

A COMPARISON OF BANKERS' PERCEPTION ABOUT THE PROFITABILITY DETERMINANTS OF ISLAMIC AND CONVENTIONAL BANKS THROUGH PERCEPTIONAL SURVEY

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ABSTRACT: *The study is conducted to evaluate the importance of internal and external factors affecting the profitability of the Islamic and conventional banks. Around 150 banks operating in Lahore and its vicinity are selected for this purpose. In order to examine the importance of different selected internal and external factors, researcher introduced questionnaire based on three Likert scale, i.e. Most important, important and least important. Bankers' perception perceived from questionnaire indicated that all internal and external factors are more or less "most important" or "important" for determining the profitability of Islamic and conventional banks except the inflation. On comparison researcher concluded that there is no significant difference in bankers' perception of Islamic and conventional banks. Many bankers highlighted variables other than studied which also affect the profitability of the banks such as risk factors, region, government policies, state bank policies and political and economic stability.*

INTRODUCTION:

The Banking sector has revolutionized the modern trade and commerce by providing them the major proportion of the finance. The growing trend of globalization has made the idea of competency and efficiency very vital for all financial institutions and the banks are the important part of financial institutions. The current political instability and economic disasters have revealed that sound functioning financial system is vital for economic strength or growth. The financial system facilitates an economy to be stronger by allowing investors with few resources to use savings for those who have few prospects of investing and the banks have the key feature of the economic stability of a country, banks fulfill various financial needs of the various sectors. Islamic banks and conventional banks both are in huge competition, that is why they are trying hard to satisfy the customers and also try to exceed the customer's expectations. Conventional banks and Islamic banks are working in the nearly similar world and providing the same services but different ways. Islamic banks follow the Islamic principles regarding lending, but the conventional banks following the man-made principle of lending money. Islamic banks are limited to the Muslim countries where as conventional banks spread all over the world. The banking system in Pakistan has developed a lot in the previous years. Now a days banks in Pakistan are growing rapidly and providing better online services and almost all conventional banks have opened separate Islamic bank window and other are preparing so. It is also observed that banking sector performed well under the favorable economical and political conditions. The necessity to keep economical and political stability will be vital in the coming years. Profitable banks can easily manage financial crises of the country and also can make a financial system consistent in the long run. As a result, it is valuable to explore what are the most important factors which can affect the profitability of banks.

LITERATURE REVIEW:

Muda, Shaharuddin, & Embaya [1] examined that up to what extent profitability of banks is effected by the global financial crisis. Overhead expenses ratio, loans ratio, deposits ratio, technical efficiency and bank size have a

positive significant effect while inflation rate has a negative significant effect in determining banks' profitability and finally the profitability of Islamic banks is negatively affected by the global financial crisis.

Ruff & Malik [2] Investigated and evaluated the profitability and return on deposits of both the Islamic and conventional banks. Total assets of the banks showed an inverse relation with conventional banks and positive relation with Islamic banks. Deposits adversely affected the efficiency of Islamic banks and vice versa of conventional banks. Whereas interest expense are both caused positive profitability.

Islam, Alam, & Hossain [3] evaluated and compared the profitability of Islamic banks and conventional banks in Bangladesh. It is realized through personal interviews with bank executives of the both banks that different business policies and style of operation are the reasons behind the difference in profitability of banks.

Saeed [4] examined the impact of bank-specific, industry-specific, and macroeconomic variables on banks' profitability. Loan, deposits, liquidity, bank size, capital ratio and interest rate have a positive impact on ROA and ROE while GDP and inflation rates have a negative impact on profitability.

Al-Jafari & Alchami [5] explored the significance of bank-specific, industry-specific, and macroeconomic variables affecting the profitability of banks in Syria. This study revealed that liquidity risk, credit risk, bank size, and management efficiency have significant impact on profitability of the bank except bank capital. This study also discovered that all macroeconomic variables; inflation rate and real gross domestic product growth rate have significant impact on profitability of banks.

Rauf & Mehmood [6] examined the impact of internet banking on the profitability of the Pakistani banking sector. Statistical results shown that in long run there is positive and significant impact of internet banking on profitability of banks.

Al-Qudah & Jaradat [7] investigated the effect of macroeconomic variables and bank characteristic on the profitability of Jordanian Islamic banks. Capital adequacy and bank size have a positive and significant impact on

profitability. The leverage measured has a negative significant impact while liquidity has negative insignificant effect on profitability.

OBJECTIVES

The objectives of this study are:

1. To assess the importance of internal and external factors on the profitability of Islamic and conventional banks.
2. To compare the Bankers' perception about the profitability determinants of Islamic and conventional banks.

HYPOTHESIS

Following hypothesis have been developed in order to know the importance of internal and external factors on the banks' profitability.

H₁: Internal factors are most important for determining the profitability of Islamic and conventional banks.

H₂: External factors are most important for determining the profitability of Islamic and conventional banks.

MATERIAL AND METHOD

This study is based on a perceptual survey. Cross-sectional survey is used to evaluate the importance of internal and external factors affecting the profitability of the Islamic banks and conventional banks in Lahore, Punjab. Around one hundred & fifty branches of different Islamic and Conventional banks operating in Lahore and its vicinity, are selected for this purpose. In order to rank the importance of different selected internal and external factors, researcher introduced questionnaire based on three Likert scale, i.e. Most important, important and least important. Questionnaires are being filled by branch managers or operational managers in order to know whether the variables are Most important, important or less important for determining the profitability of the banks. There are maximum two respondents from each branch of the bank. After getting a response from the respondents' researcher used descriptive statistics and graphs to analyze the results.

Variable used in this study

Internal Factors

1. Current deposits
2. Saving deposits
3. Time deposits
4. Investment
5. Advances
6. Loan
7. Equity
8. Expenditure
9. Liquidity
10. Size
11. Capital structure

External Factors

12. Money supply
13. Interest rate
14. Market share
15. Inflation

SURVEY FINDINGS AND DISCUSSION

Figure 1 shows that according to Conventional banking 96% respondents and according to Islamic banking 92% respondents responded that current deposits are most important for determining the profitability of the banks.

So respondents of the both banks cleared that current deposits are most important for determining the profitability because there is no obligation on part of banks as they are not paying any kind of interest or profit on current deposits.

Figure 2 shows 46% respondents of Conventional banks and 32% respondents of Islamic banks responded that saving deposits are most important and 50% respondents of Conventional banks and 48% respondents of Islamic banks responded that saving deposits are important for determining the profitability of the banks. One thing assured by respondents of the both banks through their response that saving deposits are most important as well as important for determining the profitability of the both banks as they need to pay lesser interest or markup on saving deposit as compared to time deposits.

Figure 3 represents that 48% and 30% respondents of conventional banks responded that time deposits are most important and important respectively for determining the profitability of the banks while Islamic banks 40% and 48% respondents responded that time deposits are most important for determining the profitability of the banks respectively. It is cleared from the respondents' response of the both banks that time deposits are most important as well as important for determining the profitability of the both banks. 22% respondents of conventional banks and 12% of Islamic banks are not in favour of time deposit; the reason may be the higher amount of interest or markup.

Figure 4 shows that 66% respondents of Conventional banks and 60% respondents of Islamic banks responded that investments are most important and 30% respondents of Conventional banks and 40% respondents of Islamic banks responded that investments are important for determining the profitability of the banks.

It is cleared from the respondents' response of the both banks that investments are approximately equally most important for determining the profitability of the both banks.

Figure 5 reveals that 60% respondents of Conventional banks and 68% respondents of Islamic banks responded that advances are most important and 34% respondents of Conventional banks and 16% respondents of Islamic banks responded that advances are important for determining the profitability of the banks.

It is cleared from the respondents' response that advances are approximately equally most important for determining the profitability of both banks but conventional banks respondents are more in favour.

Figure 6 reveals that 58% respondents of Conventional banks and 32% respondents of Islamic banks responded that loans are most important and 38% respondents of Conventional banks and 56% respondents of Islamic banks responded that loans are important for determining the profitability of the banks.

It is cleared from the conventional banks respondents' response that banks' loans are most important for determining the profitability of the banks but according to Islamic banks respondents, loan is not most important for determining the profitability of the Islamic bank but it is important because most of the respondents think that they are not dealing in loans; they are dealing in commodity that's why Islamic banks

respondents are not much in favor of loan as compare to conventional banks.

Figure 7 depicts that according the Conventional banking 44% respondents responded that equity are most important for determining the profitability of the banks and 46% responded that equity is important.

According to Islamic banking 44% respondents responded that equity is most important for determining the profitability of the banks and 52% responded that equity is important and remaining 4% responded that the equity is least important for determining the profitability of the banks. It is cleared from the respondents response of the both banks that equity is approximately equally most important and important for determining the profitability of the both banks. So, there is no significant difference between the opinion of the respondents of the conventional and islamic banks because initially banks required little amount to start and later on banks circulate the money of the customers.

Figure 8 represents that 52% respondents of Conventional banks and 16% respondents of Islamic banks responded that expenditures are most important and 40% respondents of Conventional banks and 72% respondents of Islamic banks responded that expenditures are important for determining the profitability of the banks. It is cleared from the conventional banks respondents response that expenditures are most important for determining the profitability of the banks but according to islamic banks respondents expenditures are not most important for determining the profitability of the islamic bank but it is important because the lesser the amount of expenditures the higher the amount of profit will be.

Figure 9 describes that 42% respondents of Conventional banks and 52% respondents of Islamic banks responded that liquidity is most important and 52% respondents of Conventional banks and 40% respondents of Islamic banks responded that liquidity is important for determining the profitability of the banks. It is cleared from the respondents response of the both banks that liquidity is approximately equally most important and important for determining the profitability of the both banks. So, there is no significant difference between the opinion of the respondents of the conventional and islamic banks.

Figure 10 shows that 36% respondents of Conventional banks and 28% respondents of Islamic banks responded that capital structure is most important and 62% respondents of Conventional banks and 44% respondents of Islamic banks responded that capital structure is important for determining the profitability of the banks. It is cleared from the respondents response of the islamic and conventional banks that capital structure is not most important and but important for determining the profitability of the islamic and conventional banks.

Figure 11 shows that 36% respondents of Conventional banks and 20% respondents of Islamic banks responded that money supply is most important and 58% respondents of Conventional banks and 40% respondents of Islamic banks responded that money supply is important for determining the profitability of the banks. It is cleared from the respondents response of the conventional banks that money supply is most important and also strongly important but on the other hand according to islamic banks respondents money supply is not

most important but important for determining the profitability of the banks and even large number of islamic banks respondents response that money supply is least important for determining the profitability of the islamic banks.

Figure 12 reveals that 52% respondents of Conventional banks and 40% respondents of Islamic banks responded that interest rate is most important and 40% respondents of Conventional banks and 56% respondents of Islamic banks responded that interest rate is important for determining the profitability of the banks. Islamic and conventional banks respondents responses are equally divided in their opinion without any significance difference that interest rate is most important as well as important for determining the profitability of the banks and both islamic and conventional banks are not much in favour that the interest rate is not important.

Figure 13 illustrates that 54% respondents of Conventional banks and 56% respondents of Islamic banks responded that size of bank is most important and 38% respondents of Conventional banks and 44% respondents of Islamic banks responded that size of bank is important for determining the profitability of the banks.

Almost equal and significant number of islamic and conventional banks respondents are in favour of the opinion that the size of the banks are most important for determining the profitability of the banks. Islamic banks respondents are little more in favour of the opinion that the size of the banks is important for determining the profitability of the banks as compare to conventional banks respondents response.

Figure 14 represents that 68% respondents of Conventional banks and 32% respondents of Islamic banks responded that market share is most important and 30% respondents of Conventional banks and 36% respondents of Islamic banks responded that market share is important for determining the profitability of the banks. Respondents of the conventional banks strongly are in favour that the market share of banks is most important for determining the profitability but Islamic bank respondents are neither much in favor and nor much againsts this point of view.

Figure 15 shows that 20% respondents of Conventional banks and 12% respondents of Islamic banks responded that inflation is most important and 48% respondents of Conventional banks and 48% respondents of Islamic banks responded that inflation is important for determining the profitability of the banks.

It is cleared from the respondents response of the both banks that inflation is not most for determining the profitability of the banks because normally interest is charged on inflation adjusted basis.

CONCLUSION

The study is conducted to evaluate the importance of internal and external factors affecting the profitability of the islamic and conventional banks operating in lahore and its vicinity. Survey results indicated that all internal and external factors are more or less most important or important for determining the profitability of islamic and conventional banks except the inflation. There is no difference in the opinion of bankers of islamic and conventional banks. Many bankers highlighted variables other than studied which also affect the

profitability of the banks such as risk factors, region, government policies, state bank policies and political and economic stability.

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APPENDIX:

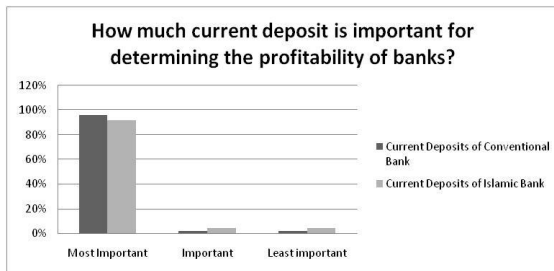


Figure 1
How much current deposit is important for determining the profitability of banks?

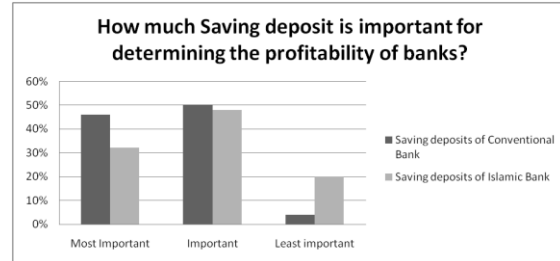


Figure 2
How much Saving deposit is important for determining the profitability of banks?

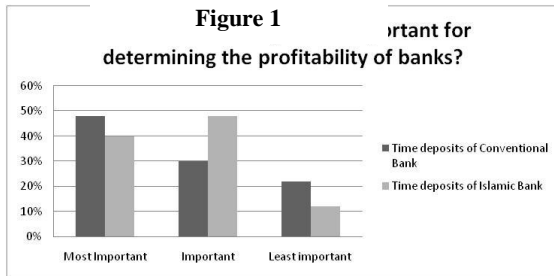


Figure 3
How much Time deposits are important for determining the profitability of banks?

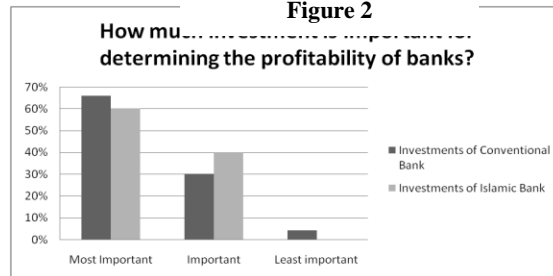


Figure 4
How much Investments are important for determining the profitability of banks?

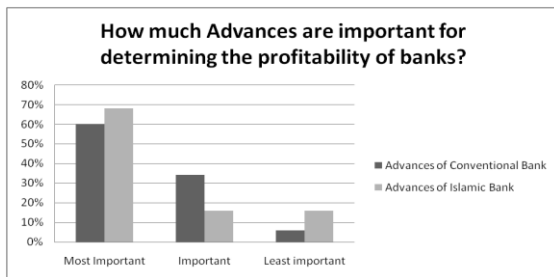


Figure 5
How much Advances are important for determining the profitability of banks?

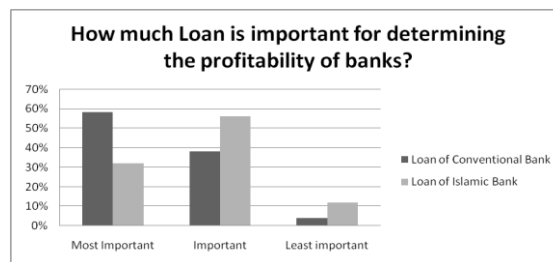


Figure 6
How much Loan is important for determining the profitability of banks?

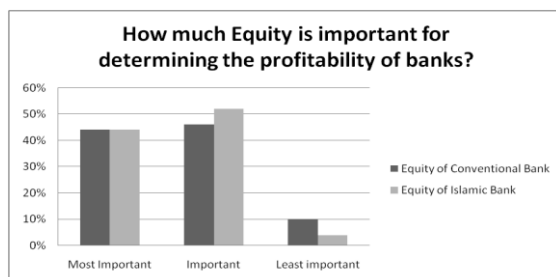


Figure 7
How much Equity is important for determining the profitability of banks?

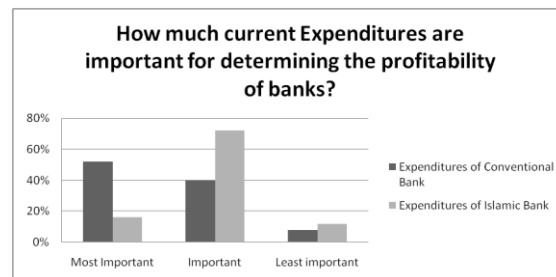


Figure 8
How much current Expenditures are important for determining the profitability of banks?

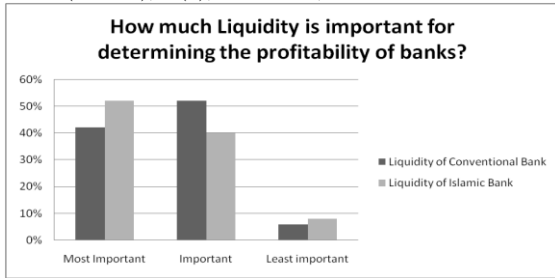


Figure 9

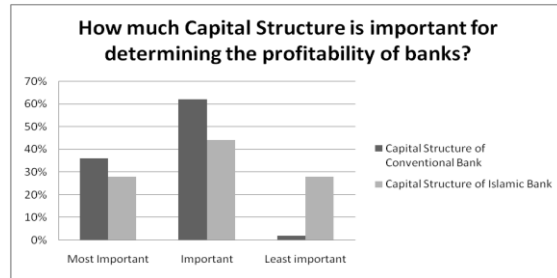


Figure 10

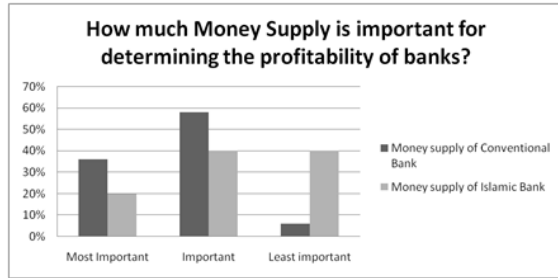


Figure 11

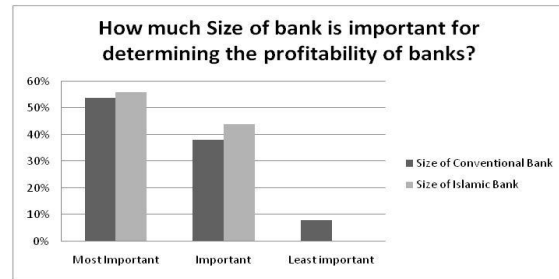


Figure 12

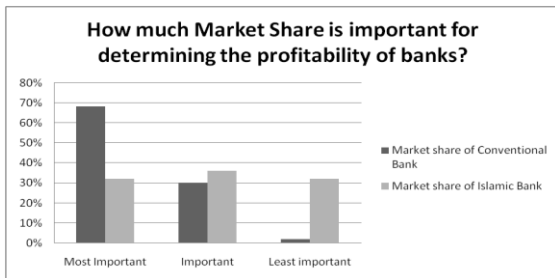


Figure 13

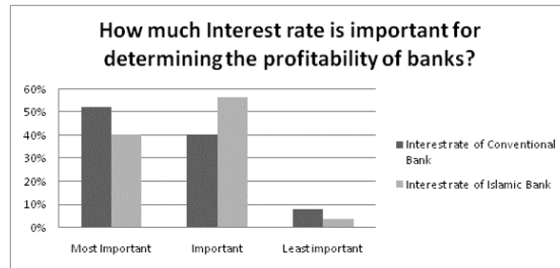


Figure 14

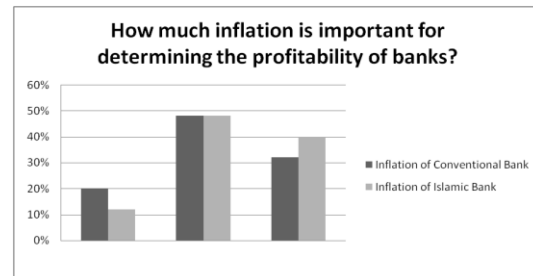


Figure 15