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Evaluating the Financial Performance of Leading Islamic Banks of Pakistan: An Intra Bank Comparison

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Abstract:

This research was conducted to observe the financial performance of leading Islamic banks working in Pakistan. This study specifically designed to facilitate the all stakeholders of Islamic banks including country heads of Islamic banks, branch managers, shareholders, creditors, investors, and regulatory bodies. Sample size consists of five leading Islamic Banks of Pakistan including Meezan Bank, Bank Islami, Burj Bank, Dubai Islami Bank and Albarka Bank. Financial statements of all leading mentioned Islamic banks

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from the period from 2010 to 2014 were used for data collection. Total nine financial ratios with reference to profitability, liquidity and risk & solvency were used to observe the financial performance leading Islamic banks of Pakistan. For calculation of ratios average of five year data used. For further analysis mean values of three profitability ratio, liquidity ratio and risk & solvency was calculated. Results of means value indicated that Meezan Bank dominated on all mentioned bank with respect to profitability, Albarka Bank dominated with respect to liquidity whereas with reference to risk and solvency Dubai Islami Bank dominated on all leading mentioned Islamic Banks of Pakistan.

Key words: Ratio Analysis, Profitability, Liquidity, Risk & Solvency.

INTRODUCTION

Core objectives of this study is to analyze the financial performance of all core leading Islamic banks which are working in Pakistan including Meezan Bank, Bank Islami, Burj Bank, Dubai Islami Bank and Albarka Bank. This piece of work will also be fruitful for all the stakeholders of mentioned banks especially for investors, managers, shareholders, customers and all the regulatory bodies working in Pakistan. This research will also be a source of information while taking decision regarding making investment, taking loan, depositing cash, career development decision and opening various types of accounts. One of the most common methods used to access the financial performance of banking sectors is the ratio analysis, for this data collected from the financial statements of all leading Islamic Banks working in Pakistan. According to Samad & Hassan (2000) one of the common indicators used for intra and inters banking performance analysis is the ratio technique. Financial performance of all mentioned leading Islamic banks was observed in this study with reference to their profitability, liquidity and risk & solvency.

Profitability Ratios:

One of the most common types of ratio that is used to analyze the financial performance of company is the profitability ratio. Profitability ratio further divided into different types including return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER) to observe the different dimension of profitability. Return on assets (ROE) indicates value of return against the value of assets after deducting the all direct and indirect expenses (Van Horne, 2005). Return on assets (ROA) can also be defined as how much company get back against the value of money invested in assets. Higher the values of return on assets indicate the higher performance of it's with reference to its efficiency whereas lower the value of return on assets showed lower efficiency of assets. According to Van Horne (2005) return on assets can be calculate by using the stated formula (ROA = Net profit after tax / Total assets). Another dimension regarding to analyze the profitability is the return on equity (ROE). Return on equity (ROE) refers as the value of return against the value of each dollar invested in equity (Van Horne, 2005).

Return on equity (ROE) normally used to analyze the managerial performance of organization (Sabi, 1996). Higher managerial performance associated with the value of return on equity (ROE) as higher the value of return on equity (ROE) leads to better managerial performance with reference to the utilization of equity capital whereas lower the value of return on equity (ROE) indicate the worst managerial performance with reference to equity utilization. According to Sabi (1996) return on equity (ROE) can be calculated by using the stated formula (ROE = Net profit after tax / Shareholder equity). Capacity of firms to pay their operating expenses can be accessed by using the profit to expense ratio (PER). Higher the value of profit to expense ratio (PER) indicates that company having excess cash to pay the operating expenses whereas lower the value of profit to expense ratio (PER) shows that

company not have enough money to pay the operating expenses. According to Samad & Hassan (2000) profit to expense ratio (PER) can be calculated by using the formula mention here (PER = Profit before tax / Operating expenses).

Liquidity Ratios:

Capacity regarding payment of liabilities is called liquidity. In this study to observe the liquidity position liquidity ratios was divided into three categories including total financing to deposit ratio (LDR), current ratio (CR) and current assets ratio (CAR).Loan to deposit ratio (LDR) us used to measures the liquidity position of banks. Higher the value of loan to deposit ratio (LDR) indicate the worst the liquidity position and more financial pain and stress by sanctioning more loan as compare to the deposit whereas lower the value of loan to deposit ratio (LDR) leads to strong liquidity position of banks as well. Loan to deposit ratio (LDR) can be calculated by using the stated formula LDR = Total loan / Total deposit. Current ratio is another important ratio used to observe the liquidity position of banks.

Strongest liquidity position associated with the higher value of current ratio (CR) whereas the worst liquidity position linked with the lower the value of current ratio (CR). Current ratio (CR) can be calculated by using the mentioned formula including CR = Cash & accounts with bank / Total Deposit. Portion of current assets against the value of total assets is called current assets ratio (CAR). Better liquidity position is associated with the higher the value of current assets ratio (CAR) and vice versa. Current assets ratio (CAR) can be calculated by CAR = Current assets / Total assets. According to Hassan & Bashir (2003) liquidity position bank can be observed by using the loan to deposit ratio (LDR), current ratio (CR) and current assets ratio (CAR).

Risk & Solvency Ratios:

Risk and solvency refer as the riskiness of the organization. Risk and solvency position can be measured by using the debt to equity ratio (DER), debt to assets ratio (DTAR) and equity multiplier (EM). Debt position of banking sector can be observed through debt to equity ratio (DER). This ratio used to observe the risk and solvency of Islamic banks. Banks considered more risky if its value of debt to equity ratio is higher whereas lower the value of debt to equity ratio (DER) leads to less riskiness. Debt to equity ratio can be accessed by using the mentioned formula DER = Total debt / Shareholder equity. Debt to total assets ratio (DTAR) referred as the percentage of debt against the value of total assets.

The banks considered is more risky if the value of debt to total assets ratio (DTAR) is high whereas banks considered less risky if the value of debts to total assets ratio (DTAR) is less. Debt to total assets ratio can be calculated by using the formula stated herewith DTAR = Total debt / Total assets. Equity multiplier (EM) indicated the relationship between the shareholder equity and total assets it's indicate how many times the total assets are of the shareholder equity. Positive association was observed between the equity multiplier (EM) and risk & solvency. If the value of equity multiplier (EM) is greater it leads to greater the risk whereas lower the value of equity multiplier (EM) leads to less riskiness banks. Equity multiplier can be find out by using the formula stated including EM = Total assets / Shareholder equity.

LITERATURE REVIEW

According to Iqbal (2001) profitability ratios including return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER) can be used to made a comparison between the conventional banks and Islamic banks. Samad & Hassan (199) analyze to explore the risk and solvency position of

conventional banks and Islamic banks. For this analysis the different ratio used in this study including debt to equity ratio (DER), debt to total assets ratio (DTAR) and equity multiplier (EM). As discussed by the Samad (2004) financial comparison of conventional banks and Islamic banks can be observed by using the different types of ratio. Three types of ratio were used in this study to observe the financial performance including profitability ratio (return on assets, return on equity and profit to expense ratio). Second types of ratio used to observe the liquidity ratio including liquidity ratio (loan to deposit ratio, current ratio and current assets ratio whereas third types of ratio used in this study is the risk and solvency ratio (Debt to equity ratio, debt to total assets ratio and equity multiplier).

According to Tihomir (2001) profitability analysis of conventional banks and Islamic banks can made by using the different types of profitability ratio including return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER). According to Moin (2008) comparative financial analysis between the Islamic banks and conventional banks can be accessed by using the ratio analysis techniques with reference to profitability, liquidity and risk & solvency. Metwally (1997) used the different types of ratio including profitability ratio, liquidity ratio, leverage, market ratio and risk & solvency ratio to observed the financial achievements of 15 interest free microfinance banks and 15 others conventional banks. According to the study conducted by Iqball (2001) profitability of conventional and Islamic banks can be observed by suing the profitability ratio, liquidity position of conventional and Islamic banks can be observed by using the liquidity ratio whereas the risk and solvency ratios can be used as decision criteria to measure the risk and solvency position of conventional and Islamci Banks. The above mentioned all ratios can also be used for Bank analysis and time series analysis.

According to Moin (2008), Sammad (2004) and Hassan (1999) observed the risk and solvency position of conventional

banks and Islamic banks by using the debt to equity ratio (DER), debt to total assets ratio (DTAR) and loan to deposit ratio (LDR). Debt to assets ratio indicates the strong position with reference to payment made to the debtor. Lower the value of risk and solvency ratio indicates the lower risk whereas higher the value of risk and solvency ratio indicates the higher risk as well. According to Awan (2009) different types of ratios including profitability, growth, efficiency, liquidity, solvency and market can be used to observe the financial performance of conventional and Islamic banks. Result of the study can be used for financial decision especially with reference to merger, acquisition and dissolution. As discussed by the Javaid, Anwar and Zaman (2011) elements of profit and loss account, balance sheet, retain earning statement and cash flow statement can be used for profitability analysis. Profitability analysis through ratio analysis explains the internal factors which are controllable for organization.

According to the study of Javed et al (2011) profitability ratio one of the most important types of ratio that is used to make a comparison between the conventional banks and Islamic banks. Profitability ratio including return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER) are the one of the key indicators used by various conventional and Islamic banks to observe their overall performance and efficiency. Return on assets (ROA) especially used for comparative analysis between conventional banks and Islamic banks. According to the study conducted by Gul, Irshad and Zaman (2011) return on equity (ROE) used to measure the efficiency of its equity dividing net profit on equity. Return on equity is an important element with reference to investors and shareholders. Profit against every rupees invested by the shareholder can be observed by using the return on equity ratio (ROE). Higher the value of return on equity (ROE) indicated that banks using its capital more effectively and efficiency.

As discussed by the Hempel and Simonson (1998) by making the comparison between the conventional banks, Islamic banks and micro-finance banks ratio analysis techniques used as the disparities in term of sizes with reference to financial strength can be removed. According to the study conducted by Flaming et al. (2009) financial performance of conventional banks, Islamic banks and micro-finance banks can be observed with special reference to efficiency of assets by using the return on assets (ROA) ratio. As discussed by the Alexandru et al. (2008) profitability of conventional banks and Islamic banks can be observed with reference to its assets efficiency, equity efficiency and availability of profit to meet the expense by using the return on assets ratio (ROA), return on equity ratio (ROE) and Profit to expense ratio (PER) respectively.

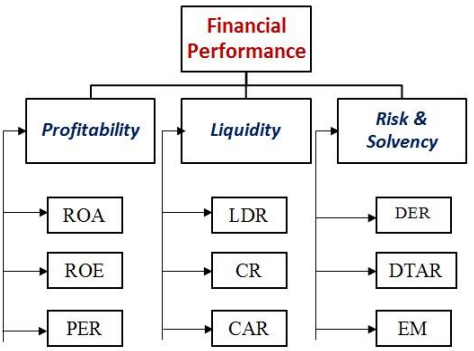
According to the Khrawish (2001) return against the every unit of money invested by the investors and shareholders in equity can be accessed by using the return to equity ratio (ROE). Another widely useable ration to access the amount of input against the value of each unit invested in assets observed by using the return on assets ratio (ROA). According to the study conducted by Moin (2008) financial analysis of conventional banks, Islamic banks and microfinance with reference to profitability, liquidity and solvency can be observed by using the different types of ratio. Profitability can be measured by using the profitability ratio like return on assets, return on equity and profit to expense ratio. Liquidity of all types of banks can be observed by using the loan to deposit ratio, current ratio and current assets ratio. Risk and solvency can be accessed through debt to equity ratio, debt to total assets ratio and equity multiplier.

METHODOLOGY

Ratio analysis techniques widely used for inter banks and intra banks comparison. According to the study of Lader and

Asarpota (2007) ratio analysis techniques can be used for inter banks and intra banks comparison. This study was conducted to make an intra comparison of all leading Islamic banks working in Pakistan. In this study intra banks comparison of all leading Islamic banks was conducted by using the various types of ratio with reference to profitability, liquidity and risk & solvency. According to the study conducted by Samad & Hassan (2000) inter banks and intra banks financial performance of conventional and Islamic banks can be observed by using the various types of financial ratio including Profitability ratio (return on assets ratio, return on equity ratio and profit to expense ratio) liquidity ratio (loan to deposit ratio, current ratio and current assets ratio) and risk & solvency ratio (debt to equity ratio, debt to total assets ratio and equity multiplier).

THEORETICAL FRAMEWORK:



OBJECTIVES OF THE STUDY:

This study helps in channelizing resources in future regarding deposit, finances, investment & others banking resources. However the key objectives of the study are given as under.

- Which of the Islamic bank is more profitable?
- Whish of the Islamic bank is more liquid?

- Which of the Islamic bank is less risky?

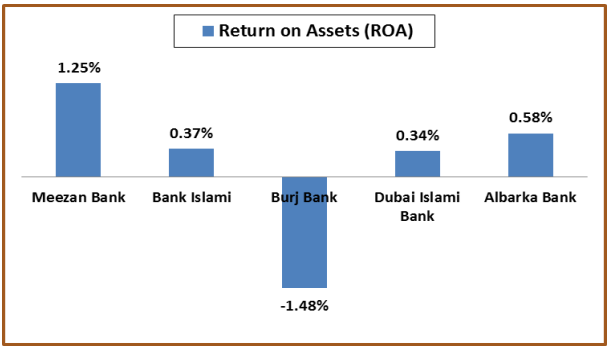
SAMPLE OF THE STUDY:

1	Meezan Bank	***Data from 2010 to 2014 used for ratio analysis***
2	Bank Islami	
3	Burj Bank	
4	Dubai Islami Bank	
5	Albarka Bank	

FINDING AND CONCLUSION:

Return on Assets (ROA):

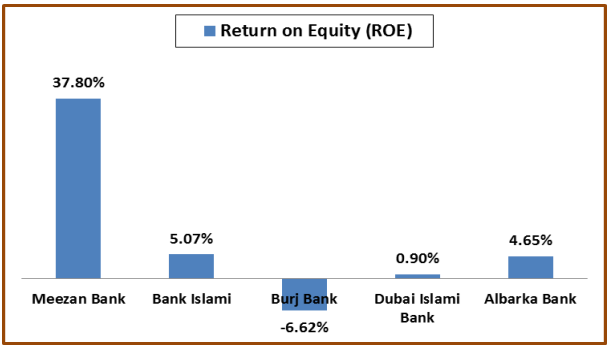
Return on assets (ROA) indicate the percentage on input against the value of money invested in assets. Following results indicate that Meezan Bank secured Rs. 1.25 profit by against Rs. 100 invested in assets whereas Bank Islami get Rs. 0.37, Dubai Islami Bank Rs. 0.34 and whereas Albarka Bank secured Rs. 0.58 against the value of Rs. 100 invested in assets. Burj Bank failed to used its assets more efficiently as its input against the value of assets is negative it means Rs. 1.48 against the value of Rs. 100 assets invested in total assets.



Return on Equity (ROE):

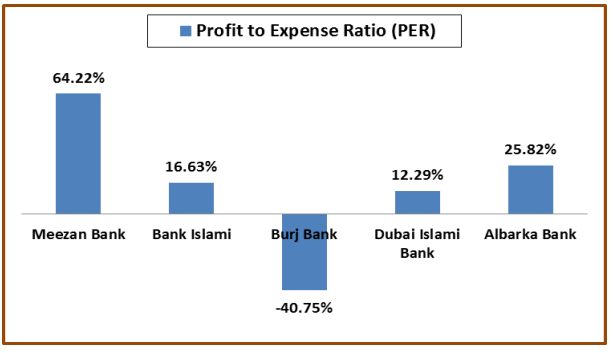
Value of input against the value of amount invested in equity is referred return on equity (ROE). The following results indicated that Meezan Bank can secure Rs. 37.80 by investing Rs. 100 in

equity, Bank Islami can get Rs. 5.07, Dubai Islami Rs. 0.90 and Albark Bank can secure Rs. 4.65 against the value Rs. 100 invested in equity. Burj Bank failed to use its equity more effectively and efficiently as compare to others mentioned banks as input of Burj Bank was negative Rs. 6.62.



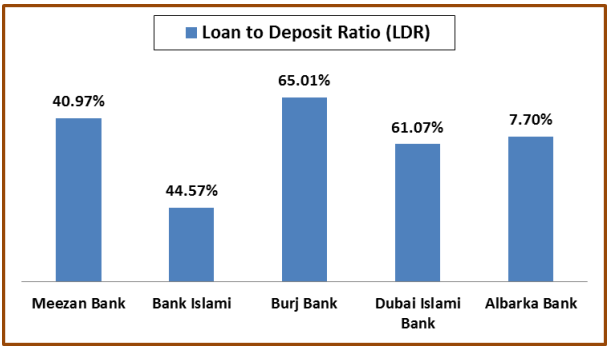
Profit to Expense Ratio (PER):

Profit to expense ratio (PER) referred to as availability of operating profit against the value of operating expense. With reference to cost efficiency higher the value of price to expense ratio (PER) indicate the higher performance and vice versa. Following results indicate that Meezan bank has Rs. 64.22 rupees to pay Rs. 100 operating expense whereas Bank Islami has Rs. 16.63; Dubai Islami bank has Rs. 12.29 and Albarka bank having Rs. 25.82 to pay the operating expense Rs. 100. Burj bank unable to pay their operating expense as its profit to expense ratio is -40.75%.



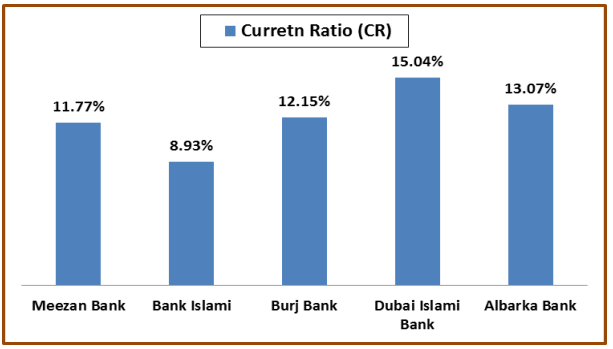
Loan to Deposit Ratio (LDR): liquidity

One of the important indicators to observe the liquidity position of banks is the loan to deposit ratio (LDR). Loan to deposit ratio (LDR) indicate that amount of loan against the value of deposit. Higher the value of loan to deposit ratio (LDR) indicating that bank having more financial pain and stress. However higher the value of loan to deposit ratio (LDR) indicating less liquidity and vice versa. The following results indicate that Meezan bank sanction loan Rs.109.90, Bank Islami Rs. 106.13, Burj Bank Rs.110.76, Dubai Islami Bank Rs. 108.80 and Albarka Bank Rs. 109.11 against the value of deposit Rs. 100. So according to the following results Bank Islami liquidity position with reference to loan to deposit ratio is better than all other banks.



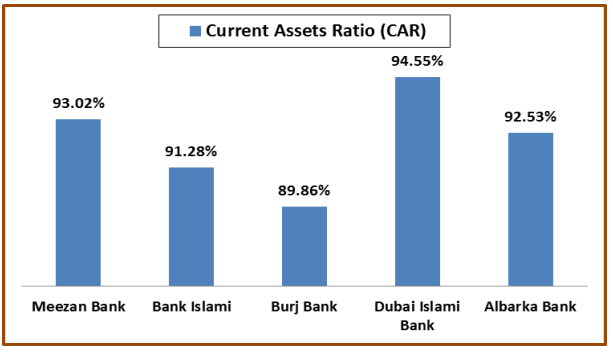
Current Ratio (CR):

Current ratio (CR) is also an important indicator to observe the liquidity position of banks besides this current ratio (CR) also indicate the confidence of customer on their respective banks with reference to the sake of investment made by the banks through their deposit. Higher the value of current ratio (CR) indicate the higher the liquidity position and vice versa. The following results indicate that Meezan Bank invested Rs. 11.77, Bank Islami Rs. 8.93, Burj Bank Rs. 12.15, Dubai Islami Bank Rs. 15.04 and Albarka Bank Rs. 13.07 against the value of total deposit Rs. 100.



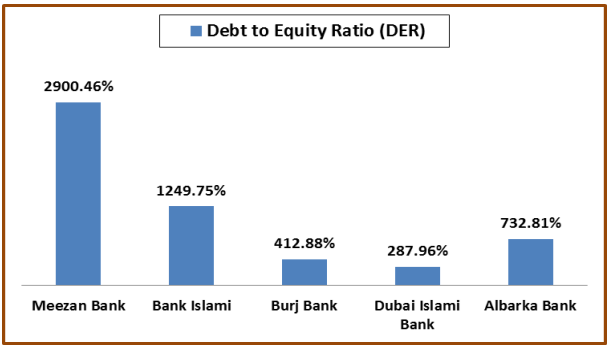
Current Assets Ratio (CAR):

Current assets ratio (CAR) is another important indicator to observe the liquidity position of banks as it indicates the percentage of current assets against the value of total assets. Higher the liquidity position of banks associated with the higher value of current assets ratio (CAR). Following results indicate that Meezan Bank having value of Rs. 93.02 current assets, Bank Islami Rs. 91.28, Burj Bank Rs. 89.86, Dubai Islami Bank Rs. 94.55 and Albarka Bank Rs. 92.53 current assets against the value of total assets Rs. 100. According to the following results liquidity position of Dubai Islami Bank has better position with reference to availability of current assets than the all other banks.



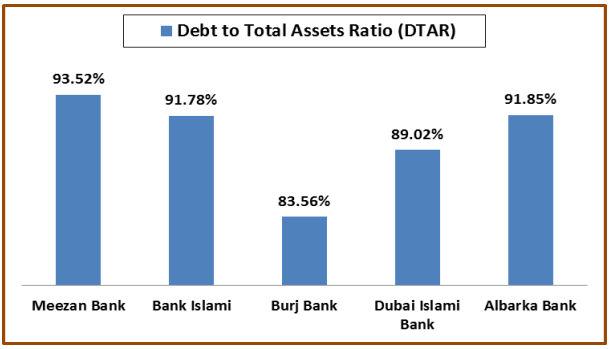
Debt Equity Ratio (DER):

Debt to equity ratio (DER) is an important indicator that is used to observe the risk and solvency position of banking sector. Debt to equity ratio (DER) indicates the value of debt against the value of shareholder equity. Higher the value debt to equity ratio associated with the highly risk and lower the value of debt to equity ratio (DER) indicate the lower risk. Following results indicate that Meezan Bank having Rs. 2900.46 debt, Bank Islami Rs. 1249.75 debt, Burj Bank Rs. 412.88 debt, Dubai Islami Bank Rs. 287.96 debt and Albark Bank Rs. 732.81 debt against the value of Rs. 100 shareholder equity.



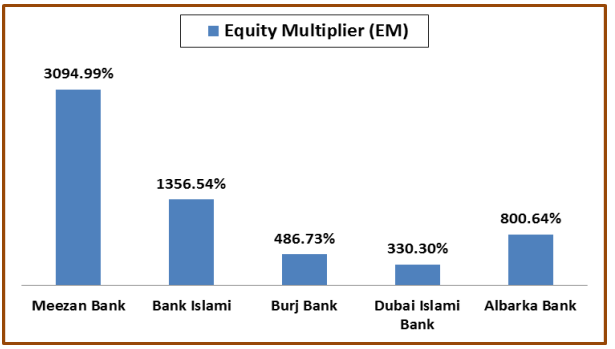
Debt to Total Assets Ratio (DTAR):

Another important indicator used to observe the solvency position of the Islamic Banks is called debt to total asset ratio (DTAR). Debt to total assets ratio (DTAR) indicate the value of debt used to finance the total assets. Higher the value of debt to total assets ratio (DTAR) indicate the highly risk whereas lower the value of debt to total assets ratio (DTAR) indicate the lower risk. According to the following results portion of debt against the value of total assets of Meezan Bank Rs. 93.52, Bank Islami Rs. 91.78, Burj Bank Rs. 83.56, Dubai Islami Bank Rs. 89.02 and Albarka Bank Rs. 91.85 against the value of total assets Rs. 100.



Equity Multiplier (EM):

Equity Multiplier (EM) indicating that how many times the total assets are of the shareholder equity. It showing amount of assets per rupees of shareholders equity. Lower the value of EM indicates the lower risk and higher the value of EM indicating the more risk. The following results indicating that total assets of Mezaan Bank are Rs. 3094.99, Bank Islami Rs. 1365.54, Burj Bank Rs. 486.73, Dubai Islami Bank Rs. 330.30 and Albarka Bank Rs. 800.64 are the shareholder equity of Rs. 100.



CONCLUSION:

The following results indicated that with respect to return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER) Meezan Bank dominated on all leading Islamic Banks working in Pakistan however according to the means of profitability Meezan Bank also dominated on all leading

Islamic Banks working in Pakistan. Dubai Islami Bank dominated with respect to current Ratio (CR) and current assets ratio (CAR), whereas Albarka bank dominating on all leading Islamic Banks with respect to loan to deposit ratio (LDR) however the overall liquidity position of Albarka Bank is better than all others leading Islamic Banks working in Pakistan. Dubai Islami Bank dominating with respect to debt to equity ratio (DER) and equity multiplier (EM) whereas with respect to debt to total assets ratio (DTAR) Burj Bank dominating, however with respect to overall risk and solvency Dubail Islami Bank dominating on all leadings Islamic Banks working in Pakistan.

RATIO	*Mezan Bank*	*Bank Islami*	*Burj Bank*	*Dubai Islami*	*Albarka Bank*	*Remarks*
ROA	1.25	0.37	-1.48	0.34	0.58	***Meezan Bank dominating on all Islamic Banks with respect to profitability***
ROE	37.80	5.07	-6.62	0.90	4.65	
PER	64.22	16.63	-40.75	12.29	25.82	
Mean	**34.42**	**7.36**	**-16.28**	**4.51**	**10.35**	
CR	11.77	8.93	12.15	15.04	13.07	***Albarka Bank dominating on all Islamic Banks with respect to Liquidity***
CAR	93.02	91.28	89.86	94.55	92.53	
LDR	(40.97)	(44.57)	(65.01)	(61.07)	(7.70)	
Mean	**63.82**	**55.64**	**37.00**	**48.52**	**97.90**	
DER	2900.46	1249.75	412.88	287.96	732.81	***Dubai Islami Bank dominating on all Islamic Banks with respect to risk & solvency***
DTAR	93.52	91.78	83.56	89.02	91.85	
EM	3094.99	1356.54	486.73	330.30	800.64	
Mean	**2029.66**	**899.36**	**327.73**	**235.67**	**541.77**	

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