

Efficiency and Performance of Islamic Banking: The Case of Pakistan

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ABSTRACT

The purpose of this study is to analyze to efficiency and performance of Islamic Bank as compare to two types of conventional banks i.e public and private sector banks in the case of Pakistan. The literature review shows that no such type of method has been used for Islamic Banking in Pakistan before this study. Therefore this study is being conducted first time in Pakistan. It will give clear understanding of the efficiency and performance of Islamic banking to decision makers. The nine financial ratios are used under (i) profitability (ii) Liquidity Risk and (iii) Credit Risk to measure the efficiency and performance. These ratios are applied on financial statements of these Islamic and conventional banks. The financial statements are used for the financial year 2006-2010. Trend analysis tool is also used to check the trends of balance sheet and income statement. The purpose of this study is to get results of efficiency and performance of interest free banking banking. The findings of this study will reflect the true picture of the Islamic Banking which will be helpful for policy makers. The study concludes that no significant difference is observed in interest free and interest based banking in respect of profitability. While this paper discovers the divergence in liquidity and credit performance. The trend analysis reveals the good trend of balance sheet of Islamic bank while in income statements there is no meaningful difference. The results of this study might be beneficial for the existing Islamic Bankers to enable them to enhance their performance.

Key Words: Performance, Ratios, Trend Analysis, Islamic Banks, Conventional Banks

Paper Type: Research Paper

INTRODUCTION

The interest free banking got start in beginning of 1970s on unpretentious level. It has reflected marvelous performance between last twenty five years. A lot of research work has been done during this era. It reflects that this interest free banking has noteworthy potential to do work as monetary intermediary. In recent times lot of interest based banks comprising foremost international banks has been shifted towards interest free banking. This is the sign of encouraging to the interest free banking. The interest free structure of Islamic banks has proven viable banking system throughout the last 30 years. The interest free banking arrangements face two different aspects. On the first side of the coin the whole monetary structure is operated under the light of Shariah principals. However on the other side of the coin the dual banking system is allowed. Before the details of regulations and performance of Islamic Banking it seems to necessary that clear all the pros and cons concerning the basic principles that regulate the whole economic set up in an Islamic way of life.

The basic difference between capitalist and Islamic economy is that the private ownership is given unbridled power to make economic decisions. The capitalists system of economy becomes the cause of wealth in the hands of few (Usmani, 2008). This system also interrupts the natural process of the supply and demand because these forces only able to do work in the situation of free competition. This capitalists system also creates gap between supply of money and real assets (Usmani, 2008). While on the other side of the picture the Islamic economy deals with the assets backed phenomena (Usmani, 2008).

In addition these financial institutions produce credit which provide services to the public and make the commerce and industry active. With creating chances for the investment and make secure savings, they try to develop the habit to save surplus money and do not appreciate the activities of unproductive wealth (Ahmed & Hassan, 2007).

The financial statements have been obtained of three types of banks from 2006 to 2010. The bank includes public and private sector which is purely involved in interest based banking system and third bank is Islamic Bank doing interest free banking. Nine ratios have been performed to measure the performance and efficiency of interest free banking. The technique of trend analysis has also been used to get the look of trends of these banks. It helps to identify that where these banks are moving forward and identify the important indicators. This trend analysis demonstrates that how effectively interest free banking may be respond to the new horizon. Literature review has been conducted to get the overview of already studies done in this regard. The tables and graphs are used to sum up the results for this paper. In profitability ratio the return on assets and cost to income ratio are better than the private sector bank and weaker than the public sector bank while return on equity is poor from both interest based banks. The liquidity ratio clears that Net Loans to Assets Ratio (NLAR) ratio is weaker from both interest based banks and Liquid Assets to Customer Deposits and Short Term Fund (LaCDSF) ratio is greater than the private bank and less than the public sector bank. Whereas the Net Loans to Total Deposits and Borrowings (NetLTDB) ratio shows that most assets of Islamic bank are not embedded into non-liquid assets that are why here the interest free bank out of the liquidity risk. The credit risk ratio clears that the equity to total asset ratio is favorable of Islamic bank over the both conventional banks. The equity to net loan ratio is stronger of the interest free bank rather

than interest based banks. The impaired loans to gross loans ratio is superior of Islamic bank as compare to private bank but inferior to the public sector bank. It is clear from the ratio analysis that the credit risk ratio has the high quality over both interest based banks among nine ratios. The trend analysis reveals that items of balance sheet of interest free banking has positive increasing trend since 2005 to 2010. However the trend of income statement shows up and down trend.

LITERATURE REVIEW

Though interest free banking disagrees with the interest based banking yet interest free banks have the similar credit risk as by the conventional banks. Therefore Basel II has suggested that the calculation of the minimum capital requirement should be the same as required by the conventional banks (Kahf, M. 2002). The Islamic Banking is different in nature from traditional banking. This article first discusses the Islamic financial operations then analyzes the Islamic procedure which has been introduced in Pakistan since 1985. This article revealed that islamization has moderate effect on this sector because the banks adopted the system that is closely resembles to traditional system. Another reason is that they are state owned (Stefflar & Cornilisse, 1995). The Islamic banking has not been applied the fully procedures as described by the pillar II of the new Basel Accord. The application of the said proposals does not create barriers for the Islamic banking and finance (Kahf, M. 2002).

It has been analyzed that conventional banking system is prevailed in all over the world but as the world is becoming global and innovations are required to survive in the global market. According to this phenomenon the conventional banks have introduced Islamic banking and some new Islamic banks have also been established in all over the world. Islamic banking is on the infant stage that's why this vehicle is facing some challenges and problems (Ahmad & Hassan, 2007).

Another study has been conducted in Bangladesh regarding regulations and performance Islamic banking. The most important findings of this research article is that there is lack of regulatory framework for its proper functioning according to Shariah. There is also lack of interbank money market which also affects the performance of the Islamic banking. The discrimination has also been observed regarding legal reserve requirements. The researcher suggested that in Bangladesh the independent banking act should be constituted to control, guide and supervise the operations and practices of the Islamic banking. So that the legal support to the stake holders may be provided (Ahmad & Hassan, 2007).

The study has also been conducted in the United Kingdom regarding problems, challenges and opportunities facing by the Islamic banking. The data was collected from the senior officials of the banks. The main problem faced in the United Kingdom that is heterogeneous and potential clients. Furthermore the lack of expert staff and competition from the conventional banks also faced in United Kingdom. It has been concluded that the e-banking can play pivotal role for the success of Islamic banking. There is need to sit together to the UK officials and Islamic banking representatives to discuss the challenges of the Islamic Banking (Karbhari, Naser & Shahin, 2004). There is need to recruit professional individuals who have the knowhow about the Islamic

banking. It is contended that the perceptions of senior. So that such problems may be resolved by using such strategy (Karbhari, Naser & Shahin, 2004).

Malaysia is the first country who played the vital roll in Islamic banking. It also introduced the dual banking as well as pure Islamic banking. In this article an innovation has been brought out that is hire purchase and also known as alijara wa iqtana (El-Din, S, Abdullah N.I, 2007). The Islamic banking is going very successful but there is still need to bring changes by the policy makers. To make strengthen the Islamic banking transactions there is need to develop strong legal framework. There is also needed to make strong both the operational regularity and substantive laws to resolve problems relating to Islamic banking (El-Din, S, Abdullah N.I, 2007).

The shariah should be analyzed to make new innovations instead to impose restrictions. There is need to explore the potential and wisdom of Shariah. There is immense need of cooperation is required to make collaboration among Shariah scholars, researchers, academicians and researchers to conduct the study in depth to make strong Islamic products(El-Din, S, Abdullah N.I, 2007). The government and other agencies should also make efforts for the new avenue of Islamic banking and hire purchase. The most important is that the government should remove the uncertainty regarding Islamic hire purchase (El-Din, S, Abdullah N.I, 2007).

Globalization has affected our life politically, economically and financially. There are both aspects in this globalization. The positive aspect is that there is the movement of human capital and new technology among countries. On the other side of the coin the government is unable to control the flow of capital. The oil prices flourished the investment in GCC countries and also encouraged the Islamic finance (Garas, N.S, 2007). There is no doubt that Islamic financial institutions having potential for growth but still there are certain challenges. There are two types of these challenges internal and external. Internal challenges include that the customers still rely on the conventional banking system and the numbers of the current IFIs are not enough to meet the requirements to international transactions. Furthermore the transaction system is still premature to attract new clients. There is also lack of unified regulatory system for the products and transactions (Garas, N.S, 2007).

On the external side there is a gap between the IFIs due to which the products are different in different countries. The IFIs should establish the effective communication system to reduce such gap and strengthen the process to enter in the international market. In such way the status of the IFIs will be increased and customers may be attracted from the non Muslim countries. In the end the IFIs should introduce the training mechanism to make expert their employees to attract the customers (Garas, N.S, 2007).

The global growth of Islamic banking is taking advantages of its uniqueness to meet the challenges of growth though the status of the Islamic banking is growing rapidly. But still the institutional arrangement is necessary to take part in the global economy. The Shariah compatibility should be judged by qualified Shariah scholar because for any medical problem the person will consult with the medical specialist to get best solution. That's why the solution of the problem in Shariah, it can be taken from the qualified Sharia scholar to get the exact decision (Khan, F.M 2007). By this way a good institutional structure may be developed. I believe it may

be the right time to start simply with an international association of shariah scholars for the finance industry (Khan, F.M 2007).

Another study has been conducted in Malaysia and Bahrain by analyzing the financial record of seven banks. The purpose of this article was to analyze the Islamic financial products viability to interest based contracts. It analyzes that Islamic banks pay Zakat and finance economic activities according to *Shari'ah*. However it concludes that there is need to make legal frame work so that the Islamic financial products may regulate in the Islamic financial market Samad, A. Gardner, D. & Cook, J.B.

Another article has been written in which the author determine the determinants of the Islamic Bank Profitability. This article demonstrates that all sources of funds are correlated with the profitability. It has also been observed that inflation and interest rate also affect the Islamic financial products. This study found that there was no significant variation in earning between Islamic banks in competitive and monopolistic market. However there was strong evidence that benefit of the investors has been observed in monopolistic market. The study demonstrated that banks performed well in competitive market then their counterpart. Therefore protectionism policy adopted by the Muslim governments is inappropriate and could distort future progress of Islamic Banking. In the end it has been recommended that establishment of more banks will make it more viable and efficient (Hameed, A. & Bashir, M).

The process of privatization of banks has not been connected with the Islamization. Islamic banks have brought no change regarding stability of the banks. The performance of the Islamic banks is not up to the mark. Then theoretical comparison has been given of Islamic banks and conventional banks. In the end of the article the author concludes that the effect of Islamization is greater but less effective (Stefflar & Cornilisse, 1990).

The Islamic banking is new discovered Islamic economics. Islamic banking is a system which really follow the Shariah rules and regulations and Islamic economic system also abide by the Shariah. In 1950 to 1960 a study was conducted in Egypt and Malaysia regarding interest free banking. But this study did not put any face value for Islamic banking. The first Islamic bank was established in 1994 in Dubai and international Islamic Banks was established in 1976 and now it has 53 member countries. Now a days Islamic bank has been established almost in all the countries around the globe. Some institutes have been established in America even small in numbers bit they are using Islamic financing (Kahf, M 2002). The purpose is to create strategic alliance between Ulama and Bankers. Further to develop Banking techniques by this Alliance (Kahf, M 2002).

Today Islamic banking is really in immense need of rethinking to compete in this rapidly growing world. There is also need to redefine the structure for success in future. The Islamic banking has really been appreciated by the conventional banking and it also finding ways to become main stream banking. The Islamic banks should enhance their efficiency to cope up new projects. Merger of the Islamic banks is compulsory for the survival in this era. There is need to increase the size, capital and should create ability to create assets (Kahf, M 2002).

Identify the determinants of the profitability are more important for the researches. In past decades the researchers has been found determinants for the profitability. But all previous study has been conducted for the conventional banks. The Islamic banks are still waiting for such kind of study. The Kahf has been conducted study about the determinants of profitability of Islamic banking. The researcher has been identified the internal and external determinants of the profitability of the Islamic Banking. The money supply also plays an important role for the profitability of the Islamic banks (Haron, 2004).

With the rapid growth the Islamic financial institutions especially banks, assessment of their performance have also flourished. The performance should be evaluated with reference to social responsibility and legal frame work (Zubair & Hassan 2007). This article tells us that Islamic banking is not out of fault. Some ratio analysis has been conducted two views the performance of the Islamic banks. Traditional banking has also been compared with the ratios of current Islamic banking (Zubair & Hassan 2007).

By using empirical data an empirical study has been conducted in 1990-1998 on Islamic Banking. The analysis in this article revealed that the growth of this banking is slow but it is not matter of worry because at the initial stage the growth of the institutions is seen slow and when the industry matures then it starts goes to up. This study revealed that there was no mobilization of funds because the Muslim community does not involve in interest based system. Consequently they keep their savings in personal lockers rather than in a bank (Iqbal, M. 2001). After that in coming days the Islamic financial institutions attracted these savings and deposit growth of these institutions increased. After that some conventional banks started to offer the Islamic products (Iqbal, M. 2001). In nineties the Islamic mutual funds were also developed and some deposits also converted to that side. The performance of the Islamic banks considered quite good and Islamic banks found good capitalize, stable and profitable (Iqbal, M. 2001).

The profitability ratio of these banks is considered reasonable according to international standard. But the current rates on assets of these banks do not considered good. However some variations have been observed in Islamic banks in terms of growth and performance (Iqbal, M. 2001). Another paper concludes that there is no any sort of difference in Islamic & conventional banks with respect to profitability and liquidity. However the study finds significant difference in credit performance (Abdus, S. 2004).

The conventional banking is existed in the whole world. But innovation is the core key to survive for the long run. Islamic banking has introduced by following this notion. Interest free banking is in the initial stage therefore facing some challenges. The regulatory frame work of interest free banking is poor and proper interbank money market is not available. The Basal II suggested that Islamic banking has the same risk like interest based banking therefore it is suggested that calculation of capital is required as desired by interest based banking. In this growing world there is need to rethink that how can efficiency of this banking be improved. The growth of this banking is bit slow but there is no need to get worry because growth is found slow at infancy stage. In this paper the attempt has been made that how the Islamic banking working in Pakistan.

Progress of Islamic Banking in Pakistan

Since the end of seventies, the cycle of Pakistan's monetary system is harmonized along with the global revival of interest free banking system. The country has achieved third position in the globe as a implementer of interest free banking system at national level. The procedure was initiated as on 29th September, 1977 after issuing the orders to local council of Islamic Ideology (CII) by the president. The directions were given to the council for the preparation of proposal to establish interest free economy in the country. In the compliance of president's orders, the report was submitted by the council in February 1980. The council demonstrated various ways to establish interest free financial system in Pakistan. The adequate information was also submitted by the council to develop such interest free financial system. The given information played a pivotal role to make Islamic banking system in the country.

The idea of interest free banking system was national and up to the mark. The plan was imposed in different phases due to its massiveness. This new system was implemented as on 1st July 1979. With the help of particular already established financial institutions i.e *National Investment Trust (NIT)*, *Investment Corporation of Pakistan (ICP)*, and *House Building Finance Corporation (HBFC)* in operations according to Islamic laws (Shariah). On *January 1, 1981*, to organize deposits on the basis of the sharing of profit and loss, operations were initiated by establishing interest free counters in all public banks and one overseas bank. Since that date, all banks were stop to accept deposits on the basis of interest. The already deposits of banks converted into interest free system. But overseas debts and deposits were allowed to deal in conventional interest based system. In the mean time the *Mudarba companies act 1984* was passed, which was breakthrough to establish financial institutions or other corporate groups under this act.

The resistance is always faced by the organization to implement the change. The implementation of change is difficult task. The extensive plan and strong dedication is required to implement the change. All parties have the core importance in this monetary structure in this modern era. Merely a rational plan with loyalty may lead to success. Unlikely the managers do not follow the right direction to move forward. Recently, there is no any sort of activity is being performed in public institutions which is known as Islamic transactions. The banks were worry on the initial stages to adopt new interest free system. It took initiated to develop policies to enter in the Islamic Financial System. A *circular No.13 dated June 1984* permitted financial institutions allow loans on the basis of markup on return basis. It was another type of interest. So, the already interest based system remained present. The interest free Islamic financial systems were not followed in many cases. The *Mudarba companies* could not able to maintain their presence; many were in troubles and moving towards other institutions. The current economic system is depending on interest based methods with or without buy back agreement.

On November 1991 the *Federal Shariat Court* announced that current system is not according to the principals of Islam. A request was made in the *Shariat Appellate Bench of the Supreme Court of Pakistan (superior court)*. The *Supreme court* rejected the appeal as on 23rd of December, 1999 and instructed regarding conventional rules cease to have effect finally by 30th of June, 2001. The *Supreme Court* gave its decision that currently interest based system would be shifted as soon as possible according to Islamic principles. The directions were given to public institutions to establish the mechanism within stipulated period of time alter the conventional

monetary structure to achieve the goals. The superior court indicated certain ways and techniques regarding the mechanism to establish the Islamic monetary system within the parameters of Islam. It was also directed by the court establish the commissions to develop Islamic financial system.

The *Commission for Transformation of Financial System (CTFS)* established under the supervision of the lender of the last resort of Pakistan (SBP). The commission presented two provisional reports in *October 2000 and May 2001* and subsequently submitted report in *August 2001* comprises on certain recommendations. Presently a team is doing work under *Ministry of Finance* to develop momentary system based on Islamic principles. One more team has established for the purpose of changes in official mechanism to follow the decision of superior court.

Current Position of Interest Free Financial System

The country is intended to adopt Islamic economy system in steady and partially way to avoid from further disturbance. Following are the snap shots taken from the affirmation presented by the *Deputy Governor of Pakistan (SBP)* in front of the higher Court of the country demonstrated the strategy to be followed in future.

“That having taken a series of steps to promote Islamic banking and considering all other practical problems associated with the complete transformation of the financial system, discussed herein, it is State Bank of Pakistan’s considered judgment that the parallel approach will be in the best interest of the country. This means that Islamic banking is introduced as a parallel system, of which beginning has already been made; it is provided a level playing field vis-à-vis the existing conventional banks, and its further growth and development is supported by Government and State Bank of Pakistan through appropriate actions. The approach will eliminate the risk of any major cost/damage to the economy, give a fair chance to Islamic banks to develop alongside the conventional banks, and will provide a choice to the people of Pakistan, and the foreigners doing businesses in/with Pakistan, to use either of the two systems”

In *December 2001* the lender of the last resort introduced a strong mechanism to build up interest free banking system. Under this mechanism developed interest free financial institutions ma be scheduled on the *Stock Exchange* by providing fifty percent of total stocks be announced for the public. The sponsor director would be share about 15% of the paid up capital. The interest free financial institutions are bound to uphold atleast capital adequacy ratio of 8% based on risk weighted assets. Meezan Bank Limited (MBL) got number one commercial banking system award in *January 2002*. After that the MBL established its network of 10 branches along with the balance of *US \$130 million*.

The central bank of Pakistan directed in *January 2003*, to establish additional and establish individually Islamic banks with the help of already established banks. Therefore already established interest based banks plus another country’s bank permitted to develop interest free banking branches. In *June, 2004* fifty percent banks have already taken initiated for prevalence of interest free based banks. The interest free based banks permitted to preserve the *liquidity requirement & cash reserve deposits*. To keep away from non Islamic financial system the

central bank of Pakistan to the utmost level of 40% of liquidity requirement and special cash reserve. It has also been observed that capital market is going well according to Islamic Principals. Recently many organizations have introduced *Term Finance Certificate (TFC)* to collect funds by following the Islamic rules of *Musharikhah*. The reward the Term Finance Certificate holder is given on the basis of profit & loss by the releasing institutions. That's why the holder of TFC will bear both profit and loss according the situation. It was allowed by the Security and Exchange commission of Pakistan in the September 2002 that the Mudarbah organizations to issue Term Finance Certificates on the basis of Musharkah.

In 2003, an important decision was made to establish *SME Mudarbah* alongwith the collaboration of twenty Murabah organizations to take on Small Medium Enterprises to start business in minor cities and far-away areas. Small Medium Enterprise (SME) has to solve the troubles of Murabah companies.

METHODOLOGY

In analyzing banks performance in Pakistan, ratio measures have been used. The method is not a new way to measure banks performance. O'Connor 1973 and Libby has adopted such way in the start of 1970. After that, many researchers used this technique such as *Shimerda & Chen 1981, Rose 1981, Splinder 1981, Sabi 1996, Semonson and Hampal 1998, Samad 1999 and Ahmed, Hassan (2007)*. This methodology shows various positive aspects. The key advantage shows, this method removes the disparities. The banking firms are not equal in size. This method removes disparities and brings all banking firms at par. The trend analysis is also used to view the trends of Income Statement and Balance Sheet from 2006-10. In this study three different types of banking firms are considered. In which one Islamic bank and tow commercial banks (Government and Private) are taken. The Financial Statements are obtained from the website of each banking firm. The Financial Statements are used for the financial years 2006-10 of all three banks.

Performance Measures

Internal factors are used in this study which can be handled easily by the managers. The financial statements are used for this study. In this study 09 ratios are used to analyze the interest free and interest based banks. Following are the financial measures which are needed to catarories as given below.

a) Measures of Profitability

Many monetary measures may be used to view the efficiency of the organization in form of profit. Following three ratios are used in this study to evaluate profitability performance of the banks. Following are the measures.

i. *Return on Assets (ROA)*= *Net Profit/Total Assets*

We can analyze the efficiency and effectiveness of management and bank. It clears that the managers are efficient in allocation assets for NP. Positive ROA shows the better efficiency of the financial instructions.

ii. *Return on Equity (ROE)*= *Net Profit/Equity*.

This ratio measures the rate of return on the bases of capital and equity capital.

iii. *Cost income Ratio (COSR)*= *Total cost/Total income*

This index is useful to measure the profit and economic efficiency. The week ratio reflects the better situation.

b) **Performance of Liquidity**

Liquidity means availability of cash that how bank rapidly may convert its assets into cash to meet the need of short term. It is considered that it is life of the banks. Higher amount of the liquid assets reflect the greater liquidity of the firm. Following liquidity measures are used to measure the liquidity efficiency.

i. *Net Loans to Asset Ratio (NLAR)*= *Net loans/Asset Ratio*

NLAR measures percentage of which is embedded in loans. Higher ratio shows the less liquid is the financial firm.

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

LaCDSF It is known as deposit run off measure. It clears the position of deposits and short term funds which meets the requirements of sudden withdrawals. Higher ratio shows the more liquid commercial bank less in danger the financial institution.

iii. *Net Loans to Deposits and Borrowing (NiTDB):* *Net Loans/Total Deposits and Borrowing*

NiTDB shows the measure about total deposits embedded into non-liquid assets. Higher NiTDB shows the more liquidity risk.

c) Performance of Credit Risk

Following three ratios are used to measure the credit risk performance of the banks.

- i. Common Equity to Total Assets (CeTA) = $\frac{\text{Common Equity}}{\text{Assets}}$

This ratio measure's the equity capital in form of percentage with regard to total assets. It shows the potential of protection of the banks against investment and assets. It also demonstrates capacity of shock absorbing for losses of potential loan assets. Higher ratio is favorable for the bank to maintain the assets losses.

- ii. Total Equity to Net Loans (TeNL) = $\frac{\text{Total Equity}}{\text{Net Loans}}$

It shows the equity capital as a percentage of total net loans. It clears the available cushion available to adjust the losses of loans.

- iii. Impaired Loans to Gross Loans (ImGL) = $\frac{\text{Impaired Loans}}{\text{Gross Loans}}$

It is more reliable method to check the quality of assets and loans of the bank. It calculate the ratio of gross loans which are bad debt in the portfolio of the commercial bank.

Empirical Results

Abundant ratios are used to express the financial measures. These measures have numerous advantages. The greatest advantage is that this method removes the disparities among banks created due to bank sizes with respect loans deposits and assets. The conventional and Islamic banks are come at the same level by this method in regard of bank sizes. The under given table clear the performance to Islamic and Conventional banks with respect to various ratios.

The financial measures of profitability (ROA, ROE, COSR) shows in table 1 shows that how much the difference is in Islamic Banks and Conventional Banks. The ratios of Islamic, national and private bank 2.10, 3.94 and 1.40 respectively shows that return on assets of Islamic Bank is higher than the private bank but poor than the national bank which indicates that the assets of the National Bank have been placed in a competent manners to get return on assets. The ROE 18.26, 317.81 and 86.31 of the Islamic bank, National and Private Bank respectively, here the performance of the Islamic Bank is not remarkable. In this ratio the performance of the national bank reveals the outstanding performance. The cost to income ratio i.e 48.26, 56.21 and 26.96 of Islamic and conventional shows the results in favor of private bank over the Islamic and conventional banks.

All measures of liquidity show that performance of the Islamic bank is only better in case of net loans to deposit and borrowings (Table 1). While net loans to assets ratio 85.51, 15.81 and 84.17 reveals that the performance of national bank is notable over the Islamic and private bank. The LdADSF clears that national bank is more efficient regarding the availability to meet sudden withdrawals. Net loan Deposit and Borrowing (LDBR) ratio is 61.86, 97.97 and 95.66 of Islamic,

national and private bank respectively. It is prominent that liquidity efficiency of the Islamic bank is stronger as compare to conventional banks.

With regard to credit performance, the study finds that equity to asset ratio 6.00, 1.15 and 1.44 of Islamic and conventional banks in that order of the Islamic bank is superior as compare to conventional banks. It shows the bank's capacity of shock absorbing against the losses of the potential loan assets. While equity to net loan ratio shown in table of Islamic bank is 12.69 and conventional banks national and private 7.51 and 1.41 respectively depict that performance of Islamic bank is noteworthy over conventional banks. However total impaired loans to Gross Loan Ratio of Islamic bank is 2.37 which is not lower from conventional banks which indicates that performance of Islamic bank is not in better quality than conventional banks.

Trend Analysis

The trend analysis of Islamic bank shows the gradually increasing trend from 2006 to 2010 regarding Assets, Liabilities, Share Capital and Reserves. Which clarifies that Islamic Banking is going to increase each year while trend analysis of the income statement of interest free banking reveals zig zag trend (Figure 1 and 2).

Trend analysis of the conventional bank shows no visible growth in 2006 and 2007 of balance sheet items whereas in growth started in 2007 and goes up to 2009 and then started decreasing and required serious attention of the management in 2010 (Figure 3 and 4).

The public sector bank demonstrates the better trend in balance sheet only Reserves have bit decreasing trend in 2010. On the other side of the picture the income statement shows dramatic decrease in 2009 which invites the concentration of the management (Figure 5 and 6)

CONCLUSION

This study concludes the efficiency of conventional and Islamic bank and other banks of Pakistan. The various financial ratios and Trend Analysis have been used to make the comparison. In ratio measures the profitability performance of Islamic banks regarding return on assets and income generated per dollar is in between the both types of conventional banks. While in case of return on equity is poor than the conventional banks. With regard to liquidity performance the performance of Islamic banks for Net loans to total asset ratio (NetLTA) is required serious attention of the management. While the Liquid assets to deposit and Short Term Fund Ratio is in center of the conventional banks. The Net loans to deposit and borrowing ratio is in favorable condition of the Islamic bank. On the other side of the coin the Equity to Asset Ratio (EQTA) and Equity to net loan ratio (EQL) of Islamic Bank is better than the conventional banks. However, the Total impaired loans to Gross Loan Ratio (IMLGL) are weaker of the Islamic bank. The Trend Analysis shows the gradually increasing trend over the both conventional banks. Whereas in income statements the Islamic Bank has not the favorable as compare to conventional banks.

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Table 1
Financial Performance of Islamic and Conventional
Banks (Average 2006-2010 Period)

Financial Measures	Islamic Bank	Conventional Banks	
		National Bank	Private Bank
A. Profitability			
1. ROA	2.10	3.94	1.40
2. ROE	18.26	317.81	86.71
3. COSR	48.26	56.21	26.96
B. Liquidity			
4. NetLTA	85.51	15.81	84.17
5. LaCDSF	17.27	21.92	15.86
6. NetLD&B	61.86	97.97	95.66
C. Credit			
7. EQTA	6.00	1.15	1.44
8. EQL	12.69	1.51	7.41
9. IMLGL	2.37	2.57	0.90

Appendix

Figure 1: Trend Analysis of Balance Sheet (Islamic Bank)

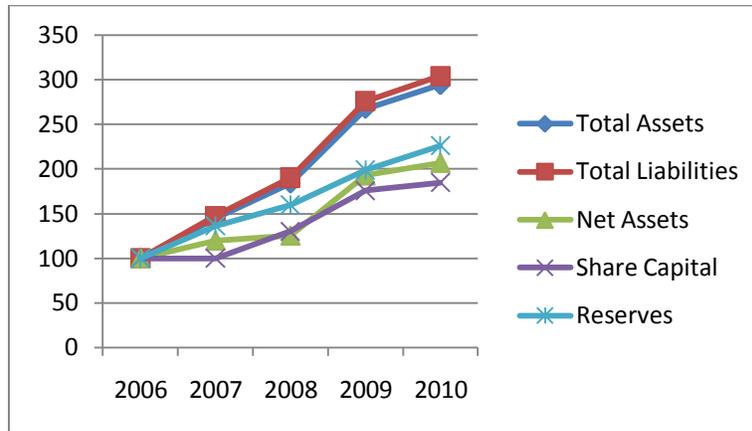


Figure 2: Trend Analysis of Income Statements (Islamic Bank)

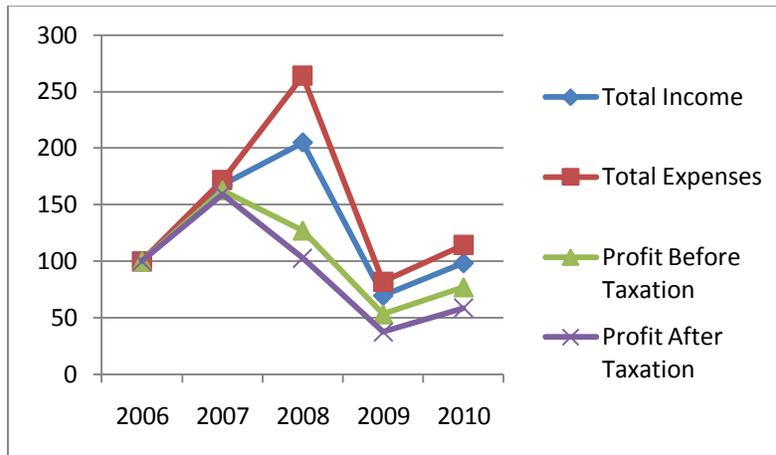


Figure 3: Trend Analysis of Balance Sheet (Private Conventional Bank)

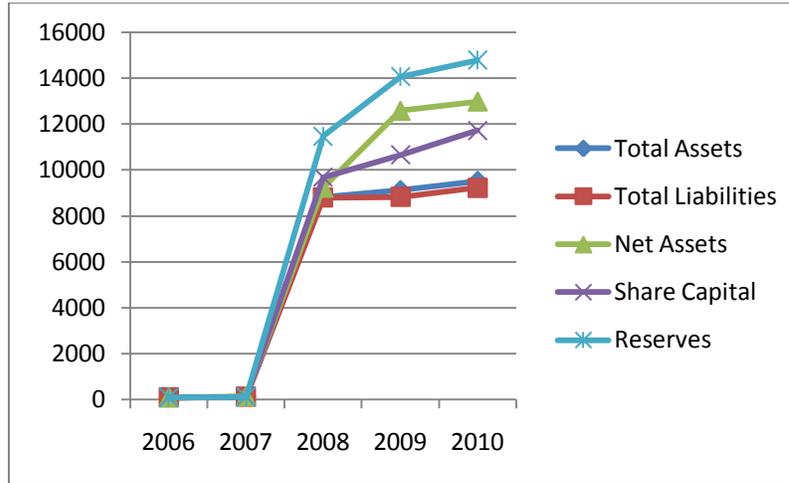


Figure 4: Trend Analysis of Income Statement (Conventional Bank)

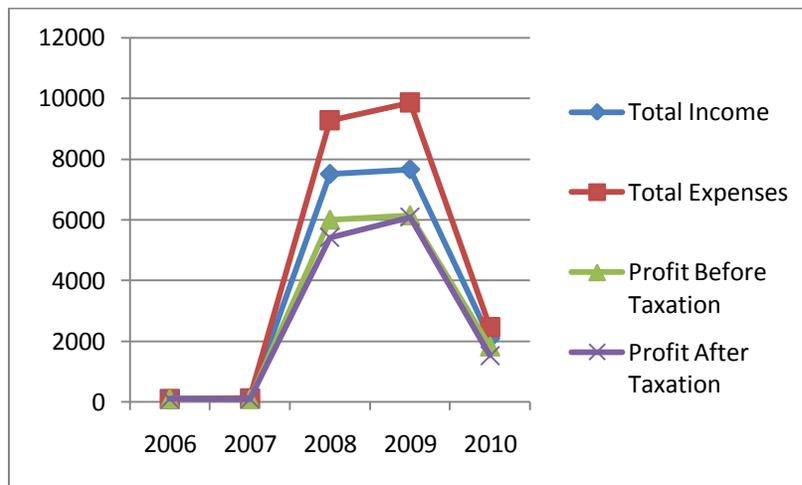


Figure 5: Trend Analysis of Balance Sheet (Public Conventional Bank)

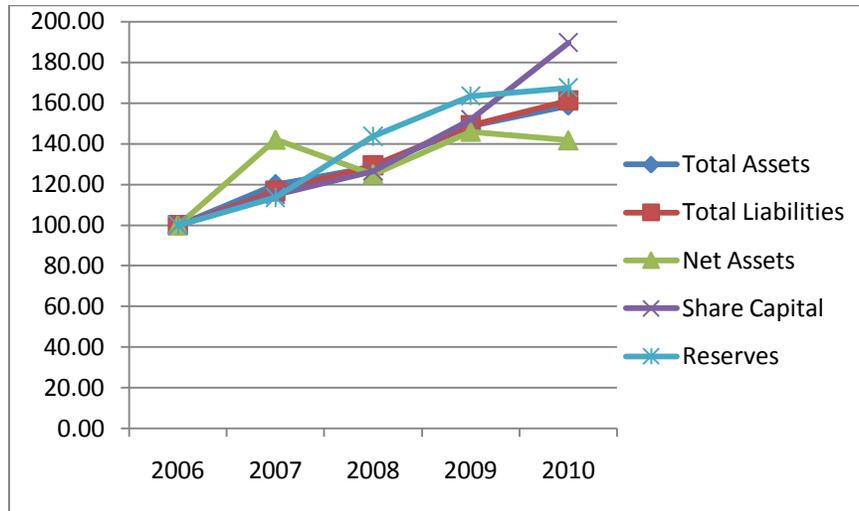


Figure 6: Trend Analysis of Income Statement (Public Conventional Bank)

