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Comparative Perusal on the Financial Performance and Market Share Growth of Islamic and Conventional Banking- Pakistan's Perspective

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Abstract
The mien of Banks is reset into financial intermediaries, developers and promoters. Thus banks act like a trustee body for the borrowers and the lenders. The axial aim of this study is to find out the extant status of financial performance of Islamic & Conventional banking in Pakistan in order to guide the stakeholders- shareholders, depositors, investors, regulatory institutes & other related organizations. To exhibit the true picture of the financial conduct of both extrusive entities the data has been extracted in the form of different financial ratios from the annual reports and financial statements for the period 2007-2011. This research paper probes the force of thirteen critical financial ratios accompanied with the major financial concerns like profitability, liquidity, risk, capital adequacy, earning ability, deployment, operational efficiency and solvency. The statistical testing tool used in this study consists of 'co-efficient of variation' analysis with an aim to find out the critical importance of the mean difference of the selected financial ratios.
Keywords: Islamic banks, Conventional banks, Financial performance, Capital adequacy, Liquidity, Risk, Profitability, EPS, Market Share

Introduction

Background of the Paper

Islam is the complete and influential code of life, it covers all the aspects of human's life. It also provides quality teachings and principles regarding different modes of finance. This significant concept got full momentum in the era of 1970s when different intellectual scholars, financial intermediaries, influential investors, economists and Shari'ah scholars advocated forcefully to implement Islamic banking system. While Riba-free business proceedings & negotiations were in practice with many fallacies well defined working model for Islamic banking was demanded.

Islamic banking concept explains all the foremost banking concepts with comprehensive principles including the factor of profit and loss sharing. The core purpose of developing Islamic banking infrastructure was to provide interest (Riba) free financial transactions. The exclusion of interest (Riba) from the financial and economical ambiance has always been an important concern of Muslim Ummah. As ALLAH says in Quran:

"And (for) their taking of usury while forbidden from it and their consuming of the people wealth unjustly and we have prepared for the disbelievers among them a painful punishment". (Al-Quran: 4: 161)

In 1970s Pakistan also implemented interest free banking (Islamic banking) concept on a limited scale. The categorical work started in the interim of Zia-ul-Haq government, in 1980s that brought Islamization of financial system and economy deliberately begun under government policy. However, the era of 1990 to 2001 has witnessed the long healthy argumentative legal debates that took place under the supervision of SCP on the issue of 'Riba', finally the court decision against interest strongly compelled the government to take serious efforts in order to make Islamic banking as a real economical and financial contributor. In the meanwhile the government and other financial institutions that were in the favor of interest based banking system showed reluctance in order to work with the crusty change.

The period from 1963-1967 experienced the spark of Islamic banking system as two financial institutions based on Islamic financing principles were formed in Mit-Gharm in the Nile and the other one was in Karachi, moreover the Dubai Islamic Bank was established in 1965. By the ending of the year 1996, the number of Islamic financial institutions achieved the milestone represented the number of 166 in 34 Muslim and non-Muslim countries. (Chapra, 2001).

Islamic banks are currently executing and facilitating Islamic banking services approx in more than 60 countries of the world (Aggarwal, Rajesh and Tarik, 2000). Islamic banking in the modern world, extensively focuses to enhance and establish the implementation of Islamic financial ideology, principles, law and modes to negotiate financial, banking and other concerned business affairs. By working on this pattern Islamic banking will protect the Islamic communities and societies from activities of (Riba) and other that are strictly forbidden in Islam (Tahir, 2003).

In Pakistan the central financial regulatory body the SBP has been paying full and quality of concentration by building up a strong Islamic banking infrastructure from 2000 to onwards. Different policy tools have been modified with an aim to make Islamic banking possible at a large scale. The first implementation is to form exclusive Islamic banks. In the second phase existing conventional banks have allowed to have Islamic Banking addends. Final stage step of this policy was the formation of stand alone branches by existing commercial banks. The State Bank also appointed the regulatory Shariah Board in order to make fully authentic guiding principles that are required to make Islamic banking possible also gave them the power to keep the check and balance on the implemented Islamic modes of banking. Being a Muslim country there is huge scope for Islamic and Modaraba banking system. Meezan Bank came into operations in 2002 considered a formal pioneer of Islamic banking in Pakistan, furthermore National Bank of Pakistan has started Mudaraba banking, however Pak-Kuwait Investment Company Limited, which is considered one of the country inaugural joint venture financial institutions, is all set to launch the first ever Islamic Insurance Company in Pakistan. That clearly shows a bright sign of market of Islamic banking in the country (Khan, 2004).

Does Islamic banking risk differ from the Conventional banking risk?

The aspect of risk of Islamic banks in some way identical to the conventional banks. The foremost element is related to the perspective of practice, which is really much parallel to conventional banking structure and also obeying the Islamic finance principles, furthermore one of the impactful schemes relates with the termination of the Murabahah agreement that prior added the proceedings for liquidity troubles (Anas & Mounira, 2008).

Literature Review

Likewise conventional bank, Islamic bank acts as an intermediary and facilitator of money between the lender and the borrower, but the difference exists in the domain that it shares profit and loss with its depositors. This distinction that acquaints the factor of mutuality in Islamic banking takes its depositors as customers with a power of some ownership of right in it (Dar and Presley 2000).

Islamic banks are agate to those of non-Islamic banks in the way that they both offer more or less same (financial) services and play a decisive role in the economic advancement of their surroundings. The major differentiation between these two financial entities is the prohibition of Riba (usury or interest) that is involved in the various financial transactions. Comparatively according to Islamic Shari'ah perfidious contracts depended on Riba (usury or interest) or unjustified contracts that involve risk or speculation are capricious.

Islamic banking and conventional banking contradict in that while the conventional banking supersades conventional interest-based methodology while the Islamic banking is based on interest-free principle and laws of Profit-and-Loss (PLS) sharing in executing their businesses as financial drivers (Arif 1988).

Justification behind the restriction on interest and the value of PLS in Islamic banking has been explained in many Islamic economics research work. Furthermore, Islamic PLS principle actualizes the affiliation of financial assurance and partnership between borrower, lender, and intermediary.

Ratti (1980) analyzed that differences in environment can produce positive (negative) income affect that result the way to extra risk exposure by banks. While Deakins and Hussain (1994) debated that methodology of risk assessment has very crucial assumption for banker and business relationships and points out on investing both in time and resources through risk analysis process, an interesting argument proposed by Metwally (1997) based on financing loans interest-free banks suggested that these transactions depend primary on their equity, intimate extra complexity, and parallel to be fairly additional conservative approach in applying their loanable resources as compared to conventional banks, assessing current suggestions on new Basel Accord and on the structure of the capital adequacy. The research accompanied the factors associated with the returning difficulty of liquidity and then demonstrates some assessment of new developments, largely in risk transfer phase. The research strongly emphasized that modernism and care should go hand in hand and further concluded risk management as a foremost goal of today's financial system. Iqbal (2001) proposed comparative approach by analyzing performance of Islamic banks with Conventional banks. He assimilated working of both types of 12 banks of equivalent size. The research was furthermore attached with the factors like profitability, liquidity, and risk also some other critical parameters such as capital adequacy and deployment efficiency were also examined. The fruition of Islamic banks has been figured out by applying both trend and ratio analysis. He concluded that Islamic banks are not afflicting from excess liquidity and are more cost efficient and profitable than Conventional analogue.

State Bank Of Pakistan Rules and Regulations For Islamic Banks & Conventional Banks:

Islamic Banks:

IBIs shall have in place a comprehensive risk management and reporting process, including appropriate board and senior management oversight, to identify, measure, monitor, report and control relevant categories of risks. The process shall take into account appropriate steps to comply with Shariah rules and principles and to ensure the adequacy of relevant risk reporting to the supervisory authority.

IBIs shall have a sound process for executing all elements of risk management, including risk identification, measurement, mitigation, monitoring, reporting and control. This process requires the implementation of appropriate policies, limits, procedures and effective management information systems (MIS) for internal risk reporting and decision making that are commensurate with the scope, complexity and nature of IBIs' activities.
IBIs shall ensure that an adequate system of controls with appropriate checks and balances is in place. The controls shall (a) comply with the Shariah rules and principles; (b) comply with applicable regulatory and internal policies and procedures; and (c) take into account the integrity of risk management processes.

IBIs shall make appropriate and tim timely disclosure of information to depositors having deposits on Profit and Loss Sharing basis, minimum requirements of which are specified by SBP in its Guidelines for Shariah Compliance in IBIs", so that they are able to assess the potential risks and rewards of their deposits and to protect their own interests in their decision making process.

These guidelines address the credit risk associated with specific features of Islamic financing contracts. The risk assessment and measurement processes undertaken by IBIs shall also be applicable to profit sharing assets (Mudarabah and Musharakah) which are classified under equity investments. Rigorous risk evaluation (including due diligence) and controls of these investments are necessary in view of their exposure to capital impairment.

The credit risk principles in this section are also applicable to credit risks associated with securitization and investment activities because, in the IBIs, an investment certificate or sukuk generally represents a direct pro-rata beneficial ownership of the holder in the assets of the underlying project.

IBIs shall have in place a strategy for financing, using various instruments in compliance with Shariah, whereby they recognize the potential credit exposures that may arise at different stages of the various financing agreements.

IBIs shall carry out a due diligence review in respect of counterparties prior to deciding on the choice of an appropriate Islamic financing instrument.

IBIs shall have in place appropriate methodologies for measuring and reporting the credit risk exposures arising under each Islamic financing instrument

IBIs shall have in place Shariah-compliant credit risk mitigating techniques appropriate for each Islamic financing instrument.

In evaluating the risk of an investment using the profit sharing instruments of Mudarabah or Musharakah, the risk profiles of potential partners (Mudarib or Musharakah partner) are crucial considerations for the undertaking of due diligence. Such due diligence is essential to the fulfillment of IBIs' fiduciary responsibilities as an investor of deposits on a profit-sharing and loss-bearing basis (Mudarabah) or a profit and loss sharing basis (Musharakah). These risk profiles include the past record of the management team and quality of the business plan of, and human resources involved in, the proposed Mudarabah or Musharakah activity

IBIs shall have in place appropriate strategies, risk management and reporting processes in respect of the risk characteristics of equity investments, including Mudarabah and Musharakah investments

IBIs shall ensure that their valuation methodologies are appropriate and consistent, and shall assess the potential impacts of their methods on profit calculations and allocations. The methods shall be mutually agreed between the IBIs and the Mudarib and/or Musharakah partners.

IBIs shall define and establish the exit strategies in respect of their equity investment activities, including extension and redemption conditions for Mudarabah and Musharakah investments, subject to the approval of the institution's Shariah Advisor.

IBIs shall have in place an appropriate framework for market risk management (including reporting) in respect of all assets held, including those that do not have a ready market and/or are exposed to high price volatility.

Liquidity risk is the potential loss to IBIs arising from their inability either to meet their obligations or to fund increases in assets as they fall due without incurring unacceptable costs or losses.

IBIs shall have in place a liquidity management framework (including reporting) taking into account separately and on an overall basis their liquidity exposures in respect of each category of current accounts and PLS deposits.

IBIs shall assume liquidity risk commensurate with their ability to have sufficient recourse to Shariah-compliant funds to mitigate such risk.

The rate of return risk is generally associated with overall balance sheet exposures where mismatches arise between assets and balances from fund providers. Since IBIs' responsibility is to manage their PLS deposit holders' expectations and their liabilities to current account holders, the rate of return risk is a strategic risk issue forming part of IBIs' balance sheet risk management

IBIs shall establish a comprehensive risk management and reporting process to assess the potential impacts of market factors affecting rates of return on assets in comparison with the expected rates of return for PLS deposit holders.

IBIs shall have in place an appropriate framework for managing displaced commercial risk, where applicable.

IBIs shall have in place appropriate mechanisms to safeguard the interests of all fund providers. Where PLS deposit holders' funds are commingled with the IBIs' own funds, the IBIs shall ensure that the bases for asset, revenue, expense and profit allocations are established, applied and reported in a manner consistent with the IBIs' fiduciary responsibilities.

All financial transactions of Islamic MFB shall be in accordance with the injunctions of Shariah.

Every Islamic MFB shall be required to appoint a Shariah Advisor who should meet the "Fit and Proper Criteria" for Shariah Advisors, issued vide IBD Circular 2 of 2007 as amended from time to time. Appointment of Shariah Advisor shall require prior written approval from State Bank of Pakistan for which information about Shariah Advisor should be submitted to the State Bank on Form SAP, provided in the aforementioned circular.

The application shall indicate the modes of finance and product structures proposed to be used for raising resources and extending financial assistance to the clients.

The applicant shall also indicate expertise and other facilities available with them for ensuring compliance of their microfinance banking business with Shariah.

All the deposits accepted by the MFB shall be accepted either on demand or on profit and loss sharing basis.

Only those commercial banks allowed to operate Islamic banking divisions and having received Camels-S rating of 'fair' or better in their most recent on-site inspections will be allowed to convert.

Such branches will be allowed to start offering Islamic banking products and services after they secure a Shariah adviser's certificate and Islamic banking licence from the State Bank.

Banks will also be required to submit a rationale for the conversion, a three-year business plan and an employee training strategy along with an official request for conversion. Additionally, banks have to obtain customers' consent and inform the public about the conversion at least four weeks before the switch.

Conventional Banks:

The total outstanding exposure (fund based and non-fund based) by a bank/DFI to any single person shall not at any point in time exceed 30% of the bank's/DFI's equity as disclosed in the latest audited financial statements, subject to the condition that the maximum outstanding against fund based exposure does not exceed 20% of the bank's/DFI's equity.

Contingent liabilities of a bank/DFI shall not exceed at any point in time 10 times of its equity. Following shall not constitute contingent liabilities for the purpose of this regulation:

a) Bills for collection.9

b) Obligations under Letters of Credit and Letters of Guarantee to the extent of cash margin retained by the bank/DFI.

c) Letters of credit/guarantee where the payment is guaranteed by the State Bank of Pakistan/Federal Government or banks/DFIs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan or Standard & Poors, Moody's, Fitch-Ibca or Japan Credit Rating Agency (JCRA).

d) Non-fund based exposure to the extent covered by liquid assets. obtain a written declaration to the effect that the borrower in his own name or in the name of his family members, has not availed of such facilities from other banks/DFIs so as to exceed the prescribed limit of Rs 500,000/- in aggregate

While taking any exposure, banks/DFIs shall ensure that the total exposure (fundbased and/or non-fund based) availed by any borrower from financial institutions does not exceed 10 times of borrower's equity as disclosed in its financial statements (obtained in accordance with para 2 of Regulation R-3), subject to the condition that the fund based exposure does not exceed 4 times of its equity as disclosed in its financial statements

Banks/DFIs shall not own shares of any company/scrips in excess of 5% of their own equity. Further, the total investments of banks in shares should not exceed 20% of their own equity. DFIs which are not mobilizing funds as deposits/COIs from general public/individuals will be exempt from the requirement of capping their total investment in equities. However, DFIs which are mobilizing funds as deposits/COIs from general public/individuals will be required to contain their investment in shares upto 35% of their equity. The shares will be valued at cost of acquisition for the purpose of calculating bank's/DFI's exposure under this regulation. The investments of the bank/DFI in its subsidiary companies (listed as well as non-listed) and strategic investments of the bank/DFI, shall not be included in these limits. The shares acquired in excess of 5% limit due to the underwriting commitments will be sold off/off loaded within a period of three months e) Claims other than those related to provision of facilities (fund based or nonfund based) to the banks'/DFIs' constituents, where the probability of conversion of these claims into liabilities are remote

While considering proposals for any exposure (including renewal, enhancement and rescheduling/restructuring) exceeding such limit as may be prescribed by State Bank of Pakistan from time to time (presently at Rs 500,000), banks/DFIs should give due weightage to the credit report relating to the borrower and his group obtained from Credit Information Bureau (CIB) of State Bank of Pakistan. However, banks/DFIs may take exposure on defaulters keeping in view their risk management policies and criteria, provided they properly record reasons and justifications in the approval form. The condition of obtaining CIB report will apply to exposure exceeding Rs 500,000/- after netting-off the liquid assets held as security

Banks/DFIs shall not provide unsecured/clean financing facility in any form of a sum exceeding Rs 500,000/- (Rupees five hundred thousand only) to any one person. Financing facilities granted without securities including those granted against personal guarantees shall be deemed as 'clean' for the purpose of this regulation. Further, at the time of granting a clean facility, banks/DFIs shall

All guarantees issued by the banks/DFIs shall be fully secured, except in the cases mentioned at Annexure-III where it may be waived up to 50% by the banks/DFIs at their own discretion, provided that banks/DFIs hold at least 20% of the guaranteed amount in the form of liquid assets as security

Banks/DFIs shall not pay any dividend on their shares unless and until:
a) they meet the minimum capital requirements as laid down by the State Bank of Pakistan from time to time;
b) all their classified assets have been fully and duly provided for in accordance with the Prudential Regulations and to the satisfaction of the State Bank of Pakistan; and
c) all the requirements laid down in Banking Companies Ordinance, 1962 relating
to payment of dividend are fully complied.

While extending fund based facilities to borrowers against hypothecation of stock and/or receivables on pari-passu basis, banks/DFIs shall obtain monthly statements from borrowers that contain a bank-wise break-up of outstanding amounts with the total value of stocks and receivables there-against.

They will also follow 'Code of Corporate Governance' issued by the Securities & Exchange Commission of Pakistan (SECP) so long as any provision thereof does not conflict with any provision of the Banking Companies Ordinance, 1962, Prudential Regulations and the instructions/guidelines issued by the State Bank of Pakistan. Foreign banks are required to adhere to these guidelines wherever feasible and applicable.

Research & Methodology

Theoretical Framework

The ratio analysis comprises the method of calculating and elucidating financial ratios to evaluate bank working efficiency. In this regard financial ratios are the key players that are being judged. In order to achieve the mentioned target that is to compare financial performance of Islamic banks and Conventional banks in Pakistan for the period of 2007-2011 the study employs comprehensive inter-bank analysis. The study looks into inter-bank performance of Islamic and Conventional banks in order to know the status of profitability, liquidity, risk and solvency, capital adequacy, deployment operational efficiency and resource allocation. This research uses fourteen financial ratios to judge the selected banks performance. These ratios are merged under five broad categories. Since there are four conventional banks and four Islamic banks. The working began with the calculation of mentioned ratios of each bank in that group and then calculated average of those five group ratios to compare that average ratio with the other ratio on yearly basis.

Profitability Ratios

Profitability ratios are usually considered the fundamental bank financial ratios in order
to judge how well bank is operating in terms of profit. There are numerous ratios that are available to calculate profitability performance of the banks, but this study employs the following stated ratios: *Return on assets (ROA), Return on Equity (ROE), and Profit Expense Ratio (PER).*

Return on Assets (ROA) = *Net profit after tax / Total assets.* It measures how much the firm is earning after tax for each dollar invested in the assets of the firm.

Return on Equity (ROE) = *Net profit after tax / Shareholders Equity.* ROE evaluates how much the shareholders are actually earning after tax for each dollar invested in the firm. Higher ROE indicates better managerial performance.

Profit to Expenses Ratio (PER) = *Profit after tax / Operating Expenses*. The ratio measures the amount of operating profit earned for each dollar of operating expense. A higher PER indicates bank's cost efficiency and profitability

Liquidity Ratios

A class of financial metrics that is used to determine a company's ability to pay off it's short-terms debts obligations. Generally, the higher the value of the ratio, the larger the margin of safety that the company possesses to cover short-term debts. Measures of liquidity are: *Loan to Deposit Ratio (LDR), Cash & Portfolio Investment to Deposit Ratio (CPID), and Loan to Asset Ratio (LAR).*

Loan to Deposit Ratio (LDR*)* = *Loan / Deposits.* If the ratio is too high, it means that banks might not have required liquidity to cover any unforeseen fund requirements; if the ratio is too low, banks may not be earning as much as they could be.

Cash & Portfolio Investment to Deposit Ratio (CPIDR) = *Cash & Portfolio Investments /Deposits*. The higher the CPIDR ratio the better is the liquidity position of the bank.

Loan to Asset Ratio (LAR) = *Loan / Assets*. This ratio shows the percentage of total assets the bank has lockedup in loans (or financing). The higher the ratio means the less the liquidity is of the bank.

Risk and Solvency Ratios
The more the debt a firm has, the higher is the probability that firm would result unable to fulfill its contractual obligations. If the amount of assets is greater than amount of liabilities, the bank is considered solvent. To measure risk and solvency of the banks this study uses: *Debt-Equity Ratio (DER), Debt to Total Assets Ratio (DTAR), and Equity Multiplier (EM).*
Debt-Equity Ratio (DER) = *Debt / Shareholders Equity*. A measure of a company's financial leverage calculated by dividing its total liabilities by stockholders' equity. It indicates what proportion of equity and debt the company is using to finance its assets.
Debt to Total Assets Ratio (DTAR) = *Debt / Total Assets*. A metric used to measure a company's financial risk by determining how much of the company assets have been financed by debt. Calculated by adding short-term and long-term debt and then dividing by the company's total assets.
Equity Multiplier (EM) = *Total Assets / Shareholders Equity.* The equity multiplier formula is used in the return on equity DuPont formula for the financial leverage portion of DuPont analysis. Broadly speaking, financial leverage is used in financial analysis to evaluate a company's use of debt.

Efficiency Ratios
In order to analyze the financial position of any entity different financial ratios are applied to get elementary information regarding the operational status of that entity, in a nutshell analyst is concerned to know how well a company uses its assets and liabilities internally. Efficiency Ratios can be used to calculate the turnover of receivables, the repayment of liabilities, the quantity and usage of equity and the general use of inventory and machinery. Efficiency ratios can be divided into the following categories:
Asset Utilization (AU), Income to Operating Expenses Ratio (IER), and Operating efficiency(OE).
Asset Utilization (AU*)* = *Total Revenue / Total Assets*. How effectively and efficiently the bank is employing all of its assets is measured by assets utilization ratio.
Income to Operating Expense Ratio (IOER) = *Total Income / Total Operating Expense*. A measure of what it costs to operate a piece of property compared to the income that the property brings in. The operating expense ratio is calculated by dividing a property's operating expense by its gross operating income. Investors using the ratio can further compare each type of expense, such as utilities, insurance, taxes and maintenance, to the gross operating income, as well as the sum of all expenses to the gross operating income.
Operating Efficiency (OE) = *Total Operating Expenses / Total Operating Revenue*. It
Indicates managerial working efficiency in producing operating revenues and effectively controlling its operating expenses.

Capital Adequacy Ratios
This ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world. This study stressed upon on two following Capital ratios.
Capital Risk Asset ratio = Total Capital/Risk weighted Assets
Equity/Liabilities ratio = Average equity/ Average liabilities

Population
The population of this research is Islamic and Conventional banks of Pakistan.

Sample
Meezan Bank Limited, Bank Islami Limited, Al-Barakah Bank Pakistan Ltd, Burj Bank Limited are selected as Islamic banks and MCB Bank, Bank Al-Falah Pakistan Ltd, Allied Bank, Standard Chartered bank Limited are selected as Conventional banks.

Data Sources
In order to make fruitful analysis the data has been taken from the Annual Audited financial statements (Income Statement and Balance Sheet) of both Islamic and Conventional banks for the period of 2007 -2011. The ratio analysis has been done by applying the mentioned ratio formulas moreover this comprehensive analysis is also based on the details published by the central regulatory body, that is the State Bank of Pakistan.

Data Analysis
Cross-sectional analysis based on the data is applied in order to compare the financial performance of Islamic and Conventional banks operating in Pakistan. The decision criterion is co-oefficient of variation the less the C.V the more stable is the ratio and vice versa.

Statistical Findings & Analysis

	Table 1: RETURN ON ASSETS RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	2.72	-0.89	1.52	2.8	3.95	2.02	1.838	0.909
CONVENTIONAL	7.26	6.4	5.56	5.42	7.62	6.452	0.984	0.152

	Table 2: RETURN ON EQUITY RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	43.48	16.08	7.27	22.7	30.28	23.962	13.8	0.575
CONVENTIONAL	80.69	66.9	64.67	63.28	93.52	73.81	13.01	0.176

	Table 3: PROFIT TO EXPENSE RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	19.59	13.42	10.99	11.31	19.39	14.94	4.25	0.284
CONVENTIONAL	110.3	110.5	104.16	115.3	127.2	113.492	8.62	0.075

	Table 4: LOAN TO DEPOSIT RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	146.9	147.5	160.43	223.1	236.14	182.81	43.2	0.236
CONVENTIONAL	221.5	248.5	258.7	286.37	268.43	256.7	24.12	0.094

	Table 5: INVESTMENT TO DEPOSIT RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	30.02	29.9	27.34	21.03	29.4	27.54	3.794	0.137
CONVENTIONAL	43.3	28.02	35.12	39.62	40.1	37.23	5.92	0.159

	Table 6: LOAN TO ASSET RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	68.34	66.2	60.9	62.4	59.7	63.51	3.64	0.057
CONVENTIONAL	64.53	62.3	69.54	50.2	57.8	60.874	7.3	0.119

	Table 7: DEBT TO ASSTE RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	5.49	2.46	1.37	2.45	2.23	2.8	1.56	0.557
CONVENTIONAL	15.8	6.76	10.7	6.6	8.9	9.75	3.78	0.387

	Table 8: EQUITY MULTIPLIER RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	12.32	9.82	10.3	11.2	11.6	11.05	1.00	0.090
CONVENTIONAL	17.89	16.02	18.12	15.5	14.5	16.41	1.56	0.095

	Table 9: DEBT TO EQUITY RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	29.3	16.9	28.6	32.2	35.6	28.52	6.84	0.238
CONVENTIONAL	98.6	53.5	86.05	71.2	60.5	73.97	18.44	0.249

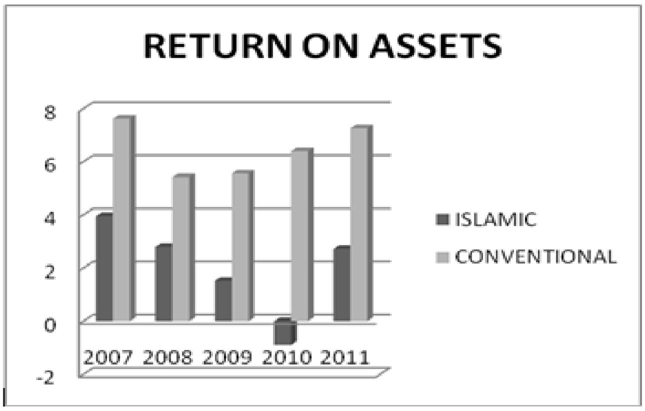
	Table 10: ASSET UTILIZATION RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	4.56	5.44	3.75	4.03	5.88	4.732	0.91	0.192
CONVENTIONAL	7.89	6.43	5.48	6.3	5.3	6.28	1.02	0.162

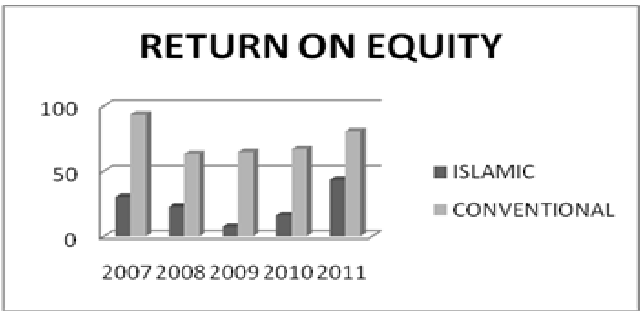
	Table 11: OPERATING EFFICIENCY RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	85.43	80.56	105.3	98.9	85.03	91.04	10.52	0.115
CONVENTIONAL	70.03	65.35	68.93	47.83	58.8	62.188	9.14	0.146

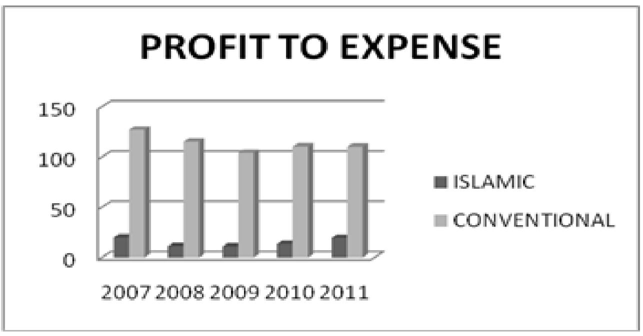
	Table 12: INCOME TO EXPENSE RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	0.95	0.87	0.65	0.77	0.04	0.656	0.362	0.551
CONVENTIONAL	2.3	4.5	3.3	0.96	0.74	2.362	1.581	0.669

	Table 13: CAPITAL ADEQUACY RATIO ANALYSIS							
	2011	2010	2009	2008	2007	MEAN	S.D	C.V
ISLAMIC	92.6	91.7	105.19	113.36	115.43	103.67	11.18	0.107
CONVENTIONAL	65.8	66.6	61.3	54.3	53.1	60.22	6.29	0.104

Graphical Illustration

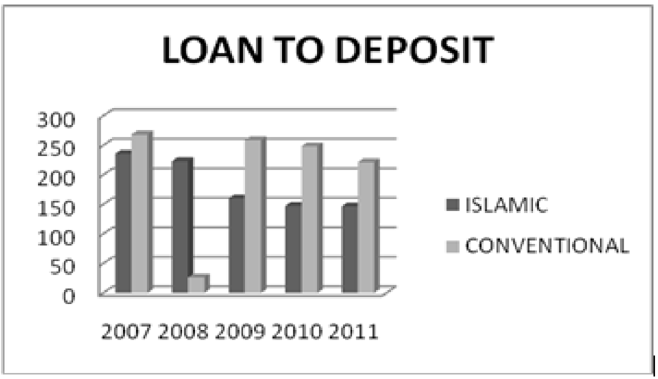


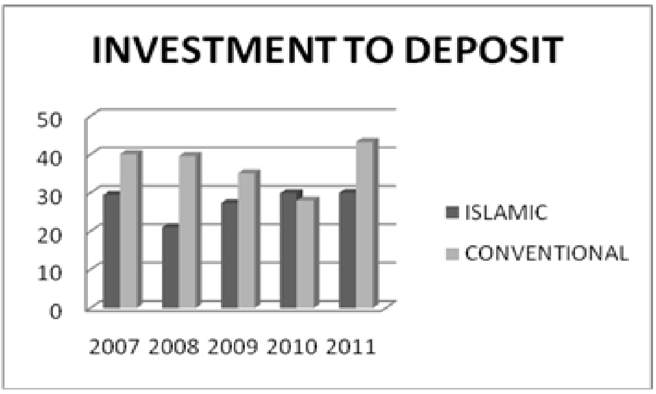


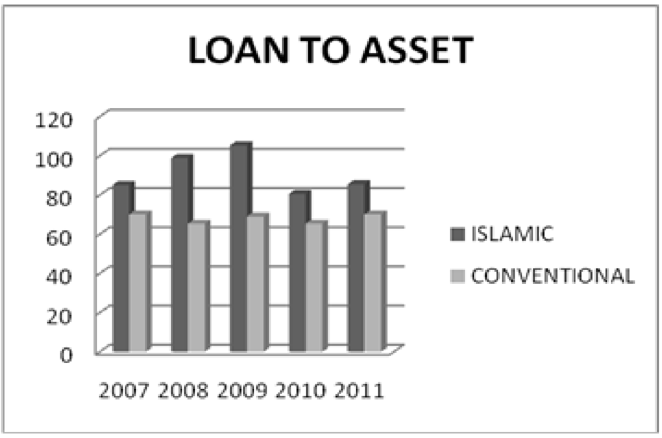


Profitibality Ratios:

The analysis of ROA ratio comparison indicates better stability for Islamic Banks as the C.V for Islamic Banks is lower than Conventional banks it means that ROA is at its strong position showing less fluctuations as compared to Conventional Banks, on the other hand the ROE analysis shows that Conventional Banks are in better position as their C.V is lower than Islamic Banks. The peak point witnessed by the Conventional Banks was reported in the year of 2007 while for the Islamic Banks it came in 2011. From the bar-diagram it can be seen that Islamic Banks are wisely managed and have taken up their ROE in the last three years, but still Conventional banks are in ruling position in case of ROE adherence, furthermore the Profit to Expense ratio analysis adds up-to the assertion that Conventional banks are quite higher as compared to Islamic Banks moreover the stability is also accompanied with the Conventional Banks it can also be seen in the mentioned Bar-Diagram illustration there is more or less stable trend in the Profit to Expense comparison as Conventional banks C.V 0.075 while for Islamic banks C.V shows 0.284.

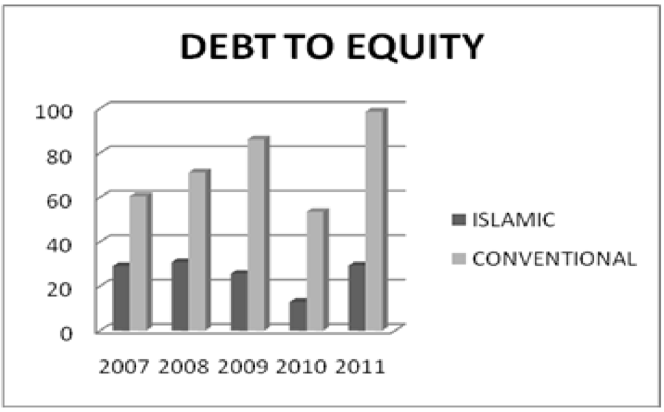


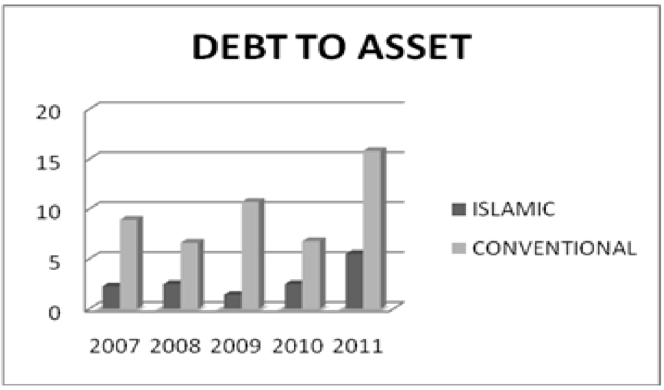


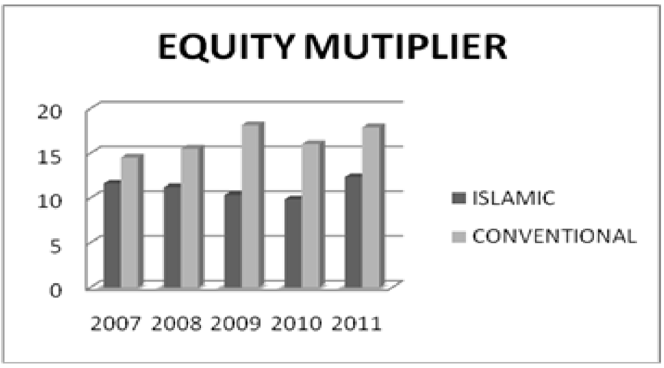


Liquidity Ratios:

The liquidity ratios analysis is quite impulsive. From the mentioned ratio statistical findings of Loan to deposit ratio Conventional banks are found to be more stable as their C.V reported 0.094 while for Islamic Banks it is 0.236, moreover the calculated mean is also higher for Conventional banks as compared to Islamic Banks, but we can also observe that Islamic banks are not far behind from the Conventional banks. It is also startling to see that Islamic Banks are having more stable C.V i.e 0.137 in terms of Investment to Deposit ratio whereas C.V for Conventional Banks is 0.159 making Islamic Banks more balanced. Similarly the statistical findings for the Loan to Asset ratio are displaying the same picture Islamic banks are on the ruling side having C.V 0.057 whereas Conventional banks C.V is 0.119. The highest peak in terms of Loan to Asset ratio for Islamic banks can be seen in the year 2009. The prominent justification behind that Islamic bank are more in liquidity state as they are not largely involved in investment transactions, moreover Islamic Banks are restricted by Shariah regulations. Lastly they are more dependent on equity while advancing loans.

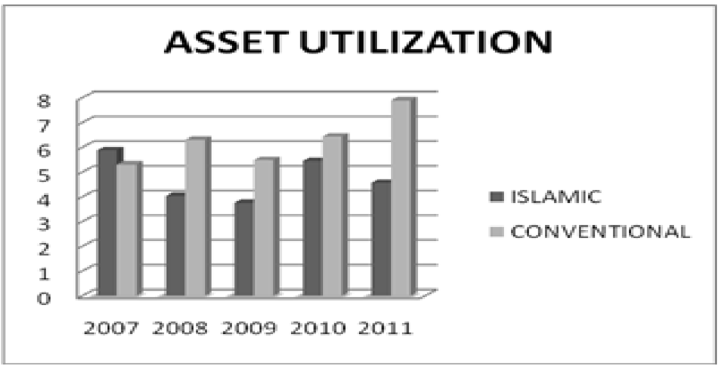


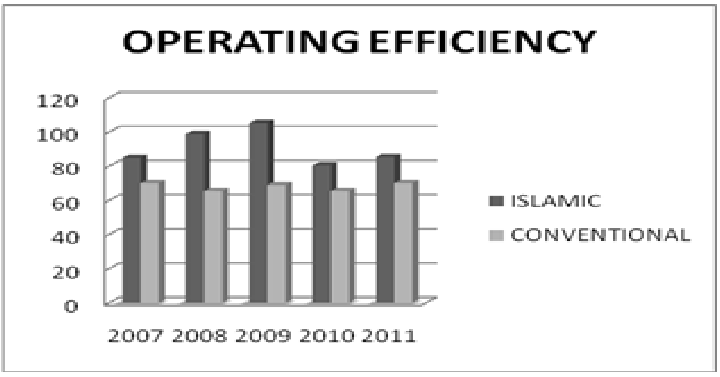


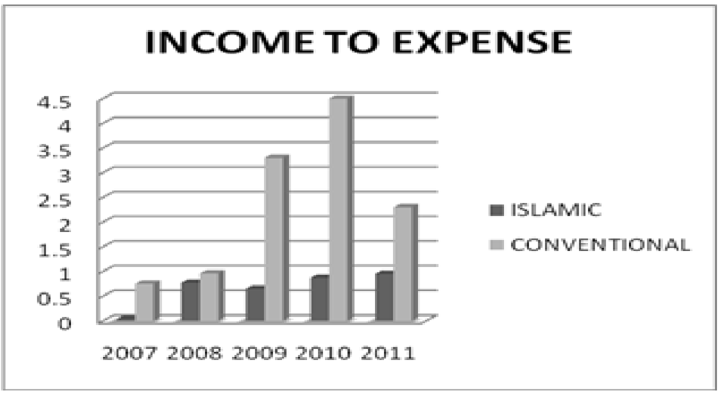


Risk & Solvency Ratios:

The statistical findings of Debt to Equity ratio explain that Conventional banks are on a more risky side with less stable C.V i.e 0.249 whereas Islamic Banks C.V is 0.238, furthermore the analysis of Debt to Asset ratio indicates Conventional Banks are on a safe side having C.V 0.387 while for Islamic Banks it is 0.557. The Equity Multiplier also revealed some interesting facts as giving ruling position in the hands of Islamic banks as their C.V is 0.090 making them more impervious as compared to Conventional Banks whose reported C.V is 0.095. The statistical findings are in favor of Islamic banks, they are less risky and more solvent as compared to Conventional Banks, many factors may lead to this conclusion as one can observe that Conventional Banks are more involved in the use of debt as compared to Islamic banks. High use of debt brings risk and insolvency threat, making Conventional Banks more risky.

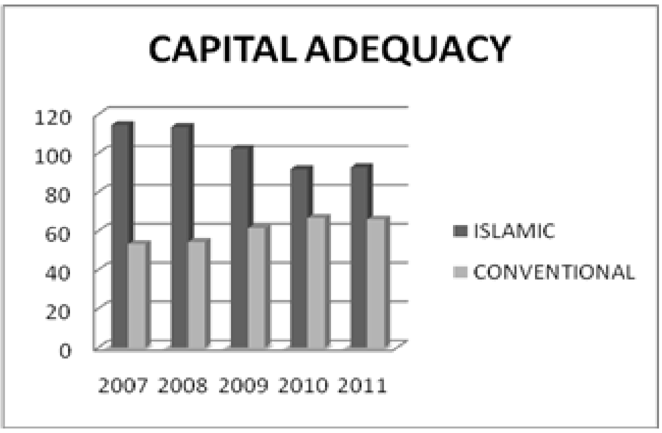






Efficiency Ratios:

The research methodology splits the efficiency ratio analysis into three components: Asset Utilization, Operating Efficiency, Income to Expense ratios. Our findings led to the conclusion that Islamic banks are operating more efficiently as compared to Conventional Banks. Analysis of Asset Utilization ratio reveals that Conventional banks are slightly in a better position as their calculated C.V is 0.162 while for Islamic Banks the recorded C.V is 0.192, on the other hand the Operating Efficiency ratio analysis strongly supported Islamic Banks as their C.V is 0.115 while for Conventional banks it is 0.146, furthermore the findings of Income to expense ratio analysis also supported Islamic Banks as their calculated C.V is 0.551 while for Conventional banks it is 0.669. Except the asset utilization ratio results, both of the findings operating efficiency and income to expense are in the support of Islamic banks, the modes of financing and working infrastructure may be considered core fundamentals for this drawn conclusion.



Capital Adequacy Ratios:

The analysis of Capital Adequacy ratio splits into Equity/Liabilities ratio & Capital Risk Asset ratio. The statistical findings came up with the results that both Isamic and Conventional Banks do not really differ in terms of Capital Adequancy as there is very slight difference between their calculated C.V. The Islamic Banks C.v is 0.107 while for Conventional Banks it is 0.104. There is a very minute difference of 0.003 between both banks co-oefficient of variation. It will be difficult to state which bank is more well capitalized. The graphical illustration is also showing little mixed trends (increasing or decreasing) for both of the banks.

Market Share & Growth Analysis

In the recent years the Government of Pakistan has delegated the Islamic banking project to the central regulatory body (i.e) the State Bank of Pakistan (SBP), which has very capably assisted Islamic banking provided by issuing guidelines to conduct Islamic banking business furthermore regulating and monitoring the financial institutions that are conducting Islamic banking and finance transactions. By far SBP has implemented the regulations aligned with the Shariah rules in the best possible mean. The State Bank of Pakistan has wisely implemented following measures in an order to promote Islamic Banking in Pakistan:

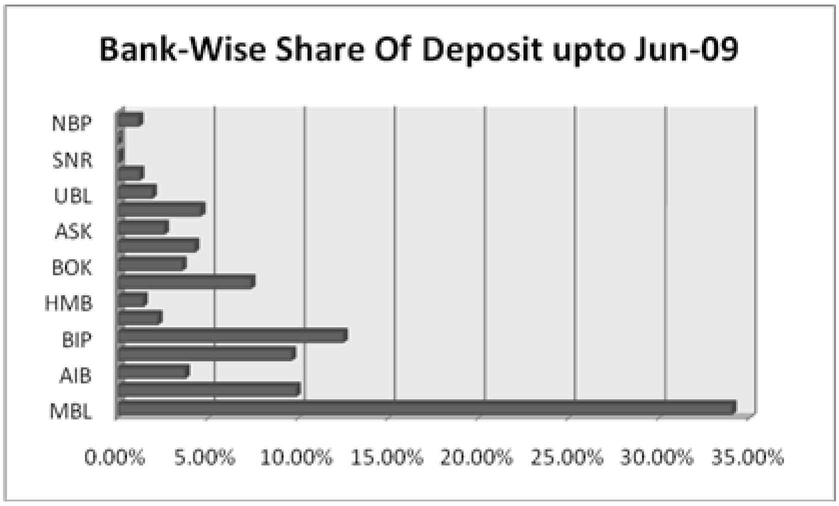
Promoting the establishment of full-fledged Islamic Banks in the private sector.

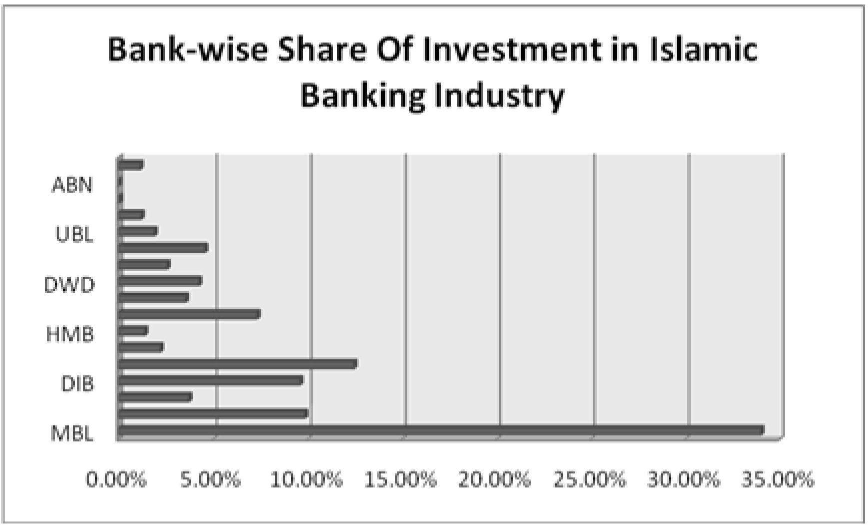
Facilitating conventional banks to form Islamic banking subsidiaries.

Facilitating currently operating conventional banks to form stand-alone Islamic Banking branches.

Table 14: Market Share Growth As Reported By SBP

	Industry Progress			Growth (QoQ)			Share in Industry		
	Dec-11 Sep-12		Dec-12	Dec-11	Sep-12	Dec-12	Dec-11	Sep-12	Dec-12
Total Assets	641	742	837	12.8%	4.3%	12.8%	7.8%	8.1%	8.6%
Deposits	*521*	628	706	12.5%	4.2%	12.5%	8.4%	9.3%	9.7%
Net Financing & Investment	*475*	*571*	*626*	28.8%	8.2%	23.0%	7.4%	7.8%	8.1%
Total Islamic Banking Institutions	*17*	*18*	*18*	_	_	_	_	_	_
Total No. of Branches*	*886*	*977*	*1097*	_	_	_	_	_	_





Source: State Bank of

Meezan Bank Ltd and Bank Islami Pakistan Ltd having current stock price per share Rs. 31.44 and Rs 6.89 respectively. While on the other hand the current stock prices of the mentioned conventional banks are Standard Chartered (Rs.17.5), Bank Al-Falah (Rs. 20.95), MCB Bank Ltd (Rs. 267.07), Allied Bank Ltd (Rs.76.66) as reported by KSE market summary 28th August, 2013. From the mentioned Earning Per Share Analysis it can be concluded that the market price stability are found more in the conventional banks largely due to their profitability and a variety of services they are providing. But on the other hand it can also be noticed that Meezan Bank Ltd as an Islamic Bank benchmark has given tough fight to the above-mentioned conventional banks except Allied and MCB, moreover the KSE trade market screen also posted Meezan Bank Ltd as a single strong competitor when compared with rest of the mentioned commercial banks (excluding Allied and MCB).

Table 15: EARNING PER SHARE ANALYSIS 2010-2011

BANKS	2011	2010
STANDARD CHARTERED	**1.41**	**0.95**
BANK AL-FALAH	**3.21**	**0.89**
MCB BANK LTD	**23.08**	**20.18**
ALLIED BANK LTD	**11.92**	**9.63**
MEEZAN BANK LTD	**3.67**	**2.27**
AL-BARAKA BANK PAKISTAN LTD	**0.46**	**(2.19)**
BURJ BANK LTD	**(0.46)**	**(1.07)**
BANK ISLAMI PAKISTAN LTD	**0.77**	**0.08**

	Table 16: MARKET PRICE PER SHARE ANALYSIS							
	2011	**2010**	**2009**	**2008**	**2007**	**MEAN**	**S.D**	**C.V**
ISLAMIC	**29.51**	**30.38**	**33.87**	**40.12**	**68.2**	**40.416**	**16.08**	**0.397**
CONVENTIONAL	**223.04**	**273.27**	**164.61**	**190.53**	**414.7**	**253.23**	**98.9**	**0.391**

Market price per share analysis for both banks revealed interesting fact. Conventional Banks in spite of having higher market prices per share as compared to Islamic Banks there is only 0.006 differences between both banks calculated C.Vs. It can be fore-casted that Islamic Banks have potential to rule out the dominance of Conventional banks in the share markets. The coming years may change the whole ambiance and may bring Islamic Banks top in share prices. From the above-mentioned statistical analysis it will be a tough task to decide which bank is in the strong status in terms of Market price Per Share stability.

Future Outlook Of Islamic Banking In Pakistan:

In contemporary years, Islamic banking in Pakistan has witnessed extraordinary growth. Islamic deposits – held by fully fledged Islamic banks and Islamic windows of conventional banks –at current status stand at 9.7% of total bank deposits in the country it indicates that in Pakistan every 10th rupee is now being deposited in an Islamic bank account. Moreover, assets counseled by banks that are offering Islamic financial services indicate the figure of 8.6% of total banking assets in the country, at the same time net Islamic savings and investments placed a figure of 8.19% that numeric figure was the share of the total savings and investment in the banking sector of Pakistan. Total Islamic banking assets in Pakistan currently stand at Rs 837 billion. This is an open reality now Islamic banking undoubtedly can be thought of as the fastest growing division of Pakistan's financial services sector, an intelligence that has made many institutions to pile onto the Shariah-compliant pattern. According to statistical figures released by the State Bank of Pakistan, (2002-2011) an interesting fact can be observed, the deposits at Islamic banks flourished at an average annual rate of 59.6%, in comparison with the banking sector average of 16.1% per year during that same period. Statistical window further explained during the period of June 30, 2012, Islamic banking deposits grew 33.4% to Rs.603 billion this was the period during which the banking sector as a whole grew by just much lower figure 14.4%. The analysis of 'Islamic Banking Bulletin July-September 2011' released by the State Bank of Pakistan (SBP) revealed that the profit of Islamic banking industry (IBI) reached Rs 8 billion by end of the first quarter of 2011-12, showing substantial growth of over 58 percent, as growth rate of Conventional banks having Islamic banking branches are quite more than the growth status of full-fledged Islamic banks. Despite this the contribution share by the full-fledged Islamic banks stand at (55% share) of overall profit of the industry. The growth of financial sector and economic sector is inter-linked. Smooth running of financial sector plays influential role in the country's economic advancement. The share of Banks in Pakistan's banking industry is 95%, thus well functioning of banks ultimately bloom Pakistan's economical structure.

State Bank of Pakistan (SBP) Governor Yaseen Anwar said that stiff efforts were required to boost the amplitude of the Islamic banking industry in Pakistan. He said this at the launch of a mass media campaign for the promotion of Islamic banking in Pakistan. Yaseen said that with the abutment of the SBP, the Islamic banking industry had shown symbolic rise, above 30 percent annually, including 8.6 and 10 percent in terms of assets and deposits, respectively. He added that "the industry both internationally and domestically remained at an evolutionary phase". The governor said that modern Islamic finance had resulted into a dynamic industry, adding that it had spread to non-Muslim countries as well, and was now functioning in more than 75 countries with a network of 430 Islamic banks and financial institutions managing assets of more than $1.3 trillion. He further added that constancy and resilience of Islamic banking had resulted in a broader acceptance of this system as a viable alternative to conventional banking. (Source: Pakistan Today)

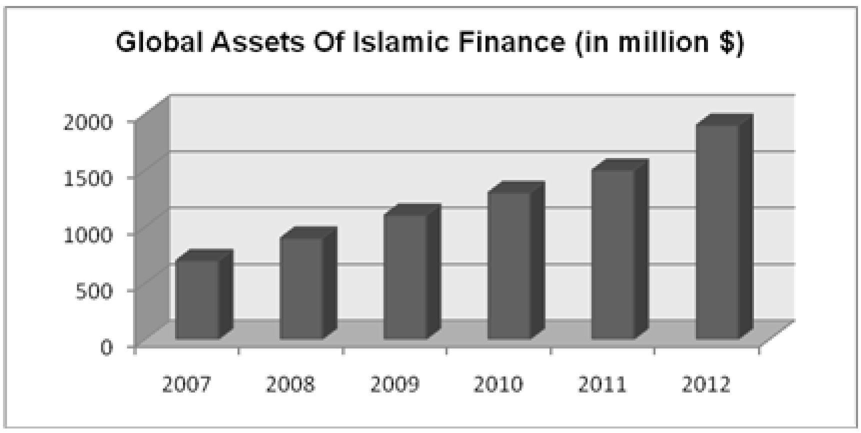
Muhammad Haroon Agar, president of Karachi Chamber of Commerce and Industry (KCCI), said the Islamic banking sector in Pakistan has registered an exponential growth during the last few years with unprecedented rise in profitability and diversified credit facility.

One of the key strains that Pakistan's Islamic banking industry currently faces is managing liabilities because deposits are far higher than the industry's commercial assets. He spells-out, only 35 paisas out of any additional rupee that comes into Islamic banking industry get into commercial assets. With the recent launch of a nationwide awareness campaign by all banks offering Shariah-compliant services, the number of customers is likely to go up steadily, leading to a higher growth rate in Islamic banking deposits.

So just like the overall banking industry, which is struggling due to the lack of quality commercial assets, banks offering Islamic banking services are also suffering. "It's an industry-wide problem. There are very few quality obligors who you can lend money to. That's why banks have been relying on investments in t-bills and Pakistan Investment Bonds (PIB)," he said. (Source: The News)

***London-based Edbiz Consulting** statistics that has recently released a ranking of the top 10 countries in Islamic banking and finance on its Islamic Finance Country Index (IFCI).*

Countries	2013 points	2013 rank	2012 rank	2011 rank
Iran	73.20	1	1	1
Malaysia	45.76	2	2	2
Saudi Arabia	44.35	3	3	3
UAE	22.12	4	5	5
Indonesia	21.67	5	7	4
Bahrain	20.12	6	6	8
Kuwait	18.00	7	4	6
Pakistan	15.17	8	8	7
Sudan	14.39	9	10	10
Bangladesh	9.85	10	12	9



Conclusion

The empiric research analysis leads to the deductive conclusion. Firstly it is evident from the analysis that Conventional Banks are more profitable than Islamic Banks in terms of ROE and Profit to Expense status, but in the case of ROA Islamic banks strongly outclass the rule of Conventional Banks. There is not a large deviation between both banks performances it can be foreseen that in near future Islamic banks can be proven more profitable in Pakistan as compared to Conventional banks.

Ascertainment of the liquidity ad-measurement, we may conclude from the findings that Islamic Banks are more in liquidator status as compared to Conventional Banks except the Loan to Deposit ratio, the set of other ratios strongly patronage Islamic Banks. It is a favorable condition for the Islamic Banks, people are found more trust oriented towards Islamic Banks, their modes of financing.

Our findings of profitability and risk & solvency thoroughly aligned in this risk-return contour and concede our research to wrap-up that conventional banks are more profitable. Consequently more risky and less solvent as compared to Islamic bank. Analysis of the results of all the risk and solvency measures, Debt Equity Ratio, Debt to Total Assets ratio and Equity Multiplier denote that conventional banks are found more risky and less stable as compared to Islamic Banks. Our statistical findings provide crucial evidence that these two banks differ to a great extent in terms of riskiness. This affirms that the financial products of Islamic banking are more reliable in investors eye. Likewise the analysis of different Efficiency ratios are also displaying the same scenario. Except the asset utilization ratio results both of the findings operating efficiency and income to expense are in the support of Islamic banks, the modes of financing and working infrastructure may be considered core fundamentals for this drawn conclusion. Islamic and Conventional Banks do not differ on a great scale in terms of Capital Adequacy. The reason that makes Conventional Banks more profitable is that Conventional banks are found very rich in their history in Pakistan. While Islamic Banks are not very old in the Pakistan Banking System ambiance. Except the profitability concern on most of the judging parameters it can be ceased that financial performance of Islamic Banks are better than Conventional Banks. By far SBP has implemented the regulations aligned with the Shariah rules in the best possible mean. This is due to this strict Shariah supervision and monitoring by the SBP accompanied with the Shariah advisory board that ‘BankIslami’ won the esteemed ‘**Shariah Authenticity Award at the Global Islamic Finance Awards’** held in Kuala Lumpur in November 2012. The Islamic bankers expect the current 9.7% share of the overall banking industry in Pakistan to double by 2017. The deposits base of Islamic banking in the country would cross the Rs 1 trillion mark by next five years or so. This was stated by Ali Ahmed Siddiqui, Executive VP of Product Development and Shariah Compliance Department of Meezan Bank, while addressing at a workshop on “Concept of Islamic Banking”. Thus this real essence of Shariah strength in Islamic banking should be further modified and enhanced in order to make Pakistan as a centre of excellence for Shariah authenticity in terms of financial activities in the global industry.

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