Comparative analysis of Islamic & Conventional banks: risk & return perspective

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The importance of Islamic banks has significantly increased after the global financial crisis caused by conventional banking systems. Investors are now looking for alternatives, which Islamic banking can provide. This paper investigates whether the Islamic banks perform better in terms of risk and return as compared to conventional banks. Specifically, the financial performance measures were evaluated using ROA and ROE ratios. To measure liquidity, net loan to asset ratio, net loan to deposit and liquid assets to deposit were evaluated. To measure credit risk performance, equity to asset ratio and equity to net loan ratio were evaluated. Results are in line with the theory of finance, as it suggests conventional banks have better returns because they are taking higher risks, whereas Islamic banks have greater liquid assets and thus provide more safer investments to the investors.

Key Words: Islamic banking, Islamic finance, Islamic modes of financing, Shari’a compliant

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1 Introduction
1.1 Background of the Study

The world is changing constantly and the demands of the financial sector are rampantly increasing day by day. To meet these demands many new techniques and ways of banking have been introduced. The Islamic world has also brought about this fairly new banking system according to what sharia says. Now the researchers are continuously putting all their efforts to find out which banking system is more successful and performance oriented i.e. conventional or Islamic banking. The main difference between the two banking system is that, in conventional banking the profit is determined in absolute terms and rate is tied up with the principal amount. Whereas in the Islamic banking, the percentage of profit defined is relevant with the profit and loss, not with the principal amount they charge against the deferred price.

This study was conducted to evaluate the Islamic banks’ performance with interest based banking system. This was done in order to examine the gap between the performance of the two banking streams. This research looked at the performances of the bank to identify which is better performing and for this reason the researcher has used three important performance indicators which included the liquidity, profitability and credit risk measures. In order to assess the profitability of both the banks, the study used two extensively used ratios i.e. return on equity and return on asset ratio. For calculating liquidity measure, the study adopted loan to asset ratio (NLTA), net loan to deposit and borrowings (NLTD) and liquidity assets to deposit ratio. Finally, for documenting the risk indicator, the ratios involved to calculate the risk of loss were Equity to Net loans ratio and Equity to Asset Ratio.

This study concluded that conventional banks show healthier performance in in terms of ROA. Whereas Islamic banks performance was better in terms of profitability measure of ROE. Moreover, the study for liquidity measurement found that Islamic banks are more competent in meeting sudden and unpredicted withdrawals. This could be because Islamic banks focus more on deposits than lending. And finally analyses of credit risk measurement showed the results in favor of conventional banking system and this could be because they focus on lending and demand fixed returns.
2. Literature Review:

2.1 Historical Perspective

The performance of banks can be assessed by using both quantitative and qualitative methods. Many studies in the past have used several statistical tools to analyze their data to evaluate performance of different banking systems. Some of the key factors i.e. profitability, solvency, credit risk performance, liquidity, efficiency and growth can easily determine the performance of a banking system. To examine the functioning of orthodox and Islamic banking, Iqbal (2001) used trend and ratio analysis to evaluate the performance of both banking systems. The findings reveal, despite the fact Islamic banking is interest-free the business profit and loss sharing is compulsory and the preference in Islamic banking is to take less risks.

Past researchers seem to agree that Islamic banking is far better choice than the mainstream banking system in terms of measuring performance (Samad 2004; Safiullah 2010). A study conducted in the functioning and assessing the proficiency of routine versus Islamic bank found no major differences. Many studies regarding general productivity of Islamic versus conventional banks have identified that there is no critical contrast between the execution of both the banks. However there is a space of change for both the banks in the event of minimizing cost and amplifying benefit. The study presumes that the age and size did not influence the execution of banks in both streams (Bader, et al, 2008; Mohammad, et al, 2008). The Stochastic Frontier Approach (SFA) is utilized by the researcher to analyze the efficiencies of the tested banks. The sample for the study by Bader, et al(2008) contained 43 Islamic banks and 33 conventional banks from the period of 1990 to 2005 within 21 countries and used “data envelopment analysis” (DEA), furthermore they looked at the average and overall time competency of banks on the basis of their size, age and region.

(Sheikh & Ali ,2009; Awan ,2009) have identified that Islamic banks in term of productivity and execution, are superior than conventional banks. The results predict that the Islamic banks are less riskier than the conventional banks. The study provided a differential analysis of risk management on the basis of its distinctive characteristic and used ROE as standard. (Sheikh & Ali 2009) assessed the efficiency of banks in a sample consisted of two conventional and two Islamic banks by using different models. (Awan ,2009) utilized degree dissection method to assess productivity, holding quality and gaining ability of Islamic and conventional banks.
Shar et. al (2010a) utilized Credit Leona's Securities Asia anxiety test (CLSA-anxiety test) to study the execution and productivity of the banks. This study was based on pre and post nationalization of state claimed banks in Pakistan and utilized balanced and unadjusted stress test. Shar et. al (2010) found that a portion of the banks were normal and some of them dependent in terms of capital quality, stake quality, liquidity and proficiency. The study specifically presented measures of dissolvability in banks. Shar et. al (2010) presented a testing apparatus known as bank-o-meter that was utilized to gauge dissolvability of the banks. From 1999 to 2002 each bank was tried on Bank-o-meter and the discoveries were weighed against CAMEL and CLSA-stress test.

(Haron 2010; Ahmad 2010) assessed the expense and efficiency of benefits provided by Islamic banks. The study period was 2003-2008 wherein sample size of the study was 193 banks classified under four locales. In this study stochastic boondocks approach (SFA) was utilized as a part of request to measure the benefit and expense proficiency of Islamic banks. The findings proposed that the Islamic banks working in these locales have better control over the expenses as contrasted with conventional banks. The performance study was conducted in four separate location of the world i.e. Far East, Central Asia, Europe and the Middle East showed that the Islamic banks in Europe are better and more productive. The study also demonstrated that the Islamic way of managing accounts and nature of administration leads to customer happiness as compared to the clients of traditional banks.

The results from the study additionally recommend that in examination to other gathering of banks, the Islamic banks in Europe are better and more benefit and expense productive which is inline with the results of the study conducted by [Tahir & Haron (2010)].

Ahmad (2010) performed the comparative study between Islamic and conventional banks with the focus on the connection between customer satisfaction and the nature of administration. The specimen for the study was comprised of 720 respondents selected through stratified arbitrary testing. This study created organized survey and additionally utilized the particular contact approach. For the administration quality the study utilized a more customized variant of SERVQUAL model. The results of the study shows positive solid affiliation amongst the nature of administration and satisfaction of the customers in Islamic banks as compared to the conventional banks.
The study conducted by Rima Turk Ariss (2010) took the monetary information for Islamic banks from the Bankscope database by Fitch-IBCA and matched it with information on accepted banks. This study utilized a specimen of banks working in thirteen separate nations which incorporated 58 Islamic banks and 192 tried and true banks throughout 2002-2006. Additionally, the study utilized diverse aggressive measures including the focus proportion and the Hirschman Index. The results demonstrated that Islamic banks in correlation to conventional banks, they allocate more resources than that of conventional banks.

The performance study conducted by (Manarvi 2011 ; Beck, et.al. 2012 ; Masruki, et.al. 2011) showed the results in favor of Islamic banks indicating the direction that in comparison of the two banking zones, Islamic interest free banks are more enhanced in terms of liquidity and quality of asset. Jaffar and Manarvi (2011) directed the study upon examination between the conventional and islamic banks working in Pakistan during a period of 2005 to 2009. The study took 5 Islamic and 5 traditional banks and analyzed the execution of both saving money streams by surveying through the CAMEL test wherein standard elements include stake quality, capital ampleness, administration quality and liquidity standing. The figures for the exploration were gathered through the fiscal bank articulations. The discoveries of the exploration uncovered that Islamic banks' capacity is superior in terms of capital, liquidity standing, administration quality and acquiring capability the expected banks. Beck et. al (2012) mulled over Islamic vs conventional banks and analyzed the plan of action, possessions worth, soundness and productivity. The study utilized distinctive pointers assessed from the wage articulation and the asset report information from the specimen of 510 banks over 22 nations with both conventional and Islamic banks. Total number of Islamic banks in a sample were 88 and the study period was 1995 to 2009. In this study numerous nations in the specimen, endured a keeping money emergency throughout the example period. This study presents illustrative facts and present mean standard deviation alongside the normal worth for both the banks including the p estimation of a two-sided t-test. The finding of the study inspected that the Islamic banks in correlation to conventional are less effective yet have higher holding quality and the results demonstrate that throughout emergency Islamic banks perform better as far as promotion and stake quality. The study predicts that in analyzings the benefit and liquidity of Islamic vs. routine keeping money framework, the results found that Islamic banks are less gainful yet have better liquidity as contrasted with customary managing an account framework. Furthermore as far as
the credit chance the traditional banks came across at higher credit hazard than Islamic banks [Masruki, et al.; (2011)]. This study directed by Ika and Abdullah (2011) portrayed the view that in performance measure of liquidity Conventional banks are less fluid and weighed and assessed the execution of Islamic banks in examination to expected banks in Indonesia. The study was led in the period from 2000-2007 with the specimen of three Islamic banks and six routine banks. The study utilized 13 budgetary proportions to study the fiscal execution and the information investigation was directed through the monetary explanations of the banks and likewise Indonesia Central Bank database got to from its site. The study led the Mann-Whitney test to analyze the methods for information breaking down. The discoveries of this exploration have demonstrated all in all not huge contrasts between Islamic and accepted banks as to budgetary execution aside from regarding its liquidity.

The study conducted by (Kouser, et al. 2011; Bunymin 2013) showed no major contrast among Islamic and non Islamic banks based on interest and the findings of the study analyzed that in budgetary execution the traditional keeping money framework is superior to those of Islamic banks. The results infer that still there is a solid need of change, development and mindfulness in the Islamic managing an account arrangement of Pakistan. The study uncovered that the size, capital sufficiency and credits have the positive impact on the execution of bank though the general costs diminish it. The results likewise indicated that noninterest banks perform superior to expected banks. A correlation investigation of Islamic and traditional saving money was directed by utilizing the CAMAL model. The example incorporated four Islamic and four customary saves money with monetary information of five years from 2006-2010 and utilized the camel rating framework as a part of request to measure the execution which included variables, for example, capital amleness, possession quality, administration competence, profit and liquidity. The information gathered for the study was from both essential and optional sources and the study led by Kouser et.al (2011) utilized distinctive test for information examination, for example, T-test, Leven's test, F-detail and the Mann-Whitney test.

The findings of the study conducted by (Rehman 2011, khan 2012) inferred that benefit measures of execution don't show a huge contrast among the exhibitions of Islamic and expected banks where as a liquidity measure demonstrate that Islamic banks are more fluid in examination to routine banks. Moreover the study uncovered that Islamic banks are performing superior to the
tried and true banks regarding the productivity component and the liquidity measures exhibit that Islamic banks in examination to expected banks are more liquid. Usman and khan (2012) led the study after assessing the fiscal execution of Islamic and tried and true banks. The specimen for the study incorporated three Islamic banks and three routine banks between the time of 2007-2009. The choice for the specimen based upon a comfort testing method on the premise of an equivalent measure of limbs and weight of contributing capital. The study utilized budgetary explanations from site and to analyze the money related execution of the Islamic and ordinary banks, the benefit and liquidity proportions were utilized along the matched example t-test was directed by this study to get the critical contrasts among the computed results.

A study to take a gander at the effect of worldwide monetary emergency on the execution of Islamic and customary banks in Malaysia anticipated that because of the money related emergency, there was no significant contrast in the gainfulness and danger among the Islamic and ordinary managing an account framework and Islamic as contrasted with traditional were in ownership of a greater amount of the fluid stakes, hence are less helpless against the liquidity dangers created by the budgetary crises Abdulle and Kassim (2012). The study was led over the period from 2006-2010 with the example of six Islamic banks and nine ordinary banks and directed the near assessment with the budgetary proportions on the effect of the money related emergency on the productivity, credit danger and liquidity of the Islamic and ordinary banks working in Malaysia. To analyze the contrast in execution of Islamic and customary banks, Mann Whitney U-test of equity of mean is utilized. Abdulle and Kassim (2012). And another study centered upon the examination of bankruptcy risk directed by Khan,et,al;(2013) in Malaysia uncovered the findings that in correlation with Pakistani banks, the Malaysian Islamic banks are viewed as more dangerous and less dissolvable. This study took a gander at the relative execution of Islamic banks over the nations and broke down the danger and dissolvability element and was completed for the period throughout 2006 -2011. The specimen of the study was five Islamic banks taken from Pakistan and five Islamic banks from Malaysia.

Said (2013) has researched the correspondence between the effectiveness and dangers for chose Islamic banks for the MENA locale. The study indicated that the credit and the operational dangers are contrarily associated with effectiveness while the liquidity hazard in Islamic banks in the MENA region demonstrated an unimportant relationship to productivity DAE model was utilized within the study to record the effectiveness while distinctive fiscal degrees were utilized
for breaking down the credit, liquidity and operational dangers. Fayed (2013) led an study to assess the execution of the Islamic versus traditional saving money frameworks in Egypt. Three Islamic banks and six accepted banks were picked with the end goal of correlation in the study. This study utilized monetary reports and proclamations to measure the fiscal degrees utilized as a part of the study to look at as far as gainfulness, credit hazard. Liquidity and Bank o meter was utilized to focus dissolvability. The discoveries of the study demonstrated that regarding gainfulness, liquidity, danger and dissolvability, the tried and true banks are more better in execution over the Islamic saving money framework.

Islam et al (2014) analysed the credit/investment risk of Islamic and conventional banks of Bangladesh and found that return on assets of conventional banks is better than that of Islamic banks whereas NPL of conventional banks are significantly higher than those of Islamic banks for the period from 2007 to 2011, which shows inefficiency of conventional banks in credit risk management. Erol et al (2014) in Turkey, signifies the results that Islamic banks performance in terms of profitability and asset management ratios as compared to the conventional banks is good but it lags in terms of sensitivity to market risk criterion during the period of 2001-2009.

Chowdhury (2015) studied the factors which influence the profitability of the Islamic banking sector and conducts a comparative analysis of the determinants of the profitability of Islamic banks operating in Malaysia for the period of 2007 to 2013. He found that the Credit risks and Liquidity risks factors are insignificant on the performance of the Islamic banks.

Khediri et al (2015) investigated the features of Islamic and conventional banks in Gulf Cooperation Council (GCC) countries over the period 2003–2010 and found that Islamic banks are, on average, more profitable, more liquid, better capitalized, and have lower credit risk than conventional banks. Also Islamic banks are less involved in off-balance sheet activities and have more operating leverage than their conventional peers. Ferhi & Chkoundali (2015) studied the credit risk and the efficiency of the Islamic and conventional banks in 28 countries during the period of 1999-2010 period. They found that most of conventional banks have a higher credit risk than the Islamic ones.
3.0 DATA AND METHODOLOGY

3.1 Hypothesis

H₀₁: Islamic and Conventional banks are equally profitable
Hₐ₁: Islamic and Conventional banks are not equally profitable
H₀₂: Islamic and Conventional banks are equally liquid
Hₐ₂: Islamic and Conventional banks are not equally liquid
H₀₃: Islamic and Conventional banks are equally riskier
Hₐ₃: Islamic and Conventional banks are not equally riskier

3.2 Sample of study

The sample size taken for the study includes, five Conventional and five Islamic banks of Pakistan. In order to conduct this study the Islamic banks that were taken under consideration are:
Meezan Bank Limited, Bank Islami Pakistan Limited, Al-Baraka Islamic Bank, Dubai Islamic Bank and Burj Bank Limited. In conventional banking system, top 5 banks were taken as the sample size and this selection criteria was based upon the market capitalization.

3.3 Period of the study

Quarterly data from the period 2008-2013 has been analyzed in order to have a healthy judgment between Islamic and conventional banking system.

3.4 Data collection

The study for the collection of data has been acquired from secondary data available through the annual reports including, income statements and the balance sheet.

3.5 Data Analysis

T-test has been used for hypothesis test. The purpose of which was, to compare two groups on their mean bases. In study followed paired t-test for comparison purpose by comparing the means of two banking streams. For the empirical evidence the study adopted ratio analyses which are classified in three areas which include; profitability performance measure, liquidity performance measure and credit risk performance measure. Various studies shows their reliance on ratio analysis for better evaluation of banks and their performances.
3.6.0 Performance Measures

This study for the collection of data, was taken from secondary data(source) i.e. the audited annual reports for the time period of 2008-2013.

3.6.1 Profitability Performance

This research uses the most extensively used profitability performance measure ratios i.e. return on assets and return on equity:

\[ \text{Return on Assets} = \frac{\text{net profit}}{\text{total asset}} \]

This ratio indicates how well is the bank performing. If this ratio is greater for the bank it shows that the bank is performing quite well in its operations.

\[ \text{Return on Equity} = \frac{\text{net profits}}{\text{equity}} \]

This ratio tells about effectiveness that how much the bank is efficient in managing its operations. Higher the ratio of ROE, means the banks performance is much more better.

3.6.2 Liquidity Performance

The word Liquidity stands for how easily the bank non assets are converted into liquid assets such as cash with minimum amount of discount in its value. It includes three important ratios used in order to measure the liquidity performances.

\[ \text{Net Loans to Asset Ratio} = \frac{\text{net loans}}{\text{total assets}} \]

This ratio assists in evaluating the banks portion of assets which are locked in loans. Greater the value of this ratio means that the bank less efficient in managing its operations.

“\text{Liquid Assets to Deposit and short term fund ratio} = \frac{\text{liquid asset}}{\text{customer deposit and short term fund}}”

This ratio for the banks makes the assessment about the deposits and short term funds that are in hand to meet the impulsive and unpredicted requirement. The bank with greater ratio of LATD are considered more liquid bank.

\[ \text{Net Loans to Deposit and borrowing} = \frac{\text{net loans}}{\text{total deposit and borrowings}} \]

This ratio asses the total deposit in percentage. If the results are higher, it indicates higher liquidity risk associated with the bank.
### 3.6.3 Credit Risk Performance

Performance ratios for risk of loss include three important ratios in order to evaluate the bank presentation on bases of risk. The three performance ratios include

**Equity to Asset Ratio** = common equity/assets

If the value for ETA is higher, this give the information that the banks with higher ratio are able face or absorb the asset loses.

**Equity to Net Loan ratio** = total equity/net loans

The greater the ratio of ETNL for the bank, means the bank has a higher capacity for inquiring losses.

<table>
<thead>
<tr>
<th>ISLAMIC BANKS</th>
<th>CONVENTIONAL BANKS</th>
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<tbody>
<tr>
<td>Meezan Bank Limited</td>
<td>Habib Bank Limited</td>
</tr>
<tr>
<td>Bank Islami Pakistan Limited</td>
<td>KASB</td>
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<tr>
<td>Dubai Islamic Bank Pakistan Limited</td>
<td>Bank Of Khyber</td>
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<tr>
<td>Albaraka Bank Limited</td>
<td>Bank Alfalah</td>
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<tr>
<td>Burj Bank Limited</td>
<td>National Bank Pakistan</td>
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</table>

### 4: Analysis

Outcomes from the financial study are represented in tables below casing three important indicators of performance measures of profitability measure, liquidity measure and credit risk measure

**Table 2. Financial profitability performance of Islamic Vs Conventional banking**

**Paired Samples Test**

<table>
<thead>
<tr>
<th>Paired Differences</th>
<th>t</th>
<th>df</th>
<th>Sig. (2-tailed)</th>
</tr>
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<tbody>
<tr>
<td>ROAI – ROAC</td>
<td>-.00505</td>
<td>.03829</td>
<td>1.78</td>
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</table>
The table above depicts the profitability measure of conventional with Islamic bank. The results show that ROA of Islamic banks is less than conventional, this illustrate that these conventional banks are able generate more asset return than Islamic. On average in islamic banks ROA is .0050 (5%) less than interest based banking system. The results are significant at 10% indicating that the mean difference between the ROA(Return On Asset) of Conventional and Islamic is significantly different, suggesting that ROA of conventional is different from the ROA of Islamic banking stream. The results conclude that in this particular area i.e ROA, interest based banks i.e. conventional banking stream is dominating. Profitability is one of the important term generally used as a gauge for measuring performance and it is important tool for the bank because they make revenue only if when they able to generate more returns (income) than their expenditures (expense). For profitability measure , ROA and ROE ratios are commonly use to portray the bank position in terms of its competence. The ratio ROA has been used by variety of different studies conducted in area of comparison between the interest based banking zone with non interest based banking area Samad (2004), Javad,et,al; (2001).

Table 2.2 financial performance ratio of return on Equity of Islamic Vs Conventional banking

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<th>Paired Differences</th>
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<tr>
<td></td>
<td>Mean</td>
<td>Std. Deviation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pair 1</td>
<td>ROEI - ROEC</td>
<td>.01917</td>
<td>.22118</td>
<td>2.16</td>
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</tbody>
</table>

Return on equity of Islamic Vs Conventional banks in the above table shows that ROE on average is .01917 times in Islamic bank is greater in comparison to conventional banks. The mean difference between the return on equity of Islamic Vs conventional banks is significantly different, applying that there is difference between the ROE ratio of Islamic and Conventional banking system. Its results are significant at 5%. This describes the efficiency of Islamic banks indicating that they are more able in making earnings (profit) as compared with conventional banks. This ratio Return On Equity tells about the shareholders position means that upon their investment how much they are getting the return and this is the reason why this ratio ROE is of great importance for the clients and the investing parties.

From the outcome, it is concluded that interest based banking system is more dominate in profitability measure of ROA where as in ROE ratio, Islamic banks are more dominate.
Table 3. financial liquidity performance of Islamic Vs conventional banks

Table 3.1 performance of Net loans to asset Ratio of Islamic Vs conventional banking

**Paired Samples Test**

<table>
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<tr>
<td></td>
<td>Mean</td>
<td>Std. Deviation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pair 1 NLTAI - NLTAC</td>
<td>-.42523</td>
<td>4.09386</td>
<td>-1.138</td>
<td>.257</td>
</tr>
</tbody>
</table>

The above table shows the results for net loan to asset ratio of Islamic Vs conventional banks. From the results it was concluded that NLTA on average is .42523 times lesser in Islamic banks when compared to conventional banking system. In this respect it shows that this ratio is dominating in conventional system, suggesting that banks based upon interest are more tried up in loans and has lower liquidity. So liquidity control is far much better in Islamic banks. The mean difference between NLTA ratio of both banks i.e. Islamic and conventional is significantly different, suggesting that there is difference between the ratio of Conventional Vs Islamic in terms of NLTA ratio.

Table 3.2 performance of Liquidity asset to deposit and short term fund ratio

**Paired Samples Test**

<table>
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<th>Paired Differences</th>
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<tr>
<td></td>
<td>Mean</td>
<td>Std. Deviation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pair 1 LATDI - LATDC</td>
<td>.00437</td>
<td>.17062</td>
<td>2.48</td>
<td>.014</td>
</tr>
</tbody>
</table>

This table shows that LATD in Islamic banks is .00437 greater that conventional banks and the results are significant at 1%. This mean difference suggest that there is difference between the performance of LDASF ratio between conventional and Islamic banks. It describes the liquidity of Islamic banks as LATD ratio is greater for these banks i.e. for Islamic and further depicts that such banks are able to meet impulsive and unpredicted extraction (withdrawals).
Table 3.3 performance ratio of Net Loans to deposit and borrowing

**Paired Samples Test**

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<th>Paired Differences</th>
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<tr>
<td></td>
<td>Mean</td>
<td>Std. Deviation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pair 1 NLTDI-NLTDC</td>
<td>-.14546</td>
<td>.67976</td>
<td>1.83</td>
<td>.069</td>
</tr>
</tbody>
</table>

The results from the above table indicate that NetLDBR on average in banks that are Islamic is -.14546 less in comparison to conventional bank and its results are significant at 10%. The value predicts that the mean difference between the performance ratio of net loans to deposit and borrowing of Conventional and Islamic banks is significantly different, suggesting that difference exists between the NetLDBR ratio of Islamic Vs conventional banks. Higher this ratio for the bank, show that these banks are more open to liquidity risk. On the whole Islamic banks liquidity management is far much better than conventional.

Hence the results show that conventional banking is dominating in liquidity management of “Net loans to asset ratio” and “Net loan to deposit and borrowing” where as Islamic banking dominate in liquid asset to deposit ratio.

**Table 4.0** performance measure of credit risk

**Table 4.1** Equity to Asset Ratio

<table>
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<th>Paired Differences</th>
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<tr>
<td></td>
<td>Mean</td>
<td>Std. Deviation</td>
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<td></td>
</tr>
<tr>
<td>Pair 1 ETAI-ETAC</td>
<td>-.05915</td>
<td>1.08516</td>
<td>-.597</td>
<td>.552</td>
</tr>
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</table>

The banks faces the risk of loss that is the credit risk incase when the borrowers who borrow loans from them, they are unable to repay their liabilities back to their banks. Credit risk is assessed by two commonly used ratios i.e. ETA ratio and ETNL ratio. The results in the above table conclude that equity to asset ratio for Islamic bank is comparative less i.e. it is less -.05915 times than that of interest based banks and the results are insignificant. This means that due to
insignificant result they could not be generalized, they are statistically insignificant, the result might be true for this sample but these results could not be generalized.

**Table 4.2 Equity to Net Loan Ratio**

**Paired Samples Test**

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<tbody>
<tr>
<td>Mean</td>
<td>Std. Deviation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pair 1</td>
<td>ETNLI - ETNLC</td>
<td>.04877</td>
<td>.52426</td>
<td>2.10</td>
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</table>

The results of above table shows that EQL on average in Islamic banks is .04877 greater than conventional banks and this value shows a mean difference between EQL of Conventional and Islamic banks is significantly different, suggesting that there is difference between the EQL ratio of both banks and the results are significant at 5%. This shows that conventional banks are more efficient and more able to digest loan losses which they lend to their customers. Hence in credit risk analysis Islamic banking is dominating in Equity to Net loan ratio.

**Conclusion**

This research covers the period of study from 2008 to 2013 that is this study analyzed six years of quarterly data in order to have a healthy comparison between Islamic Vs conventional banking system. Five Islamic Vs five Conventional banks were taken under consideration to measure their actions in how well they are performing in the society and which bank is better than the other. This study used seven financial ratios to calculate the performance measures which include profitability measure, liquidity measure and credit risk measure. The seven financial ratios includes return on asset ratio, return on equity ratio, net loan to asset ratio, liquidity asset to deposite , net loan to deposit and borrowing, equity to asset ratio and equity to net loan ratio. The researcher based the conclusion on the outcome indicating that profitability measure the interest based system is dominating in ROA where as in ROE ratio, interest free banking zone is dominating.Whereas in liquidity performance measure, conventional banking is dominating in liquidity management of Net loans to asset ratio(NLTA) and Net loans to deposit and borrowings(NLTD) where as Islamic banking dominate in liquid asset to deposit and short term fund ratio and the study found that the liquidity arrangement (position) is better handled by...
Islamic banks because of the reason that such banks they focus less upon lending and more upon deposits. This is because these Islamic banks they share profit and loss with their customers so they focus more on deposits than on lending because the society than might miss use of sharing of loss with them. The customer satisfaction increases for those bank with greater liquidity. Moreover in credit risk analysis the results conclude that Islamic banking is dominating in Equity to Net loan ratio. A bank with lower equity to net loan ratio is considered better because of the reason that banks with greater equity to net loan ratio are unable adjust the financial losses because of less capital.

**Future Direction**

The study tried to investigate the overall performance of both the banks i.e. Islamic Vs Conventional banking system. This research would add to the academia and the industry and future researchers can take help from this research and can further add up to the value by using other different performance measures including camal, trainers ratios, bank o meter.
REFERENCES


