COMPARATIVE ANALYSIS OF FINANCIAL PERFORMANCE AND GROWTH OF CONVENTIONAL AND ISLAMIC BANKS OF PAKISTAN

Ishtiaq Khan, Sarhad University of Science & IT, Peshawar.
Email: ishtiaqkhan2005@gmail.com

Wali Rahman, Associate Professor, Sarhad University of Science & IT, Peshawar. Email: wali.ba@suit.edu.pk

Saeedullah Jan, Khushal Khan Khattak University, Karak.
Email: saadullahjan2002@gmail.com

Mustaq Khan, Abasyn University of Science & IT, Peshawar
Email: mushtaqkhan2009@yahoo.com

Abstract. *Various types of the banking system are operating in the world. The most commons are conventional and Islamic. Customers evaluate these systems before they decide in invest. The prime aim of this study is to assess and compare the financial performance and growth of conventional and Islamic banks operating in Pakistan. Banks offer different types of products and services for the satisfaction of customers for their financial needs. Conventional banking is based on interest while Islamic banking offers interest-free banking. To compare their respective performance financial ratios are applied. In Pakistan, Habib Bank Limited and Allied Bank Limited are typical examples of the conventional banking whereas Dubai Islamic Bank Limited and Meezan Bank Limited are operating as Islamic banking. Three (03) years data were obtained from the "Financial Statement Analysis of Financial Sector of Pakistan 2009-2011" State Bank of Pakistan publication. The analyses reflect that the liquidity ratio of Islamic banks appeared higher as compared to conventional banks, whereas the profitability and solvency ratios of conventional banks were comparatively higher than Islamic banks. Debt to asset ratio of Islamic banks seemed better than conventional banks due to low debt financing. Also, with regard to expansion, the growth rate of Islamic banks in Pakistan is comparatively higher than conventional banks.*

Introduction

Two types of banking systems are prevalent in the world i.e. conventional and Islamic. Islamic banking has been initiated around the sixties in the world. This mode offers different operations as compared to conventional banking which concentrates on the concept of Riba. Islamic banking enjoys under the patronization of religious scholars. It is to be remembered that this philosophies and principles have been outlined in the Holy Quran and Sunnah of Prophet Muhammad (Peace be Upon Him) more than 1400 years ago.

Islamic banking was initiated by two financial institutions i.e. Nile Deltaa and Mit Ghamar and later on, they developed to Islamic banking. In 1965, Dubai Islamic Bank started operation in Karachi with full-fledged Islamic banking. Later on, in 1996, the number of Islamic banks/financial institutions jumped to 166 in 34 countries (Muslims & Non-Muslims)**.**

Chapra (2001) highlighted that in 1970's popularity of Islamic banking increased and is being operated in sixty countries of the world providing their services to their customers Aggarwal, Rajesh and Tarik (2000).

History of banking in Pakistan

Pakistan came into existence on 14th August 1947 and there was no banking channel to run financial affairs of the new state. HBL being established in 1942, only a few branches in major cities was commissioned to fill the gap and acted as a central bank of Pakistan. In July 1948, the Government established State Bank of Pakistan (SBP) as Semi government organization. Financial assistance and professional guidance were provided by HBL. In 1974, as per policy all the commercial banks of the country were nationalized and merged into five large banks as Habib Bank Limited, Allied Bank Limited, United Bank Limited, Muslim Commercial Bank and National Bank of Pakistan. In all the un-banking areas of the country, branches of these nationalized banks were opened to provide their services. For coordination and centrally monitoring a "Pakistan Banking Council" was established to work as a regulator. In 1991, the bank nationalization act was amended and privatization policy generated to privatize all the nationalized banks. As a result, twenty-three (23) commercial banks have been established in the private as well as public sector. After that Pakistan Banking Council was resolved and monitoring of the entire schedule banks were handed over to State Bank of Pakistan.

Objective of the study

The core objectives of the study are as under:

i)   To analyze the financial performance of conventional banks of Pakistan

ii) To analyze the financial performance of Islamic banks of Pakistan

iii) To compare the financial performances of both the conventional and Islamic banks of Pakistan.

iv) Whether Conventional banks or Islamic banks are operated well in Pakistan?

Literature Review

Erol, Baklaci, Aydog, and Tune (2014) analyzed both Islamic and conventional banks of Turkey. They observed that liquidity ratio of Islamic banks is better as compared to conventional banks. International firms are likely to invest in Turkeys Islamic Banks that's why the outcomes of Islamic banks have increased and so the market share also increased.

Khattak and Rehman (2010) pointed out the customer's difficulties which they faced in Islamic banks of Pakistan such as the customers of Islamic banks are less motivated than conventional banks. Conventional banks care for customer's motivation more than Islamic banks being more experienced in the banking industry.

Awan (2009) during 2006-2008 analyzed the performance of conventional banks that was not better than Islamic bank. The Islamic bank market shares experienced is increased from 2.5% to 5%, showed 100% result. SBP regulated conventional banks to open Islamic branches in all over the country.

Bader, et al. (2008) are of the view that Islamic banking and conventional banking have no big difference in term of resource utilization. Islamic banks are better than conventional banks in the response of profit generations. By using of six financial ratios, it is revealed that Islamic banks generate more profit, revenue, and even low cost effective than conventional banks.

Akhter (2007) concluded that the market share of conventional banks in the banking sector of Pakistan is lower than Islamic banks. Islamic banks increased their market share by 3.2% per year, as when Islamic banks have 170 branches in Pakistan and conventional banks have 700 branches. They further predicted that if Islamic banks provide better services to the customers, they will increase their share by13% - 20% per year in near future.

Islamic banks are operating all over the world in both Muslim and non-Muslim countries with a reasonable increasing trend. Schmith (2005) has analyzed that 1.5 billion population of the world is looking for interest-free banking. 15% -20% increases in the population of America and Europe have moved toward Islamic Banks due to noninterest banking per year.

Samad (2004) compared Islamic and conventional banks regarding their profitability, liquidity and credit performance in Bahrain and found that there was a significant difference of credit performance between the two banking system, but no significant difference in liquidity ratio and profitability ratio between two.

Hassan and Bashir (2003) collected data of twenty-one (21) foreign countries of Conventional and Islamic banks of tenure 1994-2001, concluded that Islamic banks are more profitable & low risky as compared to conventional banks.

Sources of Data

The data has been collected from the State Bank of Pakistan Publication named "Financial Statement Analysis of Financial Sector of Pakistan 2009-2011", annual reports of respective banks, SBP Islamic Banking Bulletin, and their respective official websites.

Population

The population of the study is Banking Sector of Pakistan, from which two Conventional and two Islamic banks, namely Habib Bank Ltd, Allied Bank Ltd and Meezan Bank Ltd, Dubai Islamic Bank Ltd respectively are being selected.

Sample

Twenty five conventional banks and six Islamic banks are currently operating in the banking industry of Pakistan. This research is restricted to four banks (two Islamic & two conventional banks).The researcher used simple random sample technique for choosing the said four banks. These four banks represent whole Banking Industry of Pakistan.

Research Method

For comparative study of both banking systems (Conventional and Islamic Banks) of Pakistan; by testing different financial ratios i-e liquidity ratio (current ratio, loan-deposit ratio), profitability ratios (Return on asset, return on equity & earning per share), solvency ratio (debt to equity ratio, debt to asset ratio & breakup value per share) of both banking system, Ratio Analysis Techniques is being used focusing.

Table 1   *Ratios and their respective formulae*

Ratio Name	Formula
Liquidity Ratio	
i. Current Ratio	i. Cash + Bank Balance/Current Liabilities
ii. Loan Deposit Ratio	ii. Total Liabilities/Total Deposits
Profitability Ratio	
i. ROA (Return on Asset)	i. Profit/Loss after taxation/Total Asset
ii. ROE (Return on Equity)	ii. Profit/Loss after taxation/Total Share Holder Equity
iii. iii.EPS (Earning Per Share)	iii. Profit / Loss after taxation / Number of Share
Solvency Ratio	
i. Debt to Equity Ratio	i. Total Debt / Total Share Holder Equity
ii. Debt to Asset Ratio	ii. Total Debt / Total Asset
iii. Breakup value per Share	iii. Total Share Holder Equity / Number of Share

Analysis

To statistically analyze the date different ratios have been employed. Table 2 summarizes the results.

Table 2 *Financial Ratio's Analysis*

Name of Ratio	Conventional Banks			Islamic Banks		
	HBL	ABL	Average of Both Banks	Dubai Islamic Bank	Meezan Bank Limited	Average of Both Banks
Liquidity Ratios*						
Current Ratio	16.55	8.84	12.69	17.38	29.33	23.35
Loan Deposit Ratio	5.44	3.99	4.71	7.48	14.76	11.12

Profitability Ratios*						
ROE	19.92	27.1	23.52	2.31	18.35	10.33
ROA	1.78	1.84	1.81	0.35	1.35	0.85
EPS	17.32	10.9	14.08	0.2	3.01	1.6
Solvency Ratios*						
Debt Equity Ratio	10.07	13.6	11.83	15.92	12.62	14.27
Debt to total Asset	4.56	7.9	6.23	2.22	4.96	3.59
Breakup value per Share	86.68	40	63.36	9.01	16.32	12.66

*All the findings are of three years average

Note: All data are in percentage except EPS because there value is in Pakistan Rupees.

Liquidity Ratio

Current ratio is the first ratio of liquidity to find the liquidity of the bank. The average result or values of the current ratio are 12.69 and 23.35 for both conventional and Islamic banks respectively shown in Table 1. This result shows that current liabilities of the conventional banks are more than its current asset while Islamic banks have less current liabilities than the current assets. The second ratio of liquidity is the loan-deposit ratio, it shows that conventional banks have 4.71 and Islamic bank have 11.12, and it's clear that conventional bank has enough liquidity to cover its fund's requirement as compared to the Islamic banks. The earning capacities of conventional banks are lower than Islamic banks.

Profitability Ratio

Three ratios indicate the profitability of both banks (conventional and Islamic). The three ratios are ROA (return on asset), ROE (return on equity) and EPS (Earning per Share). These ratios (profitability) signify that how much profit formatted at a particular time period.

The result in Table 1 clear that the shareholders of the conventional banks are provided more capital and the bank pay more dividends while Islamic banks have less contribution of the shareholders in the capital. It's clear that conventional banks are more profitable than Islamic banks.

Table 2 shows ROA, ROE of the conventional banks are 1.81 and 23.52, whereas Islamic banks have 0.85 and 10.33, the result indicates the

conventional banks have high ROA and ROE ratios than Islamic banks. The result shows that conventional banks formatted more profit than Islamic banks. The average EPS (Earning per Share) of conventional banks are 14.08 while Islamic banks are 1.60. Table 2 indicates that conventional banks pay more dividends to the shareholders as compares to Islamic banks.

Solvency Ratio

Solvency ratio tells us the differentiation between liabilities and assets of the banks. Solvency ratio indicates that how much a bank financed by equity and how much by debt. If the assets of the bank are high / more than its liabilities, so they will definitely pay to their creditors otherwise not.

The debts to equity ratio of conventional and Islamic banks are 11.83 and 14.27 respectively. The result clears that the debt of Islamic banks is lower than the conventional bank. The assets of conventional banks are lower than Islamic banks.

The second ratio of solvency is "debt to asset ratio", tells us how much company asset financed by debt. Lower the ratio/percentage indicates that the company financed asset by the low contribution of debt and vice versa. In table 1 this ratio of both conventional and Islamic banks are 6.23 & 3.59. The result shows that Islamic banks financed asset by the lower contribution of debt while conventional banks have high ratio/percentage so that's why they financed asset by higher than Islamic banks means by more debt.

Table 3   *Average Increase in Number of Branches*

	Conventional Banks			Islamic Banks		
Year	HBL	ABL	Average Increase in Three Years	Dubai Islamic Bank	Meezan Bank Limited	Average Increase in Three Years
2009	1494	779		35	166	
2010	1501	806	1.33%	57	223	20.15%
2011	1506	837		75	275	

Table 2 shows the total number of branches of both conventional and Islamic banks in Pakistan. The average increase results of both conventional and Islamic banks are 1.33% and 20.15%. The result indicates that the total number of conventional banks are more than Islamic banks but the growth of new branches opening of Islamic banks is high than conventional banks. As a whole, the Table 2 indicates that Islamic banks growth was faster than conventional banks in Pakistan during 2009 to 2011.

Conclusion

Researches on the financial performance of both banking system (conventional & Islamic) were conducted in every country of the world. The histories of Islamic bank are longer than conventional banks. Islamic bank branches are limited but nowadays they started the expansion. So that's why they generate less profit as compared to the conventional bank during 2009-2011. Liquidity ratio of Islamic banks is better; its means that the liquidity process is quick and good. The conventional bank generated more profit during 2009-2011 due to high ROA, ROE and EPS result. The solvency ratio of conventional banks is better than Islamic banks because the debt to equity and debt to asset were lower in 2009-2011. The chance of leverage of conventional banks is low. The development of the new business of Islamic banks is quicker than conventional banks. Overall result shows that the Islamic banks of Pakistan are good in liquidity ratio and generate good profit in short period of time. The peoples of Pakistan are motivated towards Islamic banks as compared to conventional banks, because they offer that products and services which were declared by Islam "Halal" mean interest-free. These findings of this research supported the previous researches on the comparative analysis of conventional & Islamic banks (Erol, Baklaci, Aydog and Tune, 2014) conducted in Turkey.

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