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COMPARISON OF ISLAMIC BANKING SYSTEM AND CONVENTIONAL BANKING SYSTEMS IN PAKISTAN

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Abstract: Islamic finance is one of the most rapidly growing system of the global financial systems. However, despite the increasing importance of Islamic finance, particularly in developing economies in the Middle East and South-East Asia, religious and social complexity has acted against a fuller understanding by regulators, policymakers, researchers and practitioners. The main objectives of the research are 1. To determine the Islamic modes of finance which are widely used 2. To find out the performance of the banks and companies in Peshawar, Pakistan 3. To find out the profit and loss for AL ZAMIN company in Peshawar, Pakistan 4. To compare the performance of Islamic banking systems and conventional banking systems in Peshawar, Pakistan. The research was taken in Peshawar, Pakistan. Overall banking systems in Peshawar Pakistan are the population of this research and Khyber bank Peshawar is the sample for this research. This research was statistically measured and found that there is no relationship between profitable modes of financing and Islamic modes of financing. This research also found that Islamic modes of financing are more profitable. This research showed that Islamic Banking system is more profitable than conventional banking systems.

Keywords: Islamic banking systems, Conventional banking systems, Khyber bank, Islamic modes of finance.

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INTRODUCTION

Islamic finance - financial institutions, products and services designed to comply with the central tenets of Sharia (or Islamic law) - is one of the most rapidly growing segments of the global finance industry. Starting with the Dubai Islamic Bank in 1975 (and operations in the United Arab Emirates, Egypt, the Cayman Islands, Sudan, Lebanon, the Bahamas, Bosnia, Bahrain and Pakistan), the number of Islamic financial institutions worldwide now exceeds over three hundred, with operations in seventy-five countries and assets in excess of US$400 billion (El-Qorchi 2015). Though initially concentrated in the Middle East (especially Bahrain) and South East Asia (particularly Malaysia), Islamic finance principles are now increasingly found elsewhere. This includes developing economies where the financial sector is almost entirely Islamic (Iran and Sudan) or where Islamic and 'conventional' financial systems coexist (Indonesia, Malaysia, Pakistan and the United Arab Emirates) (El-Qorchi 2015). It also includes developed economies where a small number of Islamic financial institutions have been established and where large conventional banks have opened Islamic financing windows (such as in Europe and the United States). While Islamic finance has been practiced for many centuries, it is important to recall that only in the last thirty years have the Islamic financial institutions offering Sharia-compliant products and services become more widespread and substantial (Bley, J., & Kuehn, K. 2004).

Islamic Banking in Pakistan:

The process of Islamization the financial system of Pakistan is coincided with the globally resurgence of Islamic banking in the late seventies. Pakistan was among the three countries in the world that has been trying to implement Islamic banking at national level. This process started with presidential order to the local Council of Islamic Ideology (CII) on September 29, 1977. The council was asked to prepare the blueprint of interest free economic system. The council included panelists of bankers and economists who submitted their report in February 1980, highlighting various ways and sufficient details for eliminating the interest from the financial system of Pakistan. This report was a landmark in the efforts for Islamizing the banking system in Pakistan (Khan, M. S. N., Hassan, M. K., &Shahid, A. I. 2008).

Islamic and regular banking

Islamic banking is not quite the same as the customary banking as it is sans premium. Islamic banking works under various standards and they have distinctive hazard profiles. The Islamic banks have guidelines of two sorts; first is the administration and the national bank that oversee the ordinary banks also and the other is the Shariah Supervisory Board that affirms the results of the

Islamic banks and keeps a check over the usage of the guidelines characterized by the board. The national bank characterizes a few guidelines which are explicit to the Islamic banks. For instance, least capital necessities are higher to build up an Islamic bank than the traditional banks. Islamic banks need to settle progressively regulatory expenses and enlistment costs since it is resource based banking and the bank has to claim the products it further sells which inevitably are paid by the customer, yet it expands the expense.

Present day Islamic banking

The Islamic banking was begun with the straightforward benefit and misfortune sharing records, Islamic reserve funds and speculation items yet it is presently prospering as the Islamic securities (Sukuk) and mutual funds are presented in the market, the fundamental results of Islamic banks are currently founded on benefit and misfortune sharing rule (Mudarabah), organizations or joint endeavors (Musharakah), Sales contract (Salam), renting contract (Ijarah) and premium free advances (Qard-e-Hasna), exchange with markup (Murabaha).

Islamic versus Traditional Banks and Monetary Policy

Exploring the viability of money related strategy in a double financial framework is a difficult undertaking. It requires distinguishing the job of Islamic banks in the transmission instrument of money related strategy as they have an alternate plan of action. Further, the significance of Islamic banks for the bank loaning channel is as yet being discussed (Ibrahim and Alam, 2017). They assume a similar job as regular ones as money related intermediates however are not the same as the perspective of the financing costs charged and their plan of action. For, instance, Islamic banks are not permitted to charge pre-decided financing cost on advances or offer a fixed rate on stores that is, they work as per the Sharia standards. Their job relies upon a few factors, for example, their piece of the overall industry and the structure of Islamic contracts. What's more?

Islamic monetary instruments, for example, cash and interbank markets, are either immature or have not been built up in certain nations with Islamic banks, for example, Syria.

Ibrahim and Alam (2017) contend that the confinement on giving assets to some restricted business exercises (e.g., delivering Alcohol, weapons, and so forth.) may influence the commitment of liable to raise capital from the money related market, while the medium and little estimated organizations still need to vigorously rely upon bank credits to fund their operational exercises (see Boivin et al., 2010). In spite of the fact that this divert is significant in all economies, it is relied upon to play a much increasingly huge job in transmitting money related arrangement stuns to the genuine economy in creating nations and developing markets (Mishkin, 1995b), since these economies are either bank-based or have less created budgetary markets, which are less fluid contrasted with those of the created nations.

LITERATURE REVIEW

This section of the study includes the previous studies conducted on the Islamic modes of financing and its comparison with conventional banking system and safety practices in the different firms around the world. The study also discussed the findings taken from these studies and especially it is discussed the relationship of the sample independent variables with the dependent variables.

El-Qorchi (2015) attributes the rapid growth in the last thirty years to several key developments. First, the strong demand from immigrant and non-immigrant Muslims for Sharia-compliant financial services and transactions; second, the growing oil wealth found in the Middle East; and third, the increasing competitiveness of Islamic finance products vis-?-vis their conventional counterparts (Gerrard, P., & Barton Cunningham, J. 2007).

Other factors likely include the rise of fundamentalism and resurgence of strident Muslim practice in many communities and the incentives offered by governments in some Muslim countries to encourage the establishment of Islamic banks. The global proliferation of Islamic financial institutions has been accompanied by parallel developments in Islamic financial products (Khattak, 2010). Starting with simple prohibitions on usury, investment in tobacco, alcohol, gambling and armaments and a requirement that all financial transactions be based on real economic activity, Islamic financial products now cover a broad range of financial services, including funds management, asset allocation, payment and exchange settlement services, insurance and reinsurance, and risk management.

OBJECTIVES OF THE STUDY

1. To determine BOK (Bank of Khyber) riba free certificates.
2. To determine which Islamic modes of financing is widely used by Al-Zamin modaraba Company.
3. To see the performance of these companies or banks in Peshawar.
4. To determine profit and loss account for Al-Zamin Company.

SCOPE

As it is obvious from the title of the research paper, the geographical coverage of this study was confined to the Peshawar city with special focus on the Al-Zamin modaraba and Bank of Khyber, which fulfilled their needs through Islamic modes of financing.

HYPOTHESES

H0: There is no relationship between profitable modes of financing and Islamic modes of financing.

H1: The Islamic modes of financing are more profitable modes of financing.

RESEARCH QUESTIONS

1. What are the Islamic Modes of Finance and its Comparison with Conventional Banking in Pakistan?
2. Whether there is arelationship between profitable modes of financing and Islamic modes of financing?
3. Whether the Islamic modes of financing are more profitable modes of financing?

METHODOLOGY

The methodology of the research was adopted finding the answers of research questions using statistical technique. Population of research was considered overall banking systems in Pakistan and Khyber Bank, Peshawar, Pakistan was selected as sample for research work.

Source of the study

It was clear from the objectives of the study that the secondary source of data was used. Preset study of Bank of Khyber was done for the research purposes. The researchers tried to search the given questions systematically and found out all the answers till conclusion.

Adequate and reliable data is very important for a consequential analysis. So there should be some reliable data source for these purposes because precise and most relevant form of the data is the basic part of the research. Furthermore, the data must be thoroughly checked to ensure its adequacy and consistency before performing the intended analysis. Reliable and consistent data was collected. For the present study, data had been taken from the various sources that provided information on economic basis.

The research strategy comprises of review as well as evaluation involving connected materials from newspapers, textbooks, journals as well as web.

***Theoretical* Framework:**

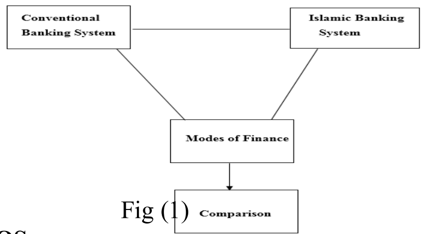


Fig (1)

FINANCIAL RATIOS

Liquidity Ratio:

Current Ratio = Current Assets/Current Liabilities

Current Ratio (2016) = 6808816/25913732 = 0.262

Current Ratio (2017) = 10025815/39272376 = 0.255

Current Ratio (2018) = 9407745/58338218 = 0.161

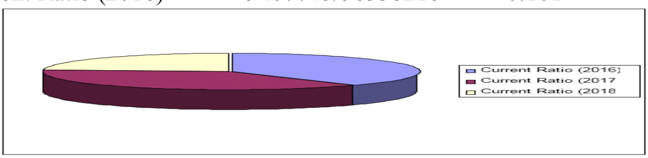


Fig (1.1)

***Interpretation*:**

It shows that current ratio has decreased from 0.262 to 0.255 from 2016 to 2017 and decrease from 0.255 to 0.161 from 2017 to 2018. The bank can pay back in short term about 0.161 of its total current liabilities by liquefying its total current assets, as compared to previous year in which the current ratio was 0.255 and 0.262.

Cash Ratio = Cash + Cash Equity/Current Liabilities
Cash Ratio (2016) = 6808816/25913732 = 0.262
Cash Ratio (2017) = 10025815/39272376 = 0.255
Cash Ratio (2018) = 9407745/58338218 = 0.161

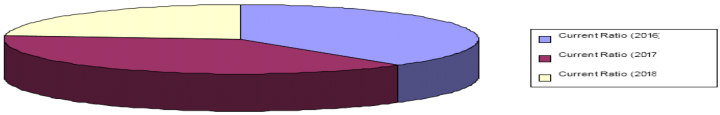


Fig (1.2)

***Interpretation*:**

Cash ratio is 0.262 in 2016 which is decrease to 0.255 in 2017, may be due to the risk taken by the bank, while decreased more in 2018 to 0.161.

Leverage *Ratios*:

Debt to Equity Ratio = Total Debt/Shareholder's Equity
Debt to Equity Ratio (2016) = 27721030/3503330 =7.91
Debt to Equity Ratio (2017) = 41698778/5443696 = 7.65
Debt to Equity Ratio (2018) = 61713371/6547816 = 9.42

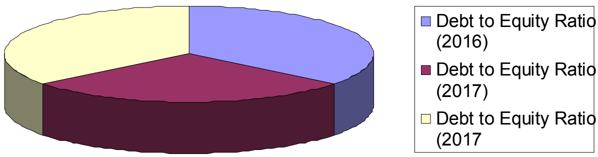


Fig (1.3)

***Interpretation*:**

The debt to equity ratio of bank has increased from last years. This is because of the banks increasing business activities, where it takes more and more risks by receiving from others investments.

Debt to Assets = Total Debts/Total Assets
Debt to Assets (2016) = 27721030/31224360 = 88.7% (0.887)
Debt to Assets (2017) = 41698778/47142747 = 88.4% (0.884)
Debt to Assets (2018) = 61713371/68261187 = 90.4% (0.904)

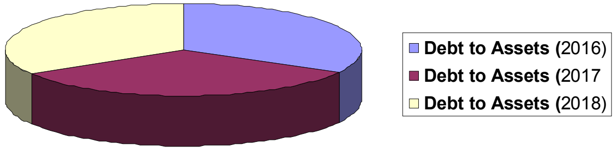


Fig (1.4)

***Interpretation*:**

The debt-assets ratio shows the risk taken by the bank. This ratio shows that in 2018, 90.4% of total assets are financed by debtors as compared to 88.7% in 2016 and 88.4% in 2017.

Profitability *Ratios*:

Return on Equity = Net Income after Taxes x 100/Shareholder's Equity
Return on Equity (2016) = 719070 x 100/3503330 = 21%
Return on Equity (2017) = 703093x 100/5310268 = 13%
Return on Equity (2018) = 1124051 x 100/6547816 = 17%

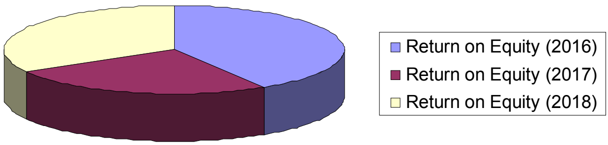


Fig (1.5)

***Interpretation*:**

Return on equity is decrease from 21% to 13% from 2016 to 2017, but again increased in 2018 to 17%.

Return on Investment = Net Income after Taxes x 100/Total Asset
Return on Investment (2016) = 719070 x 100/31224360 = 2.3%
Return on Investment (2017) = 703093 x 100/47009046 = 1.49%
Return on Investment (2018) = 1124051 x 100/68261187 = 1.64%

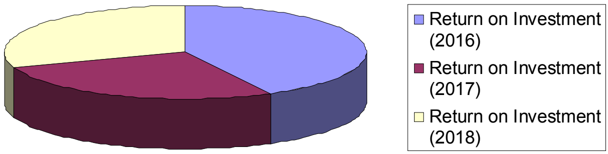


Fig (1.6)

Interpretation:

Return on Assets of the bank is decreased as compare to previous years, so the bank has now offered long-term investments and it will take some time when the bank could be having a high return on assets.

Gross Profit Margin = Gross Earnings x 100/ Total Earnings
Gross Profit Margin (2016) = 729775 x 100/1458637 = 50%
Gross Profit Margin (2017) = 1118060 x 100/2704047 = 41%
Gross Profit Margin (2018) = 2122994 x 100/4574444 = 46%

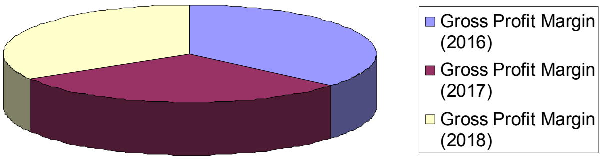


Fig (1.7)

Interpretation:

Gross Profit Margin of bank decrease from 2016 to 2017, but showing increasing trend in profit in 2018.

Net Profit Margin = Net Profit after Taxes x 100 / Total Earnings
Net Profit Margin (2016) = 719070 x 100/1458637 = 49%
Net Profit Margin (2017) = 703090 x 100/2704047 = 26%
Net Profit Margin (2018) = 1124051 x 100/4574444 = 24%

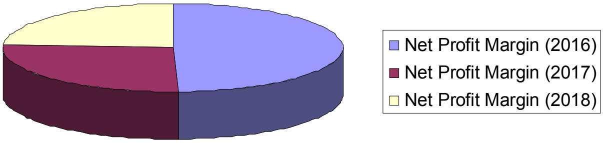
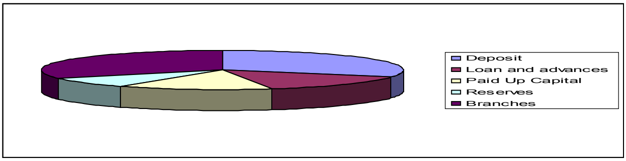


Fig (1.8)

***Interpretation*:**
The net profit margin of bank shows the actual achievements of the bank.

Growth Ratios

Growth Ratio = current year – previous year x 100 / Previous year
Deposit= 54580452 - 34423936 x 100/34423936= 59%
Loan and advances = 34575680 –27029578 x 100/27029578= 28%
Paid Up Capital = 1346017 – 1064045 x 100/1064045 = 26.5%
Reserves = 745101 – 552401x 100/552401 = 16.8%
Branches = 100 – 62 x 100/62 = 61%



CONCLUSION

Islamic modes of financing are good modes of financing. Islamic modes of financing according to the sharia rules are discussed in the research paper. Islamic finance - financial institutions, products and services designed to comply with the central tenets of Sharia (or Islamic law) - is one of the most rapidly growing segments of the global finance industry.

One distinct feature of the modern Islamic banking movement is the role of the Shari'ahboard, which forms an integral part of an Islamic bank. There are several methods of Islamic financing. Sharia, the legal framework of Islam and its Quranic interpretation, along with the teachings of Sunna, control Islamic finance. As for as the main topic of discussion in concern i.e. the case study of Peshawar the researchers had discussed the company and bank that used the Islamic modes of financing then the researchers had showed that the profitability of the bank, their profitability is increased due to these Islamic modes of financing. The researchers had selected one company and one bank for the study. And in the end discussion about the Islamization of the bank in the Peshawar. In that the researchers had discussed bank that started Islamic modes of financing and the company that also started their process with the Islamic modes of financing in their business.

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