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IMPACT OF INTEREST RATE SPREAD ON PROFITABILITY OF NATIONALIZED BANKS AND PRIVATE BANKS

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ABSTRACT

The study examines the effect of interest rate spread on the profitability of nationalized banks and private banks in India. The study measured interest rate spread using net interest spread and net profit margin. For this purpose five year study is carried out for the year 2013-14 to 2017-18. Spread rate is a difference between two related interest rates. In banking industry spread rate is the difference between debts rate (especially for deposit) and assets rate (Especially for loan). Interest rate spread has always been one of the most important and significant economic issues in different countries of the world.

KEYWORDS: Spread rate, nationalized banks, private banks, Interest rate

INTRODUCTION

Interest rate spread has always been one of the most important and significant economic issues in different countries of the world. Significant studies and researches were carried out by banking system researchers in order to find the reason of fluctuations of this rate and affecting factors on that. The high spread rate declares the problems in the regulatory environment of bank and asymmetry of information. In other words, higher spread rate can improve profitability of banking system, the depth of banking and financial stability with increased tolerance against negative shocks (Doliente, 2005) and also the high spread rate cannot always be a good indication of the efficiency of the banking system, but it may indicate inadequate regulation and banking system instability. If a bank is with poor performance, it tries to reduce lending interest rates in order to obtain a greater share of the market (Brock and Suarez, 2000, p. 113, Nazarian, Hashemi Nejad, 2010, p.131)

LITERACHER REVIEW

(1) Alhassan M., Fred K. A. & Erasmus D. G. (2018), the study examines the effect of interest rate spread on the profitability of commercial banks in Ghana. The study measured interest rate spread using net interest income (IntSp) and net interest margin (NIM) and bank profitability using Return on Assets (ROA) and Return on Equity (ROE). The results of the study show that there is a positive and statistically significant association between interest rate spread and bank profitability in Ghana. The findings could be interpreted within the context of the loanable funds theory to suggest that the demand for loans exceed the supply of same allowing banks to charge higher interest on lending relative to deposits to increase profitability. The results of the study have significant implications on research on interest rate spread and more especially on government policy to reduce interest rate spread in Ghana. With profit as a motivation, banks will only reduce interest rate spread if its reduce their profitability but the current evidence shows that banks charge higher interest margin to maximize profitability.

(2) Amna K. & Muhammad K. (2016), the purpose of this study is to explain the relationship between interest rate spread and profitability. Interest rate spread is actually the
difference between deposit rate and lending rate of bank. Interest rate spread is an important factor in profitability of banks. It means increase or decrease in interest rate will affect profitability. Many other factors also contribute in the profitability of banks. The growth of any organization depends on its profitability. When the profitability of any organization increases the value of shareholders also increase.

(3) Arezoo G. & Malihe R. (2016), this study is done to consider affecting factors on spread rate and define a suitable model of spread rate in banking industry. Spread rate is a difference between two related interest rates. In banking industry, spread rate is the difference between debts rate (especially for deposit) and assets rate (Especially for loan). Interest rate spread has always been one of the most important and significant economic issues in different countries of the world. In this study, affecting factors on spread rate are considering in an Iranian bank during the last 19 month. Some variables such as NPL ratio, ratio of demand deposits on deposits, non interest income, and interest assets to assets, capital adequacy ratio, ROA ratio and inflation and exchange rate are analyzed on spread rate and a model is defined for bank according to prior studies and economical issues of Iran.

(4) Maureen W. & Joseph W. (2014), The paper empirically investigates the determinants of interest rate spread in Kenya's banking sector based on panel data analysis. The findings show that bank-specific factors play a significant role in the determination of interest rate spreads. These include bank size, credit risk as measured by non-performing loans to total loans ratio, return on average assets and operating costs, all of which positively influence interest rate spreads. On the other hand, higher bank liquidity ratio has a negative effect on the spreads. On average, big banks have higher spreads compared to small banks. The impact of macroeconomic factors such as real economic growth is insignificant. The effect of the monetary policy rate is positive but not highly significant. The results largely reflect the structure of the banking industry, in which a few big banks control a significant share of the market.

(5) Michael Y. M. (2012), This study adopted a descriptive research design on a sample of quoted commercial banks in Kenya. The study used secondary data, collected from Bank Supervision Report. The study used quantitative techniques in data analysis to the relationship between the interest rate spread and performance of commercial banks. The data is presented using tables. The findings of the research concludes that interest rate spread affect the performance of commercial banks, as it increases the cost of loans charged on the borrowers, regulations on interest rates have far reaching effects on performance of commercial since they determine the interest rate spread in banks and also help mitigate moral hazards incidental to performance of commercial banks, credit risk management technique remotely affects the value of a bank’s interest rates spread as interest rates are benchmarked against the associated non-performing loans and non-performing loans is attributable to high cost of loans.

(6) P. Ramful (2001), This paper examines the determinants of interest rate spread in the Mauritian banking sector both analytically and empirically. Using balance sheets and income statements of commercial banks, the spread is decomposed into its various components. The empirical analysis shows that interest rate spread in Mauritius is used not only to cover the costs of operating expenses and required reserves but also reflects the prevalence of market power and compensates for the quality of loans.

**RESEARCH OBJECTIVE**

(1) To study interest spread of nationalized banks and private banks.

(2) To study net profit margin of nationalized banks and private banks.

**RESEARCH METHODOLOGY**

The study relied on secondary data collected from annual reports of nationalized banks and private banks. Data are collected from the annual report of the selected banks for five years 2013-14 to 2017-18. To satisfy the objective Analytical Research is carried out.
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Interest rate spread of all the banks nationalized banks and private banks are almost same. Interest Spread of nationalized banks and private banks are almost same in the year 2013-14 to 2017-18. Net Profit Margin of nationalized banks is lower. Net Profit Margin of private banks is higher. In the year 2017-18 net profit margin of nationalized banks is negative. And in ICICI bank it reduced in the year 2017-18. In case of HDFC bank net profit margin is increased.

CONCLUSION

By reviewing all these researches it is concluded that interest rate spread is a prominent factor behind profitability of bank. Some other factors also exist that affect the profit level of banks. Other Factors include microeconomic factors like inflation rate GDP etc. bank related factors like size, loan, deposits etc. while competition also plays an important role in interest rate spread. While interest rate spread is also derived by some factors like some macroeconomic factors, high non-performing loan ratio and high administrative costs etc.

REFERENCES