



Competitiveness of Islamic Financial System: An Empirical Analysis of Internal and External Factors Influence on Pakistan Islamic Bank's Profitability

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Received 14 Nov. 2020, Accepted, 2 Feb. 2020, Published 1 June. 2020

Abstract: Islamic banks can be defined as a non-interest-based institution that fully acts under Islamic laws. Due to being less affected by the global financial crisis Islamic bank grabbed the attention of researchers, but in Pakistan the growth rate of Islamic banks is very low. Pakistan Islamic bank sector has not achieved even 15% of overall market share in banking industry (12.9% SBP, Islamic Bank Bulletin, 2018). The purpose of this study is to find the reasons of bankruptcy and decline in profitability of Pakistan's fully fledged Islamic banks and determine the primary drivers of Islamic bank's profitability. The study proposed an integrated model which examines the Bank specific/Internal and Environment Specific/External Factors influence on Islamic bank's Profitability. Managers and academics know fairly little about how the collective effects of these internal and external factors influence the Islamic bank's profitability. Study is quantitative in nature and primary data was collected from 508 senior managers of Pakistani Islamic banks. Conclusively, finding reveal that internal/bank specific, external factors have significant and positive impact on Islamic bank's profitability. Results of study is helpful for the practitioners and policy makers to understand reasons of profitability decline and make new polices for Islamic banks growth

Keywords: Bank specific factors, Internal factors, Environment specific Factors, External Factors, Profitability, Fully Fledged Islamic Banks, Senior Managers.

JEL Classification: G21, E44

1. Introduction

Over the last four decades since its inception, the Islamic banking industry has been growing continuously. This sustained increase in the activities of Islamic banks is one of the reasons they have been receiving global attention (Omar and Mondher 2010). The total estimated number of Islamic banks around the world has reached about 400, across 53 Muslim and non-Muslim countries. In 2009, the estimated funds of the Islamic banking sector had reached between US\$500 billion and US\$1 trillion, with an annual growth of 10–20%. The banking industry in Pakistan has seen major changes in the last 62 years. It faces several problems, such as capital inadequacy, the socioeconomic condition of the country and uncertainty due to political instability (Zubair & Chaudry, 2014). Changes have been made by the State Bank of Pakistan (SBP) in accordance with the State Bank of Pakistan Act (1956), which motivates the private sector to set up banks and financial institutions (Zubair & Chaudry, 2014). In past decades, there were only conventional banks which perform operations based on interest, later on the Islamic banks were introduced as the result of conservatism trend, in which Islam followers show their need to follow banking practices in light of Sharia laws and ensure the soundness of their Muslim economies as explained by Masood, (2013).



In today's environments where high competition is prevailing in the economy, in order to retain customer in the competitive economy, financial institutions are focusing on some essential aspects which enhance the Profitability of Islamic banking sector (Akter & Mahmud, 2014). These important factors lead towards a greater performance of financial sector i.e. bigger market share and better profitability (Maqbool, 2014). Today major problem faced by Islamic banks are decline in their profitability and there are various reasons that Islamic banking sector is not as much as profitable as compared to conventional banks (Mohiuddin et al, 2018). So, focus of present study is to analyze the reasons and factors which influence the Islamic banking sector profitability in long run. This study is considering eight major factors (Quick Ratio, Cash Deposit Ratio, Non-Performing Loans, Net Gearing Ratio, Asset Composition Ratio, Service Quality, Religious Obligation and Competitive Advantage), which may influence the Islamic banking sector profitability. This study is helpful to understand the reasons of Islamic banks profitability decline and low market share (Masood, 2013). The study will be useful for policy maker and practitioners to make new structure and policies for Islamic banks and to focus on major problem faced by Islamic bank (Inyangala, 2014).

Islamic Banks Profitability: The profitability of the Islamic Bank is defined as how much profit a bank generates in respect of its operations. The profit of banks describes how much bank return is against its paid taxes and other expenses (Wulandari & Subagio, 2015; Masood & Javaria, 2017). The most common measure of bank performance and efficiency is called profitability analysis (Kumbirai & Webb, 2010). Measuring the profitability of Islamic banking sector is very important as it enables the banking system to stay competitive and finance the operations of banks. Several researchers anticipate the Islamic banking sector to be more profitable than the conventional banking system of the country (Al-Hares et al., 2013; Olson & Zoubi, 2008; Khediri et al., 2015).

Purpose of Study: The banking sector plays a vital role in development of economic system (Rasul 2013). Purpose of this study is to analyze the reasons of decline in profitability of Pakistan's fully fledged Islamic banks as currently there are only four Islamic banks working in Pakistan. After thirty years of their operation, Islamic banks can not even achieve 15% of Pakistani banking industry market share and they are still on 12.9% (SBP, Islamic Bank Bulletin 2018). This study is very important in nature because it identifies the reason that why Islamic banks are getting bankrupt in an Islamic country of "Islami Jamhoooria Pakistan". According to previous theoretical background and current scenario, researcher has identified various factors/reasons of Islamic banks profitability decline. The factors identified by present study are Bank specific/Internal Factors and External factors. Researcher has tried to include all aspects and problems which influence the Islamic banking industry internally and externally.

The motivation behind this study is to identify the problem/reasons that why Islamic banks are not competitive in Islamic country "Pakistan". In 2007 there were 7 Islamic banks including Meezan Bank Limited, Dubai Islamic Bank, Bank Islami Pakistan, Al-Baraka (Pak Ltd), First Dawood Islamic bank Limited (FDIBL), Burj bank limited, Emirates Global Islamic Bank Limited (EGIBL) were working in Pakistan (SBP Islamic Bank Bulletin, 2007). Currently there are only four fully fledged Islamic banks working in Pakistan. According to previous studies and pilot testing results, this study has identified various factors/reasons of decline in Islamic banks profitability and these factors include Bank Specific/Internal factors (Liquidity Ratios) and Environment specific/External Factors (Zubair & Chaudry, 2014). Lack of liquidity management (such as marketable securities, treasury bills) is one of the important issues faced by Islamic banks in Pakistan. These securities could be utilized either to manage liquidity excess or to cover the shortage of liquidity (Akter & Mahmud, 2014). This issue is aggravated since many Islamic banks of Pakistan are working under different operational procedures from those of the conventional banks; the resulting non compatibility prevents the "State Bank of Pakistan" from giving



support or controlling the activities of Islamic banks if gap in the liquidity should occurs (Shafana, 2015). So, the liquidity management issue must come under the scrutiny and active discussion by the involved authorities in Islamic banks of Pakistan.

Aims and Objectives of this study are:

“To identify reasons of decline in profitability/bankruptcy of Pakistan fully fledged Islamic banks.”

“To find the significant relationship between Bank Specific/ Internal Factors (Non-Performing Loans, Net Gearing Ratio, Asset Composition Ratio, Quick ratio and Cash Deposit ratio) and Islamic bank’s profitability.”

“To examine that weather External Factors (Competitive Advantage, Service quality and Religious Obligation) have significant and positive influence on Islamic bank’s profitability.”

“To identify difference between four sampled Islamic banks in relation to their internal, external and macroeconomic factors”.

2. Literature Review

11 In Pakistan, there is a set of mixed backgrounds in the context of ethnic and religion. The State Bank of Pakistan has approved two parallel systems in the country, Islamic and conventional banking systems (Zubair & Chaudry, 2014). The banking system in Pakistan started in 1947 after independence, but Islamic banking started in the 1980s when the government has identified the needs of its customers (Masood & Javaria, 2017; Zubair & Chaudry, 2014). This study is conducted in the perspective of Islamic Banks in Pakistan on why their profitability is declining over time (Faleel, 2012; Javaria, 2016). The study analyzed the reasons for the decline in profitability and factors that contributed significantly to the development of the Islamic banking industry in Pakistan. Literature review is divided into three sections where section one explains the Islamic banking sector background and current situation of Islamic banks in Pakistan. Section two explains relationship analysis and third section provide theoretical support/foundation of study.

SECTION 1: ISLAMIC BANKING SECTOR AND CURRENT SITUATION OF PAKISTAN ISLAMIC BANKS

Difference between Interest based and Interest free Banking System:

Both interest-free (Islamic) and interest-based (Conventional) banks are operating under the banking system. Both banks have different ways to operate along with their respective products, and no excess fund can be shifted from interest-based to interest-free banks. As reported by, Ahmad, (2016), in their study that all interest-free banks have greater or excess liquidity. In addition, Hamid and Azmi (2011), argues that in the absence of local capital market the interest-free banks were suffering from investing in liquidity projects, all their idle funds (Masood & Kiran, 2019). As the interest-free and interest-based banks are operating at different principles. Study findings discovered that in term of profitability/ performance of both banks (interest based and interest free) there is no significant difference, while in term of credit performance there is significant difference of interest based as compare to interest free banks.

Islamic Bank Condition in Pakistan:

Being a Muslim country, Pakistan is a favourable ground for Islamic banking to grow and explore more opportunities. As per teaching of Islam Riba (Interest) is strictly prohibited by Islam and it is haram so after independence of Pakistan, it was solid ground for marketers to preach and



practice Islamic Banking in a traditional society. After independence, the country had no trained and skilled worker and also no setup was available (Wulandari & Subagio, 2015). The country was faced lots of teething problems and most of the attention was given to those asserted issues (Novi, Emir & Farida, 2019). Country was following the basic requirement of conventional banking (Inyangala, 2014). Recently, it was recognized that Islamic banking system rules, norms and ethics are neglected in Pakistan. Therefore, all market attention was diverted towards Islamic banking system of country and formulizes the laws for Islamic banking (Faleel, 2012). An extensive growth was witnessed in Islamic banking sector from 2002 to 2010. Although the growth share of Islamic banking industry was only 5% but it was expected that this growth will increase around 15% in coming years (Hamid and Azmi, 2011). The expectations did not meet outcomes and after 2010 this sector did not flourished as it was expected to be in next five years. In Pakistan, Islamic banking sector only achieved 12.9% of market share from overall banking industry, while conventional banking has the remaining 88% shares in 2018 (SBP, Islamic Banks Bulletin, 2018). There were lots of challenges faced by Islamic banking sector during transition, at the same time this sector invites many opportunities for stakeholders and scholars to explore the new dimension of banking (Zubair & Chaudry, 2014). There were many studies conducted on Islamic banking sector which were utilized as per need of country/Pakistan (Masood, 2013).

Statistics of Islamic Banking Sector

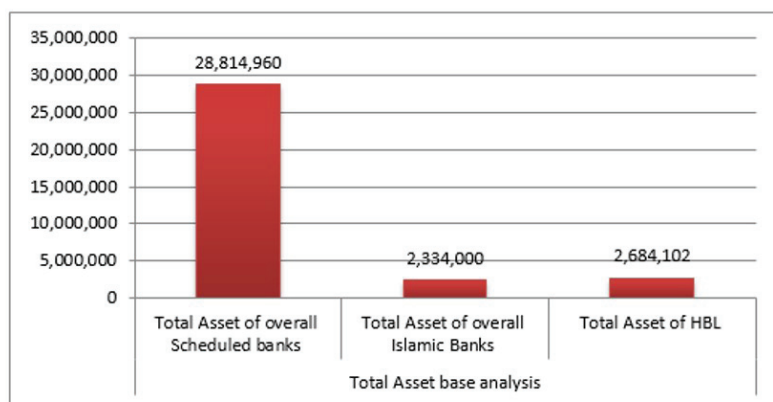


Figure 1 Source: Statistics & Data Warehouse Department, SBP (2018)

- Total Assets of overall Scheduled banks = 28,814,960.0 (In Millions) (Source: Statistics & Data Warehouse Department, SBP 2018)
- Total Assets of Islamic Banks = 2,334,000 (In Millions) (Source: Data submitted by banks under quarterly Reporting Chart of Account (RCOA), Islamic Banking Department State Bank of Pakistan, 2018)
- Total Assets of Islamic Banks are only 8% of the Scheduled bank's total assets
- Total Asset of HBL = 2,684,102 (In Millions) (HBL Annual Financial Report, 2018) (KPMG Chartered Accountant, Commercial Banks Operating in Pakistan 2018)
- Total Assets of Islamic Banks are only 87% of Habib Bank Limited's total assets.



- Islamic Banks have a 12.9% share in the overall banking industry and the remaining 88% is still under conventional banking (SBP, Islamic Banks Bulletin, 2018)
- Conventional banks' deposits are 12,522 billion and Islamic banks' deposits are 1,133 billion (KPMG Chartered Accountant, Commercial Banks Operating in Pakistan 2018)

SECTION 2: THEORETICAL AND RELATIONSHIP ANALYSIS

Importance of Profitability in Islamic Banks

The profitability of Islamic banking sector defined that how much a bank is generating profit with respect to its operations. The profit of banks describes that how much bank return is against its paid taxes and other expenses (Al Hares et al., 2013). The most common measure of bank performance and efficiency is called profitability analysis (Kumbirai & Webb, 2010). Measuring the profitability of Islamic banking sector is very important as it enables the banking system to stay competitive and finance the operations of banks. There are number of researches which expect that Islamic banking industry should be more profitable than conventional banking system of country (Al-Hares et al., 2013; Olson & Zoubi, 2008; Khediri et al., 2015). By applying the non linear, linear and generalized movement method statistical tests, researcher found the evidence regarding their hypothesis. It is analyzed that the Islamic banks higher profitability stems from their restricted access of inter-bank market equity financing. Thus, Islamic banks have to rely on safer and cheaper source of investment financing like investment deposits etc (Al-Hares et al., 2013). Conversely, Samad (2008) conducted his study on Islamic and conventional banks profitability analysis through ratio analysis of return on asset, return on investment and earnings per share. The finding of study shows that conventional banking system has more opportunities than Islamic banking system and conventional banks are to be more profitable since Islamic banks opportunities of investment are very low and they are not allowed to give or take interest rate from depositor and lender (Ben & Fatma, 2018).

Relationship Analysis

Influence of Quick Ratio on Islamic Bank's Profitability

Alshatti (2015), in his study, use quick ratio in addition with some other ratios. He calculated quick ratio by subtracting current assets and inventory and then dividing it by current liabilities, and found that quick ratio positively and significantly associated with profitability of Jordanian interest based banks.

H1: Quick ratios is important factor to influence the Islamic Banks Profitability

Influence of Cash Deposit Ratio on Islamic Bank's Profitability

Rasul (2013), use the cash deposit ratio to measure the liquidity of Islamic banks of Bangladesh. Study examined the data of 11 years (from 2001 to 2011), and found a significant relation of this variable with the profitability (Riadi, Rifki & Syaqui, 2018).

H2: Cash Deposit ratios is important factor to influence the Islamic Banks Profitability.

Influence of Non-Performing Loan on Islamic Bank's Profitability

Bhattarai (2016) stated that there is significant influence of non-performing loans on profitability of commercial banks working in Nepal. Study found that nonperforming loan has negative influence on organization return on asset whereas the ratio of nonperforming loans positively influences the return on equity of bank.



H3: Non-Performing Loans is important factor to influence Islamic Banks Profitability

Influence of Gearing Ratio on Islamic Bank's Profitability

Study conducted by Pratheepan, T., & Yatiwella (2016) investigated the listed companies of sugar in Pakistan stock exchange. Researcher analyzed the association between debt to equity ratio/ gearing ratio and profitability of firm (Return on asset and return on equity), the results of study showed that there is negative and significant relationship between gearing ratio and return on equity while positive **influence of gearing ratio and return on asset.**

H4: Net Gearing Ratio is important factor to influence the Islamic Banks Profitability

Influence of Asset Composition Ratio on Islamic Bank's Profitability

The study conducted by Riaz, (2013) explained that asset composition ratio highly influence the profitability of firm. The study shows that this ratio explains whether asset of bank includes high debt or not. High debt to asset ratio is not good for organization as it has negative influence on the profitability of firm.

H5: Asset Composition Ratio is important factor to influence the Islamic Banks Profitability

Influence of Competitive Advantage on Islamic Bank's Profitability

Study conducted by Dickinson & Sommers, (2012) results revealed that the entrant of new comers will not affect the existing banks profitability when there is huge competition prevail in the economy. Researcher stated that competitive advantage of banks help them to gain long term profit in the market.

H6: Competitive Advantage positively influence the Profitability of Islamic Banking sector

Influence of Service Quality on Islamic Bank's Profitability

The quality of service generated is highly depends upon customers and their ability to participate in process of service and also on the ability to recognize the service quality generated. According to Auka, (2012), Service quality positively and significantly influences the profitability of Islamic bank as better quality of services is always preference of customer.

H7: Service Quality positively influence the Profitability of Islamic Banking sector.

Influence of Religious Obligation on Islamic Bank's Profitability

Yusoff and Azurah (2014) asserted that in order to figure out the Muslims' behavior regarding traditional services and suitability, the most essential element is religion. Based on previous studies, Awan and Azhar (2014) defined Islamic ethical behavior. This study is Pakistan based and according to this study customer choose Islamic bank because it avoid interest which is prohibited in Islam. The study found positive relationship between religious obligation followed by banks and customer preference also positive association found with bank profitability.

H8: Religious Obligation positively influence the Profitability of Islamic Banking sector.

SECTION 3: THEORETICAL SUPPORT/ FOUNDATION

In this section, selected topic is supported by various theories which are used to define nature of relationship existence.

The Anticipated Income Theory

The theory of anticipated income was developed in 1944 and author of this theory was H.V. Prochanow. Prochanow in 1949 regarding liquidity management by the banks; according to this theory



banks should offer short term as well as long term loans. They have no need to keep too much liquid assets (Quick Ratio and Cash Deposit Ratio); neither needs they to invest in short term marketable securities for their liquidity management but they should manage their liquidity on the basis of anticipated income of the borrowers.

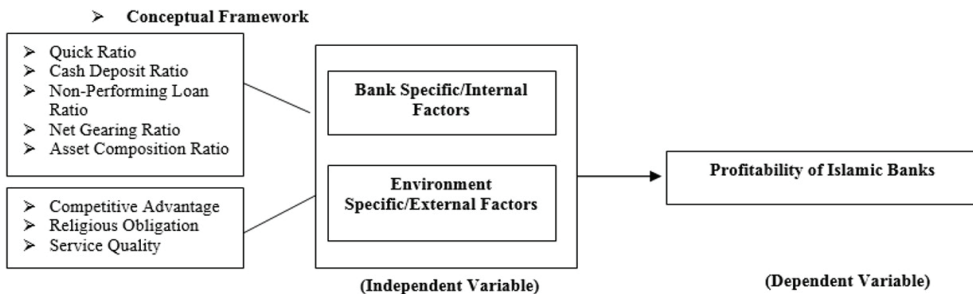
The Asymmetry information theory

The Asymmetry information theory supported the concept of non-performing loans factor selected by present study. According to current study non-performing loans of bank has serious impact on the profitability of organization. Asymmetry information theory supported this concept and explained that reasons of non-performing loans are wrong and irregular information flow between buyers and sellers and it cause low profitability of bank.

Theory of Reasoned Action

According to this theory our every action is based on some reason and theory of reasoned action model predict the behavioral intention of individual (Hosseini et al., 2015; Nguyen et al, 2017). So, customer action of making decision regarding Islamic bank product is based on bank’s excellent competitive advantage, service quality and religious obligation (following Shariah complaints).

Conceptual Framework



3. Methodology

9 Methodology section shows the research approach, specification, data collection process and details of data in order for it to be examined. Ramamurthy (2011) describes that primary data source provides efficient information, and the researcher is able to examine new updated information. Study utilized the primary data collecting technique. Survey was conducted from senior managers of Islamic banks in order to examine the internal and external factors influence on Islamic banks profitability. Researcher also gets input from senior managers regarding role (factors ranking) of internal factors in generating the profitability of Islamic banks. This is the major contribution of present study, is identifying the various factors externally and internally from profitability analysis of Islamic banks. Another contribution of methodology is that study collected data from fully fledged Islamic banks the data was collected from ten big cities of Pakistan. No study has been conducted to explore the reason of profitability decline and bankruptcy of Islamic banking from last ten year. The present study focuses on fully fledged Islamic banks and data was collected from major ten cities of Pakistan because these cities are business hubs and every Islamic bank have their many operational branches in these cities. The sample of four fully fledged Islamic banks includes Meezan Bank Limited, Dubai Islamic Bank, Bank Islami Pakistan, Al-Baraka (Pak Ltd). The study is quantitative in nature and deductive (Bose, 2017) reasoning is applied to test the hypothesis. Lastly, study’s methodology contributed in sampling



techniques of study, a multi-stage probability sampling process was used. For this study researcher made strata of four provincial capitals and one federal capital (Punjab, Sindh, Baluchistan, KPK and Islamabad federal capital area). Further, researcher made sub-strata (from big five strata) of ten big cities of Pakistan includes Karachi, Lahore, Faisalabad, Rawalpindi/Islamabad, Gujranwala, Peshawar, Multan, Hyderabad, Quetta and Bahawalpur. Reason of first ten big cities choice is that, these cities are hub of business in Pakistan and have huge number of population that's why banks mostly target their branch network in big cities so they can easily access their customers. After making sub-strata of big ten cities researcher was focused on Disproportionate Stratification (Ahamed, 2017) in which the size of each stratum is not proportional to its size in the population (Sekaran, 2014). So for this study, sample of 508 senior bank managers who were able to provide time and easily accessible were used.

Econometric Equation:

Pro (DV) = $\alpha_0 + \beta_1 QR + \beta_2 CDR + \beta_3 ACR + \beta_4 NPL + \beta_5 NGR + \beta_6 CA + \beta_7 RO + \beta_8 SQ + e$

The description of the models used in the current study is provided as below:

Pro (DV) = Profitability

QR = Quick ratio

CD = Cash to deposit ratio

ACR = Asset Composition Ratio

NPL = Non-Performing Loan Ratio

NGR = Net Gearing Ratio

CA = Competitive Advantage

RO = Religious Obligation

SQ = Service Quality.

4. Research Analysis

Demographic Analysis:

The purpose of demographic analysis is to examine the sample characteristics of the study. This analysis includes age, gender, professional training and year of experience in Islamic banking sector. Basically, demographic analysis is used to analyze the personal data regarding participant of study.

Table 1: Demographic Analysis

Questions	Options	Percent	Observation
Gender	Male	63.05%	508
	Female	36.95%	
Age	Below 20	0.49%	508
	21-30	16.75%	
	31-40	49.26%	
	41 & Above	33.50%	
Highest Educational Degree	Bachelors	10.34%	508
	Master	40.89%	
	Professional Degree	36.45%	
	Doctorate	0.49%	
	Others	11.82%	
Marital Status	Single	48.77%	508
	Married	51.23%	



Questions	Options	Percent	Observation
Year of Experience	1-5 Years 5-10 Years 10-15 Years >15 Years	28.08% 39.90% 25.12% 6.90%	508
Professional Trainings	1-5 Years 5-10 Years 10-15 Years >15 Years	22.17% 36.45% 27.59% 13.79%	508
Islamic Bank	Meezan Bank Limited Dubai Islamic Bank Bank Islami Pakistan Al-Baraka (Pak Ltd)	26.60% 24.63% 24.63% 24.14%	508
Position/ Role in Bank	Senior Loan officer Branch Manager Senior Direct Sales Representative Senior Relationship Manager Data processing Officer Customer Relationship Manager General Manager Bank Marketing Representative	10.84% 14.29% 11.33% 15.27% 12.32% 12.81% 11.82% 10.84%	508
Branch Name	Lahore Karachi Faisalabad Rwp/Isb Gujranwala Peshawar Multan Hyderabad Quetta Bahawalpur	10.34% 9.85% 11.82% 11.33% 10.34% 9.85% 8.87% 9.36% 8.37% 11.33%	508

Table 1 shows the demographic analysis of primary data. In sample of this study, majority of senior manager of Islamic banks were male. The highest educational degrees of most of the manager were "Master" as shown in the table. The answer of marital status question shows that most of the senior branch managers of bank were married. After this researcher asked for the year of experience they have in banking industry and it shows that most of the manager 40% have between 5 to 10 year experiences. According to sample of Islamic banks, most of the "Senior Bank Managers" were working at Meezan Bank Limited. There were 27% of senior banks managers who belongs to Meezan Bank Limited. There are eight positions in bank which are analyzed as senior post/ role in the banking sector. So, researcher collected data from those senior bankers for further analysis. Most of the senior manager position / role in bank were Senior Relationship Manger which was about 15% in Islamic banks. The last question was about their Branch name and address where most of the data about 12% was collected from Faisalabad.



Reliability Analysis

Reliability analysis shows the consistency and stability of item used to conduct the study.

Table 2: Reliability Analysis of Study

Figure 1. Variables	Figure 2. No of items	Figure 3. Alpha	Figure 4. Mean
Figure 5. Competitive Advantage	Figure 6. 5	Figure 7. 0.928	Figure 8. 2.871
Figure 9. Religious Obligation	Figure 10. 3	Figure 11. 0.783	Figure 12. 2.674
Figure 13. Service Quality	Figure 14. 4	Figure 15. 0.630	Figure 16. 2.434
Figure 17. Quick Ratio	Figure 18. 4	Figure 19. 0.929	Figure 20. 2.359
Figure 21. Cash Deposit Ratio	Figure 22. 4	Figure 23. 0.705	Figure 24. 2.539
Figure 25. Non Performing Loans	Figure 26. 4	Figure 27. 0.929	Figure 28. 2.431
Figure 29. Net Gearing Ratio	Figure 30. 4	Figure 31. 0.664	Figure 32. 2.468
Figure 33. Asset Composition Ratio	Figure 34. 4	Figure 35. 0.648	Figure 36. 2.589

Table 2 shows the Reliability Analysis which shows that all items understudy are reliable and consistent. So, the analysis shows that all item values are greater than 0.60 and lies above from the alpha range so it is stated that all items are reliable and accurate for further analysis.

Normality Analysis:

Test of Normality analysis is conducted to measure that data lies in normal distribution range and also to know that whether data is well-modelled.

Table 3: Normality Analysis of Study

Figure 37. Variables	Figure 38. Skewness	Figure 39. Kurtosis
Figure 40. Competitive Advantage	Figure 41. 0.510	Figure 42. -1.107
Figure 43. Religious Obligation	Figure 44. 0.333	Figure 45. -1.082
Figure 46. Service Quality	Figure 47. 0.570	Figure 48. -0.295
Figure 49. Cash Deposit Ratio	Figure 50. -0.399	Figure 51. -0.070
Figure 52. Quick Ratio	Figure 53. 0.007	Figure 54. -0.677
Figure 55. Non Performing Loans	Figure 56. -0.218	Figure 57. -0.405
Figure 58. Net Gearing Ratio	Figure 59. 0.098	Figure 60. -0.873
Figure 61. Asset Composition Ratio	Figure 62. -0.094	Figure 63. -0.688

Table 3 shows the normality analysis of study. This method is used to check the normality of data through value of Skewness and Kurtosis. The skewness and kurtosis values of all variables understudy lies between -1 to +1 and +3 to -3 respectively and it shows that data lies in range of normality and it is normally distributed.



Survey Analysis of Internal and External Factors

Table 4: Internal and External Factors Analysis

Figure 64.	Figure 65. Very Un- Important	Figure 66. Un-Important	Figure 67. Neither Important Nor Un-Important	Figure 68. Important	Figure 69. Very Important
Figure 70. Cash Deposit Ratio and Profitability	Figure 71. 6.25%	Figure 72. 16.38%	Figure 73. 11.25%	Figure 74. 41.13%	Figure 75. 25.00%
Figure 76. Quick Ratio and Profitability	Figure 77. 15.38%	Figure 78. 29.88%	Figure 79. 21.38%	Figure 80. 20.50%	Figure 81. 12.88%
Figure 82. Non Performing Loans and Profitability	Figure 83. 8.00%	Figure 84. 11.75%	Figure 85. 17.38%	Figure 86. 39.25%	Figure 87. 23.63%
Figure 88. Net Gearing Ratio and Profitability	Figure 89. 14.25%	Figure 90. 38.00%	Figure 91. 14.00%	Figure 92. 16.00%	Figure 93. 17.75%
Figure 94. Asset Composition Ratio and Profitability	Figure 95. 9.75%	Figure 96. 23.63%	Figure 97. 22.13%	Figure 98. 34.50%	Figure 99. 10.00%
Figure 100. Competitive Advantage and Profitability	Figure 101. .00%	Figure 102. .00%	Figure 103. 0.25%	Figure 104. 0.50%	Figure 105. 8.25%
Figure 106. Service Quality and Profitability	Figure 107. .00%	Figure 108. 0.63%	Figure 109. 5.38%	Figure 110. 0.25%	Figure 111. 0.75%
Figure 112. Religious Obligations and Profitability	Figure 113. .00%	Figure 114. 0.13%	Figure 115. 9.75%	Figure 116. 4.38%	Figure 117. 1.75%

Table 4 provides the details of Senior manager response regarding influence of internal and external factors influence on Islamic banks profitability. Internal factors which influence the Islamic bank profitability are quick ratio, cash deposit ratio, non-performing loans, asset composition ratio and net gearing ratio. Quick ratio is a measure of the company's ability to meet its obligations in the short term. Data collected from the senior manager of Islamic banks revealed that quick ratio is an unimportant factor of Pakistan Islamic banks. So, 12.88% or 13% of the respondent (senior bank managers) stated that quick ratio is very important to influence the profitability of banks. Study explained that quick ratio has little contribution in generating Islamic bank's profitability. In commercial banks customer are attracted with high interest rate on deposits while in Islamic banking system this activity is haram. So, Islamic banks need to provide range of products which are acceptable in Islamic Shariah and help to increase customer interest. This activity help to increase the Islamic banks cash deposit ratios and ultimately influence the profitability of Islamic banks. So 25.00% or 25% of the respondent (senior bank managers) stated that cash deposit ratio is very important to influence the profitability of banks, 41.13% or 41% stated that cash deposit ratio is important for Islamic banks. The analysis of non-



performing loans ratio and profitability shows that most of the respondent agreed on the statement that non-performing loans ratio has negative influence on profitability of Islamic banks. Data collected from the senior manager of Islamic banks revealed that non-performing loans is an important factor of Pakistan Islamic banks. So, 23.63% or 24% of the respondent (senior bank managers) stated that non-performing loans ratio is very important to influence the profitability of banks, 39.25% or 39% stated that non-performing loans ratio is important for Islamic banks. When dues is already exposed to creditors of firms, they understand that company might not be able to pay back its debts. But in case of Islamic banks gearing ratio plays very small role as Islamic banks cannot make extra capital. Islamic banks need to utilize their equity and they cannot rely on debt. So, 17.75% or 18% of the respondent (senior bank managers) stated that net gearing ratio is very important to influence the profitability of banks. The analysis of asset composition ratio and profitability shows that most of the respondent agreed on the statement that asset composition ratio has positive influence on profitability of Islamic banks. Data collected from the senior manager of Islamic banks revealed that asset composition ratio is an important factor of Pakistan Islamic banks. So, 10.00% or 10% of the respondent (senior bank managers) stated that asset composition ratio is very important to influence the profitability of banks, 34.50% or 35% stated that asset composition ratio is important for Islamic banks.

External factors which influence the Islamic bank profitability are Competitive Advantage, Service Quality and Religious Obligation. In case of Religious Obligation, many of the senior managers stated that customer have lack of awareness regarding Islamic banks products. They explained that most of the customers think that Islamic banks are not following religious obligation and they are charging hidden charges from customer which is equivalent to interest rate. The respondent (Senior bank managers) explained that it is very important for Islamic banks to follow religious obligations, sharia complaints, in order to become more profitable. So 32.17% of the respondent (senior bank managers) strongly agreed that religious obligation have major influence on banks profitability. In case of Service quality, The senior manager describe that they are trying to provide excellent services to their customer but their services are not competitive to non Islamic rivals/ Conventional banking sector of Pakistan. Reason behind this phenomenon is, Islamic banks need to follow sharia complaint and they cannot offer financing for "Haram Product" which highly influence the profitability of banks. So 51.75% or 52% of the respondent (senior bank managers) strongly agreed that service quality has major influence on banks profitability. There is huge competition exist in banking sector of Pakistan and having competitive advantage matter most for the Islamic banks. Islamic are not facing only Islamic rivals but they also need to compete with non Islamic / conventional banking rivals. So 37.80% or 38% of the respondent (senior bank managers) strongly agreed that their competitive advantage have major influence on banks profitability.

Open Ended Questionnaire: In your opinion what are other major factors and reasons of decline in profitability of Pakistan Islamic banking sector?

Researcher stated last question as open ended in questionnaire and asked for Senior Management opinion regarding Islamic banks profitability decline. There are eight factors identified in this study and researcher asked the Senior Managers of Islamic banks to identify factors other than variables understudy. Different Senior Managers identified different factors as reason of Islamic banks profitability decline. The major focused factors are given below:

- Low Awareness of Islamic banking products and procedure (lack of clarity of Shariah compliance and awareness of Islamic banking practices)
- Fear of wrong use of customer money in Non-Sharia products.
- High liquidity keeping



- Lack of Trust
- Not competitive like conventional banks
- Staff is not highly trained so cannot convince customer (Need Training)
- Customer religion sentiments does not match the Islamic banks product offering
- Low inner satisfaction/faith cause less acceptability of Islamic banks as compare to conventional banking sector

Table 5: Results Summary

Hypotheses	Theoretical Support/ Results	Graphical Representation Results	Results Justifications/ Reason
H1: Quick ratios is important factor to influence the Islamic Banks Profitability	<u>Positive and Sig Relation</u> Alshatti (2015), Malik et al. (2016), Ishaq et al. (2016)	33.38 Percent Senior Bank Managers agreed with this statement	<u>Less contribution but Significant</u>
H2: Cash Deposit ratios is important factor to influence the Islamic Banks Profitability	<u>Positive and Sig Relation</u> Mansoor Khan, Ishaq Bhatti, and Siddiqui (2008), Shahchera (2012)	66.13 Percent Senior Bank Managers agreed with this statement	<u>Positive and Insignificant</u>
H3: Non-Performing Loans is important factor to influence Islamic Banks Profitability	<u>Negative and Sig Relation</u> Bhattarai (2016), Kiran and Jones (2016), Lata (2015)	62.88 Percent Senior Bank Managers agreed with this statement	<u>Negative and significant</u>
H4: Net Gearing Ratio is important factor to influence the Islamic Banks Profitability	<u>Positive and Sig Relation</u> Nirajini and Priya (2013), Mwangi, et al., (2014), Sabin & Miras, (2015)	33.75 Percent Senior Bank Managers agreed with this statement	<u>Less Contribution but Significant</u>
H5: Asset Composition Ratio is important factor to influence the Islamic Banks Profitability	<u>Positive and Sig Relation</u> Burki & Niazi, (2010), Riaz, (2013), Ijaz et al. (2015)	44.50 Percent Senior Bank Managers agreed with this statement	<u>Positive and significant</u>
H6: Competitive Advantage positively influence the Profitability of Islamic Banking sector	<u>Positive and Sig Relation</u> Heikal, Malikussaleh, Khaddafi & Malikussaleh, (2016); Healy, Serafeim, Srinivasan & Yu, (2014)	61.30 Percent Senior Bank Managers agreed with this statement	<u>Positive and Significant</u>
H7: Service Quality positively influence the Profitability of Islamic Banking sector	<u>Positive and Sig Relation</u> Wijetunge, (2016); Warde, (2010); Al-Tamimi (2010); Khan and Fasih (2014)	88.75 Percent Senior Bank Managers agreed with this statement	<u>Positive and Significant</u>
H8: Religious Obligation positively influence the Profitability of Islamic Banking sector	<u>Positive and Sig Relation</u> Yusoff and Azurah, (2014); Awan and Azhar (2014)	87.34 Percent Senior Bank Managers agreed with this statement	<u>Positive and Significant</u>



5. Conclusions

Banking system is essential for the growth and development of any economy. Islamic banks are most important part of banking industry. Islamic banks follow the teaching of Islamic Sharia in their operations and practices. The Interest free banks' earnings are not dependent on any kind of interest; instead they largely depend on the liquidity for their survival and capital enlargements. This study aims to trace the reasons behind enlargement or shrinkage of financial performance of Islamic banks. In a nutshell, the aim of study was to identify the reason behind decline in the profitability of Islamic banking sector in Pakistan. Conclusively finding reveals that internal/bank specific, environment specific/ external factors have significant and positive impact on Islamic bank's profitability. Overall study found that Islamic banks try to balance the internal and external factors in order to prevent themselves from bankruptcy and to perform smooth operations. These results highlighted important issues faced by Islamic banks nowadays in order to maintain their good profitability level. The study found that Islamic banks cannot achieve expected profits enlargements without confirmation of its proper Bank specific/ liquid asset (liquidity level not too high, nor too low). Islamic banks also need to maintain their non-performing loans as according to statistics, MBL (Largest Islamic bank of Pakistan) nonperforming loans are 54% which is highest rate in the history. The increasing trend of nonperforming loans is alarming situation for Pakistan Islamic banks. Results of study are helpful for practitioners and policy makers to understand the customer need of Islamic product which follow the religious obligation and customer sentiments. Awareness of Islamic product is also very important factor as it is very important for high religious sentiments customer to understand that offered Islamic product is not fake. The major reason of profitability decline identified by this study is "Non-performing Loans". Banks should develop specific techniques and tools to differentiate genuine and willful defaulters. Banks must take first step of "Client Profiling" to improve the Non-Performing Loans management. Better data management means better combination of information, better client profiling and better risk taking on financial asset.

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