

Comparative Performance Study of Conventional and Islamic Banking in Pakistan

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Abstract

The purpose of this empirical study is to analyze and compare the performance of Islamic and conventional banking in Pakistan and to find out which of the banking stream is performing better than other. For this study, sample of 22 conventional banks and 5 Islamic banks were selected. For in-depth understanding and sound comparison, key performance indicators were divided into external and internal bank factors. The external factor analysis includes studying the customer behavior and perception about both Islamic and conventional banking. Internal factor analysis includes measure of differences in performance of Islamic and conventional banks in terms of profitability, liquidity, credit risk and solvency. Nine financial ratios were used to gauge profitability, liquidity and credit risk; and a model known as “Bank-o-meter” is used to gauge solvency. Findings suggest in terms of profitability and liquidity conventional banking leads, while in credit risk management and solvency maintenance Islamic banking dominates. Motivating factors for customers of Islamic banking are the location and Shari’a compliance, while in case of conventional banking it is wide range of products and services.

Keywords: Performance evaluation, Islamic banking, Pakistan, customer survey, profitability, liquidity, credit risk, solvency, Shari'a Compliance

JEL Classifications Code: G 21

I. Introduction

Ever expanding Role of modern financial services has changed the way business is taking place in the market. Revolution in telecom sector duly utilized by financial sector has eliminated the physical presence of businessmen and geographical location of markets to transect the business. Banking sector has become vital for the development as well as smooth running of the economy of any nation on the planet. Till fourth quarter of 20th century, the whole financial sector worldwide was operating on interest basis which is contradicting with injunctions of Islam and a large number of world population (Muslims) were at unrest with the prevailing system, which led to the development of interest free (Shari'a compliant) banking.

In Pakistan efforts for Islamization of economy was started in 1980s, resulted in first ever report on Islamization of economy by Council of Islamic Ideology. Whole financial system was converted to interest free system abruptly, resulting in failure in practicing of true Islamic banking due to incapacity of human resources. Higher judiciary declared the system in practice as Shari'a non compliant in 1999. From beginning of 21st century central bank of Pakistan adopted different than 80's approach and started parallel working of Islamic and conventional banking (an approach in practice worldwide). By June 2011, five full fledged Islamic banks and 12 conventional banks with independent Islamic Divisions were operating in Pakistan; covering market share of 8%, with branch network of 799 (SBP-2011).

Performance evaluation is an important tool to assess the success of any business including Islamic financial industry. For performance evaluation setting the bench mark is also vital to make the comparison of desired and actual performance. In this study we have explored the performance of both streams of banking (Conventional and Islamic). In order to study performance we have divided our population in two portfolios (conventional and Islamic) to conduct analysis. Our analysis consist of two phases; phase one consist of financial analysis for five years (2005-09) and includes profitability, liquidity management, credit risk management and solvency. To study the profitability we calculated ROA, ROE and cost to income ratio. For documenting liquidity management we calculated loan to asset ratio, liquid assets to deposits ratio and loan to deposits and borrowings ratio. In order to uncover credit risk management we calculated equity to total assets, equity to loans and percentage of impaired loans. Finally to determine the solvency we used bank-o-meter adopted from Shar et al (2010). Phase two of the project was consisting of customer survey. Total 200 (100 +100) questionnaires were filled by customers representing five Islamic and five conventional banks in Rawalpindi/Islamabad region.

Findings of study are very interesting. Out of the four financial analysis key performance indicators (KPIs) including profitability, liquidity, credit risk and solvency, in first two (profitability & liquidity) conventional banking has performed better than Islamic banking. In last two KPIs (credit risk & solvency) performance of Islamic banking dominated the conventional banking. Survey results are almost same for both streams of banking showing overall satisfaction for financial services. Major motivational factor for customers of Islamic banking was Shari'a compliance and for customers of conventional banking it was facilities (wide range of products) provided.

Rest of the study proceeds as follow. Literature review is presented in section II, followed by research objectives and methodology in section III. Findings are presented in section IV while section V concludes.

II. Literature Review

Banks performance can be measured both by using qualitative and quantitative methods and techniques. Different variables and statistical techniques have been used for analysis by different studies and results are drawn from them aiming at performance evaluation. Banks performance can be measured in terms of profitability, growth, efficiency, liquidity, credit risk performance, and solvency. There is a general agreement in literature that Islamic banks are superior to conventional or mainstream banks in terms of their performance (Samad, 2004; awan,2009; Rosly and AbuBakar, 2003; Safiullah,

2010). Keeping in view the importance of banking sector, different studies have been carried out for evaluating performance of banks.

Iqbal (2001) studied the performance of conventional and Islamic banking. This study used data for the years 1990-98 and numerous hypothesis and general perceptions about the practice of Islamic banking have been tested. The techniques used to evaluate performance of Islamic banks was both trend and ratio analyses. The performance of Islamic banks was compared with conventional banks that are the control group.

Islamic banking is interest free banking; making it compulsory to take active part in business profit and loss sharing. Islamic banks prefer to take less risk. Sheikh & Ali (2009), in their paper analyzed the risk management procedures of Islamic banking by giving differential analysis of risk management based on unique characteristics. This paper has used ROE as a bench mark. A sample of two Islamic banks and two conventional banks was taken.

For measuring the efficiency of banks, studies have been carried out using different models. Percin and Ayan (2006) studied and evaluated the efficiency of commercial banks in Turkey using a Data Envelopment Analysis (DEA) and Malmquist Productivity Index (MPI) Methodologies. Akhtar (2010) also used Data Envelopment Analysis (DEA) and Malmquist Productivity Index (MPI) to see efficiency scores and productivity indices of banks in Saudi Arabia and concluded that technical inefficiency emerges from both scale as well as pure technical inefficiencies. The results on Malmquist Productivity Index (MPI) showed an improvement in average productivity of banks. The study also found that the major source of productivity gain was the efficiency change relative to technological change.

Bader et, al., (2008), documented that there is no difference between the overall efficiency of conventional and Islamic banks which includes cost, revenue and profit efficiency, after studying performance of 43 Islamic and 33 conventional banks for the period 1990-2005 in 21 countries using Data Envelopment Analysis. This study assessed the average and overtime efficiency of banks based on their size, age, and region using static and dynamic panels.

To check the vulnerability and solvency of banks, CLSA-stress test, CAMEL and Bank-o-meter are the models that are used in different studies conducted by various researchers. Shar, et, al; (2010a) studied and evaluated the performance and efficiency of banking sector using Credit Leona's Securities Asia stress test (CLSA-stress test). This study enclosed the period of pre and post nationalization of state owned and commercial banks of Pakistan. By using adjusted and unadjusted stress test, it has been analyzed that some banks are mediocre, under stress or sound in regard to the capital strength, assets quality, efficiency and liquidity. This study gauged solvency of individual banks. Shar, et, al; (2010) developed a model known as Bank-o-meter. Ability to predict which bank is defenseless to financial distress is of critical importance to investors, creditors, accountholders and many other stakeholders. For this purpose a model was developed called 'Bank-o-meter'. To confirm the accuracy of Bank-o-meter, it was applied on individual banks during the period 1999-2002 for gauging the solvency of each bank in Pakistan and the results were compared with CAMEL and CLSA-stress test.

Jaffar and Manarvi (2011), examined and compared the performance of Islamic and conventional banks operating inside Pakistan during 2005 to 2009 by applying CAMEL test. A sample of 5 Islamic banks and 5 Conventional banks were selected to measure and compare their performance. CAMEL test is a standard test to check the health of financial institutions and to determine the performance of banks. Different ratios were used to evaluate each element of CAMEL. The study found that Islamic banks performed better in possessing adequate capital and better liquidity position while conventional banks pioneered in management quality and earning ability. Asset quality for both streams of banking was almost the same; conventional banks recorded slightly smaller loan loss ratio showing improved loan recovery policy whereas, UNCOL ratio analysis showed a nominal better performance for Islamic banks.

Safiullah (2010) did the comparative study of performance of interest based and interest free banking in Bangladesh. For this study four conventional banks and four Islamic banks were selected.

The time period for this study was 5 years from 2004 to 2008. Ratio analysis was conducted to gauge business developments, profitability, liquidity and solvency, commitment to economy and community, efficiency and productivity of both banking streams. Results showed that conventional banks were doing better than Islamic banks based on commitment to economy & community, productivity and efficiency.

Profitability is also another measure to determine the performance of banks. Javaid, Anwar and Zaman (2011) gave the analysis of the determinants of top 10 banks' profitability in Pakistan over the period 2004-2008 using the pooled Ordinary Least Square (OLS) method to examine the impact of assets, loans, equity, and deposits on one of the major profitability indicators, return on assets (ROA). This study focused on internal factors only. The empirical results showed that these variables have a strong influence on the profitability. However, the results depicted that higher total assets may not necessarily lead to higher profits due to diseconomies of scales. Study also found that higher loans contribute towards profitability but their impact is not significant. However, equity and Deposits have considerable impact on profitability.

External factor analysis is also important for measuring and evaluating performance of banks. Till date many studies have been conducted to evaluate performance of banks using external factors. From the study of Sheikh et, al; (2010), it was concluded that customers of both banks are satisfied with kinds of products both mediums are providing depending upon their nature. A questionnaire of 15 questions was distributed in banks of Bahawalpur.

Muslim customers are mostly satisfied with Availability of ATM in several locations, phone account access, safety of funds, ease of opening a current account, bank image and reputation (Al-Hashash and Bahzadi, 2008). 650 questionnaires were distributed in different banks of Kuwait to measure satisfaction level of Islamic and conventional banks. Descriptive statistical tools and ANOVA test was being used to measure customer satisfaction. The results showed a slight degree of difference in customer satisfaction of both streams. The worst factor noted in the study was interest on loans.

Islamic banking is growing at a faster pace in Pakistan and within a smaller period it has captured 8% of market share. Branch network has reached to 799 by the end of June 2011. It is pertinent to study comparative performance of well established (conventional banking) and newly introduced (Islamic banking) to uncover the strengths and weaknesses of each stream.

III. Purpose and Methodology

The purpose of this study is to conduct comparative performance evaluation of Islamic & Conventional banking sectors in Pakistan in order to document the results of each sector during period under review. This study will help in channelizing resources in future including deposits, finances, investments and other banking services. In summary following are research questions:

1. Which of the banking stream is relatively more profitable?
2. Which of the banking sector is relatively more liquid?
3. Which of the banking sector is exposed to relatively more credit risk?
4. Which of the banking stream is more solvent?
5. Which of the banks is best performer in both streams?
6. Which of the banking stream has relatively more satisfied customers?

In order to achieve the objectives listed above we selected period of 5 years (2005-09) and included 22 conventional banks and 5 Islamic banks. To answer the risk and return relationship (first four questions) we calculated financial ratios and for last question we administered customer survey. Basically, the type of research that we have conducted is a combination of financial statement analysis, ratio analysis and banks external factor analysis of the two streams of banking operating in Pakistan. We have measured banks performances on set critical factors that we think are specific to performance of any bank. We have calculated required ratios and have done necessary arithmetical and statistical working required to see the performance year wise. After all the working we have separate values for

every bank year wise. We then applied mean and standard deviation to measure the performance sector wise. This gave us two comparative values for each portfolio i.e. Islamic and conventional Banks on key performance indicators (KPIs), which are the basis of our conclusion.

Based on Literature we found that performance measure is a complex process, so for our better understanding and sound comparison, we have divided key performance indicators into (1) internal factors and (2) external factors. Internal factors include measure of differences in performance of Islamic and conventional banks in terms of profitability, liquidity, credit risk and solvency. To measure these performance indicators we have used different ratios. The ratios which we have selected to gauge profitability, liquidity and credit risk have been used in a study by Samad (2004). To measure solvency of banks we have used a model named "Bank-o-meter", developed and tested by Shar, et, al; (2010). The selected parameters are explained below.

Profitability is one of the widely used performance indicator to measure the performance of any business. Like all other business, banks earn profit when their income is more than their expenses. Profitability ratios depict banks overall performance and efficiency. Variables used for gauging profitability are: *Return on Assets (ROA) = Net Profit/Total Assets*. ROA has been used in a lot of studies to measure the performance of banks. (Samad, 2004). [(see, Ben Naceur (2003) and Alkassim (2005) as cited by Javed, et. al; (2011)]. Second ratio used to gauge profitability was *Return on Equity (ROE) = Net Profit/Equity*. ROE tells the return owners earn on their investment in bank. ROE is of great concern to the investors and shareholders. ROE measures the efficiency of banks in making profits from every unit of shareholders equity/bank capital [(Gul, Irshad and Zaman(2011)]. Potential investors look for ROE before investing in a bank so it is important for a bank to have a higher ROE. Higher the ROE, more efficient the banks performance is. Third parameter to gauge profitability was *Cost income Ratio (COSR) = Total cost/Total income*. According to Tripe (.....) Cost to income ratio is defined as non interest costs excluding bad debts and doubtful expenses, divided by total of interest income and non-interest income. COSR depicts the income generated per dollar cost incurred. Lower the cost to income ratio, better the bank's performance.

Maintaining liquidity in all circumstances is one of the major challenges that banks face. Liquidity of a bank means the ability of a bank to meet the financial obligations as and when due. Liquidity tells the capability of a bank to convert its assets into cash at the face value and meet the demands of customers, borrows and depositors at the time they need it. Liquidity is a prime parameter of banking risk. In order to asses liquidity following ratios were used. First was *Net Loans to Asset Ratio (NetLTA) = Net loans/Asset Ratio*. This ratio shows the percentage of loans that are rooted in assets. The net loans to assets ratio measure the net loans outstanding as a percentage of total assets. The higher this ratio, lower is the banks liquidity and the bank is tied up in loans. The higher the ratio, the more risky a bank is to higher defaults. Second ratio used was *Liquid Assets to Customer Deposits and Short Term Funds Ratio (LdCDSF) = Liquid Asset/Customer deposit and short term funds*. According to Samad(2004), LdCDSF is a deposit run off ratio. This ratio shows the percentage of deposit and short term funds that are available to meet the sudden withdrawals. The higher the LdCDSF, the more liquid is bank. Third ratio used to gauge the liquidity was *Net Loans to Deposits and Borrowing (NetLD&B): Net Loans/Total Deposits and Borrowing*. This ratio depicts the percentage of total deposits and borrowings that are entrenched into non-liquid asset. The higher the LDBR, the higher is the chance that bank face liquidity risk.

Credit risk is defined by State bank of Pakistan in Risk Management Guidelines for Commercial Banks & DFIs as: "Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the bank." Hence, Credit risk is the risk of loss that arises from a borrower's or counterparty's inability to meet its obligations. For any financial institution measuring and managing credit risk is very important. First ratio used to gauge credit risk was *Common Equity to Total Assets (EQTA) = Common Equity/Assets*. This ratio shows common equity as a percentage of total assets. EQTA provides percentage protection required to meet the expense by banks to its investment in asset. It

shows the overall shock captivating capacity of a bank for possible expected or unpredicted loan asset losses. The superior the ratio of EQTA, the larger is the capacity for a bank to soak up the assets losses (Samad, 2004). Second parameter used was *Total Equity to Net Loans (EQL) = Total Equity/Net Loans*. This ratio shows the total equity capital as a percentage of total net loans. EQL provides equity as a cushion to take in or adjust loan losses faced by a bank. The higher the ratio of EQL, the higher is the capacity for a bank in absorbing loan losses. Third parameter used was *Impaired Loans to Gross Loans (IMLGL) = Impaired Loans/Gross Loans*. This ratio indicates the percentage of nonperforming loans or doubtful loans to gross loans that a bank has on its books. This ratio also assesses the quality of assets or loans of the bank. The lower the ratio of IMLGL, the better is the asset/credit performance of the bank.

The ability to predict weakness and reliability of banks in financial distress is of vital importance to central banks, creditors and to equity investors. When a bank goes insolvent, creditors often lose portion of principal and interest payments, while equity investors can potentially lose all of their investment (Shar, et, al; 2010). To measure solvency of banks, we will use a model know as Bank-o-meter developed by Shar, et, al; (2010). Bank-o-meter has a quality that it uses minimum parameters and gives more accurate results on solvency of banks. Shar, Shah and Jamali, 2010; used following parameters in this model:

$$S = 1.5 * CA + 1.2 * EA + 3.5 * CAR + 0.6 * NPL + 0.3 * CI + 0.4 * LA$$

Where 'S' stands for solvency

CAR stands for capital adequacy ratio

CA stands for capital assets ratio

EA stands for equity to assets

NPL stands for non performing loans to loans

CI stands for cost to income

LA stands for loans to assets

And $50 < S < 70$. All banks having 'S' value greater than 70 are solvent and termed as super sound banks, while those banks having 'S' value below 50 are not solvent. The area between 50 and 70 is defined as gray area because of the susceptibility to error classification (Altman, 1968 as cited by Shar, et, al; 2010)

In order to answer the last question we have incorporated one non financial performance indicator that is customer satisfaction. It is an external bank factor. We have judged bank performance in accordance with the customers' perception on the factors we identified based on the nature and the functions we considered vital for effective performance of both banking streams. We took customer satisfaction as a fifth KPI because irrespective of what type of organization it is, the main focus of every business is to achieve maximum customer satisfaction to beat competitors in the market and earn higher profits. To judge customers on their satisfaction level, we made two questionnaires for customers from both banking streams. The questionnaire comprises of eight close ended questions and 2 open ended questions. For closed ended questions, we developed a scale from one to five to judge the satisfaction level. Open ended questions are more related to customer choice answer and suggestions for improvement. Open ended questions are designed just to ensure that nothing is being left out in evaluating customer choices and prime motivation factors towards selection of a bank. The questions asked by all customers are same, except that two adjustments have been made for Islamic banking questionnaire which is profit and loss sharing and banking Shari'a policies. In our study, the external factor analysis includes studying the customer behavior and perception about Islamic and conventional banking. We have explored the performance of Islamic banks and the conventional banks competitively by quality of the facilities (products and services) they are providing to their customers and satisfactory level of the customers. Our study aims to find the factors that are motivating customers to the Islamic banks and the factors that are motivating customers to the conventional banks in Pakistan. Five Islamic and five conventional banks have been selected based on random sampling. 200 questionnaires were distributed in different branches of selected banks, 100 being filled out by

customers of each stream. Branches of all banks in our sample are also selected by applying random sampling technique. Questionnaires are developed for both Islamic and conventional banking.

Main source of data collection for our study is secondary data which is extracted from the financial statements of banks. Primary data collection techniques used for conducting external factor analysis, for both Islamic and conventional banking includes Questionnaires filled by customers.

Table 1: Sample of Islamic & Conventional banks for Customer Survey

Islamic banks	Conventional banks
Bank Islami Pakistan Limited	Standard Chartered bank
Dawood Islamic Bank	Askari Bank Limited
Dubai Islamic Bank Pakistan Limited	NIB Bank Pakistan
Meezan Bank Limited	United Bank Limited
Albaraka Bank Limited	Habib Bank Limited.

VI. Empirical Results and Analysis

In this section results and analysis are presented in two subsections. In subsection one financial analysis is presented while in second subsection results of customer survey is presented.

VI. A. Financial Analysis

Results of financial analysis are presented in table 2 covering four core areas of profitability, liquidity, credit risk and solvency through simple sectorial averages for both streams of banking.

Table 2: Financial Performance of Islamic Vs Conventional Banking

PPERFORMANCE MEASURES	CONVENTIONAL BANKS	ISLAMIC BANKS	COMMENTS
Profitability			Conventional Banking is dominating in profitability
ROA	1.44%	0.26%	
ROE	14.26%	1.73%	
COSR	52.80%	97.63%	
Liquidity			Conventional banking is dominating in liquidity management
NetLTA	53.65%	91.3%	
LdCDSF	96%	82.17%	
NetLD&B	58.49%	86.84%	
Credit Risk			Islamic Banking is dominating in credit risk management
EQTA	10.10%	14.81%	
EQL	18.72%	16.22%	
IMLGL	10.64%	0.65%	
Solvency	56.36	91.95	Islamic Banking is dominating in Solvency management

ROA, ROE and COSR are the financial measures that depict the profitability of Islamic banks and conventional banks. ROA of conventional banking sector is 1.44% which is higher than Islamic banking sector that is 0.26% and this indicates that assets of conventional banks are capable of yielding more return than Islamic banks. Similarly ROE also shows that conventional banks are more profitable than Islamic banks which depicts that conventional banks are more efficient in generating profits from every unit of shareholders equity/bank capital. COSR (cost to income ratio) of Islamic banks is 97.63% which is quite high as compared to conventional banks. So COSR shows that conventional banks are performing better than Islamic banks and also that conventional banks are more efficient in generating income per dollar cost incurred, as compared to Islamic banks, hence in profitability Conventional banking stream is dominating in comparison of Islamic banking.

Three different indicators (NetLTA, LdCDSF, NetLD&B) are used to measure the liquidity risk of portfolios of Islamic and conventional banking. NetLTA(net loans to asset ratio) of Islamic banking sector is 91.3% while NetLTA of conventional banking sector is 53.65%. Higher ratio of Islamic banking sector shows that this sector is tied up in loans and has lower liquidity as compared to conventional banks. So, conventional banks are more liquid as compared to Islamic banks. LdCDSF (Liquid Assets to Customer Deposits and Short Term Funds Ratio) shows that there is not too much between the liquidity of both banking sectors, however conventional banking sector is more liquid as compared to Islamic banking sector as this ratio is higher for conventional banking. This obviously shows that conventional banks are more competent in meeting unexpected and sudden withdrawals as compared to Islamic banks. NetLD&B (Net Loans to Deposits and Borrowing ratio) of Islamic banking sector is 86.84% while that of conventional banking sector is 58.49%. Higher NetLD&B of Islamic banking sector shows that Islamic banks face more liquidity risk than conventional banking sector. Overall liquidity management of conventional banking is better than Islamic banking.

Credit risk of both banking sectors is depicted by EQTA, EQL and IMLGL. It depicts from table-2 that EQTA (Common Equity to Total Assets ratio) of Islamic banking sector is 14.81% while EQTA of conventional banking sector is 10.10% providing evidence that Islamic banks have more capacity of absorbing asset losses as compared to conventional banks. This ratio also shows that Islamic banks have more capacity to absorb potential expected or unexpected loan asset losses as compared to conventional banks. There is not too much difference in the EQL (total equity to net loans ratio) of both banking streams however, EQL of conventional banks (18.72%) is slightly more than EQL of Islamic banks (16.22%) which depicts that conventional banking sector is more proficient in absorbing loan losses as compared to Islamic banking sector. IMLGL (Impaired Loans to Gross Loans) of Islamic banking sector (0.65%) is much lower than conventional banking sector (10.64%). This clearly shows that the quality of assets or loans of Islamic banks is better than conventional banks. Credit risk performance of Islamic banking sector is better than credit risk performance of conventional banking sector. Overall dominance of Islamic banking in credit risk management is depicted in this study.

To gauge the solvency of each banking sector we have used Bank-o-meter. Our analysis shows that Islamic banking sector is much sounder as compared to conventional banking sector. Solvency of Islamic banking sector is 91.95 which show that this sector is sound and solvent. However solvency of conventional banking sector is 56.36 which according to our model fall within the grey area.

In this study we have not only traced out which banking medium is performing ahead of other but we have also traced out that which of the banks in each banking stream is performing better than all others in terms of profitability, liquidity, credit risk and solvency. Following table-3 gives a glance of the leading banks in terms of profitability, liquidity, credit risk and solvency.

Table 3: Leading Banks In Each Banking Stream

PPERFORMANCE MEASURES	LEADING CONVENTIONAL BANKS	LEADING ISLAMIC BANKS
Profitability		
ROA	MCB Bank	Meezan bank
ROE	MCB Bank	Meezan bank
COSR	MCB Bank	Bank Islami
Liquidity		
NetLTA	JS Bank	Bank Islami
LdCDSF	NBP	Albaraka Islamic Bank
NetLD&B	JS Bank	Bank Islami
Credit Risk		
EQTA	Samba Bank Ltd	Dawood
EQL	Samba Bank Ltd	Bank Islami
IMLGL	Silk Bank Limited	Dubai Islamic bank
Solvency	Silk Bank Limited	Albaraka Islamic Bank

Performance of Bankislami is at top followed by Albaraka and Meezan from Islamic banking stream while in case of conventional banking MCB Bank is at top followed by Samba, Silk and JS banks. Out of nine financial ratios Bankislami topped in four followed by MCB topped in three while Albaraka, Meezan, JS, Samba and Silk banks topped twice during study period.

VI. B. Customer Survey Results

Most of the correspondents of both stream belonged to job seeking class with an age bracket of 20-29. Most of the correspondents are males. The educational background of most of the correspondents is either they are under graduate students or post graduate students. Majority of correspondents have less than 5 years of experience with their particular bank.

Table 4,5 & 6 depicts the results of the responses given by the customers of Islamic and conventional banks operating in Pakistan. From the results presented above we can clearly see that most important factors that are motivating customers to go for Islamic banking are the location of the bank and Shari'a compliance of Islamic banking. Customers that do business with Islamic banks strongly perceive and believe that the banking is based on the rules and guidelines of Shari'a. While in case of conventional banking, factors that motivate customers are the wide range of products and services provided by the conventional banks and friendliness of personnel. Generally there's not much difference between the satisfaction level of customers of both Islamic banking and conventional banking in terms of providing fast and efficient services to the customers. Customers of Islamic banks are mostly satisfied by the terms and conditions that exist for availing the products or services, friendliness of bank personnel, and the fact that Islamic banks operate on the principle of profit and loss sharing. However in case of conventional banks, customers are mostly satisfied with the ease of obtaining loans from the bank, friendliness of bank personnel, interest rates on which bank gives loans and interest rate customers get on their saving accounts or investments. Customers of both banking streams are satisfied with the quality of e-banking services provide by the bank. We know that both banking streams provide different types and different variety of products and services. Customers of conventional banks are more satisfied by the variety of products and services provided by the bank as compared to customers of Islamic banks. 70% customers of conventional banks are satisfied by the range and variety of products and services offered by conventional banks whereas 25% customers of Islamic banks are satisfied by the products and services offered by Islamic banks. Islamic banking is asset based banking, so it cannot diversify its product portfolio as much as of conventional banking. Shari'a based banking is the only influencing factor that drives the potential customers of Islamic banking towards them.

Customer Satisfaction about Islamic Banking in Pakistan

Table 4: Customer Satisfaction and Perception about Islamic Banking in Pakistan

Questions Asked	Fully Satisfied	Satisfied	Neutral	Dissatisfied	Fully Dissatisfied
Bank provides fast and efficient services	24%	41%	28%	7%	0%
Terms and conditions for availing Islamic product or investments	29%	34%	22%	8%	7%
Friendliness of bank personnel	43%	34%	19%	4%	0%
Profit and loss sharing	23%	49%	25%	0%	3%
Bank policies are according to Islamic Law	41%	40%	14%	0%	5%
Location of bank	51%	37%	12%	0%	0%
Variety of products and services offered by the bank	26%	25%	40%	5%	4%
The quality of service of e-banking provided by the bank	12%	39%	15%	17%	17%

Customer Satisfaction and Perception about Conventional Banking

Table 5: Customer Satisfaction and Perception about Conventional Banking in Pakistan

Questions asked	Full Satisfied	Satisfied	Neutral	Dissatisfied	Fully Dissatisfied
Bank provides fast and efficient services	35%	25%	25%	15%	0%
Ease of obtaining loans (the acceptability of loan terms and conditions)	23%	15%	45%	15%	2%
Friendliness of bank personnel	23%	20%	42%	15%	0%
Interest rate/ profit you get on saving account or investments	10%	35%	35%	20%	0%
Interest rates on which bank gives you loan	20%	22%	38%	20%	0%
Location of bank	25%	37%	21%	17%	0%
Variety of product and services offered by the bank	5%	70%	17%	8%	0%
The quality of service of e-banking provided by the bank	0%	44%	30%	20%	6%

Table 6: Customer Choice of Banking

Islamic Banking		Conventional Banking	
When you have to open an account in a bank you look for?		When you have to open an account in a bank you look for?	
Shari'a based banking	36%	Friendliness of personnel	27%
Friendliness of personnel	15%	Facilities provided by the bank	30%
Facilities provided by the bank	23%	Image of bank	10%
Image of bank	12%	Return on investment	14%
Effectiveness in handling problems	5%	Effectiveness in handling problems	9%
Cost effectiveness	6%	Other	10%
Others	3%		

VI. Conclusion

This study covers five years period (2005-09) and includes total population of banking sector (22 conventional banks and 5 Islamic banks) to study the comparative performance of both streams of banking (Islamic and conventional). For performance study we constructed two portfolios of two streams of banking to perform analysis and document findings in the form of sectorial averages. On the basis of results we can conclude that in terms of profitability and liquidity management conventional banking stream is performing better than Islamic banking. However under credit risk management and solvency maintenance, performance of Islamic banking is better than conventional banking sector, which shows the strength and soundness of this banking stream. Results of customer survey depict overall satisfaction of customers with both banking streams. Among the factors we identified, single most important motivating factor for Islamic banking customer is the Shari'a compliance of Islamic banking (a unique selling point) which is lacking in its competitors. The most important motivating factor for conventional banking is variety of banking products and services.

Islamic banking is a newly established stream of banking in Pakistan and captures only 6% of market share by December 2009, and 8% in June 2011 (SBP-2010) very little market share as

compared to conventional banking. This could be the reason for lesser profitability and liquidity of this stream of banking, however sound credit risk management and solvency indicates the strength of this newly established business sector. Sharia compliance is the only difference of Islamic banking with conventional banking which must be ensured by practitioners. It is the unique selling proposition for this industry and any weakness on this front can jeopardize its very existence. It is recommended to the users of this study that size effect of both streams of banking must be kept in view while interpreting results and making decisions on their basis.

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