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Conventional and Islamic Banks in Malaysia: Performance Review

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Abstract:

The banking industry in Malaysia is regulated by the Central Bank of Malaysia and the government. There are 43 banks listed involved conventional and Islamic banks that have made greatest growth in the industry. Nevertheless, the performance of each banks may be vary depending on their strength. In establishing Malaysia as a global Islamic center, Central Bank of Malaysia has focusing on the growing of Islamic banking. It gave new insights and knowledge to the people about two different practices in the banking industry in Malaysia. Today, Islamic banking has a significant influence to the financial inter-mediation. This entity becomes competence to conventional banks. Hence, these two main streams are provided with the rules and regulations by the Central Bank of Malaysia that needs to be adhered in order to sustain a proper operations and practices. There are numerous factors that affect the performance of banks in Malaysia. The financial ratios have been used to identify the performance of these two main streams. The ratios are ROA, capital adequacy, ROE, asset quality, management adequacy, earnings power, equity multiplier, asset utilization, net loan to total assets, and liquid asset to deposit. Conventional banks in Malaysia are performing better in terms of ROA, ROE, capital adequacy, asset quality, management adequacy, earnings power, and net loan to total assets. Islamic banks are having more values compared with listed conventional banks in Malaysia for equity multiplier, asset utilization and liquid asset to deposit ratio. Overall it can be said that conventional banks are performing better since there are seven ratios out of the ten ratios in Malaysia.

Keywords: Conventional and islamic banks, performance, ratio analysis

1. Introduction

Finance is the life blood of business. The world of business is taking on a global shape and thereby increasing the complexity. Newer business domains and things have been creating new demands for financial needs. Hence, the existence of financial intermediary or financial institution comes into play. There are many types of financial institutions. Bank is one of the most vital financial institutions. Banks play an important role in today's economy. Businesses these days are depending heavily on external sources of financing. Banks provide businesses with these needy funds in order to operate smoothly in this hyper-competitive world.

There are multifarious types of banks around the world. Different countries have different types of banks which cater to the specific needs of the business community and general public. Of all the varieties of banks operating in this world, there are also two main types of banks which are conventional and Islamic banks. As the name suggests, both of these banks operate in different principles even though they are under the same roof of financial institution. In many countries around the world, both conventional and Islamic banks exist and operate simultaneously. While in some countries, conventional and Islamic banks operate separately.

Conventional banks are following the traditional economic principle and thereby they take money as deposits from customers and give out some specific portion of the collected money to the people who need it. And for doing this, banks usually charge a fee. And by keeping customers money, they also charge a fee. Hence, the difference between keeping and giving out and getting fee is the main source of income for banks. Interest is the usual term used in conventional banks. Unlike Islamic banks which operate based on the different principle. They operate based on the Shari'ah laws or Islamic commandments and thereby they cannot charge fee or interest from the customers. The transactions based on trade modes which are outlined in Islam. The following of trade modes allow them to earn profits. Thus, this is the primary difference between conventional and Islamic banks. Banks are operating in order to serve the needs of the customers profitably. As there are two mainstream banks namely conventional and Islamic banks, hence their functionality differs in many respects. Essentially the profit earning potential and other dimensions also differ between these two types of banks. When it comes to comparison, in terms of quantitative there would be so many things. But, the main thing is that due to differences between

these two types of business practices, the performance of these two banks differs significantly. But to what extent the difference between these two counterparts, that is the focus of this study. The study gradually explains the literature review followed by study objectives, methodology, data collection and result discussion subsequently. It concludes with conclusion.

2. Literature Review

Banks are the most prominent financial institutions in today's world. Banks basically act as an intermediary between the people with more money and the people with less money. People deposit their money in the banks. And banks give out loans to the needy group of people. And banks earn profit by doing this. Banking business has started long time ago when people started to involve in economic activities and also started to save money or its equivalent to spend in future. There are many types of banks around the world namely divisional banks, local banks, and cooperative banks. Not very recently, there has been the emergence of Islamic banks which is currently the counterpart of today's conventional banks.

The era of banking business has started with the establishment of conventional banks. In essence, conventional bank is the mother of the banking industry. And till today, it is the most popular type of banking system around the world. Conventional banks operate based on the principal of taking people's money and giving out some portion of that money to the customers and thus earning profit. In conventional banks, this profit earning is called as interests which become the major source for its income. In conventional banking systems, customer is the key to earn profit. More customers usually mean more opportunities to increase profit. Islam is the perfect code of living. In Islam, interest is prohibited and trade is encouraged. Islam has laid out the foundations of an Islamic economy where there will be no interest earned and halal trade is applied. Islamic banking is based on the governing principles of Islamic. Islamic banks deal with trading mechanisms as laid by Shari'ah boards and also, they do not deal with interest. In Islamic banking, the customer is not perceived as customer rather he or she is perceived as partner. Equal sharing in profit and loss sharing is one of the striking features which make the Islamic banking apart from the conventional banking systems.

Performance is a relative measure. The definition of performance varies from one organization to another organization. Bank's performance is the subject matter of many studies especially between conventional and Islamic banks. Studies usually use proxies when discussing about the performance for those studies. Most of the studies have used return on asset (ROA), return on equity (ROE), operating profit margin and total assets as a measure of performance. Besides that, operations situation, revenue growth and customer relationships are the three important indexes to measure performance (Slywotzky, Morrison & Weber, 2000). Different scholars used different things to study about the organization's performance. The main aim is basically the same across all these studies. The main objective of all these studies is to grasp how these two businesses are performing. Following is a brief summary of the various notable studies conducted so far on this topic-

Article and Authors	Variables and Method Used	Findings
Performance of Islamic and mainstream banks in Malaysia Saiful Azhar Rosly and Mohd Afandi Abu Bakar (2003)	ROA (Return on Assets), Return on Deposit (ROD), Asset Utilization (AU), Operating Efficiency Ratio (OER), Investment/Interest Margin. Paired sample t-test. Sample: 16 Islamic bank branches of mainstream banks from 1996-2001	ROA (Return on Assets), Return on Deposit (ROD), Asset Utilization (AU), Operating Efficiency Ratio (OER), Investment/Interest Margin. Paired sample t-test. Sample: 16 Islamic bank branches of mainstream banks from 1996-2001
Development and performance of domestic and foreign banks in GCC countries Mazhar M. Islam (2003)	BIS capital/asset ratio, liquid asset ratio. Sample: local and foreign banks operating in GCCs.	Domestic banks in Bahrain, Oman, the United Arab Emirates (GCC countries) have improved their performance over the past several years.
Comparative study of the performance of Islamic and conventional banks: The case of Malaysia Shaista Wasiuzzaman Umadevi Nair Gunasegavan (2013)	ROA, Board Size, Board independence, liquid assets over customer's short-term funding, net interest margin, equity over net loans, loan loss reserve to gross loans, bank size, bank type, inflation. Independent t-test and Regression Analysis Sample: 14 banks from 2005-2009	Conventional banks have been found to have higher profitability (ROAA).
Performance of banks in countries of the Gulf Cooperation Council Ramakrishnan Ramanathan (2007)	Loans, other earning assets, Fixed assets, Equity, Personnel expenses. data envelopment analysis (DEA) and Malmquist productivity index (MPI)	All the GCC Countries have at least one efficient bank.

Factors Influencing Performance of the UAE Islamic and Conventional National Banks Hussein A. Hassan Al-Tamimi (2010)	Sample: 55 banks from 2000-2004 GDP per capita, Bank size, Total assets/GDP, Total loans/Total deposits, Concentration of banks, salaries/total assets, number of branches Regression Analysis Sample: 47 banks from 1996-2008	Positive performance impact on the liquidity of conventional national banks.
Performance comparison of Islamic (participation) banks and commercial banks in Turkish banking sector Cengiz Erol Hasan F. Baklaci Berna Aydogan Gökçe Tunç (2014)	Capital adequacy, Asset quality, Management adequacy, Earnings power, Liquidity, Sensitivity to market risk Logistic regression Sample: 21 banks from 2001-2009	Islamic banks operating in Turkey perform better in profitability and asset management ratios compared to conventional banks but lag in sensitivity to market risk criterion.

Table 1: Literature Review Matrix

As it is evident so far there are two studies have been conducted in the Malaysian context but those studies are not much comprehensive in nature. This current study will focus on all the banks of conventional and Islamic banks that operating in Malaysia. Hence, it will reduce this potential gap for literature.

3. Objectives of the Study

The overall objective of this study is to evaluate the performance of conventional and Islamic banks operating in Malaysia. The specific objectives of this study are: (i) to find out the performance of conventional banks in Malaysia as described by ROA; (ii) to find out the performance of Islamic banks in Malaysia as described by ROE; (iii) to find out the difference between conventional and Islamic banking institutions in Malaysia based on CAMELS rating ratios; (iv) to find out the net loan to total asset ratio for Islamic banks and (v) to find out the liquid asset to deposit ratio for Islamic banks.

4. Methodology

Since the study is about finding the performance of conventional and Islamic banks in Malaysian context, relevant theories have been consulted to come up with a model viewing of how actually bank performance is being affected by several dimensions.

For the study, it has been observed how the usage of the selected ratios describes about the performance of the banks in conventional and Islamic banking sector. There are several ratios to describe the performance of the companies. For this study, CAMELS rating along with some other ratios will be utilized to see the performance of the Islamic and Conventional banks.

CAMELS indicators which are the most widely-used technique for performance assessment in banking studies (Wirnkar and Tanko (2008); Sangmi and Nazir (2010); Agarwal and Sinha (2010); Beaver (1966); Maishanu (2004).

To measure bank performance, financial ratios have been commonly and extensively used in the literature (Samad and Hassan, 2000; Putnam, 1983; Akkas, 1996; Sabi, 1996; Samad, 1999; Saleh and Zeitun, 2006; Atikog'ulları, 2009). The CAMELS approach is the most widely used type of financial analysis utilized to assess the managerial and financial performance of banks, originally adopted by North American Bank Regulators in order to evaluate US commercial lending institutions in the early 1970s. The CAMELS rating system is based upon an evaluation of six critical elements of a financial institution's operations: Capital adequacy (C), Asset quality (A), Management adequacy (M), Earnings power (E), Liquidity (L) and Sensitivity to market risk (S). In order to see how participation banks have performed in comparison with the conventional banks over the years, the study employs financial ratios based on the CAMELS framework. The most commonly used ratios in CAMELS analysis along with the other ratios used are shown in the following table –

Ratio	Formula
ROA (Return on Asset)	Net profit after tax/ Total Assets
Capital adequacy	Total Equity/Total Assets
ROE (Return on Equity)	Net profit after tax/Total Equity
Asset Quality	Fixed Assets/ Total Assets
Management Adequacy	Total cost/Total Asset
Earnings Power	Total income/Total cost
Equity Multiplier	Total assets/Common equity
Asset utilization	Total income/Total assets
Net loan to Total Assets	Net loan/ Total assets

Liquid Asset to Deposit

Liquid Asset/Customers' Deposit

Table 2: Ratios

5. Data Collection

Broadly, there are two types of data namely primary and secondary data. The basic difference between them is how and where the data is collected. Primary data is the data that is collected for the first time. Secondary data stands for those data which has already been collected by another source for another purpose. For this study, secondary data is obtained through the access of the websites of the selected banks.

The data collected aim to make estimates of all the listed banks in Malaysia. However, there are too many banks to evaluate. Hence, a selected list of banks has been chosen from the listed banks. This sample is small enough to examine and its results, the sample statistics, estimate the population parameters (Kazmier, Staton, Fulks & Kazmier, 2003). The initial sample size was the 40 listed banks in Malaysia. As many of these banks are lacking most of the necessary information for analysis, the total sample size has been leveled down and made to 20. While collecting the sample, the following criteria have been followed-

- Complete data for the entire period have to available from 2008 to 2014.
- The firms have to be banking institutions listed under the Central Bank of Malaysia.
- The firms are listed under conventional and Islamic banking category.

The first criterion is basically straight forward. Those banks have only been chosen which have their whole period financial reports available. The sampling period is 2008 to 2014 for the selected banks.

6. Data Analysis and Interpretation

With the data for conventional and Islamic banks, ratio analysis and some statistical analysis have been performed. Microsoft Excel and IBM SPSS Statistics 21 have been utilized to perform the analysis.

There are two groups of samples used in this study. The sampling period have been set to be from 2008 to 2014 i.e. seven years of data. The sample one consists of banks involved conventional banking activities and the second one consists of banks involved in Islamic banking activities. Both of these two groups of samples consist of 10 banking institutions over 7-year period. Hence, the total amount of observation for this study is 20 multiplied by 7 i.e. 140.

6.1 Descriptive Statistics

The following table depicts the number of mean and standard deviation of each variable. Variables used in this study are ROA (Return on Assets), ROE (Return on Equity), capital adequacy, management adequacy, earnings power, equity multiplier, asset utilization, net loan to total assets, and liquid asset to deposit ratio etc.

Following is a table showing the descriptive statistics (mean and standard deviation) for the variables used for assessing the performance of the conventional banks.

Variables	Mean	Standard Deviation
ROA (Return on Assets)	.0175	.0272
ROE (Return on Equity)	.1193	.0621
Capital Adequacy	.2008	.2791
Management Adequacy	.0266	.0058
Earnings Power	8.650	27.4291
Equity Multiplier	139.0482	183.7055
Net loan to Total Assets	2.1087	2.8708
Liquid Asset to Deposit	.1764	.1126
Asset Quality	.9956	.0777
Asset Utilization	.0204	.0165

Table 3: Descriptive Statistics for Conventional Banks

From the above table, the mean value for ROA is .0175. The mean value of ROA indicates that the firms in the sample are utilizing their resources well. The standard deviation is .0271, which suggests that the data is minimally distributed away from the mean value. The mean value for ROE is .1193. These suggest that most firms experience moderate performance in profitability. The standard deviation is recorded at .0621 indicating that the distribution of data is only minimally dispersed and tend to concentrate near to the mean value. The mean value for Capital Adequacy is .2008 which is referring capital adequacy ratio is lower for most firms. While the standard deviation for capital adequacy is .2791 meaning that the distribution of data is dispersed minimally. Management Adequacy records a mean value of .01233. Only a small dispersion is seen from the data, as the standard deviation is small at .0058 points. Earnings power shows a mean value of 8.650. The standard deviation is very large reported at 27.2491. The mean value for equity multiplier is 139.0482. The standard deviation is reported at 183.7055 which is dispersed widely from the major values. For Net loan to total assets ratio, the mean value is

2.1087. The standard deviation is 2.8708 meaning the most values are moderately dispersed from the mean value. The mean for liquid asset to deposit is .17644. The standard deviation is .1126 meaning the values are not dispersed widely.

The mean value for asset quality is .8704. The standard deviation for asset quality is .0777 meaning the dispersion of data from the mean value is quite small.

Finally, the mean value for asset utilization is .0204. The standard deviation for asset utilization is .0165 meaning there is quite small dispersion among the data sets.

Similar analysis has been done for Islamic banks as well. Following table shows the descriptive statistics for Islamic banks –

Variables	Mean	Standard Deviation
ROA (Return on Assets)	.0056	.0081
ROE (Return on Equity)	.0893	.0928
Capital Adequacy	.1387	.2015
Management Adequacy	.0077	.0033
Earnings Power	4.2981	4.5314
Equity Multiplier	67.9987	148.5371
Net loan to Total Assets	.3064	.1911
Liquid Asset to Deposit	.3111	.2653
Asset Utilization	.0270	.0145
Asset Quality	.7963	.1439

Table 4: Descriptive Statistics for Islamic Banks

From the above table, the mean value for ROA is .0056. The mean value of ROA indicates that the firms in the sample are utilizing their resources well. The standard deviation is .0081, which suggests that the data is minimally distributed away from the mean value. The mean value for ROE is .0893. These suggest that most firms experience moderate performance in profitability. The standard deviation is recorded at .0928 indicating that the distribution of data is only minimally dispersed and tend to concentrate near to the mean value. The mean value for Capital Adequacy is 4.2981. While the standard deviation for capital adequacy is .2015 meaning that the distribution of data is dispersed minimally. Management Adequacy records a mean value of .0077. Only a small dispersion is seen from the data, as the standard deviation is small at .0033 points. Earnings power shows a mean value of 4.2981. The standard deviation is reported at 4.5314 meaning the data are moderately dispersed from the mean value. The mean value for equity multiplier is 67.9987. The standard deviation is reported at 148.5371 which is dispersed widely from the major values. For Net loan to total assets ratio, the mean value is .3064. The standard deviation is .1911 meaning the most values are lowly dispersed from the mean value. The mean for liquid asset to deposit is .3111. The standard deviation is .2653 meaning the values are not dispersed widely. The mean value for asset quality is .7963. The standard deviation for asset quality is .1439 meaning the dispersion of data from the mean value is quite small. Finally, the mean value for asset utilization is .0270. The standard deviation for asset utilization is .0145 meaning there is quite small dispersion among the data sets.

6.2 Test of Significance

In order to see whether the ratios selected is of significance to this study, one sample t test has been conducted. The result of such analysis is shown in the table.

Ratio	t	Sig. (2-tailed)
ROA	5.795	.000
ROE	8.049	.000
Capital Adequacy	5.759	.000
Asset Quality	46.282	.000
Management Adequacy	19.189	.000
Earnings Power	7.936	.000
Equity Multiplier	3.830	.000
Asset Utilization	15.522	.000
Net loan to Total Assets	13.409	.000
Liquid Asset to Deposit Ratio	9.809	.000

Table 5: Test of Significance of the Ratios

From the above table, it is evident that although the ratios have different t values but the p values at 95% confidence interval is same across all the ratios i.e. .000

The rule is to accept the p value as significantly it is less than 0.05. Since here the p value is .000 which is lesser than 0.05 hence the ratios are significant in describing the performance of the conventional banks.

Doing the same thing for Islamic banks has revealed the following-

Ratio	T	Sig. (2-tailed)
ROA	5.795	.000
ROE	8.049	.000
Capital Adequacy	5.759	.000
Asset Quality	46.282	.000
Management Adequacy	19.189	.000
Earnings Power	7.936	.000
Equity Multiplier	3.830	.000
Asset Utilization	15.522	.000
Net loan to Total Assets	13.409	.000
Liquid Asset to Deposit Ratio	9.809	.000

Table 6: Test of Significance of the Ratios

From the above table, it is evident that there are differences in the values of t but the value of significance is .000. The p value is .000 which less than 0.05 and it implies that the ratios used are significantly determining the performance of the Islamic banks.

6.3 Summary of Ratios

Following is a table showing mean and standard deviation value for conventional and Islamic banks are per ratios –

Ratios	Conventional Banks		Islamic Banks		Comparison
	Mean	Std.	Mean	Std.	
ROA	.0175056	.02724685	.00561	.00811	Mean value ROA (conv.) > Mean value ROE (Islamic).
ROE	.1193690	.06219050	.08932	.09285	Mean value ROE (conv.) > Mean value ROE (Islamic).
Capital Adequacy	.2008331	.27912447	.13876	.20159	CA (conv.) > CA (Islamic).
Asset Quality	.8704443	.07776234	.79630	.14395	AQ (conv.) > AQ (Islamic).
Management Adequacy	.0123359	.00586641	.00776	.00338	MA (conv.) > MA (Islamic).
Earnings Power	8.6505797	27.42911963	4.29811	4.53148	EP (conv.) > EP (Islamic)
Equity Multiplier	139.0482253	183.70554783	148.53712	22063.27	EM (conv.) < EM (Islamic)
Asset Utilization	.0204469	.01658082	.02704110	.014575537	AU (conv.) < AU (Islamic)
Net loan to Total Assets	2.1087720	2.87085031	.3064159	.19118457	NLTA (conv.) > NLTA (Islamic)
Liquid Asset to Deposit Ratio	.1764493	.11263019	.3111330	.26538701	LADR (Conv.) < LADR (Islamic)

Table 7: Mean and Standard Deviation of the Ratios for Conventional and Islamic Banks

From the above table as it is evident that out of the ten ratios used in this study, conventional banks in Malaysia are performing better in terms of ROA, ROE, CA, AQ, MA, EP, and NLTA. For the rest three ratios, Islamic banks are having more values compared with listed conventional banks in Malaysia. Overall it can be said that conventional banks are performing better since there are seven ratios out of the ten ratios.

7. Conclusion

As the world takes on a new shape, businesses grow up. And this growing number of businesses needs a lot of financial backup to survive in this hyper-competitive economy. As a result of this, the importance of banks is on increase.

Around the world, two different steams of banks prevalent. One is the conventional bank and the last one is the Islamic banks. Both of these banks operate on different settings even though they are involved in the business of banking. As a result of this, there happens to be a lot of differences in these two different types of banks. Having financial performance difference is one of them. Therefore, this study aims to investigate the financial performance of conventional and Islamic banks listed in Malaysia. Several notable ratios have been utilized in order to gauge the performance of the conventional and Islamic banks in Malaysia and finally to see which category of bank performs better than the others. The results obtained have suggested that out of the ten ratios, conventional banks are performing better than Islamic banks in terms of the seven ratios.

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