

How to cite this article:

Ali, H. (2020). The efficiency of Islamic and conventional banking system in Pakistan. *Malaysian Management Journal*, Vol. 24(July), 19-30. <https://doi.org/10.32890/mmj.24.2020.5585>

THE EFFICIENCY OF ISLAMIC AND CONVENTIONAL BANKING SYSTEM IN PAKISTAN

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Abstract

In Pakistan, the conventional banks start their functions after the independence of Pakistan and followed by the introduction of the Islamic banking's. In this study, four Conventional and four Islamic banks were selected. The different types of ratios will be used to check the performance of banking sector these ratios are profitability, liquidity, investment and solvency ratios. The different types of ratios were used to check the performance of banking sector and to evaluate the trends of Islamic and commercial banks. The objectives of our study were to evaluate the trend of performance of conventional and Islamic banks and analyses the key performance indicators of the banking systems. The SPSS version 20 was used and the t-test was applied to the data. The findings revealed that the conventional banks were more efficient than the Islamic banks.

Keywords: *Conventional banks, Islamic banks.*

Received: 18/3/2020

Revised: 1/7/2020

Accepted: 4/7/2020

Published: 30/8/2020

Introduction

In late 20th century, Islamic ideology was at its peak in Muslim societies for suggesting modifications and developments to existing social systems. Muslim scholars faced the arena's ruling monetary, social structures and

discussed their weaknesses. In many developed countries, capitalism was scrutinized and condemned due to its measure and general acceptability. Capital is a production factor in capitalism, and hence earns the fixed incentive in the form of interest. Consequently, the main basis of sales and price of budget to standard banks is charging interest through loan and accepting deposits for interests, respectively. Interest is the principle driver of operations of conventional banks (CB). In previous studies which includes funds transfers, ensures, facilitation in worldwide alternate, safety of wealth and so forth) also are provided for incentive and shape substantial part of earnings of CB. Since CB are set up under the capitalism principles and does business with interest (which is prohibited in Islam), therefore Muslims establish Islamic banks (IB) as per Islamic ideologies. The purpose was to enhance growth and popularity of Islamic banking. Islamic finance has exposed marvelous expansion in last two decades.

The most of the time, the banking sector has become important for the development and expansion of societies and economy 'a jointly shared goal of humanity'. "The Riba of Jahiliyya is a loan set for fixed period with a fixed increase on the principal payable by the loan". Charge of interest on loans had never got support in moral principles. Interest charging is prohibited by all exposed religions with Islam. Muslims must avoid charging interest and seek the pleasure of Allah (SWT).

The perseverance of both banking system (CB and IB) creates competition among the banks. The research is aimed to assess and investigate the performances of IB and CB. In Pakistan, conventional banking has a lot of experience. It possesses a long history and dominating place in financial sector. In contrast, IB has more money assets of Pakistan. Islamic banking is equally profitable as the conventional banking of Pakistan. This research analyses and investigates the image of banks in terms of key performed of both IB and CB in Pakistan.

The gap in the literature by examining to which preceding studies have failed to provide satisfactory answers. Many researchers have already discussed the similarities and difference between conventional and Islamic banking. But there is still need to identify the most influencing parameters which can affect conventional and Islamic banking system. These parameters should be addressed in such a way First, to understand the overall efficiency of both modes of banking in Pakistan (IB and CB). The research will also analyze how they are performing their integral part in the country. Second, what are the basic reasons for any differences in efficiency between the conventional and Islamic banking system?

The objective of our research, to evaluate the efficiency of IB and CB, and to analyze the key performance indicators in both the banking systems. This study will help to understand the overall efficiency of both modes of banking in Pakistan (IB and CB). Conventional banking holds pages in history in Pakistan whereas fully fledged Islamic banking started merely a few years back. The research will also analyze how they are performing their integral part in the country.

A lot of research is been done for promoting Islamic and conventional banking system in Muslim world. However, this work have identify key parameters with emphasis on the practical implications in Pakistan. Is this research, to use the secondary data is collected through financial reports and to find the Profitability, Liquidity and Solvency Ratio to measure the efficiency of both banks. This paper is categorized in 5 sections this is the 1, 2 section is brief literature review and the 3 section is methodology of this research. The 4 section is based on results and discussion, and the last 5 section is conclusion.

Literature Review

The muslim scholars confronted the world's ruling economic and social systems and pointed out their weaknesses (Hanif, 2011). Because most of the people like or dislike of conventional banking system. In previous study, IB is the based on profit and loss sharing principle (Aggarwal & Yousef, 2014). Financial markets endure incompetent, the banks is mostly competition with the CB about the borrowers (Moore, 2014). Islamic banking is less profitability as compared to conventional banking (Ariss, 2010). In Malaysia, IB follow the profit and loss sharing principles, but closely attached to the CB (Chong & Liu, 2008).

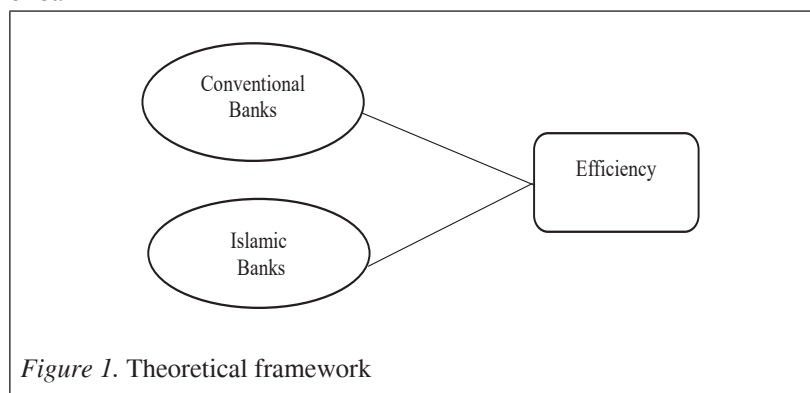
The using of Data Envelopment Analysis (DEA), the performance of Islamic and traditional banks prior to, throughout and straight away after the latest economic crisis (Johnes, Izzeldin, & Pappas, 2012). The IB is more benefits than CB, it will be the challenges for IB have less possible outputs for the given input levels (Abdul-Majid, Saal, & Battisti, 2010). The competence of IB is measured by using data envelopment analysis by adopting the intermediation approach that IB are sustain procedures through the disaster and majority of these IB were scale incompetent (Rosman, Wahab, & Zainol, 2013).

The IB follow the same circumstances of the CB but some operations are different under the Islamic laws (Olson & Zoubi, 2008). The IB is better competent than CB during the disasters in term of capitalization (Beck,

Kunt, & Merrouche, 2012). In Malaysia, Indonesia and Pakistan, there is vast request for IB, the IB communication styles is more efficient, in the point of Islamic laws (Haniffa & Hudaib, 2007). The CB is more efficient than IB in term of cost and profit level (Srairi, 2009). IB is to explore additional investment opportunity and for CB is to uphold more financial stability (Mobarek & Kalonov, 2014).

In Indian, the IB is based on Islamic laws (Shariah based system), to be establish in last so many years. In Indonesia, the theory and data of Islamic accountancy and the worldwide system of Islamic monetary causes and the reflexivity of accounting practice (Maurer, 2002).

The years of 2005 – 2009 is the data of 70 banks, the banks of Taiwanese overall the larger cost of production, but the Chinese banks operation is the lower cost competence (Huang & Fu, 2012). The foreign banks is the higher profitability of best performance the tradition of law then the high credit strength with the smaller sized of banks (Barros, Ferreira & Williams, 2007). The monetary institutions of the banks, the central place of the monetary system they have perform therefore the comparative accounts of monetary potential (Mandic, Delibasic, Knezevic & Benkovic, 2014). The valuation of performance of the bank which employs artificial intelligence technique as well as the operational research. The multi values decisions that it has been in used in many recent years, in the studies of failure forecast of the bank and the valuation of the solvency of the bank and the shortfall (Fethi & Jackson, 2009). The main cause of banks profit is the competence and competition seems to be significantly indicative of stronger local development, now the vital policy target that appears is the conservancy of a fair regional outreach of bank.



H₁: There is a significant between IB and its efficiency.

H₂: There is a significant between CB and its efficiency.

Methodology

It is a comparative analysis research study regarding the CB and IB in Pakistan. The almost 35 banks are working in Pakistan. Some banks perform the function of CB as well as IB. Total 30 CB are existed in Pakistan and perform their activities. On the other hand total 5 IB are performing their activities in Pakistan. For the present research, the random sampling technique is used, four CB; Habib Bank Limited (HBL), Muslim Commercial Bank Limited (MCB), Askari Bank Limited (ABL) and Faysal Bank Limited (FBL)] and four IB; [(Meezan Bank Limited (MBL), Dubai Islamic Bank Limited (DIBL), Bank Islamic Limited (BIL) and Al-Baraka Bank Limited (ABBL)] have been taken as a sample. All data, used in this research, is taken from annual reports of respective banks websites, and the few financial data also collected from Bank Association of Pakistan websites, thus the used data is secondary data. The current and past financial data of the bank has been taken to analyze for the purpose of investigating their financial performances.

The collected data is analyzed by using different ratios of the recent seven years up to 2019. The analyses were done on MS Excel to analyses the efficiency of IB and CB. And to find out the different ratios Profitability ratios like return on assets (ROA), return on equity (ROE), gross profit margin (GPM), net profit margin (NPM) and operating profit margin (OPM). Liquidity ratios like deposit to asset (DTA), advances to deposit ratio (ADR) and cash to asset (CTA), Investment ratios like earning per share (EPS) and solvency ratios like debt to equity (D/E) and debt ratio (DR).

Results and Discussion

In Table 1 shows that the average of four banks, MBL, BIL, DIBL and ABBL. The ROA fluctuating in these years, in this table shows that the starting two years is decreasing trend with negative values, but in coming years the profit condition is better. The overall results of ROE is showing that its trend is growing in a slow manner which is shareholders who are seeing their investment in return effectively and efficiently so according to this data trend of ROE rate is generating profits of shareholder in a slow manner. The results if GPM as also moderate in nature it was increasing

Table 1

Ratio Analysis Result of Islamic Banks

Average of Islamic Banks											
Years	Profitability Ratio				Liquidity Ratios			Investment Ratio		Solvency Ratios	
	ROA	ROE	GPM	NPM	OPM	DTA	ADR	CTA	EPS	D/E	DR
2013	0.59	-2.03	176.86	-3.21	21.26	22.04	11.33	2.10	0.01	12.85	-283.76
2014	-0.82	-20.05	112.51	-43.21	62.35	22.57	12.13	1.96	-1.37	18.99	40.42
2015	2.25	-12.04	87.71	-42.50	78.48	23.62	12.04	2.29	-1.50	26.38	1232.03
2016	8.02	23.67	134.20	22.38	31.10	23.70	11.93	2.28	2.45	30.75	512.05
2017	5.89	7.23	110.20	6.73	10.09	23.55	11.00	1.93	1.55	36.41	225.62
2018	5.86	10.15	121.60	8.91	14.11	24.54	12.53	2.35	1.49	43.58	772.24
2019	5.97	20.34	135.56	18.15	27.54	24.30	13.29	1.93	2.74	46.85	1066.34

in some years and then is also decreasing in some year. The NPM also shows decreasing trend but in 2016 to onward it shows positive trend. The OPM has a moderate trend but has positive values which shows a relatively better efficiency. So the overall result of profitability shows a decreasing trend.

In liquidity ratio DTA, ADR and CTA ratios are calculated. If we see the DTA overall result shows a fluctuating trend. The result of ADR overall results shows that the little bit change in every year, is also a little fluctuating trend. The CTA result shows that the little bit change in every year, is also a little fluctuating trend. So the overall result of liquidity shows a decreasing trend with a flatter slope, which shows a relatively better efficiency. The overall result of EPS shows a moderate trend and in two years the earning per share is negative, but in coming years it is increasing trend. In solvency ratio the D/E or DR ratios are calculated. The D/E overall result shows the moderate trend. The result of DR ratio also shows that it is rapidly change is increasing and decreasing trend, this trend is shows that the DR is not stable, it is very moderate trend.

In Table 2 shows that the average of four banks, MCBL, FBL, ABL and HBL. The ROA fluctuating in these years the upward and downward trend but ultimately have the upward trend but the 2017 it shows downward but in 2019 is rapidly increasing trend. The overall results of ROE is showing that its trend is growing in a slow manner which is shareholders who are seeing their investment in return effectively and efficiently so according to this data trend of ROE rate is generating profits of shareholder in a slow manner. The results if GPM as also moderate in nature it was increasing in some years and then is also decreasing in some year. The NPM also shows fluctuate year to year. The OPM has a decreasing trend with a flatter slope, in last year is rapidly increase but has positive values which shows a relatively better efficiency. So the overall result of profitability shows a decreasing trend.

In liquidity ratio DTA, ADR and CTA ratios are calculated. If we see the DTA overall result shows a fluctuating trend. The result of ADR overall results shows a moderate trend. The CTA result shows a moderate trend but in last year is rapidly decreasing trend. So the overall result of liquidity shows a decreasing trend with a flatter slope, which shows a relatively better efficiency. The overall result of EPS shows a moderate trend from because it is increasing in some years and is also decreasing in other years. In solvency ratio the D/E or DR ratios are calculated. The D/E overall result shows the moderate trend. The result of DR ratio also shows that it was increasing. So its shows an increasing trend with a flatter slope, which shows a relatively better efficiency.

Table 2

Ratio Analysis Result of Conventional Banks

Years	Average of Conventional Banks										
	Profitability Ratios				Liquidity Ratios			Investment Ratio		Solvency Ratios	
	ROA	ROE	GPM	NPM	OPM	DTA	ADR	CTA	EPS	D/E	DR
2013	5.30	52.42	130.11	59.72	87.18	253.96	252.97	25.86	36.72	37.20	89.13
2014	5.20	53.98	130.38	54.29	82.13	249.31	219.51	25.64	37.97	39.07	87.70
2015	5.23	52.17	136.79	56.69	86.85	256.41	197.34	25.63	43.66	40.51	78.53
2016	5.52	58.39	142.68	57.24	89.66	260.26	164.28	26.39	49.20	40.65	76.36
2017	4.59	51.42	125.14	54.91	83.74	252.77	150.35	26.14	48.67	42.41	98.97
2018	2.72	8.87	101.64	31.81	47.60	263.14	147.52	23.86	39.14	45.66	102.30
2019	5.36	68.01	157.79	71.38	107.22	260.24	141.06	17.83	58.41	45.14	87.58

In Table 3 displays the assessment results of the IB and CB by using the t-test. The total numbers of years is seven and the mean, standard deviation and the standard error mean of the both banks is given and it's compared. The profitability, liquidity and investment ratios of the mean, standard deviation and the standard error mean of the IB is less as compare to CB, this means that the CB is more efficient as compared to IB according to the given sampling. The solvency ratios of the mean, standard deviation and the standard error mean of the IB is more as compare to CB, this means that the CB is more efficient as compared to IB according to the given sampling.

Table 3

One Sample Statistics Results

	N	Mean	Std. Deviation	Std. Error Mean
Profitability Ratios (IB)	7	163.6929	44.26079	16.72901
Profitability Ratios (CB)	7	324.8743	65.57710	24.78581
Liquidity Ratios (IB)	7	37.6314	1.52499	0.57639
Liquidity Ratios (CB)	7	462.9257	41.12676	15.54445
Investment Ratios (IB)	7	0.7671	1.73878	0.65720
Investment Ratios (CB)	7	44.8243	7.79781	2.94730
Solvency Ratios (IB)	7	540.1071	560.73885	211.93936
Solvency Ratios (CB)	7	130.1714	11.34628	4.28849

Table 4, shows the assessment results of the both banking sectors, IB and CB using the t-test. The total numbers of years is seven. The profitability, liquidity and the solvency ratios of the both banking sector is significant. The investment ratio of the IB is insignificant that is 0.287 and the CB is significant. The mean difference of the overall is IB is not better as compare to CB, this means that the CB is more efficient as compared to IB. The result show that the H_1 : there is a significant between IB and its efficiency is rejected because the IB is not shows the better efficiency and the H_2 : there is a significant between CB and its efficiency is accepted because the CB is better competence.

Table 4

Financial Ratio and t-test Results

	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Profitability Ratios (IB)	9.785	6	0.000	**163.69286	122.7585	204.6273
Profitability Ratios (CB)	13.107	6	0.000	**324.87429	264.2256	385.5230
Liquidity Ratios (IB)	65.288	6	0.000	**37.63143	36.2211	39.0418
Liquidity Ratios (CB)	29.781	6	0.000	**462.92571	424.8898	500.9616
Investment Ratios (IB)	1.167	6	0.287	**0.76714	-.8410	2.3752
Investment Ratios (CB)	15.209	6	0.000	**44.82429	37.6125	52.0361
Solvency Ratios (IB)	2.548	6	0.044	**540.10714	21.5102	1058.7041
Solvency Ratios (CB)	30.354	6	0.000	**130.17143	119.6779	140.6650

Notes: ** denotes statistically significant at 5% level of significance.

Conclusion

The different types of ratios have been used to check the performance of banking sector these ratios are profitability, liquidity, investment and solvency ratios to evaluate the efficiency of IB and CB. The objective of the study is to evaluate the trend of performance of CB and IB and analyze the key performance indicators in both the banking system study proved that the result is different in CB and IB because both banks have their own historical backgrounds and own rules and regulations. The CB has long history in our county and wonderful learning experience from the method of monetary system. The CB and IB will work to satisfy the needs of the customers. The CB has make its efficiency increases in the way that its boost up the economy more than the IB, because the productivity in these areas it invests like business sectors, industrial sectors etc., with the lowest rate of interests, than the IB its makes the IB lowest rate of return than the CB. The CB is more efficient than the Islamic Banks.

Acknowledgement

This research received no specific grant from any funding agency.

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