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Financial Performance of Islamic Banks vs. Conventional Banks: The Case of Palestine

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Financial Performance of Islamic Banks vs. Conventional Banks: the Case of Palestine

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Dedication

This work is dedicated to my great parents, lovely husband,

Smart son Qais, and kindly daughter Mayar.

Declaration

I Certify that this thesis submitted for the degree of Master, is the result of my own research, except where otherwise acknowledged, and that this study (or any part of the same) has not been submitted for a higher degree to any other university or institution.

Signed……

Marwa Samih Ismae'el Qaraqe'

Date: 24/2/2019

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Abstract

Banks play a vital role in the economy of all countries. The stability of any economy depends on banks' well-performance within a country. This study intended to examine financial performance of two different banking systems in Palestine: Islamic versus Conventional.

There were two main objectives of this study the first one is to compare banks' performance in Palestine over the time period from 2008 to 2017. Secondly, to find out the factors that affects the bank's performance (DTAR, LAR, and BS).

In order to investigate and compare these two banking systems, two Islamic and two Conventional banks were selected from the Palestinian banking sector. Data collected from published financial statements (balance sheet and income statement).

Financial ratios analysis was used to analyze the data under three broad categories, which were: profitability performance (return on assets, return on equity), liquidity performance (liquid assets to total asset ratio, liquid assets to deposit ratio) and capital structure (debt to assets ratio).

The results revealed different findings in each category, as in profitability performance conventional banks had a higher return on assets ratio, while Islamic banks were performing better in allocating equity into profits, which means that Islamic banks have a higher ROE ratio. In liquidity performance, the liquid assets to total asset ratio analysis show that conventional banks are doing better, on the other side there was a major difference between Islamic banks and conventional banks in terms of liquid assets to deposit ratio, with Islamic banks being dominated.

The capital structure informs us with the type of financing, debt or equity finance .the analysis show that conventional banks have a lower debt to assets ratio, which is favorable. Such Islamic banks have a higher debt to assets ratio so they are exposed to a higher risk,

they are more debt financing.

The second part of the study focused on examining the factors that will significantly affect both the conventional and Islamic banks performance. A multiple c regression analysis was used to find out the impact of the independent variables (factors) including liquid assets to total asset ratio (LAR), debt to assets ratio(DTAR), bank size (BS), on ROA (return on assets) as a dependent variable to be examined. Results revealed that liquid assets to total asset ratio (LAR) and debt to assets ratio (DTAR) have an insignificant influence on ROA for both banking systems, on the other hand, bank size (BS) was the only significant positive determinant of the ROA for both Conventional banks and Islamic banks. Therefore, it is recommended that Islamic banks should design a comprehensive plan for identifying objectives, goals and strategies to decrease depending on debt financing. Moreover, it is suggested to cover more factors that could influence the bank's performance. In addition, for future research, it is recommended to have a longer time periods. With longer data coverage, it might be interesting to carry out the same research over different time period as different results may be observed.

Table of Contents

DECLARATION ..... **I**

ACKNOWLEDGEMENT ..... **II**

ABSTRACT ..... **III**

TABLE OF CONTENTS ..... **V**

LIST OF TABLES ..... **VIII**

LIST OF FIGURES ..... **IX**

ABBREVIATIONS ..... **X**

CHAPTER 1: **1**

INTRODUCTION **1**

1.1 Conventional banks and Islamic banks 1

1.1.1 Introduction to Islamic banking 2

1.1.2 Introduction to Conventional Banks 3

1.2 Statement of the Problem 5

1.3 Objectives of the study 6

1.4 Research questions 7

1.5 Research Hypothesis 8

Hypothesis for financial ratio analysis: 8

Hypothesis for regression analysis: 8

1.6 Importance of the study 8

Scientific importance: 8

Practical importance: 9

CHAPTER2: 10

THEORETICAL FRAMEWORK & LITERATURE REVIEW 10

2.1 Theoretical Framework 10

2.1.1 Financial performance of conventional and Islamic banks 10
2.1.2 Financial ratios analysis 11

2.2 Financial ratios 13

2.2.1 Profitability ratios 13
2.2.2 Liquidity ratios 14
2.2.3 Capital structure 16

2.3 Factors affecting banks performance 18

2.3.1 Model of the study 18

2.3.1.3 Multiple Regression Analysis 21

2.3.1.4 Descriptive analysis 21

2.4 Literature Review 24

CHAPTER3 32

METHODOLOGY 32

3.1 POPULATION 32

BANKING SYSTEM IN PALESTINE 32

3.1.1 Palestinian Monetary Authority (PMA) 32

3.1.2 Components of Palestinian Banking System 33

Palestinian banking system institutions 2018 34

3.1.3 Islamic banking in Palestine 35

Palestine Islamic Bank 35
Arab Islamic Bank 36
Safa Bank 36

3.2 Sample 37

3.3 Data 37

3.4 Methodology 38

CHAPTER 4: 39

RESULTS AND DISCUSSION 39

4.1 Financial ratios analysis 39

4.1.1 Profitability ratios 40
4.1.2 Liquidity ratios 44
4.1.3 Capital structure 49
- Debt to assets ratio (DTAR) =Total liabilities ÷ Total assets 49

4.2 Regression analysis 51

4.2.1 Descriptive analysis 51

4.2.2 Correlation Analysis 52

4.2.3 Regression Analysis 53
4.2.4 Bank size (BS) 55

CHAPTER 5: 56

5.1 CONCLUSIONS & RECOMMENDATIONS 56

5.2 Recommendations 59

References 60

APPENDICES 67

Appendix 1**:** Data for Quds Bank 67

Appendix 2**:** Data for Palestine investment Bank 68

Appendix 3**:** Data for Palestine Islamic Bank 69

Appendix 4**:** Data for Arab Islamic Bank 70

Appendix5: Regression- Conventional Banks 71

Appendix6: Regression – Islamic Banks 73

Appendix 7: Bank size (BS) = total assets 75

الأداء المالي للبنوك الاسلامية مقابل البنوك التقليدية في فلسطين 76

List of Tables

Table 4. 1: ROA 40

Table 4. 2: ROE 42

Table 4. 3: liquid assets / total Assets ratio 44

Table 4. 4: Liquid assets / Deposits ratio 46

Table 4. 5: Debt to Assets Ratio (DTAR) 49

Table 4.6-a: Descriptive Statistic for CB's for the Period of 2008 – 2017 51

Table 4.6-b: Descriptive Statistic for IB's for the Period of 2008 – 2017 51

Table 4.7-a: Correlation analysis for CB's for the Period of 2008 – 2017 52

Table 4.7-b: Correlation analysis for IB's for the Period of 2008 – 2017 52

Table 4.8- a: Model Summary for CB's 53

Table 4.8-b: Model Summary for IB's 53

Table 4.9-a: coefficients for CB'S regression equation 54

Table 4.9-b: coefficients for IB'S regression equation 54

Table 5. 1: Results 56

List of Figures

Figure 4. 1: Profitability Performance-ROA 41

Figure 4. 2: Profitability Performance –ROE 43

Figure 4. 3: Liquidity Performance-Liquid assets/total assets=LAR 45

Figure 4. 4: Liquidity Performance-Liquid assets/Deposits=L2 47

Figure 4. 5: Capital structure: Debt to assets ratio (DTAR) 50

Abbreviations

- IB's: Islamic Banks.
- CB's: Conventional Banks.
- FRA: Financial Ratio Analysis.
- ROA: Return on Assets.
- ROE: Return on Equity.
- PMA: Palestine Monetary Authority.
- DEA: Data Envelopment Analysis.
- LAR: Liquid Assets Ratio=liquid assets/ total assets.
- DTAR: Debt to Assets Ratio=total liabilities/ total assets.
- CS: Capital Structure.
- EU: European Union.
- OIC: Organization of Islamic Cooperation.
- BS: Bank Size.
- TA: Total Assets.
- Ln (TA): Natural logarithm for Total Assets.
- IMF: International monetary fund.
- Banking stream: Islamic or conventional banking system.
- MIFC: Malaysia International Islamic Financial Centre.

Chapter 1:

Introduction

A country's economic growth is based on its financial sector's performance, with the banking sector being the most prominent. Siraj and Pillai (2012) assert that the stability and growth of any economy to a great extent depends on the stability of its banking sector. As a key component of the financial system, banks allocate funds from savers to borrowers in an efficient manner. They provide specialized financial services, which reduce the cost of obtaining information about both savings and borrowing opportunities. These financial services help to make the overall economy more efficient (Econ, 2001), So Banking system plays a crucial role in the economies of all countries; it can be considered as the life-blood of modern economy.

1.1 Conventional banks and Islamic banks

Unlike conventional banks, Islamic banks must comply with the Islamic law (Shariah), which is an interest-free system. Because of this characteristic of Islamic banks, many were skeptical when the first Islamic bank was established, considering that interest-free banking can't survive. Despite this skepticism, Islamic banks are one of the fastest growing financial industries. Interest-free banking doesn't mean banking without

الأداء المالي للبنوك الاسلامية مقابل البنوك التقليدية في فلسطين

اعداد : مروة سميح اسماعيل قراقع.

اشراف :الدكتور عفيف حمد.

ملخص:

ان للبنوك دوراً حيوياً في اقتصاد جميع البلدان. حيث يعتمد استقرار أي اقتصاد على الأداء الجيد للبنوك داخل البلد.لذا تهدف هذه الدراسة إلى دراسة الأداء المالي للبنوك الإسلامية مقارنة بالأداء المالي للبنوك التقليدية.

هناك هدفان رئيسيان لهذه الدراسة ، أولا" مقارنة أداء البنوك في فلسطين خلال الفترة من 2008 إلى 2017 م .ثانياً ، تحديد العوامل التي تؤثر على أداء البنوك.

ولتحقيق مقارنة منصفة بين هذين النظامين المصرفيين ، تم اختيار مصرفين إسلاميين ومصرفين تقليديين من القطاع المصرفي الفلسطيني.حيث تم جمع البيانات من القوائم المالية المنشورة (قوائم الميزانية العمومية ،قوائم الدخل المالي).

لقد تم استخدام تحليل النسب المالية لتحليل البيانات تحت ثلاث فئات رئيسية وهي: أداء الربحية (العائد على الأصول ، العائد على حقوق الملكية) ، أداء السيولة (نسبة الأصول السائلة إلى إجمالي الأصول ، نسبة الأصول إلى الودائع) وهيكلية رأس المال (نسبة الديون إلى الأصول).

من خلال تحليل النسب المالية تم الحصول عن نتائج مختلفة في كل فئة من هذه الفئات ، حيث كان أداء الربحية للبنوك التقليدية أعلى من حيث العائد على الأصول ، في حين كانت البنوك الإسلامية تعمل بشكل أفضل في تخصيص الأسهم في الأرباح ، مما يعني أن البنوك الإسلامية لديها نسبة أعلى من العائد على حقوق الملكية. أما بالنسبة لأداء البنوك من حيث السيولة ، فقد أظهر تحليل الأصول السائلة إلى إجمالي الأصول أن البنوك التقليدية تحقق أداء" أفضل من البنوك الاسلامية ، و أيضا كان هناك اختلاف كبير بين البنوك الإسلامية والبنوك التقليدية من حيث الأصول السائلة إلى الودائع ، مع سيطرة البنوك الإسلامية.

أما بالنسبة لهيكلية رأس المال الذي يعنى بنوع التمويل المستخدم في البنوك، فقد أظهر التحليل أن البنوك التقليدية لا تعتمد على تمويل رأس المال لديها باستخدام الديون بالقدر الذي تستخدمه البنوك الاسلامية. حيث أن البنوك الإسلامية لديها نسبة أعلى من الدين إلى اجمالي الأصول،لذا فهي تتعرض لنسبة مخاطرة أعلى ، فهي أكثراعتمادا"على الديون في تمويلها لرأس المال لديها .

أما الجزء الثاني من الدراسة فقد ركز على دراسة العوامل التي تؤثر بشكل كبير على أداء البنوك التقليدية والإسلامية.حيث تم استخدام تحليل الانحدار المتعدد لتحديد تأثير المتغيرات المستقلة (العوامل) (و التي تتكون من:نسبة الأصول السائلة إلى إجمالي الأصول (LAR) ، نسبة الدين إلى الموجودات (DTAR) ، حجم البنك (BS))، على العائد على الأصول (ROA) كمتغير تابع. لقد أظهرت النتائج أن نسبة الأصول السائلة إلى إجمالي الأصول (LAR) ونسبة الديون إلى الأصول (DTAR) لها تأثير ضئيل على العائد على الأصول (ROA) لكلا النظامين المصرفيين . من ناحية أخرى ، كان حجم البنك (BS) أهم المحددات الإيجابية للعائد على الأصول (ROA) و الأكثر تأثيرا" على أداء البنوك التقليدية والبنوك الإسلامية.

بناء" على نتائج الدراسة لقد توصلت الدراسة الى عدد من التوصيات و أهمها: على المصارف الاسلامية ان تضع خطة شاملة لتحديد الأهداف والاستراتيجيات التي يجب اتبعها لتقليل اعتمادها على الديون في تمويل رأس المال.

وعلاوة على ذلك، يقترح تغطية المزيد من العوامل التي من الممكن أن يكون لها تأثير على أداء البنوك. بالاضافة الى ذلك، يوصى باجراء نفس البحث باستخدام فترة زمنية مختلفة وأطول ،حيث بالامكان الحصول على نتائج مختلفة.