PROFITABILITY AND LIQUIDITY OF CONVENTIONAL BANKS AND ISLAMIC BANKS IN NIGERIA: A COMPARATIVE STUDY (2012 – 2015)

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ABSTRACT
The aim of this research is to compare and evaluate the profitability and liquidity of conventional and Islamic bank in Nigeria. The study evaluates the profitability and liquidity of two types of banking system in Nigeria for the period of 2012 to 2015 in order to give clear picture of Islamic banking to the stakeholder, depositors, bank managers, investors and regulators. Different financial ratios i.e. Return on Asset (ROA), Return on Equity (ROE), Profit Expense Ratio (PER) was used for evaluating profitability and Loan to Deposit ratio (LDR), Loan to Assets ratio (LAR), cash portfolio investment & borrowing to deposit ratio (CPIBDR) was used for evaluating liquidity of these 2 categories of banks. A sample of Jaiz Islamic banks and Access bank as a Conventional bank were selected to measure and compare their liquidity and profitability. The results of t-test shows that JAIZ is less profitable and also less liquid compared to the conventional bank. The reasons are due to the facts that conventional banks in Nigeria have longer history and experience in doing banking business and hold dominating position in the financial sector with its large share in the overall financial assets of Nigeria, as compared to Islamic bank. The study recommends that Islamic banks should focus on new products development and innovative solutions to meet client's needs; also Islamic banks needs to strengthen their equity base.

Keywords: Profitability, Liquidity, Conventional Banks, Islamic Banks. Jaiz Bank plc, access bank plc

INTRODUCTION

Like conventional bank, Islamic bank is an intermediary and trustee of money of people. Conventional banking follows conventional interest based principle, whereas, Islamic banking is based on interest free principle and principle of profit and loss sharing in performing their business as intermediaries (Jaffar and Manarvi 2011)

Islamic banking is a growing worldwide phenomenon; in particular, the number of Islamic financial institutions has increased signicantly in the Middle East and Southeast Asia. There are also international financial institutions in Europe and the United States that have adopted some Islamic instruments to attract investors who prefer the use of Islamic credit instrument, such as Murabaha, Mudaraba, Musharaka and Ijara." It is expanding not only in nations with majority Muslim populations, but also in other countries where Muslims are minority such as the United Kingdom and Japan (Siraj and Pillai, 2012).

Howerver, for many years of the existence of Islamic Banking, West Africa has been left out in the operation, although some banks in Nigeria operate non interest windows. It was in 2011 that Jaiz Bank was established as an offshoot of the former Jaiz International Plc as a special vehicle (SPV) to be the first Nigeria full-fledged non-interest Bank. In 2012 full Islamic bank with independent Islamic divisions were operating in Nigeria with branch network in six geo political region (Yahaya & Lamidi, 2015).

Moin (2008) defined Islamic banking as banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid by Islamic Shariah. Even though there are similarities and dissimilarities between Conventional Banking and Islamic Banking, both exists in a competitive environment and must apply proper risk management mechanism to mitigate the risks in business.

Commercial banking is based on a pure financial intermediation model, whereby banks mainly borrow from savers and then lend to enterprises or individuals. They make their profit from the margin between the borrowing and lending rates of interest. They also provide banking services, like letters of credit and guarantees. A proportion of their profit comes from the low-cost funds that they obtain through demand deposits. Commercial banks are prohibited from trading and their shareholding is severely restricted to a small proportion of their net worth.

Islamic banks differ both in their assets and liabilities from their conventional counterparts. On liabilities side Islamic banks accept deposits on the basis of current and savings accounts. Current accounts are based on Islamic contract of Qarz-e-Hasana and savings accounts are opened on the basis of Mudarbara and Musharika. On assets side Islamic banks offer three types of Islamic modes of finance. Firstly, sale based modes i.e., Murabaha, Salam and Istisna. Secondly Islamic banks offer participatory modes, Musharika, Mudarbaha, and Diminishing Musharika. Thirdly, Islamic banks offer Islamic leasing mode i.e., Ijarah. Islamic asset products are different from conventional debt based products.

This study is aimed at comparing financial performance of Islamic banking industry with conventional banks for the years 2012-2015. The performance comparison has been made for 4 years on the basis of liquidity and profitability. The study is important as there are many stakeholders interested in financial performance of Islamic banking industry. Firstly, financial performance indicators help regulator to keep an eye on financial industry outlook and its future growth and challenges. On the basis of financial indictors corrective measures can be taken which can be helpful for the banking industry. Secondly shareholders need to know the performance in order to assess their investment potential and future investment strategy. The objective of the study is to find out comparative performance of Islamic and conventional banks operating in Nigeria for the period of four years 2012 to 2015.

LITERATURE REVIEW

Olson and Zoubi (2008) studied and compared the Islamic and conventional banks in the GCC over a period of 2000 – 2005. Utilizing 26 financial ratios, the authors found that profitability between Islamic and conventional is not much different. However, Islamic banks are found to be less efficient and operating with higher risk. The reason for Islamic banks are risky is Islamic banks uphold funds that are to be used in case of bad loans. Conventional banks on the other hand offer deposits fund that are completely predetermined by interest rates whereas Islamic Bank offer deposit funds that are similar to equity as they share reverse types of risk.

Merchant (2012) examined the performance of Islamic and Conventional banks based in the Gulf Cooperation Currency (GCC) during the crisis and

after the crisis for the period of 2008 – 2011 by deploying the CAMEL testing factors using the 2 failed t-test. The study found that after crisis Islamic bank increased their LLR, while Conventional banks increased their LLR and EQTA. During the four year period of 2008 – 2011, Islamic banks possessed adequate capital structure but have recorded lower ROAE and poor management efficiency. Asset quality and liquidity for both the modes of banking system have not recorded any significant difference.

However, there is less research on the area in Nigeria. Yahaya and Lamidi (2015) examined the financial performance of Jaiz Bank Plc in terms of Profitability, Liquidity, Leverage and growth using time series data, analyzed by way of Gray Comparative Index. The authors found a positive relationship between Profitability, Leverage, growth ratios and financial performance. It also found a negative relationship between liquidity and financial performance.

Elmassah and Al-Sayed (2015) analyzed and compared the performance of Islamic and Conventional banking in United Arab of Emirates using financial ratio analysis (FRA) for the period 2008 – 2014. The authors used panel data and choosed 11 conventional bank ratio and 5 Islamic banks measured by Profitability, Liquidity, Solvency and credit risk. The study indicated the superiority of conventional banks over Islamic ones in profitability, credit risk management as well as solvency.

Jaffar and Manarvi (2011) examined and compared the performance of Islamic and Conventional banks operating inside Pakistan during 2005 to 2009 by analyzing CAMEL standard factors of 5 Islamic banks and 5 Conventional banks. The study found that Islamic banks performed better in possessing adequate capital and better liquidity position while Conventional banks in management qualify and earning ability. Asset quality for both modes of banking was almost the same; Conventional banks recorded slightly smaller loan loss ratio showing improved recovery policy whereas, UNCOL ratio analysis showed a nominal better performance for Islamic banks.

Loghod (2010) compared the financial performance (profitability, liquidity and structure) of Conventional and Islamic banks over the time period 2000 – 2005. The study found that there is no significant difference in terms of profitability; however Islamic banks are less exposed to liquidity risk. On the other hand, Conventional banks depend more on external liabilities than Islamic Banks. Naturally, GCC markets showed that customers were more

attracted to use financial instruments offered by Islamic Banks. The author also found that there is no statistical significant difference on internal growth of both types of banking.
Hanif, Tariq, Tahir, and Momeneen (2012) analyzed and compared the performance of Islamic and conventional banking in Pakistan using internal and external factors for the period of 2005 – 2009. 22 conventional and 5 Islamic banks were selected. The study employed nine financial ratios to gauge profitability, liquidity and credit risk; and a model known as Bank-O-Meter is used to gauge solvency. The authors found that conventional banking leads in terms of profitability and liquidity, while Islamic banking dominates in credit risk management and solvency maintenance. According to their study motivating factors for customers of Islamic banking are the location and sharia compliance, while in case of conventional banking it is wide range of products and services.
Iqbal (2012) studied the performance of conventional and Islamic banking. This study used data for the years 1990 – 1998 and numerous hypothesis and general perceptions about the practice of Islamic banking have been tested. The techniques used to evaluate performance of Islamic banks was both trend and ratio analysis. The performance of Islamic was compared with conventional bank that are the control group.
Bader (2008), documented that there is no differences between the overall efficiency of Conventional and Islamic Banks which includes cost, revenue, and profit efficiency, after studying performance of 43 Islamic and 33 Conventional banks for the period 1999 – 2005 in 21 countries using data development analysis. This study assessed the average and overtime efficiency of banks based on their size, age, and region using static and dynamic panels.
Safiullah (2010) did the comparative study of performance of interest based and interest free banking in Bangladesh. For this study four conventional banks and four Islamic banks were selected. The time period for this study was 5 years from 2004 to 2008. Ratio analysis was conducted to gauge business developments, profitability, liquidity and solvency, commitment to economy and community, efficiency and productivity of both banking streams. Results showed that conventional banks were doing better than Islamic banks based on commitment to economy and community, productivity and efficiency.
Ibrahim (2015) studied the financial performance of two UAE based Islamic

bank and conventional banks between the years 2002 and 2006. Ratios were employed on the banks liquidity, profitability, management capacity, capital structure and share performance, and analyzed using descriptive statistics. It was found that both banks performed reasonably well during the period studied. While the conventional benefitted by having an overall higher degree of liquidity, profitability, management capacity and capital structure, Islamic bank was better off in relation to share indicators performance and in terms of overall stability.

Paul (2013) examined and evaluated the profitability and liquidity of 5 conventional banks with 5 Islamic banks in Bangladesh for the period of 2008 to 2012. Profitability was proxy with ROA, ROE, PER, NPM, EPS, profit per branch and profit per employee. While liquidity were proxy with loan to deposit ratio and loan to asset ratio. T test and F – test have been used. The authors found that Islamic banks are less preferable than conventional banks. Islamic banks performed better in profitability performance while conventional banks performed better in liquidity.

Havidz and Setiawan (2015) investigate efficiency as a basis of financial measurement in the conventional and Islamic banks in the period of 2008 – 2013 with 6 conventional banks and 3 Islamic banks. The bank efficiency is measured using financial ratio and macroeconomics determinants. It was found that the bank inefficiency is caused of not-well function of banks and managers of banks are not able to use the firms given resources.

Al-Mamun (2014) examined the financial performance of Islamic banks and Conventional banks from 2003 – 2010 in Malaysia. The study used accounting ratios which included profitability ratio, liquidity and credit risk ratio to measure financial performance of the Malaysia banks. The results showed that conventional banks perform better in profitability, while Islamic banks perform better in liquidity and credit risks.

Kouser (2011) compared the financial performance of the interest – free and interest – based banks operation in Pakistan. Financial performances of these two categories were assessed using the CAMEL model. 5 conventional and 5 Islamic banks are included in the study with financial data of five years 2006 – 2010. Statistical methods deployed are comprised of Levine's test, t-test, and non-Whitney test. Inferences imply that yet Islamic banks in Pakistan do not have much robust financial health as compared to the conventional banking in country.

Elsiefy (2013) investigated the determinants of conventional and Islamic banks' profitability in Qatar over the period 2006 – 2011 using least-squares regression analysis. 18 banks were selected, variables grouped into seven categories representing capital adequacy, bank size, liquidity, asset quality, cost efficiency, asset mix, and funding (liability) management are investigated as determinants of banks profitability measured using profitability indicators; ROA, ROE, Net interest income NIM, and RORWA return on risk weighted assets. The study found that the determinants of profitability differ widely between conventional and Islamic banks.

Siraj and Pillai (2012) reviewed and compared performance of Conventional banks and Islamic banks in GCC region during 2005 – 2010. Their study selected 6 conventional banks and 6 Islamic banks, they are analyzed based on performance indicators such as OER, NPR, ROA, ROE, EOA, operating expense, profit, assets, operating income, deposits and total equity. The analysis revealed better performance of Islamic banking during the study period. It was also revealed that Islamic banks are more equity financed than conventional banks.

RESEARCH METHODOLOGY

This study uses panel data for 2 banks (Islamic and conventional) in a Nigeria during the period from 2012 to 2015, Based on Literature we found that performance measure is a complex process, so for our better understanding and sound comparison, we have divided key performance indicators into; profitability and liquidity. To statistically test the differences in financial performance amongst Conventional banks and Islamic counterparts using financial ratio analysis (FRA) in terms of profitability and liquidity, the study uses a descriptive financial analysis to describe, measure, and compare the financial situations of all banks. We first calculate the average of each ratio in each group, and then use a t-test and f-value to test the significance of the difference in performance. Whereas, profitability ratios assess the ability of the bank to generate earnings as compared to its expenses and other relevant costs, the study measures profitability using return on assets (ROA), return on equity (ROE) and profit to expense ratio (PER). Liquidity ratios indicate the ability of the bank to meet its short-term financial obligations as they come due. Our study tests liquidity using the total loans to deposits ratio (LDR), total loans to total assets ratio (LAR), and cash and

portfolio investment to deposit and borrowing ratio (CPIDBR).
Data were collected from annual financial report of Access Bank Plc andJaiz Bank Plc for the December 2012 through December 2015 period. We present in this section t-test model used in the modeling and classification of Islamic and conventional Banking performance: In general t-test response model can be expressed as follows:

1. Profitability
Variables;
ROE =Return on Assets
ROE =Return on Equity
PER = Profit Expense Ratio

$$t = \frac{\overline{CBPr_I} - \overline{IBPr_I}}{\sqrt{\frac{SCBPR_i}{n-1} + \frac{SIBPR_i}{n-1}}}$$

$$SCBPr_{it} = \sum (CBpr_{it} - \overline{IBPr_{it}})^2$$

$$SIBPr_{it} = \sum (CBpr_{it} - \overline{IBPr_{it}})^2$$

2. Liquidity
Variables;
LAR Total Loans to Assets Ration
LDR Total Loans to Deposit Ratio
CPIDBR Cash and Portfolio Investment to Deposit Ratio

$$t = \frac{\overline{CBLr_I} - IBLr_I}{\sqrt{\frac{SCBLr_i}{n-1} + \frac{SIBLr_i}{n-1}}}$$

$$SCBLr_{it} = \sum (CBLr_{it} - \overline{IBLr_{it}})^2$$

$$SIBLr_{it} = \sum (CBLr_{it} - \overline{IBLr_{it}})^2$$

RESULTS AND DISCUSSION

The performance of conventional bank and Islamic bank are presented below;

Profitability

The profitability is measures using return on asset (ROA), return on equity (ROE) and profit to expense ratio (PER).
Return on Asset ROA

Table 1

ROA	N	Mean	Std. Deviation	Std. Error Mean	F	Sig.
CB	4	2.0900	.40939	.20469	13.92	.010
IB	4	-1.07 25	3.24 059	1.620 30		

ROA of both sets of bank show different results in the different years. The results show the mean of conventional banks' ROA (2.09) is higher than ROA of Islamic banks (-1.07). Moreover, statistically there is difference between the two means at 5% significance level. From an investor perspective, investing in conventional banks is safer and more certain in terms of return compare with Islamic bank.

Return on Equity ROE

Table 2

R OE	N	Mean	Std. Deviation	Std. Error Mean	F	Sig.
C B	4	14.1700	2.43809	1.21904	21.589	.004
IB	4	-1.1000	6.89490	3.44745		

Like ROA, ROE of both types of bank shows different results in different years.ROE of both sets of bank show different results in the different years. The results show the mean of conventional banks' ROE (14.17) is higher than ROE of Islamic banks (-1.10). Moreover, statistically there is difference between the two means at 5% significance level, this is because the p-value is less than 5% (0.004< 0.005). The increase in ROE for conventional Bank is a very significant indicator that can be interpreted that the conventional banking System provides adequate return for shareholders compared to the islamic banking system.

Profit Expense Ratio PER

Table 3

P ER	N	Mean	Std. Deviation	Std. Error Mean	F	Sig.
C B	4	55.5575	8.80310	4.40155	19.076	.005
IB	4	-12.0425	41.49311	20.74655		

Similar to ROE, PER of Conventional bank is higher than PER of Islamic bank during the period of study. Further study of conventional banks' financial statements revealed a declining trend of PER is not only due to increase in expenses but also decrease in profits for some of the banks in the group. The results also show the mean PER (55.55) of conventional banks is higher than PER of Islamic banks (-12.04). The results indicate that difference between the two means is statistically different at 5% significance level.
These results of profitability ratios are consistent with earlier findings in literature (Metwally, 1997; Moin, 2008; Jaffar and Manarvi, 2011; Hanif et.al, 2011 an; Fayed, 2013). But the results are inconsistent with findings in other literature that found out profitability ratios higher for Islamic banks (Olson and Zoubi, 2008; Iqbal, 2012).

Liquidity Ratio

The liquidity ratio is measures using total loans to total assets ratio (LAR), total loans to deposit ratio (LDR) and cash and portfolio investment to deposit and borrowing ratio (CPIDBR)
Total Loans to Total Assets Ratio LAR

Table 4

LAR	N	Mean	Std. Deviation	Std. Error Mean	F	Sig.
C B	4	38.5850	11.96011	5.98006	8.424	.027
IB	4	30.6825	22.43625	11.21812		

LDR of both sets of bank show almost similar results in the different years. The results show the mean of conventional banks' LDR (38.58) is higher than LDR of Islamic banks (30.68). Moreover, statistically there is significance difference between the two means at 5% significance level. This finding demonstrates that both the sets of banks maintain an adequate level of liquidity, when a bank maintains high liquid asset, as a result it will have a high liquidity ratio, so the bank can mitigate liquidity risks.

Total Loans to Deposit Ratio LDR

Table 5

LDR	N	Mean	Std. Deviation	Std. Error Mean	F	Sig.
C B	4	67.3600	14.31373	7.15686	.154	.708
IB	4	65.7275	21.31691	10.65846		

LAR of Islamic bank is on increasing trend LAR during the period of study which indicates higher loans (investments) made by Islamic bank. The average LAR of Islamic banks is higher than conventional banks' LAR. However, statistically there is no difference in two means at 0.05% level of significance, this finding demonstrates that Islamic bank maintain an adequate level of liquidity compared to conventional bank.

Cash and Portfolio Investment to Deposit and Borrowing Ratio CPIDBR

Table 6

CPIDBR	N	Mean	Std. Deviation	Std. Er ror Mean	F	Sig.
CB	4	27.9675	3.12052	1.56026	5.675	.055
IB	4	112.2450	52.79722	26.39861		

There is an increase in ratio of cash & portfolio investment to deposits & borrowings of both Islamic bank and conventional bank during period of study. However, the most important thing to note is that the ratio of Islamic bank is very higher than that conventional bank.

Higher CPIDBR of conventional bank supports that conventional bank are less liquid as compared to Islamic bank. Table 6 shows that mean CPIDBR of Islamic bank (112.24) is higher and statistically different from mean CPIDBR of conventional banks (27.96) at 5% significance level. Overall result indicates that Islamic bank is as liquid as the conventional bank but conventional bank is more liquid than Islamic bank. Table-6.6 shows that the average LAR of conventional bank is very high than that of Islamic bank; however, the difference is statistically significant at 5% significance level

The results of LDR, LAR and CPIDBR are consistent with some studies' outcomes (e.g. Jaffar and Manarvi, 2011 and Iqbal, 2012). On the other hand, however our findings contradict with results reported by other studies (e.g. Hanif et.al, 2012 and Fayed, 2013). While another stream of literature

indicates no significant difference between the two sets of banks in terms of liquidity performance (e.g. Moin, 2008).

CONCLUSION AND RECOMMENDATIONS

The main objective of this study is to assess the financial performance of banking sector in Nigeria using financial ratio analysis (FRA). With a focus to compare between Islamic and conventional banks performance over the period (2012-2015). Aiming to answer the question as to which group of banks, Islamic or conventional, is pioneer in performance. This is one of the few research attempts to compare between performance of conventional bank and Islamic bank in Nigeria.

However, On the basis of analysis of profitability measures, conventional banks are more profitable and are significantly different from Conventional bank in Return on Assets (ROA), Return on Equity (ROE), and Profit Expense Ratio (PER), these are stated on the mean and p-value of the analysis. In case of liquidity measures, LDR and LAR of the two set of banks shows that conventional banks are found to be better in liquidity position than the Islamic banks. Findings also show that LDR of both the two sets of banks are stable and moving within a particular range. In case of LAR and LDR conventional banks' liquidity position is better than that of Islamic banks. Islamic bank perform better than conventional bank only on Cash and Portfolio Investment to Deposit and Borrowing Ratio CPIDBR.

The limitation of this study is that both Islamic banks and conventional banks are placed on an equal footing under financial ratio measures, irrespective of the bank's size and its ownership. Although the study has clear limitations, it makes useful contribution to the financial performance literature. Future studies could examine the effects of bank size (i.e. small, medium, and large) and the capital ownership on the determinants of the financial performance of Islamic and conventional banks in Nigeria.

The study recommends that Islamic banks should focus on new products development and innovative solutions to meet client's needs, also Islamic banks needs to strengthen their equity base.

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