

CORPORATIVE PERFORMANCE OF ISLAMIC AND COMMERCIAL BANKS

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This note compares the financial performance of Islamic and conventional banks. In this regard, two Islamic banks “Meezan Bank Limited” and “Al Baraka Islamic Bank” and two conventional banks “KASB Bank” and “Bolan Bank” have been chosen for evaluation. Meezan Bank Limited has been compared with KASB Bank and Al Baraka Islamic Bank has been compared with Bolan Bank. we have selected banks of broadly similar size in terms of deposits. Banks selected for comparative analysis have roughly equivalent deposit levels.

The financial performance ratios have been calculated from the annual financial statements of these banks. Ratios of the period 2002-2004 have been calculated for evaluation. The statistical method of *t-test* has been used at 0.10 level of significance to identify significant difference. The null hypothesis is “The performance of Islamic Banks is superior to that of commercial banks”. The hypothesis has been rejected or accepted for each performance ratio separately.

The following performance ratios have been calculated for the evaluation:

PROFITABILITY RATIOS

Return on Equity
Return on Total Assets
Yield on Earning Assets
Cost of Funds
Profit Growth
Net Markup Margin
Earning per Share

BUSINESS DEVELOPMENT RATIOS

Total Assets Growth
Deposits Growth
Advances Growth
Investment Growth

EFFICIENCY & PRODUCTIVITY RATIO

Total Operating Expenses to Deposits

LIQUIDITY MANAGEMENT RATIOS

Cash to Deposit
Borrowing to Deposit
Advances to Deposit

Table 1-8 present our results

A. Meezan and KASB

Table 1 : PROFITABILITY

Performance Measure	Meezan		KASB		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Return on Equity	0.134975	0.022463	-0.01677	0.124322	2.08	Accept
Return on Total Assets	0.029227	0.018096	-0.00364	0.018101	2.22	Accept
Yield on Earning Assets	0.039207	0.01994	0.021317	0.012661	1.32	Reject
Cost of Funds	0.238417	0.373049	0.040682	0.01524	0.92	Reject
Profit Growth	-0.1486	0.091563	-0.47245	0.880431	0.63	Reject
Net Markup Margin	0.032029	0.008012	0.024218	0.009155	1.11	Reject
Earning Per Share	2.092623	0.242805	-0.26427	1.403524	2.87	Accept

Table 2 : BUSINESS DEVELOPMENT

Performance Measure	Meezan		KASB		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Total Assets Growth	1.254045	0.992627	0.593844	0.760162	1.27	Reject
Advances Growth	1.615621	1.289778	1.061465	1.736683	0.44	Reject
Deposits Growth	2.756928	3.649444	0.593793	0.807423	0.99	Reject
Investment Growth	1.711287	2.451347	0.390019	0.446681	0.92	Reject

Table 3 : EFFICIENCY & PRODUCTIVITY

Performance Measure	Meezan		KASB		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Total Operating Expenses to Deposits	0.049244	0.017896	0.075283	0.023318	-0.74	Reject

Table 4 : LIQUIDITY MANAGEMENT

Performance Measure	Meezan		KASB		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Cash to Deposit	0.151569	0.03382	0.139704	0.014393	0.56	Reject
Borrowing to Deposit	0.11256	0.103574	0.232409	0.100301	-1.52	Reject
Advances to Deposit	0.848382	0.13558	0.419054	0.287732	2.39	Accept

B. Al Baraka and Bolan**Table 5 : PROFITABILITY**

Performance Measure	Al-Baraka		Bolan		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Return on Equity	0.139079	0.200813	0.029743	0.029348	0.95	Reject
Return on Total Assets	0.013813	0.004724	0.003123	0.003199	3.24	Accept
Yield on Earning Assets	0.025435	0.002998	0.030502	0.008006	1.03	Reject
Cost of Funds	0.034348	0.02089	0.021037	0.014951	0.34	Reject
Profit Growth	0.015894	0.168156	4.65618	7.532676	0.014	Reject
Net Markup Margin	0.115521	0.19186	0.053669	0.028291	0.52	Reject
Earning Per Share	0.034199	0.586617	0.3216	0.310389	-0.76	Reject

Table 6 : BUSINESS DEVELOPMENT

Performance Measure	Al-Baraka		Bolan		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Total Assets Growth	0.197887	0.032955	0.169093	0.076036	0.58	Reject
Advances Growth	0.203272	0.030836	0.370443	0.357172	-0.80	Reject
Deposits Growth	0.255355	0.140807	0.178078	0.030118	0.41	Reject
Investment Growth	0.265115	0.392015	0.52148	0.554772	0.39	Reject

Table 7 : EFFICIENCY & PRODUCTIVITY

Performance Measure	Al-Baraka		Bolan		Statistica l Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Total Operating Expenses to Deposits	0.022928	0.000674	0.040994	0.006896	-4.51	Accept

Table 8 : LIQUIDITY MANAGEMENT

Performance Measure	Al-Baraka		Bolan		Statistical Test	Hypothesis
	2002-04		2002-04		t-value	
	Mean	SD	Mean	SD		
Cash to Deposit	0.250448	0.023675	0.154464	0.015625	5.999	Accept
Borrowing to Deposit	0.233858	0.036903	0.118449	0.066587	2.73	Reject
Advances to Deposit	0.895141	0.031904	0.434159	0.224701	3.52	Accept

MEEZAN BANK & KASB BANK

In case of *profitability*, the hypothesis has been accepted with respect to the ratios of Return on Equity, Return on Total Assets and Earning per Share but rejected for Yield on Earning Assets, Profit Growth, Cost of Funds and Net Markup Margin. Since cost of funds of Meezan Bank is higher as compared to KASB Bank, the net markup margin is lower and it is also affecting the profit growth which is also lower than KASB Bank.

In case of *business development*, the hypothesis has been rejected with respect to all the four ratios of Total Assets Growth, Advances Growth, Investment Growth and Deposits Growth. This situation indicates that the business of Meezan Bank is not developing as well as that of KASB Bank. This fact is reflected in profit growth.

In case of *efficiency & productivity*, the hypothesis has also been rejected. This means that Meezan Bank is less efficient than KASB Bank.

Table 4 shows that KASB's liquidity position is clearly superior to Meezan Bank. It has a significantly lower advances to deposit ratio and a lower borrowing to deposit ratio.

AL BARAKA BANK & BOLAN BANK

In case of *profitability*, only the ratio of Return on Total Assets has been accepted as superior for Al-Baraka. All the other ratios, Yield on Earning Assets, Profit Growth, Cost of Funds, Net Markup Margin and Return on Equity have been found to be insignificantly different. This situation shows that the profitability of Al Baraka Islamic Bank is not superior to KASB Bank due to less control on cost which is the major factor inhibiting al Baraka's performance.

In case of *business development*, the hypothesis has been rejected with respect to all the four ratios of Total Assets Growth, Advances Growth, Investment Growth and Deposits Growth. This situation indicates that Al Baraka Islamic Bank has a lower

level of assets and deposits growth as compared to Bolan Bank and this directly effects profitability.

Al Baraka's total operating expenses to deposits ratio is however significantly lower than that of Bolan Bank.

In case of *liquidity management*, the position is mixed. Al Baraka has a significantly higher cash ratio but also a significantly higher advances to deposit ratio. Its borrowing to deposit ratio is also higher than Bolan. Overall Al Baraka appears riskier than Bolan.

This comparison shows that the financial performance of Islamic banks is not superior to that of matched conventional banks. The experience in Egypt, Tunisia and Turkey has been that the profitability of Islamic Banks falls over the years and riskiness rises. They therefore rapidly loose market share in terms of both deposits and advances. Government support and subsidization is of vital importance for the survival of Islamic banks whose market share is in any case insignificant—less than 1.5 percent in terms of deposits in 2004.

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