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PERFORMANCE OF ISLAMIC BANKS; A COMPARATIVE ANALYSIS OF PAKISTAN AND MALAYSIA

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Abstract

This research has been conducted to compare the financial performance of pure Islamic Banks from Malaysia and Pakistan. For this purpose, three pure Islamic Banks were selected from Malaysia (Bank Islam, Bank Muamalat and Bank Rakyat) and three from Pakistan (Meezan Bank, Albaraka Bank and Dubai Islamic Bank). Last 10 year financial statement have been used for data collection, and financial ratios are used to calculate the financial results, and these results have been empirically tested with regression model, in which Performance (ROA) has been selected as dependent variable, and factors (CA, Ef, LR) affecting the performance has been selected as independent variable. From data analysis results, it is found that, independent variables (factors) have a significant impact on the performance of pure Islamic banks. Whereas, in financial performance comparison, it is seen that Pure Islamic Banks from Pakistan are far behind from Malaysian Pure Islamic Banks.

INTRODUCTION AND BACKGROUND

Islamic Banking in Pakistan

Banking sector is an important part of a country's economy. They play very vital role for development of a developing country like Pakistan. In Pakistan, Islamic Banking was started properly in 2002 with Meezan Bank Ltd. and after that it was developed gradually. Up to 2012, there were 7 full fledge Islamic Banks working in Pakistan, and at present there are only 5 full fledge Islamic Banks are left. Now all conventional Banks are also trying to shift toward Islamic Banking day by day, but still there is no fast growth of Islamic Banking in Pakistan. On the other hand, Islamic Banks in Pakistan are not earning a good profit. Most of the Banks are suffering from Losses from last few years. Only Meezan Bank is one Islamic Bank in the country, which is earning good profits regularly. Whereas other Pure Islamic Banks are facing continuous losses. It can be seen from the financial statements of all Islamic Banks for last many years.

Islamic Banking in Malaysia

The Islamic Banking had been initially presented in Malaysia in 1983. There are 17 Islamic banks working in Malaysia. (Bank Negara Malaysia). Among them three are completely fledged Islamic Banks, to be specific 1) Bank Islam, 2) Bank Muamalat, and 3) Bank Kerjasama Rakyat. A couple of these 17 Banks are from worldwide Islamic banks e.g. Al Rajhi Bank, Kuwait Money House and some are divisions of the nine local gatherings working in Malaysia, additionally offer Islamic keeping money items and administrations under the Islamic Managing an account Plan (IBS banks). The keeping money division in Malaysia, rehearsed double managing an account framework, i.e. ordinary and Islamic keeping money frameworks. Malaysia has nine noteworthy residential banks and 13 remote banks in its routine saving money segment. Parallel to the routine keeping money segment is the Islamic Banking Sector.

In this world, Malaysia is considered a pioneer in Islamic Banking, and it is also growing continuously from last 2 decades. But in Pakistan, it is not the same case. Pure Islamic Banks are surviving very hard in Pakistan, it is clear from the background section above, there were 7 pure Islamic Banks up to 2012, and now there are only 4 Pure Islamic Banks left in the financial Market. Why it is not same like Malaysian Islamic Banks? This research will focus on a financial comparison of Malaysian and Pakistani pure Islamic Banks, and try to find out the reason for low growth of Pure Islamic Banks working in Pakistan.

STATEMENT OF THE PROBLEM/PURPOSE STATEMENT

Purpose of this research is financial performance analysis and comparison of Islamic banks working in Pakistan and Malaysia. This research will find the clear picture of financial results of Islamic banks from Pakistan. In Pakistan, all the previous studies in this field have focused on few selected commercial and Islamic banks of Pakistan, but in this study, Malaysian Islamic Banks will be taken in comparison of Islamic Banks from Pakistan.

OBJECTIVE OF RESEARCH

The objectives of this research work is to analyze and compare financial performance of Islamic banks in Pakistan and Malaysia through quantitative analysis. To reach the aim of this research work, following Objectives are developed:

(a) To Analyze the Individual financial performance of Islamic Banks in Pakistan and Malaysia for the last five years.
(b) To Compare the financial performance of Islamic Banks in Pakistan and Malaysia.
(c) To find the significant factors (Internal) having impact on performance of Islamic banks.

SIGNIFICANCE OF THE RESEARCH

This research will add, new comparative performance analysis of Islamic banks in Pakistan and Malaysia, to the existing literature. All previous studies were focused on few selected commercial and Islamic banks from Pakistan and Malaysia, and in this study, 3 pure Islamic banks from Pakistan and 3 pure Islamic Banks from Malaysia have been added in sample to get more reliable results. This research will also help in decision making of investors and policy makers related to the Islamic banks. It will also help the bankers to improve the performance of the banks. Ultimately, this research will give a clear financial picture for all the stakeholders of Islamic banks working in Pakistan.

RESEARCH QUESTIONS

This research will focus on the following research questions. An empirical analysis will be done to find the answer of these research questions:

1) What is the impact of internal factors on the performance of Islamic Banks?
2) Are Islamic Banks in Pakistan performing same as Islamic Banks in Malaysia?
3) How Islamic Banks performance can be improved in Pakistan?

HYPOTHESIS OF RESEARCH

To find the answer of above research questions, following research hypothesis has been designed.
H0: There is no significant impact of Internal Factors on performance of Islamic Banks working in Pakistan and Malaysia.

H1: There is a significant impact of Internal Factors on performance of Islamic Banks working in Pakistan and Malaysia.

LITERATURE REVIEW

Factors having impact on bank profitability have been under discussion for more than 2 decades. There is still a big research gap for further discussion on this issue. This part of my research proposal will shed light on the previous work done by different researches from Pakistan as well as other countries of the world. Most these work was done for commercial banks, and few writers from Pakistan discussed the factors having impact on profitability of Islamic Banks in Pakistan. There has been expansive number of experimental studies in which specialists have assessed the execution of managing an account segment utilizing diverse factual procedures, for example, relapse examination, proportion investigation, and CAMEL model. Further, various studies have been endeavored to investigate the experimental determinants of bank execution over the globe. This segment gives outline of the writing identified with bank particular, industry particular, budgetary and macroeconomic determinants of money related execution of banks.

There are a few studies that have been reported that few inside and outside components are huge in deciding bank financial performance. For instance, Safrali and Gumus (2010) analyzed the Azerbaijan's Bank Performance for the period of six years, 2003 to 2008. They had additionally assessed the relationship between bank performance and macroeconomic markers indicators. They first figured the bank's performance by utilizing the CAMEL model strategy, and after that they used regression for bank performance on Gross domestic product and Inflation. They found that albeit both Gross domestic product and swelling are adversely identified with banks' execution, the impact of expansion is measurably noteworthy, while, the Gross domestic product impact is irrelevant. Also, Tamimi (2010) inspected the execution of UAE's Islamic and customary banks for the time of 1996 to 2008. He gauged the bank execution by profit for resources (ROA) and profit for value (ROE). He considered a few autonomous variables, for example, Gross domestic product, bank size, focus, liquidity, monetary improvement marker, cost, and no of branches. For traditional bank, he found that both liquidity and fixation significantly affect banks' execution (on both ROA and ROE), though for Islamic banks, he demonstrated that working expense and number of branches have a noteworthy effect.

Alper and Anbar (2011) examined the Turkish banks' execution by considering a few inward and outside components. They utilized information covering the period 2002 to 2010. They utilized ROA and ROE as execution markers and they contended that productivity is the best measure to check the banks' execution.

Evaluating the altered impact model, they presumed that bank size and non-premium proportion impact sly affect gainfulness. They additionally found that the genuine loan cost has a huge and constructive outcome on productivity, while, Auto, stores, swelling, Gross domestic product, liquidity, and interest edge don't have any noteworthy effect on execution. Also, Akhtar, Ali, and Sadaqat (2011) measured the Islamic banks' execution in Pakistan over the period 2006 to 2009. They utilized ROA and ROE as execution markers furthermore, took diverse variables, for example, bank size, adapting proportion (all out obligation to value), resource administration, non-performing advance proportion, working proficiency, and capital ampleness. They utilized multivariate relapse to examine the effect of these variables on execution pointers. They found that adapting proportion and capital sufficiency proportion have a huge positive effect, while, bank size has a negative and inconsequential connection with ROA and ROE.

So also, Ansari and Rehman (2011) contrasted and analyzed the monetary execution with give review about present budgetary situation of Islamic and ordinary banks over the period from 2006 to 2009. Monetary proportions (liquidity, danger, dissolvability, and capital) were utilized to break down the execution of Islamic and customary banks. Investigation of fluctuation (ANOVA) and t-test were connected to inspect the noteworthy contrast between banks. They found that customary banks are less fluid, more hazardous, and less proficient when contrasted with Islamic banks. Thus, Islamic banks pick up force in their execution with the progression of time. Gul, Irshad, and Zaman (2011) inspected the impact of bank-particular and macroeconomic variables on banks' productivity for main 15 Pakistani banks for the period 2005 to 2009. They have utilized normal minimum square system to analyze the effect of bank size, advances, the rate expansion, stores, Gross domestic product, and business sector exploitation of gainfulness markers (ROA, ROE, ROC, and NIM). They discovered solid effects of these variables on benefit. They presumed that banks are sheltered what's more, perform better when they have great capital, resource quality, stores, and great monetary conditions and after that at last, banks leads towards high benefits.

Sehrish, Saleem, Yasir, Shehzad, and Ahmed (2012) examined and thought about the execution of 4 Islamic and 4 customary banks in Pakistan over the period 2007 to 2011. They found that in initial 3 years Islamic banks' execution was better, while, traditional banks was best in gainfulness they facilitate reasoned that Islamic banks will indicate change in benefit in not so distant future and there is no huge contrast in both banks. Usman and Khan (2012) looked at Islamic and ordinary banks' execution. They have utilized productivity and liquidity proportions of Islamic and traditional banks over the period 2007 to 2009. Agreement inspecting procedure and t-test were connected. The outcomes demonstrated that Islamic banks have great development, higher benefit, and more liquidity when contrasted with routine banks.

Choong, Thim, and Kyzy (2012) explored the banks' exhibitions in Malaysia looking at a few inner also as outside markers. They utilized ROA and ROE as execution markers. They found that the credit hazard has a noteworthy sway on banks' execution. They additionally inferred that other imperative variables are liquidity and focus yet they have measurably immaterial connection with banks' execution over the analyzed period. Zeitun (2012) inspected the impacts of outside possession, bank-particular variables, and macroeconomic pointers on the execution of Islamic and customary in GCC area. He utilized yearly information covering the period 2002 to 2009. He observed that bank size has a positive huge effect on Islamic banks' execution measured ROE. He likewise found that the expense to salary proportion has a critical and negative effect on the execution of both Islamic and traditional banks. He assist inferred that Gross domestic product what's more, swellings are altogether identified with bank execution, however remote possession has no critical effect on both Islamic and traditional banks' execution. Curak et al. (2012) investigated the effect of determinants on Macedonian banks' gainfulness over the period from 2005 to 2010. Summed up strategy for development (GMM) system was connected. Their outcomes uncover that working cost, dissolvability hazard, Gross domestic product, fixation, and liquidity danger are altogether identified with bank productivity, while, both bank size and credit hazard have factually, irrelevant effects. Bukhari and Qudous (2012) assessed the interior and outer variables' effects on Pakistani banks' gainfulness over the period 2005 to 2009. They found that most affecting variables are advances, intrigue, and credit hazard. However, they additionally observed that bank size, liquidity, the rate of expansion, imports, and fares have factually irrelevant sway.

Another study by Srairi (2013) contemplated the impacts of proprietorship structure (nature of proprietors and possession fixation) on danger taking conduct of both Islamic and routine banks. Yearly information covering the period 2005 to 2009 for banks working in 10 MENA nations have been utilized as a part of the observational investigation. The consequences of the study show that there is a negative relationship between possession focus furthermore, hazard. The outcomes likewise uncover that danger dispositions change with classes of shareholders. By looking at traditional what's more, Islamic banks, the creator demonstrated that private Islamic banks are as steady as private traditional banks, however generally speaking Islamic banks have a fundamentally bring down introduction to acknowledge hazard when contrasted with their partner traditional banks.

Ongore and Kusa (2013) inspected the ordinary bank execution in Kenya for the time of 2001 to 2010. They utilized ROA, ROE, and NIM as an intermediary of execution markers. CAMEL parameters are utilized as bank-particular variables, while both Gross domestic product and the rate of swelling are considered as macroeconomic markers. Summed up minimum squares (GLS) and customary slightest squares (OLS) systems were connected to examine the effect of these variables on banks' execution. They reasoned that the impacts of bank variables are more significant when contrasted with the impacts of macroeconomic markers. Bilal, Saeed, Gull, and Akram (2013) dissected the effect of bank-particular variable and macroeconomic pointers on bank benefit for the period 2007 to 2011. They utilized ROA and ROE as an intermediary for gainfulness and connected relapse also, relationship investigation to break down the determinants of productivity. They found that Gross domestic product, bank size, and the financing cost edge have huge and constructive outcomes, though, swelling and NPL have negative and critical effects. They additionally presumed that capital has a critical positive connection with ROA. Riaz and Mehar (2013) analyzed the bank variables (size, hazard, and store proportion) and macroeconomic pointers (Gross domestic product, loan cost, and CPI) sway on productivity over the period 2006 to 2010. They ascertained the productivity as far as ROA and ROE and chose test of 32 ordinary banks. They reported that danger and the loan fee both significantly affect ROA and ROE, while bank size and store proportion significantly affect just ROE.

Guillen, Rengifo, and Ozsoz (2014) proposed the observational model to inspect the determinants benefit for a specimen of 200 banks situated in Latin American. They utilized Information Envelopment Investigation. They discovered proof of the developing of banks' benefit higher than the danger balanced typical level of benefits. Bougatef (2015) analyzed the effect of adjustment on monetary well being of Islamic banks. He utilized GMM estimation technique for a board of 69 Islamic banks over the period from 2008 to 2010. He gave solid confirmation of the noteworthy impact of the level of debasement on money related soundness of Islamic banks. His discoveries propose that the defilement level is one the main considerations behind the issue of weakened financing. Similarly, Yousaf & Aziz, (2015) revise the same topic with different view for profitability improvement for Islamic Banks in Pakistan. This study provided a reflection on profitability of the Islamic banks with usage of profitability ration analysis with in context of lender and user of funds. The ration in between bank and user of the funds indicated the mutual advantage and positive relationship with profitability and total expenses incurred. The result about assets-liability managing and profitability for usual characteristics of banking corporations. The market share of the banks and money supply showed a negative relationship with profitability. The result of the respective study concluded with no significant variation in profitability with respect to competitive and monopolistic markets but except shareholder. The results of this study designated that Islamic banks in a viable market where better accomplished profitability then their complements. Consequently, formation of more Islamic banks will give more assistances to the investors. There are many points of study which are similar in conventional and Islamic banks to conduct research within comparison of them with assets-liability. So, more studies which involved asset-liability managing of an Islamic bank are deliberated one of the more stimulating and added promising areas for future research (Yousaf & Aziz, 2015).

SAMPLE, DATA AND METHODOLOGY

According to KPMG (Taseer Hadi & Co.) Annual Banking Survey 2015, Pakistan banking sector has been divided into three parts: **Large size Banks, Medium size Banks and Small size Banks** on the basis of their capacity, size, deposits, assets, loan and financing to other banks. According to this survey, 1) Meezan Bank, 2) Dubai Islamic Banks and 3) Albarak Bank are considered as Pure Islamic Banks working in Pakistan. First two are considered as medium size bank, and third bank is considered as small size bank. For this research, 3 Pure Islamic Banks from Pakistan will be selected for comparison with 3 Pure Islamic Banks from Malaysia. Therefore, **Pakistani Pure Islamic Banks are as follows:**

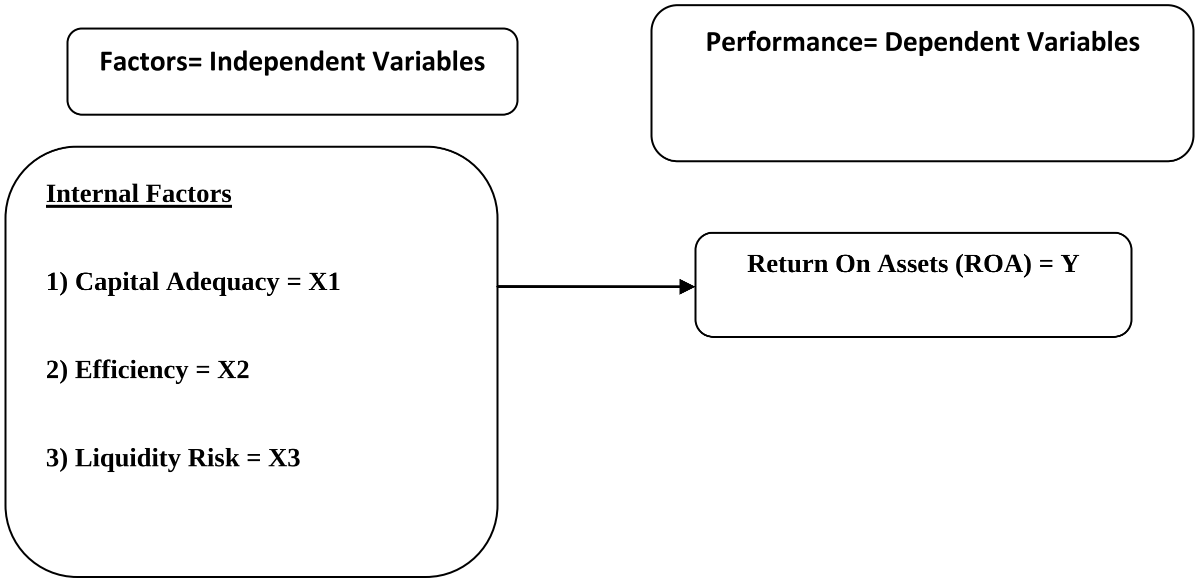
1) Meezan Bank
2) Dubai Islamic Bank
3) Albaraka Bank

Whereas in Malaysia, there are total 17 listed Islamic Banks working at present from which three are pure Islamic Banks (Ramlan & Adnan, 2016), therefore, following **3 Pure Islamic Banks from Malaysia have been selected for this study.**

1) Bank Islam
2) Bank Muamalat
3) Bank Rakyat

Financial statements of at least last 5 years will be used for analysis and collection of financial data. All the data will be analyzed empirically by using statistical techniques with SPSS. Regression Model will be designed for empirical analysis of performance as dependent variable, and factors (Internal only) effecting the performance as Independent Variables. All the results will be presented in a critical analysis.

Model Framework



According to Petria, et al., (2015) most commonly used variables for performance measurement of banks are Return on Assets (ROA) and Return on Equity (ROE). **Petria, et al., (2015)** further stated that, factors impacting the performance of a bank are divided in two main groups. One is internal factors and the other is External factors. For this study, only 3 internal factors and ROA will be considered. Following are regression equations for this model.

Model

$Y = \alpha + X1\beta1 + X2\beta2 + X3\beta3 + e$

Where as

Y Stands for Dependent Variables, i.e ROA and ROE respectively, whereas X1 to X3 Stands for Independent variables, i.e. CA, EF and LR Respectively. Details are given in the table below. While, **α** and **β** are fixed quantities, i.e the parameters of the model, and **e** stands for error term.

Variables Explanation and their Proxy

Type	Name	Symbol	Proxy
Performance = Dependent Variable	**1) Return on Assets**	**ROA**	**Net Profit/Average Assets**
Factors Affecting Performance = Independent Variables	**1) Capital Adequacy 2) Efficiency 3) Liquidity Risk**	**CA EF LR**	**Equity/Total Assets Cost/Income Financing/Customer Deposits**

DATA ANALYSIS AND RESULTS

Based on the above model and data collected for analysis, results are divided in 2 parts, one is financial Ratios comparison and the other part of analysis is empirical analysis of model variables.

1) Financial Ratios Comparative Results

	Pakistan	Malaysia	Pakistan	Malaysia	Pakistan	Malaysia	Pakistan	Malaysia
	ROA	ROA	CA	CA	EF	EF	LR	LR
2011	0.95	1.88	12.28	13.02	97.17	45.79	50.27	60.58
2012	0.38	1.68	10.91	12.26	101.64	50.87	44.1	66.44
2013	0.48	1.80	9.25	13.06	102.27	46.67	48.49	69.34
2014	0.64	1.59	8.57	11.99	99.19	52.60	58.33	76.39
2015	0.53	1.31	7.76	12.79	99.66	60.23	62.42	78.74

Explanation:

For this financial results comparison, recent five years financial data have been analyzed with financial ratios. From the above comparative financial results we can see that, there is a big difference in financial results of Pakistani Islamic Banks and Malaysian Islamic Banks. Pakistani Islamic Banks are very low in ROA, CA, EF and LR ratios. Whereas, Malaysian Islamic Banks have got very strong financial results for these ratios. These ratios have a significant impact on the financial performance of a Banks; it can be seen from the Empirical results below.

2) Empirical Results

Above model variables are also tested Empirically with regression model and following results are obtained. For this purpose, last ten years financial data of Pakistani and Malaysian Islamic Banks have been analyzed to get more reliable results.

2.1) Correlation and Autocorrelation Test Results

Following is the result summary for correlation of dependant variable ROA with 3 Independent Variables, CA, EF and LR.

CA	EF	LR	Durbin-Watson
0.754	0.687	0.785	1.57

Explanation

From the above results we can see that there is a positive correlation between variables, which means all variables move in the same direction. Whereas Durbin-Watson value represents the auto correlation between variables, and 1.57 means there is less auto correlation between dependent and independent variables, it is better for this model.

2.2) Model Summary and NOVA Results

R Square	Adjusted R Square	Std. Error of The Estimate	F Value	Sig. (P Value)
0.764	0.647	0.387	6.49	0.026

Dependent Variable: ROA

Independent Variables: CA, EF and LR

Explanation

From the above regression model results, we can see that sig. (P Value) is less than 0.05, which means model is significant, and R Square shows that these variables contribute 64.7% impact on the dependent variables, whereas there are 35.3% other variable which may have impact on the dependent variables. Therefore, it is clear from the above statistical results that, CA, EF and LR have a significant impact on the ROA of Pure Islamic Banks. The same result is described in the correlation results in previous table, there is a positive correlation between ROA and CA, EF and LR, it means with an increase in independent variables, dependent variable will also increase, and vice versa.

2.3) Coefficients

Independent Variables	Standardized Coefficients (Beta)	T Value	Sig. (P Value)
CA	0.454	1.784	0.125
EF	0.275	0.920	0.393
LR	0.297	0.858	0.424

Explanation

The last step of data analysis is the analysis of above coefficients table. Check the value of Beta under standardized coefficients, we can compare different variables as far as their Beta level, we must look at standardized coefficient only, it means these values for each of the different variables has been converted to the same scale, so we can easily compare them. As we see from Correlation table, there is positive correlation between Dependent variable (ROA) and Independent Variable (CA, EF and LR). So there is positive value of Beta for CA, EF and LR, under standardized coefficient column. If p-value is less than 0.05, it has a significant unique contribution to the prediction of the outcome, from the above results; we can see individual significance value of three independent variables. P-value of CA is 0.125, which shows that this variable do not have a significant impact on ROA as a unique variable. Whereas other variable, EF, has P-value 0.393. It also shows that EF also has a no significant effect on ROA as a unique variable. In the same way, LR also have p-value more than 0.05, i.e. 0.858, which also show that, LR also has a no significant effect on ROA as a unique variable. Whereas overall, three independent variables together, i.e. CA, EF and LR, have a significant effect on ROA, because its p-value is less than 0.05, i.e. 0.026. It means, all three independent variables have a significant impact on dependent variable when used collectively. It is also clear from the above ANOVA table, as already discussed above.

CONCLUSION AND RECOMMENDATIONS

From the above result, it is concluded that, internal factors have a significant impact on the performance of Islamic Bank, so in Pakistan, these factors should be given high concentration for better performance. Banks should design new policies to improve the CA, Ef and LR ratios. In comparison with Malaysian Islamic Banks, the same result is shown. Pakistani Islamic Banks should improve their CA, EF and LR Ratios. So performance may be improved in future. This study is limited to the following facts:

- ✓ Only Pure Islamic Banks from Pakistan and Malaysia has been taken in sample.
- ✓ Secondary data has been used for this study.
- ✓ Only 3 Internal Factors have been taken into consideration.
- ✓ Time period of data analysis is limited to last 10 financial years.
- ✓ Only regression model and comparative ratio analysis are done for comparative performance analysis of Malaysian and Pakistani Islamic Banks.

It is recommended for future research; Increase the sample size with Islamic Banking part of the conventional Banks from both countries, Increase the time period to get more data, Use of primary data to find the other significant internal as well as external factors' impact on banks' performance.

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