Financial Performance Analysis of Islamic and Conventional Bank in Pakistan: A Comparative Study

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IN THE NAME OF

ALLAH

The most Beneficent

The Most Merciful

"To Allah belongs whatever is in the heavens and whatever is in the earth. Whether you show what is within yourselves or conceal it, Allah will bring you to account for it. Then He will forgive whom He wills and punish whom He wills, and Allah is over all things competent."

(Al- Baqarah, 2:284)

GOLDEN SAYING OF
THE HOLY PROPHET
(Peace Be Upon Him)

The Prophet Muhammad (PBUH) said: “If anyone travels on a road in search of knowledge, Allah will cause him to travel on one of the roads of Paradise. The angels will lower their wings in their great pleasure with one who seeks knowledge. The inhabitants of the heavens and the Earth and (even) the fish in the deep waters will ask forgiveness for the learned man. The superiority of the learned over the devout is like that of the moon, on the night when it is full, over the rest of the stars. The learned are the heirs of the Prophets, and the Prophets (no monetary inheritance), they leave only knowledge, and he who takes it takes an abundant portion”.

(Sunan of Abu-Dawood, Hadith1631)

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May ***Allah Almighty*** *bless you all.*

Ali Raza

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Abstract:

Basically; there are two type of banking systems working in Pakistan i.e. Islamic banking system and conventional banking system. The Islamic banking system is based on principles of Islamic law (Shari'ah) and directed by the Islamic economy. While, conventional banks are working on manmade principles, where the predetermined interest rate is the main activity. This study analyzes the performance of Islamic banks and Conventional banks of Pakistan during the period 2005-2018. The objectives of this study is to compares the financial ratio analysis, which includes {return on Asset (ROA), Advances to Deposit ratio (ADR), Capital adequacy ratio (CAR), Investment to Liability Ratio (ILR), Equity Multiplier Ratio (EMR) and Cash Flow to revenue ratio (CFR)} and CAMEL model analysis (Capital adequacy, Asset Quality, Management Quality, Earnings and Liquidity) of Islamic banks and Conventional banks in Pakistan. The results of the study indicate that Conventional banks in Pakistan have better financial performance than Islamic banks. In term of ROA, ADR, ILR and EMR Conventional banks are performing better than Islamic banks. In term of CAR and CFR Islamic banks are performing better than conventional banks. In term of CAMEL model, Asset quality, Management quality and Earning, Conventional banks are performing better than Islamic Banks. Capital adequacy and liquidity perspective Islamic banks are performing better than Conventional banks.

Keywords: Ratio Analysis, CAMEL Analysis, Islamic Banks, Conventional Banks, Pakistan.

Chapter: 1

Introduction

Liberalization, Privatization and Globalization have provided a way for the expansion of the banking and financial sector. In Pakistan two banking sector, Islamic banking system and commercial banking system and both are working under central bank of Pakistan. Both banking sectors are operating all over the country with a large number of networks. Conventional banks are the main performers in the financial system to make money in the economy and convert saving into investment and contribute to capital formation in the economy. Islamic banks also play a very significant part in the development of economies. In this regard banks also stimulate savings and investment activities in the economy. However; shareholders such as investors, owners, creditors, debtors, depositors, governments, administrators and regulators are more concerned about the bank's financial performance. In today's most competitive environment, banks need to increase their profitability to meet the requirements of all interested parties such as shareholder, investor and stakeholders. The survival and growth of banks also depends on financial performance. Bank credibility is important for the creation of a strong customer base. Banks are developing links between deficit and surplus units to promote business and trade activities. Banks also perform various functions to offer different products and services to different economic sectors.

1.1. Background of the Study

Banks are financial entity that actively participates in economic development. In last two centuries significant reforms and formalization can be observed into banking industry operations. At the time of modern era, banking system has new goods and new services to provide a good flow of capital in the economy. Establishing Bank's successes is essential for investors, borrowers, policy makers and decision makers (Saleem et.al. 2012).

The banking system in Pakistan has experienced great variations since 1947. In the beginning, because of the political impact and the low quality of goods and services, the banking system confronted a lack of capitals and resources. However; with privatization, liberalization and infrastructure improvement of the banking system, the banking sector has grown rapidly. After increased in infrastructure banking industry in Pakistan shows the best growth in the banking sector by more than 60 billion dollars. In Pakistan, banks have high competition in terms of quality of service and wealthy customer.

The presence of very strong competition Islamic banks and commercial banks have become popular in 1970 from operations that have been based on Islamic Shariah principles. The primary purpose of the Islamic banking is the development interest free (RIBA) banking. The reason for the non-interest funding is to dismiss the fixed rate of return on capital. In this respect, the Islamic banking offers a variety of products based on profit and loss principles of the Shariah division. The Islamic funding method is used for leasing and other financial instruments. Islamic banks are primarily associated with eradicating interest based funding by promotion of risk sharing practice for economic welfare. It is clear that banks can earn Halal income, (Ashraf and Rehman, 2011).

At present, almost 22 countries are having Islamic banks across the globe and running with dual banking system. Saudi Arab and Iran have only Islamic banks, other countries Islamic banking is one of the branch of conventional banking, (Chong and Liu, 2009). The Islamic Sharia Banking is not only focused on the Islamic banking, but also provides direction on financial instruments, brokers and trading operations. However, Islamic banking is becoming increasingly among more than 300 Islamic institutions around the world with more than $ 400 billion of investments (El Qorchi, 2005). Britain, China, Singapore, France and other countries have established special rules to promote Islamic banking. The share of Islamic bank grew by 2% in the 1970s and to 15% in the 1990s (Aggarwal and Yousef, 2000). The instant development of shariah banking in a very short time has amazed all, especially financial specialists and financial forecasters of the West. Shariah banking in the modern world are focused on the design and development of Islamic principles, laws of business and banking business. Thus, Islamic banks can protect the Muslim community and also the Islamic Society from actions that are banned in Islamic shariah (Tahir, 2003). Islamic banking not only attracts persons from Islamic countries but also from non-Islamic developed countries like Japan, USA, France and China (Massah and Sayed, 2013).

In our country, the serious effort about establishing of Islamic banking, generated in January 2000, when the State Bank started a Commission for transformation of financial system (CTFS).

In January 2002, the real enhancement to Islamic banking in Pakistan provides for the development of Meezan Bank Limited as the first Islamic bank (Saeed, 2011). To introduce Shariah financing on September 15, 2003 the State Bank of Pakistan (SBP) establishes the Department of Islamic banking. Over the last few years, there was rapid growth of Islamic banking in Pakistan. Now, almost 5 Islamic banks and more than 13 independent Islamic banking branches of conventional banks are working in Pakistan and the number of branches has extent across the country. (Rashid and Jabeen 2015)

According to SBP, Islamic banking sector is developing through a vision to make the first choice for the customers. The Conventional bank and Islamic bank is separated on the base of Riba, purposes and risk sharing. Islamic Banks pursue Shariah's principles according to the Islam whereas Conventional Banks follows manmade rules. Islamic Banks makes revenue as profits whereas Conventional Banks makes from the rate of interest that is fixed. In Islamic banks risk is common between debtor and creditors whereas Conventional Banks handovers the entire risk to others. State Bank of Pakistan played an important role to create an Islamic banking in Pakistan according to the Islam.

Usman and Khan evaluated the performance of Islamic and commercial banks, Usman A, Khan MK (2012). Shar, Shah, and Jamali assessed the performance of the CAMEL model of banking sectors before and after nationalization in Pakistan, Shar AH, Shah MA, Jamali H (2011). Kouser, Amir, Mehvish and Azeem, tried and evaluate the CAMEL analysis of Islamic and traditional banks in Pakistan. In the existing literature, other researchers used a CAMEL model to measure the bank's performance, Kouser R, Aamir M, Mehvish H, Azeem M (2011). Bokhari, Ali and Sultan used one component of the CAMEL model, i.e. capital adequacy to determine the impact on the Bank's performance, Bokhari IH, Ali, SM, Sultan K (2012). The objective of the research is to analyze the effect of CAMEL models on the influence of 13 commercial banks in Pakistan and three Islamic banks. Data from 2005 to 2018 were taken.

Extensive research was carried out to measure the financial performance of ordinary banks and Islamic banks, some of which are analyzed in detail in Pakistan.

Moin (2008) measured five conventional banks with only one Islamic bank for the period of 2003 to 2007. Shahid et al. (2013) measured the financial performance of two conventional banks and two Islamic banks during 2008-2010. Furthermore, Rana et al. (2016) inspects the act of Islamic banks and commercial banks in Bangladesh for the period of 2013-2014. The study of Usman & Khan (2012) examined the analysis of the financial performance of interest free and commercial banks. For an appropriate analysis, Islamic banks and commercial banks were used in the period 2007-2009. Sehrish et al. (2012) examined the financial performance of the interest free banking system and the traditional banking sector in Pakistan from 2007 to 2011. Moreover, in 2007, Kader and Asarpota (2007) assessed the financial results of Conventional and Islamic banks in the UAE for the period 2000-2004 etc.

1.1. Research Gap

The researchers took the data only for three or four years because of Islamic banks were on starting stage on that period of time. The study is distinguished from other studies as none of the study has compared the financial performance of traditional banks and Islamic banks in Pakistan for a long time period. The present study is intended to fill this gap.

As the banking sector is the backbone of the economy. The country's financial resources are allocated through banks. In addition, the banking sector acts as a core which puts money into the economy. Therefore, ongoing performance needs to be assessed. The CAMEL model is a useful tool for assessing performance and checking the integrity of banks. After the 1980s, there were significant losses in loans and banks, so the need for bank supervision increased. Previous research has shown that Pakistan's banks have been extensively researched. However, a detailed analysis of Pakistan was not carried out to assess the performance of banks.

1.2. Scope of research

The research framework is limited to 13 commercial banks and 3 Islamic banks in Pakistan, because of time limits and lack of data availability, and the purpose of this research is to evaluate financial performance based financial ratios i.e. . Return on Assets (ROA), Advances to Deposits ratio, Capital Adequacy ratio, Equity Multiplier, Investment to Liability Ratio, and Cash Flow to Revenue ratio and five CAMEL model criteria. Capital, asset quality, management efficiency, profitability and liquidity. However, there are ratios that can be used to analyze these factors.

1.3. Research Problem

Since the inception of the first Islamic bank in Egypt in 1963, Islamic banking is increasing fast around the world, as well as raising awareness among consumers about the quality of product and service. This creates aggressive competition between banks and makes effective management of the bank's performance. Many researchers worked on different aspects of performance measurement. The modern development of Islamic banking has observed fast progress, and more than 300 Islamic financial institutions operating in more than 75 major countries of the Middle East and Southeast Asia. There are many Islamic banks in various countries, especially in Europe and the United States. South Africa also interested in Islamic banking. Due to the uncertainty in the conventional bank, at present, many countries around the world recognize that Islamic banks are one of the most powerful alternatives for conventional banks. However; it is important to compare the financial performance of Islamic and conventional banks. As conventional banks were considered one of the most profitable institutions.

1.4. Objective of the Study

The objective of this study is to analyze the performance of Conventional banks and Islamic banks and CAMEL analysis in Pakistan for the period of 2005 to 2018 and to investigation the financial outcome of both banks and effort to determine that there is remarkable changes in perspective of profitability, capital adequacy, liquidity, risk and solvency, equity multiplier and deployment ratio. Consider the quality of the assets of selected Conventional and Islamic banks and study the liquidity of both banking sectors.

1.5. Limitations of the Study

There are currently almost 20 commercial banks and 6 Islamic banking banks in Pakistan. Five Islamic banks are private banks and one is a foreign bank. Among the entire Islamic banks, Meezan Bank Limited is the oldest, largest and most experienced Islamic bank in Pakistan, and has been working for over fifteen years. Almost all other Islamic banks have been affiliated with their country of minority processes but AL Baraka Islamic Bank Pakistan has been operating as a foreign bank since 1991 (Source, Al Baraka) Al Baraka Islamic Bank Bahrain branch. As a foreign bank, we did not choose AI Baraka as an Islamic bank for our research, because the purpose of this research is to compare the financial performance of both banks in Pakistan. In this study, we had a wide range of conventional banks, due to time limits, data accessibility and other boundaries were the main limitations that constrained us to choose only 13 conventional bank, i.e. (Allied Bank Ltd, Askari Bank, Bank Al Habib, Bank Alfalah, The Bank Of Punjab, Faysal Bank, Habib Metro Bank, HBL, JS Bank, MCB (Muslim Commercial Bank), NBP (National Bank Of Pakistan), Soneri Bank Ltd and Zarai Taraqiati Bank Limited) to compare financial performance with 3 Islamic bank i.e. (Meezan Bank, Bankislami Pakistan and Dubai Islamic Bank).

1.6. Significance of the Study

The fundamental importance of research is to get to know the main differences between conventional and Islamic banks. Research is useful for facilitating the development of their management capabilities in the banking sector in order to facilitate future customers. Research helps other students as a source of reference. The aim of the research is to give the shareholders, management and investors a clear image of the banks' financial position. Research will provide creditors with valuable information to make a quick and fair decision on which bank system is best placed to invest or borrow.

Assessing the overall performance of the organization and monitoring the financial situation is necessary for investors, owners, regulators and depositors, Tamimi HA (2006). The research was conducted to examine the outcome of banks with regard to the camel model. This study focuses on the CAMEL model, focusing on various signs that are particularly significant for the protection and integrity of the banking industry.

This study will deliver information about investors and shareholders and about important issues affecting the Bank's outcome. This research will also improve our information and knowledge such as financial statements and revelation issued by banks in their financial statements. Based on the all information, shareholders will be able make a more rational decision to spend in a particular bank.

The results of this study will help to meet the performance of the bank, and to overcome the gap in the use of bank measures. The reader will also be able to obtain the specific data of the model, which will determine the strengths and weaknesses of the banking sector, and will provide better knowledge and understanding the performance of the banking sector, particularly in Pakistan. In addition, the results of the research can be used as a base for future studies.

Chapter: 2

Literature Review

2.1. Importance of Financial Performance

Financial performance is a subjective measure that makes an organization able to use resources from major business modes and make profits. This term is used as a common measure of the general financial health of the organization for a specific period of time, and can be used to link the organization through the same company or through businesses. In addition, there are several shows to get financial results. But all measures must be taken and aggregate line items, such as operating income, or operations cash flows, can be used together with all sales units and may be more thoroughly analyzed by looking for financial reports and margin growth rates or any restrictions. Many empirical research has been carried out about the financial performance analysis of commercial and interest free banking in Pakistan by using various types of techniques.

2.2. Studies in Favor of Islamic banks

Here some of the past studies are discussed about whose results are according to the research is in favor of Islamic banks. Masud Rana et al. (2016) inspected the conduct of interest free and commercial banks in Bangladesh for the years of 2013-2014. The main cause of this analysis was to relate the liquidity and productivity of commercial and Islamic banks. The outcomes of the research presented that Shariah base banks have superior financial performance than commercial banks. Interest free banks performance in liquidity, profitability, business development and risk is more to that of commercial banks. That is somewhat interest free banks are greater in economic position to that of commercial banks (Masud Rana et al. 2016).

While Ahmad et al. (2010) in his research he examined the correlation between customer satisfaction and service quality about Islamic banks and commercial banks in Pakistan. He examined how service quality affects satisfaction of customer in evaluating the extent of the alliance between the selected variables. The results reflected that there is a strong good alliance between the service quality and customer satisfaction in the perspective of Shariah base and commercial banks in Pakistan (Ahmad et al. 2010).

Study of Waemustafa and Sukri (2015) on the other hand checked the specific macroeconomic and banking credit risk for Shariah base and commercial banks. A research trial of 15 commercial and 13 interest free banks in Malaysia were used during the period 2000 and 2010. The study has shown that the precise credit determinants of the Bank's credit risk are individually affected by Islamic and the usual bank’s credit risk of the formation. It also narrated that there are further variables that only influence credit risk through Islamic banks, as evidenced by ISCON in which new variable testing research shows a great effect on the formation of credit risk Islamic banks, so that coming study should be created on unique characteristic interest free banks Defining Factor B should be involved in the equation to control the credit risk of the interest free banks in a further extensive way (Waemustafa. sukri 2015).

Also Sardar et al. (2013) researched about regulation to establish the effectiveness of interest free banking in Pakistan. It contained several windows of Shariah base and commercial banks, of which there were 5 pure interest free banks. Though, there were data on fifteen Shariah base banks that were possessed for the period of 2008 to 2010. The main outcomes of the study were that the massive outcomes of interest free banks was greater than the commercial banks. In addition, the performance of Shariah base banks has improved over time. The research also established that pure interest free were more efficient than commercial banks. This research depicted that Shariah base banks must to rise resources and total profits, as these variables have a reasonable effect on performance even though liabilities show an adverse effect (Sardar et al. 2013).

While Hanif et al. (2012) inspected and associated the positions of interest free and interest based banks in Pakistan in order to understand that which bank flow is better than others. For this study, samples were selected from twenty two commercial banks and five interest free banks. For a more thoroughly understanding and reliable relationship, the important performance signs were separated into internal and Outer Factor Analysis studies the activities and understanding of the clients for both Islamic and traditional banking In-house internal review includes variances in the performance of Shariah base and commercial banks in perspective of credit risk, profitability, liquidity and solvency. Based on its results, it was concluded that in terms of managing liquidity and profitability, the interest based banking flows are superior to interest free banking. Though, in managing solvency and risk maintenance, interest free banking performance is superior to the traditional banking (Hanif et al. 2012). Also Hamza (2016) examined the compliance of the return on investment deposit on the P&L sharing principle. This correspondence was examined by the effect of bank risk, governance mechanisms and the competitive situation in returning investment deposits. The pool regression model was applied to a group of sixty Islamic banks during the 2004 - 2012 assessment showing that the investment management and deposit property of the PLS is characterized by the behavioral moral risk and excessive risk-taking. The analysis portrayed that the ratio of the capital and the interest rate has a positive impact on return on investment. Smaller Islamic banks offer better return on deposits than the big banks. Also there was no evidence of the effect of management and of Sharia. Following these results it was suggested that holders of an investment account need to be included in the bank's governance system. In addition Shariah base banks are encouraged to build a new generation of investment deposits (Hamza, 2016).

While Usman & Kashif Khan (2012) inspected the financial outcomes of Shariah base and commercial banks. For an appropriate analysis, interest free banks (Meezan Bank, Bank Islami and AL Baraka) and commercial banks (Bank of Khyber and Faysal Bank) were used in the period 2007-2009. The outcomes showed that Shariah base banks have a high rate of development and productivity associated to commercial banks. Also, Shariah base banks have a higher in liquidity compared to commercial banks (Usman & Kashif Khan, 2012). Also Sehrish et al. (2012) examined the financial outcomes of the Shariah base banking sector and the traditional banks in Pakistan from 2007 to 2011. Islamic banks in Pakistan are new related to commercial banks. Therefore, in order to provide a strong image of Shariah base banks to interested parties, the economic situation of Shariah base banks has been examined and related with that of the recognized commercial banks in Pakistan. The outcomes showed that interest free banks are low risky in perspective of loan trading and low cost-effective than conventional banks. Considering that no important change in the performance of the both banking sectors has been identified (Sehrish et al., 2012).

On the other hand Ben Khediri (2009) analyzed the bases of the profitability of interest free banks in the Middle East area over the period 1999-2006. He evaluated different conditions to inspect the consequence of specific bank and country variables, with macroeconomic circumstances, institutional development and market structure on the positions of banks. The outcomes deliver indication that capitalization and administration effectiveness increase the performance of banks. The consequences also showed that banks' returns are clearly linked to economic growth, inflation and banking concentration. They also presented that the productivity of Shariah banks is greater in countries with superior socio-economic conditions and superior legal systems (Ben Kedri, 2009). In another perdpective Kader and Asarpota (2007) assessed the financial results of Shariah base and commercial banks in the United Arab Emirates for the years of 2000-2004, the outcomes showed that interest free banking are comparatively greater gainful, low in liquidity - low in uncertainty related to the commercial banks (Kader & Asarpot, 2007).

Another study by Saleem et al. (2012) was carried out to analyze the financial position of Shariah base and commercial banking in Pakistan, a comparative exploration was carried out. The research found that Shariah base banks are high in productivity than commercial banks and Shariah based banks are less efficient than commercial banks and Shariah based banks have a low in uncertainty related to commercial banks (Saleem et al. 2012). Recently Erol et, al. (2014) has tried to analyze the outcomes of Shariah based banks against commercial banks in Turkey using a pooled regression technique between 2001 and 2009. The outcomes presented that Shariah based banks are improving in terms of productivity and assets ratios related to interest based banks, but gap behind equity risk. These results could be clarified mainly by the circumstance that these banks agree smaller temporary harms than interest based banks and have certain excise benefits, (Erol et. al. 2014).

Also Trad et, al. (2017) investigated if the interest free banking can be a substitute to the commercial financial system and can assurance constancy in times of crisis. In the research seventy eight interest free banks in twelve countries were interviewed in the period 2004-2013. A set of country-precise indicators and other country-precise indicators are mutual to describe the reliability of the interest free banking system in perspective of ROA and ROE profitability and the risk divided by credit risk evaluated by IMLGL and EQL and the risk of insolvency evaluated with SCORE. The goal was to evaluate 5 regressions using panel data (GMM system). The outcomes showed that the scope and capital of banks are the main features for growing the profitability and stability of interest free banks and decreasing credit risk. But the variable liquidity and asset quality coefficients regularly lead to uninterrupted outcomes. It also established that economic variables, with the exemption of price rises, were able to improve the stability of Islamic banks. This is not the situation for credit risk, where the relationship is still negative (Trad et. al 2017).

While Latif et al. (2016) in Pakistan firstly attempted at Islamization banking in the 1980s led to many changes in the banking sector regulation of 1962. The payment of certificates, the establishment of the Financial Transformation Commission (CTFS) and the establishment of the Department Islamic banking of the SBP were the main phases occupied by the Govt. The purpose of this study was to understand the environment of interest free banks, evaluate and relate the outcome of 5 interest free banks with 5 interest based banks operating in Pakistan for five years from 2006-10. The results were showed by analyzing trends and using 12 financial indicators in the risk, profitability, efficiency category and liquidity. The research concluded that interest free banks are low in uncertainty, high effective and solvent than commercial banks, but there is no big change in perspective of productivity. With regard to trend examination, the income statement and balance sheet of Shariah based banks showed worthy progressive trends associated to interest based banks. The outcomes of the research will be useful for the existing administration of interest free banks to progress their effectiveness, along with potential investors (Latif et al, .2016).

2.3. Studies in Favor of Conventional banks

After having an eye view of the studies in favor of Islamic banks, here is the discussion about those studies whose results according to the research is in favor of commercial banks. El Massah and Al-Sayed (2013) analyzed the financial outcome of interest free and traditional banks in the United Arab Emirates. With a focus on comparing the position of Shariah base and commercial banks in the period (2008-2014). Results showed that there are major variances between the two kinds of banks in terms of solvency, profitability, and liquidity and risk ratios. While the average Shariah based banks are less in uncertainty and low profitable. Whereas traditional banks are the pioneers of profitability and solvency. These results showed the supremacy of interest based banks compared to interest free yields, solvency and risky (lower risk) (El Massah & Al-Sayed, 2013).

On the other hand Louati et al. (2015) examined and related the behavior of Shariah based and commercial banks at the similar time as regards the relationship of capital adequacy in dissimilar competitive conditions. They came to the conclusion that the financing ratio method had a significant effect on the outcome of seventy commercial banks and forty seven Shariah based banks. Though, competitive circumstances do not have a substantial result on the alliance between the asset ratio and the behavior of interest free banks that means this kind of bank put on theoretic models created on the prevention of interest rates. This outcome presented that Shariah based banks are less productivity to the situations of market place. Furthermore, it was discovered that the outcomes of Shariah based banks is independent of the level of marketplace and consequently of the interest rate. As a result, both sectors behave differently, indicating that interest free banks apply their theoretic models (Louati et al, 2015).

While Al-Tamimi (2010) examined the significant differences in Shariah based and commercial banks in the UAE in the period 1996-2008. Shariah based banks in the UAE have a very small portion, although there is a growing demand for their facilities. This leads to a study of the features that effect the financial position of both banks. The outcomes showed that concentration and liquidity are the important features of the work of commercial banks (Al-Tamimi, 2010). In Egypt Fayed study (2013) assessed the interbank behavior of three Shariah based banks and six commercial banks operating in Egypt from 2008 to 2010 in perspective of solvency and uncertainty, profitability and liquidity. The results of the research indicated that commercial banks are superior to the Shariah based banks in perspective of solvency and uncertainty, productivity and liquidity (Fayed, 2013).

2.4. Past studies supporting both

After considering the studies in favor of conventional banks, now here we discuss about those studies whose results according to the research in favor of both banks, Shariah banks as well as commercial banks. Iqbal (2012) in his study, the author used secondary data from twenty two commercial banks and five interest free banks, noting that Islamic banks exceed the ratio between impaired NP Land Capital Adequacy (CAR) over the period 2007-2010. Considering that the NPL report indicates that interest free banks have a low NPL ratio related to commercial banks. Conversely, the capital return for conventional banks appears to be higher than that of interest free banks, while the return on asset of interest free banks appearances a faster downward trend from 2007 to 2008 than commercial banks, representing a deficiency of supervision of interest free banks (Iqbal, 2012).

While Soon Chong & Hua Liu (2009) in their research on distribution of profits and losses (PLS) paradigm examined that the Shariah based banking is not very diverse from traditional banking. Their research on Malaysia showed that simply a small part of the interest free banks is based on PLS and the deposits of Shariah banks are not without interest, but are very close linked to commercial deposits. Their conclusions recommended that the speedy progress of the interest free banks is basically due to the Islamic renaissance around the world, and not the benefits of PLS paradigm and that interest free banks should be subjected to provisions alike to those of their western complements, instantly (Chong & Hua Liu, 2009).

Also Youssef & Samir (2015) examined the impact of interbank factors and the size of banks on the financial outcomes of these banks operating in the Egyptian market. The objective of the survey was to make a relative examination of the financial outcomes of interest free and interest based banks. The research analyzes used in this study were expressive, relationship and regression analyzes to examination the research hypotheses. The outcomes of this research showed that some of the interbank factors have had a important effect on the financial position of these banks; however, no major variance was established between the two groups, suggesting that the type of bank is not a significant variable and that commercial and Shariah based banks do not differ in perspective of variables (Youssef & Samir, 2015).

Thonse Hawaldar et al. (2017) studied interest based banks in Bahrain and Islamic banks with no interest (based on Islamic Sharia). The effectiveness of conventional and unconventional banks was satisfactory in Bahrain. The study focused on a relative examination of Bahrain expenditures and Shariah based banks and commercial bank revenues. The research used financial instruments such as solvency, profitability and liquidity, engagement with the reduced and the communal, and the efficiency and outcomes of both bank flows. The outcomes of the research were similar. The researcher didn’t find a significant change in liquidity and profitability between Shariah based and commercial banks (Thonse Hawaldar et al. 2017).

Also Eyceyurt Batir et al. (2017) examined the competence of the banks in Turkey and related the outcomes of Shariah based banks and commercial banks. The outcomes showed that the Bank's normal outcomes of Shariah based banks is greater than the normal efficiency of commercial banks every year. As for the Tobit study, while credit costs and value have a important adverse result on the performance of commercial banks, they have a significant link with the productivity of banks'. While total claims have a meaningfully positive alliance, outer variables have a meaningfully adverse alliance with the effectiveness of both types of banks (Eyceyurt Batir et al. 2017).

On the other hand Samad (2004) examined the relative behavior of Bahrain's uninterested Shariah based banks and commercial banks established on Gulf War interest in perspective of liquidity risk, credit risk, and profitability. 9 ratios were used to calculate these indicators. The paper concluded that there is no substantial variance in outcomes between Shariah based banks and commercial banks in perspective of liquidity and profitability (Samad, 2004). Focusing on the Malaysian financial sector, Wasiuzzaman et al, (2013) examined the variances between five interest free banks and nine interest based banks in the year of 2005 to 2009. The outcomes present that ROAA, banking size and conventional banking higher than Islamic banks. The other variables, the NIM, the LLRL, the LATF, the capital ratio with respect to net loans (ENL) and the independence of the board are lower, greater for interest free banks (Wasiuzzaman et. al, 2013).

Another research was carried by Moin (2008) examined the work of Pakistan's first Shariah base bank, Meezan Bank, related to a group of five interest based banks in perspective of profitability, liquidity, effectiveness and uncertainty for the year of 2003 to 2007. Outcomes showed that Meezan Bank is low in productivity, high in solvency, less in uncertainty and low in effective than the mean of the 5 commercial banks. Though, Moin pointed out that interest free banks are improving over time by exploiting asset returns, handling their operating prices and sufficient their investors by proposing competitive or even superior profits that result in merger with the results of traditional banks. In perspective of liquidity, the study found that there was no major variance between the two banks (Moin, 2008).

Furthermore, Rosley and Bakar (2003) in their study used 6 financial indicators in the Malaysian financial sector for the years 1996-1999, compared to commercial banks, whereas the operating efficiency, utilization and liquidity rates of the activities of interest free banks are statistically lower than traditional banks (Rosley & Bakar, 2003). A survey by Jaffar & Manarvi (2011) used a five Shariah base banks and five commercial banks in Pakistan to relate its results from 2005 to 2009 using CAMEL techniques, including capital adequacy, asset quality, management quality, earning and liquidity. The results showed that Islamic banks are improving with adequate capital and superior liquidity, while commercial banks are creators of supervision quality and capability to obtain, but both types of banks have practically the similar patrimonial quality (Jaffar & Manarvi, 2011).

2.5. Studies during Financial Crisis

After having an eye view of the past studies in favor of both banks, here is the literature discussion about those studies that were held during the financial crisis. Al-Atrash and Hardy (2010) reviewed the results of Islamic banks and commercial banks throughout the financial disaster by monitoring the effect of the disaster on external ratings, asset and credit growth, and profitability and classifications in a set of countries there 2 kinds of banks have a major portion and the analysis shows that interest free banks are precious inversely by commercial banks. Features correlated to the business ideal of interest free banks facilitated to curb the negative outcome on productivity in 2008, while lower in uncertainty performs in certain interest free banks directed to a greater decay in productivity in 2009 related to commercial banks. The growth of assets and Shariah based banks improved than commercial banks in 2008-2009, causal to financial and economic constancy. The revaluation of evaluation activities for risk from interest banks was normally more satisfactory (Al-Atrash & Hardy, 2010).

Bashier (1983) and Khan (1986) attempted to study the financial condition and level of risk of Shariah based banks is greater than traditional banks through an economic crisis using the technique of financial ratio and panel data sixteen banks in the UAE, five of which were interest free, and the other eleven were commercial over the period 2008-2014 (Bashier, 1983), (Khan, 1986).

Parashar & Venkatesh (2010) related the outcomes of commercial and Shariah banking to Gulf Countries before and through the financial disaster by analyzing the ratio. The research covered six Shariah based banks and six commercial banks over the year of 2006-2009 by using 6 ratios, ROA, ROAC, capital ratios, and cost / benefit ratio, equity and the net ratio of whole assets and fluid assets to the ratio of whole assets. These ratios were divided into 5 parameters of bank results, i.e. productivity, Capital, efficiency, liquidity and influence. The outcomes showed that interest free banks had been hit higher than commercial banks throughout the financial disaster in perspective of equity, stock yields and leverage, while traditional banks have hurt more in perspective of average assets and liquidity yields (Parashar & Venkatesh 2010).

2.6. Comparison of both banks in GCC region

After having the comparison of both banks throughout the financial disaster, here is the discussion about the comparison of both banks in Gulf Cooperation Council (GCC) countries. Two samples were arranged, the first sample was comprised of thirty eight commercial banks and the second sample was comprised of thirteen Shariah based banks. The results showed that the capital of the bank is significant for explanation and growing only the outcomes of commercial banks. Moreover, the expected magnitude of the effect delivers sign of economies of scale in interest free banking using return on equity, although it is not relevant for commercial banks. However, external possession did not increase the performance of interest free and commercial banks. In addition, the banking developments did not affect the bank's profitability. In conclusion, GDP correlates positively with the Bank's profitability, while inflation is adversely connected with the Bank's performance (Zeitun, 2012).

While in another research Siraj and Pillai (2012) studied and related the work of commercial banks and interest free banks working in the Gulf Cooperation Council constituency over the year of 2005-2010. The survey explored the presence, if any, of the performance indicators selected by commercial banks and Shariah Banks in the Gulf Cooperation Council region. The survey had chosen 6 Shariah based banks and 6 commercial banks. Comparative research was created on behavior indicators based on ROE, ROA, EOA, OER, NPR operative costs, earnings, resources, operating revenue, credits and total resources. Conclusions built on the examination showed a superior position of the interest free bank during the survey period (Siraj & Pillai 2012).

During their research Olson and Zoubi (2008) examined financial ratios that vary expressively between the two types of banks by inspecting sixteen ratios. The outcomes showed that features such as performance ratios, efficacy ratios and indicators of asset quality are well-defined in the Gulf Cooperation Council. They also meant that interest free banks are on normal high in profit than the commercial, even low in efficient banks, (Olsen & Zubi, 2008).

In 2013 a research by Al-Hares et.al, (2013) concentrated on the financial outcomes and capital of interest free banks vis-à-vis interest based banks working in the Gulf Cooperation Council. The survey ratios for fifty five commercial and twenty interest free banks in Kuwait, Oman, UAE, Qatar, Bahrain and Saudi Arabia between 2003 and 2011. The outcomes showed that interest free banks are low capable but more cost-effective, high liquidity, less uncertainty and with greater domestic growing rates than commercial banks (Al-Hares et.al, 2013).

In additional research article Al-Deehani et al. (2015) found that the capital structure of an Shariah bank differed significantly from that of the commercial bank, so the risk levels for both types of banks and their depositors may vary. Based on this fact, the author argued that the differences in yield exist between the two types of banks, especially during the economic downturn. To confirm this argument, the author interviewed 25 Gulf Council (CCG) countries classified as Shariah and commercial for the year of 2001 to 2013. Banks remain the same, and the reason for commercial bank deposits is greater than Shariah based banks. Throughout the crisis, return on investment returns to declining Shariah based banks in association to commercial banks (Al-Deehani et.al, 2015).

While in his research P. Merchant (2012) examined the work of interest free banks and interest based banks before and after global financial disaster. The survey focuses on finding the measures taken by the banks to mitigate the effects of the crisis. The study will be examined comparing the results of the interest free and interest based Banks of the (CCG) for the period 2008-2011. Throughout the year of 2008-2011, Shariah based banks have an adequate capital structure but have reported less Return on Equity and poor management efficiency. The assets quality and liquidity for both kinds of banking system did not show a major change. It has been verified that Return on Average Equity results are significant only in the recovery phase, where commercial banks perform superior than interest free banks in performance perspectives, which shows that, unlike Islamic banks, they are improving with Return on Average Equity during a crisis rather than a Recovery phase (P. Merchant, 2012).

Also DulalMiah & HelalUddin (2017) is his study aimed to explore the variances between Shariah based and interest based banks in perspective of stability, business orientation and efficiency. The data for this study were selected from forty eight commercial banks and twenty eight interest free banks of the GCC for the year of 2005 to 2014. However, Shariah based banks are stronger in perspective of short-term solvency, but not that difference in terms of long-term stability. The regression assessment displays that processes of interest free banks are diverse from their commercial correspondents and the outcomes remained statistically significant even after control for detailed base variables. In addition, superior banks have lower intermediate ratios, indicating the inefficiency of the scale. The outcomes also show that banks with high capitalization are high stable, but inefficient in terms of cost, which shows that superior in capital, bank could not enjoy the leverage effect (DulalMiah & HelalUddin, 2017).While Karim and Ali (1989) examined that Shariah based banks are high in profitability than commercial banks in the GCC region (Karim & Ali 1989).

Chapter: 3

Theoretical Framework

Banking sector is considered as one of the main component of any economy. It originates from the time when the merchants of Babylonian market give loans to purchase different stuffs from the market. Modern banking sector developed in England as Bank of England was the earliest bank in the world which was established in 1694 in London. A bank actually play a role as mediator between the saver and investor. Banking sector is well established sector in Pakistan and it contributes to almost three-fourth of total financial sector. The banking sector in Pakistan is rapidly growing and since 1990. Just like the banks of any other developed country Pakistani banks provide extensive range of facilities to its customers like online banking, online billing and it deeply influence the economy of Pakistan. The CAMEL model also define for the performance of both banking sector.

The CAMEL model, established in the 1970s by the 3 federal banks of the United States of America i.e. Federal Reserve, FDIC and OCC, as a part of organizers, 'Uniform Financial Institutions Rating System' to give a brief explanation of the bank statement at the time of studies. This model has five indicators: capital adequacy, asset quality, management efficiency, profitability and liquidity. The CAMEL framework highlights five banking system criteria when assessing the P&L statement, assessing the financial outcomes and balance, assessing the financial bank position, Tom KA. (2012). The CAMEL model is essentially a normally used methodology for determining the outcomes of the banking sector within and outward Pakistan, Trivedi KRA (2011).

In the research, the CAMEL model focused on assessing Pakistan's bank performance. The CAMEL is renowned for its effectiveness among regulators. This model is very good for assessing bank outcomes. The CAMEL technique is based on the percentages used to calculate bank performance and is used to classify banks. The CAMEL analysis is a key to investigate of the state of the bank's financial situation and present its analysis as a tool for assessing banks' strength. In the current review, the CAMEL model was used as a benchmark to measure capital adequacy, asset quality, management efficiency, profitability and liquidity in 5 national banks, Nag AK, Khatik SK (2014).

The CAMEL component for each element marked 1 to 5 rating, the final point of the CAMEL rating and the total CAMEL calculation, as a measure of the general position of the Bank. A review of the CAMEL model was carried out again in 1996 when extra “S” to assess market risk sensitivity by the agencies. The National Credit Union Administration (NCUA) implemented this System in 1987. In addition, the US Federal Reserve evaluates its banks on 1 to 5 scales using components of the CAMEL model which control aspects of the bank's condition. Scale 1 is the highest level (highest results) and 5 is the lowest (least performance). Liquidity, profitability and reliability are the most significant conditions for assessing the Bank's competitive results. For this reason, since 1988, the Bank's Management Committee has stated that the CAMEL model is necessary for the evaluation of financial institutions. In 1997, additional factor added to the CAMEL model was market risk (S). Though, CAMELS is being replaced by developing countries of CAMEL to assess the performance of financial institutions. This means that there is no danger that the market will be at risk. Pakistan is a developing country and that's why we use the CAMEL model. CAMELS is a common vision for an organization’s financial health. This method was generated by US bank supervisory organizations. The banking sector's outcomes is based on the CAMELS technique, including exploration and evaluation of the 5 core aspects of banking processes. The CAMEL technique therefore contains a series of performance calculate that banks offer in their entirety, Nimalathasan B (2008).

The CAMEL technique (capital adequacy, asset quality, management efficiency, earning and liquidity) was expanded by the Bank Control Unit to assess and evaluate the Bank's performance and monetary performance. CAMEL stands for the classification model that evaluates the Bank and provides a classification of the various parameter hypotheses, Babar HZ, Zeb G (2011).

This model is used all over the world. In developed countries, there has been a lot of research in the application and use of this beautiful model. In Pakistan, no research is available using a trial model. Pakistan's academic was using camel model ratios to compare banking to another bank or sector in another sector to see how banks worked. They did not specify the effect of the CAMEL technique on bank outcomes, Alam HM, Raza and Akram public and private Commercial banks were compared, Alam HM, Raza A, Akram M (2011).

In addition, these criteria are used by the Asian Development Bank, the African Development Bank, the Federal Reserve Bank and the World Bank to assess the outcomes of financial institutions. The IMF also uses the Financial Institutions Index to assess the accurateness of members of the economic structure. The CAMELS test requires knowledge from a variation of sources, such as balance sheet funding, macroeconomic data, budget forecasting, cash flow, personnel and operation. This model assesses the general position and strengths and weaknesses of banks.

Chapter: 4

Sample, Data and Variables

4.1. Sample

The main aim of this research is to analyze the comparative financial performance and CAMEL analysis of conventional banks and Islamic banks in Pakistan for the period of 2005 to 2018. Currently almost 23 commercial banks and 5 Shariah based banks (Islamic banks) are operating in Pakistan. Out of these banks, 13 Conventional banks i.e. (Allied Bank, Askari Bank, Bank Al Habib, Bank Alfalah, The Bank Of Punjab, Faysal Bank, Habib Metro Bank, Habib Bank, JS Bank, Muslim Commercial Bank, National Bank Of Pakistan, Soneri Bank Limited and Zarai Taraqiati Bank Limited) and 3 Islamic banks i.e. (Meezan Bank, Bankislami Pakistan and Dubai Islamic Bank) are included in the sample of the study. Due to unavailability of data the rest of the banks are not considered.

4.2. Data

Data have been chosen from secondary bases. For research the purpose, 3 Shariah based Islamic banks and 13 commercial banks have been taken for the period of 2005 to 2018. The data is taken from the annual reports of banks (assets & liabilities and Profit &loss account).

4.3. Variable Used in the Study

These are following variables that used in the study i.e. Return on Assets (ROA), Advances to Deposits ratio, Capital Adequacy ratio, Equity Multiplier, Investment to Liability Ratio, Cash Flow to Revenue ratio, Liquidity management and Asset Quality to calculate the financial performance and CAMEL analysis of commercial banks and Shariah based Islamic banks in Pakistan for the years of 2005 to 2018.

The financial outcomes measures are located in different classes as given below.

4.3.1. Profitability

There are certain financial measures to calculate bank profitability. The present study use ROA for measuring the financial performance, because in past studies all researchers took ROA to measures performance of both banking sector that why we choose ROA for comparison of Shariah based Islamic banks and commercial banks

4.3.1.1. Return on Assets (ROA)

The return on assets (ROA) determines the profitability of bank assets after costs and taxes (Van Horne 2005). Ross et al. (2005) has mentioned that ROA is a common measure for management performance. Banks calculate the profit after tax, for each dollar invested in the company's assets. For example, to calculate the net profit per unit of a particular asset, it secures the bank's assets and change asset into profits (Samad and Hassan; 2000). Usually, a greater ratio indicate well administrative performance and effective use of the resources of the company and low ratio is the means of incompetent use of resources. Companies can increase returns on asset, increase profit margins or asset turnover, but they cannot be competitive at the same time due to tradeoff between turnover and margins. ROA is calculated as under:

ROA = Net Income or Earning After Taxation (EAT) / Total Assets

4.3.2. Liquidity:

Liquidity ratios show that banks meet regular financial responsibilities. Liquidity is significant for companies to avoid their default financial obligations and thus to avoid financial problems (Ross, et.al 2005). Banks can get into liquidity difficulties particularly when taking away surpass new credit meaningfully for a short time (Samad and Hassan 2000). These ratios calculate the company's ability to respond to short-term obligations, maintain financial position and receivables that may be collected. Overall, the higher liquidity shows that the bank has the capacity to cover a higher safety margin and overcome short-term obligations. These surveys use the Credit Deposit ratio to calculate the financial outcomes of Shariah based Islamic banks and commercial banks.

4.3.2.1. Advances or Loan to deposits ratio:

Advances to deposit is the significant ratio to calculating the bank liquidity. Advances means the financings for the Islamic banks and advances or loan for the conventional banks. Shariah based Islamic banks are forbidden to spread financing and make interest *(*Riba) and constrained to monitor Principles of Islamic Shariah in demonstrating their banking business operations, the only technique that Islamic banks can use for their deposits is funding through Islamic financial assets. Banks with a low borrowing ratio are measured by high liquidity, with lower results and, therefore, a lower risk, compared to the bank between the loan and the deposit ratio. However, as the loan to deposit ratio is higher, a bank has taken on more financial pressure with unnecessary loans and also displays uncertainty that to see depositor’s rights, bank may have to vend some advances at loss.

4.3.2.2. Management Quality;

It is one more dynamic example of the CAMEL model that confirms the existence and development of the bank. Good managerial is important to the organization's outcome. Competence management plays a significant part in the achievement of the institute. The effective management makes the managing system answer fast to an active and varying situation. The company's management acts as an agent and is responsible for the smooth functioning of all operations. The management's overall success in terms of tendency is measured by keeping expenditure significantly below income levels, ie, it is recognized when calculating deposit advances ratios. Liquidity and Management Quality is calculated under:

Loan deposit ratio (LDR) = Loan or Advances /deposit.

4.3.3. Capital adequacy ratio (CAR):

It is an important parameter to be measure the financial outcomes and CAMEL exploration of the banks. In our study, it is measured by using the (EQTA) Equity to total assets ratio (Vong & Chan, 2006). EQTA is revealed to be a degree of capital adequacy and support our research in considerate the protection and economic consistency of the banks. This ratio help us in important the magnitude of assets that have been financed by owner's funds. Greater Equity to total assets ratio help the bank in providing a strong cushion to rise its credit undertakings and low the unexpected risks. Samad (2004) states, that higher level of EQTA frequently supports the association in delightful asset losses. This suggests that as the quantity of the equity to back the assets of banks decreases, the insolvency uncertainty of the bank increases. Furthermore, Hassan et.al. (2005) state that constant lowering of Equity to total assets ratio suggestions to invite of uncertainty in the banks and so highlight the capital adequacy of the bank.

Capital adequacy ratio (CAR) = total equity / total assets

4.3.4. Risk and Solvency Ratios:

These ratios determine bank uncertainty and solvency. It's also called gear, leverage and debt ratio. These ratios regulate the possibility of banks failing their liability. The more debt a business will be in a debt that will develop business without complying with the promised obligations. In other perspective, the higher level of liability can create financial insolvency and suffering. While, liability financing is an important way, while giving a significant benefit to a tax, can lead to a conflict between shareholders and creditors (Ross et.al, 2005). If the value of assets exceeds the value of the liability, the bank will be measured solvent. This study uses Equity multiplier to calculate the financial outcome of Shariah based Islamic banks and commercial banks.

4.3.4.1. Equity multiplier (EM):

The equity multiplier is also the financial leverage ratio that calculate the number of assets of a company that finances shareholders, relating the total shareholder's with total assets. The multiplier express the ratio of the assets which is owned by shareholders. On the other hand, it also express that the debt financing levels are used to obtain assets and the operations are maintained. The greater EM shows that the bank has received more funds to become into asset with capital stock. The greater EM value shows that there is a higher risk for a bank.

Equity multiplier (EM) = total assets/total shareholder equity.

4.3.5. Deployment Ratios:

These ratios are measured to assess how the bank uses its resources. This study use the investment to liability ratio to calculate the financial outcomes of Shariah based Islamic banks and commercial banks.

Investment to Liabilities = Total Investment /Total Liabilities

4.3.6. Cash Flow to Revenue Ratio:

This ratio calculate the efficiency of interior cost controls. A greater ratio generally shows the firm is capable to opportunity a greater ratio of its income into revenues and cash flow. A straight or growing trend line is mostly a sign of reliable trade’s development and effective cost management. Reduced receivables collection and greater costs are certain of the causes for a decreasing trend line.

Cash Flow to Revenue Ratio= Net cash flow from operating activities / Revenue or Income

4.3.7. Asset Quality:

The strong point of Islamic and interest based banks can be evaluated through the assets quality they hold. Quality of Asset assurance is a necessary requirement of the every Bank. One of the biggest risks facing banks is the uncertainty of advances losses that can happen because of an increase in non-performing loans. NPL which are also in defaulting or closed to defaulting. According to Bock et.al. (2012), financial movement is slowing because of an increase in NPL or credit agreements. Quality of Asset depends to a large extent on the ability of the borrower to repay the loan in a timely manner. According to Baral (2005), the degree of credit uncertainty depends on the quality of assets detained by separate banks. Asset Quality is calculated as under;

Non-performing loan / Total Assets

4.3.8. Liquidity Management:

It is a significant element that demonstrates the ability to meet the Bank's financial duties. Bank liquidity means many liquid funds detained by bank to cover short-term liabilities. Banks can see their economic requirements by assembling short-term customer payments or making their assets in cash. Dang (2011) said that liquidity synchronization was good profitability. The Bank could have a serious impact on the short-term liquidity requirements in the Bank's overall profitability and performance. The large liquidity key shows that the bank is wealthier in all reasonable conditions for the protection of liquidity risk. Liquidity Management is calculated as under; **liquid assets / Total Assets**

Chapter: 5

Ratio Analysis and Performance Measure

Performance	Islamic Banks		Commercial Banks	
	Average	**S.D**	**Average**	**S.D**
ROA	0.50	0.62	1.19	0.77
ADR	56.56	10.65	127.05	58.91
CAR	15.79	7.19	12.32	4.07
ILR	25.72	11.39	36.43	14.14
CFR	25.83	83.79	11.51	24.90
EMR	11.70	4.74	13.04	3.58

Table 5.1. Shows the average (ROA, ADR, CAR, ILR, CFR and EMR) of Shariah based Islamic and commercial banks. In perspective of profitability which include Return on Asset, it is a financial ratio that shows the ratio of income a bank makes in relative to its whole capitals. ROA determines the profit on banks resources in spite of everything like costs and taxes (Van Horne 2005). This is a mutual amount of performance of management (Ross et.al, 2005). The results show that the fourteen years average return on assets (ROA) for commercial banks are expressively high as compared to Shariah based Islamic banks as the ROA of commercial banks is 1.91% and Islamic banks is 0.50% which means the financial performance of commercial banks is better than Shariah based Islamic banks. According to the above outcomes the assets of commercial banks are high capability of yield high profit than Shariah based Islamic Banks. The results of Mona etal (2013) are also in favor of commercial banks as the study concludes that commercial banks are more effective in creating revenues from each component of shareholders capital. When banks extending their business volume than it’s very difficult for them to control

their operating expenses. The same problem is with Shariah based Islamic banks because of Shariah Islamic banks as compared to commercial banks are new in the market and the focus of Shariah based Islamic banks to increasing business volume. This is the one reason the profit of Shariah based Islamic banks is lower than commercial banks (Latif et.al, 2016). There are many studies whose results about ROA in is favor to the conventional banks such as (Moin, 2008); (Jaffar and Manarvi, 2011); (Metwally, 1997); Al-Hares, et.al, (2013); Hanif et.al, (2012); and (Fayed, 2013) etc.

In term of liquidity which include Advances to deposit ratio, it's meaning the capability of a bank to see the requirements as and when payable. ADR is the very significant ratio for calculating the liquidity of banks (Mona et.al, 2013). According to Basel III 2009 the average ADR is 80% to 90%. Basel III is an international regulatory concurrence that announced a set of reforms designed to improve the supervision, regulation and risk management. If a bank has higher ADR which means that bank has high cushion to cover short term obligations and also higher ADR means that bank is high profitable and more risky as compare to lower ADR (Latif et.al, 2016). In this research, commercial banks are performing better results in advances to deposit ratio and also show that LDR ratio of Shariah based Islamic banks is falling overtime because the average of commercial banks is 127.05 and the average of Shariah banks is 56.56. As shown in table the average of commercial banks is greater than ideal ADR which means commercial banks are high in profit and more risky as relate to Shariah based Islamic banks which is low in profit and also less risky. (Latif et.al, 2016). Due to high ADR conventional banks are taking financial stress because of extend in loan and in future may have to sell loan at loss to meet shareholders rights (Latif et.al, 2016). This indications that commercial banks face high liquidity uncertainty than Shariah based Islamic banks. Though, total management liquidity of commercial banks is superior to Shariah based Islamic banks (Mona et.al, 2013). Such outcome is reliable with certain research results e.g. (Parashar and Venkatesh, 2010); (Jaffar and Manarvi, 2011); (Iqbal, 2012); Al-Hares, et.al, (2013) and Wasiuzzaman et.al, (2013) etc.

Capital adequacy ratio is a significant parameter for calculating the financial performance of banks and it is calculated using Equity to Total Asset (Vong & Chan, 2009). The least capital adequacy ratio is 10.5% (Basel III 2009). The main purpose to calculate the CAR is ensure that banks have more cushion to meet all obligation and losses before they become insolvent (Samad 2004). As presented in table the average of CAR of both Shariah Islamic banks and commercial

Banks are above than minimum requirements that's mean both banks have ability to meet the abnormal losses in future (Samad 2004). (Hassan and Bashir 2003) confirm that the steady decrease in equity in the proposals for a ratio of total assets to the call for risk in banks and thus highlight the adequacy of the Bank's capital. Such outcome is reliable with certain researches results e.g. Hanif et.al, (2012); (Samad 2004); (Hassan and Bashir 2003); (Vong and Chan 2009); and Saleem et.al, (2012) etc.

In term of deployment ratio which include investment to liability ratio (ILR). It calculate the source distribution proficiency. The greater these ratios are measured superior (Ansari and Rehman, 2010). These ratios are used to assess how well the bank uses and invested in its resources (Iqbal, 2011). In case of ILR the results is in favor of again commercial banks because the average of ILR of commercial banks is 36.43 and the average of ILR of Shariah banks is 25.72. Due to high in ILR conventional banks effectively use of its resources to earn more income as relate to Shariah based Islamic banks in Pakistan. Result shows that Shariah bank source distribution proficiency is lower than commercial banks. This is decided from these outcomes that this ratio is in favor of commercial banks and they earn greatly superior use of their assets (Ansari and Rehman 2010).

The next is (CFR), which means to assess the efficiency of inner control over expenditure (Moin, 2008). A greater ratio generally means that the banks can try a larger ratio of its earnings into cash (Moin, 2008). According to the table the CFR of Shariah Islamic banks is 25.83 and the average of CFR of commercial banks is 11.51 which is lesser than Shariah banks that's mean Shariah banks has more efficient in internal control over expenditure and also high percentage of earning convert into cash to meet the daily basis transactions than commercial banks in Pakistan Al Hares et.al, (2013).

And last in perspective of solvency and uncertainty ratio which include equity multiplier ratio (EMR), this ratio indicate how much dollar of assets should be held by each dollar of shareholder's capital (Ika and Abdullah 2011). It indicate the number of assets per dollar shareholder's capital. Greater amount of EM shows that bank has used extra liability to exchange into assets with share capital. Normally, the greater is the EM the superior is the uncertainty for a bank (Moin 2008).The results show that the EMR of commercial banks is 13.04 and EMR of Shariah Islamic banks is 11.70 that's mean conventional banks has extra obligation to exchange into assets and high uncertainty than Shariah banks because the average EMR of conventional banks is higher than Islamic banks Al Hares et.al, (2013); (Hamid and Azmi, 2011), and (Ika & Abdullah 2011). This outcome is reliable with previous results in the literature review e.g. (Samad, 2004); (Kader and Asarpota, 2007); and (Moin, 2008) etc.

Chapter: 6

Camel Analysis

Performance Measure	**Islamic Banks**				**Conventional bank**	
	Average	**SD**			**Average**	**SD**
CAR	0.15	0.071			0.12	0.040
AQ	0.0019	0.0037			0.0053	0.00822
MQ	0.56	0.10			1.27	0.58
ER	0.005	0.006			0.011	0.007
LR	0.12	0.058			0.096	0.025

Interpretation of CAMEL composite rating	Rating Range	Rating Analysis	Interpretation
1	1.0-1.4	Strong	Bank is basically good in every aspect.
2	1.6-2.4	Satisfactory	Bank is primarily good but has several identified weaknesses.
3	2.5-3.4	Fair, with some categories to be watched	Bank has financial, operational, or compliance weaknesses to be watched that provide reason for supervisory concern.

4	3.5-4.4	Marginal, with some risk of failure	Bank has serious financial weaknesses that can damage its risk of failure future capability to ensure normal growth and development.
5	4.5-5.0	Unsatisfactory with a high degree of failure	Bank has critical financial weaknesses that indicate the degree of failure probability of failure to be extremely high in the near future.

6.1. Capital Adequacy

It calculate the bank's ability to meet different unexpected shocks and losses during risk. Capital Adequacy factor plays a key role in decision-making and confirm that banks can support a sensible level of sufferers happened because of operating loss and assess the Bank's ability to deal with losses. Therefore, the high capital adequacy highlights better financial performance of the Banks, Samad (2004).

Table 6.1 express the average capital adequacy of Shariah based banks and commercial banks. Commercial bank Capital adequacy is small as related to Islamic bank. Average capital adequacy of Shariah bank is 0.15 and for commercial bank is 0.12 which displays that Shariah banks have higher capability to meet unexpected shock and losses during risk than commercial banks. Table 6.2 present the rating of Shariah and commercial banks. Average of both banks are less than 1 which means in term of capital adequacy both banks are good in every aspect. According to camel results the capital adequacy performance of Shariah based Islamic banks are little superior than commercial bank.

6.2. Asset Quality

It refers to the amount of bank assets occupied by loans, and the asset quality is used mainly as a sign or proxy measure to assess the amount of advances and credit worthiness of banks.
Table 6.1 explains the average quality of asset of Shariah Islamic banks and conventional banks. Quality of Asset of interest free bank is small as compared to commercial bank. Asset quality of Shariah bank is 0.0019 and for conventional bank is 0.0053 which displays that conventional

bank has greater amount of bank assets occupied by loans and also higher in assess the value of loan and credit worthiness as related to Shariah bank. Table 6.2 present the rating of Shariah based Islamic and commercial bank. Average of both banks are less than 1 which means in term of quality of asset of both banks are good in every aspect. According to camel results the assets outcomes of commercial banks are superior to Shariah banks.

6.3. Management Quality

It means superior in supervision. Administrators should be secure banks processes so, they should be have abilities and capability to controller the budget, rise efficiency and productivity Table 6.1 explains the average quality of management of Shariah banks and commercial banks. Management quality of commercial bank is higher as related to Sharih bank. Average Management quality of commercial bank is 1.27 and for Shariah bank is 0.56 which present that managing efficiency of conventional bank is better and have more skill and ability to control banks operations than Islamic bank. Table 6.2 present the rating of Shariah banks and commercial banks. Average of both banks are less than 1.4 which means in term of management proficiency both banks are decent in every aspect. According to camel result the management outcomes of commercial banks are better than Shariah bank.

6.4. Earnings ratio

This study usages the ROA to calculate the financial performance of Shariah banks and Conventional banks. ROA specifies the productivity on the assets of the banks in spite of everything like taxes and expenses (Van Horne 2005).

Table 6.1 explains the average earning ratio of shariah and commercial banks. The ratio of commercial bank is greater as related to Shariah bank. Average earning ratio of commercial bank is 0.011 and for Shariah bank is 0.005 which means for profitability perspectives commercial banks are performing better than Islamic banks. Table 6.2 present the rating of Shariah and commercial bank. Average of both banks are less than 1 which means in term of earning ratio both banks are good in every aspect. According to camel result the financial outcomes of commercial banks are superior to Shariah Islamic banks.

6.5. Liquidity ratio

It is very important for all banks because the liquidity difficulties can principal to failure and insolvency. It is the capability to certainly exchange assets into cash. The greater liquidity index shows that the bank is richer to protect itself from liquidity uncertainty in all sensible situations, Dang (2011).

Table 6.1 explains the average liquidity ratio of Shariah and commercial banks. Liquidity ratio of conventional bank is small as compared to Islamic bank. Average liquidity of commercial bank is 0.096 and for Shariah based bank is 0.12 which means that Shariah banks have more ability to easily change assets into cash as compare to commercial bank. Islamic bank is richer to protect itself from liquidity risk. Table 6.2 shows the rating of Islamic and conventional bank. Average of both banks are less than 1 which means in perspective of liquidity ratio both banks are good in every aspect. According to camel result the liquidity performance of Shariah based banks are superior to commercial banks.

Chapter: 7

Conclusion

The objective of this research was to examine the comparison between Shariah banks and conventional banks in Pakistan for the years of (2005 to 2018).

For this comparison purpose two models were selected, one is financial ratio analysis and the other one is CAMEL model analysis. For the research purpose these are following were used in this research i.e., uncertainty & Solvency, Profitability ratio, Deployment ratio, Cash flow to Revenue ratio, capital adequacy, quality of asset, managing efficacy, and liquidity to measures the financial outcomes and CAMEL techniques analysis of commercial banks and Shariah banks in Pakistan for the period of 2005 to 2018.

In term of (ROA) of financial ratio, we found that the financial performance of commercial banks was superior to Shariah banks. The main reason to least in ROA because the Shariah banks were fresh in the marketplace and the focus of Shariah banks on that time was to extend their business volume.

In term of liquidity of financial ratio analysis, we establish that commercial banks performed greater than Shariah banks which means conventional banks were high in profit and high in uncertainty as related to Shariah banks which were low in profit and also less risky. With perspective of CAMEL model in term of liquidity management we found that commercial bank was small as related to Shariah bank which means that Shariah banks had more ability to easily change assets into cash as related to commercial banks. Shariah banks were also richer to defend itself from liquidity risk.

In perspective of capital adequacy of both models which included (Equity to Total Assets), we found that both banking sector were performing better.

In term of deployment ratio of financial ratio analysis, we found that the results were in favor of commercial banks. Due to higher ILR conventional banks effectively used its resources to earn more income as related to Islamic banks in Pakistan. In term of Cash Flow to Revenue ratio of financial ratio analysis, commercial banks performing lesser than Islamic banks which means Shariah banks had been high in proficient in internal control over expenditure and also higher in percentage of earning convert into cash to meet the daily basis transactions than commercial banks in Pakistan. In perspective of solvency and uncertainty ratio of financial ratio analysis we found that commercial banks are performing better than Islamic banks that means conventional banks had more debt to change into assets and more risky than Shariah banks because the average EMR of conventional banks was greater than Shariah banks.

In perspective of asset quality of CAMEL model, we found that asset quality of Shariah bank was small as related to commercial bank which presented that commercial banks had greater amount of bank assets occupied by loans and also higher in assess the value of loan and credit worthiness as related to Shariah banks. In perspective of management quality of CAMEL model, we found management quality of commercial banks was higher as related to Shariah banks which showed that supervision efficiency of commercial banks was superior and have more skill and ability to control banks operations than Islamic banks.

We interpreted the CAMEL rating from 1 to 5. According to CAMEL composite rating, average amount of all variable was lower than 1 that means both banks were basically good in every aspect and the composite rating of CAMEL was in strong category.

The results of this study are in favor of Conventional banks because in term of financial ratio analysis out of 6 variables, the performance of conventional banks of four variables (ROA, ADR, ILR and EMR) is greater and better than Islamic banks. The performance of just two variables (CAR and CFR) is in favor of Shariah based Islamic banks which means the results are in favor of conventional banks. In term of CAMEL model out of 5 variables the performance of conventional banks of three variables (Earning ratio, asset quality and management quality) is greater and superior than Shariah Islamic banks. In perspective of CAMEL techniques the outcomes of only two variables (capital adequacy and liquidity managing) is in favor of Shariah

Islamic banks which means in term of CAMEL model the results are also in favor of commercial banks.

The results of this research will be very valuable for banks administration in the banking industry of Pakistan, which can undoubtedly focus on these important factors of the CAMEL technique to calculate outcomes and make suitable results. Shareholders and Depositors can also assess the outcomes of the bank in order to make the accurate and appropriate investment decisions.

7.1. Limitations of the study

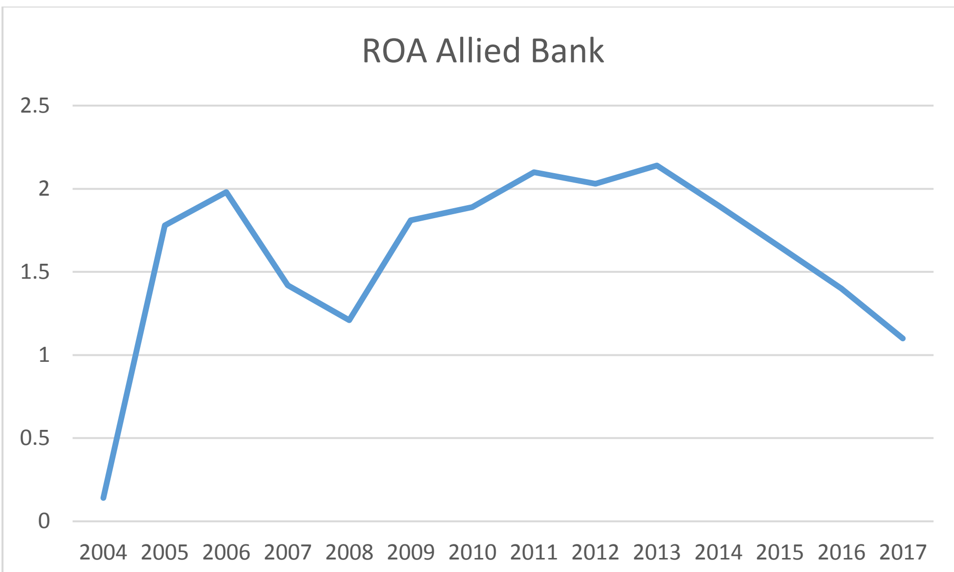
This research has some limitations.

- First, many banks are excluded from our sample due to the missing data for many years over the period of the study.
- Second, some other variables were not included from financial ratio because of the lack of information, data availability and time constraint.
- A study can be done in future by comparing other variables of financial ratios.

Appendix

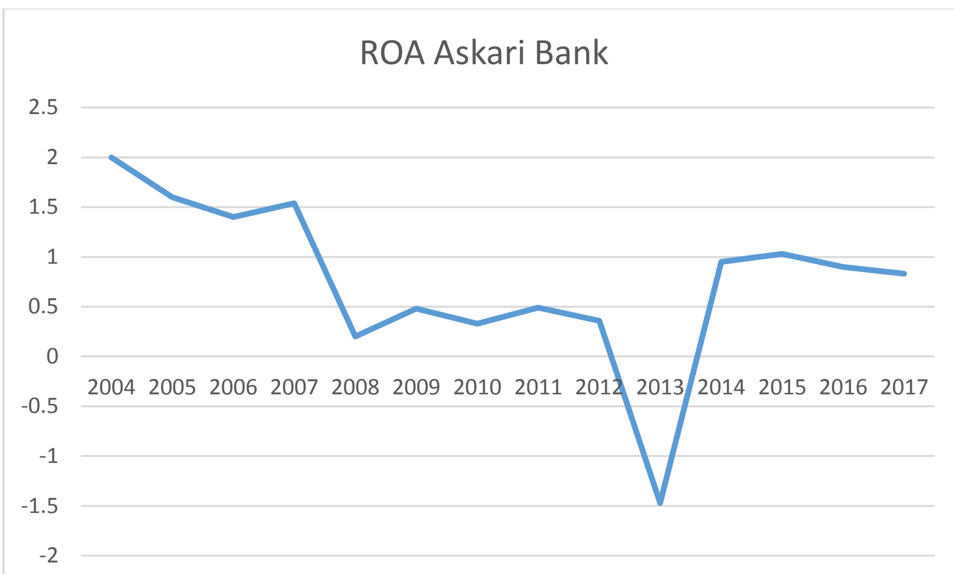
Appendix A: Graphical Analysis of Conventional banks

Figure 1



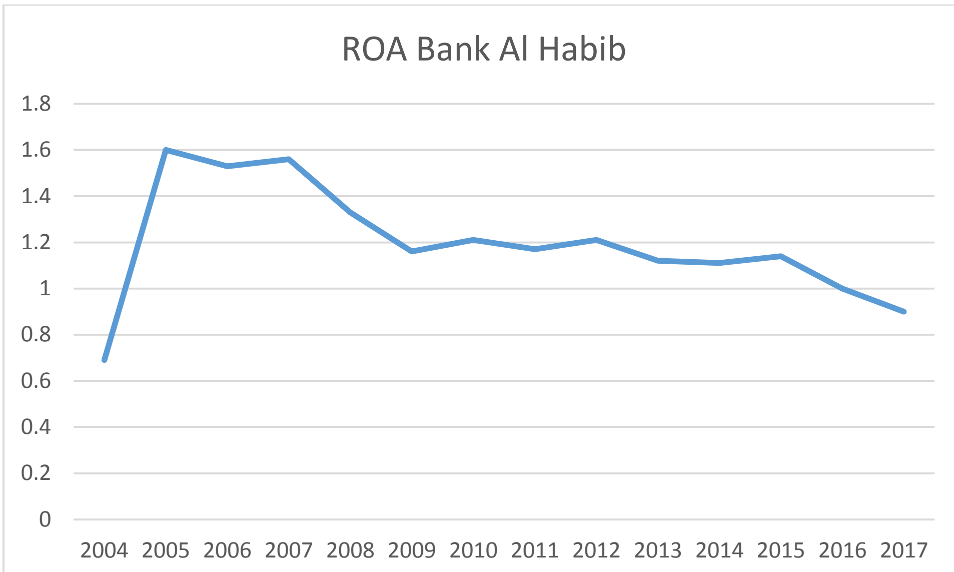
In 2005 Allied bank made major changes in its supports groups and business. The main focused of Allied bank is on customer satisfaction and services. The management organized customers sections i.e. Consumer banking, Company and asset banking and profitable and trade investment. Objective of these groups is to develop quicker than the marketplace by completely exploiting on the possible clients by provided that superior facilities and fresh product to current consumers. Due to these new strategies the profit of Allied bank increased by 892% [Annual Report, 2005]. During 2006 Allied bank generated successfully high profit because of customer fully satisfied to the services of this banks and one more reason to generated high profit in 2006 which is strong branch network of allied bank [Annual Report, 2006]. Due to the economic disaster, Allied bank also suffered and their profit came from 2% to almost 1.5% [Annual Report, 2007]. In 2008 Allied bank faced same issued that happened in 2007 and their profit came from 1.5% to 1.25%. Due to the better financial performance in 2007 and 2008 in the market Allied bank profit was reduce only [Annual Report, 2008]. In 2009 the financial crisis was over and Allied bank under the challenge environment, manage to control and maintain a high profit [Annual Report, 2009]. In 2010 Management of Allied bank decide to increase the percentage on import and export transaction due to this strategy the profit increase by almost 15% [Annual Report, 2010]. Until 2013 the profit of Allied bank fluctuate around 2% after 2013 the profit was gradually decreased until 2017 because of increasing in admin and operating expenses and increase funding [Annual Report, 2017].

Figure 2



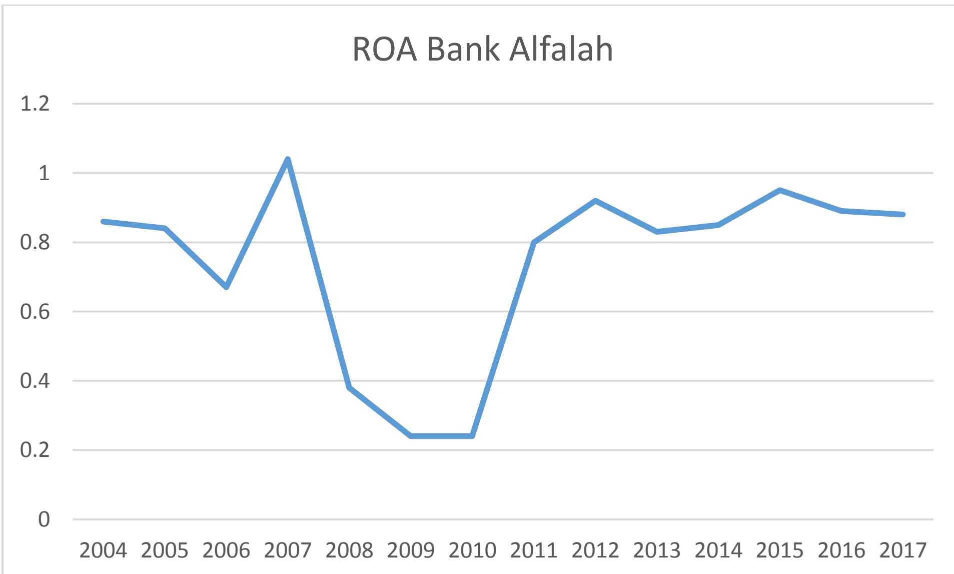
In 2008 the profit of Askari bank was decline by 31% due to recognized tax credit previous year [Annual Report, 2008]. The profit and loss in 2013 recorded sharp decrease as compare to previous year due to a lot of major changes in requisite provisions, revenue against non performing and other assets to upward [Annual Report, 2013]. In 2014 healthy increase in profit of Askari bank was increased by 129% as compared to last year due to improvement in business volume and net spread and also avail some markets opportunity and cost control measure [Annual Report, 2014]. Other rest years the profit and loss was fluctuated normally.

Figure 3



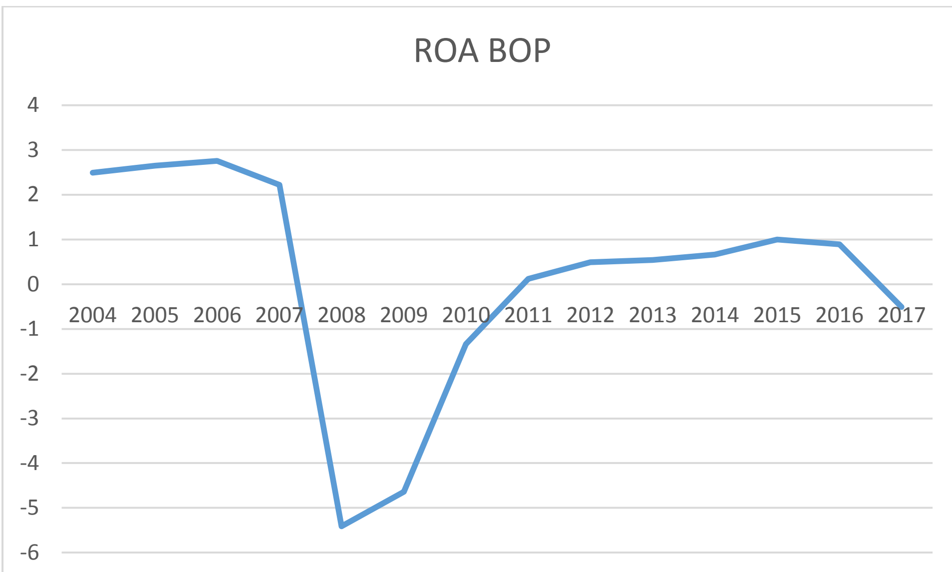
In 2005, big change in the profit of Bank al Habib to upward because to extend the business volume extend in and also Bank al Habib was started Islamic banking system in 2005 due to this on that time the profit of Bank al Habib was on peak [Annual Report, 2005]. In 2009 the business network of branches to 255 including 6 Islamic branches. Due to financial crisis, this bank profit was declined in 2009 and also due to increase in admin expenses the profit was reduced [Annual Report, 2009]. Next some years the profit and loss was fluctuated normally.

Figure 4



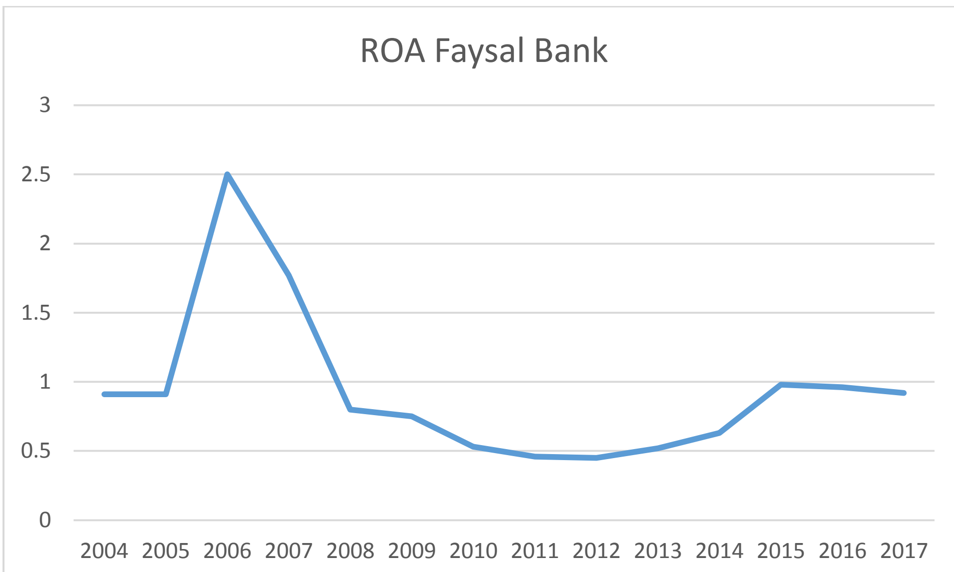
In 2007 the profit of Bank Alfalah was increased by 111% because of whole rise in networking and corporate volume and also increase in assets improvement on trade of share Warid telecom [Annual Report, 2007]. In 2009 Bank Alfalah faced deficit due to financial crisis and also revaluation of equity investment as classified as available on sale have been indicted to the P&L account as loss in agreement with the requirement of IAS [Annual report, 2009]. During the year 2011 bank profit stood at Rs 5433.718M as related to Rs 1368.745 for the last year and also bank avail FSV benefit and on that time the business volume of Bank Alfalah was 406 branches which include Islamic and abroad branches [Annual Report, 2011]. Rest years profit and loss fluctuated normallys.

Figure 5



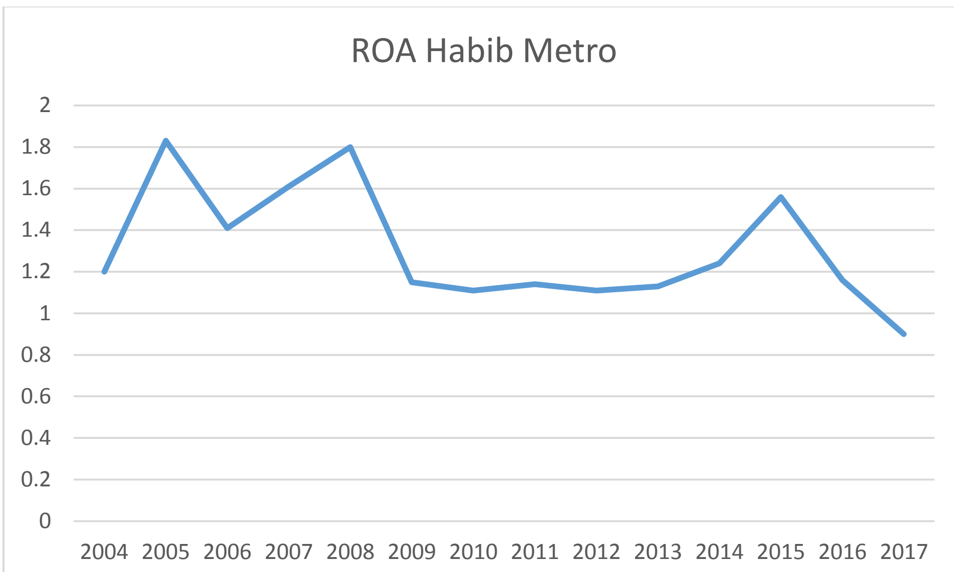
During the year 2008 a lot of declined in the profit of BOP due to the global financial crisis [Annual Report, 2008] and even in 2010, this bank was in loss but their loss was greatly reduced due to control in admin expenses and also concentrate in Govt. Securities [Annual Report, 2010]. During the year 2011 the bank on the pathway of success due to focus on CASA (current account and saving account) [Annual Report, 2011]. In 2017 this bank again faced loss because of changed in some internal policies by Board of director [Annual Report, 2017].

Figure 6



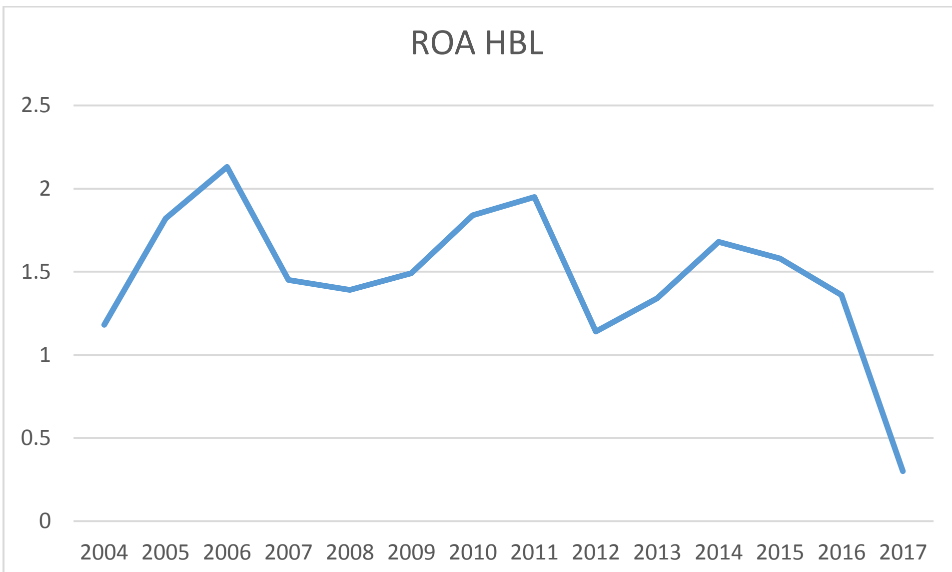
The overall net assets of faysal bank were increase by 22.4% in 2006 and profit was increased by 113M as related to 5M last year. This rise in profit due to full year operation by the fund as against three month operation by the fund in last year [Annual Report, 2006]. During the year 2008, the profit of Faysal bank was decreased due to financial global crisis and due to better performance by the management and with the sharp focus on the strength was able to do well in these difficult times[Annual Report, 2008]. In the years of financial crisis. The bank profit was only reduce, due to good performance this bank did not faced any loss until 2017.

Figure 7



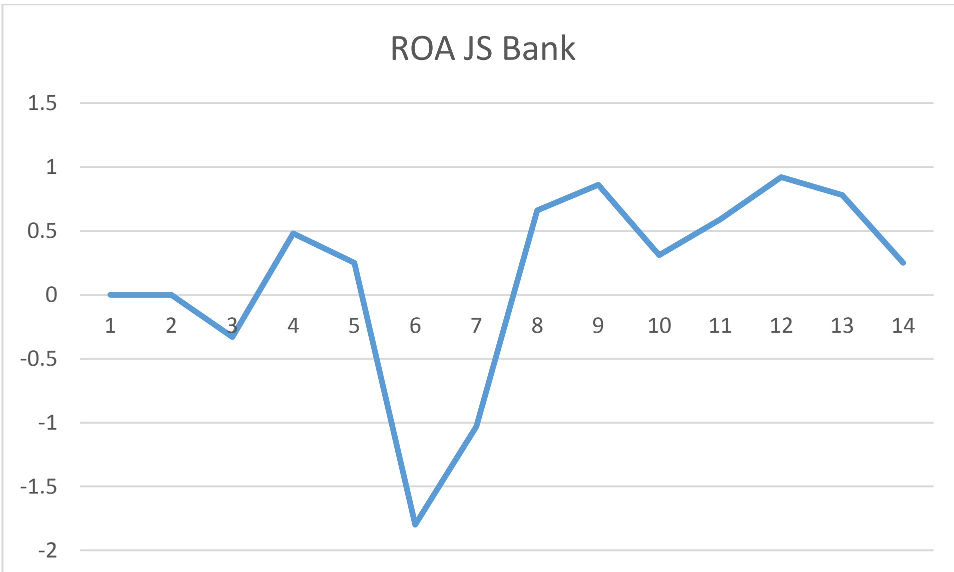
During the year 2005, the economic instability due to the impact of earthquake and rising energy prices. The overall banking sector experienced higher in profitability due to rising interest rates [Annual Report, 2005]. In 2006 the profit of this bank is high but as compare to last year the profit was decreased by 0.6% due to changes in upper level management policies [Annual Report, 2006]. In 2007 of profit of the bank showed a growth of 34% while average assets grew by 40% this because of significant growth in investments, operating fixed assets and advances [Annual Report, 2007]. Due to financial crisis the profit was decreased in 2009 [Annual Report, 2009]. In 2015 the productivity improvement of 147% due to the Bank attained broad-based organic development, with its small budget source mobilization, change in asset outline and appropriate realization of capital expansions [Annual Report, 2015].

Figure 8



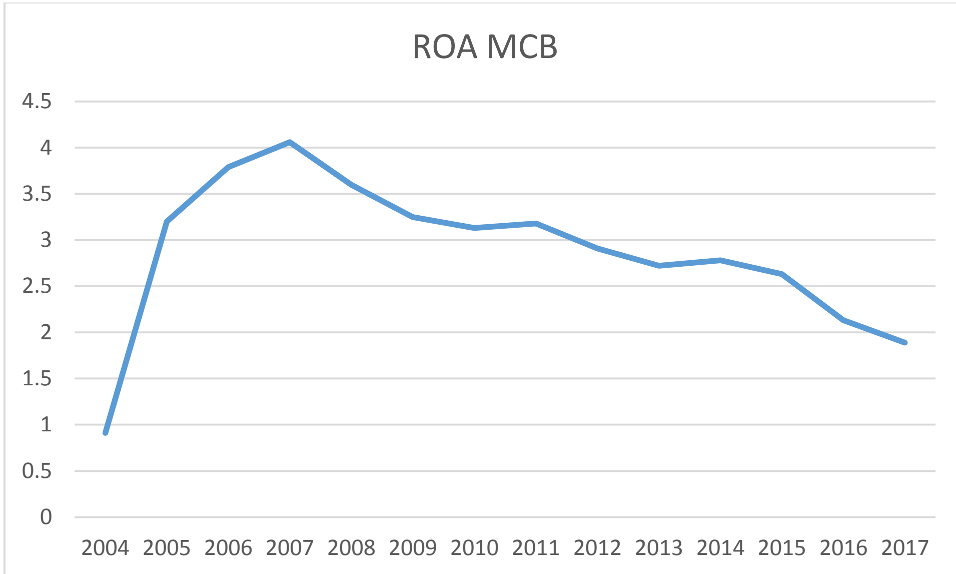
The profit for the year 2006 of HBL was increased by 36% as compared to last year and earning per share of 2006 was increased by 32% due to manage and control risk through organizational structure, framework, risk management and follow the instruction given by the SBP [Annual Report, 2006]. Over 2007 the profit of HBL has decreased by 19.6% due to SBP require provision to be made on the complete amount deprived of any decrease of involuntary sale amount of securities detained [Annual Report, 2007]. In 2012 the profit of HBL again decrease because of increase in some admin expenses and changes in internal policies by the management [Annual Report, 2012]. Over 2014 the profit increased by 38% due to heavily invested in infrastructure, in technology and human resource management [Annual Report, 2014]. During the year 2017 the profit of HBL was recorded 8.2 billion which is very lower than last year and earnings per share Rs.5.34 as compared to Rs.23.23 for 2016 [Annual Report, 2017].

Figure 9



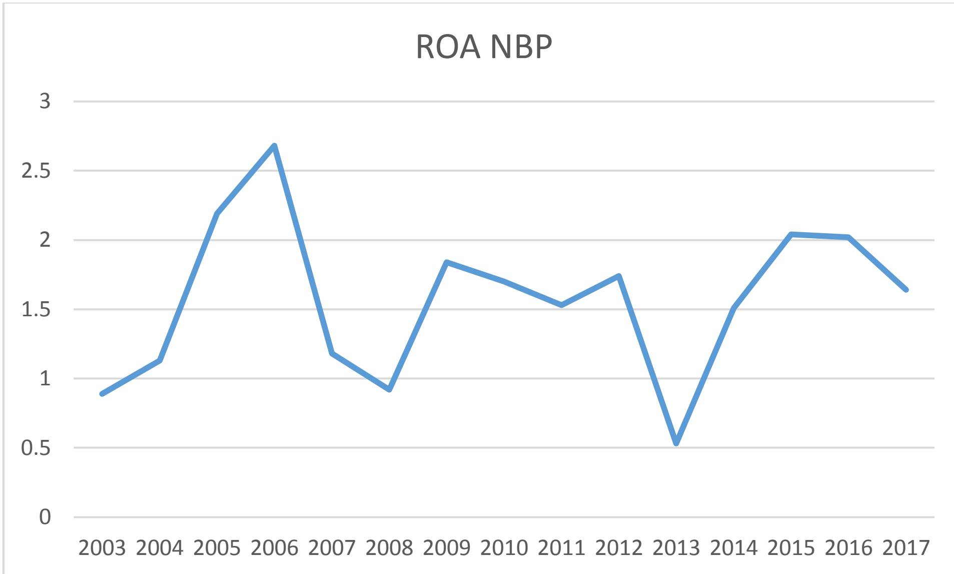
The loss of JS Bank in 2009 was recorded Rs 1721M compared to profit of Rs 549.368 million for the last year due to the financial global crisis [Annual Report, 2009]. In 2010 the profit was increased due to increase in bank deposits and in 2011 the profit was increased by 186% because of improvement in liquidity and investment in Treasury Bills and Pakistan Investment bonds [Annual Report, 2010 and 2011].

Figure 10



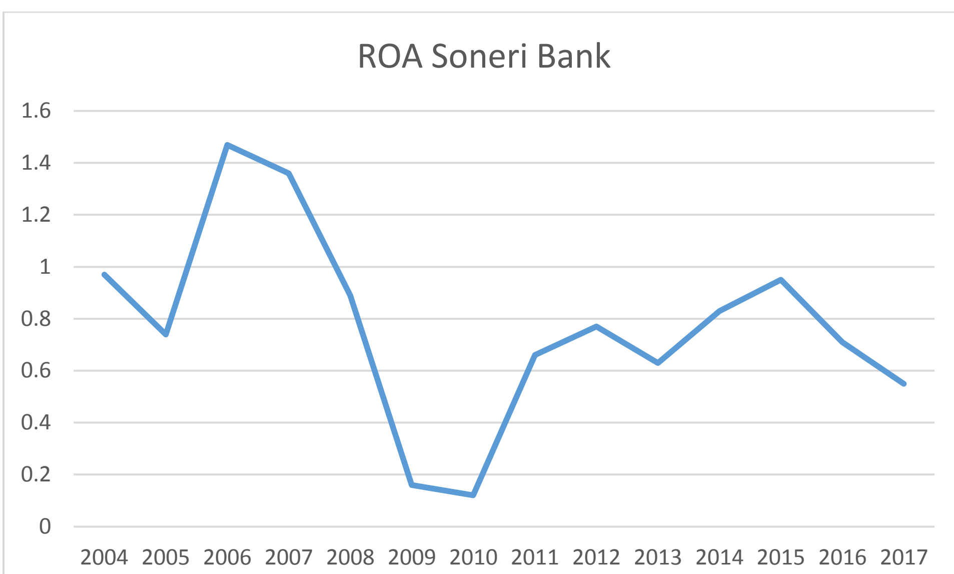
The profitability of MCB was more than tripled in 2005 due to following strategies such as customer services, investing in technology, instilling a bank wide selling culture and risk management [Annual Report, 2005]. The year 2007 was very successful year to all shareholder and customer because of the profit was on peak due to increase outreach, human resource strengthen, changing in senior management and also manage and control risk management [Annual Report, 2007]. The profitability ratios was one of the best in the banking industry in 2012 which are reflective of the effective management of the affairs and adoption of prudent strategies [Annual Report, 2012]. The profit in 2017 was decreased by 14% as related to last year due to rise in admin expenses by 23% [Annual Report, 2017].

Figure 11



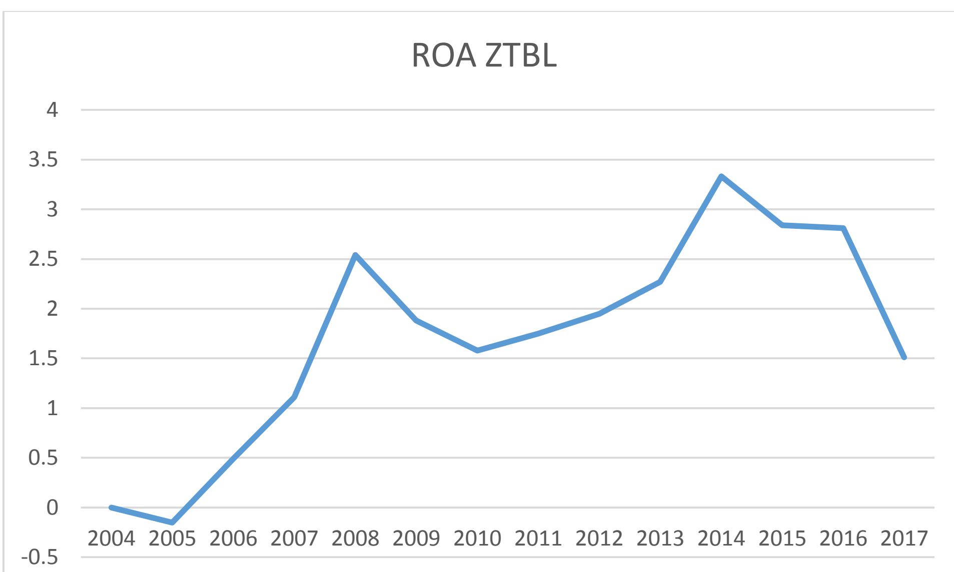
Over year 2006 was an outstanding year because the profit highly recorded due to strong branch networking and strength in fundamental and also highest integrity standard, merit culture, team work and excellence in customer services [Annual Report, 2006]. In 2008 NBP also suffered by financial global crisis because of this a big decrease in profit [Annual Report, 2008]. During 2009 the profit increased by 18% due to higher fee and higher commission, capital gain and tax credit [Annual Report, 2009]. In 2013 it's a historical loss due to changes in upper management and in 2015 profit increased due to increase in capital gain, non-performing loan recovery and gain on sale of non-banking assets [Annual Report, 2013 and 2015].

Figure 12



In 2006 the profit of this bank increase due to investment in infrastructure, technology and training and development of management [Annual Report, 2006]. Next three years Soneri bank faced gradually decreased in profit due to worldwide economic disaster and in 2011 the profit of Soneri bank was increased due to increasing in branches and manage to increase the net assets by 23% [Annual Report, 2011]. The year 2015 was record high profit for the bank due to cost control and high fee and commission charged [Annual Report, 2015].

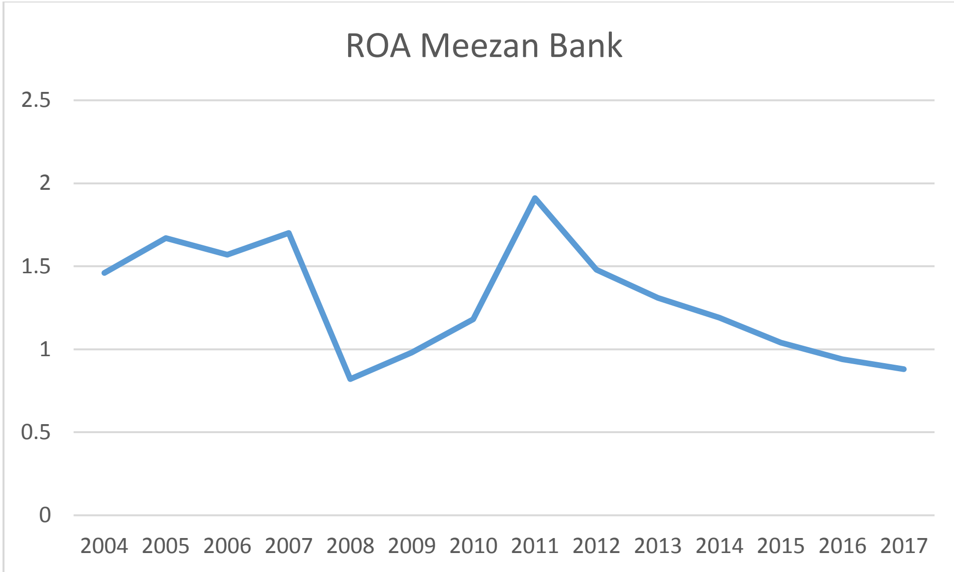
Figure 13



The profit of ZTBL in 2008 was very high due to recover previous all banks dues from insolvent clients, development of business, Human resource development and Kissan support services [Annual Report, 2008]. In 2014 the profit of ZTBL was on peak due to new products launched in the market such as Sada bahar scheme, Awami Zarai scheme and kissan dost scheme and also other product developed such as Asan Qarza, Khawateen Rozgar, Shamsi Tawanai and Tawanai Bachat scheme [Annual Report, 2014].

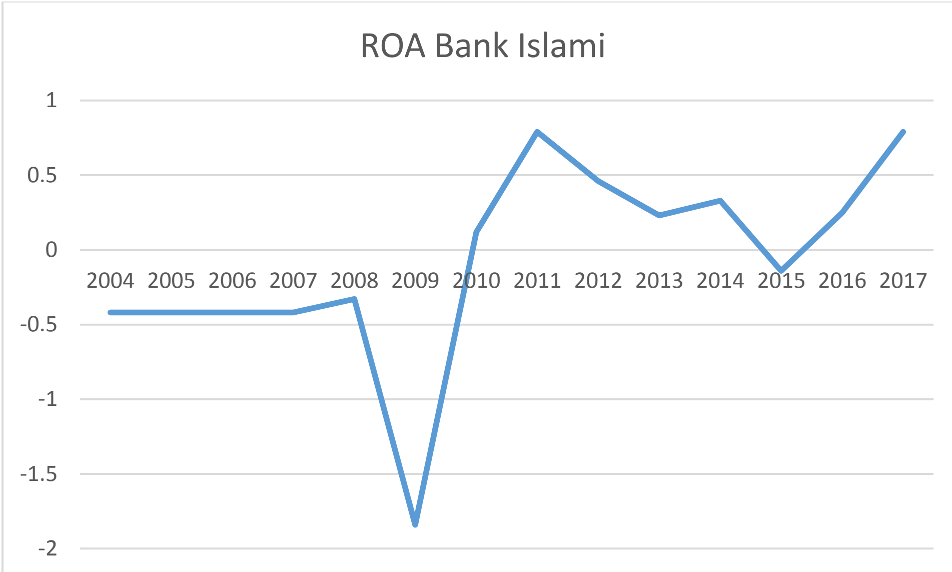
Appendix B: Graphical Analysis of Islamic banks

Figure 1



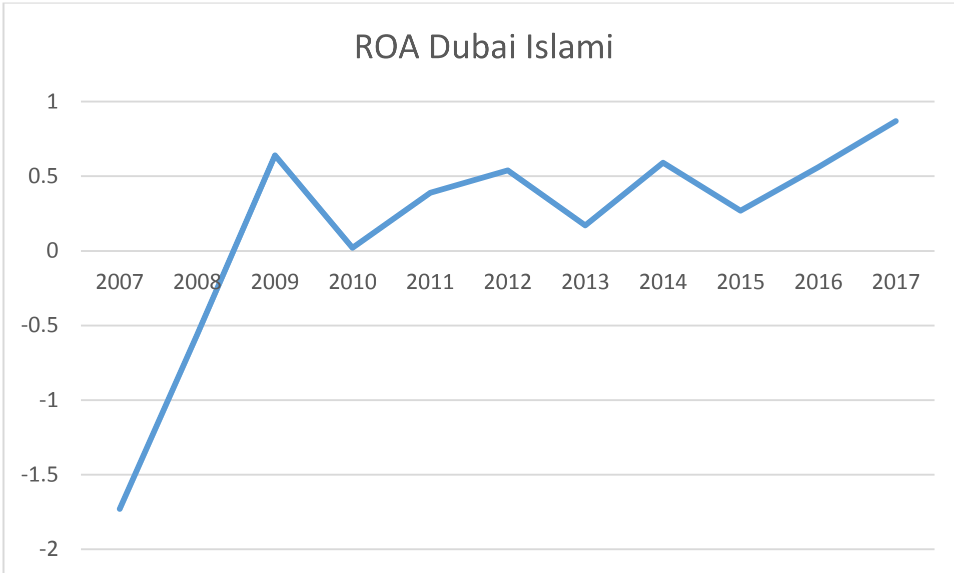
Due to financial crisis the profit of Meezan bank also effected in 2008 [Annual Report, 2008]. In 2010 the profit increased due to strong deposit growth and also high growth in assets [Annual Report, 2010]. The profit recorded excellent in 2011 due to the Bank sustained to retain a large liquidity, which is in mark with the careful funding rule accepted by the administration and also reliable with the development appreciated in further banks in Pakistan during 2011 [Annual Report, 2011]. And in 2017 the profit was decreased due to increase in admin and operating expenses by 14% [Annual Report, 2017].

Figure 2



In 2009 bank islami faced loss due to financial global crisis and economic instability in the country [Annual Report, 2009]. The profit was highly recorded in 2011 due to increase in overall deposits by 32.4% [Annual Report, 2011]. The year 2015 was tough year for this bank because of faced loss again due to the bank became fully MCR compliant and amalgamation in KASB bank [Annual Report, 2015]. In 2017 the profit of BankIslami was increase again due to improvement in deposits and reducing cost and also increased business volume [Annual Report, 2017].

Figure 3



In 2009 the profit of Dubai Islamic banks was highly recorded due to the business volume extend and number of branches of Dubai Islamic bank was 35 and 1 sub branch operate in all over the country [Annual Report, 2009]. In 2010 the profit was decreased due to decrease in sales [Annual Report, 2010]. And in 2017 the profit was gradually increase due to invested in infrastructure and training and development and also invested in assets growth [Annual Report, 2017].

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