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# Comparative Financial Performance Analysis of Conventional and Islamic Banks in Pakistan

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**Abstract**
Financial performance is a general measure of firm's overall financial health over a given period of time. The aim of this study is to compare financial performance of Islamic and Conventional banks to support depositors, bank managers, shareholders, investors, and regulators by providing true picture of financial position of Islamic as well conventional banks in Pakistan Ratio analysis technique is used to analyze financial performance of both banks. Data is collected from annual financial statements i.e. Balance sheet and Income statement for the period of 2008-2012. Nineteen ratios were estimated to measure these performances in terms of profitability, liquidity, risk and solvency, capital adequacy, operational, deployment and cash flow. Independent sample t test was used to determine significance of mean differences of these ratios between two banks. The study concludes that Conventional banks are more profitable, deployed and operationally efficient while less liquid and more risky as compared to Islamic Banks and also found a significant mean difference in profitability, capital adequacy, and cash flow ratio of both banks. To increase performance banks should conduct internal evaluation to improve its activities and to overcome weaknesses.

**Keywords:** Financial performance, Comparative analysis, Pakistani Banking Sector, Investors

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**I. Introduction.**

A country's economic growth depends on various factors; among those various factors, financial sector performance is one of the important factors, especially the financial institutions working in that country. One of them is the banking sector. Banking sector performance plays a significant role in the overall economic performance of a country. It represents a key financial service sector in economic growth of a country. A country is economically stable and developed depends largely on banking sector's performance. It functions as an intermediate to link surplus and deficit components provide funds to utilize in productive purposes thus struggling for the economic development (Ansari and Rehman, 2010). Although banks are existed differently in earliest times too but in last two decades industrial revolution have brought a drastic revolutionary change in operations, management and performance of banking sector. Today banks are incorporated with many new products and services to flush the flow of funds in the economy (Sehrish, Saleem and Yasir, 2012).

To motivate the economy of any particular country Government does this with help of "monetary tools" through banking sector. All of the business and finance transactions involved in this process are managed by banks. Not only advantages come out from conventional banks policies there are disadvantages too. Major crisis whether financial and economic occurred due to conventional banks policies that are Global financial crisis (Faizulayev, 2011). IMF studied the effect of financial crisis on the performance of both Islamic and Conventional banking sector and found that on average Islamic banking showed stronger resilience during crisis. But when crisis hit real economy Islamic banks faced huge losses comparative to Conventional Banking sector. Islam is uncut and comprehensive way of life, which provides stability between religious obligations and materialistic needs of human being. One of important need of human being life is to have a system which provides proper laws or rules for financial management in their life. Every human being have right to spend their life according to neither their will nor it is necessary that one method or one system is proper and acceptable for all. Same as two different banking sectors performing at the same time in Pakistan; Conventional banks and Islamic banks (Amjad, Tahira, Akram and Usman, 2013).

Abundance of studies is available about different aspects of Conventional Banks while rare for other. This research aims to seal this gap. Main focus is to evaluate these two banking system i.e. Islamic banking and Conventional Banking with reference to financial performance. The acute shortage of any recent study after 2010 in Pakistan inspired to conduct a comparative performance analysis of existing five full-fledged Islamic banks of Pakistan with five large Conventional Banks of Pakistan from 2008-2012.In Pakistan no empirical research has still compared financial performance of Islamic and Conventional banks particularly after 2010. Similarly Islamic banks practices are newly introduced in Pakistan so requires a comparative study to contribute towards literature. During 2010 to 2012 Islamic banks makes extraordinary arrangements to create awareness throughout the country and this may be one of the factors in the performance of Islamic banks. A comparative study is demanded/needed based on existing literature to analyze and compare performance of both banks. This study examines and compares the financial performance of both Islamic and Conventional Banks in Pakistan. The study is conducted to investigate: What are the performance measures of Islamic and Conventional banks?

Financial Institutions plays significant role in economy because for advancement and growth of economy they add the most and keep economies on track. As global financial system suffered an intense and traumatic shock in September 2008. The impact of crisis directly on the economy of Pakistan was limited because our system in not integrated with global financial sector (IMF, 2009). Financial health of any organization can be measure through ratio analysis. To improve performance of organization Ratio analysis considered as vital technique. To provide full and clear view of banks financial position to its stakeholders like investors, management, shareholders etc. is the core purpose of this study. Study is significant to create awareness of performance of Islamic banks, their financial position.

Aim of the study is to make comparative study of the results of performance of Islamic and Conventional banks in order to detect, which one has better financial position so that the consumers may enjoy the true aspects of Islamic banking competing with conventional banks on uneven terms.

**II. Research Theory**

Ansari and Rehman (2012) conducted their research on comparison between financial performance of both Islamic and Conventional banks. The objective was to help investors, shareholders, depositors, bank managers and regulators by providing them clear picture of banks position. Several financial ratios were estimated from statement of financial position and statement of comprehensive income of banks for the period of 2006-2009. T tests and

ANOVAs were used to determine significance level of these ratios. Islamic banks are more liquid less risky and efficient operationally relative to their counterparts (Ansari and Rehman, 2012).

Kakakhel, Raheem and Tariq (2013) examined and assessed the Islamic and Commercial banks performance in Pakistan for the year 2008 to 2010. Financial ratio analysis for liquidity, solvency, profitability and activity analysis of both banks were performed to test overall performance of banks. The results showed that Conventional banks were more profitable than Islamic banks from 2008-2010 (Kakakhel, Raheemand Tariq, 2013).

Amjad, Tahira, Akram, and Usman (2013) explored the Islamic banks performance compared to Conventional banks in year 2008-2011. Financial ratio analysis was used as ratios are the best tool to analyze financial health of an institution. 12 ratios were assessed to gauge the performance regarding solvency, liquidity, profitability, activity, and capital adequacy. Conclusion is that Islamic banks are more efficient, profitable, liquid, and less solvent in comparison with conventional banks (Amjad, Tahira, Akram andUsman, 2013). Siraj and Pillai (2012) studied and relate Islamic and Conventional banks performance during 2005-2010. The study is carried on performance indicators such as OER, NPR, ROE, and ROA. This analyses shows positive results in favor of Islamic Banks during the period studied (Siraj and Pillai, 2012)**.** Samad (2004) inspected the performance indicators like liquidity risk, credit risk and profitability of banks traded in interest and those not in interests during the period 1992 to 2001. This study is the comparative study done in Bahrain between interest based banks and non-interest banks performance (Samad, 2004).

Dirdi and Venkatesh (2010) focused on financial crises and analyze situation using financial ratios for performance comparison of commercial banks and Islamic banks. They found that2007 crises effect differently on both Islamic and conventional banks (Hasan and Dridi, 2010; Parashar andVenkatesh, 2010). Ongore (2013) conducted research on commercial banks of Kenya and found that performance of commercial banks significantly affected by elements such as asset quality management and capital adequacy. However capital adequacy, management efficiency and performance of bank show positive behavior but for asset quality relationship show negative relationship. Assessment showed that poor quality of asset or loans that are non-performing to total assets related to poor bank performance (Ongore, 2013).

Johnes, Izzeldin and Pappas (2012) accomplished their research by comparing the performance of interest based and non interest based banks using data envelopment analysis (DEA) earlier to, after financial crises of and during that crises (2004-2009). Islamic and Non Islamic banks show no significant difference in mean when efficiency is measure against common frontier. Some basic differences have been showed while using Meta frontier analyses (MFA) between Conventional and Islamic banks. Islamic banks efficiency frontier lies inside the frontier for conventional banks. This position inside frontier shows that Islamic banking system is less efficient as compared to conventional banks (Johnes, Izzeldin and Pappas, 2012). Majid (2005) and Bhattacharyya (1997) found number of reasons for estimated lower performance of Islamic banks than non-Islamic banks. Firstly, because of stringent Shariah rules applicable, consequently following these rules products are not standardized and then resulted in increased operational cost in comparison to Non Islamic banks. Secondly, size of Islamic banks tends to be small in comparison to non-Islamic banks. Due to size technical efficiency increases in a banking sector (Majid et al., 2005; Bhattacharyya et al., 1997).

Kader and Asarpota (2007) used data from banks to examine the performance of United Arab Emirates (UAE) Islamic Banks. Five years data of Islamic and non-Islamic banks from 2000 to 2004 has been used including Income statements and balance sheets. To examine the performance of Islamic banks ratio analyses was used like liquidity ratio, profitability ratio, efficiency, risk and solvency ratio. Results showed that Islamic banks are more profitable, less uncertain and perform efficiently as compared to Non-Islamic banks in UAE (Kader and Asarpota, 2007). Saleh and Rami (2006) examined the performance of Islamic banks in Jordon,the study analyze their experience with Islamic banking for the first and second Islamic bank, Jordan Islamic Bank for Finance and Investment (JIBFI), and Islamic International Arab Bank (IIAB) in Jordon. The study also highlighted the challenges faced by this sector not only domestic challenges but global as well. . While doing test like profit maximization, capital structure and liquidity test for measuring performance several interesting facts were found. Firstly, both these banks increases investment and financial activities and also revealed that capability of both these banks have been increased in terms of efficiency as well. Second, both these banks played an important role in financing projects related to business. Third, mainly short term investment was the emphasis of JIBFI and IIAB banks. Fourth, high profitability ratio has

been noticed for JIBFI. Conclusion of this study was Islamic banks show significant growth in profitability and in credit facilities (Saleh and Rami, 2006).

Alkassim (2005) investigated whether or not bank's internal characteristics may explain the profitability ratio difference between Islamic and non-Islamic banks in the GCC over the period 1997-2004. He conducted this study by using Ordinary Least square (OLS). The results of his study indicated that conventional banks were less profitable than Islamic banks, and higher capital ratios favored Islamic banks profitability. Furthermore, the results also showed that Islamic banks profitability was negatively impacted by customer deposits whereas contributing to conventional banks profitability, total loans had a positive impact on profitability for both kinds of banking sector indicating that expansion of lending helped improving profitability for both categories of banks (Alkassim, 2005). Zahoor, Farooq, and Fawad (2010) studied the Islamic banks performance and conventional banks and applied the Ratios. The findings of their study suggested that Islamic banks performed equally in term of profitability in spite of the fact that Islamic banks are new in this sector of banking in Pakistan. Islamic banks also performed better than non-Islamic banks as suggested while measuring liquidity and solvency ratios because capital. Islamic banks are cost efficient but shows low efficiency in revenue and profits in comparison with conventional banks (Zahoor, Farooq and Fawad, 2010).

Awan (2009) studied and found conventional banks were not performing well as compared to Islamic banks in Pakistan. During period of 2006 to 2008, Islamic banks market share showed 100% growth by increasing from 2.5 percent to 5 percent. He discussed that allowing conventional banks to open their Islamic section by state bank put hurdle and pressure on newly created Islamic banks to compete against conventional banks (Awan, 2009). Jaffar and Manarvi (2011) inspected conventional banks performance less superior than Islamic banks. They support their study and test performance by applying CAMEL framework methodology. To examine and evaluate the performance and financial health of banks CAMEL is one of the customary tests. Evaluation showed that performance of Islamic banks was better than conventional banks .Their study found that Islamic banks performed better than non-Islamic banks in relations of capital adequacy while non-Islamic bank's management quality is better than Islamic banks. However, earning capability and quality of management of non-Islamic banks are greater than Islamic (Jaffar and Manarvi, 2011). Jaffar and Manarvi (2012) in a comparative analysis on Islamic banks and conventional banking using CAMEL test approach and reported better performance of Islamic banks on adequate capital ratio and liquidity position compared to conventional banks. This study also found similarity between conventional banks and Islamic banking on asset quality management while conventional banks were found superior in management of quality and earning ability (Jaffar and Manarvi, 2012).

**III. Methodology**

The design of this study is Comparative and facilitates comparison of financial performance and profitability of Islamic banks and Conventional banks. The area of this research is related with all Pakistani banks where sampled Islamic and Conventional banks are performing their jobs according to same rules and regulations of social, economic, and political framework. Awan (2008) conducted research to compare the performance of Islamic Banking and Conventional Banking. The techniques used by the author to conduct this research was Direct interviews from the bankers to record their personal views about Islamic banking a primary source, Comparative analysis technique was applied to compare operational framework of both banking sectors and finally ratio analysis technique was used to measure asset quality, profitability ratio and earnings ratio of Islamic and Conventional banks (Awan, 2008).Kakakhel, Raheem, and Tariq (2013) examined and evaluated the performance of two Islamic banks and two Commercial banks in Pakistan for the year 2008 to 2010. Financial ratio analysis for liquidity, solvency, profitability and activity analysis of both banks was performed to test overall performance of banks (Kaka Khel, Raheem and Tariq, 2013). Kader and Asarpota (2007) utilized bank level data to assess the performance of the UAE Islamic banks. For this assessment financial ratios analysis was applied to examine the performance of the Islamic banks in profitability, liquidity, risk and solvency, and efficiency (Kader and Asarpota, 2007).

Being a comparative research study and related to the comparison of financial performance of Islamic banks and Conventional banks in Pakistan, data of banks are analyses by financial ratio analysis tool because only ratio analysis tool can accurately relate two pieces of financial data and can measure financial performance of both banks. Similarly only with ratio analysis tool, one accounting figure can easily be calculated and compared with another figure. The study estimates interbank performance of Islamic and Commercial Banks in terms of profitability, liquidity, risk and solvency, capital adequacy, operational and resource allocation efficiency. Independent t test is

used to determine significance level of mean differences of these ratios between and among banks. The decision criterion is p-value. If p-value is less than 0.05 then there is a significance mean difference between ratios.

**Table-1: Performance Measures & Proxies**

| | |
|---|---|
| ***Profitability Ratio*** | |
| Return on Equity (ROE) | *Profit after tax/Total Equity* |
| Return on Assets (ROA) | *Profit after tax/Total Assets* |
| Earnings Per Share (EPS) | *Net Income/Weighted Average Outstanding Shares* |
| ***Liquidity Ratio*** | |
| Current Ratio (CR) | *Current Assets/Current Liabilities* |
| Current Asset Ratio (CAR) | *Current Assets/Total Assets* |
| Investment Asset Ratio (IAR) | *Total Investments/Total Assets* |
| Advances Deposit Ratio (ADR) | *Gross Advances/Deposits and other accounts* |
| ***Risk and Solvency Ratio*** | |
| Debt to Equity Ratio (DER) | *Total Liabilities/Total Equity* |
| Total Liabilities/Total Equity (DTAR) | *Total Liabilities/Total Assets* |
| **Capital Adequacy Ratio** | |
| Capital Ratio (CR) | *Total Equity/Total Assets* |
| Commitment and Contingencies to Equity Ratio (CCER) | *Commitment and Contingencies/Total Equity* |
| Total Deposits to Total Equity Ratio (TDTER) | *Total Deposits/Total Equity* |
| ***Operational Ratio*** | |
| Net Interest Margin (OR1) | *(Mark up interest expensed-Markup interest earned)/Total Assets* |
| Non Mark up Interest Income to Total Assets (OR2) | *Non markup interest income/Total Assets* |
| Markup Interest Expense to Total Assets (OR3) | *Markup interest expense/Total Assets* |
| Non Markup Interest Expense to Total Assets (OR4) | *Non markup interest expense/Total assets* |
| ***Deployment Ratio*** | |
| Investment to Equity Ratio (IER) | *Total investments/Total Equity* |
| Investment to Liabilities Ratio (ILTR) | *Total Investments/Total Liabilities* |
| ***Cash flow Ratio*** | |
| Cash from Operations to Profit After Tax (CFOP) | *Cash generated from operating activities/Profit after tax* |

**IV. Results and Discussion**

On average profitability ratios of Conventional banks is higher than Islamic Banks. Return on Equity (ROE) of Conventional banks are greater than Islamic banks from year 2008-2012.It indicates that the profit generated by conventional banks from the money invested by stockholders are higher than those of Islamic Banks from year 2008-2012. On an average return on assets of Conventional banks are higher than Islamic banks from year 2008-2012. Also Islamic banks have negative return on asset from 2008-2010.It indicates that Conventional bank earnings after tax for each dollar invested in banks are higher than Islamic Banks. It also indicates that Conventional Banks have better Managerial performance and effective utilization of resources than Islamic banks from year 2008-2012. On an average earning per Share of Conventional banks are much higher than those of Islamic Banks from year 2008-2012. As earnings per share is considered as an important and single component for determining Share price. So it indicates that Conventional banks are more efficient at using its capital to generate income than Islamic banks from year 2008-2012. On an average Current Asset ratio of Islamic banks are higher than conventional banks from year 2008-2012. As high CAR is a sign of liquidity for financial companies.

**Table-2: Descriptive Statistics of Financial Ratios of Islamic and Conventional Banks**

| Ratios | Banks | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| **ROE** | Conventional | 0.20694 | 0.21096 | 0.20778 | 0.21828 | 0.2142 |
| | Islamic | 0.00088 | 0.01776 | 0.02172 | 0.07552 | 0.05136 |
| **ROA** | Conventional | 0.01848 | 0.01928 | 0.07098 | 0.02052 | 0.01864 |
| | Islamic | -0.00268 | -0.00906 | -0.00734 | 0.00464 | 0.00336 |
| **EPS** | Conventional | 13.932 | 14.436 | 14.394 | 15.592 | 13.97 |
| | Islamic | 0.072 | 0.02 | 0.116 | 1.07 | 0.912 |
| **CAR** | Conventional | 0.127458 | 0.126927 | 0.124568 | 0.126251 | 0.120208 |
| | Islamic | 0.177314 | 0.168014 | 0.163528 | 0.133677 | 0.121147 |
| **CR** | Conventional | 0.1222 | 0.119375 | 0.116315 | 0.117531 | 0.11361 |
| | Islamic | 0.12742 | 0.1313 | 0.1373 | 0.11336 | 0.1071 |
| **IAR** | Conventional | 0.20314 | 0.26064 | 0.30646 | 0.37646 | 0.4205 |
| | Islamic | 0.18198 | 0.1717 | 0.27038 | 0.36792 | 0.40338 |
| **ADR** | Conventional | 0.78458 | 0.74328 | 0.66874 | 0.58984 | 0.554 |
| | Islamic | 0.73288 | 0.59156 | 0.5674 | 0.54152 | 0.50454 |
| **DER** | Conventional | 9.470603 | 8.544928 | 7.995187 | 7.924076 | 8.731036 |
| | Islamic | 4.985327 | 5.850332 | 7.908542 | 9.007908 | 11.18647 |
| **DTAR** | Conventional | 0.8882 | 0.8913 | 0.8885 | 0.8912 | 0.8951 |
| | Islamic | 0.7468 | 0.81216 | 0.86512 | 0.88238 | 0.90984 |
| **CAPR** | Conventional | 0.09862 | 0.0921 | 0.0956 | 0.0948 | 0.0684 |
| | Islamic | 0.23588 | 0.18636 | 0.13364 | 0.11644 | 0.08838 |
| **CCTE** | Conventional | 4.7860 | 5.1880 | 3.2720 | 4.0960 | 4.1660 |
| | Islamic | 2.952 | 2.716 | 3.136 | 2.654 | 2.924 |
| **TDTER** | Conventional | 8.116 | 8.8460 | 8.6640 | 8.5520 | 9.1840 |
| | Islamic | 4.492 | 4.38926 | 7.296 | 8.342 | 10.232 |
| **OR1** | Conventional | 0.04244 | 0.0409 | 0.0422 | 0.0146 | 0.0163 |
| | Islamic | 0.03592 | 0.02734 | 0.02276 | 0.03626 | 0.02916 |
| **OR2** | Conventional | 0.01574 | 0.0155 | 0.0140 | 0.0146 | 0.0163 |
| | Islamic | 0.0174 | 0.0172 | 0.00778 | 0.00762 | 0.00842 |
| **OR3** | Conventional | 0.031195 | 0.0420 | 0.0394 | 0.0411 | 0.0404 |
| | Islamic | 0.039227 | 0.047741 | 0.041995 | 0.052468 | 0.050377 |
| **OR4** | Conventional | 0.023867 | 0.0253 | 0.0261 | 0.0265 | 0.0228 |
| | Islamic | 0.0311 | 0.0510 | 0.0419 | 0.03779 | 0.0329 |
| **IER** | Conventional | 2.0872 | 2.7922 | 3.2645 | 4.0416 | 4.9670 |
| | Islamic | 1.00756 | 1.17767 | 2.54784 | 3.8595 | 5.1597 |
| **ILTR** | Conventional | 0.2275 | 0.2822 | 0.3460 | 0.4233 | 0.4700 |
| | Islamic | 0.25112 | 0.21802 | 0.3126 | 0.4165 | 0.4420 |
| **CFOP** | Conventional | -0.32 | 3.9420 | 5.0200 | 6.6640 | 7.4920 |
| | Islamic | -2.178 | -2.53 | 137.594 | 13.212 | 32.04 |

So analysis indicates that Islamic banks have high percentage of liquid assets than Conventional Banks from year 2008-2012. Thus Islamic banks showed high liquidity than Conventional Banks. On an average Current Ratio of Islamic banks are higher than Conventional Banks from year 2008-2010 but from 2011-2012 Conventional Banks showed higher Current Ratio than Islamic Banks. As Current Ratio is an indicator of Bank's ability to pay its financial debts. So analysis indicates that from year 2008-2010 Islamic banks had more liquid assets to back to its depositors than Conventional Banks. However in year 2011 and 2012 Conventional banks had showed more liquid assets. On an average Conventional Banks have higher Investment Ratio than Islamic Banks from year 2008-2012.

Thus analysis indicates that from year 2008-2012 Conventional Banks have higher Investments than Islamic Banks. On an average Conventional banks showed higher advance deposit Ratio than Islamic Banks from year 2008-2012. As Advance deposit Ratio indicates the degree of Bank relines on borrowed funds or advances . So higher ADR of Conventional Banks indicates that they are more relying on borrowed funds than Islamic Banks from year 2008-2012. Hence indicates that from year 2008-2012 Conventional banks were more illiquid than Islamic Banks. On an average Debt to equity Ratio of Islamic Banks are higher than Conventional Banks from year 2008-2010. However

from year 2010-2011 Islamic Banks showed more Debt to Equity ratio than Conventional Banks. As Debt to equity ratio is a measure of Company's financial leverage. So analysis indicates that from 2008-2010 Conventional banks had higher ability to absorb financial shocks than Islamic Banks but in 2011 and 2012 Islamic banks showed higher financial leverage than Conventional Banks. On an average Conventional Banks have higher Debt to total asset Ratio than Islamic banks from year 2008-2011 but in 2012 Islamic banks have higher debt to total asset Ratio than Conventional Banks.

As Debt to total Asset Ratio is a measure of financial Risk. So analysis indicates that from year 2008-2011 Conventional Banks have higher financial strength to pay its debtors than Islamic banks but in 2012 Islamic Banks have higher ability to pay back its debts. On an average Capital Ratio of Islamic banks are higher than Conventional Banks from year 2008-2012. As Capital ratio measures bank's financial stability and Capital adequacy . So analysis indicates that Islamic banks are more financially stable than Conventional Banks from year 2008-2012. On an average Conventional Banks have higher Commitment to Contingencies ratio than Islamic Banks from year 2008-2012. This analysis indicates that from 2008-2012 Conventional Banks have more Capital to pay its financial commitment and Contingencies than Islamic Banks.

On an average Deposit to equity Ratio of Conventional Banks are higher than Islamic Banks from year 2008-2011. But in 2012 Islamic Banks have higher Deposit to Equity Ratio than Conventional Banks. On an average Net Interest Margin of Conventional Banks are higher than Islamic banks from year 2008-2010 but from year 2011-2012 Islamic Banks have more Net Interest Margin ratio than Conventional Banks. So analysis indicates that conventional banks have higher investments than Islamic Banks from year 2008-2010 but in 2011 and 2012 Islamic banks have higher Investments than Conventional Banks. Lesser investments in Islamic Banks are due to Islamic Bank's products that based on risk sharing system and most of people are risk avoiders. On an average non markup interest income to total assets ratio of Conventional banks are higher than Islamic banks from year 2008-2012. As the ratio is an indicator of company's financial efficiency. So analysis indicate that from year 2008-2012 generated more interest income to total assets than Islamic Banks. On an average Mark up interest expensed to total assets ratio of Islamic Banks are higher than Conventional Banks from year 2008-2012.

As interest expense ratio is a measure of Banks financial efficiency. So analysis indicates that Islamic Banks are more efficient in generating income than Conventional Banks. On an Average Islamic Banks show higher Non markup interest expense ratio than Conventional Banks from year 2008-2012. As this ratio is an indicator of financial stability of a company. . So analysis indicates that Islamic Banks are more associated in targeting customers to deposit funds in their banks than Conventional Banks from year 2008-2012. On an average Conventional banks have higher Investment Equity ratio than Islamic Banks from year 2008-2011 but in 2012 Islamic Banks have higher ratio than Conventional Banks which indicates that from 2008-2011 Conventional banks have more investments than Islamic Banks. But in 2012 more investment shown by Islamic Banks. On an average Islamic Banks have more Investment to Liabilities Ratio in 2008 but from 2009-2012 Conventional banks show higher ratio than Islamic Banks. Analysis indicates that in 2008 Islamic banks have more investments than total debts but from 2009-2012 Conventional Banks have higher ratio of investments than debts. On an average Conventional Banks have higher Cash flow Ratio than Islamic Banks from 2008 and 2009. But in 2010 there is a huge increase in Islamic Banks Cash flow ratio. From 2010-2012 Islamic Banks have higher cash flow ratio than Conventional Banks. This means that from 2010-2012 Islamic Banks are more liquid and viable than Conventional Banks.

The result generated in table illustrates about significance level of both Islamic Banks and Conventional Banks. The t test results of profitability ratios show that mean value of Conventional Banks in all three profitability ratios that is ROE, ROA, and EPS is higher than mean value of Islamic Banks. The overall results shown by the t-test imply that results of both the bank groups are significantly different. The results of liquidity analysis show that mean value of Conventional Banks in CAR, and CR is lower than Islamic Banks which shows higher level of significance of Islamic Banks than Conventional Banks. But in IAR and ADR Conventional Banks show higher mean value than Islamic Banks. Further P value of CAR shows a significant difference between both Banks. While a P value indicates that there is no significant association between CR, IAR, and ADR of both Islamic and Conventional Banks.

**Table-3: Independent Sample -T Test of All Ratios of Islamic and Conventional Banks 2008-2012**

| Ratios | Ratios | N | Mean | Standard Deviation | F-value | P-value |
|---|---|---|---|---|---|---|
| **ROE** | Conventional | 25 | .2116 | .04322 | 11.389 | .001 |
| | Islamic | 25 | .0244 | .11132 | | |
| **ROA** | Conventional | 25 | .0193 | .00619 | 14.076 | .000 |
| | Islamic | 25 | -.0022 | .01338 | | |
| **EPS** | Conventional | 25 | 14.4648 | 6.08485 | 29.269 | .000 |
| | Islamic | 25 | .4380 | 1.46995 | | |
| **CR** | Conventional | 25 | .1521 | .03070 | 6.769 | .012 |
| | Islamic | 25 | .1527 | .06026 | | |
| **CAR** | Conventional | 25 | .1178 | .04087 | 1.122 | .295 |
| | Islamic | 25 | .1233 | .04587 | | |
| **IAR** | Conventional | 25 | .3114 | .10026 | .414 | .523 |
| | Islamic | 25 | .2791 | .11704 | | |
| **ADR** | Conventional | 25 | .6681 | .10438 | 2.512 | .120 |
| | Islamic | 25 | .5876 | .15826 | | |
| **DER** | Conventional | 25 | 8.5335 | 4.95143 | .223 | .639 |
| | Islamic | 25 | 7.7877 | 4.25195 | | |
| **DTAR** | Conventional | 25 | .8937 | .02383 | 17.245 | .000 |
| | Islamic | 25 | .8469 | .09617 | | |
| **CAPR** | Conventional | 25 | .0913 | .01946 | 20.474 | .000 |
| | Islamic | 25 | .1521 | .09626 | | |
| **CCTE** | Conventional | 25 | 4.2432 | 1.80622 | 5.810 | .020 |
| | Islamic | 25 | 2.8764 | 3.18902 | | |
| **TDTER** | Conventional | 25 | 8.9916 | 2.19987 | 13.459 | .001 |
| | Islamic | 25 | 6.5903 | 4.07621 | | |
| **OR1** | Conventional | 25 | .0400 | .01175 | .455 | .503 |
| | Islamic | 25 | .0303 | .01326 | | |
| **OR2** | Conventional | 25 | .0153 | .00326 | 1.340 | .253 |
| | Islamic | 25 | .0104 | .00939 | | |
| **OR3** | Conventional | 25 | .0397 | .00705 | 1.481 | .230 |
| | Islamic | 25 | .0464 | .00955 | | |
| **OR4** | Conventional | 25 | .0251 | .00304 | 23.780 | .000 |
| | Islamic | 25 | .0308 | .02029 | | |
| **IER** | Conventional | 25 | 3.5154 | 1.23920 | 5.189 | .027 |
| | Islamic | 25 | 2.7505 | 2.33110 | | |
| **ILTR** | Conventional | 25 | .3494 | .11517 | .063 | .803 |
| | Islamic | 25 | .3281 | .12354 | | |
| **CFOP** | Conventional | 25 | 4.5600 | 4.19119 | 5.810 | .020 |
| | Islamic | 25 | 35.6276 | 116.83551 | | |

The results of risk and solvency ratios show that mean value of both DER and DTAR is higher in Conventional Banks as compared to Islamic. This shows that Conventional Banks have higher significance level in both ratios as compared to Islamic. Further P-value shows no significant association between both banks a while DTAR shows a significant difference between both Islamic and Conventional Banks. The results of capital adequacy ratios analysis show that mean value of CAPR in Islamic Banks is higher than Conventional Banks whereas mean values of CCTE and TDTER is higher in Conventional Banks than in Islamic Banks. Further P value indicates that there is a significant difference between all three ratios CAPR, CCTE, and TDTER of both Islamic and Conventional Banks. The results of operational ratios show that mean values of OR1, OR2 and OR3 is higher in Conventional Banks than in Islamic Banks while mean value of OR4 is higher in Islamic banks. Further P values shows that there is only significant difference in OR4 of both Conventional and Islamic Banks.

The results of deployment ratios show that mean value of IE and ITLR is higher in Conventional Banks than in Islamic Banks. Further P value indicates that IE shows a significant differences between both banks while there is no significant association between ITLR of both Islamic and Conventional Banks .The results of Cash flow ratios show

that mean value of CFOP is higher in Islamic Banks than in Conventional Banks and there is a note able difference between mean values of both banks. Further P value indicates a significant difference between CFOP of both Conventional and Islamic Banks.

**V. Discussion**

Several studies have been conducted earlier on Comparative analysis of Islamic and conventional Banks; focuses either on performance or efficiency of both banking sectors. This study is to conduct a performance analysis of Islamic and Conventional Banks of Pakistan. Ratio analysis used to assess performance of both banks is also supported by Ansari and Rehman (2007). Kakakhel, Raheem and Tariq (2013) also examined and evaluated the performance of Islamic banks and Commercial banks in Pakistan for the year 2008 to 2010 with financial Ratio analysis. Ansari and rehman (2012) also conducted their research to compare financial performance of Islamic and Conventional Banks for period of 2006-2009. Eighteen financial ratios were estimated from balance sheet and income statements of banks. In this study profitability ratios of Conventional Banks are higher than Islamic Banks which is similar to results found by different researchers in their study Kakakhel, Raheem and Tariq (2013), Amjad, Tahira, Akram and Usman (June, 2013) and Moin (2008).

Kakakhel, Raheem and Tariq (2013) examined the performance of Islamic banks and Commercial banks in Pakistan for the year 2008 to 2010 and the results indicated that Conventional Banks were more profitable than Islamic Banks. Amjad, Tahira, Akram and Usman (2013) investigated the performance of Islamic banks vs. Conventional banks in year 2008-2011 and conclude that Conventional Banks found to be more profitable than Islamic Banks. Moin (2008) investigated the performance of first Islamic bank of Pakistan in comparison with a group of conventional banks by analyzing financial ratios and found that first Islamic bank was less profitable than Conventional Banks. In current study Islamic banks found to be more liquid and less risky than Conventional Banks , this is also similar to different researches conducted previously like Zahoor, Farooq and Fawad (June, 2010) andMoin (2008). Zahoor, Farooq and Fawad (June, 2010) examined the performance of Islamic banks and non-Islamic banks and found that Islamic banks are based on maintaining lower debt and more equity.

In the current research independent t test is used to check significance of both banks. Several studies conducted this test to check significance level of variables Moin (2008), (Amjad,Tahira, Akram and Usman, 2013) and (Ansari and Rehman,2007). In current research profitability ratios of Conventional banks show higher significance level than Islamic Banks similar to Ansari and Rehman (2007), whereas significance level of liquidity ratios is higher in Islamic banks than conventional banks similar to (Ansari and Rehman, 2007). Through inferential analysis, results clearly indicate the significance level of all variables.

**V. Conclusion**

In today's world economic growth of a country depends on its financial sector especially banking institutions working in that country. This study is conducted to compare financial performance of both banking sectors running at the same time in Pakistan i.e. Conventional Banks and Islamic Banks. For this purpose a sample of 10 Banks are selected including five Conventional and five Islamic Banks. Data of these 10 banks are obtained of 5 years from 2008-2012 from their Audited Annual Financial Statements i.e. Income Statement and Balance Sheet. The techniques of ratio analysis and Independent t test are used. To conduct this analysis 19 financial ratios are calculated under seven different heads including profitability ratios, Liquidity ratios, Risk and Solvency ratios, Capital Adequacy ratios, Operational ratios, Deployment Ratios and Cash flow Ratios.

Ratio analysis shows financial performance of every company. It is a useful tool to calculate and to conduct a quantitative analysis of information available in company's financial statements. Findings of Profitability Ratios show that Conventional Banks are more profitable than Islamic Banks from year 2008-2012. In liquidity Ratios Current Asset Ratio, Current Ratio, Investment Asset Ratio and Advance Deposit Ratios shows that Islamic Banks have more liquid Assets and Percentage of liquidity is higher in Islamic Banks than Conventional Banks from year 2008-2012. Findings of Risk and Solvency Ratios indicate that Conventional banks have higher debts than equity so Islamic Banks are less risky and more solvent than Conventional Banks from year 2008-2012. Further Capital adequacy ratios indicate that Islamic banks are more financially stable than Conventional banks from year 2008-2012. Operational ratios indicates that Conventional banks are operating more efficiently than Islamic banks, there are higher investments in Conventional Banks and fewer in Islamic banks from year 2008-2012. However Islamic Banks are struggling to target customers for investment purposes. Deployment Ratios indicates that how efficiently

assets are utilizing for productive purposes. Both Islamic and Conventional banks are effectively indulged in profit generating activities.

In independent t test mean values and P values of both Islamic and Conventional Banks are compared. A finding of profitability ratios indicates that Conventional Banks shows higher significance level than Islamic Banks. Findings of liquidity ratios indicate that Conventional Banks have higher significance level in CAR and CR whereas Islamic Banks have higher significance level in IAR and ADR. In risk and solvency ratios Conventional banks have higher significance level than Islamic Banks. Capital adequacy ratio indicates that Islamic banks have higher significance level in CAPR whereas Conventional Banks have higher significance level in CCTE and TDTER. Further operational ratios and Deployment ratios show higher significance level in Conventional Banks whereas Cash flow Ratio indicates higher significance level in Islamic Banks. Results show that from year 2008-2012 Conventional banks are more profitable, deployed and operationally efficient whereas Islamic Banks are more liquid and less risky.

As in financial business market, Islamic Banks are new and having methods at initial stage, so Islamic Banks should expand their financing services and aim a suitable unattached market to expand their depositions. The accounts of balance sheet and income statement are most important to analyze financial performance of the organization. There should be capability of additional cash available with banks for useful purposes. To increase performance of banks skilled employees properly trained and experienced should be acquire. Proper course should be started to educate people basics of Islamic Banking and different products offered by them. For a bright future of banking sectors bankers should conduct internal evaluation to improve its activities and to overcome weaknesses.

The model to compare financial performance is developed in this study. By using these models the creditors can predict the financial health of the banks before giving them loan. This analysis is also helpful for lenders and investors to forecast the financial position of banks before investing their money. The practical implications of findings for Islamic Banks is to discover new investment opportunities whereas for Conventional Banks is to sustain more financial stability. There are some limitations in this study. In this study the sample of 10 banks are selected five Conventional and five Islamic Banks. The sample size is too small for this study. The data is collected only from banking sector of Pakistan. Some ratios are excluded due to non-availability of data related to those ratios. This study is conducted to analyze the performance of Islamic Banks and Conventional Banks in Pakistan. There are some restrictions to conduct this study as this study is just comparing performance of both banking sectors. This study may further perform to conduct comparative efficiency of both banks or to compare financial products and to check their impact on performance etc. Sample size should increase for this study. This study can also be conducted globally.

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