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The conventional and presenting of Islamic banks in the UK: A comparative analysis

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The study investigates the performance efficiency of conventional banks and Islamic banks in the United Kingdom between 2007 and 2011. A comparative study of the top four Islamic and five conventional banks is undertaken based on selected financial ratios as performance indicators. The collated secondary data derived from the banks' financial statements are transformed to percentages and ratios so that comparison can be made between the different banks and periods. Comparing conventional and Islamic banks and controlling for all other factors, the authors find few significant differences in business orientation and performance in the areas of liquidity, profitability, risk and solvency and efficiency. The conventional banks are more profitable in addition to being better able to effectively and timely meet up with financial obligations. However, Islamic banks are less exposed to liquidity risk and appear to be more cost-effective while the conventional banks depend more on external sources for funding. The study recommends the broadening of Islamic banking finance management skills. In addition, innovation and differentiation would strengthen Shari'a-compliant products and provide greater attraction to all customers as well as fostering integration with the real economy.

Keywords: Conventional banking, Islamic banking, Financial ratios, United Kingdom banking sector.

INTRODUCTION

The stability of the financial environment plays an important role in the economic development of a country. Conventional banking is based on a pure financial intermediation model, whereby banks generate profits from the margin earned from savers' deposits and demand deposits on the one hand and the funds lent to enterprises or individuals (Ryu et al., 2012). The banks also provide services like Letters of Credit, Trade Guarantees, risk management including foreign exchange, interest rates, commodities, derivatives and custodial services.

The process of efficient bank lending by conventional banks may be truncated by information asymmetry arising from the ability of borrowers who are in a position to withhold information about their own operations. They

can use the loans obtained for purposes other than those specified in the loan agreement thereby exposing banks to unknown risks. The banks may misreport their cash flows and may have to declare bankruptcy arising from these fraudulent activities of such customers. The conventional banking system as part of the global economic system has been fraught with crises including the great Wall Street crash of 1929, the economic depression of the 1930s, the Asian financial crises, the 'dotcom' bubble burst of late 2000s, the US housing crises of 2007 and the European sovereign debt overhang currently confronting some European countries. These crises have led to the adoption of innovative and stricter control policy mechanisms by the relevant supervisory bodies like the Financial Supervisory Authority (FSA) in the United Kingdom.

The government of the United Kingdom has been supportive of the operation of Islamic banking in its territory. The country ranks 9th in the world with Shari'a-compliant asset base of about US\$20bn (The City

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UK, 2011). London is fast becoming a major hub for Islamic financing on a global scale with regional centers in Edinburgh and Birmingham (Ireland is another country outside of the United Kingdom). Five full fledged Islamic retail banks are operational in addition to 17 Conventional banks that have set up windows in the UK to provide Islamic financial services. The City UK (2011) reports that the 22 Islamic banks in the UK exceed those in any other western country and that Islamic finance has the growth potential particularly with a Muslim community of over 2 million people. Other key aspects of the report show 31 *Sukuk* issues raising \$19bn listed on London Stock Exchange; 34 Islamic funds managed from the UK worth \$0.3billion and about 20 law firms supplying services in Islamic finance. A review of the top 500 Islamic banks by return on assets (ROA) world-wide in 2011, shows however, that none of the UK banks is in the global top 25. The topmost appearance of any UK bank in profit performance is LloydsTS number eleven (The Banker, 2012).

Conventional banks have long existed before Islamic banks have and do have greater access to deposits and customer confidence. However, with the advent of Islamic banking, some of these conventional banks have opened Islamic products windows in order to compete in this new market niche. They have also created products to suit their existing customers who want to carry out financial transactions based on their religion disposition. However, the Islamic model, particularly in the retail sector, is fundamentally troubled. Barclays and Deutsche Bank have scaled back their Islamic banking teams in Dubai. The decision of HSBC Amanah (which operates the largest Islamic window) in October 2011 to pull back from operations in the UK, the United Arab Emirates, Bahrain, Bangladesh, Singapore and Mauritius has been driven not by any reassessment of Islamic products per se but on broader economic grounds (Financial Times, 2011). Nevertheless, this is a blow to the development of Islamic finance since HSBC Amanah held the largest Islamic banking assets in the UK as at the time of the announcement (The City UK, 2011).

Sufficient time has elapsed to allow an in-depth analysis of Islamic compared to Conventional banking in the United Kingdom. This paper therefore seeks to contribute to the emerging literature on this topic. The study evaluates the differences in financial performance between Islamic banks and conventional banks in terms of liquidity, profitability, risk and solvency, and efficiency. It covers the period 2007 to 2011, which follow the global financial sector crisis. The next section of the paper provides a brief literature review on Islamic banking and the performances of the two banking genres. Section three presents the methodology employed while section four presents our estimations and results. Section five concludes and proffers recommendations.

Literature Review

The Islamic financial institutions have grown from about US\$150 billion in the mid-1990's to around US\$700 billion in 2007 (HM Treasury, 2007). The top 500 Islamic Financial Institutions (TIFI) listing shows that the global total of Shari'a-compliant assets, based on the latest official figures, grew by 29.7% over the past year (2011)) to reach \$500,482m. This is however relatively small compared with the \$74,232.2bn in total assets amassed by the top 1,000 Conventional banks (The Banker, 2012). Islamic finance has made incursions into countries with minority Muslim populations such as United Kingdom, France and South Africa. Conventional financial institutions also eager to expand their service offerings have devised new innovative financial products channeled to customers who want to execute financial transactions based on their religious beliefs (Kevin et al., 2009).

The clamour for Islamic products becomes greater as Islamic banks are perceived to be less likely to fail than conventional ones (Čihák and Hesse, 2010). The Islamic financial institutions are providing products predominantly based on sharing of profit and loss among the parties of Islamic partnership as opposed to the receipt or payment of interest (*Riba*), which is not allowed in Islam (Hennie and Zamir, 2008; Zamir and Abbas, 2011). The other features distinguishing Islamic from Conventional banking are presented in the next section.

Comparison of Islamic and Conventional Banking Framework

Conventional banking utilises a combination of debt and equity in financing projects. A fixed percentage of interest is expected from the debt finance. The Islamic banking system which is based on the tenets of Islamic law (*Shari'a*) prescribes equity participation in investment. A distinctive feature of Islamic finance is that it does not allow the creation of debt through direct lending and borrowing of money or other financial assets. Debts can only be created through the sale or lease of real assets through lease based financing schemes. The asset which is leased or sold must be real (building, property, or any other physical infrastructure) and the debt cannot be sold or transferred to someone else (Ryu et al., 2012).

The broad objective of Islamic banking is to do away with unethical practices prohibited in the Islam. The Islamic system prohibits investment in the followings: alcohol, tobacco and pork related products, entertainment (hotels, gambling, cinemas, music, weapon and defense, conventional financial activities, biotechnology (human and animal genetic engineering) and trading of gold on deferred basis. This reduces the scope of investment of

the Islamic banks.

According to Jill et al., (2009), growth in the Islamic banking sector has been ignited by the introduction of innovative products aimed at satisfying its customers. The Islamic bonds (*Sukuk*) introduced in 1978 provided access to the capital markets. The launch of the Islamic equity funds and the *Shari'a*-compliant life and general insurance (*Takaful*) introduced in the late 1990s also gave fillip to the development of the Islamic financial system. The 21st century brought about the inclusion of Islamic indexes in major stock exchanges (FTSE, Dow Jones, and Standard & Poor).

The retail product offerings of Islamic system include *Murabaha* (cost plus sales) Under this method of sales, the buyer of the object is aware of the price in which the seller purchased the object that is to be financed; the buyer pays a percentage in addition to the original price of the object. The *Musharaka* is the joint venture partnership. *Mudaraba* is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The sharing of profit and losses is based on rules that are in accordance with *Shari'a*. The *Salam* and *Istisna* (Islamic Forwards) forms of finance are rarely used in Islamic banking, as it is forbidden under Islamic law to sell objects that do not exist, although they help aid with specific types of business. Under *Murabaha*, the seller (i.e. the Islamic bank), must possess ownership of the object, as at the time in which the buyer agrees to buy it (Jeroen, 2005). Exceptions given in Islamic banking under these two contracts account for many Islamic mortgages (Jeroen, 2005). *Sukuk* Issues and *Takaful* (Islamic Insurance) constitute the bulk of Sharia compliant investment offerings of Islamic banks (The City UK, 2011).

The conventional banks provide an array of retail products which include Term Deposit which is a deposit with a precise maturity date. Mortgage is an advance collected from the bank for the purchase of a property. The money borrowed is paid back with interest over an agreed period of time and secured against the property. In the event of default, the bank sells the property in order to retrieve the outstanding sums (The Money Advice Services, 2011). The Savings Account is devised for pooling medium to long-term capital. The customer is free to withdraw and deposit money from and into the account. Cash is easily accessible from the savings accounts. Current accounts allow customers to transfer and distribute money to each other; it allows the access to cheque book and overdraft facility. Several investment products are also offered including the guarantee of the sale of stock and bond issues, investment management and advisory services to corporations on capital market activities such as mergers and acquisitions.

Under conventional banking, money is traded presently against money in the future. This is

referred to as debit transaction. Institutions that participate in conventional credit markets are involved in large speculative transactions, which usually turn to a considerable source of instability. These international capital flows may endanger the world economy resulting in wide spread contagion effect on other markets from a single debt market. (Salman and Ausaf, 2004). Under Islamic banking on the other hand, debt by its self cannot be traded except through the credit sale of goods and services. The value of the debt is determined by the equilibrium mark-up rate, which is derived from the demand and supply of goods and services on credit. Under this credit market, the possibility of large and sudden movements of debt is limited, therefore the possibility of economic wide spread instability is restricted. Institutions that participate in Islamic credit markets are not allowed to carry out speculative activities such as gambling activities, that Islamic financial markets help reduce activities that endanger the economy (Salman and Ausaf, 2004).

The difference in the use of money is the differentiating factor between the two financial systems (Ibrahim, 2000). Under Islamic banking, money is supplied to traders for transactionary purposes. The profit or loss generated from the business activity would be shared in accordance with the agreement. Therefore, Islamic banks are seen as not using money as a means of increasing its wealth. However under the Conventional banking system, money is used as commodity that is bought and sold, on these 'two-way' transactions, interest is charged and profits are made (Ibrahim, 2000). Similarities exist in the evaluation of the soundness of proposals for any project brought for the consideration of the financial institution. However, of the 5 evaluation criteria -5Cs (*condition, collateral, capital, character and capacity*) required for granting facilities to customers, the conventional banks give priority to *collateral, capital and capacity*. The Islamic banks however, see *character* as being most important. They also prefer *capacity to capital* (Ibrahim, 2000).

Islamic banking is considered superior to conventional banking by El and Zeinab (2005) who contend that Islamic banking concentrates more on the social cum economic advancement of the citizens rather than just financial growth of the firms. They also add that whereas conventional banks do not buy fixed assets or capital assets unless it is for the banks' own use, Islamic banks enhance the economic value chain by getting involved in the procurement and management of capital assets and commodities.

The clamour for Islamic products becomes greater as Islamic banks are perceived to be less likely to fail than conventional ones (Čihák and Hesse, 2010). The Islamic financial institutions are providing products predominantly based on sharing of profit and loss among the parties of Islamic partnership as opposed to the receipt or payment

of interest (*Riba*), which is not allowed in Islam (Hennie and Zamir, 2008; Zamir and Abbas 2011). The next section reviews the relative performance of the two banking brands.

Review of Islamic and Conventional Banking Performance

Islamic banks which tend to be generally smaller than conventional banks are likely to be less efficient since technical efficiency tends to increase with the size of a firm in the banking industry (Bhattacharyya et al., 1997). The investigation by Haseeb et al., (2010) into the efficiency comparison between conventional and Islamic Banks in Pakistan took a sample of five Islamic and five conventional banks from 2005 to 2009. A Data Envelopment Analysis (DEA) model is applied to measure the efficiencies of both banking sectors under Constant Return to Scale (CRS) and Variable Return to Scale (VRS) approach. The results show that the technical efficiency of conventional banks is better than the Islamic banks, but in allocative efficiency (AE), Cost Efficiency (CE), both sectors show a healthy competition. The t-statistics show that there is no significant difference in mean efficiencies scores of conventional and Islamic banks except in year 2008.

Johnes et al., (2012) compare the performance of Islamic and conventional banks prior to, during and immediately after the 2008 financial crisis (2004-2009) using data envelopment analysis (DEA) and found no significant difference in mean efficiency between conventional and Islamic banks when efficiency is measured relative to a common frontier. However, the result of the use of the Meta-Frontier analysis (MFA) suggests that the Islamic banking system is less efficient than the conventional one. Siraj and Sudarsan (2012) investigate the presence, if any, of similarity in the growth of chosen performance indicators of conventional banks and Islamic banks in the Gulf cooperation council (GCC) region. The study selected six Islamic banks and six conventional banks using financial ratio analysis. The analysis revealed that Islamic banks are more equity financed than conventional banks. Conventional banks registered growth in revenue during the period, but could not achieve improved profitability on account of higher provisions towards credit losses and impairment losses. The results of the study conducted by Ryu et al. (2012) show that the Islamic financial system is less risky and more profitable than the conventional financial system. In practice, Waseem, 2008 submits that its costs of funding are almost the same as those of conventional banks since interest rates in lieu of administrative costs and share of profit are also as relevant to Islamic banks as they are to conventional banks. Ashraf, and Zia-ur-Rehman (2011), using bank level data from 2007-2010,

applied the use of financial ratios of profitability, earnings, liquidity, credit risk and assets activity in analysing and comparing the performance of Islamic and conventional banks in Pakistan. The research establishes that banking performance of Islamic banks is less effective because of augmented operating cost and inefficiency of management.

The effects of the global crisis on Islamic and Conventional banks was the comparative study conducted by Hasan and Dridi (2010) which examined the impact of the financial turbulence on their profitability, credit and asset growth. They report that the style of debt creation feature of Islamic banking business model helped limit the adverse impact on profitability. In fact, Islamic banks' credit and asset growth performed better than those of conventional banks between 2008 and 2009. However, Jill et al., (2009) contend that there are no fundamental differences between the Islamic and conventional financial systems. The disparities are only operational since both systems are geared towards the provision of services to their customers following the rules and regulations of whatever state they operate in like the Financial Services Authority (FSA) in the UK.

The literature is not conclusive on the long term merit of Islamic financial practice. In the next section, we present the empirical techniques used to obtain answers to our research aims and objectives.

METHODOLOGY AND DATA SPECIFICATION

Two ways by which banking efficiency can be studied are identified by Johnes et al., (2012). These are the use of Financial Ratio Analysis (FRA) and Data Envelopment Analysis (DEA). The former allows for comparisons of the strengths and weaknesses between companies, between industries, between different time periods for one company and between a single company and its industry average. The performance of the banks can be examined from various perspectives including costs, revenue and profit. The FRA is easy to calculate and interpret and lends itself to both inter-bank comparisons and comparisons between banks and the average of the industry sector benchmark (Hassan and Bashir, 2005; Rosly and Abu Bakar, 2003; Siddiqui 2008, Olson and Zoubi, 2008). Johnes et al., (2012) however, adopted the use of DEA method in preference to FRA on the strength of the contention of Abdul-Majid et al., (2010) that the underlying assumption in the use of financial ratios are cost minimisation, profit maximisation, or revenue maximisation. These they argued, are not the most pressing objectives of Islamic banks. This position does not hold in the face of the fact that Islamic banks are not charitable organisations and as such, must deliver value to its stakeholders which must be quantifiable and comparable to other options. Halkos and Salamouris,

(2004) advised that the DEA method can be used as an alternative to FRA. This study therefore deployed the FRA technique to compare the performances of Islamic and conventional banks.

This study adopts the argument proffered by The Banker (2011) that one inherent difficulty with developing a topology of an emerging industry like Islamic financial system is the lack of a formalised structure. This allows the comparison of the underlying value of institutions and their relative contribution to the industry. Conventional banks for example, provide basic mechanisms for comparisons in terms of assets, capital and profits. However, financial institutions such as investment banks and insurance companies present a problem for inclusion in an industry benchmark because the use of a measurement such as Shari'a assets does not accurately reflect the business activity or the overall contributions they make to the industry as a whole. The top five conventional UK banks based on assets and market capitalisation reported by Moneystock (2012) as of end of 2011 were selected. These are HSBC Holdings PLC, Barclays Bank Limited, Royal Bank of Scotland (RBS), Lloyds Banking Group and Standard Chartered Bank.

This study, in order to avoid mixing apples with oranges, selected only the four full Shari'a compliant banks out of 22 Islamic banks in the UK as of end December, 2011. The selected banks are Bank of London and the Middle-East (BLME), European Islamic Investment Bank (EIIB), Islamic Bank of Britain (IBB) and Qatar Islamic Bank (QIB). They represent 98% of the full Shari'a compliant banks' assets (The City UK, 2011).

For this research the secondary data were sourced from the following sources: Annual Financial Statements of the banks (2007–2011), database of Bloomberg financial suite and databases of IMF and World Bank. The collated secondary data derived from the companies' financial statements are transformed to percentages and ratios so that comparison can be made between different companies and periods. The following broad ratios were utilised: liquidity, profitability, risk and solvency and efficiency. The analysis of financial ratios and their interpretations are presented in the next section.

PRESENTATION OF RESULTS AND DISCUSSIONS

The result of the study is presented and discussed in four parts starting with the next sub section. The graphical representation of the findings is presented as Appendix 1.

Liquidity Ratios

The results of the liquidity ratios are presented in Table 1. The mean loan to deposit ratio (LDR) which is the proportion of customers deposit used advances is the

most significant liquidity ratio to calculate in measuring a bank's liquidity condition. On this measure, the Islamic banks were less liquid. In fact, the LDR nearly doubled its counterpart all through the study period.

The mean cash and portfolio investment to deposit ratio (CPIDR) which is ability of banks to meet customers' drawings from short-term funds and deposits was also far higher for Islamic banks during the period of study. The higher level of average CPIDR signifies greater utilisation of the deposits. For the conventional banks, the average ratio increased gradually to its highest level in 2011. In comparison with Islamic banks, this ratio was flatter. The annual average loan to asset ratio (LAR) is the proportion of the bank's asset that is committed to loan. The lower LAR for the conventional banks indicated greater asset coverage and liquidity. There were slight fluctuations reported for both Islamic and conventional banks during the tenure of the research.

On the average, the conventional banks were better able to effectively and timely meet up with its financial obligations. This could be attributed to the fact that conventional banks possess a greater variety of short-term liquid assets including Treasury Bills and Certificates and other negotiable instruments that could be converted to cash before maturity. On the contrary, the Islamic non-interest-bearing loans such as the inter-bank commodity *Murabahah* cannot be converted to cash before maturity and has a fixed duration. Where the client defaults on the payment terms, the financier is not allowed to charge extra fees for late payment/penalty. However, charging additional fees in cases of loss or damage due to a client's default is allowed but such fees and penalties must be given to charity and cannot be treated as income for the bank (Jamaldeen, 2012). These factors are seen to constrain both the liquidity and profitability positions of Islamic banks. In all, the conventional banks appear to have managed their funds better given greater familiarity with the market.

Profitability Ratios

The mean values of profitability ratios for the two classes of banks are reported in Table 2. The profitability measures are Return on Asset (ROA), Return on Equity Ratio (ROE), and Profit to Expenses Ratio (PER). The average of the ROA of the Islamic banks was lower than that of the conventional banks. Indeed, it is negative and unstable. It increased year on year from 2007 to 2008, declining steeply in 2009 and remained negative.

This negative ROA could be attributed to the decline in the quality of their assets, particularly the loan's portfolio as substantial provisions were made against non performing loan. The ROA of the conventional banks has remained positive and stable during the review period. While the return on equity (ROE) of the

Table 1. Mean Values Liquidity Ratios

Year	Loan to Deposit Ratio (LDR) %		Cash and Portfolio Investment to Deposit Ratio (CPIDR) %		Loan to Asset Ratio (LAR) %	
	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks
2007	111.4	193.28	3.59	33.04	43.49	56
2008	117.36	206.37	6.12	39.4	38.48	53.31
2009	115.28	196.23	11.66	350.2	43.77	55.17
2010	111.65	245.35	13.56	209.7	42.41	51.7
2011	105.22	211.88	17.74	2888.98	39.74	53.56
Mean	112.18	210.62	10.54	703.64	41.54	53.94

Source: Authors' computation

Table 2. Mean Profitability Ratios

	Return on Asset Ratio (ROA) %		Return on Equity Ratio (ROE) %		Profit to Expenses Ratio (PER) %	
	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks
2007	0.7	0.79	15.80	0.46	-17.8	-23.99
2008	0.05	2.14	1.11	2.02	9.29	-28.91
2009	0.39	-7.9	7.75	-14.65	-25	-63.75
2010	0.32	-0.87	5.08	-3.67	-39.47	-3.26
2011	0.60	-2.36	3.8	-12.4	-32.19	-25.86
Mean	0.41	-1.64	6.71	-5.65	-29.09	-32.04

Source: Authors' computation

conventional banks fluctuated during the period, the performance of Islamic banks was worse. It went into red for more than half of the review period. The overall average was also negative. The comparison shows that Islamic banks performed much lower with substantial losses. It is important, however, to state that the use of ROE may lead to inaccurate results due to size differences between companies with regards to credit risk (Lindblom et al., 2002). This may have affected the Islamic banks as they are smaller than their conventional counterparts. The profit to expenses ratio (PER) shows that the conventional banks have made more profits from their operating expenses than those of the Islamic banks. There was an increase in the PER of the Conventional banks in 2008, followed by a decreasing trend in the subsequent years. A careful study of the financial statements revealed a rise in operating expenses of the conventional banks especially the administrative expense in the second year due to the global financial crisis. The average PER of the Islamic banks was lower than that of the conventional banks.

The profitability ratios of these two models of banking indicate that the conventional bank on the average recorded higher operating profitability than the Islamic

banks. This is may be due to in part to the aggressive strategy of Islamic banks of booking higher impaired loans than conventional banks compared to their gross loans. The consequential effect of this is the higher levels of non-performing instruments / loans in their portfolio which led to prudential provisions against bad loans. Also, the strict application of Shari'a rules means that many of the Islamic banking products are un-standardised thereby increasing the operational costs relative to those of conventional banks. Overall, the conventional bank recorded higher operating profitability than the Islamic banks.

Risk and Solvency Ratios

Risk and Solvency Ratios are measured by using the Equity Multiplier, Debt to Total Assets Ratio and Debt to Equity Ratio. The mean values of the risk and solvency ratios for the two classes of banks are presented in Table 3.

The equity multiplier connotes the amount of assets per Pound of the shareholders' funds i.e. the proportion of the bank's assets being financed with shareholders' fund. The conventional banks with a higher equity multiplier

Table 3. Mean Values of Risk and Solvency Ratios

Year	Equity Multiplier		Debt to Equity Ratio (DER) %		Debt to Total Assets Ratio (DTAR) %	
	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks
2007	23.98	3.67	557.85	193.28	17.47	17.96
2008	32.95	4.84	665.13	206.37	14.92	30.13
2009	20	4.54	471.39	196.23	10.48	16.76
2010	18.96	4.54	401.89	245.35	9.1	17.22
2011	14.92	5.6	391.26	211.88	19.54	15.23
Mean	22.16	4.64	502.98	144.81	14.30	19.47

Source: Authors' computation

Table 4. Mean Efficiency Ratios

Year	Income to Expense Ratio (IER) %		Operating Efficiency %		Assets Utilization Ratio (AUR) %	
	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks
2007	-273.51	92.63	-174.71	11.93	3.09	4.68
2008	-209.31	86.30	-73.32	31.9	1.77	4.55
2009	-227.34	32.99	-40.51	153.2	2.64	2.91
2010	-242.06	16.89	-128.95	84.43	2.55	2.97
2011	-227.27	37.88	-214.08	76.2	6.22	2.74
Mean	-235.89	53.34	-126.31	71.53	3.26	3.57

Source: Authors' computation

meant that they employ more of loan capital in acquiring assets which is a good feature, but a riskier one. The Islamic banks which had access to less equity combined with lower Equity Multiplier are less risky on this one measure.

The evaluation of the average debt to equity ratio (DER) which gauges the banks' ability to deal with financial shocks was that the Islamic banks are less risky than conventional banks given their lower ratio. For the conventional banks however, there had been a noticeable reduction trend in the debt to equity ratio during the period, which was mainly as a result of increase in their equity capitalisation. The higher debt/equity ratio indicated that the conventional banks have been more aggressive in financing its growth with debt which can result in volatile earnings as a result of the additional interest expense. In the absence of interest payments, Islamic banks face less risk but may have had less access to funding.

On the other hand, the estimation of the debt to total assets ratio (DTAR) which is the percentage of asset sponsored by debt capital for Islamic banks was higher than conventional banks. The DTAR for the conventional banks displayed a decreasing trend for most of the review period. For Islamic banks, DTAR fluctuated during the period but is lower on the average than that of

conventional banks. This ratio which also measures the level of a bank's solvency, its financial strength, and the bank's ability to source for additional funds to finance potentially profitable investment opportunities signified that Islamic banks with higher debt/asset ratios were more "leveraged" and could be in greater danger if creditors were to demand for the repayment of debt. In summary, the reported higher equity multiplier and debt to equity ratios coupled with the lower DTAR of the Conventional banks meant Islamic banks are riskier. This is consistent with the finding of the survey by Hussain, and Al-Ajmi (2012) that levels of risks faced by Islamic banks are found to be significantly higher than those faced by conventional banks. Also, higher country, liquidity, operational, residual, and settlement risks are found in Islamic banks.

Efficiency Ratios (Mean Values)

The measure of efficiency denotes the firm's overall effectiveness in using its assets to create revenues and control of its expenses. Three of the measures are: Income to Expense Ratio (IER), Operating Efficiency and Assets Utilization Ratio (AUR). The results are presented in Table 4.

The average income to expense ratio (IER) is a measure of the income generated per Pound Sterling of operating expense. The IER of the Islamic banks which was larger than the conventional banks indicated that the management of Islamic banks were able to squeeze more from each Pound Sterling of expense. The operating efficiency revealed that the Islamic entity incurred more much expense per Pound Sterling of its operating revenue in comparison to conventional banks. Since cost is generated by performing activities and cost advantage arises from performing particular activities more efficiently than competitors, the less efficient performance of Islamic banks can be attributed to the nature of its operation and products which are dictated by Shari'a. In this percentage measure of the management's ability to generate sales revenue and to control costs, the Islamic banks have been less efficient. This supports the findings of Yudistira (2004) which examined 18 Islamic Banks located in GCC countries and reported that these banks are slightly less cost efficient than conventional banks. due to the formers' lack of economies of scale and because customers of Islamic banks are pre-disposed to Islamic products regardless of cost.

The trend of the asset utilization ratio which calculates the total revenue earned for every Pound Sterling of assets a company owns was reducing for the Islamic banks during the study period. The Islamic banks were therefore less efficient in the utilization of their assets. On the average, the asset utilization of the Islamic banks was not statistically different from those of the conventional banks.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The Islamic banks seem to be engaged in frontal competition with conventional bank for which they are ill suited. Whereas the conventional banks have strategically diversified by operating Islamic product windows, in which case, being Shari's-compliant is no longer a product differentiator; the Islamic banks are ethically precluded from adopting similar strategy. The summary of the findings of this study is that conventional banks out perform their Islamic counterpart although Islamic banks seem more cost-effective. The Islamic banks are less liquid in comparison with the conventional banks in terms of the loan to deposit ratio. On the other hand, the conventional banks are less liquid using the cash & portfolio investment to deposit ratio. The greater ratio of loan to asset ratio of the Islamic banks indicates greater illiquidity. The efficiency ratios performances of both bank types were epileptic during the research period. It is crucial for the banks to consistently improve on this score in order to translate their performances to

improved profitability.

Recommendations

This study recommends the continuation of the flexible tax regime of the UK government as it relates to Islamic investment, products and services in order for the country to remain the Western world financial hub. Also, Shari'a finance requires, like any business model to ingrain decisive performance improvement initiatives in its evolution in order to ensure sustainable growth. Furthermore, the concept of division of labour and the theory of comparable advantage portend that the Islamic bankers should concentrate on financial structuring and management leaving the job of procurement and project management to other specialists in order for them to achieve higher profitability levels. In addition, increase their operational size in order to take advantage of positive economies of scale, a requisite for improved efficiency.

The requisite excellence in its operations can be better achieved by transforming to a customer-centric, efficient and scalable operating model; driven by an enhanced risk and technology orientation. In addition, new product innovation which strengthens the Shari'a differentiation and provides greater integration with the real economy would be required to sustain the industry in the long run. There is also the need to broaden the education and skills base in Islamic finance which is essential to meet the expanding demands for qualified practitioners in the industry.

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APPENDIX 1

LIQUIDITY RATIOS

PROFITABILITY RATIOS

RISK AND SOLVENCY RATIOS

EFFICIENCY RATIOS