

**FINANCIAL PERFORMANCE OF ISLAMIC BANKS AND
CONVENTIONAL BANKS IN MALAYSIA: A COMPARATIVE STUDY**

By

NOR BAAYAH IDRIS

Thesis submitted to

**Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia,
in Partial Fulfillment of the Requirement for the Master of Sciences (Finance)**

PERMISSION TO USE

In presenting this dissertation/project paper in partial fulfillment of the requirements for a Post Graduate degree from the Universiti Utara Malaysia (UUM), I agree that the Library of this university may make it freely available for inspection. I further agree that permission for copying this dissertation/project paper in any manner, in whole or in part, for scholarly purposes may be granted by my supervisor(s) or in their absence, by the Dean of Othman Yeop Abdullah Graduate School of Business where I did my dissertation/project paper. It is understood that any copying or publication or use of this dissertation/project paper parts of it for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to the UUM in any scholarly use which may be made of any material in my dissertation/project paper.

Request for permission to copy or to make other use of materials in this dissertation/project paper in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Business

Universiti Utara Malaysia

06010 UUM Sintok

Kedah Darul Aman

FINANCIAL PERFORMANCE OF ISLAMIC BANKS AND CONVENTIONAL BANKS IN MALAYSIA: A COMPARATIVE STUDY

ABSTRACT

This paper has analyzed and compared the financial performance of Islamic banks and conventional banks in Malaysia. This study is useful for depositors, bank managers, shareholders, investors, regulators and researchers in order to provide a true picture of Islamic banks and conventional banks financial condition. Study has been conducted in term of profitability, liquidity, risk and solvency and efficiency for five years period from 2008 to 2012. Study was taken only for five years period due to some of Islamic banks chosen was just started the operation e.g. CIMB Islamic (2003), Maybank Islamic (2008) and AmIslamic (2006). Data had been generated from income statement, balance sheet and notes to the accounts of the banks' annual reports. The sources of banks' annual reports are from the websites of the banks and also Bloomberg. This study had selected six Islamic banks and six conventional banks established in Malaysia, which includes Bank Islam (M) Berhad, Bank Muamalat (M) Berhad, Bank Kerjasama Rakyat (M) Berhad, Maybank Islamic Berhad, CIMB Islamic Bank Berhad, AmIslamic Bank Berhad, Affin Bank Berhad, CIMB Bank Berhad, Malayan Banking Berhad, Ambank (M) Berhad, HSBC Bank (M) Berhad and Hong Leong Bank Berhad. The list of conventional banks and Islamic banks is obtained from Bank Negara Malaysia's (BNM) website. The significant of data has been determined using independent sample t-test and one-way ANOVA analysis. Study has concluded that Islamic banks are less profitable, less liquid, more risky but more efficient in managing the operating expenses to generate revenue as compared conventional banks.

Keywords: islamic banks, conventional banks, comparative study, financial performance, profitability, liquidity, risk and solvency, efficiency, malaysia

PENCAPAIAN KEWANGAN BANK ISLAM DAN BANK KONVENSIONAL DI MALAYSIA: KAJIAN PERBANDINGAN

ABSTRAK

Kertas ini menganalisis dan membandingkan pencapaian kewangan bank Islam dan bank konvensional di Malaysia. Kajian ini berguna kepada pendeposit, pengurus bank, pemegang-pemegang saham, pelabur, penggubal undang-undang dan pengkaji untuk memberikan gambaran sebenar keadaan kewangan bank Islam dan bank konvensional. Kajian telah dijalankan dari segi keuntungan, kecairan, risiko dan kesolvenan dan keefisienan untuk tempoh lima tahun dari tahun 2008 hingga 2012. Kajian hanya untuk tempoh lima tahun disebabkan beberapa buah bank Islam yang dipilih baru memulakan operasi sebagai contoh CIMB Islamic (2003), Maybank Islamic (2008) dan AmIslamic (2006). Data telah didapati dari penyata kewangan, kunci kira-kira dan nota-nota kepada akaun yang telah dilaporkan dari laporan tahunan bank-bank terbabit. Sumber laporan tahunan bank-bank terbabit diperolehi daripada laman sesawang bank dan juga Bloomberg. Kajian ini telah memilih enam bank Islam dan enam bank konvensional yang ditubuhkan di Malaysia, yang mana termasuk Bank Islam (M) Berhad, Bank Muamalat (M) Berhad, Bank Kerjasama Rakyat (M) Berhad, Maybank Islamic Berhad, CIMB Islamic Bank Berhad, AmIslamic Bank Berhad, Affin Bank Berhad, CIMB Bank Berhad, Malayan Banking Berhad, Ambank (M) Berhad, HSBC Bank (M) Berhad dan Hong Leong Bank Berhad. Senarai bank Islam dan konvensional diperolehi daripada laman sesawang Bank Negara Malaysia (BNM). Kepentingan data telah ditentukan dengan menggunakan ujian 'independent sample t-test' dan analisis sehala ANOVA. Kajian telah menyimpulkan bahawa bank Islam adalah kurang menguntungkan, kurang kecairan, lebih berisiko tetapi lebih efisien dalam menguruskan perbelanjaan operasi untuk menghasilkan pendapatan jika dibandingkan dengan bank konvensional.

Kata kunci: bank islam, bank konvensional, kajian perbandingan, pencapaian kewangan, keuntungan, kecairan, risiko dan kesolvenan, keefisienan, malaysia

Acknowledgement

First and foremost, I would like to take this opportunity to thank the Almighty God for giving me strength, capability and ideas to accomplish this dissertation with His blessings. I also would like to express my gratitude to Dr Ahmad Rizal as my supervisor, for his help, guidance and continuous support in preparing this study. Without his guidance and full support, I may not be able to complete this dissertation successfully. I am really appreciated for every single second of time and efforts he spend for me.

Not forgetting my husband, Ahmad Khuzaimi Bin Aziz, for understanding me and giving me so much support to complete my dissertation. He helped me so much by carry out household work as I am busy to complete this paper. Warmest love to my parents, Idris Bin Salam and Rodziah Binti Abdul Rahman, for continuous support me to complete this paper.

Next, my sincere appreciation to my colleague, Nur Hamizah Dzulkaflī, for her kind taught and cooperation to generate data for this paper. I also would like to thank my friends and course mate for valuable opinions towards dealing with this paper. Last but not least, special thank to those who has contributed an ideas either directly or indirectly for me to write this paper. Your support is much appreciated. Thank you.

TABLE OF CONTENT

	Page
Certification of Thesis Work	ii
Permission to Use	iii
Abstract	iv
Abstrak	v
Acknowledgement	vi
Table of Content	vii
List of Tables	viii
List of Figures	ix
List of Abbreviation	ix

CHAPTER

ONE

INTRODUCTION

1.1	Background	1
1.2	Overview of Malaysia's Islamic Banking	2
1.3	Overview of Islamic and Conventional Banking	4
1.4	Problem Statement	7
1.5	Research Questions	8
1.6	Research Objectives	8
1.7	Scope and Limitations of the Study	8
1.8	Significance of Study	9
1.9	Organization of the Study	10
1.10	Chapter Summary	11

TWO

LITERATURE REVIEW

2.0	Introduction	12
2.1	The Bank Performance	12
2.1.1	Profitability and performance	14
2.1.2	Liquidity and performance	22
2.1.3	Risk and solvency and performance	27
2.1.4	Efficiency and performance	29

2.2	Chapter Summary	32
THREE	DATA AND METHODOLOGY	
3.0	Introduction	33
3.1	Framework of study	34
3.2	Hypothesis Development	34
3.3	Research Design	41
3.4	Operational Term	42
3.5	Measurement of Variables/Instrumentation	43
3.6	Data Collection and Sample of the Study	47
3.7	Techniques of Data Analysis	52
3.8	Chapter Summary	53
FOUR	FINDINGS	
4.0	Introduction	54
4.1	Overall Performance of Islamic banks and conventional banks	54
4.2	Independent Sample T-Test	62
4.3	ANOVA Analysis	67
4.4	Chapter Summary	78
FIVE	CONCLUSION AND RECOMMENDATION	
5.0	Introduction	81
5.1	Findings on Demographic	81
5.2	Findings on Independent Variables and Dependent Variables	83
5.3	Limitation of Study	86
5.4	Theoretical and Practical Contribution of the Study	86
5.5	Recommendations for Future Research	87
5.6	Conclusion	88
	REFERENCES	89
	LIST OF TABLES	
1.1	Features of Islamic and conventional banks	5
3.1	Background of selected banks	48
4.1	Independent Sample T-test for profitability ratio of Islamic banks	

	and conventional banks	62
4.2	Independent Sample T-test for liquidity ratio of Islamic banks and conventional banks	63
4.3	Independent Sample T-test for risk and solvency ratio of Islamic banks and conventional banks	65
4.4	Independent Sample T-test for efficiency ratio of Islamic banks and conventional banks	66
4.5	One-way ANOVA for profitability ratio of Islamic and conventional banks	67
4.6	One-way ANOVA for liquidity ratio of Islamic and conventional banks	69
4.7	One-way ANOVA for risk and solvency ratio of Islamic and conventional banks	73
4.8	One-way ANOVA for efficiency ratio of Islamic and conventional banks	75
4.9	Independent Sample T-test of Islamic banks and conventional banks	78
4.10	ANOVA analysis of Islamic banks and conventional banks	79

LIST OF FIGURES

3.1	Framework of Study	34
4.1	Comparison between Islamic banks and conventional banks in term of profitability	55
4.2	Comparison between Islamic banks and conventional banks in term of liquidity	56
4.3	Comparison between Islamic banks and conventional banks in term of risk and solvency	59
4.4	Comparison between Islamic banks and conventional banks in term of efficiency	61

LIST OF ABBREVIATION

NPM	Net Profit Margin
ROAE	Return on Average Equity
ROAA	Return on Average Assets
ROIC	Return on Invested Capital
CR	Current Ratio
CAR	Cash Ratio
LDR	Loan Deposit Ratio
LTA	Loan to Assets Ratio

DER	Debt Equity Ratio
DTAR	Debt to Total Asset Ratio
EM	Equity Multiplier
AU	Asset Utilization
ET	Equity Turnover
OE	Operating Efficiency
ANOVA	Analysis of Variance
GDP	Gross domestic product
LAR	Loan asset ratio
CIR	Cost income ratio
HI	Herfindahl Index

APPENDICES

92

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Islamic banking in Malaysia has been set up in 1983 and had regulated under Islamic Banking Act 1983. However, Islamic banking in other countries had started the business from 1963 which mainly in Middle East and Asian regions. Islamic banking aims to provide products and services approved by Islam. In Malaysia, Islamic banking hand-in-hand with conventional banking but the Islamic banking products offered are not restricted only to Muslims. Thus, this had created a bigger opportunity for Islamic banking to grow. In order to ensure Islamic bank in Malaysia operate under *Shariah* principles, the bank is compulsory to appoint *Shariah* Advisory to monitor the whole banking system. Gradual development of Islamic banking had created a competition among Islamic and conventional banks. Since Islamic banks offered products under Islamic principles, most of Muslim preferred Islamic banks rather than conventional banks. Currently, even non-Muslim prefer Islamic banking as the banks starting to offer an attractive products and services. However, some people still in doubt and argued on Islamic banks' performance as compared to performance of conventional banks. Therefore, the performance comparison between Islamic and conventional banks is aim to shows in this study.

The contents of
the thesis is for
internal user
only

REFERENCES

- Al-Mahfuz, SS. (2012). "A Comparative Study of Profitability Between Islamic Banks and Conventional Banks In The Context of Bangladesh". Retrieved from: www.sb.iub.edu.bd/internship/Summer2012/0820535.pdf.
- Ansari, S., & Rehman, A. (2011). "Financial Performance of Islamic and Conventional Banks in Pakistan: A Comparative Study", *International Conference on Islamic Economics and Finance*.
- Ansari, S., & Rehman, K.U. (2011). "Comparative Financial Performance of Existing Islamic Banks and Contemporary Conventional Banks in Pakistan", *International Conference on Economics, Business and Management*.
- Al-Smadi, AAMA., Hamdan, F., & Almsafir, MK. (2012). "Islamic Banking Vs Conventional Banking, During The Global Financial Crisis: Malaysia as a Case", *Journal of Islamic and Human Advanced Research*, 3(1), 27-40.
- Awan, AG. (2009). "Comparison of Islamic and Conventional Banking in Pakistan". Retrieved from [http://www.ciitlahore.edu.pk/pl/abrc/Proceedings/All%20papers/COMPARISON%20OF%20ISLAMIC%20AND%20CONVENTIONAL%20\(Abdul%20Ghafoor%20Awan\).pdf](http://www.ciitlahore.edu.pk/pl/abrc/Proceedings/All%20papers/COMPARISON%20OF%20ISLAMIC%20AND%20CONVENTIONAL%20(Abdul%20Ghafoor%20Awan).pdf)
- Ayub, S., Sohail, N., & Mumtaz, Raheel. (2012). "Performance Evaluation of Islamic and Conventional Banks in Pakistan", *World Applied Sciences Journal*, 20 (2), 213-220.
- Educational Addendum: *Understanding Your Right. The Essence of Islamic Law*. Retrieved from <http://www.islamicity.com/politics/shariah.htm>
- Faizulayev, A. (2011). "Comparative Analysis between Islamic Banking and Conventional Banking Firms in terms of Profitability, 2006-2009". Retrieved from i-rep.emu.edu.tr:8080/jspui/bitstream/11129/107/1/Faizulayev.pdf
- Hamid, M.A., & Azmi, S.M., (2011). "The Performance of Banking During 2000-2009: Bank Islam Malaysia Berhad and Conventional Banking in Malaysia", *International Journal of Economics and Management Sciences*, 1(1), 9-19.
- Hanif, M., Tariq, M., Tahir, A., & Momeneen, W.U. (2012). "Comparative Performance Study of Conventional and Islamic Banking in Pakistan", *International Research Journal of Finance and Economics*, 83, 62-72.
- HSBC Bank Malaysia Berhad.
Retrieved from <http://www.hsbc.com.my/1/2/about-hsbc/corporate-information>
- Hussain, HA. & Al-Ajmi, J. (2012). Risk management practices of conventional and Islamic banks in Bahrain. *Journal of Risk Finance*, 13 (3):215 - 239.

- Institute of Bankers Malaysia. *Islamic Banking in Malaysia*. Retrieved from www.ibbm.org.my/v2/wpcontent/.../06/CIAFIN-July-08-Chap-3.pdf.
- Investopedia. *Definition of 'T-Test'*. Retrieved from <http://www.investopedia.com/terms/t/t-test.asp>
- Iqbal, M. (2001). "Islamic and Conventional Banking in the Nineties: A Comparative Study", *Islamic Economic Studies*, 8(2), 1-28.
- Johnes, J., Izzeldin, M., & Pappas, V. (2012). "A comparison of performance of Islamic and conventional banks 2004 to 2009". Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=20716155
- Khair, K., Gupta, L & Shanmugam, B. (2008). *"Islamic Banking: A Practical Perspective"* Pearson Malaysia Sdn Bhd.
- Laghari, MK., Rani, I., Bhutto, NA., & Butt, FUD. (2011). "Comparative Analysis of Islamic Banks with Conventional Banks", *Interdisciplinary Journal of Contemporary Research in Business*, 3(7), 1091-1111.
- Landau, S, & Everitt, B.S. (2004). *"A Handbook of Statistical Analyses using SPSS"* Chapman & Hall/CRC.
- Loghod, HA. (2005). *"Do Islamic Banks Perform Better than Conventional Banks? Evidence from Gulf Cooperation Council countries"*. Retrieved from <http://www.iefpedia.com/english/wp-content/uploads/2013/02/wps1011-Do-Islamic-Banks-Perform-Better-than-Conventional-Banks.pdf>
- Masruki, R., Ibrahim, N., Osman, E. & Wahab, HA. (2011). "Financial Performance of Malaysian Founder Islamic Banks versus Conventional Banks", *Journal of Business and Policy Research*, 6(2), 67-79.
- Merchant, I.P. (2012). "Empirical Study of Islamic Banks Versus Conventional Banks of GCC", *Global Journal of Management and Business Research*, 12(20), 32-42.
- Metwally, M.M. (1997). Differences between the Financial Characteristics of Interest-Free Banks and Conventional Banks. *European Business Review*, 97(2), 92-98.
- Moin, M.S. (2008). Performance of Islamic Banking and Conventional Banking in Pakistan: A Comparative Study. *Master Degree Project*, School of Technology and Society, University of Skövde.
- Onakoya, Babatunde, A., & Olaitan, A. (2013). "The Performance of Conventional and Islamic Banks in the United Kingdom: A Comparative Analysis", *Journal of Research in Economics and International Finance*, 2(2), 29-38.
- Palaniappan, A.K. (2009). *"Penyelidikan dan SPSS (PASW)"* Prentice Hall
- Rahim, S.R.M., & Zakaria, RH. (2013). "Comparison on Stability Between Islamic and

- Conventional Banks in Malaysia”, *Journal of Islamic Economics, Banking and Finance*, 9(3), 131-149.
- Rosly, S.A., & Abu Bakar, MA., (2003). “Performance of Islamic and mainstream banks in Malaysia”, *International Journal of Social Economics*, 30(12), 1249–1265.
- Ross, S. A., Westerfield, R.W., & Jaffe, J. (2005). “*Corporate Finance*.” McGraw-Hill Inc., 7th Ed.
- Safiullah, M.D. (2010). “Superiority of Conventional Banks & Islamic Banks of Bangladesh: A Comparative Study”, *International Journal of Economics and Finance*, 2(3), 199-207.
- Samad, A. (2004). “Performance of Interest-free Islamic banks vis-à-vis Interest-based Conventional Banks of Bahrain”. *IJUM Journal of Economics and Management*, 12(2), 1-15.
- Samad, A., & Hassan, M.K. (1999). “The Performance of Malaysian Islamic Bank During 1984-1997: An Exploratory Study”, *International Journal of Islamic Financial Services*, 1(3), 1-14.
- Sehrish, S., Saleem, S., Yasir, M., Shehzad, F., & Ahmed, K. (2012). “Financial Performance Analysis of Islamic Banks and Conventional Banks in Pakistan: A Comparative Study”, *Interdisciplinary Journal of Contemporary Research in Business*, 4(5), 186-200.
- Shahid, H., UrRehman, R., Niazi, G.S.K., & Raoof, A. (2010). “Efficiencies Comparison of Islamic and Conventional Banks of Pakistan”, *International Research Journal of Finance and Economics*, 49, 2-42.
- Siraj, K.K., & Pillai, PS. (2012). “Comparative Study on Performance of Islamic Banks and Conventional Banks in GCC region”, *Journal of Applied Finance & Banking*, 2(3), 123-161.
- Usman, A., & Khan, M.K. (2012). “Evaluating the Financial Performance of Islamic and Conventional Banks of Pakistan: A Comparative Analysis”, *International Journal of Business and Social Science*, 3(7), 253-257.
- Viverita, (2010). “*Performance Analysis of Indonesian Islamic and Conventional Banks*”, Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1868938.
- Wasiuzzaman, S., and Gunasegavan, U.M. (2013). “Comparative study of the performance of Islamic and conventional banks. The case of Malaysia”, *Humanomics*, 29(1), 43 – 60.