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### COMPARATIVE PERFORMANCE STUDY OF CONVENTIONAL AND ISLAMIC BANKING IN SAUDI ARABIA AL JAZIRA BANK

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#### **ABSTRACT:**

This research aims to compare the financial performance of profitability of bank Al Jazira pre and post converting from mixed bank (conventional and Islamic bank) to totally full Islamic bank gives two stages of conversion. Financial ratios were estimated from annual reports and financial statement, which include income statement and balance sheet for the period of time from 2000 to 2013. Financial ratios were estimated to measure performances of the bank itself between the years and stages of converting in term of profitability. Using regression model to analyze and estimate the data in order to compare two stages. The study concluded that bank Al Jazira while they converted to fully Islamic bank has negative direction of profitability according to ROE and ROA, which is in mixed stage al jazirah bank, generated more profits as compared to Islamic stage.

#### **INTRODUCTION**

Conventional banking is based on the debtor-creditor relationship, which is depositors' borrowers, and the bank. Interest is considered to be the price of credit, reflecting the opportunity cost of money [1]. The Islamic bank (IB) has been characterized by the International Association of Islamic Banks (IAIB): The Islamic Bank another keeping money idea that it include entirely to the tenets of Islamic Shari`ah in the fields of back and different dealings [2]. Besides, the Bank working along these lines must reflect Islamic standards, in actuality. The Bank should move in the direction of the foundation of an Islamic culture. Thus, one of its essential objectives is the extending of

religious soul among the general population [3]. The key distinction is that Islamic Banking is an arrangement of monetary exercises steady with Shariah dependent on Islamic standards, which at the center reuses gathering premium exchanges including vulnerability and theory [4]. Along these lines, all managing, exchange, business approach, item highlight, speculation center, duty are gotten from the Shariah law, which prompt the huge distinction in numerous piece of the tasks with as of the regular [5].

Islamic fund work uniquely in contrast to ordinary keeping money and the individuals who utilize Islamic bank viewed as a moral. Clients realize that their cash will never be put resources into ventures that are precluded under Sharia, for example, liquor and betting and so forth. In contrast to traditional bank, Islamic bank work without premium or riba, which is prohibited in Islamic. "Under Islamic law, any dimension of intrigue is denied. Islam energizes the creation benefit however restricts the charging of intrigue" [6]. Rather Islamic bank exercises depend on exchange. Islamic bank can make their benefits in other path, for example, 'benefit sharing. Banks work under the Islamic saving money framework are managing in settled premiums rates of return, while in the ordinary saving money framework there is the arrangement of variable financing cost, were foreordained before the arrangements. Any foreordained installment far beyond the genuine measure of central is restricted (intrigue) the main credit it permits is "qarda-ul-hassana" whereby moneylender does not charge any premium [7].

As indicated by [8]it was accounted for that Islamic Banking is developing at a fast speed and has demonstrated phenomenal development and extension in most recent two decades regardless of befuddling of existing money related system and business rehearses. Before the finish of 2011 volume of benefits under Islamic saving money has come to US \$ 1,3 Billion with task in excess of 50 nations [9]. Center East is the focal point of Islamic managing an account with commitment of around 80% while rest of the world contributes 20% offer [9].

All the more as of late, Elsayed Elsiefy [10] plans to look at execution of Islamic banks (IBs) in Qatar with their regular partners (CBs) over the period 2006-2010 utilizing monetary proportion examination. Tried utilized budgetary proportion examination as per productivity, resources value, effectiveness markers, liquidity, and hazard dissolvability. Additionally a few examinations like Shahid, [11] who expects to look at and assess the execution of the two Islamic banks, (Meezan and Dubai Islamic) and two ordinary banks (MCB and HBL) in Pakistan for the year over the time of 2008-2010. He rely upon near investigation, and utilized budgetary proportions productivity proportion: premium overall revenue, Another line of research gives another arrangement of results about the execution of Islamic banks and traditional However, In Saudi Arabia, not all banks are totally following the sharia principle. Some of them are conventional banks and others are Islamic. Also, some of the Islamic banks in Saudi Arabia have adopted the fully of Islamic banking through their products with only Sharia compatible instruments.

Therefore, Financial performance is the process of identifying the financial strengths and weaknesses of banks in terms of profitability, growth, efficiency, liquidity, activity, financial leverage, and shareholder. So, this work will focus on the financial profitability Performance of bank al Jazira pre and post converting from conventional bank to semi Islamic bank and finally fully Islamic bank.

## METHODOLOGY

### *Data*

This examination will assess Banks execution as far as gainfulness. This examination measure benefit utilizing (ROA) return on resources, (ROE) return on value, (NIM) net intrigue edge and (ROD) return on stores [12]. Auxiliary quantitative information utilized for the examination incorporate asset report & Income Statement, which are the most critical report for assessment where were sourced from authority elements. Having research for the information and reached the bank's senior administration no information was accessible for the pre arrange, which is the regular stage. Consequently, the exploration plan was changed in accordance with just consider blended and full sharia agreeable stages. The blended stage information was gathered from yearly monetary reports of bank Al jazira for the time of 2000-2007. Furthermore, the Islamic stage information was gathered from yearly budgetary reports of tdawol site. In this way, The yearly information ranges from just 2 phases which are □ i)Over the period 2000 - 2007which is shown to pre Islamic stage. ii)Over the period 2008 - 2013, which was framed a full Islamic stage.

### *Model Specification*

This research is planning to run on regression analysis of the performance in term of profitability of al jazira bank, which was obtained from the balance sheet and income statement. Two kinds of variables were applied in this study: Dependent and Independent variable. Two dependent variables and five independent variables were put in an application. In order to find out profitability of the bank, in this research, CAMEL system that is a useful tool to investigate performance of banks was applied. The most important ratio measurements that can be properly used are Return on Assets (ROA) and Return on Equity (ROE). The independent variable studied were Capital Adequacy (CAR), Asset Quality (ASQ), Management Efficiency (EFF), Liquidity (LQR) and Bank Size .The following is the econometric form of the regression:  $Y_{i,t} = \beta_0 + \beta X_{i,t} + D_{i,t} + \varepsilon_t$ , Where , $Y_{i,t}$  is the dependent variable in the function,  $B_0$  is the intercept,  $X_{i,t}$  represents the independent variables,  $D_{i,t}$  represents the dummy variable  $E_t$  is the error term.

The models, which will be applied, are as follow:

Without dummy:

$Y = f(CAR_{i,t}, ASQ_{i,t}, EFF_{i,t}, LQR_{i,t}, SIZE_{i,t})$ ,  $ROA = \beta_0 + \beta_1 (CAR_{i,t}) + \beta_2 (ASQ_{i,t}) + \beta_3 (EFF_{i,t}) + \beta_4 (LQR_{i,t}) + \beta_5 (SIZE_{i,t}) + \varepsilon_t$ ,  $ROE = \beta_0 + \beta_1 (CAR_{i,t}) + \beta_2 (ASQ_{i,t}) + \beta_3 (EFF_{i,t}) + \beta_4 (LQR_{i,t}) + \beta_5 (SIZE_{i,t}) + \varepsilon_t$ , With dummy:

$$Y = f(CAR_i, t, ASQ_i, t, EFF_i, t, LQR_i, t, SIZE_i, t, Di, t), ROA = \beta_0 + \beta_1 (CAR_i, t) + \beta_2 (ASQ_i, t) + \beta_3 (EFF_i, t) + \beta_4 (LQR_i, t) + \beta_5 (SIZE_i, t) + Di, t + \epsilon_t$$

## RESULT AND DISCUSSION

In order to examine the profitability of bank al jazira using regression model to determine the significant between each factor in both stages. The result shows that: The analyzed of correlations were made through all stages, mixed stage and Islamic stage separately. Referring to table 1: The value of the correlation indicates a positive liner relationship between LQR, CAR and ROA, whereas indicates a negative effect between EFF, ASQ, LSIZE and ROA. The value of the correlation indicates a positive liner relationship between LQR, CAR and ROE, whereas indicates a negative effect between EFF, ASQ, LSIZE and ROE.

**Table 1.** Correlations of Variables for All stages

	<i>LQR</i>	<i>EFF</i>	<i>CAR</i>	<i>ASQ</i>	<i>l Size</i>	<i>ROA</i>	<i>ROE</i>
LQR	1						
EFF	0.690676	1					
CAR	-0.17076	-0.49801	1				
ASQ	0.74082	0.717985	-0.4793	1			
l Size	0.845772	0.642983	-0.09394	0.843343	1		
ROA	0.094859	-0.28006	0.850717	-0.44519	-0.05511	1	
ROE	0.144087	-0.21037	0.784413	-0.41535	-0.02424	0.97849	1

Referring to table 2: The value of the correlation indicates a positive liner relationship between LQR, CAR, LSIZE and ROA, whereas ASQ and EFF have a negative effect on ROA. LQR, CAR, and LSIZE The value of the correlation indicates a positive liner relationship between ROE, whereas ASQ and EFF have negative effect on ROE.

**Table 2.** Correlations of Variables for mixed stage

	<i>LQR</i>	<i>EFF</i>	<i>CAR</i>	<i>ASQ</i>	<i>l Size</i>	<i>ROA</i>	<i>ROE</i>
LQR	1						
EFF	-0.78146	1					
CAR	0.588478	-0.27006	1				
ASQ	0.216783	-0.44148	-0.2719	1			
l Size	0.766392	-0.63855	0.75413	0.403183	1		
ROA	0.758611	-0.40635	0.967907	-0.22518	0.779411	1	
ROE	0.775634	-0.42726	0.963695	-0.13063	0.829747	0.993849	1

Referring to table 3: the value of the correlation indicates a positive liner relationship between CAR and ROA, whereas LSIZE, LQR, EFF and ASQ have a negative effect on ROA. The value of the correlation indicates a positive liner relationship between LQR, CAR, and LSIZE and ROE, whereas EFF and ASQ have negative effect on ROE.

**Table 3.** Correlations of Variables for Islamic stage

	<i>LQR</i>	<i>EFF</i>	<i>CAR</i>	<i>ASQ</i>	<i>l Size</i>	<i>ROA</i>	<i>ROE</i>
LQR	1						
EFF	0.726125	1					

CAR	-0.78499	-0.80334	1				
ASQ	0.734709	0.815762	-0.8917	1			
lSize	0.820325	0.716756	-0.9715	0.809668	1		
ROA	-0.04493	-0.3737	0.554517	-0.66979	-0.40553	1	
ROE	0.331144	-0.11747	0.177101	-0.36346	0.002504	0.910525	1

### ***Regression Analysis Results of All stages***

According to Regression Tests, CAR has statistically significant affects that on ROA of all stages. Since  $R = 0.850717$  it has positive impact on Return on Asset of banks. It is implied that when Capital Adequacy increases 1 %, ROA will increase 85.07%. Thus, if banks' managers increase Capital Adequacy, the bank will gain a considerable amount of fund. This indicates the importance of manage capital. Another independent variable that significantly affects on ROA is (LQR) Liquid Assets over Total Assets. It implied that when Liquid Assets over Total Assets increase 1%, ROA will increase 9.48%. Means al jazirah bank has sufficient money (cash assets) to repay to its depositors. Consequently, it is safer in terms of insolvency and bankruptcy. Because more of assets are kept in cash instead of utilizing it as loans. Considering profitability factor ROE, similarly to ROA, independent variable CAR has positive effect on ROE. It means when CAR, LQR increases, return on equity will increase. Moreover, Dummy variable that is an indicator for showing impact of 2008 financial crisis has negative effect on ROE at significance level  $\alpha = .05$ .

### ***Regression Analysis Results of mixed stages***

According to Regression Tests, (LQR) Liquid Assets over Total Assets has statistically significant affects that on ROA on mixed stage. Since  $R = 0.758611$  it has positive impact on Return on Asset of this stage. It implied that when Liquid Assets over Total Assets increase 1%, ROA will increase 75.86 %. Means al jazirah bank has sufficient money (cash assets) to repay to its depositors. Consequently, it is safer in terms of insolvency and bankruptcy. Because more of assets are kept in cash instead of utilizing it as loans. Considering profitability factor ROE, similarly to ROA, independent variable LQR has positive effect on ROE. It means when LQR increases, return on equity will increase at significance level  $\alpha = .05$

### *Regression Analysis Results of Islamic stages*

According to Regression Tests, all variable have no significant affects that on ROA, ROE on Islamic stage. At significance level  $\alpha = .05$ . According to impact of 2008 financial crisis, which has negative effect on ROA, ROE. The result is different in almost all stages because of this fact that conventional stages has long history in al jazirah bank where few years back the Islamic stage was fully. While on the other side the conventional stage has a very long history, great learning experience from the process of financial banking. Thus overall, Islamic and mixed stage systems have different performance comparison in terms of profitability. Profitability measured by two variables such as ROA and ROE. The first variable is Return on Assets (ROA). Returns on assets of both systems were calculated for the period of 2000-2006, which is regarded to mixed stag, and the period of 2007- 2013 regarded to Islamic stage. Graph shows that ROA has Slowly increasing with a changeable rate until 2004. Growing with a steady rate and up to the maximum in 2006. Decreasing at a steady rate on 2007, which reflect the beginning of a fully Islamic stage. And Decreasing with a changeable rate and reach to the minimum on 2009 and continues to decline steadily until 2010. This decreasing may be due to the behavior of Bank customers, mismanagement or financial crisis, which was, included the Islamic stage. Also small size of the sample, the short time series, and the less of the data used may be a reason of that. At the end of 2010 and above, the ROA begin again to grow. In short, we can say that mixed stage performed better than Islamic stage; in mixed stage al jazirah bank generated more profits as we compared it with Islamic stage. Considering profitability factor ROE, similarly to ROA, has the same direction.

### **CONCLUSION**

This examination makes for a humble commitment on the enormous existing writing on the theme of the execution of bank al jazirah in term or productivity while they changed over from blended stage to completely Islamic stage. As has been set up, there is a linkage between two phases of changing over as far as gainfulness. Additionally, the motivation behind this examination has been to give a top to bottom investigation utilizing relapse investigation of a predictable example of bank al jazirah while they changed over from blended bank to completely Islamic bank over the time of 2000 to 2013. This exploration did to think about of this significance of bank money related execution of bank al jazirah. With the end goal to look at banks money related execution, two fundamental productivity markers of banks, including ROA and ROE. In this examination, ROA and ROE are two fundamental productivity markers of al jazirah bank. Since a few bank particular components affecting these elements, some of them such a Capital Adequacy, Liquidity, Asset Quality, and Efficiency were discovered their effect on bank's al jazirah productivity. In addition, one virtual variable called Dummy was connected to discover whether 2008 money related emergency has influenced bank al jazira or not. In this examination, the main Data was gathered from

yearly budgetary reports of al jazira bank for the time of 2000-2007. Furthermore, the second information was gathered from yearly budgetary reports of tdawol site. A while later, applying some connection and relapse examination was executed on information. To whole up, effect of autonomous factors on ward factors was found. The exact investigation shown that free the empirical analysis demonstrated that autonomous variable LQR have positive influenced benefit of blended stages. Benefit of Islamic isn't noteworthy with Capital Adequacy, Liquidity, Asset Quality, and Efficiency. As per p-esteem at centrality level  $\alpha = .05$ .in al jazirah bank for the year 2000-2013.

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