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Key Financial Indicators of Bank Performance: A Comparative study of Islamic versus Conventional Banks in Bahrain

(Dr. Faran Ahmad Qadri)
Assistant Professor
College of Business Rabigh, King Abdulaziz University, Kingdom of Saudi Arabia

Abstract: *The main purpose of present study is to analyze the key financial indicators of Islamic and conventional banks of Bahrain. For the said purpose following indicators have been taken for analysis, Return of Assets (ROA), Return of Equity (ROE), Net Profit Margin (NPM), Deposit Ratio (DR) and Earning Per Share (EPS). Secondary data has been used for analysis over the period of 2012 to 2018. To the measure the financial performance of the said banks ratios analysis have used. The studyhas taken Al Baraka Banking Group (ABG) as an Islamic and Ahli United Bank (AUB)is used as conventional bankof Bahrain.*
The findings of the study concluded that thefinancial resultof conventional bank (Ahli United Bank)is better in profitability ratio like ROA,ROE and NPMthan the Islamic bank. The performance of deposit ratio of both the banks is very soundwhile Islamic bank in case of earning per share (EPS) is better than the conventional bank, study also found that in last four years EPS is declining continuously and in the last year the conventional bank EPS is improved as compared to Islamic bank.

Keywords: *Islamic banks; Conventional Bank; Financial Ratios; Bank performance;*

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I. Introduction

Background of the study:

Financial ratios are utilized for a wide range of purposes. Ratio analysis assess the capacity of a business to pay its obligations. Managerial success and company performance and even evaluation of business is also measured with the help of ratio analysis. No doubt ratio analysis is one of the important tool to judge the actual performance of the business. The traditional text books of financial analysis also focus the necessity for a business to practice industry-wide averages as objective (Foulke, 1968), and to achieve such type of target, there is a proof, business do modify their financial ratios.

Whittington (1980) recognized two main uses of financial ratios.The prescriptive, traditionalpracticeforanalyzation of an organization's ratiomatched with anaverage, and the constructive usage in assessingexperientialrelations, generally for predictionof the future performance. In the late 19th century, the growth in US bank loanprovided as anoutcome of the Civil Battle when current and fixed nature items were separated and a ratio was established between the current assets and current liabilities. (Horrigan, 1968; and Dev, 1974). From that time the practice of ratios both for loanpoint of view and managerial point of view, emphasizing on income measurement soon started. The du Pont Company, to evaluate its performance,startedutilization of its famous ratio 'triangle' near 1919. By the "British Productivity Council in 1959" and the "British Institute of Management", announced modern interfirm assessmentsystem in the United Kingdom (UK).

In more than 51 countries there are almost three hundred Islamic banks, including the United States. The main reason for this research is to find out the comparative study between Islamic and Conventional Bank. This study is focused upon financial ratios mainly return on assets, return on equity, net profit margin, deposit ratio and earning per shareratio is used for the comparative study between sampled banks. The data for the study concentrates on the past seven year's performance from 2012 to 2018.Islamic banks are based on the rules and regulations prescribed by the sharia and it is considered as more vigorous to the financial shocks like global financial crisis of 2008 (Bilal 2015).

Overview of the sample banks

Al Baraka Banking Group ("ABG")

Al Baraka Banking Group ("ABG") was established in Manama Bahrain in 2002. Central bank of Bahrain gave license of Wholesale Islamic bank to Al Baraka Banking Group B.S.C. (ABG). It is also registered on two place one in stock exchange (BOURSE) of Bahrain and the second in Nasdaq Dubai.

The graphical presence of this group is in the form of subsidiary banking offices which is almost in 17 different location globally and offer services through more than 700 offices. This group has operations in Germany, Morocco, Sudan, South Africa, Jordan, Pakistan, Egypt, Tunis, Saudi Arabia, Syria, Bahrain, Algeria, Lebanon, Turkey and Iraq. It also has two representative offices in Libya and Indonesia.

ABG group dealsin retail, treasury, corporate and investment financeservice area which strictly follow Islamic Sharia (law). Ithas US$ 2.5 billion authorized capital and head office is located in Manama, Kingdom of Bahrain.

Ahli United Bank (AUB):

The United Bank of Kuwait (UBK) and Al-Ahli Commercial Bank (ACB) were amalgamated and a new bank ‘Ahli United Bank (AUB)’ came into existence on 31st May 2000. Central Bank of Bahrain (“CBB”) issued a retail banking license to AUB. Now this (AUB) group is dealing in retail banking, treasury and investment services, corporate banking, Islamic banking products & services, private banking and wealth management services, and inviting conventional and Takaful life insurance products.

AUB has 147 branches. Its offices are in Libya, Kuwait, Bahrain, United Arab Emirates, United Kingdom, Oman, Egypt and Iraq. It has 3901 employees. It is listed on stock exchange (BOURSE) of Bahrain and its head quarter is in Manama, Kingdom of Bahrain.

II. Literature Review

According to the International Association of Islamic Banks (IAIB)“concept of Islamic Bankingmainlyintroduced another banking idea in that it followsrigorously to the guidelines of Islamic Law in the financial transactions of banks. Hence, the idea is very clear that this IslamicBanking concept is totally changed from conventional/generalbanking system. Sharia (Islamic Law) clearly defines terms and conditions. It also describes its duty and goals and responsibilities toward the people and nature. In comparison to conventional bank, Islamic bank focusin a better way on all the responsibilities and duties, (Hassan & Adnan, 1998). Basically Conventional banksaretotally dependentthe giver and taker .This giver and taker may be the bank and depositors or bank and borrowers. It takes money from the depositors and give that money the borrowers and charge very high interest rate on it.Interest plays a very important role to maintain the relationship between debtors and creditors and between banks and those who wants loan from the bank. Interest is considered as the price of credit thatdisclose the opportunitycost of money.

In the Middle-Eastern province between 1993 and 1998, Bashir (2000) defined the result of IB (Islamic Banks). To measure income, Bashir used non-interest margin, profitability ratios such as return on equity, return on assetsand Before Tax Profit. The profitability confirm pastperformance and display that Islamic Banks’ productivity is definitelyassociated to equity and loans. The outcomes also show that promising macroeconomic situationscertainlyinfluenceproductivity.

According to Hassoune (2002) analyzed the Islamic Bank (IB)incomeon the basis of interestrate. This studysays that IBare operated on the profit and loss basis whereas conventional/General banking clearly operates on the interest bases. Hassoune also compares return on assetsand return on equity instability for both the banks in three Gulf Cooperation Council region. Which includes Saudi Arabia, Qatar and Kuwait. According to Hassoune Islamic banking is totally operated on the basis profit and loss sharing.Therefore,business have to makesatisfactoryprofits for shareholdersallocated that they are not eagerto admit no returns (Hassoune, 2002).

Research Methodology and Source of Data: The study uses descriptive research design as it collected data from the financial statements of the sample banks. The data collected from the sample banks website and it is analyzed by using the ratio analysis. The ratio analysis is considered an important tool for analyzing the data and making the investment decision (Yeh, 1996). Five financial ratios namely, return on asset (ROA), return on equity (ROE), net profit margin(NPM), deposit ratio (DR) and earning per share ratios (EPS) has been used as a statistical tool to analyze the performance of the sample banks.

Analysis of Data and Interpretation

Secondary data is collected from the annual reports of the said banks. For analysis five key financial ratios have been used over the period of 2012 to 2018. After that for the purpose of comparison cross tabulation is used for the said period.

The Section outline will be in the following order:

1. The study identify every financial ratio used.
2. A table that represent the records of each bank in every year from 2012 to 2018.
3. A graph that shows the values and rates for each sector among years.

4. Analysis the results of each ratios.

Major ratios:

Key financial ratios are used to assess the performance of the said banks. The study hasused five different ratios to evaluate the bank's performance.

1. Return on Assets Ratio (RAO):

ROA is calculated by dividing the banks net profitby its total assets of the period, calculation of this ratio will give an insight about the banks' ability to meet up with its short term obligations like deposit withdrawals and other overhead expenses, calculation of this ratio is essential to assess the banks liquidity position which is a crucial factor in maintaining financial stability of the bank, the higher the ROA ratio is better for the bank functioning.It means that the bank is in a good liquidity position to meet up with the demands of short-term stability (Burton, 2020)

ROA = Net Income of the Period/ Total Assets of the Bank**.**

Table.1
ROA ratio of Al-Baraka Banking Group (ABG) and Ahli United bank

Years	Islamic Banks			Conventional Bank		
	Al Baraka Banking Group ("ABG")			Ahli United Bank(Bahrain)		
	Net Income	**Total Assets**	**Ratio in %**	**Net Income**	**Total Assets**	**Ratio in %**
2012	235,242,000	19,055,131,000	1.23	377,735,000	29,896,422,000	1.26
2013	257,779,000	20,967,559,000	1.23	624,243,000	32,651,893,000	1.91
2014	274,767,000	23,463,589,000	1.17	531,254,000	33,444,888,000	1.59
2015	286,186,000	24,618,201,000	1.16	556,610,000	33,965,317,000	1.64
2016	267,636,000	23,425,265,000	1.14	624,310,000	31,322,484,000	1.99
2017	206,919,000	25,453,211,000	0.81	666,514,000	33,241,855,000	2.01
2018	216,728,000	23,831,238,000	0.91	752,365,000	35,507,577,000	2.12

Figure 1: Graphical Presentation of ROA ratio

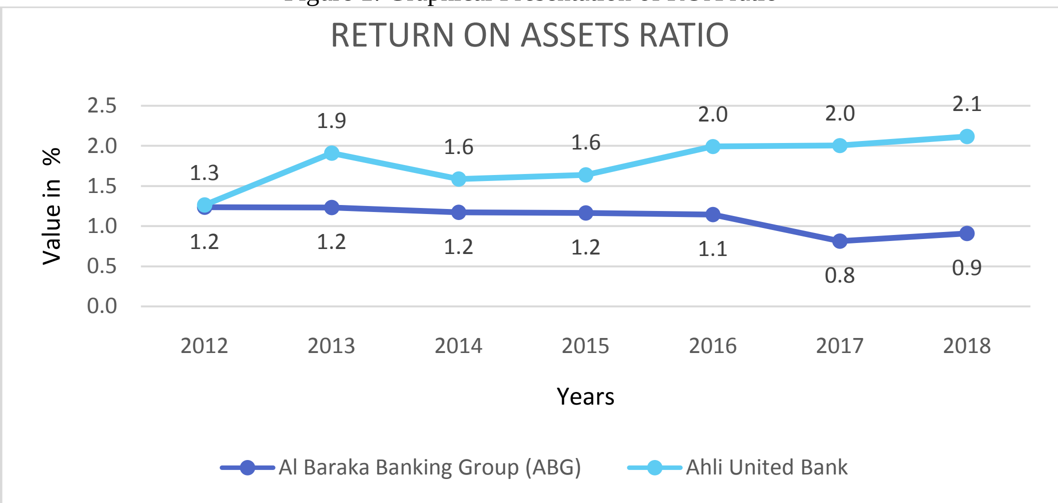

Figure No. 1 shows that from 2012 to 2016, ROA of ABG is always >= 1 but slightly low in the year of 2017 and 2018. In case of AUB it is always >=1 throughout the years from 2012 to 2018.The Conventional bank has an increasing trend from 2015 to 2018 while Islamic bank have a declining trend in the same years. Therefore, on the basis of ROA, it can be said that the health of Conventional bank is better in comparison of Islamic Bank.

2. **Return on Equity Ratio (ROE):**

Return of equity is an important tool to examine the profitability of the business in relation to the equity of the business. Shareholders equity can be calculated by substracting all the liablities from the sum of assets (Brav, 2002).

This ratio shows how effectively the managers of the bank are successfully managing the bank's assets, because equity fills up the gap between total assets and total liabilities, study can consider return on equity ratio as an alternative measure to how effectively the bank is managing its assets, the higher ROE ratio is better for the bank. It shows that the bank is making a sufficient amount of profits and they are managing their assets in an efficient way.

ROE= net income during the period/average shareholders' equity

Table 2
Return on Equity (ROE Ratio) of Al-Baraka Islamic Bank and Ahli United Bank

Years	Islamic Banks			Conventional Bank		
	Al Baraka Banking Group ("ABG")			Ahli United Bank(Bahrain)		
	Net Income	**share capital**	**Ratio in %**	**Net Income**	**share capital**	**Ratio in %**
2012	235,242,000	1,014,475,000	23.19	377,735,000	1,303,164,000	28.99
2013	257,779,000	1,048,291,000	24.59	624,243,000	1,415,570,000	44.10
2014	274,767,000	1,093,869,000	25.12	531,254,000	1,530,471,000	34.71
2015	286,186,000	1,115,746,000	25.65	556,610,000	1,623,030,000	34.29
2016	267,636,000	1,149,218,000	23.29	624,310,000	1,711,322,000	36.48
2017	206,919,000	1,206,679,000	17.15	666,514,000	1,889,213,000	35.28
2018	216,728,000	1,242,879,000	17.44	752,365,000	1,992,541,000	37.76

Figure 2: Graphical Presentation of ROE Ratio

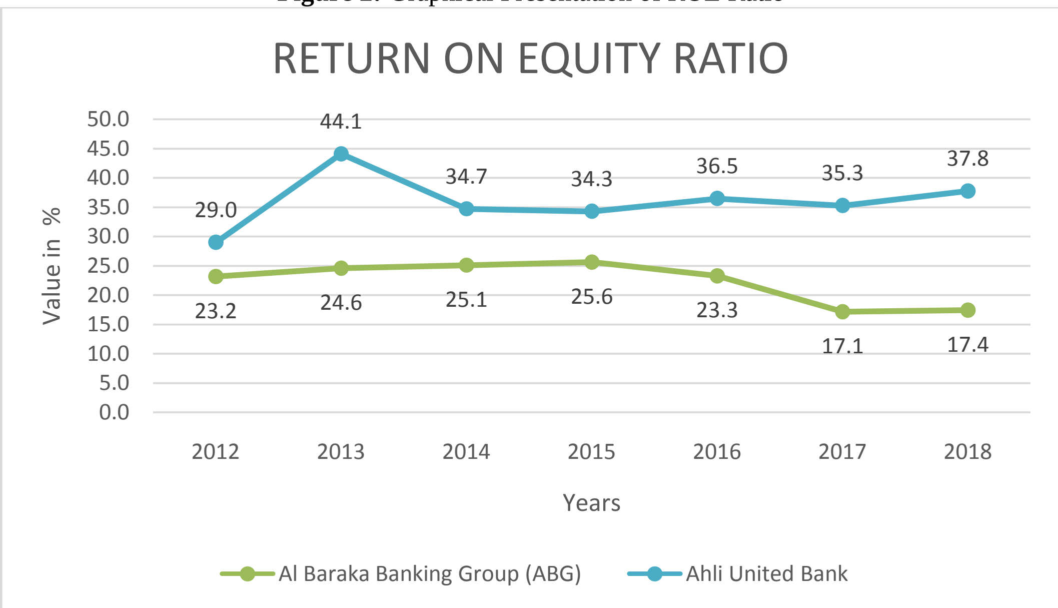

Figure 2 shows that from 2012 to 2018 ROE of ABG is between 17.1 to 25.6 which is a good sign of return on equity. Whereas the ROE of AUB is always greater than twenty nine in all seven years which shows a very satisfactory performance.The Conventional bank has an increasing trend from 2015 to 2018 while Islamic bank have a declining trend one.Hence, on the basis of comparative study of ROE it can be said that the performance of Conventional bank is far better than the performance of Islamic Bank.

3-Net Profit MarginRatio (NPM)

It comes under the category of profitability ratio. This ratio is based on Sales/Revenue. Profit Margin ratio andReturn on sales ratio is the same thing. It includes, Gross Profit Margin Ratio, Operating Profit Margin Ratio, Pretax Margin ratio and Net Profit Margin Ratio.In this case Income of different level is divided by sales. In other words, whatever percentage of sales is left after deducting all expenditure of the business from the sale is called profit margin ratio.

This ratio is generally used by investors and creditors to know how effectively a business can change its sales into net profit. Investors want to know about the dividend and creditors wants to make sure the business have adequate income to pay the loan. In short it is used to calculate which institution makes money.

Net Profit margin= (Net Income /Revenue) *100

About the NetIncome divided by Revenue *100 to calculate the Profit Margin Ratio.

Table 3

Net Profit Margin Ratio of Al-Baraka Islamic bank and Ahli United bank

Years	Islamic Banks			Conventional Bank		
	Al Baraka Banking Group ("ABG")			Ahli United Bank(Bahrain)		
	Net Profit	**Revenue**	**Ratio in %**	**Net Profit**	**Revenue**	**Ratio in %**
2012	235,242,000	879,770,000	26.74	377,735,000	892,806,000	42.31
2013	257,779,000	909,484,000	28.34	624,243,000	958,329,000	65.14
2014	274,767,000	917,562,000	29.95	531,254,000	1,041,268,000	51.02
2015	286,186,000	999,553,000	28.63	556,610,000	1,091,947,000	50.97
2016	267,636,000	1,074,159,000	24.92	624,310,000	1,149,041,000	54.33
2017	206,919,000	998,690,000	20.72	666,514,000	1,119,372,000	59.54
2018	216,728,000	987,819,000	21.94	752,365,000	1,210,550,000	62.15

Figure 3: Graphical Presentation of Profit Margin Ratio

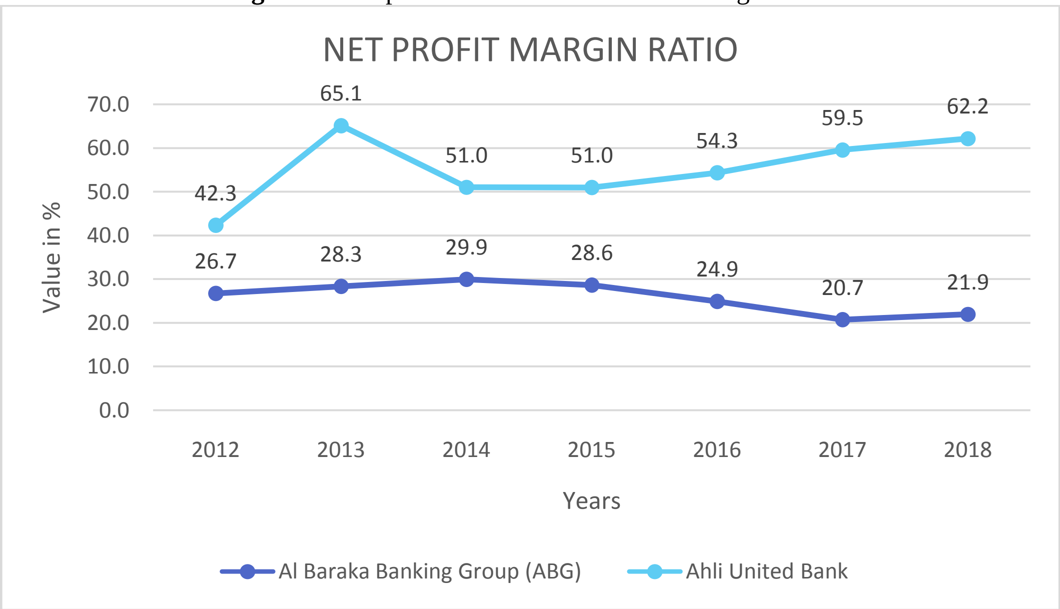

Figure 3 shows that all NPM are more than 20. If the Profit Margin Ratio is > 20, it is assumed that the performance of the business is good but here in the case of AUB the profit marginn > 42.3.The Conventional bank has an increasing trend from 2014 to 2018 while Islamic bank have a declining trend in the same years.Thus on the basis of PMR it can be said thatthe performance of Conventional bank is farbetter than Islamic Bank.

4. Deposit Ratio/Loan Deposit Ratio

Deposit ratio means that how many percentage of amount is given as a loan by the bank from the money deposited by the depositors. This ratio (LDR) is used to calculate a bank's liquidity by comparing a bank's total loans to its total deposits for the same period. High ratio means that bank does not have sufficieny amount to pay to cover any unforeseen requirements of funds. It is also known as credit to deposit ration. In other words loan to deposit ratio helps in asscessing a banks liquidity and indicates its financial health. A higher ratio indicates that the loan dispersed are more than deposits and vise versa. If the ratio is to low it means bank may not be earning as much as they should and it also indicates that banks are not mobilising their resources fully.

Ideally, there is no range of deposit ratio but generally it is assumed good if it standsbetween 80% to 90%. If this ratio is more than 100% means it means bank has given loan of one dollar to customers for every dollar was received as deposits in the bank.

$$\boldsymbol{Deposit\ Ratio = \frac{Bank's\ Total\ Loan\ Disbursed}{Total\ Deposit\ r\ Rceived}}$$

Table 4

Deposit Ratio of Al-Baraka Islamic bank and Ahli United bank

Years	Islamic Banks			Conventional Bank		
	Al Baraka Banking Group ("ABG")			Ahli United Bank(Bahrain)		
	Loan (Receivables)	**Deposits**	**Ratio in %**	**Loan (Receivables)**	**Deposits**	**Ratio in %**
2012	10,462,501	11,604,628	90.16	15,972,219	18,231,131 18,231,131	87.61
2013	10,818,219	12,399,444	87.25	17,305,682	22,028,457	78.56
2014	11,999,547	14,139,792	84.86	18,646,536	23,006,768	81.05
2015	11,959,052	14,514,599	82.39	19,353,181	23,495,227	82.37
2016	11,423,448	13,276,794	86.04	18,606,883	21,703,358	85.73
2017	12,001,050	13,882,109	86.45	19,498,702	22,009,857	88.59
2018	10,303,868	13,122,368	78.52	19,503,961	23,660,035	82.43

Figure 4: Graphical Presentation of Deposit Ratio (DR)

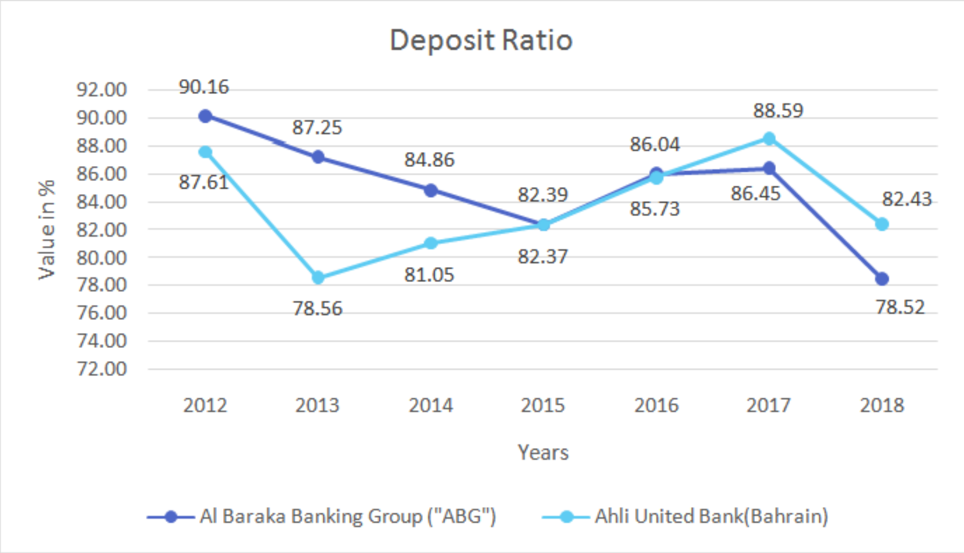

Figure 4 shows that ratios of Islamic and conventional banks are almost between 80 to 90 which is a positive sign. Only in the year of 2013 and 2018 the debit ratio of Ahli United Bank (conventional Bank) is little bit down from the ideal range of deposit ratio but in the case of Al Baraka Banking Group (Islamic Bank) deposit ratio is is under the ideal range throughout the all seven years. The study shows that the position of both the banks are satisfactory but as a comparison point of view Islamic Bank is in better position in the first three years from 2012 to 2014 than conventional bank while in 2015-16 both have almost same performance but in 2017 and 2018 Conventinal bank is in better health than Islamic bank.

5- Earning Per Share Ratio:

Also known as EPS ratio. It is one of the most popular ratio for measuring the health of the company. It actually tells us about that how much profit the company is earning as compare to the each share held by the company. Higher EPS is better for the shareholders (Safitri, 2013).

This ratio explains the ratio for valuing that measure it current share price relative to per share earnings. Price to earnings per share ratio=market value per share / earning per share. The market value per share divided by earning per share.

Table 5
Earnings Per Share (EPS) of Al-Baraka Islamic bank and Ahli United bank
(The ratiosare already shown in the income statement.)

Islamic Banks		Conventional Bank	
Al Baraka Banking Group ("ABG")		Ahli United Bank(Bahrain)	
Years	**Ratio %**	**Years**	**Ratio %**
2012	13.21	2012	6.30
2013	13.31	2013	9.90
2014	13.98	2014	8.00
2015	14.27	2015	7.70
2016	13.29	2016	8.00
2017	9.19	2017	7.40
2018	7.93	2018	8.30

Figure 5: Graphical Presentation of Earning per share

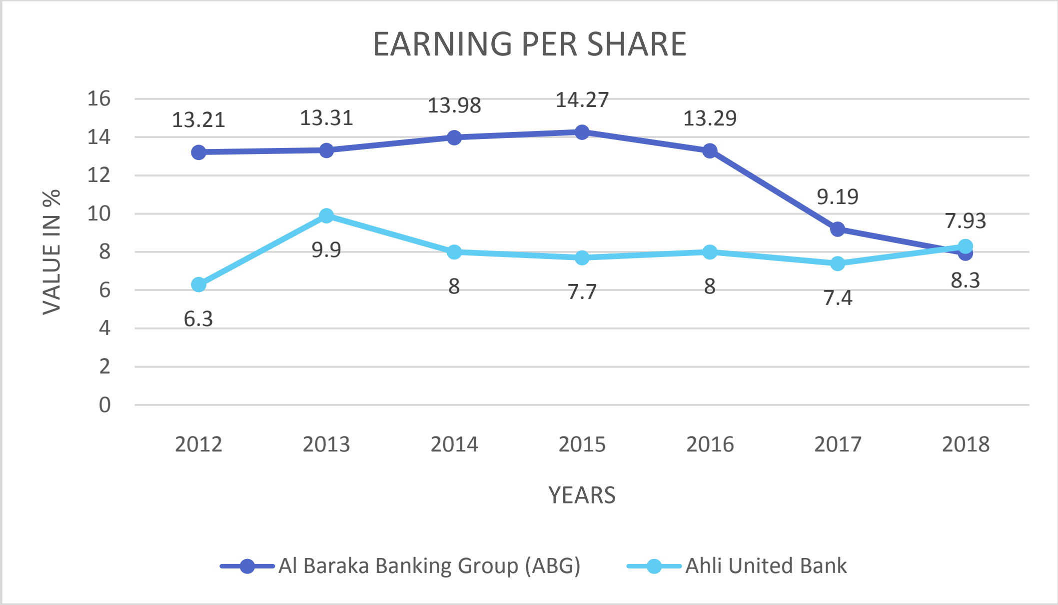

Figure Number 5 shows that the EPS of Islamic bank is continuously better from 2012 to 2017 but in 2018 EPS of conventional bank takes a little lead. Therefore, overall earning per share (EPS) performance of Islamic bank is better than the Conventional Bank.

The Islamic bank has a declining trend from 2015 to 2018 while in the year of 2018 Conventional bank have taken a lead. Taking overall results of all ratios If comparison is taken on the basis of Return on Assets Ratio (ROA), Return on Equity Ratio (ROE) and Net Profit Margin Ratio (NPM) the performance of Conventional bank looks far better than the Islamic Bankbut in other handif overallEarning per share (EPS) is taken as a base, in that case the performance of Islamic Bank is better than the conventional bank.

III. Conclusion

Using the data for the two major banks from 2012 to 2018, the research is focused on providing comparative analysis of financial performance of the selected banks. The results of the analysis reveal that Conventional bank have better return of assets (ROA) ratio though the Islamic bank is not far behind still it has to work on to increase the return on assets. As far as the return of equity (ROE) is concerned the conventional banks return of equity is also better as compared to its Islamic counterpart. In case of net profit margin, performance of conventional bank is much better than Islamic bank but in the case of deposits ratio both banks have allocated a sufficient portion of deposits in providing loan. As far as EPS is concerned the performance of Islamic bank is quite strong than conventional bank.

It is concluded from the study that the overall performance of conventional bank is better than Islamic bank.Therefore, Al Baraka Bank should take some serious action to improve the ROA, ROE, NPM ratios so that it could compete in a better way with conventional banks.

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