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Profitability and liquidity of conventional banking and Islamic banking in Bangladesh: A comparative study

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Abstract
Islamic banking is the system of banking consistent with principles of Islamic law (Shari'ah) and guided by Islamic economics. Islamic banking, the more general term is expected not only to avoid interest based transactions, prohibited in the Islamic Shari'ah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy. On the other hand, conventional banks are operating on the man-made principles where the predetermined rate of interest is the core activity. This research study analyses the performance of Islamic banks versus conventional banks in Bangladesh over the period of 2013-2014. The objectives of this research work is to compares the profitability and liquidity of Islamic banks to conventional banks in Bangladesh. The study includes as profitability ratios: Return on average assets (ROAA), Return on average equity (ROAE), and Profit expense ratio (PEM). Also includes as liquidity ratios: Current Ratio (CR), Current Asset Ratio (CAR), Loan Deposit Ratio (LDR) and Net Loan/ Total Asset Ratio (NLTA).The results of the study indicate that Islamic banks in Bangladesh have better financial performance than Conventional banks. Performance of interest-free Islamic banks in business development, profitability, liquidity and solvency is superior to that of interest-based conventional bank. That is comparatively Islamic banks are superior in financial performance to that of interest-based conventional banks.

Keywords: Profitability, liquidity, conventional banking, Islamic banking, Bangladesh

Introduction

Bangladesh is a developing country in South Asia. Economical strength of the country is increasing day by day. In the country there are lots of private commercial banks working under central bank, Bangladesh Bank. Those commercial banks are operating all over the country with a large number of branches. Private Banks is the highest growth sector due to the dismal performances of government banks. They tend to offer better service and products**.** After the independence, banking industry in Bangladesh started its journey with 6 nationalized commercialized banks, 2 State owned specialized banks and 3 Foreign Banks. In the 1980's banking industry achieved significant expansion with the entrance of private banks. Now, there are 56 scheduled banks in Bangladesh who operate under full control and supervision of Bangladesh Bank which is empowered to do so through Bangladesh Bank Order, 1972 and Bank Company Act, 1991. Scheduled Banks are classified into following types: (a) State Owned Commercial Banks (SOCBs): There are 4 SOCBs which are fully or majorly owned by the Government of Bangladesh. (b) Specialized Banks (SDBs): 4 specialized banks are now operating which were established for specific objectives like agricultural or industrial development. These banks are also fully or majorly owned by the Government of Bangladesh. (c) Private Commercial Banks (PCBs): There are 39 private commercial banks which are majorly owned by the private entities. PCBs can be categorized into three groups: Conventional PCBs: 31 conventional PCBs are now operating in the industry. They perform the banking functions in conventional fashion i.e interest based operations. Islamic Shariah based PCBs: There are 8 Islami Shariah based PCBs in Bangladesh and they execute banking activities according to Islami Shariah based principles i.e. Profit-Loss Sharing (PLS) mode. Foreign Commercial Banks (FCBs): 9 FCBs are operating in Bangladesh as the branches of the banks which are incorporated in abroad.

There are now 4 non-scheduled banks in Bangladesh which are: Ansar VDP Unnayan Bank,_Karmashangosthan Bank, Probashi Kallyan Bank,_Jubilee Bank. The competitiveness of Islamic banks with the conventional bank gives the initiative to compare the profitability and liquidity between these two extreme systems of banking. The purpose of this paper is to investigate which type of banking is more profitable and what are the possible reasons for superiority for the particular type. Today's modern banks are not only providing traditional banking but also expanding the many financial services. In today's world the life of the people directly or indirectly are within the arena of banking whether conventional or Islamic banking. Although Islamic banking is not a newer concept in Bangladesh as it has started its operation since 1983, very few people are aware about its operation. But things are changing. Islamic Banking is also getting popularity in the country which is the main focal point in this research shown the differences between Profitability and Liquidity of Conventional Banking and Islamic Banking in Bangladesh**.**

Review of Literature

Ibrahim *et al*. (2014) [3] have used financial data obtained from the annual reports of the sample banks the study has evaluated the performance of six Islamic banks listed at both Dhaka Stock Exchange and Chittagong Stock Exchange. Their objectives were to evaluate the performance of these banks, and to make a comparison among different Islamic banks from different variables. The results show that some banks are better off than others using different ratios. The overall performance of all Islamic banks is satisfactory. The researchers believe that the future of Islamic banking system in Bangladesh is very bright. But for exploring the market opportunity the Islamic banks must develop market driven strategy.

Islam, Alam & Hossain (2014) conducted a research work on 'Examination of Profitability between Islamic Banks and Conventional Banks in Bangladesh: A Comparative Study'. The aim of this research work is to compares the profitability of Islamic banks to conventional banks in Bangladesh. It considers reasons behind the difference in profitability. Profitability ratios: return on assets and return on equity is used to find out the superiority in terms of profitability between the two types of banks. The study includes 2nd Generation banks and annual reports for the year 2009-2011is used. The results of the study indicate that conventional banking is more profitable in Bangladesh. Adoption of certain business policies and modes of operation are the reasons behind the difference in terms of profitability as found through personal interviews conducted on bank executives from both spheres. The result of this study implies that even though Bangladesh is among the biggest Muslim community country in the world, the awareness of consuming Shariah compliance products and services are still low.

Paul *et al* (2013) stated that, to compute the financial ratios, Microsoft Excel has been used in order to materialize the objectives of evaluating and comparing the profitability and liquidity of Conventional banks as well as Islamic banks in Bangladesh. The objectives of the study are to evaluate, compare and comment on the profitability and liquidity of Conventional banks as well as Islamic banks in Bangladesh. The study found that Islamic Banks are less preferable than Conventional banks in the year 2008 and 2009 in all the profitability indicators. In 2010, Conventional banks had been more profitable than Islamic banks except ROE, PER. In 2011 and 2012, Islamic banks' profitability performance is better than that of Conventional banks in the performance indicators except EPS, Profit per Branch and Profit per Employee. However, there is no significant difference in liquidity between the two sets of banks.

Moin (2013) conducted a study on Financial Performance of Islamic Banking and Conventional Banking in Pakistan: A Comparative Study**.** The aim of this study is to examine and evaluate the performance of the first Islamic bank in Pakistan, i.e. Meezan Bank Limited (MBL) in comparison with a group of 5 Pakistani conventional banks. The study evaluates performance of the Islamic bank (MBL) in profitability, liquidity, risk and solvency, and efficiency for the period 2003-2007. The study found that MBL is less profitable, more solvent (less risky), and also less efficient comparing to the average of the 5 conventional banks.

Ali, Ali & khwaja (2013) done a Comparison of Islamic and Conventional Banking on the Basis of Riba and Services. The Research is conducted to find out the problems of Islamic Banking system that blocked the growth of Islamic Banks as compared to conventional Banking System. This study present the results of research carried out mainly with people who currently use conventional and Islamic banking and Islamic banking knowledge. In this research, they tried to highlight some of the problems that are causing problems for the growth of Islamic banking. The dependent variables in this research are changing in other Islamic banks, customer satisfaction. They selected a sample size of 150 banking client (male and female) and used descriptive and correlation analysis to analyze the relationship between customer satisfaction and Islamic Banking Services in Peshawar. The study is based on both secondary and primary data, 150 account holders of Islamic banking were selected who were the customers of conventional banking at the same time as well the data is secured through questionnaires, informal interviews. It consisting of both sources of data that is, secondary as well as primary. Difficulty in this observes is shortage of consciousness among the people concerning the Islamic Banking.

Zia-ur-Rehman (2011) analyzed and compared the performance of conventional and Islamic banking by using financial tools. They selected two banks each from Islamic and conventional sector and used bank level data from 2007-10. They have used ratios of liquidity, profitability, credit risk, earnings and assets activity to compare the performance of two types of banks. The study concluded that performances of Islamic banks are less effective due to inefficiency of management and enhanced operating cost.

Rayhan, Ahmed & Mondal (2011) conducted a research study named 'Performance Evaluation and Competitive Analysis of State Owned Commercial Banks in Bangladesh'. The broad objective of this study is Performance Evaluation and Competitive Analysis of state owned commercial banks in Bangladesh. The study reveals all the state owned commercial banks in Bangladesh are not able to achieve a stable growth, net profit, earning per Share, return on equity, return on assets, net asset value per share but they are capable to achieve a stable growth of deposit, loan and advances, equity. It is also observed that all the of state owned commercial banks have high non performing loan/classified loan and % of classified loan to total loan is very high.

Jamal (2011) conducted a research on Comparative Financial Performance of Islamic Banks And Conventional Banks in Kenya. The objective of the study was to compare the financial performance of Islamic banks and conventional banks in Kenya. Specifically, the research sought to establish if there is significant difference in the financial performance of the two banking categories. Various ratios measuring capital adequacy, asset quality, management efficiency, earnings quality and liquidity were analyzed and tested in this research. The study revealed that Conventional banks performed better than Islamic banks in terms of Capital adequacy, Asset quality, Management quality, Earnings and Liquidity position. However, except for Capital adequacy, there were no significant differences between the two banking categories in terms of Asset quality, Management quality, Earnings and Liquidity position.

Ika and Abdullah (2011) [17] conducted a comparative study of financial performance of Islamic banks and conventional banks in Indonesia. The paper compared and examined financial performance of Islamic banks against conventional banks before and after the enactment of Indonesia's Islamic Banking Act No. 21/2008.

Financial performance measures were expressed in terms of various financial ratios in which were categorized into profitability, liquidity, risk and solvency and efficiency. To test the hypotheses, Mann-Whitney was employed to compare financial performance of Islamic banks and conventional banks. In general, the study found no major difference in financial performance between Islamic banks and conventional banks, except in terms of its liquidity. This indicated that Islamic banks are generally more liquid as compared to conventional ones.

Ansar & Rehman (2010) conducted A comparative study to examine the performance of Islamic and Conventional banks in Pakistan found that Islamic banks in Pakistan have better financial performance than their Conventional counterparts. Profitability measures of performance of ROAA, ROAE and PEM do not show (statistically) significant difference between the performances of Islamic and Conventional banks and reject the hypothesis that Islamic banks are more profitable than Conventional banks. These finding support the hypothesis that Islamic banks are less risky than Conventional banks. Capital adequacy measures do not support the hypothesis that Islamic banks are well capitalized than conventional bank. They concluded from the overall research that Islamic banks are more liquid, less risky and operationally efficient than Conventional banks.

Gamaginta and Rokhim (2009) state that Islamic banking has grown rapidly both in size and number in many countries around the world (Sundararajan and Errico, 2002). Although the total assets of Islamic banks internationally are still very small compared to the whole world's total banking assets, its growth rate is phenomenal, especially in the Middle East and Southeast Asia (Karwowski, 2009). In some countries, Islamic banking and other forms of Islamic finance have become systemically important and in many cases they are considered as "too big to be ignored" (Hasan and Dridi, 2010). The results show that UUS have significantly higher level of stability compared with BUS but an important note is taken into account regarding the equity calculation of UUS that indicates a financial dependency from the holding conventional banks.

Majid, S. Saal & Battisti (2008) examining efficiency in Islamic and conventional banking: An international comparison. The paper investigates the efficiency of a sample of Islamic and conventional banks in 10 countries that operate Islamic banking for the period 1996 to 2002, using an output distance function approach. This study employs an output distance function to examine the efficiency and returns to scale of Islamic banks relative to conventional banks in countries that have Islamic banks, namely Malaysia, Sudan, Bangladesh, Tunisia, Jordan, Lebanon, Yemen, Indonesia, Bahrain and Iran for the period 1996-2002. We finally note that on average, the banks in each of the 10 sample countries exhibit moderate returns to scale. However, the average estimated returns to scale for conventional banks are lower than those for Islamic banks, with the exception of Malaysia and Jordan. However, while this result suggests that Islamic banks will benefit more from increased scale than conventional banks, the average scale economy estimate of 1.052 for all Islamic banks indicates that only moderate gains will be achieved even if Islamic banks strive to increase their scale size.

Alam (1995) states that, The article undertakes a case study on an Interest-Free Financial Institution in Bangladesh known as Islami Bank Bangladesh Limited (IBBL). The aim of the study was to see how Islamic banking activities differ from a conventional bank and also to see how Islamic banks may contribute to render financial services towards small and rural sector. By discussing various aspects of the IBBL, it is shown in detail how interest-free bank functions besides many established conventional banks in the country. To understand problems of the Islamic banking activities a case study method is used in the study. The main objective of using case study method is to find how an Islamic banks functions among other established conventional banks in the country. Hence, to realize the said objectives, apart from depth interview, participants' observation is also used in the study.

Objectives of the Study

The study was conducted in the following objectives:

1. To focus the attributes of Islamic banking system and Conventional banking system.
2. Show the comparison between the Conventional bank and Islamic banks.
3. To analyze the performance of Conventional and Islamic banks.
4. To keep some suggestions, findings and recommendations of Conventional and Islamic banks.

Methodology of the Study

The study is mainly based on the secondary data which has been collected from the published materials especially the annual reports of banks, internet, books and journals as well as working paper, magazines, newspaper and some others specialized books. For the research purpose 4 conventional banks and 4 Islamic banks have been taken and study period of the bank from 2013 to 2014. For the research purpose we take Dhaka Bank Ltd. Sonali Bank Ltd. AB Bank Ltd. And Agrani Bank Ltd.as conventional bank. and Islami Bank Bangladesh Ltd., EXIM Bank Ltd., Social Islami Bank Ltd, and Shahjalal Islami Bank Ltd as Islamic Bank. Convenience sampling was employed in this study.

Selected ratios

For the purpose of analysis we classify ratios into the following categories: (1) Profitability ratios (2) Liquidity ratios (3) Risk and solvency ratios (4) Capital Adequacy Ratios (5) Operational Ratios. These ratios used in the study are now identified and briefly discussed.

Profitability Ratios

Profitability ratios measure the managerial efficiency. These ratios use margin analysis and show the return on assets, deposits, investments, and equity. The higher profitability ratios are indicator of better performance. Sammad and Hassan (1999) [6] used three profitability ratios to evaluate the performance of Islamic bank Malaysia. These ratios were Return on average assets (ROAA), Return on average equity (ROAE), and Profit expense ratio (PEM).This study uses the same Profitability measure to analyze the performance of banks in Bangladesh.

Return on average assets (ROAA) = $\dfrac{\text{profit after tax}}{\text{average assets}}$

Return on average equity (ROAE) = $\dfrac{\text{profit after tax}}{\text{average equity}}$

Profit Expense Margin (PEM) = $\dfrac{\text{profit before tax}}{\text{operating expense}}$

Liquidity Ratios

Liquidity ratios measure the banks ability to meet its short-term obligations. Banks face liquidity problem due to excess withdrawal from current and saving account. There are several measures of liquidity. Iqbal (2001) used current ratio as liquidity measure. Samad & Hassan (1999) [6] used two more measures which include Loan/deposit ratio (LDR) and Current asset ratio (CAR) to evaluate the performance of Malaysian Islamic bank during 1984-1987. Hassan & Bashir (2003) also used Net loans/ total assets ratio as liquidity measurement indicator. Liquidity position of banks in Bangladesh is measured by using four above ratios.

Current Ratio (CR) = $\dfrac{\text{cash and account with banks}}{\text{Total deposits}}$

Current Asset Ratio (CAR) = $\dfrac{\text{current assets}}{\text{Total assets}}$

Loan Deposit Ratio (LDR) = $\dfrac{\text{Total Loans}}{\text{Total Deposits}}$

Net Loan/ Total Asset Ratio (NLTA) = $\dfrac{\text{Net Loans}}{\text{Total Assets}}$

Risk and Solvency Ratios

Solvency ratios give a picture of a bank's ability to generate cash flow and pay its long-term financial obligations. If the total value of bank assets is greater than its equity then the bank is solvent. Samad & Hassan (1999) [6] used three risks and solvency ratios in their study. These ratios included Debt equity ratio (DER), Debt to total asset ratio (DTAR) and Loan deposit ratio (LDR).This study uses the same hold to measure risk and solvency of banks in Bangladesh. The above mention ratios are calculated with the help of following formulas.

Debt Equity Ratio (DER) = $\dfrac{\text{Total Debts}}{\text{Shareholders Equity}}$

Debt to total asset ratio (DTAR) = $\dfrac{\text{Total Debts}}{\text{Total Assets}}$

Loan Deposit Ratio (LDR) = $\dfrac{\text{Loans}}{\text{Deposits}}$

Capital Adequacy Ratios

Capital ratios indicate the healthiness of financial institution to shock withstanding losses. These ratios identify the already existing banking problems. Adverse trends in these ratios may increase risk exposure and capital adequacy problems. Iqbal (2001) used Capital Asset Ratio (CAR) as capital adequacy measure. Hassan & Bashir (2003) in addition to CAR used Equity/Liabilities ratio to measure capital adequacy in their study.

Equity/Liabilities ratio = $\dfrac{\text{Average Equity}}{\text{Average Liability}}$

Operational Ratios

Operational ratios show how efficient a company is in its operations and use of assets. There are several ways of measuring operations. Iqbal (2001) used cost to income ratio to evaluate the operational efficiency of banks. Hassan & Bashir (2003) used thirteen operating ratios to evaluate operating efficiency of banks in their study. Some ratios used by Hassan & Bashir as operating ratios other researchers used them as profitability ratios. This study also focused them as profitability measures.

This study uses Net Interest Margin (NIM), Other Opt Income / Average Assets, Non Interest Exp / Average Assets and Cost income ratio to measure bank efficiency in its operations and use of assets. The following formulas are given to calculate these ratios**:**

Net Interest Margin = $\dfrac{\text{Net Markup \& Interest Income}}{\text{Average Assets}}$

Other Operating Income to Average Assets = $\dfrac{\text{Other Operating Income}}{\text{Average Assets}}$

Non Interest Expense /Average Assets = $\dfrac{\text{Non – Interest Expense}}{\text{Average Assets}}$

Theoretical & Conceptual Framework

Theoretical Framework

A theoretical framework consists of concepts and, together with their definitions and reference to relevant scholarly literature, existing theory that is used for particular study. The theoretical framework must demonstrate an understanding of theories and concepts that are relevant to the topic of a research paper and that relate to the broader areas of knowledge being considered.

The ratio analysis involves method of calculating and interpreting financial ratios to asses' bank performance. Financial ratios are the indicator of financial performance of bank. In order to compare performance of Islamic banks and Conventional banks for the period of 2012-2013 the study uses inter-bank analysis. The study evaluates inter-bank performance of Islamic and Conventional banks in term of profitability, liquidity, risk and solvency, capital adequacy, operation and resource allocation efficiency. Financial ratios are applied to measure these performances. The study uses eighteen (18) financial ratios to evaluate bank performances. These ratios are grouped under six broad categories.

Concept of Profitability

Profitability can be defined as the final measure of economic success achieved by a company in relation to the capital invested in it. This economic success is determined by the magnitude of the net profit accounting**.**To achieve an appropriate return over the amount of risk accepted by the shareholders, is the main objective of companies operating in capitalist economies. After all, profit is the propulsive element of any investments in different projects.

The assessment of profitability is usually done through the ROA **(**Return on Assets**)**= Net Income / Total Assets) and ROE (Return on Equity = Net Income / Equity), which is the ultimate measure of economic success.

Concept of Liquidity

Liquidity is the company's capacity to liquidate maturing short-term debt (within one year)**.** Maintaining adequate liquidity is much more than a corporate goal is a condition without which it could not be reached the continuity of a business. Solvency and liquidity are two concepts that are closely related and reflect upon the actions of company's working capital policy. A low liquidity level may lead to increasing financial costs and result in the incapacity to pay its obligations. It is common to find reference to the fact that it is desirable to keep the company liquidity ratio higher than 1.00. That would prove the firm's ability to repay short-term commitments, with the liquidation of short term assets. Any ration below 1.0 may mean that the business may not be generating cash enough to meet the short term obligations. if an analyst is observing a company's balance sheet and face a liquidity ratio of less than 1.00 he shall not, in principle, consider it to be unable to pay its debts on time. The liquidity ratio would most appropriately be interpreted as an indicator of the degree of independence of the company against creditors and its ability to face crises and unexpected difficulties.

Conceptual Framework

A conceptual framework is an analytical tool with several variations and contexts. It is used to make conceptual distinctions and organize ideas. Strong conceptual frameworks capture something real and do this in a way that is easy to remember and apply**.** A theoretical framework can be thought of as a map or travel plan. At the start of any research study, it is important to consider relevant theory underpinning the knowledge base of the phenomenon to be researched**.**

Introduction to Islamic Banking

After its first introduction on experimental basis in a small town of Egypt in 1963, many Islamic Banks, both with letter and spirit, were established in the Middle Eastern andn Asian regions. The growth of Islamic banking has been increasing ever since, not only in terms of number of countries it is operating in but also in term of areas of finance it has ventured in (El Gamal, 2006). In three decades, Islamic banks have grown in number as well as in size worldwide and are being practiced on even more intensive scale. Some countries like Sudan and Iran, have converted their entire banking system to Islamic banking. In other countries where conventional banking is still dominating the Islamic Banking is operating alongside. Today, Islamic banks are operating in more than sixty countries (Aggarwal and Yousaf 2000). Islamic Banking and Finance is growing at between 10%-15% per annum and is boasting global assets in excess of $1Trillion. A recent survey indicated that there are more than 160 Islamic financial institutions existing worldwide (Dar 2003). Gradual and steady spread of the Islamic banks over time over the world is a lucid manifestation of success and the symbolic growth rate is the hallmark of this emerging market. Being fastest growing segment of the credit market in Muslim countries, market share of Islamic banks in Muslim countries has risen from 2% in the late 1970s to about 15 percent today (Aggarwal and Yousaf 2000). Islamic banking is getting popularity, warm welcome, and appreciation also by non-Muslims in Muslim and non-Muslim countries. According to Yudistira (2003), although, most of the Islamic banks are within Middle Eastern and/or Emerging countries, many universal banks in developed countries have started to spigot huge demand of Islamic financial products. This also confirms that Islamic banking is as viable and efficient as the conventional banking is. Where the financial liberalization and deregulation have created new challenges and new realities for Islamic banks, the globalization effect has also put these institutions in cutthroat competition with traditional financial institutions in well developed financial markets. It has become indispensable for Islamic banks to be innovative in designing Islamically acceptable instruments to grapple with the unremitting innovations in financial markets and to compete in local and global deposit markets. Moreover, for fund mobilization and utilization, Islamic banks must seek investment opportunities and avenues that offer competitive rates of return at acceptable degrees of risk. In order to maximize the value of the bank, management of the bank should carefully consider interactions between different performance measures.

Islamic finance refers to the means by which corporations in the Muslim world, including banks and other lending institutions, raise capital in accordance with Shari'ah, or Islamic law. It is also referred to the types of investments that are permissible under this form of law. A unique form of socially responsible investment, Islam makes no division between the spiritual and the secular, hence its reach into the domain of financial matters.

Islamic Banking and Finance Defined

Islamic banking has been defined as banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shari'ah. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. Islamic banking, the more general term is expected not only to avoid interest based transactions, prohibited in the Islamic Shari'ah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy (Source: SBP). Islamic banking is the system of banking consistent with principles of Islamic law (Shari'ah) and guided by Islamic economics. Islamic economics is referred to that body of knowledge which helps realize human well-being through an allocation and distribution of scarce resources that is in conformity with

Islamic teachings without unduly curbing individual freedom or creating continued macroeconomic and ecological imbalances (Chapra 1996). A key element of Islamic economics is distribution of equitable rewards to the different factors of production. Islamic economic system seeks system of Redistributive justice where concentration of wealth in a few hands is countered and flow of money into the economy is fluent. Islamic banking is, therefore, seen as a lynchpin to achieving the economic and social goals of the Islamic economic system. (Source: Bank Alfalah).

As system of Islamic banking is grounded in Islamic principles and all the undertakings of the banks follow Islamic morals so it could be said that financial transactions within Islamic banking are a culturally-distinct form of ethical investing. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of Usury, the collection and payment of interest, also commonly called Riba in Islamic discourse. Although collecting and paying interest is not permitted under Islamic law, revenue-sharing arrangements are generally permitted.

Islamic finance is defined as a financial service principally implemented to comply with the main tenets of Sharia (or Islamic law). In turn, the main sources of Sharia are the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad. The Holy Quran is the book of revelation given to the Prophet Muhammad; Hadith is the narrative relating the deeds and utterances of Muhammad; Sunna refers to the habitual practice and behavior of Muhammad during his lifetime; Ijma is the consensus among religion scholars about specific issues not envisaged in either the Holy Quran or the Sunna; Qiyas is the use of deduction by analogy to provide an opinion on a case not referred to in the Quran or the Sunna in comparison with another case referred to in the Quran and the Sunna; and Ijtihad represents a jurists' independent reasoning relating to the applicability of certain Sharia rules on cases not mentioned in ether the Quran or the Sunna.

Comparison between Islamic Banking and Conventional Banking: An Overview

Like conventional bank, Islamic bank is an intermediary and trustee of money of other people but the difference is that it shares profit and loss with its depositors. This difference that introduces the element of mutuality in Islamic banking makes its depositors as customers with some ownership of right in it (Dar and Presley 2000). 12 Islamic banking and conventional banking differs in that while the conventional banking follows conventional interest-based principle, the Islamic banking is based on interest free principle and principle of Profit-and-Loss (PLS) sharing in performing their businesses as intermediaries (Arif 1988). Rationale behind prohibition of interest and the importance of PLS in Islamic banking has been discussed in many Islamic economics studies. Moreover, Islamic PLS principle creates the relationship of financial trust and partnership between borrower, lender, and intermediary (Yudistira 2003). Islamic finance is a financial system with the aim to fulfill the teaching of Holy Qur'an as opposed to reaping maximum return on financial assets. Conformity to norms of Islamic ethics is the main concern of Islamic financial system. These norms of Islamic ethics as enunciated by the Shari'ah govern all transactions in an Islamic financial system. At a fundamental level, an Islamic financial system can be described as a "Fair" and a "Free" system where "Fairness" is the primary objective; however, it also circumscribes the "freedom" of the participants in the system. Though, in Islam participants are free to enter into transactions but this basic norm of freedom does not imply rampant freedom to contract and is constrained by other norms, such as, the prohibition of Riba and Gharar.

An Islamic bank is essentially a partner with its depositors, on the one side, and also a partner with entrepreneurs, on the other side, when employing depositors' funds in productive direct investment as compared to a conventional bank which is basically a borrower and lender of funds. Difference between the two banking systems also lies in terms of governance structure. Islamic banks must obey a different set of rules – those of the Holy Qur'an – and meet the expectations of Muslim community by providing Islamically-acceptable financing modes (Suleiman 2001). Islamic banks are similar to those of non-Islamic banks in that both offer similar **(**financial) services and play a pivotal role in the economic development of their societies. But they are different in that Islamic banks, unlike non-Islamic banks, are bound to follow Islamic Shari'ah in their operations. For instance, according to Islamic Shari'ah exploitative contracts based on Riba (usury or interest) or unfair contracts that involve risk or speculation are unforeseeable.

Islamic banks compared with non-Islamic banks seek a just" and "equitable distribution of resources". Islamic bank is based on Islamic Faith and its operations must be within the boundaries of Islamic Law or the Shari'ah. There are four rules that govern investment behavior:

- The absence of interest-based (RIBA) transactions;
- The avoidance of economic activities involving speculation (GHARAR);
- The introduction of an Islamic tax, ZAKAT;
- The discouragement of the production of goods and services which contradict the value pattern of Islam (HARAM).

Analysis & Interpretation of Data

Table 1: Ratio analysis at a glance of (sample companies) conventional and Islamic banks of year 2014:

Organization	**Conventional Banks**				**Islamic Banks**			
Name of Banks	**AB Bank**	**Agrani Bank**	**Dhaka Bank**	**Sonali Bank**	**IBBL**	**SIBL**	**EXIM Bank**	**Shahjalal Islamic Bank**
Year Ratios	2014	2014	2014	2014	2014	2014	2014	2014
Return on Average Asset	0.0052	0.0219	0.0168	0.044	0.0096	0.0067	0.0105	0.008
Return on Average Equity	0.0613	0.4228	0.217	0.0989	0.1190	0.075	0.103	0.105
Profit Expense Margin	0.67	0.88	1.12	0.2126	1.003	0.785	1.006	1.02
Current Ratio	0.07	0.129	0.102	0.072	0.093	0.087	0.133	1.22
Current Asset Ratio	0.22	0.12	0.1461	0.0626	0.407	0.41	0.23	0.25
Loan Deposit Ratio	0.87	0.87	0.314	0.5007	0.81	0.86	0.868	0.885
Net Loan to Total Asser Ratio	0.67	0.58	0.06	0.0645	0.608	0.738	0.735	0.955

Debt Equity Ratio	11.28	11.46	11.15	16.04	11.58	11.58	8.48	10.13
Debt to Total Asset Ratio	0.91	0.92	0.918	0.9413	0.92	0.9205	0.894	0.91
Loan Deposit Ratio	0.87	0.87	0.86	0.50	0.811	0.859	0.867	0.885
Equity to Liability Ratio	0.094	0.054	0.0843	0.047	0.067	0.088	0.114	0.087
Net Interest Margin	0.020	0.0490	0.02	0.0238	0.0213	0.0127	0.123	0.115
Other Operating Income To Average Asset	0.005	0.0022	0.0028	0.0019	0.0018	0.0144	0.005	0.003
Non Interest Expense to Average Asset	0.0029	0.0466	0.0035	0.0029	0.0035	0.0156	0.0178	0.0167
Investment to Equity & Deposit Ratio	0.1603	0.3901	0.1467	0.3699	0.2590	0.732	0.772	4.45
Investment to Liability Ratio	0.15	0.3670	0.1415	0.339	0.18	0.72	0.82	0.772

Sources: Self study from the annual report

Table 2: Ratio analysis at a glance of (sample companies) conventional and Islamic banks of year 2013***:***

Organization	**Conventional Banks**				**Islamic Banks**			
Name of Banks	**AB Bank**	**Agrani Bank**	**Dhaka Bank**	**Sonali Bank Ltd.**	**IBBL**	**SIBL**	**EXIM Bank**	**Shahjalal Islamic Bank**
Year Ratios	2013	2013	2013	2013	2013	2013	2013	2013
Return on Average Asset	0.0089	0.047	0.0165	-0.031	0.0086	0.0108	0.0119	0.014
Return on Average Equity	0.0102	0.0972	0.199	-0.689	0.1098	0.122	0.1157	0.104
Profit Expense Margin	0.78	-2.6	0.679	-2.48	1.00	1.45	1.34	1.94
Current Ratio	0.068	0.070	0.102	0.0696	0.085	0.119	0.186	1.22
Current Asset Ratio	0.21	0.1461	0.1461	0.0615	0.409	0.38	0.25	0.25
Loan Deposit Ratio	0.76	0.72	0.314	0.6309	0.79	0.83	0.84	0.883
Net Loan to Total Asser Ratio	0.61	0.13	0.064	0.3954	0.66	0.723	0.677	0.855
Debt Equity Ratio	9.84	51.86	12.75	32.67	10.90	11.00	9.03	12.76
Debt to Total Asset Ratio	0.91	0.98	0.9272	0.970	0.90	0.9008	0.900	0.93
Loan Deposit Ratio	0.76	0.72	1.24	0.6309	0.81	0.828	0.842	0.883
Equity to Liability Ratio	0.009	0.0538	0.0821	0.0399	0.065	0.083	0.105	0.078
Net Interest Margin	0.025	0.0502	0.0273	0.0223	0.0211	0.0122	0.113	0.112
Other Operating Income To Average Asset	0.0008	0.0022	0.0030	0.0017	0.0016	0.0122	0.006	0.004
Non Interest Expense to Average Asset	0.0009	0.0436	0.0028	0.0025	0.033	0.0126	0.01578	0.0145
Investment to Equity & Deposit Ratio	0.1673	0.39	0.1571	0.2395	0.243	0.723	0.75	3.98
Investment to Liability Ratio	0.1654	0.3084	0.1491	0.204	0.18	0.69	0.786	0.781

Sources: Self study from the annual report

Profitability Analysis

Profitability of banks is analyzed by using three profitability measures ROAA, ROAE and PEM. ROAA is the net earnings per unit of a given asset. ROAE is the net earnings of per dollar equity capital. PEM is measure of cost efficiency which analyzes the bank efficiency of making higher profits with given expense. Results show a fluctuating situation in all the profitability measures of Islamic banks from 2013-2014. There is a declining trend in Conventional bank's ROAE from 2013-2014 while ROAA and PEM volatile. It is analyzed from these figures that the profitability of both banks has increase, decrease trends. Average profitability ratios ROAA, ROAE and PEM for Islamic bank are 2.1975, 20.0 and 72.06 compared to.9725, 10.0500 and 95.3500 for Conventional banks. T-test shows that this difference in profitability performance of two banks is not significant at 5% level of significance. However, ANOVA shows significance difference among the ROAE and PEM of banks from 2013-2014.

Table 3: T-test of Return on Average Assets (ROAA)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	2.1975 .9725	1.62613 .12580	.81306 .06290	3.945	1.502	0.094*
2013	Islamic Bank Conventional Bank	2.0850 1.0025	1.80653 .31352	.90327 .15676	5.217	1.181	0.062*

Table 4: T-test of Return on Average Equity(ROAE)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	20.0000 10.0500	16.26732 1.84300	8.13366 .92150	6.191	1.216	0.047*
2013	Islamic Bank Conventional Bank	8.2325 11.2875	11.11912 .77345	5.55956 .38673	4.081	-.548	0.90*

Table 5: T-test of Profit Expense Margin (PEM)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	72.0650 95.3500	38.53799 11.25774	19.26900 5.62887	3.193	-1.160	0.120*
2013	Islamic Bank Conventional Bank	-88.0000 1.4300	191.74288 38.87909	95.87144 19.43954	126.647	-2.364	0.000**

Overall result shows that profitability performance of Islamic and Conventional banks is not significantly different so research hypothesis is rejected that Islamic banks are more profitable than conventional banks.

Liquidity analysis

The liquidity position of Islamic and Conventional bank is analyzed through Current ratio, Current Asset ratio, Loan Deposit ratio and Net Loans to Total Asset ratio. CR indicates the bank ability to meet its current liabilities. A higher value of CR shows that the bank has more liquid assets to pay back to its depositors. CAR indicates the percentage of bank liquid assets. A high CAR is sign of liquidity. LDR measure the degree of bank relines on borrowed funds. The high figure of LDR shows that bank is more relying on borrowed funds and leads to illiquidity. Net loans to total assets ratio measures the total loans outstanding as a percentage of total assets. The higher this ratio indicates that a bank is loaned up and its liquidity is low.

Table 6: T-test of Current Ratio (CR)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	7.8000 10.8750	1.60831 2.22467	.80416 1.11234	1.963	-2.240	0.211*
2013	Islamic Bank Conventional Bank	7.9375 12.7500	1.56278 4.12351	.78139 2.06175	1.617	-2.183	0.251*

Table 7: T-test of Current Asset Ratio (CAR)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	13.5500 32.2500	6.53274 9.56992	3.26637 4.78496	3.376	-3.228	0.116*
2013	Islamic Bank Conventional Bank	13.7750 32.0000	6.08845 8.12404	3.04422 4.06202	2.210	-3.590	0.188*

Table 8: T-test of Loan Deposit Ratio (LDR)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	63.8500 85.3750	27.78891 3.14576	13.89445 1.57288	28.732	-1.539	0.002**
2013	Islamic Bank Conventional Bank	60.6000 83.5750	20.21155 3.81958	10.10577 1.90979	4.448	-2.234	0.079*

Table 9: T-test of Net Loan to Asset Ratio (NLTAR)

Year	Nature Of Bank	Mean	Std. Deviation	Std. Error Mean	F	t	P-Value
2014	Islamic Bank Conventional Bank	34.2500 75.5000	32.82656 14.47987	16.41328 7.23994	14.199	-2.299	.009**
2013	Islamic Bank Conventional Bank	29.8500 73.0000	25.08565 9.01850	12.54283 4.50925	6.600	-3.237	.042*

Result shows that there is declining trend in CR and CAR of Islamic banks while LDR and NLTAR ratio volatiles. There is rise and fall condition in all the liquidity measure of Conventional banks. However the values of CR and CAR are higher for Islamic bank during whole selected period. This shows that Islamic bank has lower liquid asset to meet its current liabilities. Islamic bank average CR and CAR are 7.8000 and 13.5500 as compared to10.8750 and 32.2500 for Conventional banks and this mean difference is statistically significant at 1% level of significance. Islamic bank average LDR and NL/TA ratio are 63.8500 and 34.2500 as compared to 85.3750 and 75.5000 for Conventional banks. This mean difference between two banks is not significant at 5% level of significance. ANOVA shows significant mean difference in LDR and NLTA ratio of banks at 5% and 1% respectively. LDR and NLTAR ratio are in the favor of Islamic banks. These ratios are lower for Islamic banks, the lower these ratios it is considered better. These ratios show that Islamic banks do not rely more on borrowed funds and their percentage of assets tied up in loan is lower than conventional banks. Overall results of liquidity ratios support the hypothesis that Islamic banks are more liquid than conventional banks.

The reasons of Islamic bank high liquidity are firstly they do not have enough investment opportunities. Secondly, they are bound by religion and are allowed to invest only in Sharia approved projects. Thirdly, they rely more on their equity in making loans so they lack lending opportunities.

Findings, Recommendations and Conclusion

Findings

Profitability Ratio

Profitability ratios show the following results:

1. Islamic banks have higher Return on Average Assets (ROAA) ratio than conventional banks for the year 2013 to 2014. ROAA is the net earnings per unit of a given asset. The higher ROAA ratios are indicator of better performance of the banks.
2. As Return on Average Equity (ROAE) ratios of Islamic bank is higher than conventional bank in year 2014 but in year 2013 the ratio of Return on Average Equity (ROAE) of Islamic bank is less than conventional bank.
3. Islamic banks have lower Profit Expense Margin (PEM) ratio than conventional banks for the year 2013 to 2014.
4. Islamic banks have higher net interest margin ratio than conventional banks of Bangladesh for the year 2013 to 2014.Some people are risk avoiders so they do not want to do investments in conventional banks.

Thus overall result shows that Islamic banks are more profitable than conventional banks in Bangladesh for the year 2013 to 2014.

Liquidity ratio

Liquidity ratios show the following results:

1. Result shows that there is declining trend in CR and CAR of Islamic banks while LDR and NLTAR ratio volatiles.
2. There is rise and fall condition in all the liquidity measure of Conventional banks. However the values of CR and CAR are higher for Islamic bank during whole selected period.
3. Islamic bank has lower liquid asset to meet its current liabilities. Islamic bank average CR and CAR are 7.8000 and 13.5500 as compared to10.8750 and 32.2500 for Conventional banks and this mean difference is statistically significant at 1% level of significance.
4. LDR and NLTAR ratio are in the favor of Islamic banks. These ratios are lower for Islamic banks, the lower these ratios it is considered better. These ratios show that Islamic banks do not rely more on borrowed funds and their percentage of assets tied up in loan is lower than conventional banks.

Overall results of liquidity ratios support the hypothesis that Islamic banks are more liquid than conventional banks. The reasons of Islamic bank high liquidity are firstly they do not have enough investment opportunities. Secondly, they are bound by religion and are allowed to invest only in Sharia approved projects. Thirdly, they rely more on their equity in making loans so they lack lending opportunities**.**

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Recommendations

In today's business market the Islamic banks are new and having the different methods that are in a starting stage and period but its knowledge curve will increase rapidly with good experiences and time in market.

1. Although Islamic banking has gone through tremendous growth in the past few decades in Bangladesh and in the rest of the world, but it is still at its infancy compared to the existence of conventional banking.
2. Raising awareness and explaining the modes of operations to existing and potential clients can increase profitability and overall competitiveness of Islamic banks.
3. There should be a start of a course related to articulated marketing and education program to inform and teach the people very well about Islamic banks and different types of finance, that are being ready to use.
4. Islamic Banks should develop awareness about Islamic Banking among the clients more effective efforts like seminars and get-together along with different motivational programs should be taken and implemented.
5. For the bright future of both conventional and Islamic banks they must try to improve its activities in order to overcome its weaknesses.

Conclusion

A comparative study conducted to examine the performance of Islamic and Conventional banks in Bangladesh found that Islamic banks in Bangladesh have better financial performance than their Conventional counterparts. Profitability measures of performance of ROAA, ROAE and PEM do not show (statistically) significant difference between the performances of Islamic and Conventional banks and reject the hypothesis that Islamic banks are more profitable than Conventional banks. Liquidity measures CR, CAR show that interbank liquidity performances of Islamic and Conventional banks are statistically different. Islamic banks are less liquid than Conventional banks in CR and CAR measures. LDR and NL/TA ratios are lower for Islamic banks which mean that Islamic banks do not rely more on borrowed funds and their percentage of assets tied up in loan is lower than Conventional banks**.** Both banking categories provide equal opportunities and are recommended to Investors, savers, borrowers among other decision makers**.**

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