An Analysis of Islamic and Conventional on Banking Industries

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An Analysis of Islamic and Conventional on Banking Industries

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Abstract

This paper aims to analyze the banking industries of Islamic and conventional banks. A banking industry is an economic symbol off financial dynamic in a country. Then lately an Islamic banking becomes a huge demand and some countries aside it with conventional banking. They grow together and perform well. An analysis of this industry becomes interesting and vary.

The study using banks of some countries and analyze of its power in banking industries in Indonesia, Malaysia, Singapore, Philipine, Thailand. The result shows that Islamic banking is capable enough of strengthening their positions in the presence to conventional banking.

Keywords*: Islamic bank, conventional bank, banking industry.*

1. Introduction

Presence banking industry still becomes a dynamic component of country economics. Beside conventional banking, Islamic banking grows exponentially. The increasing of number institutions and participants all over the world make it grows. This growth is accounted for by the interest of both Muslims and non-Muslims marking its presence in more than 70 countries of the world (Iqbal and Molyneux, 2005; Chong and Liu, 2005; Khan 2010). It is to be noted that the accumulation of "Islamic assets" and astounding growth rates of Islamic Banking assets over the past few decades had significant impact in global finance (Khan 2010).

The first modern Islamic bank established in 1975 in the United Arab Emirates named as the Dubai Islamic Bank. many other countries subsequently embraced the Sharia principle to their banking system. However, Islamic banking co-exists with conventional banking in other countries. Interestingly, the Sharia based banking is not restricted within the Islamic world these days rather, it has expanded within the non-Muslim countries as well. Islamic Bank of Britain becomes the first bank licensed by a non-Muslim country. In addition, globally, "Citibank, ABN Amro. Bank of America, HSBC, Standard Chartered, and the Union Bank of Switzerland, either have Islamic Banking subsidiaries or offer Islamic financial products to their customers" (Khan 2010:805).

The Islamic financial services industry comprises an increasingly diverse range of institutions, including commercial and investment banks, mutual insurance and investment companies. Banks, however, remain the core of the financial services industry in many countries. The rapid growth of Islamic banks internationally and operating beyond the domestic jurisdictions require the establishment of its own financial infrastructure to give support for the stability and performance of the Islamic financial industry. With the rapid growth of Islamic banks. in this research analyze the condition of growth in profit and equity especially in Asia Countries. In this research countries are included Indonesia, Malaysia, Singapore, Thailand, Philippine.

Literature Review

2.1 Sharia Banking

The theoretical ideology of Sharia (Islamic Laws) comes to economic activities (where banking is a sub part) are based on the Islamic principles which are proposed by the Quran and various Hadiths and Sunnah" (Asutey, 2007). It is mandatory (not a choice) for all Muslims to follow an Islamic financial system which is established on and guided by the principles of the Sharia (Iqbal, 1997). Theoretically, Sharia based banking, also known as Islamic banking. Particularly, Sharia based banking prohibits the use of interest (riba): is pillared by the profit and loss sharing mechanism (also known as Mudarabah); thus risk-sharing, on both the liability and asset side and posits that all transactions have to be backed by a real economic transaction that involves a tangible asset" (Beck et. al. 2012). Sharia based banking advocates that all financial activities/ transactions must involve real economic activities (Bechat.el. 2012; Khan, 2010). It is apparent that the Sharia based banking have several principles that the Islamic banks need to comply, however, as the use of interest is inherent, directly or indirectly, within all financial activities, 'interest-free' operations have become the fundamental issue for any bank claimingitself as 'Islamic' (Khan, 2010). The Islamic scholars are also more intrigued by the role of the profit loss sharing agreement as it is the major fundamental distinguishable factor that the Muslims consider while choosing Islamic banking in comparison to conventional banking.

Most studies agree for the need of a regulatory framework that encourages greater disclosure of information and strengthened the accounting standards. it is necessary that either the general banking laws or specific laws pertaining to Islamic banks define in detail the nature of these banks and their specific operating relationship with the central bank and other conventional banks. Such legal framework should contain provisions relating to licensing, permissible mode of financing and the power to address compliance with laws and regulations clearly. Such provision should determine which enterprises may call themselves Islamic banks, collect deposits and carry out banking practices on the basis of Islamic principles. Moreover, the laws should state clearly that central bank (or supervisory authority) has the authority and all necessary powers to supervise Islamic banks and conventional banks.

3. Methodology Research.

Research analysis explains the banking industry of Islamic banking and conventional banking. This is importance for the banking environment. We evaluate the condition of Islamic banking and conventional banking. The Islamic and conventional banks of each Asia country. then, we suggest a descriptive statistic that enables us to analyse the factors affecting the banking dynamic environment of the region. Countries that include are Indonesia, Malaysia, Singapore, Thailand and Philippine.

3. Data

The panel data set is extracted from non-consolidated income statements and balance sheets of 79 conventional and 29 Islamic banks in 5 countries (Indonesia, Malaysia, Singapore, Philippine, and Thailand). The financial data. which are converted into the US dollar.

Table 1. Structure of sample by country and type of bank

Country	Conventional banks	Islamic banks
Indonesia	37	6
Malaysia	12	15
Singapore	3	6
Thailand	22	1
Philippine	26	1

Source: Bloomberg data Stream

This table indicates that the number of Islamic banks operating in the sampled countries is inferior to that of the conventional banks, which reflects the embryonic stage of the industry of the Islamic finance. Table 2 shows the descriptive statistics of capitalization, profitability, cost efficiency, liquidity and loan performance of conventional banks (Panel A) and Islamic banks (Panel B).

Table 2.1.1 Indonesia Banking descriptive statistic (Conventional Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Indonesia	Mean	1.1147059	7.143088235	107020.72	14023.2998	71549.80824
	Standav	2.2135148	16.42439216	200171.7	27366.76667	131086.6796
	Min	-9.72	-86.75	745.65	107.21	13.2
	Max	13.39	32.61	1036710	153370	676180

Table 2.1.2 Malaysia Banking descriptive statistic (Conventional Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Malaysia	Mean	1.0396	12.39789474	203.68947	18.76791386	134.957193
	Standav	0.2435	3.553641136	180.68156	16.19616229	228.8731953
	Min	0.55	4.55	11.56	0.87703	8,07
	Max	1.47	22.99	735.96	70.47	485.74

Table 2.1.3 Singapore Banking descriptive statistic (Conventional Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Malaysia	Mean	1.03	11.98	364.710	34.46	217.46
	Standav	0.13	1.99	67.820	6.34	47.00
	Min	0.87	9.79	252.900	25.27	144.03
	Max	1.39	17.83	481.570	46.97	305.41

Table 2.1.4 Thailand Banking descriptive statistic (Conventional Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Thailand	Mean	1.19	12.29	1337.71	143.08	923.48
	Standav	0.52	4.91	1062.96	119.90	698.47
	Min	-0.21	-2.34	122.43	14.17	86.25
	Max	2.36	21.54	2940.00	379.24	2030.00

Table 2.1.5 Philippine Banking descriptive statistic (Conventional Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Philippine	Mean	1.38	11.13	473.78	53.55	247.81
	Standav	0.75	7.81	577.55	58.99	329.93
	Min	-0.17	-0.18	0.10	0.10	0.83
	Max	3.56	59.75	2320.00	217.54	1480.00

Table 2.2.1 Indonesia Banking descriptive statistic per country (Islamic Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Indonesia	Mean	0.339828	2.240728	1195687	160543.1	24465.0206
	Standav	2.259728	26.07106	2682804	366051.3	16561.709
	Min	-11.1444	-132.525	4052.701	-19649	2581.8825
	Max	2.63	26.23	9158061	1203016	57977.439

Table 2.2.2 Philippine Banking descriptive statistic per country (Islamic Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Philippine	Mean	7.45	12.526	13380154.79	6303808.516	3330171
	Std dev	4.65824	6.632678946	1090949.536	1216243.341	593292.2
	Min	3.18	6.41	11905165.33	4534199.577	2489572
	Max	7.45	12.526	13380154.79	6303808.516	3330171

Table 2.2.3 Singapore Banking descriptive statistic per country (Islamic Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Malaysia	Mean	0.98388	10.76493	365103.9	33901.57	160167.5
	Std dev	0.563598	5.518621	217284	20060.18	96996.93
	Min	0.00916	0.09842	23151.49	2443.254	14345.22
	Max	2.599798	25.72387	765302	75184	323099

Table 2.2.4 Malaysia Banking descriptive statistic per country (Islamic Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Malaysia	Mean	0.45123	11.62442	465132	123542	25453.0206
	Std dev	0.36542	5.518621	317284	366051.3	15631.32
	Min	0.00821	0,09842	131151.49	-15632	2534.2425
	Max	2.35113	0.09842	13151.49	11216	4523.439

Table 2.2.5 Thailand Banking descriptive statistic per country (Islamic Bank)

Country		ROA	ROE	Tot Asset	Tot Eqty	Total Loans
Thailand	Mean	0.467	9.6575	8209160	4265566	2010223
	Std dev	0.491	6.3632	996839	458694	8835000
	Min	-0.496	0.6744	12893038.2	6654435.493	2375473.918
	Max	1.855	24.563	14802274.22	7571729.634	4098115.909

Garas (2017) explores that Islamic financial institution facing two types of challenges i.e. internal and external. The internal challenge is to involve those customers who are using conventional banking products whereas external challenge is to fulfill the international transaction requirements due to lack of Islamic regulatory system. To penetrate in international market and increase local potential customers the sharia knowledge and training is required to communicate Islamic product. The application of sharia principles and implication of Islamic products analyze through collaborative research from Sharia scholars and researcher (El-Din & Abdullah, 2007). Whereas Garas (2017) suggests that Islamic banking utilize the expertise of sharia scholars to judge the sharia compatible problems for financing local and international business.

The banking share (investment) in the market increases by 15% per annum in the world in last decade (Moody's, 2008). The rationale behind the growth of Islamic banking is the element of interest free system (Khan, 1986; Khan & Mirakhor, 1987; Dar, 2003). The nature of Islamic Banking is different from traditional (conventional) banking but Islamic banks have moderate impact on Business sector because Islamic banks follow the systems that are resembles to traditional system and governed by State Bank.

The ratio of equity by total assets on table 2 is always higher for the Islamic banks tells us that the Islamic banks are better capitalized compared to their conventional counterparts. This may be due to the banking regulations which impose more requirements on equity for the establishment of the Islamic banks compared to the conventional ones. Concerning the measures of profitability, the average ROA of the Islamic and conventional banks are, respectively, 2.418% and 1.729%, whilst the percentages corresponding to the ROE are 14.29% and 14.14%. This means that the Islamic banks make profits and are capable of strengthening their positions in the presence of the conventional banks. Karim and Hichem (2009) argued that better socio-economic conditions and better legal system are determinants for better Islamic banks' profitability in ASEAN.

We have analyzed the cost to income ratio as an indicator of efficiency which measures the general expenses from the turnover, given that a higher value of this ratio reflects an inferior level of cost-efficiency. This ratio averages 58.59% for the Islamic banks and 43.84% for the conventional ones. Therefore. the level of cost-efficiency is higher in the conventional banks. Miranti et al. (20 LO) investigated the efficiency of Islamic banks during 2002-2007. The analysis of the asset quality of both types of banks shows that the ratios of loans to total assets in the Islamic and conventional banks are. respectively, 46.02% and 51.39%, which means that these banks allocate a bigger share of their assets for loans and therefore they have a higher level of credit risk compared to the Islamic banks.

Table 3 contains a comparison of Herfindhal-Hirschman Index based on total assets, deposits and credits between the Islamic and conventional banks. Based on these results, we note that concentration in the Islamic banks is three times as high as it is in the conventional banks.

Table 3. Herfindal-Hirschman index by total asset, deposit and credits.

	Assets		Deposits		Loans	
Country	IB	CB	IB	CB	IB	CB
Indonesia	0.340	0.504	0.682	0.435	0.732	0.54582
Malaysia	0.451	0.427	0.731	0.49	0.542	0.58966
Singapore	0.987	0,556	0.462	0.603	0.427	0.46272
Thailand	0.467	0.227	0.261	0.250	0.284	0.45492
Philippine	0.908	0.516	0.249	0.142	0.249	0.2986
Average	0.631	0.446	0.477	0.356	0.447	0.470

Table 4. Evaluation of the market power of the Islamic and conventional banks during the period 2012-2017.

Year	Islamic Bank	Conventional bank
2013	0.3911	0.5993
2014	0.3830	0.6248
2015	0.4437	0.6368
2016	0.4197	0.6470
2017	0.4015	0.6462

our study rejects the assumption according to which Islamic banks have a greater market power and therefore a higher price-setting power. Our assumption is based on the fact that the Islamic bank customers have religious motivations, i.e., they are less price sensitive and their demand would be more inelastic than that of the conventional banks. Based on a study carried out by Laurent Weill and published in terms of the Islamic finance, two explanations led up to this result.

Even though the Islamic banks are considered as profit-seeking businesses, their profits must be in accordance with their specific values. Therefore, a number of obligations limiting the activities of the Islamic banks, such as the principle of Halal investment, the prohibition of speculation n and the enforcement of the fair price practice, may contribute to the minimization of their market power of the Islamic banks.

Furthermore, a second explanation emerged from the principle of sharing the profits and losses. Based on this principle, an Islamic bank's depositor can be considered as a shareholder in the way that he/she does not receive a fixed interest rate but rather share the parts and the profits of the bank. Thus, higher profits stemming from the services provided and billed to the depositors mean higher prices paid by them. As a result, these depositors have incentives to limit the charges of the financial services performed by the Islamic banks on their clients.

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