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COMPARATIVE ANALYSIS OF MALAYSIAN BANKING SYSTEM: ISLAMIC VS. CONVENTIONAL BANKS

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ABSTRACT: *The objective of this paper is to determine and compare the financial performance of Islamic and conventional banks in Malaysia. A Regression model consisting of nine accounting ratios was applied for 2006-2015 period. The suggested model along with correlation is used to examine the relationship between dependent and independent variables. Profitability in terms of ROA, ROE and CI is considered as the dependent variable while liquidity in terms of NetLTA, NetLD&B, Credit risk as EQTA, EQTNL , IMLGL and Solvency under Bank-o-meter model is considered as independent variables. The results show that inn combined financial analysis, Islamic banks are leading in profitability while conventional banks are better in absorbing loan losses. Bank-o-meter model indicate that both banking streams are in super sound position. The Regression model shows that in terms of ROA and ROE, strength of model is more appropriate in Islamic banks. While in conventional banks, CI model indicate that value of F is better than Islamic banks*.

Keywords: Financial performance; Islamic banks; Conventional banks; ROA; ROE

1. INTRODUCTION

Banks are one of most important part of any country. The banking industry is very essential for economic development of any society. The .banking sector is important in the context of motivating people to save, provide risk free income for depositors, generate employment and attain economic welfare. There is two main banking systems in Malaysia, Islamic banking and conventional banking. There are some differences between Islamic and conventional banking. The main difference between them is sharia law.But in conventional banks, functions and operations do not follow any religious laws or guidelines rather all the operating models are based on secular principles.[1]. As, Islamic banking follow sharia law while conventional banking does not follow religious laws and functions. In Islamic banks there is profit and loss sharing rule while conventional banks charge high interest from borrowers in order to maximize their profit. Similarly mode of financing and investment is also different in both types of banking.In Islamic banking, loans are provided on the basis of profit and loss (PLS). While conventional banks charge high interest rates on all types of loans. In conventional banking, financing is interest oriented and for the use of money, interest rate is charged which can be fixed or floating. Concept of money is also different between two types of banking. In Islamic banking system there is a clear vision about equitable distribution of income and resources, particularly for poor class and profit and loss both are shared with depositors.[2].

2. Literature Review

Different writers from all over the world compare and examine the financial performance of Islamic and conventional banks in terms of profitability, liquidity, credit risk and solvency like [3;1,4]

[5] from Pakistan, [4] from Malaysia used different financial ratios in their study and conclude that conventional banks profitability is much higher as compared to Islamic banks. While authors [5,6,7]argued that by using different financial ratios it is clear that Islamic banks are leading in profitability as compared to conventional banks.

3. Methodology

The purpose of this study is to conduct comparative financial performance of Islamic and conventional banking sectors in Malaysia. The research questions of this study are as follows: Which of the banking system in Malaysia is relatively more profitable? Is there significant difference between liquidity of Islamic and conventional banks in Malaysia? Which of the banking system is exposed to more credit risk? Are Islamic banks are more solvent than conventional banks? Which of the banking system is best performer in Malaysia? 5 commercial banks and 5 Islamic banks are selected for making comparison of financial performance for the time period of 10 years from 2006 to 2015.

Sample Banks List

Table 1: Sample of Islamic and Conventional Banks

Islamic Banks	**Conventional Banks**
Bank Muamalat	MAy Bank
Bank Islam	Public Bank
CIMB Islamic Bank	CIMB Bank
RHB Islamic Bank	RHB Bank
AFFIN Islamic Bank	HONG LEONG Bank

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Table 2: Conventional Banks for 2006 to 2015.

		ROA	ROE	CI	NETLTA	NETLDB	EQTA	EQTNL	IMLGL	SOLVENCY
ROA	Pearson Correlation	1	.866**	-.549**	.165	.389**	-.002	-.316*	-.229	.056
	Sig. (2-tailed)		.000	.000	.252	.005	.989	.025	.110	.698
	N	50	50	50	50	50	50	50	50	50
ROE	Pearson Correlation	.866**	1	-.675**	.314*	.234	-.219	-.632**	-.209	-.365**
	Sig. (2-tailed)	.000		.000	.026	.102	.126	.000	.145	.009
	N	50	50	50	50	50	50	50	50	50
CI	Pearson Correlation	-.549**	-.675**	1	-.130	-.223	-.003	.505**	.411**	.303*
	Sig. (2-tailed)	.000	.000		.367	.120	.985	.000	.003	.032
	N	50	50	50	50	50	50	50	50	50
NETLTA	Pearson Correlation	.165	.314*	-.130	1	.031	-.933**	-.467**	-.089	-.274
	Sig. (2-tailed)	.252	.026	.367		.832	.000	.001	.538	.054
	N	50	50	50	50	50	50	50	50	50
NETLDB	Pearson Correlation	.389**	.234	-.223	.031	1	.256	-.467**	-.065	.225
	Sig. (2-tailed)	.005	.102	.120	.832		.072	.001	.654	.117
	N	50	50	50	50	50	50	50	50	50
EQTA	Pearson Correlation	-.002	-.219	-.003	-.933**	.256	1	.342*	-.031	.419**
	Sig. (2-tailed)	.989	.126	.985	.000	.072		.015	.833	.002
	N	50	50	50	50	50	50	50	50	50
EQTNL	Pearson Correlation	-.316*	-.632**	.505**	-.467**	-.467**	.342*	1	.108	.616**
	Sig. (2-tailed)	.025	.000	.000	.001	.001	.015		.457	.000
	N	50	50	50	50	50	50	50	50	50
IMLGL	Pearson Correlation	-.229	-.209	.411**	-.089	-.065	-.031	.108	1	-.006
	Sig. (2-tailed)	.110	.145	.003	.538	.654	.833	.457		.966
	N	50	50	50	50	50	50	50	50	50
SOLVENCY	Pearson Correlation	.056	-.365**	.303*	-.274	.225	.419**	.616**	-.006	1
	Sig. (2-tailed)	.698	.009	.032	.054	.117	.002	.000	.966	
	N	50	50	50	50	50	50	50	50	50

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Table 3. Correlations

		ROA	ROE	CI	NETLTA	NETLTDB	EQTA	EQTNL	IMLGL	SOLVENCY
ROA	Pearson Correlation	1	-.958**	.037	-.069	.005	.579**	.499**	-.288*	.715**
	Sig. (2-tailed)		.000	.797	.636	.970	.000	.000	.043	.000
	N	50	50	50	50	50	50	50	50	50
ROE	Pearson Correlation	-.958**	1	-.156	.063	-.012	-.564**	-.477**	.327*	-.792**
	Sig. (2-tailed)	.000		.280	.664	.935	.000	.000	.020	.000
	N	50	50	50	50	50	50	50	50	50
CI	Pearson Correlation	.037	-.156	1	-.113	-.128	.019	.067	.021	.255
	Sig. (2-tailed)	.797	.280		.433	.375	.894	.642	.885	.073
	N	50	50	50	50	50	50	50	50	50
NETLTA	Pearson Correlation	-.069	.063	-.113	1	.975**	.015	-.550**	-.414**	.184
	Sig. (2-tailed)	.636	.664	.433		.000	.920	.000	.003	.201
	N	50	50	50	50	50	50	50	50	50
NETLTDB	Pearson Correlation	.005	-.012	-.128	.975**	1	.106	-.456**	-.424**	.250
	Sig. (2-tailed)	.970	.935	.375	.000		.463	.001	.002	.080
	N	50	50	50	50	50	50	50	50	50
EQTA	Pearson Correlation	.579**	-.564**	.019	.015	.106	1	.813**	.003	.711**
	Sig. (2-tailed)	.000	.000	.894	.920	.463		.000	.986	.000
	N	50	50	50	50	50	50	50	50	50
EQTNL	Pearson Correlation	.499**	-.477**	.067	-.550**	-.456**	.813**	1	.233	.473**
	Sig. (2-tailed)	.000	.000	.642	.000	.001	.000		.103	.001
	N	50	50	50	50	50	50	50	50	50
IMLGL	Pearson Correlation	-.288*	.327*	.021	-.414**	-.424**	.003	.233	1	-.284*
	Sig. (2-tailed)	.043	.020	.885	.003	.002	.986	.103		.045
	N	50	50	50	50	50	50	50	50	50
SOLVENCY	Pearson Correlation	.715**	-.792**	.255	.184	.250	.711**	.473**	-.284*	1
	Sig. (2-tailed)	.000	.000	.073	.201	.080	.000	.001	.045	
	N	50	50	50	50	50	50	50	50	50

**. Correlation is significant at the 0.01 level (2-tailed).

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*. Correlation is significant at the 0.05 level (2-tailed).

REGRESSION EQUATION:

The econometric of the panel regression will be as following.

Y = β0 + βX+ εt

ROA= **β+NetLTA+EQTA+Solvency+εt**

ROE= **β+NetLD&B+EQTNL+Solvency+εt**

CI=**β+NetLD&B+IMLGL+Solvency+εt**

4. Data analysis and empirical results

Table 2 summarizes the correlation for conventional banks for 2006-2015. Results show that relation of dependent variable ROA with independent variables NetLTA, NetLD&B and solvency is positive and strength of relation between all the variables is weak. Similarly strength of relation between ROE and all independent variables is weak except in EQTNL which is moderate. In caseof dependent variable CI, correlation is insignificant with NetLTA and EQTA. While strength of relation is moderate between CI and EQTNL as r= 0.505.

In table 3, it is noticed that correlation in Islamic banks specially between independent variables with dependent variables ROA and ROE is more appropriate as compared to conventional banks. Strength of relationship between ROA and Solvency is strong and strength of relation between ROA with EQTA and EQTNL is moderate. Similar is the case in ROE with these independent variables. In Islamic banks the correlation between CI and all independent variables is insignificant at all levels and strength of relation between them is weak.

Regression Model:

Results obtained from table 4.3 indicate that 22% of variation in ROA is explained by independent variables and remaining 78% of other variables effect on dependent variables. Significance value is .010 and value of F is 4.240.

Regression; ROA con

Table 4:Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	SOLVENCY, NETLTA, EQTA[b]	.	Enter

a. Dependent Variable: ROA

b. All requested variables entered.

Table 4.1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.465[a]	.217	.166	.29595

c. Predictors: (Constant), SOLVENCY, NETLTA, EQTA

In case ofliquidity both types of banking systems set side by side. In credit risk, conventional banks are in leading position means conventional banks have more capacity of absorbing loan losses and quality of assets and loans is better in conventional banks of Malaysia. In terms of solvency, although conventional banks are ahead but results from Bank-o-meter show that both banking streams are in safe and stable condition.

Descriptives for Conventional banks:

Table 5:Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	50	.37	1.62	1.0445	.32398
ROE	50	3.75	24.20	13.3767	4.92638
CI	50	25.54	57.97	41.1873	8.73622
NETLTA	50	7.67	75.23	48.6605	21.13720
NETLDB	50	48.83	89.01	71.6917	8.98395
EQTA	50	4.92	128.11	29.3118	43.81716
EQTNL	50	8.82	17.98	13.7820	2.70224
IMLGL	50	.05	4.46	1.9115	1.08925
SOLVENCY	50	89.30	128.11	109.1579	8.99079
Valid N (listwise)	50				

Descriptives for Islamic banks:

Table 6:Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	50	-8.88	1.63	.5306	1.39274
ROE	50	4.31	466.74	20.5322	64.59161
CI	50	12.64	77.83	35.3791	16.12161
NETLTA	50	27.67	73.91	53.6741	11.55460
NETLTDB	50	29.96	92.94	60.0202	13.52031
EQTA	50	-1.90	9.00	6.2136	2.14573
EQTNL	50	-3.21	21.31	12.1233	4.73341
IMLGL	50	.88	9.54	3.0391	2.01437
SOLVENCY	50	20.31	130.12	102.3554	15.45676
Valid N (listwise)	50				

Table 6 show descriptive statistics of conventional banks while other tabel show descriptions of Islamic banks. N show total number of observations while results show each variable minimum and maximum value along with its mean and standard deviation which makes results more clear and reliable.

5. CONCLUSION AND RECOMMENDATIONS:

The aim of this paper was to analyze and compare Islamic and conventional banks of Malaysia. For this purpose total 10

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banks were selected (5 Islamic and 5 conventional) for the time period of 10 years from 2006 to 2015. Combined ratio analysis showed that Islamic banks are leading in Profitability while conventional banks are leading in credit risk. In liquidity both banks are standing side by side. In case of solvency, both Islamic and conventional banks are in stable position. According to Regression model, strength of model is more appropriate in Islamic banks in terms of ROA and ROE. While in case of CI, this dependent variable is insignificant with other independent variables except in solvency.

So we can say that conventional banks must take some initiatives to make their financial position strong in terms of profitability while Islamic banks must improve their loans and asset quality. Along this, Islamic banks must increase their products and services while conventional banks must create their unique selling points to attract more and more customers.

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