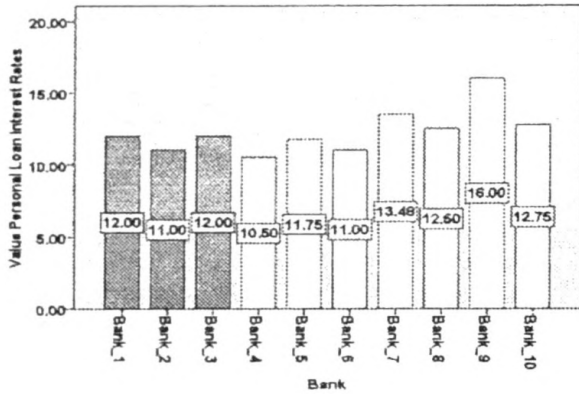


Figure 10: Personal Loan Interest Rate

RESULTS AND DISCUSSION

To get an idea about the interest income potential of the selected banks, a rough estimate of interest spread was calculated as the difference between the average lending rate and the average borrowing rate. The calculated values of interest spread are given in Figure 11.

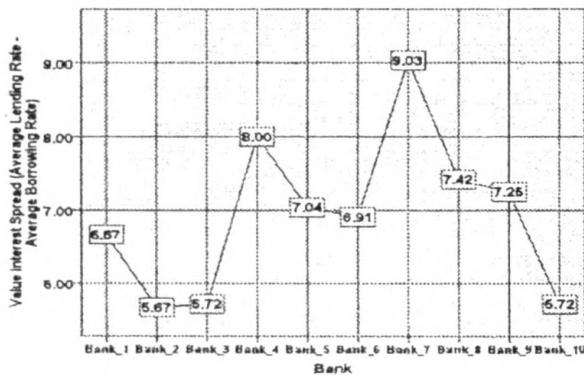


Figure 11: Calculated Interest Spread for Banks

According to those estimates, private bank 7 had the highest interest spread and a popular state bank had the lowest interest spread. From the customers' point of view, a lower interest spread means low costly borrowings and more profitable savings. So it is not a surprise that state banks have relatively low interest spread ranging from 5.67% to 6.67%. Yet most banks are within the range of 6.0% to 8.0% while 3 banks are

below that range and one is above the range. However it should also be noted that there are many other financial products/services offered by these banks which were not considered in this survey. So the results are valid with respect to the selected banks and for the selected products only.

The popular perception is that government banks are the safe places for long term savings. As a result, kids' savings are mostly attracted by the government banks. For example BOC Ran Kekulu is quite popular all over the country. However findings of this survey provide evidence that some private banks (Banks 4 and 5) offer higher rates for kids' accounts compared to even specialized government banks.

It is clear that one private bank (Bank 9) offers significantly higher interest rates for FDs, trying to attract more customers and cash in to the bank by giving more rates. This particular bank was confronted by a sudden, unexpected crisis of public confidence resulted from allegations on defrauding funds deposited by the public. That affected for their image and they were rated as A-(lka) in Fitch Ratings also.

As the results indicate, the government bank which has the largest market share is not the bank which offers best rates to the customers. Perhaps, the customers may have overlooked interest benefits in favor of service quality.

CONCLUSION

The findings of this research clearly indicate that the same bank is not always the best for all kind of savings and borrowings. So a thorough investigation of interest rates and other benefits associated with various products /services offered by different banks should be considered in selecting the right bank to deposit or borrow money.

Although there are high rates, customer must identify the risk involved with the relevant bank before deciding where to go. So whether this research shows some banks have high rates if the investment

of that bank is a high risk, the customer should think it twice. Because this report is only about which banks give more benefits to customers.

To identify the risk, Fitch Ratings can be used. Fitch Ratings Inc. is one of the three nationally recognized statistical rating organizations (NRSRO) and it rates our Sri Lankan banks to several grades.

Table 1. National Ratings by Fitch Ratings (Lanka) Ltd. As at 23rd Sep 2013

Bank	Fitch Ratings
HSBC	AAA (lka) Stable
NSB	AAA (lka) Stable
BOC	AA + (lka) Stable
People's Commercial	AA + (lka) Stable
NDB	AA (lka) Stable
DFCC Vardhana	AA - (lka) Stable
HNB	AA - (lka) Stable
Sampath	AA - (lka) Stable
Seylan	A - (lka) Stable

HSBC and NSB have been ranked high and from the selected banks Seylan is in the last position. By occupying last position in this rating it proves that Seylan is in an unstable position and they are trying to attract customers by giving high rates to products such as FDs.

There are some perceptions on peoples' mind that private banks offer more rates than government banks. But according to the findings it seems there is no such difference and some private banks offer high rates while some offer low rates compared with government banks.

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