

Efficiency and Performance of Islamic and Conventional banks in Pakistan

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Abstract

The main object/motif of this research is to find the efficacy and achievement of Islamic banking in comparison of the government and private phrases of the customary banking in Pakistan. This study is based on the data taken from banking sectors of Karachi stock exchange, Official web sites of the bank and Google. In banking Sector three Islamic banks, 3 government banks and 3 private banks have been selected. Here, the statement of the financial-year 2008-2012 year are being used and we are to derive the sequences of the efficiency and achievement of interest - free banking. This research drive that there are no clear differences between interest-free and interest-based banking in view of profitability. The result of this research will portrait the real picture of Islamic banking and it will be a good guide line for the policy makers. The derivations of this research may also be very helpful for the Islamic banks to enable them in developing their performance. This research will pave the way of the decision maker understand the efficiency and performance of Islamic banks. Profitability, Liquidity, Risk and credit Risks are the ratio to gauge the efficiency and performance, the financial statement of the cited banks is the ground on which these ratios are utilized.

I. INTRODUCTION

In the Past, the people having some saving were in the problem of keeping their deposit saved with some trusting personalities. Their purpose was just to save their money and not to earn Profit (Foerstl, Reuter, Hartmann, & Blome, 2010). It was the earliest concept of money depositing banks of present times. In the same way some rich and considerate People invested their money in the trading of honest and skillful traders to enhance the trade and get profit. In that times the nature of business was to buy things from there where these were in abundance and to sell there where these were in shortage after wards the profit gained was handed over to the financiers are investors besides traveling changes. It was an early way of investing that has become the soul of advanced financing. In Islamic finance literature, this type of Investing is known as this type of investing is known as “Modarba Transaction” (Zainol, Rosman, & Wahab, 2018).

By viewing these historical grounds and financial crisis of customary banking; Islamic banking department was instituted in Pakistan on 15-09-2003. This department was given with task to permute and develops the Islamic banking system as a collateral and congenial banking scheme till the end of year 2012 the assets of Islamic banking industry had reached to 7.6 trillion rupees which was the 10% of the total assets of the national banking sector (Salman, Nawaz, Bukhari, & Baker, 2018).

In comparison to the previous year, in 2012 the assets of Islamic banking in Pakistan grow up by 35% as the statement of stat bank of Pakistan. As to a close survey the deposits of Islamic banking have grown up by 30% within the previous 5 years. The investment of Islamic banks in different fields also touched the increasing rate of 14% in 2012. Just a couple of the years ago, the total assets of Islamic banks were 5% in the banking sector but now it has been double within 2 years (Anwar & Jadoon, 2018).

In the global financing business, Islamic banking in one of the most arising fields with prodigious dormant and rising with a notable swift pace around the globe. By the time being, this type of banking has been being more and more famous banking system in Pakistan, By dint of its interest free transaction. Owing to the increasing investments in Islamic banking is exalting in banking sector. At the time, 6 authorized Islamic banks and 12 customary have been established in our country. As to the survey of the year 2012, 1076 branches of Islamic banks, are covering the five provinces and AJ and K in Pakistan. The first authorized Islamic bank in Pakistan in Meezan bank authorized by SBP in 2002. It is the largest Islamic banks in Pakistan with 300 branches in 94 cities across the country.

II. LITERATURE REVIEW

This study examines the cost and efficacy level of 71 commercial banks in GCC countries from the dated of 1999-2007. This study also explains efficacy of conventional and Islamic banks to examine the efficacy of banks.

This study use Stochastic Frontier Analysis approach and Supply of Welcome Approach, also uses economic tackles and identify the purpose from the cost & profit purposes. The outcomes of commercial banks in GCC countries on Middling, are utmost cost and profit effectual than Islamic banks. (Srairi, 2010)

This study examine the cost, revenue and profit efficacies of 43 Islamic and 37 conventional banks in 21 countries in Africa, Asia and Middle East with the use of ratio examination from the dated of 1999-2005. These findings are on the base of Facts Envelopment Analysis (DEA) and Stochastic Frontier Analysis. Islamic banking efficiency has been study to find out the viability of this 'NEW' banking system compare to conventional banking. The result show that the income and profit efficiency for ancient banks are the lower than the new banks. (Mohammed Khaled I. Bader, 2007)

This study related to bank specific variables foreign ownership and economic factors on Islamic and conventional banks in GCC countries in which use cross sectional time series and sampling for the data of time period 2002-2009. The sample contains 38 conventional and 13 Islamic banks. Banks age and development has no effect on bank performance. Foreign ownership doesn't improve Islamic and conventional banks performance. GDP is positively correlated bank profit ability and inflation is negative. (Zeitun, 2012)

The study is about background history of Islamic banks in GCC countries. Rules and principles of Islamic banks are also discussed in this study. In methodology, sampling technique, regression and correlation are used with the model and descriptive statistics on the variables. This study explains the background of profitability of Islamic banks operating in GCC countries and the assessment of conventional banks. (Alkassim, 2005)

This study is about productivity growth in GCC countries on banking sector during the period of 1999-2007. Methodology which use to investigate the productivity change in banking industry of GCC countries are non-parametric Frontier approach, Malmquist index to find out the measure of change in total factor of productivity from year to year. The results show that banks have a positive impact on growth for all models where as capitalization is negatively to the efficiency model of Islamic banks only. (Samir Abderrazek Srairi, 2009)

This study is based on the fastest growing of Islamic banks in Pakistan, while the declining situation of conventional banks in the country. That study compares the concert of Islamic and conventional banking, comparison of earning, asset excellence shares, debit managing ratios, liquidness ratios and solvency ratios. Islamic banks outperform conventional banks in assets, credits, funding, savings, efficacy, and excellence of facility and recapture of loans. In Pakistan Islamic banking have a bright future. (Awan, 2009)

This study related to efficacy and concert of Islamic banks relate to conventional banks in civic and private part. It provides the understanding of the performance of efficiency of Islamic banking to judgment creators. Financial ratios are usage below productivity, liquidness and danger& credit risk to measure the efficacy of concert. Financial statements are used for the year 2006-2010 for analysis. The finding of the education driver produce the exact image of the Islamic banking which obliging for the strategy creators.(Dr. Waheed Akhter, 2011)

This Study related to the financial concert of Islamic and conventional banks. This education moreover argued the savers, bank managers and shareholder, investor and regulators positions of Islamic and conventional banks in Pakistan. Financial statements are use for the period of 2006-2009. Finance ratios are applied to measure the performance. Sampling t-test and ANOVA is use to define the meaning of main difference of these ratios among banks. This education decided that Islamic banks shown to be extra liquefied minus risky & operationally effective than conventional banks. (Ansari, 2012)

This education assesses the efficacy equal of banking part in Pakistan. The education contains 16 conventional and 6 Islamic banks for the time period of 2006-2010. Frontier non-parametric technique of Data envelopment analysis (DEA) is used to measure the efficacy show. The results shows that the banking sector was not perform efficient in this sampling period. Islamic banks performed well rather than the conventional banking in Pakistan. (Adeel Tariq, June 18, 2012)

This study related to the efficiency of banking system in Pakistan. In this study ratio analysis found the cost, revenues and profits and Facts and figure envelopment examination for comparison of the Islamic and conventional banks. The results show that the Islamic banks are most cost efficient and less revenue efficient. Islamic banking should reduce their wastes. In Pakistan banking industry, hybrid banking may not be feasible. (Muhammad Azeem Qureshi, April 1, 2012)

This study included the efficiency of Islamic banks during the crisis period from 2006-2009. The question arises in the study that Islamic banks were efficient and stable in the crisis period? To measure the efficiency of banks, non-parametric technique, Data envelopment analysis and t-test use to check the hypothesis. The results shows that Islamic banks operate in Middle Eastern and non-Middle Eastern counties have increased during an economic crisis. (Said, 2012)

This study dealings and matches the income, cost and profit efficacy of 43Islamic and 37 conventional banks after the dated 1990-2005 in 21 countries. The methodology uses in this study, Data Envelopment Analysis (DEA). It evaluates the average efficacy of Islamic and conventional banks base on their scope, age, and area with the by static and dynamic boards. The results show that there are no major variances among the

efficacy results of conventional versus Islamic banks.(MOHAMAD, 2, January 2008)

This education examines the cost and profit efficiency of the Islamic banks and Islamic spaces processes of domestic and foreign banks in Malaysia after the dated from 2002 to 2008. The methodology using in the study is non-parametric frontier method, Data Envelopment Analysis (DEA). The effects display that Islamic banking workers are comparatively extra effective than Islamic gaps jumps in relations of the cost and profit efficiency. Islamic banking operatives in Malaysia are more effective at creating profits relatively than adjusting their costs.(Nai-Chiek Aik, 1, July 2012)

This study related to the efficiency of Islamic Banking System in Pakistan. The most influential and rapidly growing sector of the world is financial sector. Now a day Islamic banks fast introduce in the market with concept of saving, investment and other experiences for the benefit of human beings. Stochastic frontier approach (SFA), DEAP (data envelopment analysis program) and ANOVA are used to measure the efficiency level. The outcomes display that the efficacy of Islamic banks is higher than conventional banks in Pakistan.(Naveed Azeem Khattak, 2010)

This education covers the financial module which gives to the production growing of a country. Financial area is the wildest rising area afterward the globalization period. The advances in commercial banking method makes a variation in performances of people has been pragmatic in this education. People improved their saving activities and invest decisions. This learning has been conduct to evaluate the methodological and cost efficacy of the Islamic and conventional banking structure in the Pakistan financial marketplace. Data Cover Study programmer has been used for detected this education. This education has also applied Study of Alteration (ANOVA) to test the existence or non-existence of valueless hypothesis as there is meaning variance among Cost efficiency of dissimilar conventional banks. The conclusion stated that this type of banking method influences the efficiency of the banking system.(Ellahi, 2012)

III.METHODOLOGY

Data source and sample

This study is based on the data taken from banking sectors of Karachi stock exchange, Official web sites of the bank and Google. In banking Sector three Islamic banks, 3 government banks and 3 private banks are used. These sources provide information of the annual financial statements of listed banks in Pakistan (Karachi stock exchange) for the period of five prior years (2008-2012).

Performance Measures

In this study inside issues are used in which controls imply via executives. The financial reports after the dated 2008-2012 are used for that study. This study Contains 09 ratios to examine the interest able and interest created banks. After the financial methods which wanted to categories as given below.

Measure of Profitability:

Profit on Assets (ROA)= Net Profit / Assets

Earning on Equity (ROE) = Net Profit / Equity.

Cost income Ratio (COSR)= Total cost / Total income

Performance of Liquidity:

Net Loans to Asset Ratio (NLAR)= Net loans / Asset Ratio

Liquid Assets to Customer Deposits and Short Term Funds Ratio (LaCDSF)= Liquid Asset / Customer deposit and short term funds

Net Loans to Deposits and Borrowing (NiTDB)= Net Loan / Total Borrowing and Deposits

Performance of Credit Risk:

Equity to Total Assets (CeTA)= Common Equity / Assets

Total Equity to Net Loan (TeNL) = Total Equity / Net Loan

Impaired Loans to Gross Loans (ImGL) = Impaired Loan / Gross Loan

IV.DATA ANALYSIS

In this analysis, data is evaluated by applying the ratio analysis to recognize the comparison of three:

Measure of Profitability

Performance of Liquidity

Performance of Credit Risk

The measurements of ratios given on the technique/methodology section and results are also shown under the heading of tables. Data uses from the financial statement from the time period of 2008-2012

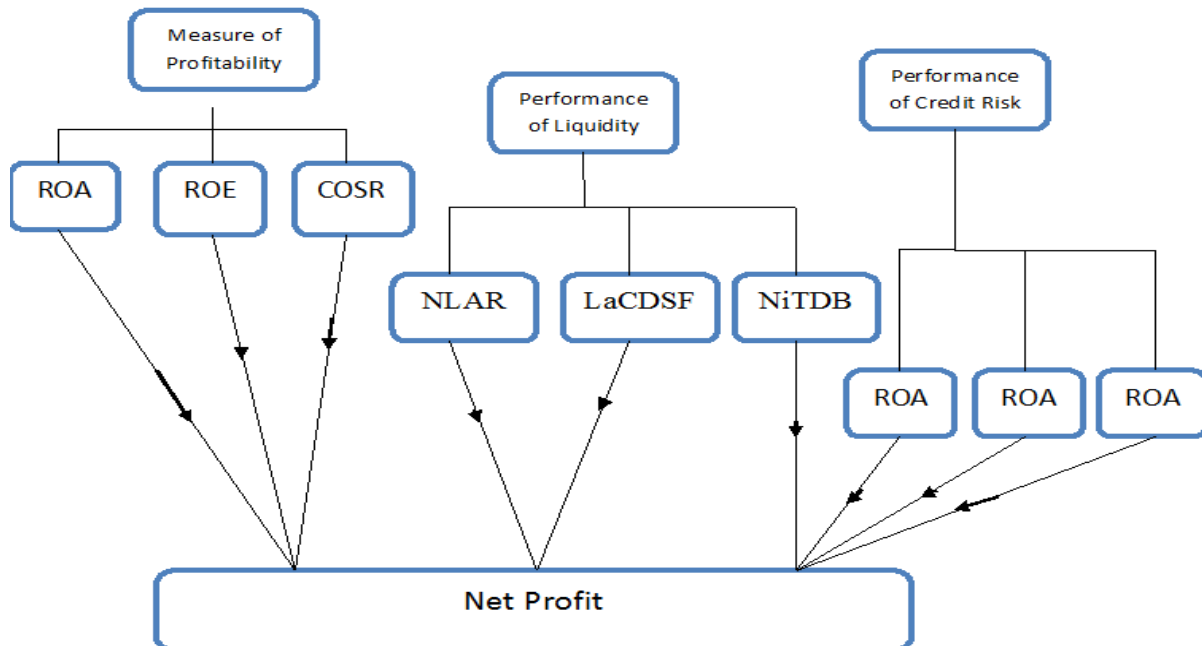


Fig.1 Flow Chart

These ratios are used to explain the financial measures. The Islamic and Conventional (government and private) bank are comes by the equal level of this technique in scopes of banks. The below set tables clarify the concert to Islamic and Conventional (government and private) banks through according to dissimilar ratios.

Table .1 Performance of Islamic Banks

	Meezan Bank	Al-Baraka Bank	Dubai Islamic Bank
Profitability			
ROA	0.01	0.01	0.01
ROE	0.22	0.06	0.11
COSR	1.25	2.05	0.36
Liquidity			
NetLTA	0.38	0.50	0.35
LaCDSF	0.25	0.38	0.14
NetLD&B	0.45	2.63	0.44
Credit Risk			
EQTA	0.07	0.42	0.13
EQL	0.19	1.35	0.40
IMLGL	0.95	0.44	0.55

The financial methods of profitability (ROA, ROE, and COSR) create in these stands that exactly how much the variation is in Islamic Banks and Conventional (government and private) Banks. The ratios of Islamic and private bank display that profits on assets of some Islamic Bank is upper than the private and government bank but on the other side also reduced than the specific private and government bank which specifies that the assets of performance banks well must be located in a efficient behaviors toward grow profit on assets. The ROE of the Islamic banks, government and private Banks here the concert of the Islamic Banks is not extraordinary. The concert of the national bank exposes the brilliant performance in the ROE ratio. The cost to income ratio of private and government banks shows the results in favor of Islamic banks from private and government banks.

Table.2 Performance of Government Commercial Banks

	National Bank of Pakistan	The Bank of Khyber	The Bank of Punjab
Profitability			
ROA	0.01	0.04	0.05
ROE	0.13	0.08	1.99
COSR	1.14	0.29	0.32
Liquidity			
NetLTA	0.39	0.34	0.41
LaCDSF	0.22	0.14	0.07
NetLD&B	0.62	0.48	0.48
Credit Risk			
EQTA	0.10	0.16	0.03
EQL	0.15	0.46	0.11
IMLGL	4.13	0.86	0.52

Completely the processes of liquidness display that concert of the Islamic bank are individual superior in example of net loans to deposit and borrowings. Although net loans to assets ratio display that the concert of government, Islamic and private banks are equal. The LdADSF clear the private banks are well-organized about the obtain ability to meet quick extractions. We examine that liquidness efficacy of the Islamic bank is stouter as compare to conventional banks.

Table.3 Performance of Private Commercial Banks

	Muslim Commercial Bank	Bank Al-Habib	United Bank Limited
Profitability			
ROA	0.06	0.01	0.02
ROE	0.42	0.22	0.17
COSR	0.39	1.27	1.52
Liquidity			
NetLTA	0.44	0.33	0.50
LaCDSF	0.33	0.10	0.17
NetLD&B	1.43	0.51	0.63
Credit Risk			
EQTA	0.14	0.05	0.13
EQL	0.33	0.14	0.75
IMLGL	0.93	0.97	0.75

The credit concert shows that in equity to asset ratio Islamic banks performance higher from the government and private banks. In equity to net loan ratio shown of Islamic banks is higher and conventional banks performance noteworthy. Though whole reduced loans to Gross Loan Ratio of Islamic banks is lesser after conventional banks which direct that concert of Islamic banks is improved value than conventional banks.

V.CONCLUSION

This study achieves the efficacy of conventional and Islamic banks in Pakistan. The dissimilar financial ratios used to make the assessment. The ratio we measure the methods of profitability shows the Islamic banks profit on assets and income produced each rupee is in among the both (Islamic and conventional) categories of banks. Although in situation of profit on equity is lower than the commercial banks. With respect to liquidity performance the concert of Islamic banks on behalf of Net loans to total asset ratio (NetLTA) is compulsory thoughtful kindness of the managers. The Liquid assets to deposit and small period reserve ratio are in middle of the commercial banks. The Net loans to payment and borrowing ratio are in positives intuition of the Islamic bank. The Equity to Asset Ratio (EQTA) and Equity to net loan ratio (EQL) of Islamic Bank are improved than the commercial banks. Though, the whole compromised loans to Gross Loan Ratio (IMLGL) are weaker of the Islamic bank. While in earnings reports of the Islamic Bank has not the positive as evaluate to conventional banks.

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