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ماجستير إدارة الأعمال

Using Financial Ratios to distinguish between Islamic and Conventional Banks in Palestine

استخدام النسب المالية للتفريق بين البنوك التقليدية والإسلامية

العاملة في فلسطين

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إقرار

أنا الموقع أدناه مقدم الرسالة التي تحمل العنوان:

استخدام النسب المالية للتفريق بين البنوك التقليدية والإسلامية العاملة في فلسطين

Using Financial Ratios to distinguish between Islamic and Conventional Banks in Palestine

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Using financial ratios to distinguish between Islamic and Conventional banks in Palestine

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والله ولي التوفيق ،،،

نائب الرئيس لشئون البحث العلمي والدراسات العليا

أ.د. عبدالرؤوف علي المناعمة



بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

﴿يَرْفَعُ اللَّهُ الَّذِينَ آمَنُوا مِنْكُمْ وَالَّذِينَ
أَوْتُوا الْعِلْمَ دَرَجَاتٍ وَاللَّهُ بِمَا تَعْمَلُونَ
خَبِيرٌ﴾

[المجادلة 11،]

Abstract

This study determines whether it is possible to distinguish between conventional and Islamic banks Palestine on the basis of financial characteristics alone.

Islamic banks operate under different principles, such as risk sharing and the prohibition of interest, yet both types of banks face similar competitive conditions. The combination of effects makes it unclear whether financial ratios will differ significantly between the two categories of banks. We input 26 financial ratios into logit to determine whether researchers or regulators could use these ratios to distinguish between the two types of banks. Although the means of several ratios are similar between the two categories of banks, non-linear classification techniques are able to correctly distinguish Islamic from conventional banks in out-of-sample tests at about a 92% success rate.

Keywords: Islamic Banks, Commercial Banks, Profitability,Risk, Palestine Exchange Market.

Dedication

Personally, I'd like to thank all those who have helped with their advice and efforts ...

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For my father`s soul, my mother, my fiancé, my family, friends and everyone, I offer my research.

With love

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List of Abbreviations

ALL	Allowance For Loan Losses At The End Of The Year
APL	Adequacy Of Provision For Loan
ATA	Average Total Assets
ATD	Average Total Customer Deposits
ATLA	Average Total Loans And Advances
ATO	Asset Turnover
CTA	Cash To Assets
CTD	Cash To Deposit
DTA	Deposits to assets
EM	Equity multiplier
ETD	Equity to deposits
IBS	Islamic Banking Scheme
IE	Interest Expenses
IEE	The Interest Income To Expenses
IFI	International Financial Institutions
IN	Interest Income
LR	Loan Ratio
LTD	Loans To Deposits
NI	Net Income
NIE	Net Non-Interest Expenses
NIM	Net Interest Margin
NIN	Net Non-Interest Income
NNIM	Net Non-Interest Margin
NOM	Operating Margin
OE	Operating Expenses
OEA	Operating Expense To Assets
OER	Operating Expenses To Revenue
OI	Operating Profit Or Income
OIA	Operating Income To Assets
OIC	The Organization Of Islamic Conference
PEA	Provisions To Earning Assets

PLL	Provision For Loan Losses
PM	Profit Margin
PMA	The Palestinian Monetary Authority
RE	Retained Earnings
RETA	Retained Earnings To Total Assets
ROA	Return On Assets
ROAA	Return on Average Assets
ROD	Return On Deposits
ROE	Return On Equity
ROSC	Return On Shareholder Capital
BOP	Bank of Palestine
PCB	Palestine Commercial
USDS	Quds Bank
PIBC	Palestine Investment Bank
TNB	National Bank
ISBK	Arab Islamic Bank
AIB	Arab Islamic Bank
ISBK	Palestine Islamic Bank

Chapter 1

Introduction

Chapter 1

Introduction

1.1 Introduction

Banking sector performs an important role in national economy; it works as a facilitator to achieve a country's sustainable economic growth through providing efficient monetary intermediation. Banks are very old entities, the word "Bank" is derived from the Italian word "BANCO" (desk/bench), but the industrial revolution in the last two centuries has brought major reforms and formalizations in the operations of banking sector. Van Horne, James and Wachowicz, John (2005) identifies bank as, "A bank is a corporation registered with either the central bank or the federal government of the country. They provide the services of deposits, withdrawals, interest dealing, making loans, discount notes, investments in financial securities etc. depending on bank's type".

During the last decades intensified competition in banking has been putting an increasing pressure on banks' returns, major financial institutions are strategically entering new markets and/or offering a diverse spectrum of products and services to consolidate their presence and boost their profitability. Among such developments comes the creation of interest free (Shariah compliant) banking, the expansion of interest free banking got popularity in 1970s with the operations entirely based on the principles of Shariah by the establishment of the Dubai Islamic Bank, since then it has been growing continuously all over the world in order to eliminate the use of interest based financial treatments and transactions, Islamic banking creates a non-interest mode of financing and it has been gaining a growing recognition as a viable mode of financing in the last three decades.

Ahmed (2000) stated that Islamic banks are just like the other conventional banks in the business of money management. However Islamic banks must be directly involved in business on the principles of profit and loss sharing in order to ensure social equity and justice among Muslims as a way of financing.

According to the organization of Islamic conference (OIC) Islamic bank is “a financial institution whose status, rules and procedures expressly state its commitment to the principle of Islamic Shariah and to the banning of the receipt and payment of interest in any of its operations”

As the Conventional banks are established under the principles of capitalism and transect business by charging interest, which is unacceptable in Islamic law, therefore Muslims left with no choice except to establish their own financial institutions under Islamic principles.

Islamic banks have grown in size and number around the world starting with the establishment of two financial institutions in Mit-Ghamr in the Nile Delta and in Karachi from 1963-1967. The progress was made in this movement by the establishment of full- fledged Islamic bank with the name of Dubai Islamic Bank in 1975(Chapra, 2001). The Islamic banking industry’s world-wide annual growth rate is more than 16%. Islamic banking has also gained approval by international financial institutions (IFI), professional bankers and the academics successfully established its identity and started performing its operations distinct from the conventional counterparts (Tahir, 2003). There are more than 300 Islamic financial institutions all over the world with investment funds in excess of \$400 billion (El-Qorchi, 2005).

Islamic banks are now operating and providing Islamic banking services in more than 60 countries worldwide with an asset base of more than \$166 billion. Some countries like Sudan and Iran have converted their entire banking systems into Islamic banking. The market share of Islamic Banks has grown from around 2% in the 1970s to around 15% in the 1990s (Aggarwal and Yousef, 2000).

It is surprising to note that global conventional banks like HSBC, Standard Chartered Bank, Deutsche Bank, Citibank, etc., offering Islamic banking services to their Muslim clients and even to those non-Muslim clients who are interested in profit and loss sharing (PLS) financial instruments.

In Palestine the financial system generally dominated by banking sector with 2 banking system; Islamic and Conventional banks. The last two decades the banking system in Palestine has begun to grow and form as a real financial institution.

The Palestinian Monetary Authority (PMA) has been established in 1994 and emerged in Palestine accompanied by the opportunity to open the Palestinian banking sector. Since 1967 extended blockade the Palestinian banking sector has been regularly increasing to reach a total of 17 banks with more than 237 branches in 2013, 10 of the 17 banks were foreign banks (8 Jordanian, one Egyptian and one foreign) with 112 branches, and 7 are local banks (5 Conventional and 2 Islamic) with 125 branches (PMA 2014).

1.2 Importance of Financial Performance Analysis

Financial performance of banks does not concern only investors, creditors and managers but also people and government authorities. In 2008, the economy in the majority of countries experienced a great recession as a result of the banks' bad performance. Consequently, many people lost their jobs and houses .

Banks performance can be measured by using both qualitative and quantitative methods and techniques, among different tools and techniques that have been provided by financial management theories accounting ratios were quite commonly used in banks performance studies. For example, (Ahmed &Khababa 1999, and Kader &Asarpota 2007) studies that have been carried for measuring banks performance using financial ratios. However, in competitive financial market, one can better understand the performance of a bank by an analysis of inter-bank comparison, studies on assessing financial performance of Islamic banks and conventional banks are pretty common in the existing literature. For instance, (Samad& Hassan, 2000; Rosly and Bakar, 2003; Samad, 2004; Olson and Zoubi, 2008, and Sehrish et al., 2012) studies explored the performance of both streams of banking (Conventional and Islamic) using financial ratios.

Khan and Jain (2007) defined the analysis of financial statements as a “process of evaluating the relationship between component parts of financial statements to obtain a better understanding of the firm’s position and performance”.

Performance evaluation is an important tool to assess the success of any business including Islamic financial industry. Generally, financial ratios are the banks’ indicators of financial performance; the financial ratio analysis provides a method for assessing the historical and current financial strengths and weaknesses of banks using information found in its financial statements as well as important clues for predicting its future.

1.3 Problem Statement

In this study, the problem statement is whether the financial ratios can be used to meaningfully distinguish between the two types of banks or not.

Islamic banking and conventional banking perform the same intermediary function and differ in the system that is used in Islamic banking which is consistent with principles of Islamic law (Shariah), there are two basic Islamic banking principles based on the interest free concept which are the Profit-and-Loss (PLS) and the prohibition of Usury .

The collection pre-determined interest from borrowers and the payment predetermined interest to the depositors, also commonly called “Riba” in Islamic discourse in performing their business intermediaries, while the conventional banking follows conventional interest-based principle; the predetermined rate of interest is the core activity .

Conventional banks make profits from the spread between the interest rate received from borrowers and the interest rate paid to depositors based on its competitive advantage at gathering information and underwriting risk.

In conventional banking, there is no risk sharing concept between the buyer and seller but assurance of fixed interest rate.

1.4 Research Objectives

The objective of this research study is to determine whether Islamic and Conventional banks in Palestine are distinguishable from one another on the basis of financial characteristics alone. Specifically the researcher utilizes 26 financial ratios to investigate whether researchers or regulators could correctly categorize a bank as Islamic or Conventional, and to understand and analyze the reasons behind performance differences. Similar to the study introduced by Olson and Zoubi (2008) that used the accounting ratios to distinguish between Islamic and conventional banks in the Gulf Cooperation Council (GCC) region.

This 26 financial ratios falls into five general categories as follows:

- Profitability ratios
- Efficiency ratios
- Asset quality ratios
- Liquidity ratios
- Risk ratios

1.5 Research Importance

Banking sector plays an important role to keep economies on the path of consistent and continuous growth and development. Indeed, given the international spread of Islamic banking practices. A study, comparing the performance of Islamic and Conventional banking using widespread interest, motivates the researcher to investigate whether accounting ratios can be used to distinguish between Islamic and Conventional Palestinian national banks, and to understand the underlying reasons for any differences between Islamic and conventional banks to have a greater understanding of performances and its drivers .

Moreover the study tries to provide full picture of banks' financial position to investors, management and shareholders. Finally the researcher hopes that the results of this study would be valuable to researchers and scholars, as it forms a basis for further research. The study is a source of reference material for future researchers on

other related topics; it would also help other academics who undertake the same topic in their studies .

1.6 Research Variables

- Profitability ratios
- Efficiency ratios
- Asset quality ratios
- Liquidity ratios
- Risk ratios

1.7 Research hypotheses

An examination of previous study by Olson and Zoubi (2008), suggest the hypothesis as follows:

- A. There is a significant difference at 5% level between Islamic banks and Conventional banks in term of profitability.
- B. There is a significant difference at 5% level between Islamic banks and Conventional banks in term of efficiency.
- C. There is a significant difference at 5% level between Islamic banks and Conventional banks in term of assets quality.
- D. There is a significant difference at 5% level between Islamic banks and Conventional banks in term of risk.
- E. There is a significant difference at 5% level between Islamic banks and Conventional banks in term of liquidity.
- F. Accounting ratios can be used to distinguish between Islamic and Conventional banks at 5% level of significance.

1.8 Research Methodology

The aim of this research is to investigate whether the “two” Islamic banks and the “five” Conventional banks in the state of Palestine are distinguishable from one another in the term of financial characteristics alone. This research employs 26 accounting ratios to distinguish between Islamic and Conventional banks that adopted from Olson and Zoubi (2008). These ratios are grouped under five

categories: **(a) profitability ratios; (b) efficiency ratios; (c) Asset quality ratios; (d) Liquidity ratios; and (e) Risk ratios .**

The remainder of the research is organized as follows: **Chapter 2**: provides a review of the literature referring to the subject matter, **Chapter 3**: discusses Palestine Stocks Market, **Chapter 4**: discuss the context of Islamic banking, **Chapter 5**: describes the research methodology used for the research, while **Chapter 6**: presents data analysis, and **Chapter 7**: discusses the empirical results and conclusion.

Chapter 2

Literature Review

Chapter Two

Literature Review

2.1 Literature Review

The standard way of thinking about banks performance focused primarily on banks structure and competition, then the desire toward researches in this area expanded to focus on banks profitability from the stand point of the effect of efficiency, thus by extension in this area researches currently are willing to distinguish between banking systems among different countries.

A number of researchers in banking literature generally agreed that direct competition between two different bank types in the same market allows a direct financial comparison between Islamic and conventional banks, hence follows national and international regulatory requirements under the supervision of the monetary authorities of their host countries, and both bank types adhere to the same accounting standards. Interestingly those literatures shed light on how accounting ratios can distinguish between Islamic and conventional banks, and to verifying the causes of the differing. For instance (Iqbal, 2001; Rosly and Bakar, 2003; Olson and Zoubi, 2008) studied the performance of Islamic Banks and compared it with conventional banks' performance using financial ratios and frontier approaches. In addition to that (Al-jarrah and Molyneux, 2003, Bader, Shamsher, and Taufiq, 2007), studies compared the efficiency of Islamic with conventional banks.

1. Ahmed and Khababa (1999):

in assessing the financial performance of commercial banks in Saudi Arabia indicate that the business risk and the bank size were the main determinant of banks performance. This conclusion was achieved through using three measure of profitability as dependent variables ROE, ROA and percentage of change in earning per share. On the other, they used four independent variables (business risk, market concentration, market size and size of the bank).

2. Samad and Hassan (1999)

study adopted inter-temporal and inter-bank performance analysis of Islamic bank (Bank Islam Malaysia Berhad, BIMB) and 8 conventional banks for the period 1984-1997. They used financial ratios in order to examine performance with respect to liquidity, profitability, risk and solvency, and community involvement of BIMB. The study reveals that statistically BIMB is relatively more liquid, less risky and more solvent as compared to conventional banks.

3. Iqbal (2001)

compares Islamic and conventional banking performance of 12 banks from both types of the same size during 1990-1998. There were two methods which were used in the research for analysis i.e. analytical trends and ratio analysis. Profitability, liquidity, risk, capital adequacy and deployment efficiency were also studied. This work concluded that both return on assets (ROA) and return on equity (ROE) for the Islamic banks are substantially higher than the conventional banks in almost all years. Moreover, the study explained that the profit ratio of Islamic banks compare favorably with international standards.

4. Rosly and Abu Bakar (2003)

examined and compared performance analysis of Islamic and mainstream banks in Malaysia, the study showed that mainstream banking performed better than Islamic Banking Scheme (IBS). Regardless of the fact that the ROA, PM, NOM and OER are found to be significantly higher in the IBS banks. However he claims that the reasons behind this was due to the larger market size, long-term experience and financial deepening factor, which IBS banks have yet to develop. Furthermore, the study claimed that, into certain extent the IBS failed to direct its' Islamic banking system away from the conventional banking system. Thus, Islamic banks are less efficient than conventional banks. This argument is supported by the study conducted by Olson and Zoubi (2008) study examined whether financial ratios can be used to distinguish between conventional and Islamic banks in the GCC region.

5. Yudistira (2003)

using non-parametric technique, Data Envelopment analysis (DEA), empirically investigated efficiency of 18 Islamic banks over the period 1997-2000. He provides new evidence on the performance of Islamic banks. He selected the intermediation approach as it is in line with the principle of Islamic financial system. The following variables were used for analysis i.e. Bank Assets, Fixed Assets, Staff Cost, Total Deposits, Other Income, Loan and Liquid Assets. The study found that the overall inefficiency level across 18 Islamic banks (at just over 10%) which is considerable as compared to the conventional banking sector. Similarly, during global crisis in 1998-1999 Islamic banks somehow suffered, however, they performed better afterwards. This study suggested the merging of Islamic banks due to existence of diseconomies of scale for small-to- medium Islamic banks. Moreover, as compared to the non public Islamic banks, publicly listed Islamic banks are found to be less efficient. Finally, there were Country specific factors mainly determined the efficiency differences across sample data.

6. Al-Tamimi and AL-Amiri (2003)

evaluated the service quality in the UAE Islamic bank and made comparison between Dubai Islamic bank and Abu Dhabi Islamic bank in terms of service quality. They observe that Service quality in banking plays a significant role since it influences profitability.

7. Samad (2004)

examined the comparative performance interest free Islamic banking against interest-based conventional bank in Bahrain by application of nine financial ratios including profitability, liquidity risk and credit risk during the post Gulf War period 1991-2001. The study showed in terms of credit risk Islamic banks is better than conventional banks. However, the study finds no major difference in profitability and liquidity performances between Islamic banks and conventional banks. He concluded that the concept of Islamic banking is new but still is performing as better as conventional banks.

8. Kader and Asarpota (2007)

investigated the financial performance of the UAE Islamic banks covering 2000 to 2004. Balance sheets and income statements of 3 Islamic banks and 5 conventional banks are used to compile data for the study. By application of financial ratios including profitability, liquidity, risk and solvency, and efficiency. The study indicated that Islamic banks of UAE are relatively more profitable, less liquid, less risky, and more efficient.

9. Olson and Zoubi (2008),

the study examined whether financial ratios can be used to distinguish between conventional and Islamic banks in the GCC region over the period 2000–2005 utilizing 26 financial ratios, the researchers found that Islamic banks more profitable than conventional banks but not that much different. However, Islamic banks are found to be less efficient and operating with higher risk. The author's explain that Islamic banks are risky because they uphold funds that are to be used in case of loan losses. Furthermore the authors found 92% success using the non-linear technique to correctly distinguish between the two types of banks.

10. Alkhatib and Harsheh (2012)

examined the financial performance of five Palestinian commercial banks listed on Palestine securities exchange. Annual Time series data for independent-dependent variables were extracted from banks' annual audited financial statements from the period 2005-2010. Financial performance has been measured by using three indicators; Internal-based performance measured by Return on Assets, Market-based performance measured by Tobin's Q model (Price / Book value of Equity) and Economic-based performance measured by Economic Value add.

The study employed the correlation and multiple regression analysis of annual time series data from 2005-2010 to capture the impact of bank size, credit risk, operational efficiency and asset management on financial performance measured by the three indicators, and to create a good-fit regression model to predict

the future financial performance of these banks. They found that there is an effect (statistically significant) of the size of bank, credit risk, operational efficiency and asset management on the financial performance of Palestinian commercial banks.

11. Sehrish ,et. All (2012)

examined financial performance of Islamic banks and made comparison analysis with conventional banks from year 2007-2011 on Pakistan's banks. The result on comparison suggests that Islamic banks are less risky than conventional banks but in terms of profitability there is no big difference between both systems. However, the study claims that in total Islamic banks performed more satisfactory than conventional banks.

12. Wesam M. A. Hamed (2014)

Evaluated Profitability and Efficiency Performance for 7 commercial banks in Palestine based on their asset size covering a period from 2005 until 2011. The study evaluates how the banks specific factors and the macroeconomic factors (interest rate and inflation rate) affect the financial performance in Palestinian banks. The study found that the capital adequacy ratio has a positive impact with the return on asset and that means the profitability should be accompanied with the adequacy of banks capital. On the other hand, there is negative relationship between the capital adequacy and the return on equity. For that the researcher recommends that the Palestinian banks should increase their reserve accounts to increase their capital adequacy ratio for the coming period to enhance the safety of their banking systems and also to affect the return on equity by increasing positively, because banks interested in high return for shareholders and they considered as profit making organizations. So, they will optimize their capital levels to earn a higher return on equity.

Also, the study concluded that there is a positive relationship between the liquidity ratio and the dependent variables (return on assets and return on equity) and that shows that Palestinian banks are able to cover the short term debts from the good

liquidity that it has and this also shows that the banking sector will be able to continue as a going concern in the future.

According to the study results, it was found that there is also a significant positive relationship between the management efficiency ratio and the dependent variables (return on equity and return on assets) and that means the Palestinian banks managements have been successful in managing their assets and liabilities and this result encourages the Palestinian investors to invest more in the coming years even they know that Palestine banking sector and economy are under development.

13. Saba. M. Maged (2008):

This Study aims at determining to extent knowledge and dealing the Palestinians accountants with international financial reporting standards, and what's the advantages and what is the disadvantages resulting from implement these standards, and try to find solutions to them.

used descriptive analytical approach to achieve the objectives of the study , and used the questionnaire for collection data, the questionnaire distributed to 225 accountants, whether academic, accountants in the accounting offices, and accountants in public corporation companies or private. The questionnaire were analysis by statistical tests.

Study result that international financial reporting standards not applied fully in Gaza Strip companies , due that to many restrictions the most important not adoption significantly on financial statement in decision making in Palestinian companies , and lack of awareness of importance applied these standards , in addition the absence of laws and legislation that obliges companies to implement international accounting standards.

14. Abdallah a. Mohamed (2014):

This study aimed to identify the role of the International Accounting Standards No. (16,12,7,2,1) in the reduction of creative accounting, and through the

Case Study on Mobile Company, where study sample consisted of 37 employees working in the Jawwal company in the Gaza Strip, the researcher used descriptive and analytical approach to the study, and questionnaire tool for the study, and the study reached the following results and recommendations

Study result that There is statistically significant relationship between the standard number (1) offer of Financial Statements and creative accounting in the Jawwal company, There is statistically significant relationship between Standard No. (2) inventory and creative accounting in Jawwal company, There is statistically significant relationship between the standard number (7) cash flows and creative accounting in Jawwal company, There is no statistically significant relationship between Standard No. (12) Income Tax and Accounting creative in Jawwal company, There is statistically significant relationship between Standard No. (16) property, plant and equipment and the creative accounting in the mobile company, There is no statistically significant differences between the estimates mean of sample study on these diminution and diminution together are attributable to the following personal variables (gender, age, degree, practical experience, professional certification).

15. Daske, and Gebhardt (2006):

From 2005, over 7,000 listed firms in the European Union and many more around the world are required to adopt International Financial Reporting Standards (IFRS). The introduction of a uniform accounting regime is expected to ensure greater comparability and transparency of financial reporting around the world. However, recent research has questioned the quality of financial statements prepared under IFRS standards, particularly in the presence of weak enforcement mechanisms and adverse reporting incentives. In this paper, we assess the quality of the financial statements of Austrian, German and Swiss firms which have already adopted internationally recognized standards (IFRS or U.S. GAAP). The study makes use of available disclosure quality scores extracted from detailed analyses of annual reports by reputed accounting scholars ('experts'). This work complements other contemporary research on the quality of IFRS financial statements where the properties of earnings are used as an evaluation metric. Our evidence shows that

disclosure quality has increased significantly under IFRS in the three European countries we analyse. This result holds not only for firms which have voluntarily adopted IFRS or U.S. GAAP, but also for firms which mandatorily adopted such standards in response to the requirements of specific stock market segments. Although we cannot establish direct causality due to the inherent self-selection issues for most of our sample firms, the evidence shows that the quality of financial reports has increased significantly with the adoption of IFRS.

16. Omneya H. Abd-Elsalam (2003):

The purpose of this study is to assess the effect of relative familiarity and language accessibility on the International Accounting Standards (IASs) disclosures when IASs are first introduced in an emerging capital market. The study focuses on the annual reports of listed non-financial companies in Egypt when IASs were first introduced. The method used applies a disclosure index measurement to a sample of listed company annual reports and evaluates relative compliance with IASs in relation to corporate characteristics. The results show that for relatively less familiar requirements of IASs, the extent of compliance is related to the type of audit firm used and to the presence of a specific statement of compliance with IASs. A lower degree of compliance with less familiar IASs disclosure is observed consistently across a range of company characteristics. Consideration of agency theory and capital need theory would lead to prior expectation of a distinction in disclosure practices between different categories of companies. The results were, therefore, counterintuitive to expectations where the regulations were unfamiliar or not available in the native language, indicating that new variables have to be considered and additional theoretical explanations have to be found in future disclosure studies on emerging capital markets.

Study contribution

Financial Institutions are very important for every economy because they are the most contributing factor to keep economies on the path of economic growth and development. Financial ratios are the indicator of financial health of organization. Ratio analysis is not only important for depositors but also for management to

improve organization future performance. The purpose of the study is to provide full picture of banks financial position to investors, management and shareholders .The another purpose of research is to make people aware of Islamic banks financial position and to make comparison of performance of Islamic and Conventional banks in order to identify, which one has, better financial position.

This research provides background of Islamic banking's origin and growth as well as the details of Islamic Sharia Law and concept along with the types of financial contracts available in Islamic banks. This is followed by the examination of 7 Islamic and conventional banks using (26) financial ratios from different categories in order to compare which type of bank is better of during the quarters of 2010 – 2014 with the current economic condition. The conclusion summarizes the findings followed by issues which act as problems and challenges faced by Islamic banks.

This research makes several contributions. It is the first study in Palestine that analyses the determinants of banks performance for both Islamic and conventional, using financial ratios.

The current study attempts to analyze the effect of some internal and external factors on Islamic banks' performance as they are different from conventional banks. Furthermore, this research attempts to shed light on the effect of equity on IB and CB due to differences in product structure and deposits. This paper is intended to help Islamic and conventional banks to improve their performance to remain competitive.

Chapter 3

Palestinian Financial System

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3.1 Palestinian financial sector

According to the Palestinian banking law, any financial system should provide four essential sets of services. The first is a stable monetary framework, which is reflected by low and stable inflation and stable exchange rates. The second is an efficient payment system in both domestic and international trade. The third is a system of financial intermediation, which encourages savings and productive investment, as well as an efficient allocation of capital. Fourth and finally, there should be efficient distribution of risk throughout the economy by, for instance, providing insurance on deposits.

The current Palestinian monetary and financial system was set forth by the 1994 Paris Protocol, which established a “contractual agreement” to formalize economic relations in the West Bank and the Gaza Strip (WBGS) for an interim period of five years. However, despite the expiration of the interim period sixteen years ago, the Paris Protocol still constitutes the basis of economic relations between the Palestinians and the Israelis, and the main framework for the Palestinian Authority’s (PA) economic, monetary, and fiscal policies. Among the main outcomes of the Paris Protocol was the establishment of the Palestinian Monetary Authority (PMA). The PMA has been able to operate in a difficult environment that uses multiple currencies, establishing a financial sector that offers most services, such as banking, a securities market, and insurance.

According to the Paris Protocol, the PMA has several functions:

1. Act as the sole economic and financial agent of the PA.
2. Supervise the performance, stability, solvency, and liquidity of financial institutions.
3. Manage the PA’s foreign currency reserves.
4. Authorize foreign exchange transactions.
5. Determine liquidity requirements on all deposits in banks working in the WBGS.

6. Create or license a clearinghouse to clear money orders between banks.
7. Convert excess NIS obtained from banks in the WBS into foreign currency at the Bank of Israel.

The PMA thus acts as a central bank but without the ability to issue a currency. The shekel was in fact designated as “one of the circulating currencies” that “will legally serve as means of payment for all purposes including official transactions”. Hence, the current financial system operating in Palestine is a multi-currency system, as three main currencies are used: USD (which amounted to around 39.7 percent of banks’ deposits in the fourth quarter of 2014), NIS (30.8 percent), and JD (25.7 percent).

3.2 Palestine Monetary Authority

The Palestine Monetary Authority (PMA) is an independent public institution responsible for the formulation and implementation of monetary and banking policies, to safeguard the banking sector and ensure the growth of the national economy in a balanced manner was established by presidential decree in 1994 following the Oslo Agreement between the Palestine Liberation Organization and the State of Israel. The PMA acts with full autonomy in the pursuit of its objective of monetary and financial stability. One of the most important task undertaken by the Palestinian Monetary Authority (PMA), is the task of supervisory and regulatory of banks, since the other traditional functions did not fall within the scope of its functions because of the Palestinian conditions and circumstances which has hampered the efforts that aim to take the PMA intention of the functions of the Central Bank in full. Centered policies and tools that are adopted by Monetary Authority including reserve requirement policies, licensing policies and other activities to do the job, is the basis for solid future sound banking system.

Contents of the terms of the authority of law: the Palestinian Monetary No. (2), 1997:

- 1- Regulating banking activities, issuance and cancellation of licenses of banks and financial companies and control and supervision.

- 2- Development, organizing and implementation of monetary and credit policies, and policies for dealing in foreign currency and in accordance with the provisions of the laws and regulating that.
- 3- Development and implementation of regulations, decisions and instructions to ensure an effective, safe and sound banking system. Also monitoring and controlling of banks in order to ensure the safety of its financial position and protect the rights of depositors.
- 4- Regulate the amount, quality and cost of credit, to respond to the requirements of economic growth and monetary stability in accordance with the banking provisions and laws banking.

PMA like other monetary authorities and central banks are adopting quantity and quality surveillance methods and tools within its policy framework towards the achievement of its various objectives and functions to promote sustainable economic growth.

The PMA has issued a Corporate Governance Code for banks to ensure that banks adopt and implement sound corporate governance practices and therefore maintain public trust and confidence in the Palestinian banking sector. The Code has been set at a high standard, consistent with the international best practices.

The PMA also applies a broad range of prudential instruments, including required reserves ratios, minimum capital requirements, minimum liquidity ratios, and limits on credit concentration and currency exposure. Since 2008, it has been monitoring banks' compliance with a corporate governance code in line with Basel II standards.

3.3 Palestinian banking sector

The banking sector is one of the most important components of the Palestinian financial system, and the most influential factor in financial and economical stability in general, as it is the major funding channel for both the private and public sectors.

The banks in Palestine provide a variety of corporate services: Opening and Closing an Account, Current Accounts, Overdrafts, Commercial loans, Money Transfers and Other Services.

According to the report of the Association of Banks in Palestine in 2014, there are 17 licensed banks by end 2014, of which 7 were local and 10 were foreign banks (8 Jordanian, one Egyptian and other foreign). The banks operated through a network of branches and offices spread across different regions, constituting related to foreign banks. There are 15 conventional banks and 2 Islamic Banks employing about 5,764 employees. Banks in Palestine were subject to Jordanian law until the adoption of Banking Law No. 2 of 2002, which governs bank formation, management, and capital requirements.

The conventional banks are the main section of banking business in Palestine and include Palestinian, Arab and foreign banks. Palestinian banks operate as national public corporations, while Arab and foreign banks register as foreign corporations. All conventional banks are regulated by the PMA.

Banks operating in Palestine are profitable, although these profits vary significantly between years. In 2014, banks achieved a total profit of US \$124.2 million. Key to note is that the Palestine Banking Sector continued to generate positive growth in profits during the heart of the global economic recession (between 2008 and 2010), indicative of a resilient industry. In fact, many Palestinians living abroad repatriated funds to Palestine banks for ‘safe keeping’.

All banks operating in Palestine must meet the minimum capital requirement of US \$50 million. In 2014, the banking sector managed US \$7.5 billion in banking deposits, and provided US \$4.2 billion in credit facilities to the market, equaling 56% of total deposits. Of the US \$7.5 billion in deposits, current deposits made up 40% while time and savings deposits accounted for roughly 30% each.

3.4 Challenges in the Banking Sector

1. Consumer protection in financial services is an important component of financial sector development. Consumers of financial services have less information than providers and are therefore at a disadvantage in the market. Consumer protection regulation of the PMA attempts to correct that market disparity through improved transparency and market discipline. To achieve the correct balance between consumers' rights and the cost of regulation, market regulators need to understand both sides.
2. The new banking policy to improve customer services. Due to the recent Fair Credit Instructions issued by the PMA, banks are required to act as advisors to their customers and provide them with sufficient information to select the most suitable product or service, ensure the products are affordable for the customer, and provide a mechanism for dissatisfied customers to complain. However, these Instructions fall short in certain areas such as: requiring a uniform calculation of interest rate; disclosing the PMA as the regulator; and providing a simple Key Facts sheet. Implementation of the instructions is not yet uniform across providers. The Code of Conduct of the Association of Banks in Palestine could fill in some gaps in consumer protection, but it is not implemented by banks or enforced.
3. There is no specific protection for depositors. Due to the lack of a deposit insurance scheme, and the volatility of the economic situation, depositors are actually taking a with their deposits in case of loss by the banks. The PMA, however is in the process of establishing a deposit insurance scheme that would cover up to a certain ceiling of individual deposits in any bank. The current regulations of the PMA, also tend to reduce the risk of failure by any bank tremendously, and ensures that a large percentage of the deposits are safe, in order to cover any immediate rise in the rates of withdrawals.
4. There is no specific protection for depositors. Due to the lack of a deposit insurance scheme, and the volatility of the economic situation, depositors are actually taking with their deposits in case of loss by the banks. The PMA, however is in the process of establishing a deposit insurance scheme that would cover up to a certain ceiling of individual deposits in any bank. The current

regulations of the PMA, also tend to reduce the risk of failure by any bank tremendously, and ensures that a large percentage of the deposits are safe, in order to cover any immediate rise in the rates of withdrawals.

5. The most vulnerable consumers have the least protection from providers seeking to use their information advantage. As more vulnerable consumers enter the expanding market for financial services, they are likely to be served by unregulated microfinance institutions. The draft microfinance law would establish the PMA as regulator, but it is unclear when the law will be passed and instructions written. In the meantime, consumers rely on the goodwill of the microfinance institutions to ensure protection against abusive practices. There is no third party to whom microfinance customers can complain or seek redress.
6. The PNA lacks its own national currency. Instead, it has a system with three co-existing currencies: the Jordanian Dinar (JD), the Israeli Shekel (NIS), and United States Dollar (USD). The exact share of each currency in the Palestinian economy is unclear and hard to gauge, because a particular currency is often associated with particular transactions. For example, the majority of bank deposits are in USD, JD or Euro, rarely in NIS. The majority of loans are in USD or JD, while most overdrafts loans are in NIS. The Palestinian budget is prepared in both USD and NIS. The same principle applies to transactions for goods and assets. For example, trade in land and durable goods occurs in JD or USD, while trade in consumables occurs in NIS.

Chapter 4

Palestine Stocks Market

Chapter 4

Palestine Stocks Market

4.1 The Palestine Exchange (PEX)

Following an initiative by the Palestine for Development and Investment Company (PADICO), the Palestine Exchange (PEX) was established as a self-regulating private shareholding company. The PEX was fully automated upon establishment- a first amongst the Arab Stock Exchanges. It became a public shareholding company in February 2010 responding to principles of transparency and good governance. The PEX operates under the supervision of the Palestinian Capital Market Authority.

4.2 The Establishment of PEX

The Palestinian National Authority (PNA) was formed in 1994, pursuant to the Oslo Accords between the Palestine Liberation Organization (PLO) and Israel, as a five-year transitional authority. Following the creation of the PNA, the Palestine Securities Exchange (PSE) was founded as a privately owned exchange in 1995, and it held its first trading session on 18 February 1997. It was the first Arab exchange to automate all of its operations; including: trading, depositing, securities exchange and other information systems/applied programs. Palestine Exchange (PEX) was established in to promote investment in Palestine.

The PEX transformed into a public company in 2010 to become the only publicly-traded Arab stock exchange entirely owned by the private sector. Headquartered in Nablus, the PEX provides investors with a fair, transparent and fully automated trading environment. It focuses on attracting a range of regional and global investors including those among the Palestinian Diaspora. With paid-up capital of US10\$ MN, the PEX is financially sound and able to weather a volatile world as demonstrated by its performance relative to other MENA exchanges during the global financial crisis.

4.3 PEX Governance

In 2005, with the development of the legal structure of the securities sector in Palestine, particularly the issuance of the Securities Law No. (12) of 2004 and the Capital Market Authority Law No. (13) of 2004, the Palestine Capital Market Authority (CMA) took over the responsibility of supervising the PEX and issuing securities by the public shareholding companies.

4.4 PEX Regulations

The PEX works also in accordance with modern regulations, which form a strong basis to ensure a fair trading environment. These regulations include: listing regulation, trading regulation, disclosure regulation, membership regulation, dispute resolution regulation and the regulation of professional conduct.

4.5 PEX Vision

It seeks to be a model for Arab and regional financial markets through providing innovative services, proposing investment opportunities in the capital market, attracting investment, the use of state of the art technology, compliance to the rules of corporate governance and establishing constructive relations with Arab, regional and global markets.

4.6 PEX Mission

To provide a fair, transparent and efficient market for trading securities that serves investors, protects their interests, contributes to creating an enabling environment that attracts local and foreign investments, and interacts with local and Arab relevant institutions in a manner that serves the national economy and enhances the culture of investment in financial markets.

4.7 The PEX Objectives

1. Provide a safe and enabling trading environment characterized by efficiency, fairness and transparency.
2. Increase the investment awareness of the local community.

3. Enhance PEX relations with local, Arab and international economic institutions and forums.
4. Develop domestic investments and attract Palestinian Diaspora & foreign capital.
5. Increase the depth of the exchange by continuously listing new companies and providing new and diverse financial tools and services.
6. Create a proficient working environment within the PEX by investing in human capital, and maintaining up-to-date technologies of stock markets.

The Palestine Exchange provides trading systems, control, settlement, transfer and ownership-transfer of securities in such a way that guarantees efficiency and accuracy in completing buying and selling transactions. It also facilitates in finding out fair prices through enhancing factors of supply and demand. The PEX is committed to putting good trading codes into practice and delivering information to assure fairness among all securities traders, regardless of their relative geographical regulations, so that all investors have equal exposure to gains and losses.

4.8 Companies listed on PEX:-

There are 49 listed companies on PEX as of 31/01/2016 with market capitalization of about \$3,330 billion across five main economic sectors; banking and financial services, insurance, investments, industry, and services. Most of the listed companies are profitable and trade in Jordanian Dinar, while others trade in US Dollars.

4.9 PEX Qualities

The PEX is small yet robust, it has great spring back potential, it is tried & tested, listed stocks are undervalued. The PEX owns an evolving and efficient regulatory environment within international best practice and has no restrictions on foreign investment or taxation of capital gains.

4.10 The Al Quds Index

The Al Quds Index is the main index of the PEX and is composed of 15 listed companies across all business sectors. The sample companies included in Al Quds Index are changed at the beginning of every year in order to include the most active companies in terms of value of traded stocks, the amount of traded stocks, total number of transactions, number of trading days, the stock turnover ratio, and market value of companies at the end of the previous year.

4.11 Advantages of companies listed on PEX

Companies listed on the PEX has many advantages including: providing the opportunity for listed companies to diversify the available financing sources, listed companies are more reliable since they will be working under a supervisory and monitoring umbrella that ensures disclosure and transparency for investors, listing contributes to the fair evaluation of equities of listed companies through the interaction between demand and supply forces, it also provide founding members with the opportunity to recover a part of their initial investment with the possibility to achieving good returns. Additionally, listing will enhance company's image and public profile, expanding the investors' base via trading its stocks which furnishes a platform of entry for new shareholders and ensuring the availability of liquidity for the company's shareholders.

4.12 Disclosure Consequences

Companies listed on the PSE are subjected to standardized information disclosure requirements, including quarterly financial reports. The PEX, and in cooperation with the Capital Market Authority, takes strict measures against companies which do not disclose, or lag to do so, to protect investors and maximize transparency that promote the principles of fair trading.

4.13 Monitoring Deals

Trading is monitored via Smarts on line, which monitors all orders for any irregularities or breaches. Transactions are thoroughly scrutinized to unveil any other violations. If warranted, warnings and other supervisory information are issued by

the system and forwarded to the trading supervisor enabling him/her to halt or cancel orders and/or transactions in question.

4.14 Encouraging Foreign Investment

PEX provide an encouraging legal and regulatory environment vis-à-vis foreign investment in the stock exchange. There are no capital gain taxes and no income tax on the revenues generated out of trading.

4.15 The role of PEX to increase investors awareness

PEX make any effort to increase knowledge and awareness of investors through the extensive activities of the Investment Education Program, launched in June 2006 to provide investors and other interested parties with the general knowledge about the securities sector, functions of the Exchange and investment mechanisms and tools. The program targets all investors to raise their awareness, and educate them by providing sufficient information that enables them to take sound investment decisions based on relevant information of companies' performance, not on baseless predictions or rumours. The program also promotes the culture of disclosure and corporate governance among public shareholding companies as a pre-requisite for a fair trading environment.

On 31 December 48 ,2014 companies were listed on the PEX with a total market capitalization of some US3.18\$bn. listed companies comprise five sectors: banking and financial services, insurance, investment, industry, and services. Shares and Bonds trade in Jordanian dinars and US dollars. On 31 December 2014, eight member securities companies (brokerage firms) with operations across the West Bank and Gaza Strip operated via the PEX.

4.16 PSE Listed Companies

PSE has categories which appears in table(3.1) with their market capitalization:-

- A. **Services:** Arab Hotels (AHC), Arab Real Estate Establishment (ARE), Global-com Telecommunications Company (GCOM), Grand Park Hotel & Resorts (HOTEL), Nablus Surgical Center (NSC), Palestine Telecommunications (PALTEL), Palestine Electric (PEC), Arab Palestinian Shopping Centers

(PLAZA), The Palestinian Company for Distribution & Logistics Services (WASSEL).

- B. Industry:** Arab Concrete Products (ACPC), Arab Company for Paint Products (APC), Palestine Poultry (AZIZA), Birzeit Pharmaceuticals (BPC), Golden Wheat Mills (GMC), Jerusalem Cigarette (JCC), Jerusalem Pharmaceutical (JPH), Palestine Plastic Industrial (LADAEN), The National Carton Industry (NCI), The Vegetable Oil Industries (VOIC).
- C. Banking:** Arab Islamic Bank (AIB), Alrafah Microfinance Bank (AMB), Bank Of Palestine (BOP), Palestine Commercial Bank (PCB), Palestine Investment Bank (PIBC), Al-Quds Bank (QUDS), Palestine Islamic Bank (ISBK).
- D. Insurance:** Arab Insurance Establishment (AIE), Ahliea Insurance Group (AIG), AL-Mashreq Insurance (MIC), National Insurance (NIC), Trust International Insurance (TRUST).
- E. Investment:** Arab Investors (ARAB), Al-I-Timan for Investment & Development (IID), Jerusalem Real Estate Investment (JREI), Palestine Development & Investment (PADICO), Palestine Investment & Development (PID), Palestine Industrial Investment (PIIC), The Palestine Real Estate Investment (PRICO), Union Construction and Investment (UCI).

Table(4.1):listed Companies in PEX

Company	Symbol	Currency	Market Cap
AL-Wataniah Towers	ABRAJ	US\$	11,220,000
Arab Hotels	AHC	JOD	20,259,976
Arab Islamic Bank	AIB	US\$	55,500,000
Ahliea Insurance Group	AIG	US\$	5,600,000
Arab Paints Products	APC	JOD	7,827,925
Arab Palestinian Investment "APIC"	APIC	US\$	64,200,000
Al- Aqariya Trading Investment	AQARIYA	JOD	4,167,001
Arab Investors	ARAB	JOD	12,798,637
The Arab Real Estate Establishment.	ARE	JOD	388,121
Palestine Poultry	AZIZA	JOD	54,973,193
Bank Of Palestine	BOP	US\$	448,000,000
Birzeit Pharmaceuticals	BPC	US\$	61,059,323
Al-Shark Electrode	ELECTRODE	JOD	2,126,234
Globalcom Telecommunications	GCOM	US\$	447,647
Golden Wheat Mills	GMC	JOD	15,444,285
Global United Insurance	GUI	US\$	15,040,000
Palestine Islamic Bank	ISBK	US\$	60,500,000

Company	Symbol	Currency	Market Cap
Jerusalem Cigarette	JCC	JOD	12,693,933
Jerusalem Pharmaceuticals	JPH	US\$	29,002,000
Jerusalem Real Estate Investment	JREI	US\$	5,700,000
Palestine Plastic Industries	LADAEN	JOD	1,875,881
AL Mashriq Insurance*	MIC	US\$	2,496,000
National Aluminum & Profile "NAPCO"	NAPCO	JOD	7,299,011
The National Carton Industry	NCI	US\$	5,050,000
National Insurance	NIC	US\$	39,600,000
Nablus Surgical Center	NSC	JOD	7,798,863
Palestine Development & Investment	PADICO	US\$	340,000,000
PALAQAR for Real Estate Dev.& Management	PALAQAR	JOD	2,269,463
Palestine Telecommunications	PALTEL	JOD	1,058,197,990
Palestine Commercial Bank	PCB	US\$	31,919,021
Palestine Electric	PEC	US\$	61,800,000
Dar Al-Shifa Pharmaceuticals	PHARMACARE	US\$	31,650,210
Palestine Investment Bank	PIBC	US\$	55,000,000
Palestine Insurance	PICO	US\$	5,950,000
Palestine Investment & Development	PID	JOD	7,168,461
Palestine Industrial Investment	PIIC	JOD	50,775,732
Arab Palestinian Shopping Centers	PLAZA	JOD	14,315,936
Palestine mortgage & Housing Corporation**	PMHC	US\$	0
Palestine Real Estate Investment	PRICO	JOD	47,664,474
Palestine Securities Exchange	PSE	US\$	49,500,000
Quds Bank	QUDS	US\$	48,500,000
The Ramallah Summer Resorts	RSR	JOD	16,577,596
Al-Takaful Palestinian Insurance	TIC	US\$	11,560,000
The National Bank	TNB	US\$	91,548,986
Trust International Insurance	TRUST	US\$	25,000,000
Union Construction and Investment	UCI	US\$	12,800,000
The Vegetable Oil Industries	VOIC	JOD	44,682,644
Palestinian for Distribution & Logistics Services	WASSEL	US\$	10,011,082
Wataniya Palestine Mobile Telecommunications	WATANIYA	US\$	219,300,000

* Symbol is suspended

** Symbol was delisted since
18/12/2014

4.17 Trading Volumes and Values:-

A 245 trading sessions were held in Palestine Exchange Market during the period from 1-1-2014 until 31-12-2014, during which 181,545,154 shares traded value of US \$ 353,917,125 were Implemented through 41,257 contracts.

The top five gainers in share prices has included all of the NSC by 58.18%, WASSEL by 29.41%, GUI by 28.77%, TIC rate of 25.93%, VOIC by 20.92%. The last five companies which are most declined in share prices has included all of the GCOM by (55.56%), LADEN rate (42.42%), PEC by (27.46%), ARE by (23.68%), ISBK by (21.43%).

Regarding the size of the market, The shares market value of listed companies at the end of 2014 reached to (3,187,259,624) US dollars with a decreasing rate of (-5.48 %) from the previous year.

While the value of traded shares reached to US \$ 353,917,125 up to 3.86% from the previous year as shown in table(4.2) and table(4.3).

Table(4.2):Sectors statistics for 2014

Sector	Listed companies	Volume	Value (US\$)	No. of transactions	Market Cap (US\$)
Banking & Financial Services	8	66,612,640	111,626,482	8,099	840,468,007
Insurance	7	6,387,299	4,273,400	1,193	105,246,000
Investment	9	73,144,267	109,532,601	16,552	545,274,304
Industry	12	4,820,022	9,139,003	2,773	273,684,639
Services	12	30,580,926	119,345,639	12,640	1,422,586,674
Total	48	181,545,154	353,917,125	41,257	3,187,259,624

By end of 2014, the PEX Index (Al-Quds) declined by 5.5 percent against the previous year closing at 511.8 points. The decline followed the drop in the indices of all sectors, with the exception of the insurance sector which rose by about 2.8 percent to the level of 46.8 points. Sector indices fell for services sector by about 5.8 percent to close at 49.2 points; for banking and financial services by 4.2 percent to close at the level of 119.7 points; the industry by 0.9 percent to close at the level of

67.7 points and the investment sector by 0.3 percent having closed at the level of 25.5 points, compared to the previous year. PEX performance has been adversely affected by the deteriorating general conditions in Palestine, in particular for the second half of the year in the wake of the recent war waged by Israel against GS in summer of 2014, alongside an absence of political and economic favourable prospects. Analysis of PEX performance indicators shows a decrease in the trading volume by 10.6 percent over 2014 compared to the previous year, to reach 181,545,154 shares of listed companies totalling about USD 353.9 million, an increase of 3.9 percent over 2013. The number of trading sessions reached 245, compared with 241 sessions in 2013, through which 41,257 deals were carried out, a decline of 7.3 percent over 2013. The market value of these shares amounted to USD 3.2 billion, a drop by about 1.9 percent against the previous year, which led to the decline in the market liquidity levels (the traded shares' turnover ratio reflects the availability of orders to buy and orders to sell over the entire period of trading days).

As for trading by sector, the investment sector continued to rank first acquiring 40.3 percent of total number of traded shares, valued at USD 545.3 million, the equivalent of 17.1 percent of listed companies' total market value. The banking and financial services sector came second, accounting for 36.7 percent of total number of traded shares valued at USD 840.5 million, the equivalent of 26.4 percent of total market value. The services sector followed accounting for 16.8 percent of total number of traded shares, valued at USD 1,422.6 million, the equivalent of 44.6 percent of total market value. The insurance sector claimed 3.5 percent of total number of traded shares, valued at USD 105.2 million, the equivalent of 3.3 percent of total market value. Finally, the industry sector accounted for 2.7 percent of total number of traded shares, valued at USD 273.7 million, the equivalent of 8.6 percent of total market value. Regionally, PEX ranked third, after Sudan and Saudi Arabia, in the set of financial markets witnessing decline in key indicators. It is worth mentioning that the Egyptian market was the best-performing market amongst Arab markets, achieving the highest index rise of about 13.6 percent, whereas the Iraqi market was the worst-performing market with an index drop of 18.7 percent against its result of 2013.

Table(4.3):Total Monthly Trading activity for 2014

Month	Volume	Value (US\$)	Daily Average Turnover Value (US\$)	No. of trading sessions	No. of transactions	Market Capitalization (US\$)	AI-Quds Index	Monthly Change (%)
Jan	29,829,261	60,790,802	3,199,516	19	7,060	3,534,023,404	598.60	10.55%
Feb	26,135,795	53,960,442	2,698,022	20	5,743	3,495,755,340	590.79	-1.30%
March	20,442,562	51,352,586	2,334,208	22	4,631	3,341,511,340	548.37	-7.18%
April	9,441,090	17,282,766	785,580	22	4,002	3,196,105,574	518.82	-5.39%
May	7,463,383	14,391,280	757,436	19	3,072	3,222,888,562	523.07	0.82%
June	15,612,050	25,547,812	1,161,264	22	3,201	3,120,321,800	502.81	-3.87%
July	3,327,941	7,155,082	420,887	17	1,597	3,144,975,317	505.15	0.47%
Aug	8,557,188	15,881,925	756,282	21	3,014	3,227,400,217	521.46	3.23%
Sep	21,510,407	31,821,403	1,446,427	22	2,241	3,179,464,971	511.14	-1.98%
Oct	13,024,704	26,160,534	1,453,363	18	1,762	3,143,179,171	500.59	-2.06%
Nov	13,707,342	26,972,369	1,284,399	21	1,946	3,052,073,688	482.45	-3.62%
Dec	12,493,431	22,600,123	1,027,278	22	2,988	3,187,259,624	511.77	6.08%
Total 2014	181,545,154	353,917,125	1,444,560	245	41,257	3,187,259,624	Annual Growth	-5.48%

Table(4.4):Total yearly activity from 2010 to 2014

Year	AI - Quds Index	Market Cap (US\$)	Daily average turnover transactions	Daily average turnover Value (US\$)	Daily average turnover Volume	No. of transactions	Value (US\$)	Volume	No. of trading Sessions
2010	489.6	2,449,901,545	331	1,812,082	925,768	82,625	451,208,529	230,516,370	249
2011	476.93	2,782,469,900	250	1,474,388	744,131	61,928	365,648,216	184,544,375	248
2012	477.59	2,859,140,375	166	1,098,154	591583	41,442	273,440,441	147,304,208	249
2013	541.45	3,247,478,385	184	1,414,001	842182	44,425	340,774,269	202,965,939	241
2014	511.77	3,187,259,624	168	1,444,560	741000	41,257	353,917,125	181,545,154	245
Total						1,078,529	8,258,785,626	2,801,363,535	3,705

Chapter 5

Islamic Banking Features

Chapter 5

Islamic Banking

5.1 Islamic Banking Features

Islamic banks today exist in all parts of the world and are looked upon as a viable alternative system which has many things to offer. While it was initially developed to fulfill the needs of Muslims, Islamic banking has now gained universal acceptance. Al-Hayat Al-Iqtisadiyah (2005) reported that the world have been witnessing a widespread of Islamic banks all over the five continents. Today, there are 280 Islamic banks in 48 countries, whose total deposits have reached US\$400 billion, in addition to 300 conventional banks, which opened branches, windows or provide Islamic financial products.

Like conventional bank, Islamic bank is an intermediary and trustee of money of other people but the difference is that it shares profit and loss with its depositors. This difference that introduces the element of mutuality in Islamic banking makes its depositors as customers with some ownership of right in it (Dar and Presley 2000).

The core concept of Islamic banking is to provide services to its customers free from interest and the giving and taking of interest (riba) is prohibited in all transactions (Lewis and Algaoud, 2001). Prohibition of interest (riba) makes Islamic banking system differ from conventional banking system. In other words, the main difference between Islamic and conventional banks is the use of money. In conventional banks, money is used as a commodity that is bought and sold through the interest's usage according to Alkassim (2005).

Islamic banking is the system of banking consistent with principles of Islamic law (Shari'ah) and guided by Islamic economics. Islamic economics is referred to that body of knowledge which helps realize human well-being through an allocation and distribution of scarce resources that is in conformity with Islamic teachings without unduly curbing individual freedom or creating continued macroeconomic and ecological imbalances (Chapra 1996).

As the conventional banks are established under the principles of capitalism and transact business by charging interest, which is unacceptable (forbidden) in Islamic law, so Muslims left with no choice except to establish their own financial institutions under Islamic principles. The milestone, in growth and popularity of Islamic Financial Institutions (IFIs), was the Conference of Foreign Ministers of Muslim countries (1973) under Organization of Islamic Conference (OIC), where decision to establish Islamic Development Bank (IDB) was taken place. The growth became steady in 1990s; the market attracted the attention of public lawmakers and institutions interested in introducing innovative products.

The Islamic legal principles that regulate the conduct and content of commercial transactions in Islamic banking date back to the early days of Islam in Arabia. The Muslim scholars of the middle ages made elaborate efforts to establish the fundamental principles of finance and commerce. Accounting and Auditing Organization for Islamic Financial institution (AAOIFI) was established in Bahrain to highlight the special regulatory needs of Islamic financial institutions. Islamic insurance (Takaful) is introduced, Islamic equity Funds are also established (Greuning and Iqbal, 2008). The main objective of Islamic Banking is to develop an environment of interest (Riba) free financing. The reason of interest free financing is to eliminate the fixed return on capital. Islamic Shariah prohibits the effort less and risk free transactions.

In this regard, Islamic banking offers different products on the basis of profit and loss sharing principle of Shariah. Islamic modes of finance are used for leasing and other financial contracts. According to (Samad, 2004): Islamic banks compared with non-Islamic banks seek a “just” and “equitable distribution of resources”. Islamic banks follow Islamic morals and its operations must be within the boundaries of Islamic Law or the Shari'ah.

There are four basic principles that govern investment behavior:-

1. All transactions are of interest free; any predetermined payment above or over the actual amount of principle is prohibited legitimately. Therefore, the only loan that Islam accepts is Qard al hasan (literally good loan) whereby the lender

doesn't charge any interest or additional amount above the money lent (Kettell, 2007).

2. Speculative activities or transactions (Gharar) must be abstained. Gharar refers to entering into a contract in absolute risk or uncertainty about the ultimate result of the contract and the nature and/or quality and specifications of the subject matter or the rights and obligations of the parties. Means to undertake a venture blindly without sufficient knowledge or to undertake an excessively risky transaction, although minor uncertainties can be permitted when there is some necessity (Lewis and Hassan, 2007).
3. Zakat (Islamic tax) should be paid by the banks to benefit society and it is compulsory in earning from transactions.
4. The production or consumption of all goods and services that are illegal according to Islamic shariah must be avoided in contract. Meaning that all products should be useful not harmful as it is defined in Holy Qur'an (Lewis, 2001). For example, Activities such as liquor, pork, pornography, adultery, dance clubs, conventional banking, insurance etc. are unlawful; hence earning return through investment in any of these activities is not allowed under Islamic financial system and should not be financed.

To conclude Islamic financial system ensures justice between savers and investors. By demolishing risk free return and promotion of profit and loss sharing, justice is ensured for both parties i.e. capital supplier as well as capital user. Under Islamic financial system bank can invest in businesses to earn variable return based on actual results of activities and share profit earned with depositors based on agreed sharing formula. Hence it is ensured to distribute the actual outcome and none is to bear risk alone and none is to earn with zero risk.

There are many instruments that are being used in Islamic banking sector. Using these various tools makes Islamic banking more diversified and effective. According to Alkassim (2005), in Islamic banks, there have been sixteen different lending contracts or sales contracts, some of them will be explained in this section. Hanif&Iqbal, (2010), categorized Islamic modes of financing objectively in two heads; Shari'a compliant and Shari'a based.

5.2 Shari'a Compliant

5.2.1 Murabaha

Murabaha is a cost-plus sale contract whereby disclosure of cost to the buyer is necessary. Under Murabaha arrangement customer requests to the Islamic Financial Institution (IFI) to purchase an asset for him (customer) and sell on deferred payment. An essential feature of Murabaha is that IFI must purchase the required commodity from supplier first and then sell to customer. Bank charges a certain profit usually linked with Inter Bank Offered Rate. Recovery could be agreed in installments or Balloon payment. Amount of installment or price of the asset cannot be (stipulated) increased or decreased in case of default or early payment (Shari'a standard 8). Murabaha has successfully replaced the overdraft and short term loans facility under conventional banking. According to Hanif&Iqbal, (2010), 75per cent of Islamic financial transactions are Murabaha contracts.

5.2.2 Ijarah

Ijarah is a rental contract whereby IFI leases an asset for a specific rent and period to the client. Ownership risks of the asset are born by IFI while expenses relating to use the asset are the responsibility of client. The difference between Ijarah and sale is that ownership in Ijarah remains with lesser while in case of sales it is transferred to purchaser. Ending Ijarah in sale of asset is allowed by IFA through a separate contract at completion of term of lease.

Contract can be executed prior to purchase and possession of asset. Consumables cannot be leased out. Right of lessee to use the asset is restricted to lease agreement or/and as per normal course of business.

Lessee is liable for any harm to the asset caused by any misuse or negligence on his part. Rentals of joint property are shared according to equity. A joint owner can rent his share only to the co-partner. Inter Bank Rate can be used as a benchmark for amount of rentals. At the completion of Ijarah term either asset is returned to IFI or purchased by client (Shari'a standard 9).

Ijarah has replaced successfully the facility of leasing under conventional financial system. It is also a popular instrument counted around 10 per cent used in Islamic banks.

5.2.3 Diminishing Musharaka

Diminishing Musharaka is a form of declining partnership between IFI and client generally used to finance real estates. When a customer requests to IFI for financing to purchase an asset IFI participates in the ownership of asset by contributing required finance. Certain portion (e.g.20%) must be contributed by customer. Total equity of bank is divided into units of smaller amounts which are purchased by client in installments. Under this mode of financing one of the partners (client) promises to buy the equity share of the other partner (IFI) gradually until the title to the equity is completely transferred to him. Buying and selling of equity units must be independent of partnership contract and must not be stipulated in partnership contract. Generally IFI rent out his share to client and earns rentals. Any profit accruing on property is distributed among the co-owners according to agreed ratio however losses must be shared in proportion of equity (Shari'a standard 12). Diminishing Musharaka is used for house financing by IFIs and has replaced successfully conventional mortgages.

5.2.4 Bai Salam

Bai e Salam is a form of sale contract where by IFIs purchase goods for spot payment with deferred delivery. Practically it is used in financing of agricultural needs of farmers. Farmers sell their crops prior to harvesting to IFIs in order to get money to purchase seeds and fertilizers. Generally spot price agreed is lesser than future the actual date of delivery, hence IFIs are making profit. As a matter of practice IFIs are entering into a parallel Salam contract with third party to sell the proceeds once taken over however execution of second contract is not conditional to the fulfillment of first (Shari'a standard 10).

5.2.5 BaiMuajjal

Literal meaning is deferred / credit sales. Islamic financial Institutions (IFIs) are using this mode to finance the customers' needs by supply of desired commodities. The difference between Murabaha and BaiMuajjal lies in disclosure of cost. Under BaiMuajjal cost may or may not be disclosed. All other features are same as discussed in Murabaha.

5.2.6 `Istisna'a

This mode of financing is designed to transect business through an order to manufacture and/or supply. It is a sales contract with the exception of existence of subject matter. This tool of financing is useful for infrastructure projects. Parallel Istisna'a contract is allowed however performance of second Istisna'a contract must not be conditional on the fulfillment of first contract (Shari'a standard 11).

5.3 Shari'a Based

5.3.1 Musharaka

According to Hadith Qudasi (revelation reported by Prophet Muhammad PBUH) "Indeed, Allah the Exalted says: I am the third of the two partners so long as the one does not cheat the other, and when he cheats, I withdraw myself" (Khan, 1989). Literal meaning of Musharaka is sharing. Its root in Arabic language "Shirka" means being a partner. Musharaka means a joint enterprise formed conducting some business in which all partners share the profit according to pre agreed ratio while loss is shared according to the ratio of contribution (Meezan bank guide 2002). For a valid Musharaka fulfillment of certain conditions required. First is there must be an agreement written (verbal) among the partners stating clearly the terms and conditions including management, capital contributions, profit and loss sharing among the partners.

Second capital can be contributed in cash as well as in assets. However once an asset is contributed as capital that belongs to firm and contributing partner is relieved from the bar of risks and returns attached with ownership. Third profit is distributed according to agreement of partnership however sleeping partner cannot

claim share in profit more than his proportionate share in equity. None of the partner can guarantee the capital or profit share to any other partner (Shari'a standard 12). Under Musharaka IFIs are receiving deposits and finances business requirements for profit and loss sharing.

5.3.2 Mudaraba

Mudaraba is a type of partnership whereby skill and money brought together to conduct business. Profit is shared according to agreement while loss is born by capital provider only. Under this scheme of financing IFIs provide capital to financially weak but skilful people to do the business and share outcome with IFIs. This scheme is also used in deposit collection.

Mudaraba contract can be restricted or unrestricted. No one can claim a lump sum amount of profit it must be based on actual outcome (Shari'a standard 13).

Chapter 6

Conventional banking system

Introduction:

Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the great agencies of commerce. Although banking in one form or another has been in existence from very early times, modern banking is of recent origin. It is one of the results of the Industrial Revolution and the child of economic necessity. Its presence is very helpful to the economic activity and industrial progress of a country.

A Conventional bank is a profit-seeking business firm, dealing in money and credit. It is a financial institution dealing in money in the sense that it accepts deposits of money from the public to keep them in its custody for safety. So also, it deals in credit, i.e., it creates credit by making advances out of the funds received as deposits to needy people. It thus, functions as a mobiliser of saving in the economy. A bank is, therefore like a reservoir into which flow the savings, the idle surplus money of households and from which loans are given on interest to businessmen and others who need them for investment or productive uses.

Definition of a Bank

The term 'Bank' has been defined in different ways by different economists. A few definitions are: According to Walter Leaf "A bank is a person or corporation which holds itself out to receive from the public, deposits payable on demand by cheque."

Horace White has defined a bank, "as a manufacture of credit and a machine for facilitating exchange." According to Prof. Kinley, "A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use." Thus, we can say that a bank is a financial institution which deals in debts and credits. It accepts deposits, lends money and also creates money. It bridges the gap between the savers and borrowers. Banks are not merely traders in money but also in an important sense manufacturers of money.

Types Of Banks

Broadly speaking, banks can be classified into Conventional banks and central bank. Conventional banks are those which provide banking services for profit. The central bank has the function of controlling Conventional banks and various other economic activities. There are many types of Conventional banks such as

1. Deposit banks.
2. Industrial banks.
3. Savings banks.
4. Agricultural banks.
5. Exchange banks.
6. Miscellaneous banks.

FUNCTIONS OF CONVENTIONAL BANKS

Conventional banks have to perform a variety of functions which are common to both developed and developing countries. These are known as ‘General Banking’ functions of the Conventional banks. The modern banks perform a variety of functions. These can be broadly divided into two categories: (a) Primary functions and (b) Secondary functions.

a) Primary Functions

Primary banking functions of the Conventional banks include:

1. Acceptance of deposits
2. Advancing loans
3. Creation of credit
4. Clearing of cheques
5. Financing foreign trade
6. Remittance of funds

1. Acceptance of Deposits: Accepting deposits is the primary function of a Conventional bank mobilise savings of the household sector. Banks generally accept three types of deposits viz., (a) Current Deposits (b) Savings Deposits, and (c) Fixed Deposits.

(a) Current Deposits: These deposits are also known as demand deposits. These deposits can be withdrawn at any time. Generally, no interest is allowed on current deposits, and in case, the customer is required to leave a minimum balance undrawn with the bank. Cheques are used to withdraw the amount. These deposits are kept by businessmen and industrialists who receive and make large payments through banks. The bank levies certain incidental charges on the customer for the services rendered by it.

(b) Savings Deposits: This is meant mainly for professional men and middle class people to help them deposit their small savings. It can be opened without any introduction. Money can be deposited at any time but the maximum cannot go beyond a certain limit. There is a restriction on the amount that can be withdrawn at a particular time or during a week. If the customer wishes to withdraw more than the specified amount at any one time, he has to give prior notice. Interest is allowed on the credit balance of this account. The rate of interest is greater than the rate of interest on the current deposits and less than that on fixed deposit. This system greatly encourages the habit of thrift or savings.

(c) Fixed Deposits: These deposits are also known as time deposits. These deposits cannot be withdrawn before the expiry of the period for which they are deposited or without giving a prior notice for withdrawal. If the depositor is in need of money, he has to borrow on the security of this account and pay a slightly higher rate of interest to the bank. They are attracted by the payment of interest which is usually higher for longer period. Fixed deposits are liked by depositors both for their safety and as well as for their interest. In India, they are accepted between three months and ten years.

2. Advancing Loans: The second primary function of a Conventional bank is to make loans and advances to all types of persons, particularly to businessmen and

entrepreneurs. Loans are made against personal security, gold and silver, stocks of goods and other assets. The most common way of lending is by:

(a) Overdraft Facilities: In this case, the depositor in a current account is allowed to draw over and above his account up to a previously agreed limit.

(b) Cash Credit: Under this account, the bank gives loans to the borrowers against certain security. But the entire loan is not given at one particular time, instead the amount is credited into his account in the bank; but under emergency cash will be given. The borrower is required to pay interest only on the amount of credit availed to him. He will be allowed to withdraw small sums of money according to his requirements through cheques, but he cannot exceed the credit limit allowed to him. Besides, the bank can also give specified loan to a person, for a firm against some collateral security. The bank can recall such loans at its option.

(c) Discounting Bills of Exchange: This is another type of lending which is very popular with the modern banks. The holder of a bill can get it discounted by the bank, when he is in need of money. After deducting its commission, the bank pays the present price of the bill to the holder. Such bills form good investment for a bank. They provide a very liquid asset which can be quickly turned into cash. The Conventional banks can rediscount the discounted bills with the central banks when they are in need of money. These bills are safe and secured bills. When the bill matures the bank can secure its payment from the party which had accepted the bill.

(d) Money at Call: Bank also grant loans for a very short period, generally not exceeding 7 days to the borrowers, usually dealers or brokers in stock exchange markets against collateral securities like stock or equity shares, debentures, etc., offered by them. Such advances are repayable immediately at short notice hence, they are described as money at call or call money.

(e) Term Loans: Banks give term loans to traders, industrialists and now to agriculturists also against some collateral securities. Term loans are so-called because their maturity period varies between 1 to 10 years.

(f) Consumer Credit: Banks also grant credit to households in a limited amount to buy some durable consumer goods such as television sets, refrigerators, etc., or to meet some personal needs like payment of hospital bills etc.

(g) Miscellaneous Advances: Among other forms of bank advances there are packing credits given to exporters for a short duration, export bills purchased/discounted, import finance-advances against import bills, finance to the self employed, credit to the public sector, credit to the cooperative sector and above all, credit to the weaker sections of the community at concessional rates.

3. Creation of Credit: A unique function of the bank is to create credit. Banks supply money to traders and manufacturers. They also create or manufacture money. Bank deposits are regarded as money. They are as good as cash. The reason is they can be used for the purchase of goods and services and also in payment of debts. When a bank grants a loan to its customer, it does not pay cash. It simply credits the account of the borrower. He can withdraw the amount whenever he wants by a cheque. In this case, bank has created a deposit without receiving cash. That is, banks are said to have created credit. Sayers says “banks are not merely purveyors of money, but also in an important sense, manufacturers of money.”
4. Promote the Use of Cheques: The Conventional banks render an important service by providing to their customers a cheap medium of exchange like cheques. It is found much more convenient to settle debts through cheques rather than through the use of cash. The cheque is the most developed type of credit instrument in the money market.
5. Financing Internal and Foreign Trade: The bank finances internal and foreign trade through discounting of exchange bills. Sometimes, the bank gives short-term loans to traders on the security of Conventional papers. This discounting business greatly facilitates the movement of internal and external trade.
6. Remittance of Funds: Conventional banks, on account of their network of branches throughout the country, also provide facilities to remit funds from one place to another for their customers by issuing bank drafts, mail transfers or telegraphic transfers on nominal commission charges. As compared to the postal

money orders or other instruments, bank drafts have proved to be a much cheaper mode of transferring money and has helped the business community considerably.

b) B. Secondary Functions

Secondary banking functions of the Conventional banks include:

1. Agency Services
2. General Utility Services

These are discussed below.

1. Agency Services: Banks also perform certain agency functions for and on behalf of their customers. The agency services are of immense value to the people at large. The various agency services rendered by banks are as follows:
 - a) Collection and Payment of Credit Instruments: Banks collect and pay various credit instruments like cheques, bills of exchange, promissory notes etc., on behalf of their customers.
 - b) Purchase and Sale of Securities: Banks purchase and sell various securities like shares, stocks, bonds, debentures on behalf of their customers.
 - c) Collection of Dividends on Shares: Banks collect dividends and interest on shares and debentures of their customers and credit them to their accounts.
 - d) Acts as Correspondent: Sometimes banks act as representative and correspondents of their customers. They get passports, traveller's tickets and even secure air and sea passages for their customers.
 - e) Income-tax Consultancy: Banks may also employ income tax experts to prepare income tax returns for their customers and to help them to get refund of income tax.
 - f) Execution of Standing Orders: Banks execute the standing instructions of their customers for making various periodic payments. They pay subscriptions, rents, insurance premia etc., on behalf of their customers.
 - g) Acts as Trustee and Executor: Banks preserve the 'Wills' of their customers and execute them after their death.

2. General Utility Services: In addition to agency services, the modern banks provide many general utility services for the community as given.
- a) Locker Facility: Bank provide locker facility to their customers. The customers can keep their valuables, such as gold and silver ornaments, important documents; shares and debentures in these lockers for safe custody
 - b) Traveller's Cheques and Credit Cards: Banks issue traveller's cheques to help their customers to travel without the fear of theft or loss of money. With this facility, the customers need not take the risk of carrying cash with them during their travels.
 - c) Letter of Credit: Letters of credit are issued by the banks to their customers certifying their credit worthiness. Letters of credit are very useful in foreign trade.
 - d) Collection of Statistics: Banks collect statistics giving important information relating to trade, commerce, industries, money and banking. They also publish valuable journals and bulletins containing articles on economic and financial matters.
 - e) Acting Referee: Banks may act as referees with respect to the financial standing, business reputation and respectability of customers.
 - f) Underwriting Securities: Banks underwrite the shares and debentures issued by the Government, public or private companies.
 - g) Gift Cheques: Some banks issue cheques of various denominations to be used on auspicious occasions.
 - h) Accepting Bills of Exchange on Behalf of Customers: Sometimes, banks accept bills of exchange, internal as well as foreign, on behalf of their customers. It enables customers to import goods
 - i) Merchant Banking: Some Conventional banks have opened merchant banking divisions to provide merchant banking services.

Chapter 7

Research Methodology

Chapter 7

Research Methodology

7.1 Research Methodology and Data Collection

7.1.1 Methodology

In order to achieve aforementioned objectives, two types of methodology will be applied:

7.1.2 Qualitative Study:

Through all chapters; an introductory analytical descriptive approach will be developed based on literature reviewed in books, journals, Arabic & foreign articles, related legislation, Palestinian banks websites.

7.1.3 Quantitative Study:

The selected Palestinian banks will be assessed by using ratio analysis such as profitability ratios, liquidity ratios, leverage ratios, and efficiency ratios. In addition, panel data regression is used to test the hypothesis with five percent level of confidence.

7.1.4 Data

The audited financial statements i.e. Income Statement and Balance Sheet of both islamic and conventional banks for the period of 2010 -2014 are used for ratio analysis. The ratios have been calculated with the help of ratio formulae.

Inter-bank comparison or cross-sectional analysis is used to compare the performances of both banks. Independent Sample t-test is used to determine the significance of mean differences of these ratios between and among banks.

The ratio analysis involves method of calculating and interpreting financial ratios to asses' bank performance. Financial ratios are the indicator of financial performance of bank. The study evaluates inter-bank performance of Islamic and

Conventional banks in term of The 26 financial ratios used in this study are defined below they fall into five general categories: profitability, efficiency, asset quality, liquidity, and risk. Financial ratios are applied to measure these performances.

The researcher collected 35 observations, or bank-years of data, for banks operating in Palestinian territories for the calendar years 2010–2014.

There are 25 observations for conventional banks and 10 observations for Islamic banks. Our sample contains 7 banks (5 conventional and 2 Islamic).

The data set excludes multinational banks (e.g., ARAB BANK, HSBC, Cairo Amman Bank, and Housing bank) that operate in the Palestinian territories, but includes all other Palestinian banks.

7.2 Definitions of 26 Financial Ratios

The 26 financial ratios used in this study fall into five general categories: profitability, efficiency, asset quality, liquidity, and risk. Previous studies of the Middle Eastern banking industry have generally focused on profitability and bank efficiency. For example, Rosly and Abu Bakar (2003) examine bank profitability based upon return on assets (ROA), profit margin (PM), and return on deposits (ROD).

In addition to these ratios, our profitability measures include return on equity (ROE) and return on shareholder capital (ROSC). Based on previous studies (Olson and Zoubi, 2008) focus on the following measure of efficiency: $\text{interest spread} = \text{interest revenues} - \text{interest expenses}$. It is similar to our net interest margin (NIM) and the interest income to expenses (IEE) ratio. Other bank efficiency ratios for this study include operating margin (NOM), interest income to expenses (IEE), operating expense to assets (OEA), operating income to assets (OIA), operating expenses to revenue (OER), asset turnover (ATO), net interest margin (NIM), and net non-interest margin (NNIM).

The asset-quality indicators—provisions to earning assets (PEA), adequacy of provision for loan (APL), and the write-off ratio (WRL)—indicate how banks

manage assets. Larger PEA or APL ratios indicate greater reserves for bad loans or unforeseen emergencies and probably reflect lower risk. However, another possible explanation could be that banks maintain allowances for loan losses in direct proportion to expected losses. A priori, we expect that Islamic banks may be riskier than conventional banks, but we have no strong expectations regarding how the asset-quality ratios vary between Islamic and conventional banks.

The final five ratios—cash to assets (CTA), cash to deposits (CTD), loans to deposits (LTD), total liabilities to equity (TLE), and total liabilities to shareholder capital (TLSC) are somewhat similar to the asset-quality indicators. If Islamic banks are riskier than conventional banks, they may hold more cash relative to assets or deposits. Since Islamic banks do not use debt financing, we would expect shareholder equity to be a larger source of funds relative to conventional banks. Therefore, TLE and TLSC should be smaller for Islamic banks.

7.2.1 Bank Profitability Ratios

The profitability ratios are used to assess the capability of company to generate earnings as compared to its expenses and other relevant costs incurred during certain period of time. This study uses following ratios for measuring profitability of bank.

- A. **Return on Asset (ROA)**= profit after tax/total asset. It shows how a bank can convert its asset into net earnings. The higher value of this ratio indicates higher capability of firm. This ratio provides indicator for evaluating the managerial efficiency (Samad, 1999; Samad and Hassan, 2000; Samad, 2004; Kader, et al., 2007)
- B. **Return on Equity (ROE)**= profit after tax/equity capital. This ratio indicates how bank can generate profit with the money shareholders have invested. The higher value of this ratio shows higher financial performance. Like ROA, this ratio is also an indicator for managerial efficiency.
- C. **Profit to Total Expenses (PER)**= profit after tax/total expense. This ratio indicates profitability of the firm with regard to its total expenses. A high value of this ratio indicates that bank could make high profit with a given expenses.

- D. **Return on Deposit (ROD)**= profit after tax/total deposit. This ratio shows percentage return on each dollar of customers' deposit. In the other words, it indicates the effectiveness of bank in converting deposit into net earnings (Rosly and Bakar, 2003, p. 1257).
- E. **The Return On Shareholder Capital (ROSC) Ratio**= expressed as a percentage, complements the return on equity (ROE) ratio by adding a company's debt liabilities, or funded debt, to equity to reflect a company's total "shareholder capital". This measure narrows the focus to gain a better understanding of a company's ability to generate returns from its available capital base.
- F. **Net Profit Margin** = Often referred to simply as a company's profit margin, the so-called bottom line is the most often mentioned when discussing a bank's profitability. While undeniably an important number, investors can easily see from a complete profit margin analysis that there are several income and expense operating elements in an income statement that determine a net profit margin. It behoves investors to take a comprehensive look at a company's profit margins on a systematic basis.
- G. **Operating Profit Margin** = By subtracting selling, general and administrative (SG&A), or operating, expenses from a bank's gross profit number, we get operating income. Management has much more control over operating expenses than its cost of sales outlays. Thus, investors need to scrutinize the operating profit margin carefully. Positive and negative trends in this ratio are, for the most part, directly attributable to management decisions.
- H. **Return on deposits**= It's calculated as a percentage by dividing total net income over total customer deposits, This measure reflects the profitability of the deposits compared to the total income.

Table(7.1) Bank Profitability Ratios

ROA	Return on assets= $NI / ATA = \text{net income} / \text{average total assets}$.
ROE	Return on equity= $NI / SE = \text{net income} / \text{average stockholders' equity}$.
PM	Profit margin= $NI / OI = \text{net income} / \text{operating income}$.
ROD	Return on deposits= $NI / ATD = \text{net income} / \text{average total customer deposits}$.
ROSC	Return on shareholder capital= $NI / SC = \text{net income} / \text{shareholder contributed capital}$.
NOM	Operating margin= $OI / IN = \text{operating profit or income} / \text{interest income}$.

7.2.2 Bank Efficiency Ratios

Ratios that are typically used to analyse how well a company uses its assets and liabilities internally, They may also be called asset management ratios.

Bank Efficiency Ratios includes seven different ratios as shown in table(7.2)

- A. **Operating Income to Assets (OIA)** = Total operating income/total asset. This ratio measures capability of firm to generate revenue with its asset. The high value of this ratio indicates the high productivity of firm's asset, It also called Asset Utilization ratio (AU).
- B. **Operating expenses to revenue(OER)** = total operating expenses/total operating income. This ratio indicates how efficiently firm uses its assets, revenues and minimizing the expenses. In other words, it shows how well firm could reduce the expenses and improves productivity,It also called Operating Efficiency ratio (OE).
- C. **Interest income to expenses(IEE)**= (interest income–interest expenses) / average total loans and advances.This ratio measures the amount of gross income that is being spent to pay the interest on borrowed money
- D. **Operating expense to assets(OEA)** =This ratio is calculated by dividing operating expenses/ average total assets, Operating expenses to average assets reflects the percentage of assets used for operations. If this ratio is high or if there is an increasing trend, examiners should determine the cause.
- E. **Asset turnover(ATO)**= It is a measure of a company's ability to use its assets to generate sales or revenue, and is a calculation of the amount of

sales or revenue generated per dollar of assets, A higher number is preferable, since it suggests that the company is using its assets efficiently to make money. A lower number may convince a company to try other methods to help maximize the efficiency of its assets

- F. **Net Interest Margin(NIM)**= A performance metric that examines how successful a firm's investment decisions are compared to its debt situations. A negative value denotes that the firm did not make an optimal decision, because interest expenses were greater than the amount of returns generated by investments.
- G. **Net non-interest margin(NNIM)**= Bank and creditor income derived primarily from fees. Examples of non-interest income include deposit and transaction fees, insufficient funds (NSF) fees, annual fees, monthly account service charges, inactivity fees, check and deposit slip fees, etc. Institutions charge fees that provide non-interest income as a way of generating revenue and ensuring liquidity in the event of increased default rates.

Table(7.2)Bank Efficiency Ratios

IEE	Interest income to expenses= $(IN-IE) / ATLA = (\text{interest income} - \text{interest expenses}) / \text{average total loans and advances}$.
OEI	Operating expense to assets= $OE/ATA = \text{operating expenses} / \text{average total assets}$.
OIA	Operating income to assets= $OI / ATA = \text{operating income} / \text{average total assets}$.
OER	Operating expenses to revenue= $OE/OI = \text{operating expenses} / \text{operating income (revenue)}$.
ATO	Asset turnover= $IN/ATA = \text{interest income} / \text{average total assets}$.
NIM	Net interest margin= $(IN-IE) / ATA = (\text{net interest income} - \text{net interest expenses}) / \text{average total assets}$.
NNIM	Net non-interest margin= $(NIN-NIE) / ATA = (\text{net non-interest income} - \text{net non-interest expenses}) / \text{average total assets}$.

7.2.3 Assets-Quality Ratios

Assets quality ratios reflect the qualities of assets of the bank and productive and efficient utilization of available resources. Generally seven ratios are used to measure the quality of assets as shown in table(7.3):-

- A. **Provision to earning assets(PEA)**=Loan Loss Provisions calculated as a percentage of Gross Loans.
- B. **Adequacy of provision for loans(APL)**= Loan Loss Reserves calculated as a percentage of Gross Loans.
- C. **Write-off ratio(WRL)**= A reduction in the value of an asset or earnings by the amount of an expense or loss. Companies are able to write off certain expenses that are required to run the business, or have been incurred in the operation of the business and detract from retained revenues.
- D. **Loan ratio(LR)**=A lending risk assessment ratio that financial institutions and others lenders examine before approving a mortgage. Typically, assessments with high LR ratios are generally seen as higher risk and, therefore, if the mortgage is accepted, the loan will generally cost the borrower more to borrow or he or she will need to purchase mortgage insurance.
- E. **Loans to deposits(LTD)**= A commonly used statistic for assessing a bank's liquidity by dividing the banks total loans by its total deposits. This number, also known as the LTD ratio, is expressed as a percentage. If the ratio is too high, it means that banks might not have enough liquidity to cover any unforeseen fund requirements; if the ratio is too low, banks may not be earning as much as they could be.

Table (7.3)Asset-Quality Indicators

PEA=	Provision to earning assets=PLL/ATLA=provision for loan losses / average total loans and advances.
APL=	Adequacy of provision for loans=ALL/ATLA=allowance for loan losses at the end of the year /average total loans and advances.
WRL=	Write-off ratio=WR/ATLA=write-off of loans during the year / average total loans and advances.
LR=	Loan ratio=ATLA/ATA=average total loans and advances / average total assets.
LTD=	Loans to deposits=ATLA/ATD=average total loans and advances / average total customer deposits

7.2.4 Liquidity Ratios

The liquidity ratios measure the capability of a bank to meet its short-term obligations. Generally, the higher value of this ratio indicates that firm has larger

margin safety to cover its short-term obligations. Among the various liquidity measures.

A. Cash to assets(CTA)=A ratio used to compare a business's performance among other industry members. The ratio can be used internally by the company's analysts, or by potential and current investors. The ratio does not however include any future commitments regarding assets, nor does it include the cost of replacing older ones.A high cash return to assets ratio can indicate that a higher return is to be expected. This is because the higher the ratio, the more cash the company has available for reintegration into the company, whether it be in upgrades, replacements or other areas.

B. Cash to deposits(CTD)= is the ratio of how much a bank lends out of the deposits it has mobilised. It indicates how much of a bank's core funds are being used for lending, the main banking activity. It can also be defined as Total of Cash in hand and Balances with RBI divided by Total deposits.

Table(7.4)Liquidity Ratios

CTA=	Cash to assets=C/ATA=cash / average total assets.
CTD=	Cash to deposits=C/ATD=cash / average total customer deposits.

7.2.5 Risk(Solvency) Ratios

Simons (1985:149) states that “A Company is solvent if the break-up value its total assets exceeds its total liabilities. In such a case, all being paid in full. The degree of solvency of a company is qualified by its “Solvency Ratio”, which is the percentage of the total of Islamic banks.

A. Deposits to assets (DTA)= The deposits to Total Assets ratio is an important management tool to assess on ongoing basis the extent assets can support its asset base.

B. Equity multiplier(EM)=The ratio of a company’s total assets to its stockholder’s equity. The equity multiplier is a measurement of a company’s financial leverage. Companies finance the purchase of assets either through equity or debt, so a high equity multiplier indicates that a larger portion of asset

financing is being done through debt. The multiplier is a variation of the debt ratio.

- C. **Equity to deposits(ETD)**= The equity/deposit ratio helps assess a bank's liquidity, and by extension, the aggressiveness of the bank's management. If the equity /deposit ratio is too high, the bank could be vulnerable to any sudden adverse changes in its deposit base. Conversely, if the equity /deposit ratio is too low, the bank is holding on to unproductive capital and earning less than it should.
- D. **Total liabilities to equity(TLE)**= is a debt ratio used to measure a company's financial leverage, calculated by dividing a company's total liabilities by its stockholders' equity. The ratio indicates how much debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity.
- E. **Total liabilities to shareholder capital(TLSC)**= is another risk ratio that compares a company's total liabilities to its total shareholders' equity. This is a measurement of how much suppliers, lenders, creditors and obligors have committed to the company versus what the shareholders have committed.
- F. **Retained earnings to total assets(RETA)**= The Retained Earnings to Total Assets ratio measures the company's ability to accumulate earnings using its Total Assets, A high, or increasing Retained Earnings to Total Assets ratio is usually a positive sign, showing the company is able to continually retain increasingly more earnings. As a company grows and matures, you should see this ratio increase.

Table(7.5)Risk Ratios

DTA=	Deposits to assets=ATD/ATA=average total customer deposits / average total assets.
EM=	Equity multiplier=ATA/SE=average total assets / average stockholders' equity.
ETD=	Equity to deposits=SE/ATD=average shareholders' equity / average customer total deposits.
TLE=	Total liabilities to equity=TL/SE=average total liabilities / average stockholders' equity.
TLSC=	Total liabilities to shareholder capital=TL/SC=average total liabilities / shareholder contributed capital.
RETA=	Retained earnings to total assets=RE/ATA=retained earnings / average total assets

Chapter 8

Data Analysis

Chapter 8

Data Analysis

8.1 Financial Analysis Tools

The definition of financial analysis indicates that it is one of the most objective ways of adequate evaluation of an entity and that it provides possibilities not only for more precise understanding of the ongoing processes but also for the presentation of information quality (Palepu, Healy, 2008). Financial analysis of the data of financial statements is broadly used. Financial analysis is divided into three types: horizontal, vertical, and the analysis of ratios (William, Dale and Gregory, 2009; Ouda, 2010; Villis, Kazlauskiene, 2012):

8.1.1 Horizontal Analysis

When financial statements of a number of years of the same firm are compared and reviewed, it is known as Horizontal Analysis. Horizontal analysis helps to observe the changes in the financial variables, across the years. For this analysis, first base or standard year is chosen as a starting point. Any year may be taken as the base year, but, generally, the starting or initial year is taken as the base year. All the financial tables are presented in a horizontal manner. Keeping the data of base year in the beginning, the data of the different years are kept in separate columns. Horizontal analysis may be employed for the evaluation of all financial statements.

The purpose of the analysis is to identify the strengths and weaknesses of the bank. Comparison of the item, over several years, shows the development of trend. The management would be able to get insight of the strength or problem for necessary action, in time. Since this analysis is based on the data from year to year rather than on one-year data, this analysis is also termed as dynamic analysis.

Comparative financial statements use the technique of Horizontal Analysis. Based on the prevailing trend, it is possible for the firm to make a rational forecast about the future progress.

8.1.2 Vertical Analysis

Vertical analysis refers to the study of relationship of the various items contained in the financial statement of one accounting period. It indicates the percentage value of each element in a specific statement in comparison with the general base value. Ratios are expressed in percentage values; the cumulative value stands at 100%. Such analysis is useful in comparing the performance of several companies in the same group or industry, or divisions or departments in the same company. Vertical analysis is also known as ‘Static Analysis’.

Common – size financial statements and financial ratios are the two tools employed in vertical analysis.

Horizontal Analysis is used for comparing data of several years of one firm, while Vertical Analysis is used for comparing the relative performance of different firms in the same industry for one particular period or year.

Combined use of Horizontal and Vertical Analysis: Both analyses can be used, simultaneously. Vertical analysis can be used along with horizontal analysis to make it more effective and meaningful.

8.1.3 Ratios Analysis

Ratios are an analyst’s microscope; they allow us to get a better view of the firm’s financial health than just looking at the raw financial statements. This analysis is extremely common when comparing and evaluating a number of enterprises. On the grounds of data of financial statements, financial forecasts are developed. There are a number of financial ratios for profit-seeking enterprises contributing to exhaustive financial analysis.

Financial ratios are a means of using the information that is reported in one or more of the financial statements and interpreting it another way. By definition, the word ratio implies some value relative to some other value and thus most financial ratios are independent of the size of the business allowing different sized business to be compared to each other more easily.

8.2 Data Analysis

8.2.1 Return on assets (ROA):-

Table (8.1): ROA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.021	0.012	0.012	0.006	0.001	0.010
2011	0.021	0.010	0.003	0.010	0.003	0.009
2012	0.021	0.007	0.000	0.007	0.007	0.008
2013	0.019	0.009	0.001	0.007	0.008	0.009
2014	0.017	0.012	0.005	0.009	0.007	0.010
Average	0.020	0.010	0.004	0.008	0.005	0.009

Table (8.2): ROA for Islamic bank

Years	ISBK	AIB	Average
2010	0.005	0.000	0.003
2011	0.011	0.003	0.007
2012	0.014	0.002	0.008
2013	0.014	0.008	0.011
2014	0.014	0.008	0.011
Average	0.012	0.004	0.008

ROA Shows the ability of banks managements to acquire deposits in a reasonable cost and reinvest them in profitable investments. It indicates how much net income is generated per \$ of assets. The higher the ROA the more profitable the bank

- The Conventional banks table shows a somehow stable aggregate trend from 2010 to 2014 with a slight decrease in 2011 and 2012. BOP has the most favorable ROA among Conventional banks during the study period but with a dramatically decreased trend from 2012 to 2014. The strong assets growth during this period combined with a lower growth in earnings reflect BOP situation.
- The Islamic Banks table shows a growth in the aggregate average from 2010 to 2014 with stability through 2013 until 2014. ISBK has the most favorable ROA among Islamic banks during the study period with an increasingly distinction point in 2011, after that increase comes a constancy from 2012 to 2014.

8.2.2 Rate on Equity (ROE):-

Table (8.3): ROE for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.191	0.091	0.066	0.026	0.007	0.076
2011	0.190	0.087	0.021	0.040	0.020	0.072
2012	0.185	0.058	0.002	0.028	0.050	0.065
2013	0.171	0.077	0.004	0.029	0.068	0.070
2014	0.151	0.107	0.037	0.041	0.066	0.080
Average	0.178	0.084	0.026	0.033	0.042	0.073

Table (8.4): ROE for Islamic bank

Years	ISBK	AIB	Average
2010	0.038	-0.046	-0.004
2011	0.081	0.017	0.049
2012	0.106	0.011	0.059
2013	0.108	0.059	0.084
2014	0.115	0.064	0.090
Average	0.090	0.021	0.055

ROE is the most vital indicator of banks profitability and growth potential. It is the rate of return to shareholders or the percentage return on each \$ of equity invested in the bank.

- The Conventional banks table shows a decreasing trend from 2010 to 2012 at aggregate level then it start increasing until 2014. At a narrower level, Bop shows a decreasing scheme which is in line with ROA. This decreasing trend could be justified by increased credit impairments owing to defaults, which negatively influenced profitability. Other banks show some volatility during the period. This randomness could be attributable to income volatility as there is no irregular acceleration in equity during the period. The more volatility the earnings the more riskily the investment.
- The table of Islamic Bank shows an increasing trend from 2010 to 2014 at aggregate level. . At a narrower level, ISBK An increasing scheme at the whole study period which is in line with ROA

8.2.3 Profit Margin (PM):-

Table (7.5): PM for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.397	0.270	0.255	0.140	0.042	0.221
2011	0.387	0.198	0.091	0.241	0.087	0.201
2012	0.401	0.137	0.010	0.173	0.189	0.182
2013	0.365	0.184	0.015	0.160	0.247	0.194
2014	0.345	0.221	0.115	0.301	0.232	0.243
Average	0.379	0.202	0.097	0.203	0.159	0.208

Table (8.6): PM for Islamic bank

Years	ISBK	AIB	Average
2010	0.108	-0.188	-0.040
2011	0.225	0.066	0.146
2012	0.312	0.045	0.179
2013	0.279	0.208	0.244
2014	0.268	0.217	0.243
Average	0.238	0.070	0.154

Profit margin shows how much every dollar of sales kept as earnings. To a large degree, it is the quality and growth of banks earnings that drive their stocks price.

- At the aggregate level, the table of Conventional Banks shows a negative trend of profit margin from 2010 to 2012 while it returns to positive in 2013 and 2014 respectively. Bop shows consistent ratios during the period compared by other banks, which reflects consistent investment decisions. PCB shows some an obvious randomness, which can be translated to earnings volatility and much higher risk. On the other hand, TNB shows a positive trend, which reflects the development of the bank investment quality.
- The Islamic Bank table shows a positive trend of profit margin from 2010 to 2013 and it remained constant in 2014. As the table shows ISBK and AIB are both

managing their expenses relative to their net sales positively, but according to the table ISBK has a better situation.

8.2.4 Return on Deposits (ROD):-

Table (8.7): ROD for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.028	0.014	0.019	0.013	0.003	0.015
2011	0.028	0.012	0.006	0.020	0.006	0.014
2012	0.028	0.010	0.001	0.014	0.014	0.013
2013	0.026	0.013	0.001	0.013	0.017	0.014
2014	0.022	0.016	0.008	0.016	0.015	0.015
Average	0.026	0.013	0.007	0.015	0.011	0.015

Table (8.8): ROD for Islamic bank

Years	ISBK	AIB	Average
2010	0.022	-0.027	-0.003
2011	0.049	0.011	0.030
2012	0.066	0.008	0.037
2013	0.064	0.035	0.050
2014	0.061	0.034	0.048
Average	0.052	0.012	0.032

ROD could be defined as the amount of profit generated for each dollar held in debt, which is mainly client deposits in our case. The more the ratio the more the efficiency of the bank to maintain a low cost source of financing to their investments.

Not so much to address at the Conventional Banks table shows except the stability of average among commercial banks during the period and still BOP maintains the highest return on debt, which decreased during 2013 and 2014, justified by the same reason of ROA and ROE downward trend.

- The above table of Islamic Bank represents a slightly stable growth through the study period, At a narrower level ISBK has higher return on debt than AIB.

8.2.5 Return on Shareholders (ROSC):-

Table (8.9): ROSC for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.301	0.088	0.060	0.031	0.007	0.097
2011	0.283	0.092	0.020	0.048	0.019	0.092
2012	0.286	0.065	0.002	0.034	0.041	0.086
2013	0.270	0.095	0.004	0.037	0.072	0.096
2014	0.251	0.145	0.040	0.051	0.063	0.110
Average	0.278	0.097	0.025	0.040	0.040	0.096

Table (8.10): ROSC for Islamic bank

Years	ISBK	AIB	Average
2010	0.035	-0.056	-0.011
2011	0.088	0.019	0.054
2012	0.124	0.014	0.069
2013	0.131	0.072	0.102
2014	0.151	0.083	0.117
Average	0.106	0.026	0.066

- **ROSC** measures the proportion of adjusted earnings to the amount of capital and debt required for a bank to function. For a bank to remain over the long term, its return on shareholders capital should be higher than its cost of capital; otherwise, continuing operations gradually reduce the earnings available to shareholders.
- The Conventional banks table shows a slight decrease through the years 2010 to 2012, after that it represents a good increase from 2013 and 2014, at a narrower level QUDS Bank has increased its return on shareholders' capital through the study period but the bank faced a surprisingly descending gap in 2012 and turned back to increase in 2013.
- The above table Islamic Bank shows a positive scheme at the aggregate level, and the ISBK is the dominant.

8.2.6 NOM

Table (8.11): NOM for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	1.500	1.174	1.262	1.229	1.075	1.248
2011	1.342	1.220	1.019	1.150	1.135	1.173
2012	1.305	1.155	0.895	1.255	1.019	1.126
2013	1.221	1.051	1.009	1.219	0.972	1.094
2014	1.270	1.194	1.086	0.863	0.857	1.054
Average	1.328	1.159	1.054	1.143	1.012	1.139

Table (8.12): NOM for Islamic bank

Years	ISBK	AIB	Average
2010	1.278	1.510	1.394
2011	1.145	1.384	1.265
2012	1.123	1.247	1.185
2013	1.122	1.289	1.206
2014	1.170	1.228	1.199
Average	1.168	1.332	1.250

- **NOM** shows what proportion of revenues is available to cover non-operating costs like interest expense. This ratio is important to both creditors and investors because it helps show how strong and profitable a bank's operations are.
- As it is shown in the commercial banks table there was a decrease in the aggregate average through the period from 2010 to 2014, At a narrower level all Conventional banks shows a decrease in 2011 except QUDS Bank, but BOP remains at the top.
- Islamic banks table shows a negative trend through the study period with a slight increase in 2013, AIB represents a higher profitable average compared to ISBK through the study period.

8.2.7 IEE

Table (8.13): IEE for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.105	0.071	0.111	0.089	0.084	0.092
2011	0.092	0.064	0.093	0.089	0.069	0.081
2012	0.075	0.056	0.080	0.089	0.064	0.073
2013	0.073	0.064	0.064	0.094	0.050	0.069
2014	0.067	0.070	0.062	0.089	0.052	0.068
Average	0.082	0.065	0.082	0.090	0.064	0.077

Table (8.14): IEE for Islamic bank

Years	ISBK	AIB	Average
2010	0.085	0.091	0.088
2011	0.078	0.084	0.081
2012	0.075	0.073	0.074
2013	0.077	0.068	0.073
2014	0.070	0.067	0.069
Average	0.077	0.077	0.077

- IEE measures the amount of gross income that is being spent to pay the interest on borrowed money
- The Conventional banks table shows a negative scheme from 2010 to 2014, at a narrower level BOP shows a decreasing in their gross income that is being spent to pay the interest on borrowed money, while PIBC is the dominant.
- Islamic banks table also shows a negative aggregate trend through the study period divided equally between ISBK and AIB.

8.2.8 OEA

Table (8.15): OEA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.002	0.005	0.002	0.009	0.028	0.009
2011	0.003	0.013	0.003	0.009	0.026	0.011
2012	0.003	0.013	0.002	0.009	0.023	0.010
2013	0.003	0.011	0.003	0.008	0.021	0.009
2014	0.003	0.014	0.004	0.004	0.021	0.009
Average	0.003	0.011	0.003	0.008	0.024	0.010

Table (8.16): OEA for Islamic bank

Years	ISBK	AIB	Average
2010	0.012	0.001	0.007
2011	0.015	0.041	0.028
2012	0.013	0.039	0.026
2013	0.013	0.028	0.021
2014	0.016	0.028	0.022
Average	0.014	0.027	0.021

- OEA reflects the percentage of assets used for banks operations.
- The Conventional banks table shows a consistency through the study period, and QUDS Bank shows the better use of assets among its competitors'.
- Islamic banks table also shows a constant aggregate increase from 2010 to 2011 then it has dropped through the years 2012 and 2013 and then it turned back up slightly, looking at each bank shows AIB reflects the better use of assets more than ISBK.

8.2.9 OIA

Table (8.17): OIA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.054	0.043	0.046	0.044	0.032	0.044
2011	0.055	0.052	0.038	0.042	0.032	0.044
2012	0.052	0.050	0.034	0.042	0.036	0.043
2013	0.051	0.051	0.036	0.045	0.033	0.043
2014	0.049	0.054	0.041	0.031	0.032	0.041
Average	0.052	0.050	0.039	0.041	0.033	0.043

Table (8.18): OIA for Islamic bank

Years	ISBK	AIB	Average
2010	0.045	0.001	0.023
2011	0.048	0.046	0.047
2012	0.046	0.043	0.045
2013	0.051	0.040	0.046
2014	0.051	0.037	0.044
Average	0.048	0.033	0.041

- **OIA** measures capability of a bank to generate revenue with its asset. The high value of this ratio indicates the high productivity of bank's asset.
- The Conventional banks table shows a stable revenue generating through the study period, PIBC at a narrower level shows an increase in revenue generated from 2010 to 2013 with a sudden drop in 2014.
- Islamic bank table shows a fluctuations between raising and dropping from 2010 to 2014 in the aggregate average.

8.2.10 OER

Table (8.19): OER for Conventional I bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.045	0.120	0.035	0.204	0.894	0.260
2011	0.053	0.253	0.089	0.207	0.801	0.281
2012	0.063	0.250	0.063	0.224	0.636	0.247
2013	0.058	0.218	0.092	0.176	0.626	0.234
2014	0.069	0.266	0.089	0.131	0.660	0.243
Average	0.058	0.221	0.074	0.188	0.723	0.253

Table (8.20): OER for Islamic bank

Years	ISBK	AIB	Average
2010	0.276	1.141	0.709
2011	0.312	0.897	0.605
2012	0.279	0.927	0.603
2013	0.266	0.704	0.485
2014	0.322	0.747	0.535
Average	0.291	0.883	0.587

- OER (Operating expenses / gross operating income). Measures the operating income generated by \$ of cost. That is how expensive it is for the bank to produce a unit of output. The lower the better the performance of management especially financial planning divisions. The trend reflected by ROA and ROE is also reflected in this ratio.
- The Conventional banks table shows an average of 0.25 at the aggregate level. We could obviously address the higher performance of BOP and PCB in this regard. Years of experience and capacity of these two banks allow them to use their resources effectively and reduce their operating costs. focusing on BOP, the significant increase of the ratio from 0.045 in 2010 to 0.069 in 2014 could be due

to the management expansion policy particularly in the west bank and adopting "leading the market technique" there.

- Islamic bank table shows an aggregate average of 0.58. among Islamic banks ISBK represents the higher performance.

8.2.11 ATO

Table (8.21): ATO for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.036	0.037	0.037	0.036	0.029	0.035
2011	0.041	0.042	0.037	0.036	0.028	0.037
2012	0.040	0.044	0.038	0.034	0.035	0.038
2013	0.042	0.048	0.036	0.037	0.034	0.039
2014	0.039	0.046	0.037	0.036	0.037	0.039
Average	0.040	0.043	0.037	0.036	0.033	0.038

Table (8.22): ATO for Islamic bank

Years	ISBK	AIB	Average
2010	0.035	0.001	0.018
2011	0.042	0.033	0.038
2012	0.041	0.034	0.038
2013	0.045	0.031	0.038
2014	0.044	0.030	0.037
Average	0.041	0.026	0.034

- **ATO** measures the amount of revenue generated per \$ of assets, A higher number is preferable, since it suggests that the bank is using its assets efficiently to make money. A lower number may convince a bank to try other methods to help maximize the efficiency of its assets.
- The Conventional banks table shows an average of 0.038 at the aggregate level. We could obviously address the higher performance of QUDS and BOP in this regard.

- Islamic bank table shows an aggregate average of 0.034 which is almost the same as the Conventional banks aggregate average. Among Islamic banks ISBK represents the higher performance.

8.2.12 NIM

Table (8.23): NIM for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.033	0.030	0.030	0.031	0.023	0.029
2011	0.036	0.035	0.029	0.031	0.020	0.030
2012	0.035	0.034	0.030	0.031	0.023	0.031
2013	0.035	0.037	0.026	0.033	0.021	0.030
2014	0.032	0.036	0.028	0.029	0.023	0.030
Average	0.034	0.034	0.029	0.031	0.022	0.030

Table (8.24): NIM for Islamic bank

Years	ISBK	AIB	Average
2010	0.034	0.001	0.018
2011	0.037	0.030	0.034
2012	0.036	0.033	0.035
2013	0.040	0.029	0.035
2014	0.039	0.029	0.034
Average	0.037	0.024	0.031

- **NIM** Shows how successful banks investment decisions compared to its debt situation. It is very important to stakeholders to maintain acceptable and stable margin between debt and credit interest.
- The Conventional banks table shows stable average of NIM during the study period. Banks ratios closed to average except BOP and Quds bank, which exceed the average slightly in 2014.

- Islamic bank table shows an aggregate average of 0.031 which is almost the same as the commercial banks aggregate average. ISBK average ratio exceeds the aggregate average slightly through the study period.

8.2.13 NNIM

Table (8.25): NNIM for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	-0.011	-0.019	-0.018	-0.066	-0.022	-0.027
2011	-0.017	-0.025	-0.025	-0.021	-0.019	-0.021
2012	-0.012	-0.028	-0.029	-0.024	-0.020	-0.023
2013	-0.016	-0.028	-0.026	-0.026	-0.013	-0.022
2014	-0.015	-0.024	-0.023	-0.020	-0.015	-0.019
Average	-0.014	-0.025	-0.024	-0.031	-0.018	-0.022

Table (8.26): NNIM for Islamic bank

Years	ISBK	AIB	Average
2010	-0.029	-0.001	-0.015
2011	-0.027	-0.027	-0.027
2012	-0.022	-0.031	-0.027
2013	-0.026	-0.021	-0.024
2014	-0.026	-0.021	-0.024
Average	-0.026	-0.020	-0.023

- **NNIM** It is expressed as a percentage of how much noninterest revenue banks are earning minus the non-interest expense. Noninterest income includes revenues earned from loan and investments or fee income from fiduciary activities, services charges on deposit accounts, trading account gains and fees, revenues income from investment banking, security brokerage and insurance services. Noninterest expenses include salaries, wages and employee benefits
- For Conventional banks NNIM ratio has increased from 2010 to 2011 but in 2012 it decreased a bit but after that it kept increasing to the end of the study period. For PIBC In 2010 the net non-interest margin was too low and negative thus

indicating huge operating expenses, then in the year 2011 the ratio increases again and keeps increasing to 2013 but it remains negative. This indicates the spread between its non-interest expenses and its non-interest revenue has increased.

- Islamic banks shows a decreased aggregate average ratio, For AIB NNIM ratio is decreasing through the study period but it remains in a better situation than ISBK.

8.2.14 PEA

Table (8.27): PEA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.000	0.005	0.004	0.021	0.015	0.009
2011	0.000	0.007	0.004	0.017	0.014	0.008
2012	0.002	0.004	0.001	0.020	0.004	0.006
2013	0.002	0.004	0.001	0.015	0.004	0.005
2014	0.003	0.005	0.000	0.005	0.004	0.003
Average	0.001	0.005	0.002	0.016	0.008	0.006

Table (8.28): PEA for Islamic bank

Years	ISBK	AIB	Average
2010	0.002	0.019	0.011
2011	0.003	0.000	0.002
2012	0.009	0.001	0.005
2013	0.002	0.002	0.002
2014	0.002	0.000	0.001
Average	0.004	0.004	0.004

- PEA is an amount set aside in the event that the loan defaults. a loss on a loan is still a loss of an asset. However, on an operating basis, because of the loan loss provision, cash flow remains available. The loan loss provision ensures that banks will have sufficient funds to provide services to its depositors, The lower the better the performance of management.

- The Conventional banks table shows an aggregate average of 0.006, at a narrower level BOP and PCB have the best sufficient funds to provide services to their depositors.
- Islamic bank table shows a better aggregate performance than Conventional banks while AIB has better situation than ISBK.

8.2.15 APL

Table (8.29): APL for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.017	0.011	0.022	0.030	0.021	0.020
2011	0.011	0.011	0.004	0.032	0.027	0.017
2012	0.009	0.010	0.004	0.042	0.016	0.016
2013	0.008	0.011	0.003	0.043	0.012	0.015
2014	0.009	0.010	0.001	0.031	0.009	0.012
Average	0.011	0.011	0.007	0.036	0.017	0.016

Table (8.30): APL for Islamic bank

Years	ISBK	AIB	Average
2010	0.018	0.026	0.022
2011	0.014	0.002	0.008
2012	0.010	0.002	0.006
2013	0.007	0.004	0.006
2014	0.008	0.003	0.006
Average	0.011	0.007	0.009

- **APL** Every bank must have a program to establish and regularly review the adequacy of its allowance. The allowance must be maintained at a level that is adequate to absorb all estimated inherent losses in the loan and lease portfolio as of its evaluation date. (See the Glossary for a discussion of the term inherent loss.) A bank that fails to maintain an adequate allowance is operating in an unsafe and unsound manner.
- Conventional banks table shows that PIBC has maintained an appropriate level that is adequate to absorb all estimated inherent losses during the study period

- Islamic banks also show that AIB has maintained an appropriate ratio level compared to ISBK.

8.2.16 WRL

Table (8.31): WRL for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.010	0.034	0.504	0.124	0.048	0.144
2011	0.006	0.051	0.374	0.088	0.036	0.111
2012	0.005	0.071	0.292	0.094	0.026	0.098
2013	0.004	0.033	0.220	0.064	0.020	0.068
2014	0.004	0.042	0.151	0.072	0.001	0.054
Average	0.006	0.046	0.308	0.088	0.026	0.095

Table (8.32): WRL for Islamic bank

Years	ISBK	AIB	Average
2010	0.013	0.000	0.007
2011	0.002	0.000	0.001
2012	0.005	0.001	0.003
2013	0.005	0.000	0.003
2014	0.006	0.000	0.003
Average	0.006	0.000	0.003

- WRL is a reduction in the value of an asset or earnings by the amount of an expense or loss. Banks are able to write off certain expenses that are required to run the business, or have been incurred in the operation of the business and detract from retained revenues.
- Conventional banks table shows a slow reduction in the expense or loss compared to the assets and BOP according to its years of experience in the sector remains the dominant as it reduces the expense very well compared to the assets.
- Islamic banks have a constant aggregate reduction average of 0.003 and AIB has the best average among all banks of 0.000.

8.2.17 LR

Table (8.33): LR for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.313	0.423	0.268	0.346	0.277	0.325
2011	0.395	0.545	0.311	0.343	0.294	0.378
2012	0.463	0.613	0.368	0.346	0.366	0.431
2013	0.477	0.572	0.411	0.355	0.421	0.447
2014	0.472	0.519	0.442	0.331	0.436	0.440
Average	0.424	0.534	0.360	0.344	0.359	0.404

Table (8.34): LR for Islamic bank

Years	ISBK	AIB	Average
2010	0.396	0.006	0.201
2011	0.478	0.361	0.420
2012	0.486	0.452	0.469
2013	0.517	0.430	0.474
2014	0.567	0.426	0.497
Average	0.489	0.335	0.412

- **LR** is A lending risk assessment ratio that banks examine before approving a mortgage. Typically, assessments with high LR ratios are generally seen as higher risk and, therefore, if the mortgage is accepted, the loan will generally cost the borrower more to borrow or he or she will need to purchase mortgage insurance.
- The first table shows increasing in the loan risks ratio from 2010 to 2014, considering all Conventional banks situations Quds bank has the highest average risk of 0.534 which means Quds bank is improving loans policy using higher risks.
- The second one also shows higher risk through the study period with an aggregate average of 0.412.

8.2.18 LTD

Table (8.35): LTD for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.405	0.510	0.438	0.709	0.678	0.548
2011	0.516	0.657	0.506	0.686	0.652	0.603
2012	0.621	0.894	0.604	0.680	0.733	0.706
2013	0.657	0.789	0.685	0.637	0.855	0.725
2014	0.629	0.696	0.765	0.573	0.871	0.707
Average	0.566	0.709	0.600	0.657	0.758	0.658

Table (8.36): LTD for Islamic bank

Years	ISBK	AIB	Average
2010	1.784	1.016	1.400
2011	2.180	1.295	1.738
2012	2.255	1.775	2.015
2013	2.345	1.801	2.073
2014	2.531	1.790	2.161
Average	2.219	1.535	1.877

- **Loan to deposit ratio** is specified by the monetary authority in order to protect clients' deposits. PMA did not impose a specific ratio yet but many banks has internally impose a ratio averages between 65% to 70%. The higher the ratio the more investment potential and more risk.
- The Conventional banks table shows an increasing average from 2010 to 2013, which may interpreted as a lower acceleration in deposits growth compared with loans growth. It also can be interpreted by adopting expansionary granting policy by commercial banks. Another point could be useful here is the Israeli economic siege upon WB and Gaza, which enforce Conventional banks to be more conservative in accepting short-term deposits.
- Islamic banks table shows an increasing average through the study period same as commercial banks.

8.2.19 CTA

Table (8.37): CTA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.226	0.182	0.141	0.246	0.200	0.199
2011	0.160	0.178	0.290	0.151	0.129	0.182
2012	0.217	0.229	0.169	0.238	0.175	0.206
2013	0.293	0.167	0.141	0.192	0.140	0.187
2014	0.145	0.198	0.141	0.186	0.142	0.162
Average	0.208	0.191	0.176	0.203	0.157	0.187

Table (8.38): CTA for Islamic bank

Years	ISBK	AIB	Average
2010	0.474	0.005	0.240
2011	0.388	0.219	0.304
2012	0.379	0.240	0.310
2013	0.239	0.210	0.225
2014	0.199	0.140	0.170
Average	0.336	0.163	0.249

- CTA ratio used to compare a bank performance among other financial members. The ratio can be used internally by the bank's analysts, or by potential and current investors. The ratio does not however include any future commitments regarding assets, nor does it include the cost of replacing older ones. A high cash return to assets ratio can indicate that a higher return is to be expected. This is because the higher the ratio, the more cash the bank has available for reintegration into the bank, whether it be in upgrades, replacements or other areas.
- The Conventional banks table shows a decreasing average through the study period with a sudden increase in 2012 and BOP represents the highest return on assets through the whole period.
- The Islamic banks table shows increase in the aggregate average from 2010 to 2012, then the average starts to decrease, at a narrower level we can observe a significant difference between ISBK and AIB .

8.2.20 CTD

Table (8.39): CTD for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.293	0.219	0.392	0.504	0.489	0.379
2011	0.209	0.214	0.230	0.303	0.286	0.248
2012	0.290	0.334	0.475	0.468	0.350	0.383
2013	0.404	0.230	0.281	0.345	0.285	0.309
2014	0.194	0.266	0.244	0.322	0.283	0.262
Average	0.278	0.253	0.324	0.388	0.339	0.316

Table (8.40): CTD for Islamic bank

Years	ISBK	AIB	Average
2010	2.134	0.827	1.481
2011	1.771	0.789	1.280
2012	1.756	0.944	1.350
2013	1.084	0.879	0.982
2014	0.889	0.588	0.739
Average	1.527	0.805	1.166

- **CTD** is the ratio of how much a bank lends out of the deposits it has mobilised. It indicates how much of a bank's core funds are being used for lending.
- The Conventional banks table shows a constant decreasing scheme through the study period with sudden increase in 2012 of the money lending. At a narrower level BOP shows a decrease in the bank's loans from 2010 to 2011 then the ratio starts to increase from 2012 to 2013 after that comes a flopping in 2014 from 0.404 to 0.194 because the Israeli economic siege upon WB and Gaza, which enforce commercial banks to be more conservative.
- The Islamic banks table shows a slight decline from 2010 to 2014 with an aggregate average of 1.166 which is higher than the aggregate average of the Conventional banks.

8.2.21 DTA

Table (8.41): DTA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.773	0.830	0.613	0.488	0.409	0.623
2011	0.766	0.830	0.615	0.499	0.451	0.632
2012	0.747	0.685	0.609	0.509	0.500	0.610
2013	0.725	0.726	0.600	0.558	0.493	0.620
2014	0.749	0.745	0.578	0.577	0.500	0.630
Average	0.752	0.763	0.603	0.526	0.471	0.623

Table (8.42): DTA for Islamic bank

Years	ISBK	AIB	Average
2010	0.222	0.006	0.114
2011	0.219	0.278	0.249
2012	0.216	0.254	0.235
2013	0.220	0.239	0.230
2014	0.224	0.238	0.231
Average	0.220	0.203	0.212

- **DTA** is a ratio used to examine the funding situation of a banks, DTA ratio reflects the bank`s loans and assets whether it is high then number of loans bowered from the bank is high which means increasing assets through the years and vice versa.
- Conventional banks table shows an aggregate average which reflects a good increasing in deposits from 2010 to 2014, QUDS BANK and BOP ratios shows an equivalent ratios in this area.
- Islamic banks table shows stability through the study period.

8.2.22 EM

Table (8.43): EM for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	8.986	7.785	5.608	4.153	5.580	6.422
2011	8.929	8.515	6.083	4.027	6.993	6.909
2012	8.808	8.427	6.324	3.853	7.425	6.967
2013	9.202	8.241	7.483	4.087	8.284	7.459
2014	8.969	8.868	7.969	4.461	8.961	7.846
Average	8.979	8.367	6.693	4.116	7.449	7.121

Table (8.44): EM for Islamic bank

Years	ISBK	AIB	Average
2010	7.778	5.519	6.649
2011	7.492	5.585	6.539
2012	7.417	5.921	6.669
2013	7.624	7.057	7.341
2014	8.378	7.921	8.150
Average	7.738	6.401	7.069

- **EM** measures a bank's financial leverage by using a ratio of the bank's total assets to its stockholders' equity. Generally, a lower equity multiplier indicates a bank has lower financial leverage. It is better to have a low equity multiplier, because a bank uses less debt to finance its assets.
- The first table shows a stable increasing scheme from 2010 to 2014 which means lower performance and lower financial leverage, taking BIBC at the narrower level which is decreasing its EM ratio from 2010 to 2012 and then it increases again but remains with a better performance comparing with other banks situations in the same area.
- The Islamic banks table shows that AIB uses less debt to finance its assets although it has an increasing scheme from 2010 to 2014 .

8.2.23 ETD

Table (8.45): ETD for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.144	0.155	0.291	0.493	0.438	0.304
2011	0.146	0.141	0.267	0.497	0.317	0.274
2012	0.152	0.173	0.259	0.510	0.270	0.273
2013	0.150	0.167	0.223	0.438	0.245	0.245
2014	0.149	0.151	0.217	0.388	0.223	0.226
Average	0.148	0.157	0.251	0.465	0.299	0.264

Table (8.46): ETD for Islamic bank

Years	ISBK	AIB	Average
2010	0.579	0.585	0.582
2011	0.609	0.643	0.626
2012	0.625	0.664	0.645
2013	0.595	0.593	0.594
2014	0.533	0.531	0.532
Average	0.588	0.603	0.596

- ETD ratio helps assess a bank's liquidity, the aggressiveness of the bank's management. If the ratio is too high, the bank could be vulnerable to any sudden adverse changes in its deposit base. Conversely, if the ratio is too low, the bank is holding on to unproductive capital and earning less than it should.

8.2.24 TLE

Table (8.47): TLE for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	7.986	5.871	4.608	3.153	4.580	5.240
2011	7.929	6.669	5.083	3.027	5.993	5.740
2012	7.808	7.427	5.324	2.853	6.425	5.967
2013	8.202	7.241	6.496	3.087	7.284	6.462
2014	7.969	7.868	6.980	3.461	7.961	6.848
Average	7.979	7.015	5.698	3.116	6.449	6.051

Table (8.48): TLE for Islamic bank

Years	ISBK	AIB	Average
2010	2.285	1.927	2.106
2011	2.419	1.738	2.079
2012	2.392	1.887	2.140
2013	2.386	2.475	2.431
2014	2.872	2.967	2.920
Average	2.471	2.199	2.335

- TLE measures a bank's debt relative to the total value of its stock, A high TLE ratio generally means that a bank has been aggressive in financing its growth with debt. Aggressive leveraging practices are often associated with high levels of risk. This may result in volatile earnings as a result of the additional interest expense.
- First table shows that the aggregate average through the study period has been increasing and causing a high risk in financing banks assets and growth with lager debts especially BOP as it has the highest ratio.
- Comparing the aggregate ratio of the Islamic banks with Conventional banks shows that Islamic banks are less risky in using debts to finance their assets with aggregate ratio of 2.335.

8.2.25 TLSC

Table (8.49): TLSC for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	12.567	5.706	4.153	3.873	4.407	6.141
2011	11.836	7.003	4.735	3.602	5.817	6.599
2012	12.101	8.360	4.976	3.508	5.190	6.827
2013	12.932	8.905	6.111	3.898	7.760	7.921
2014	13.252	10.664	7.525	4.297	7.571	8.662
Average	12.538	8.128	5.500	3.836	6.149	7.230

Table (8.50): TLSC for Islamic bank

Years	ISBK	AIB	Average
2010	2.096	2.321	2.209
2011	2.631	1.912	2.272
2012	2.789	2.257	2.523
2013	2.896	3.036	2.966
2014	3.763	3.859	3.811
Average	2.835	2.677	2.756

- **TLSC** This is a measurement of how much suppliers, lenders, creditors and obligors have committed to the company versus what the shareholders have committed
- Conventional banks shows TLSC ratio is significantly larger at the 7.23 level for Conventional banks. This makes the denominator larger and the TLSC ratio larger for commercial banks. By itself, this ratio suggests that Conventional banks are more risky.
- Islamic banks table shows Total liabilities to shareholder capital (TLSC) are significantly smaller at the 2.75 level for Islamic banks – perhaps because of the greater reliance upon initial shareholder capital in Islamic banks. This makes the denominator larger and the TLSC ratio smaller for Islamic banks. By itself, this ratio suggests that Islamic banks are less risky than conventional banks.

8.2.26 RETA

Table (8.51): RETA for Conventional bank

Years	BOP	QUDS	PCB	PIBC	TNB	Average
2010	0.015	-0.019	-0.030	0.001	-0.013	-0.009
2011	0.015	-0.012	-0.025	0.008	-0.011	-0.005
2012	0.015	-0.005	-0.026	0.013	0.001	0.000
2013	0.011	-0.001	-0.026	0.014	0.001	0.000
2014	0.015	0.010	-0.018	0.007	0.006	0.004
Average	0.014	-0.005	-0.025	0.009	-0.003	-0.002

Table (8.52): RETA for Islamic bank

Years	ISBK	AIB	Average
2010	-0.004	0.000	-0.002
2011	0.004	-0.003	0.001
2012	0.011	0.001	0.006
2013	0.006	0.004	0.005
2014	0.010	0.009	0.010
Average	0.005	0.002	0.004

- **RETA** ratio measures the bank's ability to accumulate earnings using its Total Assets, A high, or increasing Retained Earnings to Total Assets ratio is usually a positive sign, showing the bank is able to continually retain increasingly more earnings. As a bank grows and matures, you should see this ratio increase.
- Conventional banks shows a positive increase scheme from 2010 to 2014, at a narrower level all commercial banks are increasing through the study period while BOP remains constant and dominant in the total earnings.
- Islamic banks table shows a better earnings in the aggregate average while each bank situation still lower than BOP.

Chapter 9

Results

Chapter 9 Results

The empirical results of this study indicate that measures of bank characteristics such as profitability ratios, efficiency ratios, asset-quality indicators, and cash/liability ratios are good discriminators between Islamic and conventional banks in Palestine. Such findings are consistent with the literature on corporate failure, credit rating, and assessment of risk that also shows that accounting numbers are useful for classifying firms within the same industry into two or more categories based on financial characteristics.

An initial glance at the data reveals that most accounting ratios are similar for Islamic and conventional banks. This result seems logical since both types of banks operate in the same industry in the same region of the world. It is consistent with PMA regulations that impose similar regulations on all banks.

9.1 Results

Table (9.1) Results

	Variable	Conventional bank	Islamic bank	P-Value (Sig.)
1	ROA	0.0095	0.0079	0.441
2	ROE	0.0725	0.0551	0.362
3	PM	0.2080	0.1541	0.376
4	ROD	0.0145	0.0322	0.137
5	ROSC	0.0962	0.0658	0.224
6	NOM	1.1391	1.2496	0.003*
7	IEE	0.0767	0.0766	0.969
8	OEA	0.0097	0.0207	0.037*
9	OIA	0.0430	0.0406	0.640
10	OER	0.2528	0.5873	0.001*
11	ATO	0.0376	0.0335	0.275
12	NIM	0.0300	0.0307	0.837
13	NNIM	-0.0225	-0.0229	0.908
14	PEA	0.0064	0.0040	0.142
15	APL	0.0162	0.0093	0.036*
16	WRL	0.0950	0.0033	0.004*
17	LR	0.4043	0.4117	0.835
18	LTD	0.6579	1.8771	0.000*
19	CTA	0.1911	0.2493	0.093
20	CTD	0.3165	1.1661	0.002*
21	DTA	0.6230	0.2116	0.000*
22	EM	7.1208	36.7692	0.376
23	ETD	0.2643	0.5958	0.000*
24	TLE	6.0513	2.3348	0.000*
25	TLSC	7.2300	2.7559	0.000*
26	RETA	-0.0022	0.0037	0.000*

9.2 Profitability Analysis

In terms of profitability all measures do not show any statistically difference between Islamic banks and conventional banks in the period 2010-2014.

Profitability ratios differ from previous studies which show that Islamic banks are less profitable than conventional banks. For example, Rosly and Abu Bakar (2003) reported higher ROA for Islamic banks. In this study the ROA of 0.0095 for conventional banks versus 0.0079 for Islamic banks. ROE averages 0.0551 annually for Islamic banks versus 0.0725 for conventional banks. But, The difference is insignificant. Another measure of profitability, the net operating margin (NOM) was smaller for conventional banks and the p-value equals 0.003 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant difference between Commercial bank and Islamic bank and the reason behind it is that the Islamic banks are better in managerial expenditures due to the higher expenses of commercial banks on advertising their renewable and diversified services over the Islamic banks and this is because Islamic banks do not offer all their services and due to the instructions of the Monetary Authority which serves the conventional banks more, as the better conventional situation in the country more than the investments situation, as Islamic banks grow more better in the investment environment.

Profitability of Islamic banks did not lag behind the profitability conventional banks that also increased steadily in that period due to, particularly, the increasing interest rate. A profitability ratio shows that conventional banks are more profitable than Islamic ones but the difference is not significant.

9.3 Efficiency Analysis

Average of ratios are relatively indicates that there are no significant differences between Islamic banks and conventional banks in all efficiency measures. Thus, this result is inconsistent with the finding by (Rosly and Bakar, 2003; Samad, 2004; Olson and Zoubi). From the researcher observation, Efficiency ratios differ somewhat between the types of banks, but not significant. The means of two efficiency ratios are significantly different between types of banks.

Operating expense to assets (OEA) which is operating expenses divided by average total assets is significantly larger for Islamic banks and The p-value equals 0.003 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant different from conventional bank and Islamic bank as it is Higher In Islamic bank due to lack of financing diversification which leads to fewer assets, and also the Islamic banks are newly established with fewer branches compared with commercial banks. However, operating expenses to revenue (OER), which is operating expenses divided by operating income, is significantly smaller for conventional and The p-value equals 0.001 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant different from Commercial banks and Islamic banks, due to the higher attraction of deposits with lower prices in conventional banks greater than Islamic banks., and provide diversified financing operations. Because commercial banks provide more financing expenses.

There are several reasons that contribute to this situation. Firstly, poor former government support during the initial stage of the development of Islamic banking in Palestine could have contributed to the lack of awareness among the Muslims to utilize the shariah compliance products and services. Where, there were least disseminations of Islamic product campaigns through the media such as newspapers and electronic advertisements.

9.4 Asset-quality indicators.

The asset-quality indicators reveal some additional differences between Islamic and conventional banks. The APL (allowance for loan loss divided by total loans) ratio are significantly smaller for Islamic banks and The p-value equals 0.036 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant different from conventional bank and Islamic bank. Conventional banks maintain higher reserves for loan losses, this is because the bad loans called subprime in which conventional banks were committed. Alternatively, Islamic banks may be operating with greater risk because they maintain smaller contingency reserves for bad loan like products. The write off ratio (WRL) (which is the write-off

of loans during the year divided by the average total loans and advances) is smaller for Islamic banks and the p-value equals 0.004 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant difference from conventional bank and Islamic bank. The WRL ratio shows that collection policy is better in Islamic banks more than the conventional banks and thus bad debts (write-offs) will be less.

Conventional banks maintain higher reserves for loan losses, but the interpretation is unclear. For example, Ijara and various Islamic leaseback schemes may involve less risk than conventional loans, so less reserve is needed. Alternatively, Islamic banks may be operating with greater risk because they maintain smaller contingency reserves for bad loan-like products.

The liquidity ratios are significantly different between types of banks at cash to deposits (CTD) the mean for Commercial bank equals 0.3165 and the mean for Islamic bank equals 1.1661. The p-value equals 0.002 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significantly different from Commercial bank and Islamic bank, Islamic banks keep more cash relative to deposits and less relative to assets

This finding is inconsistent with the finding by (Rosly and Bakar, 2003; Samad, 2004; Olson and Zoubi). The possible reason for this scenario related to dominant form of Islamic banks financing which is short term nature. Thus, Islamic banks are required to maintain high liquidity to cover their short term financing. This may explain the absence of lenders as a last resort for Islamic banks.

9.5 Risk indicators.

The risk ratios indicate some important differences in operational characteristics. Islamic banks extend more loans or equivalents relative to deposits (LTD) than conventional banks. The difference is significant at the 5% level and may suggest greater risk for Islamic banks. Total liabilities to shareholder capital (TLSC) are significantly smaller for Islamic banks the p-value equals 0.000 which is smaller than the level of significance $\alpha = 0.05$. This implies that there is significant difference

from conventional bank and Islamic bank. Perhaps because of the greater reliance upon initial shareholder capital in Islamic banks. This makes the denominator larger and the TLSC ratio smaller for Islamic banks. By itself, this ratio suggests that Islamic banks are more risky than conventional banks.

The risk ratios indicate some important differences in operational characteristics. The total liability to equity ratio (TLE) has smaller for Islamic banks at the 5% level because Islamic banks extend more equity relative to liabilities. Islamic banks extend more equity relative to deposits (ETD) than conventional banks. The difference is significant at the 5% level and may suggest greater risk for Islamic banks. The retained earnings to total assets ratio (RETA) is statistically smaller for Conventional banks at the 5% level. Conventional banks tend to distribute profits rather than retain them.

This findings support the previous studies conducted by (Rosly and Bakar, 2003; Samad, 2004; Olson and Zoubi)

9.6 Result

The economy's system is closely connected to the banking system. In other words, one of the factors behind the growth of the economy is a well-banking system. Palestine banking system is on the stand of improvement. So, it is essentially to control and improve this banking sector. In this regard, the researcher decided to consider this theme.

The empirical results of this study indicate that measures of bank characteristics such as profitability ratios, efficiency ratios, asset-quality indicators, and cash/liability ratios are good discriminators between Islamic and conventional banks in the Palestinian territories. Such findings are consistent with the literature on corporate failure, credit rating, and assessment of risk that also shows that accounting numbers are useful for classifying firms within the same industry into two or more categories based on financial characteristics.

An initial glance at the data reveals that most financial ratios are similar for Islamic and conventional banks. This result seems logical since both types of banks operate in the same industry in the same part of the world. It is consistent with Palestinian monetary authority regulations in the Palestinian territories that impose similar regulations on all banks. Nevertheless, some financial characteristics of Islamic banks are different from those of conventional banks.

Results from our classification models imply that the operational characteristics of the two types of banks may be different. Conventional banks are more profitable than Islamic banks, but probably not quite as efficient. Some of the higher profitability of conventional banks may be due to risk, while the remainder may be due to the greater reliance on deposits for providing capital. Islamic banks voluntarily hold more cash relative to deposits than conventional banks due to the risk of withdrawal of deposits, but they also maintain lower provisions for possible loan losses (or losses from Ijara leasing and investments for Islamic banks) than conventional banks.

Such views have also been expressed by Ainley (2000) in “A Central Bank’s View of Islamic Banking” where he notes that Islamic banks deal in new and unfamiliar forms of finance where assets are long-term and illiquid. In response, regulators may need to impose higher capital requirements on Islamic banks—particularly during the early years of Islamic bank operations. Each Islamic bank must currently establish a Sharia committee to ensure that it complies with Islamic principles; however, these individual committees do not ensure that Islamic banks as a group have prepared for the risks unique to Islamic banking. There may be a role for central banks in the region to monitor Islamic banks separately from conventional banks and to adopt specific regulations for Islamic banks. For example, the Palestinian monetary authority could establish a Sharia committee within an Islamic division to ensure Sharia compliance nation-wide, and to advise banks on modes, procedures, law, and regulations for Islamic banking. The Palestinian monetary authority might arrange for an accounting firm to conduct Sharia-compliant audits of Islamic banks, and to create a Sharia audit manual. Flexible, but differential, regulation may increase the confidence of depositors and investors in Islamic banks,

provide proper asset/liability management incentives, and maintain financial stability in the Palestinian banking industry in the future.

Conventional banks are better off than Islamic banks in terms of generating interest income from their Earning Assets or Loans thereby reducing capitalization, risk and improving diversification for Conventional Banks sources of revenue.

The credit policy of Islamic banks in reserves and provisioning is more conservative than Conventional banks.

Islamic Banks are highly dependent on their investment deposits in their financing activities leading to high level of liquidity ratios compared to Conventional banks. This is reflected in the Net income margin from Financing Activities of the Islamic banks as it is cheaper to depend on customer deposits

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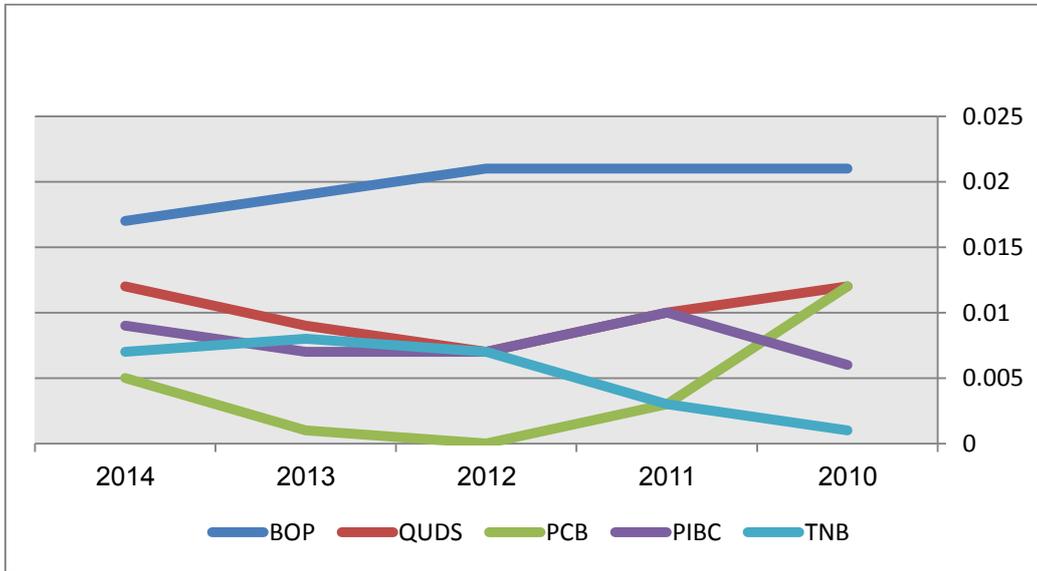
Appendix

Appendix

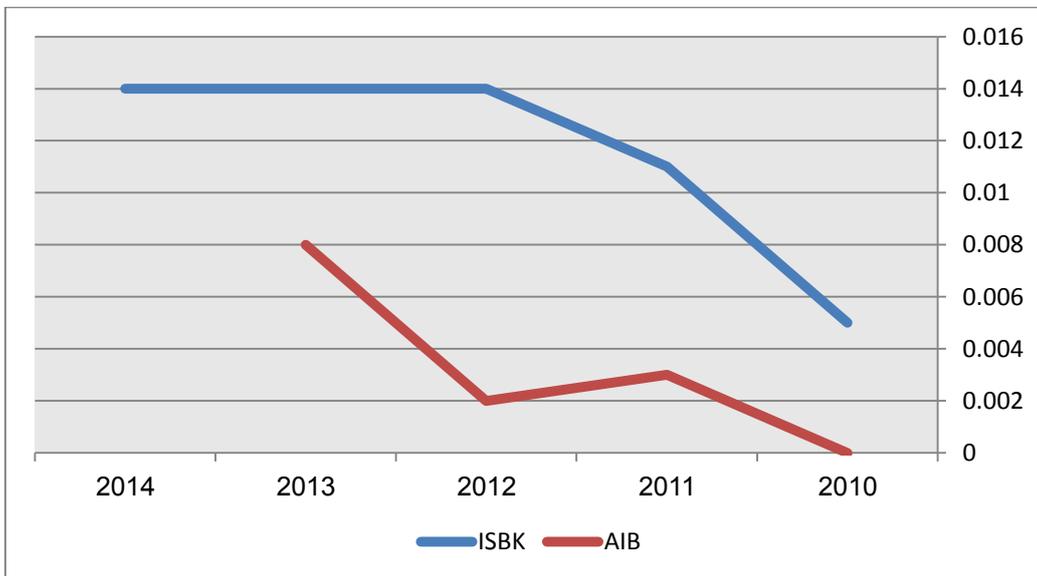
Data Analysis Charts:-

1. ROA

Chart(8.1) ROA for conventional banks

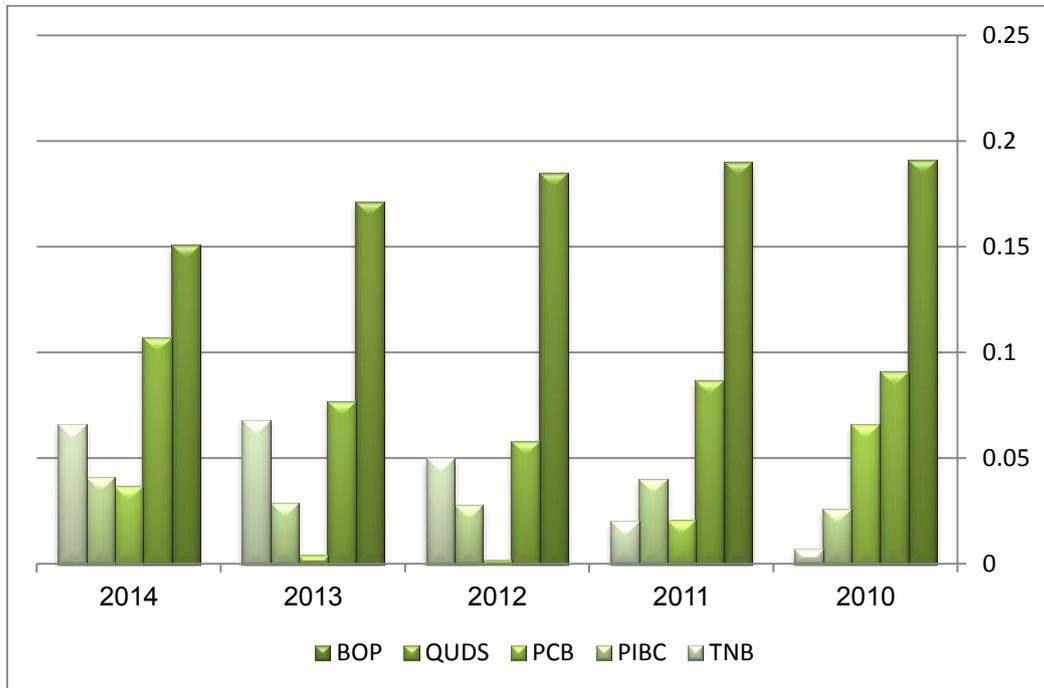


Chart(8.2) ROA for Islamic banks

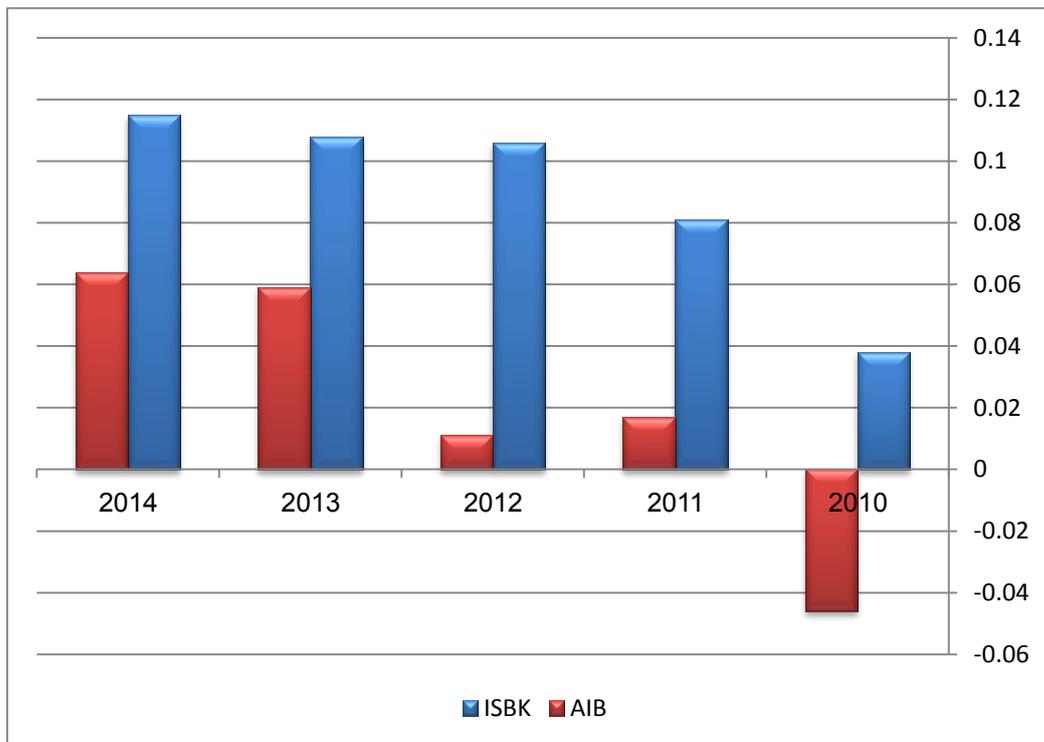


2. ROE

Chart(8.3) ROE for conventional banks



Chart(8.4) ROE for Islamic banks



3. PM

Chart (8.5): PM for conventional bank

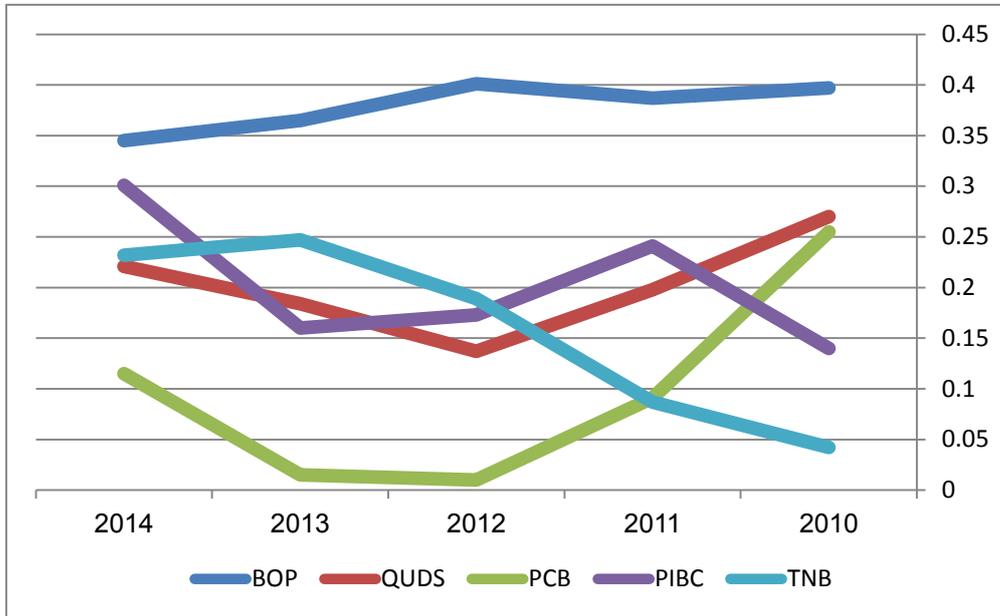
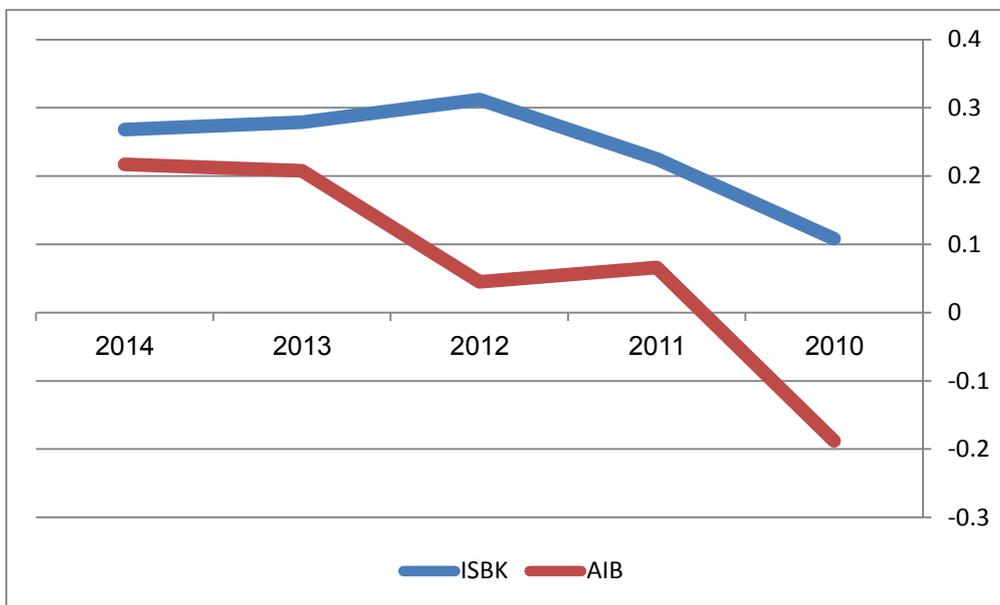


Chart (8.6): PM for Islamic bank



4. ROD

Chart (8.7): ROD for conventional bank

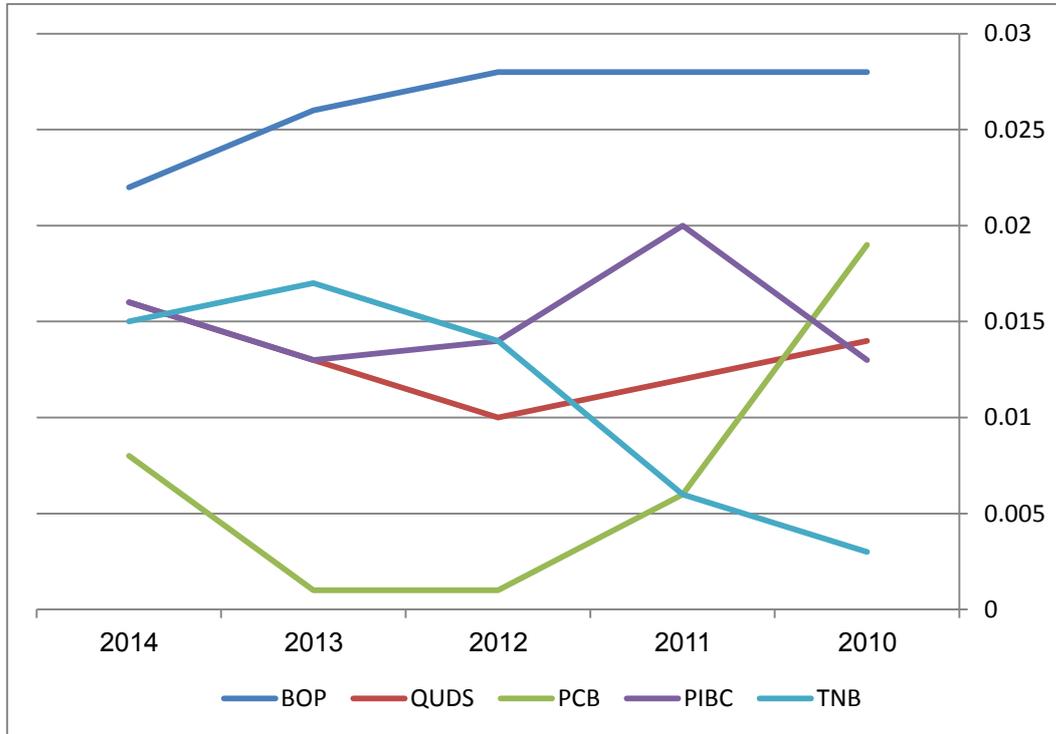
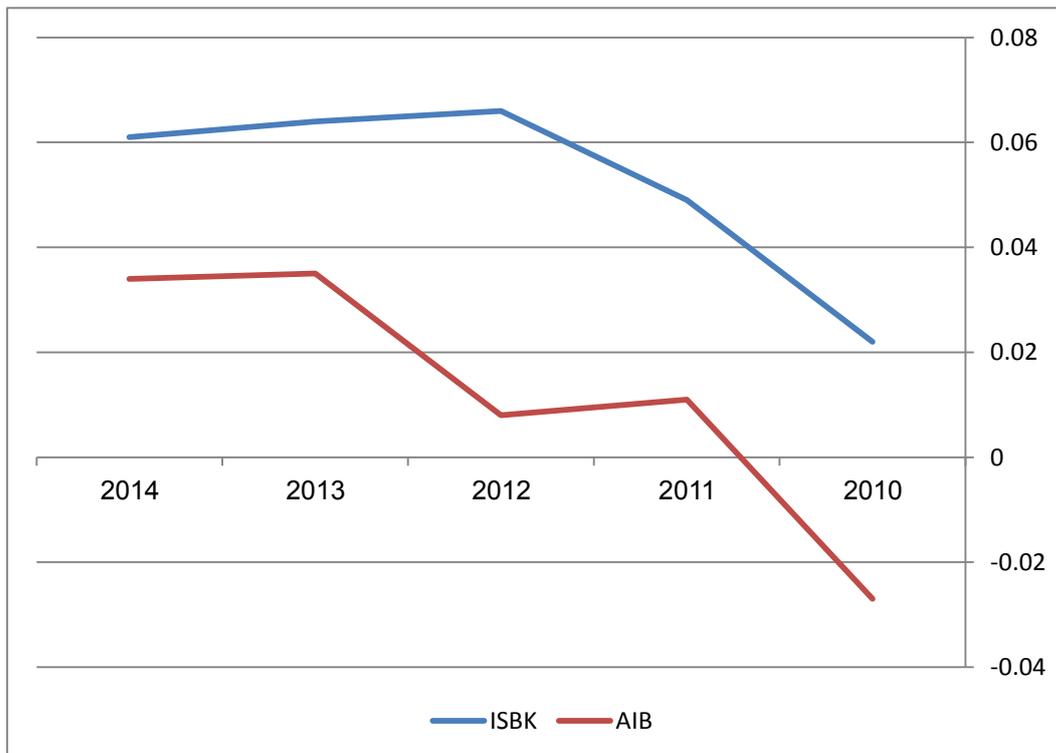
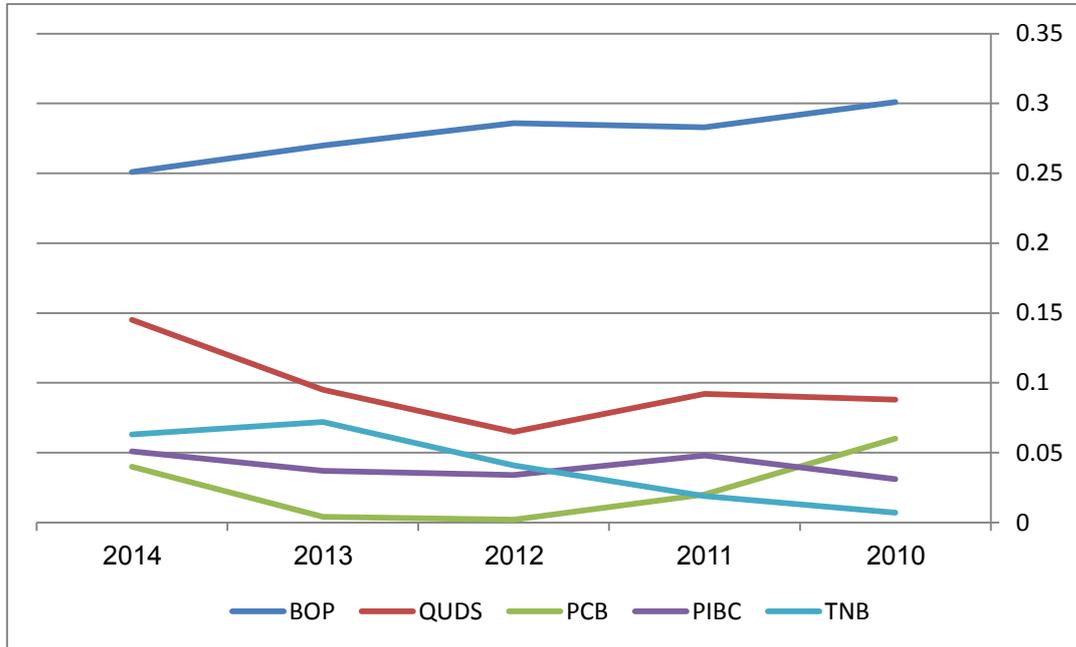


Chart (8.8): ROD for Islamic bank

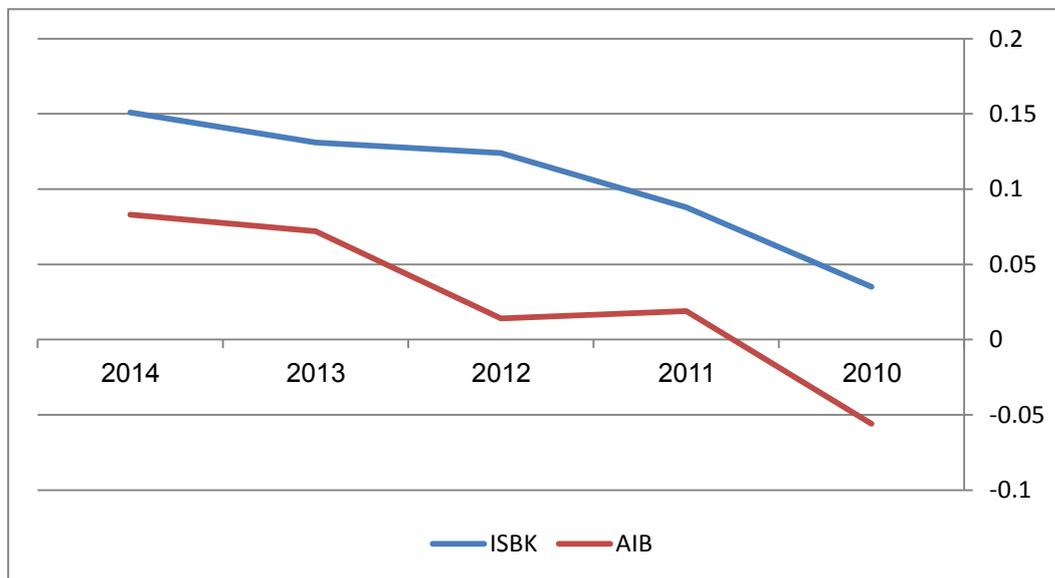


5. ROCS

Chart (8.9): ROSC for conventional bank



Charts(8.10): ROSC for Islamic banks



6. NOM

Chart (8.11): NOM for conventional bank

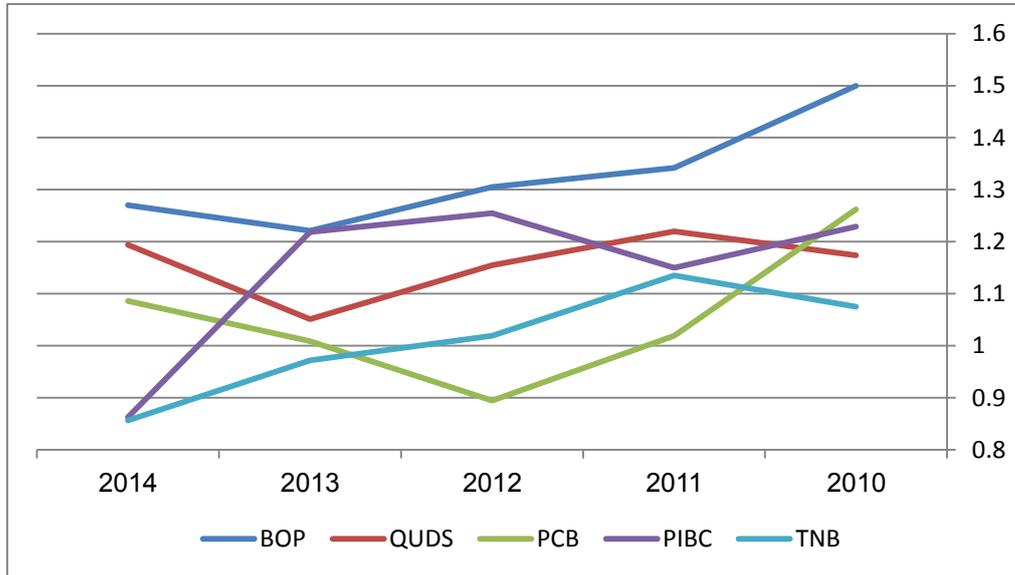
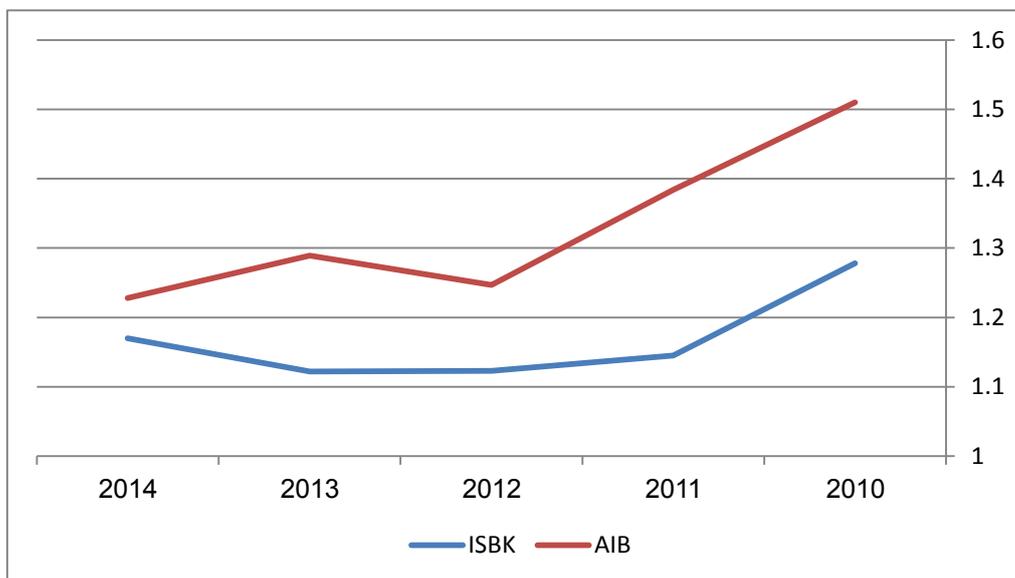


Chart (8.12): NOM for Islamic bank



7. IEE

Chart (8.13): IEE for conventional bank

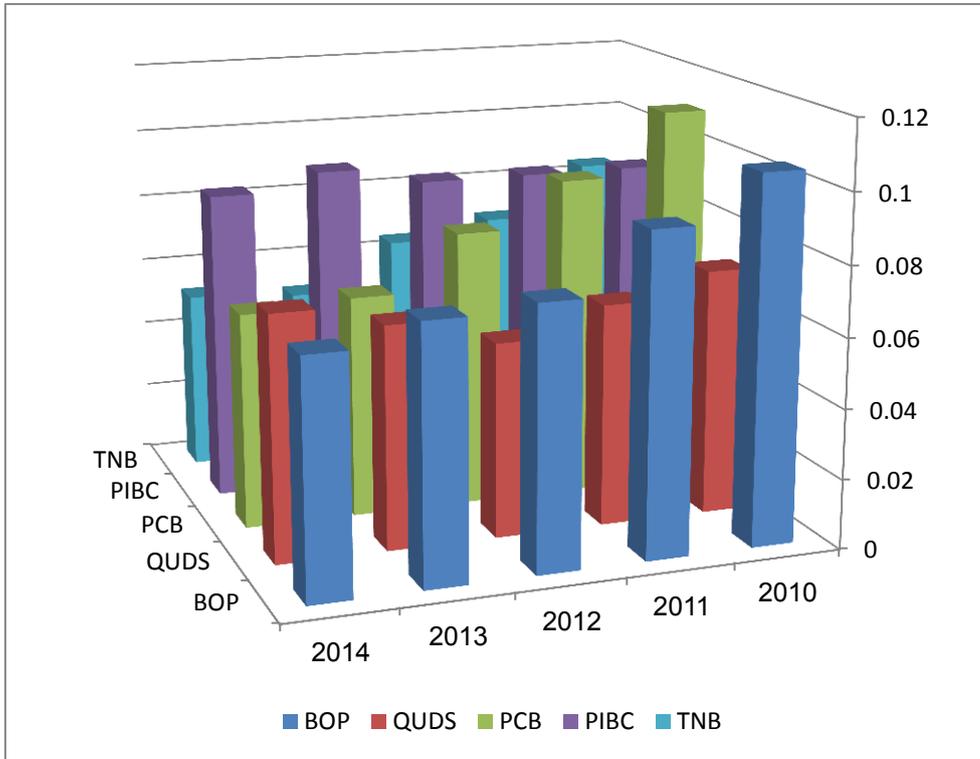
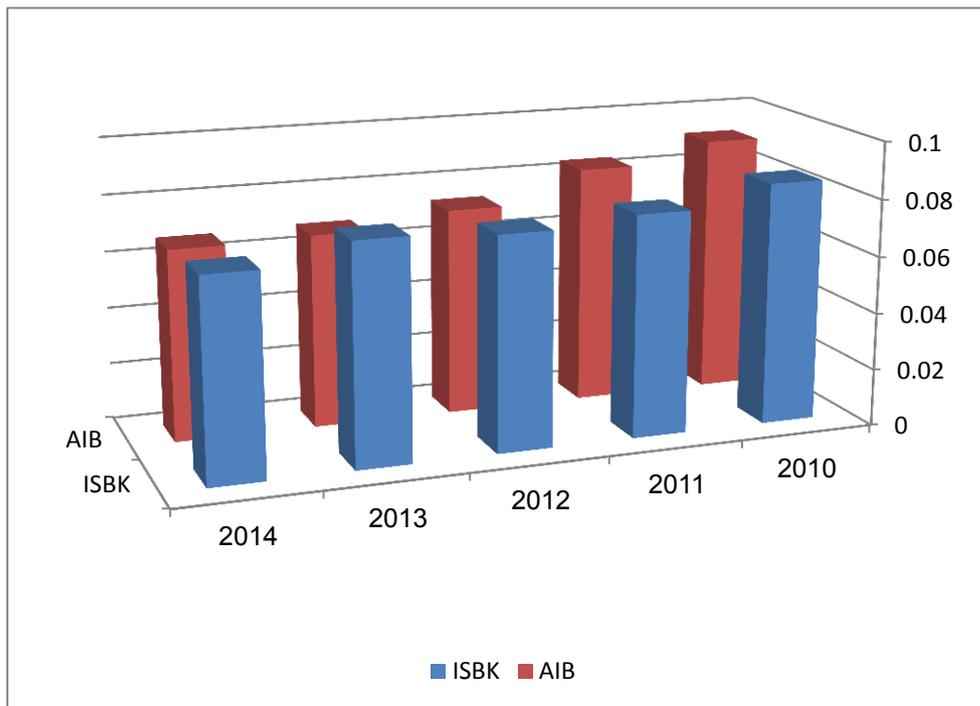


Chart (8.14): IEE for Islamic bank



8. OEA

Chart (8.15): OEA for conventional bank

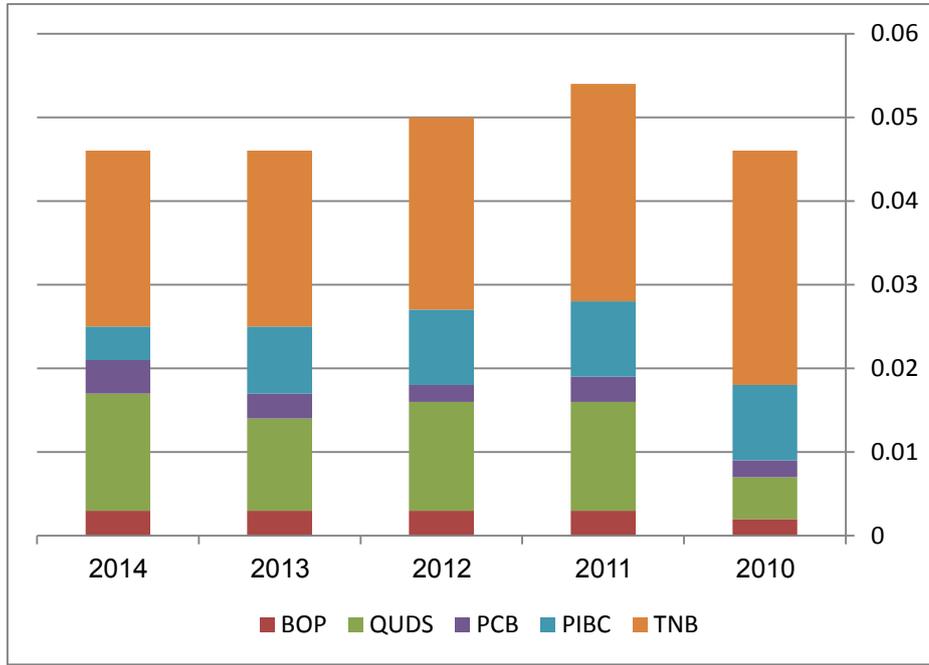
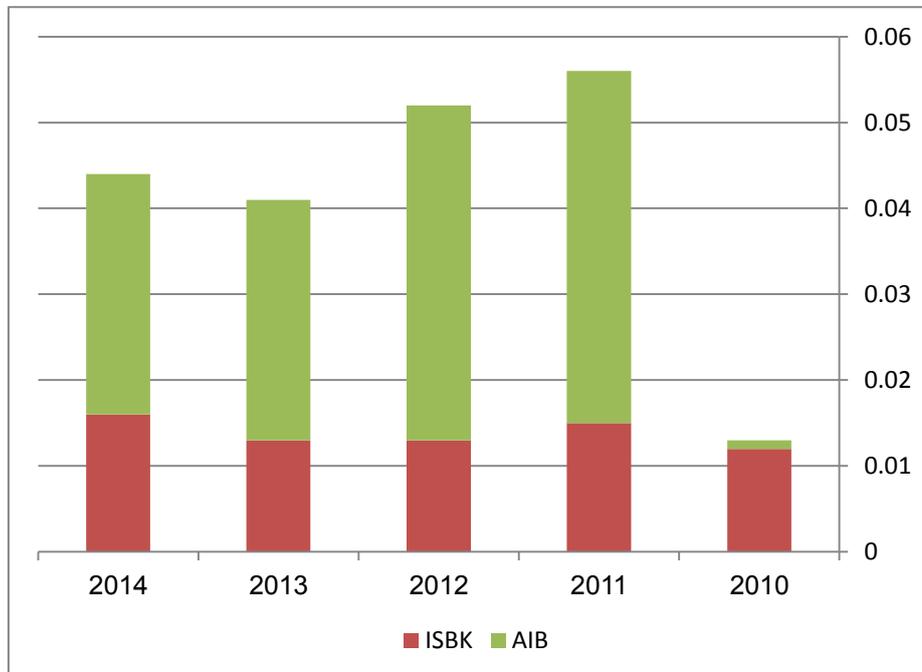


Chart (8.16): OEA for Islamic bank



9. OIA

Chart(8.17): OIA for conventional bank

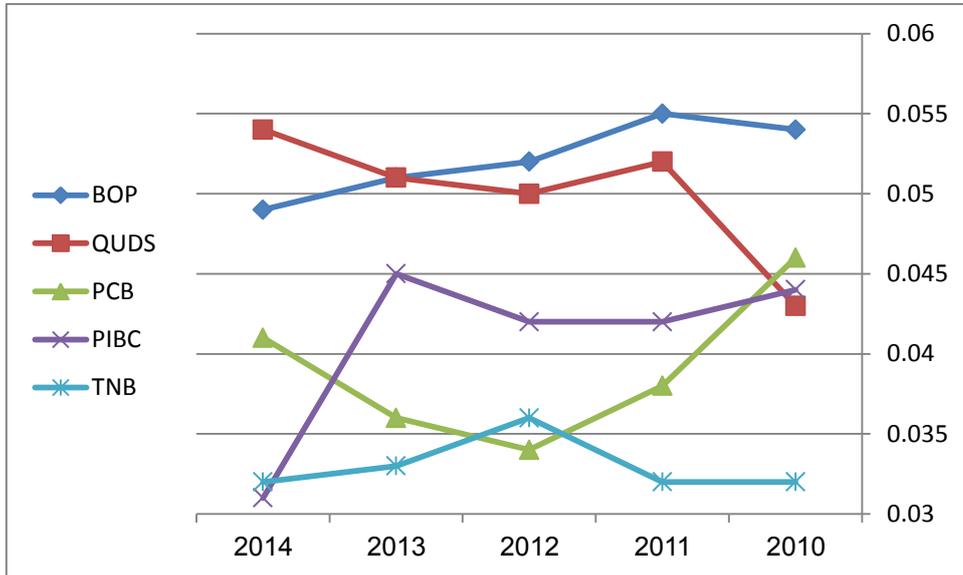
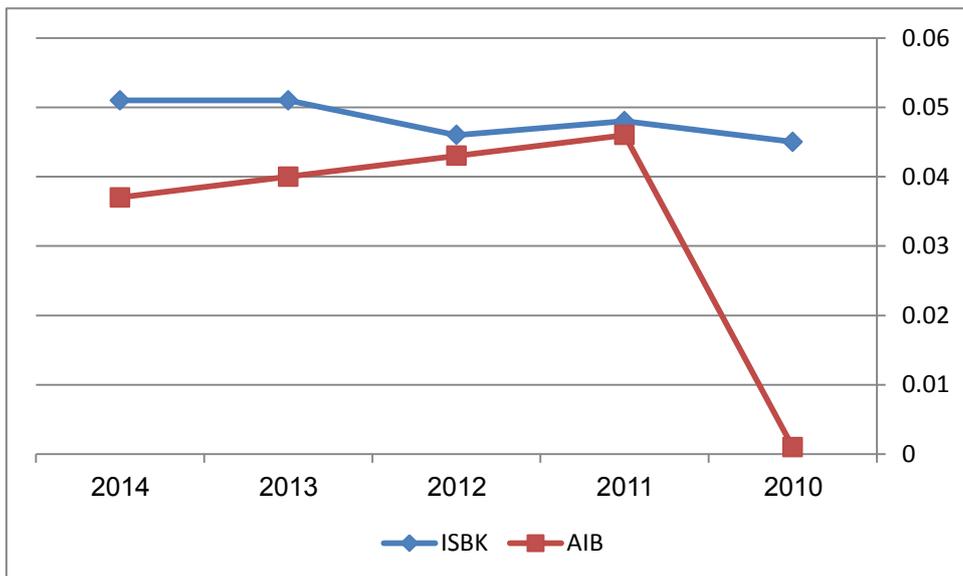


Chart (8.18): OIA for Islamic bank



10. OER

Chart (8.19): OER for conventional bank

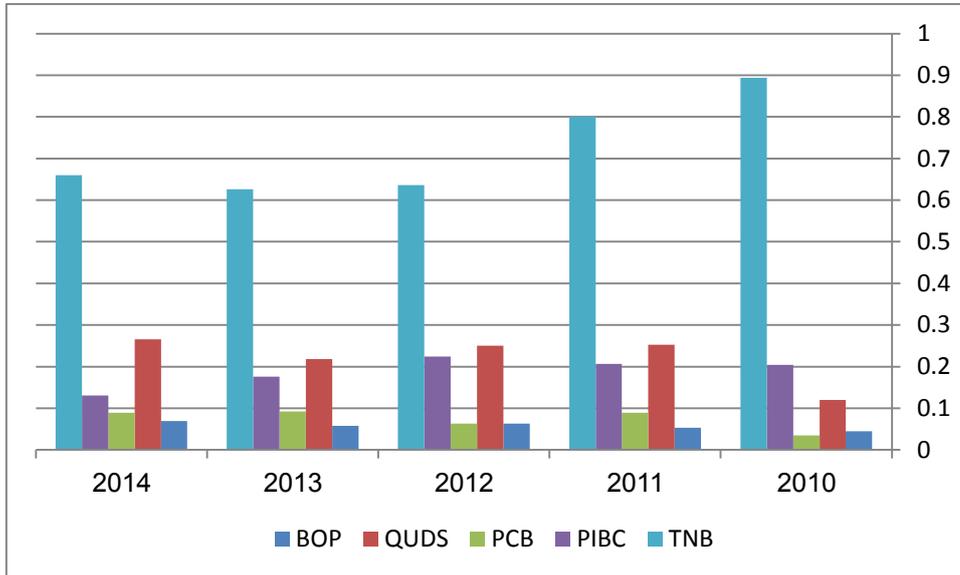
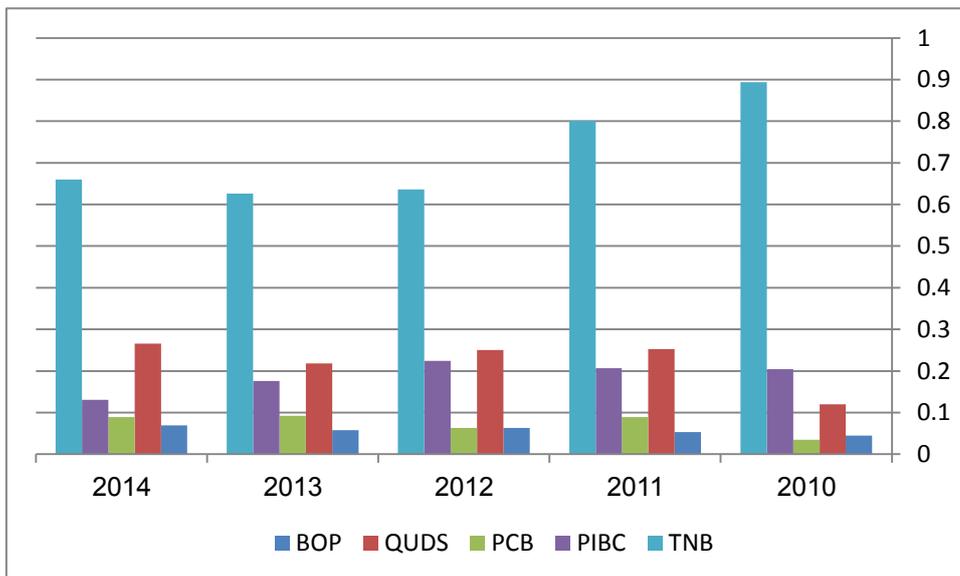


Chart (8.20): OER for Commercial bank



11. ATO

Chart (8.21): ATO for conventional bank

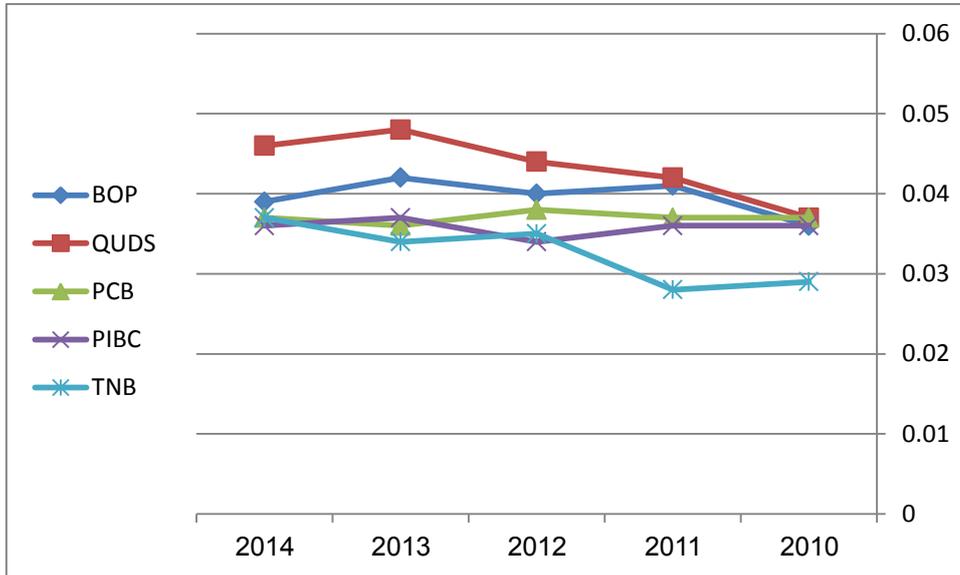
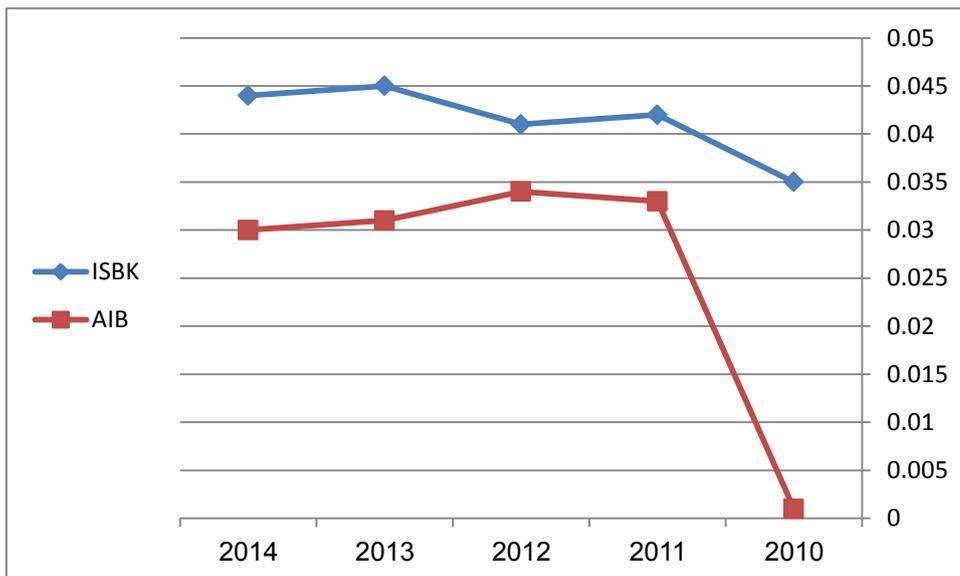


Chart (8.22): ATO for Islamic bank



12. NIM

Chart (8.23): NIM for conventional bank

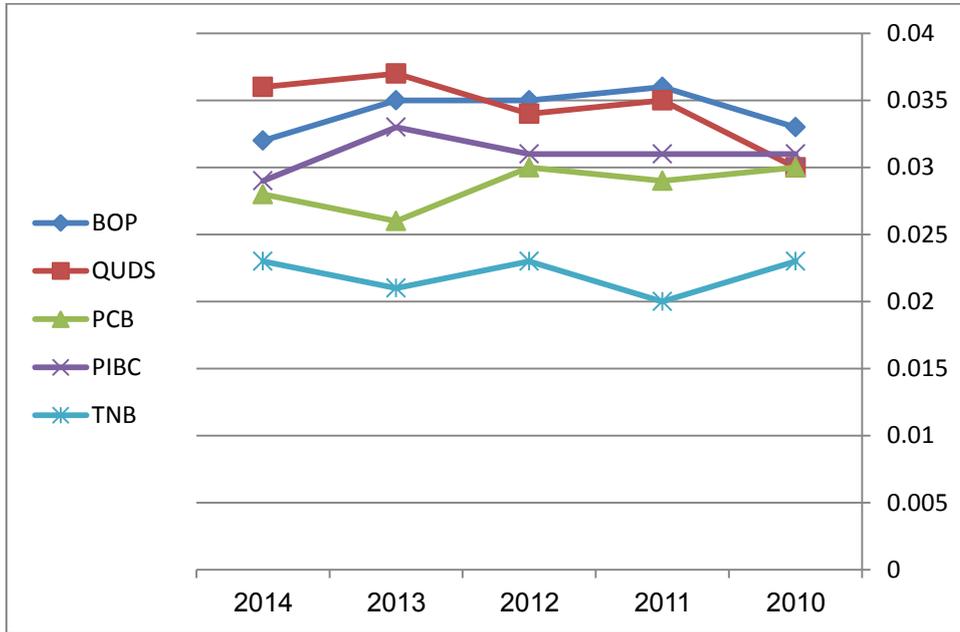
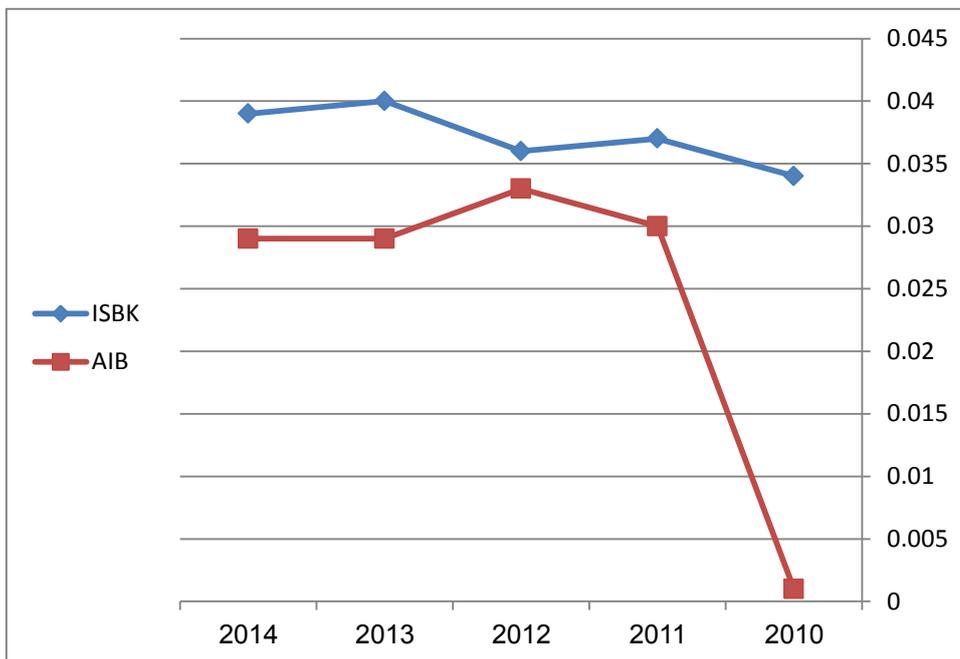


Chart (8.24): NIM for Islamic bank



13. NNIM

Chart (8.25): NNIM for conventional bank

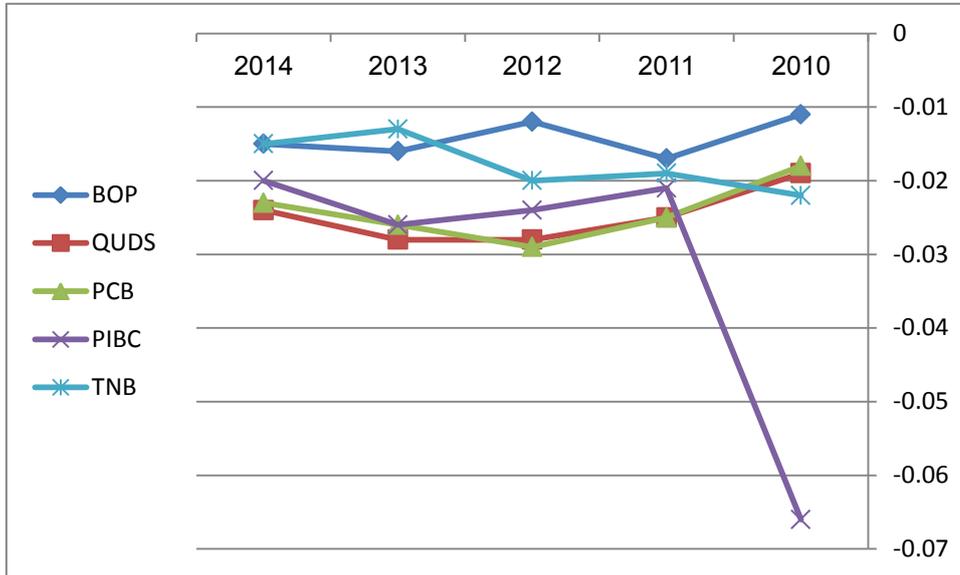
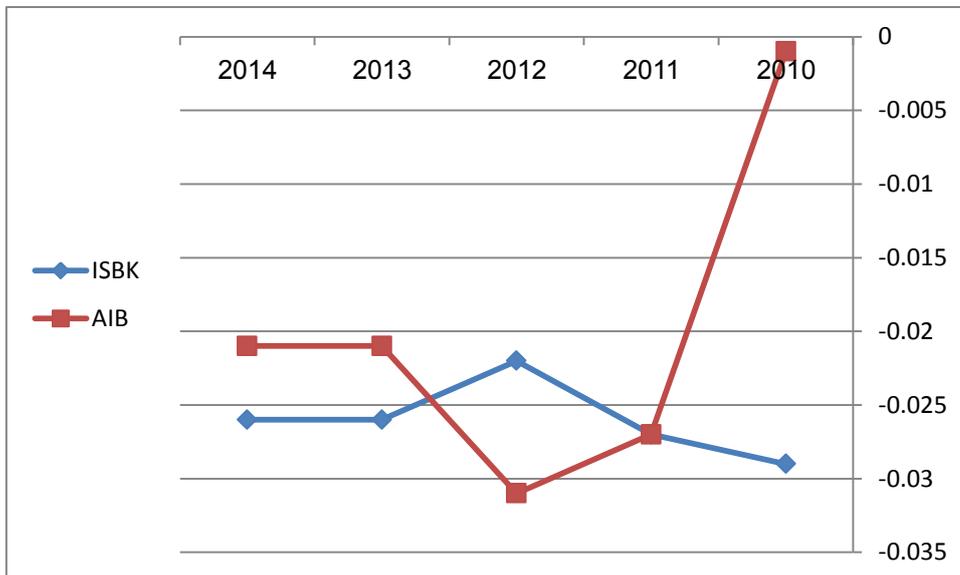
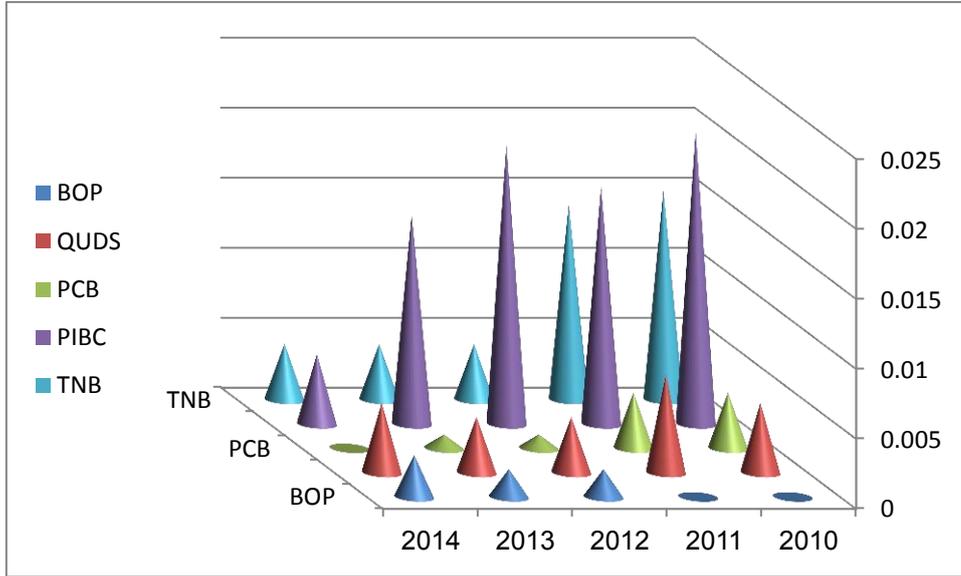


Chart (8.26): NNIM for Islamic bank

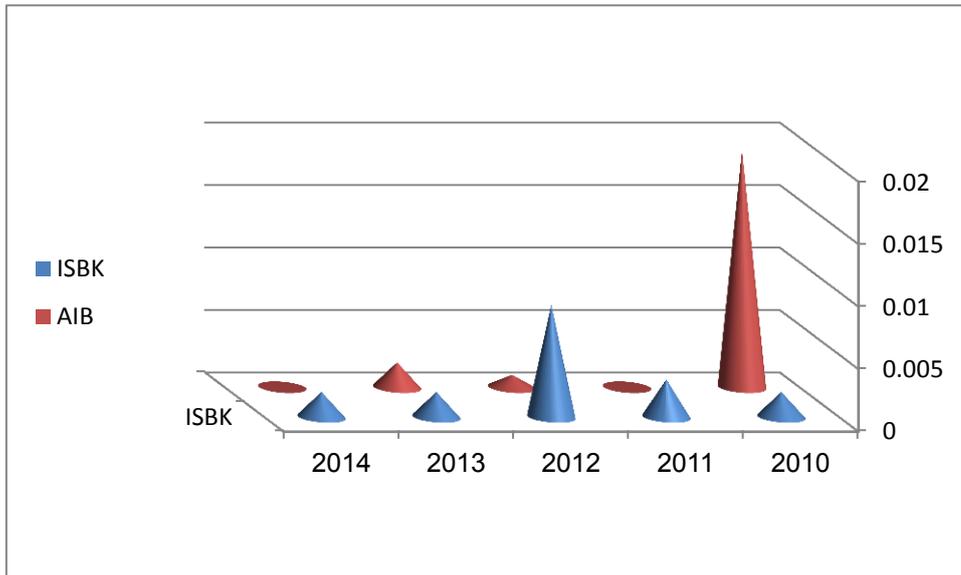


14. PEA

Chart(8.27) PEA for conventional banks

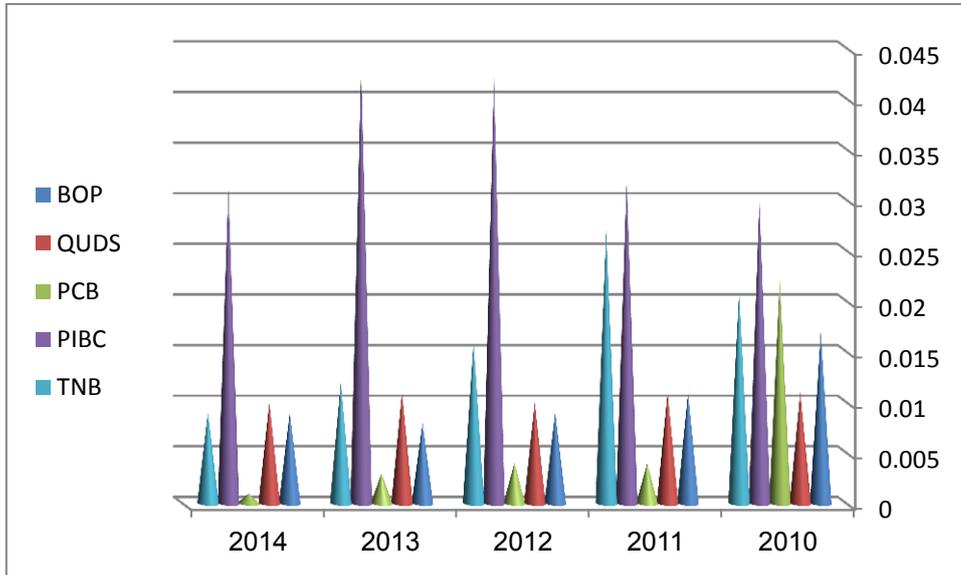


Chart(8.28) PEA for Islamic banks

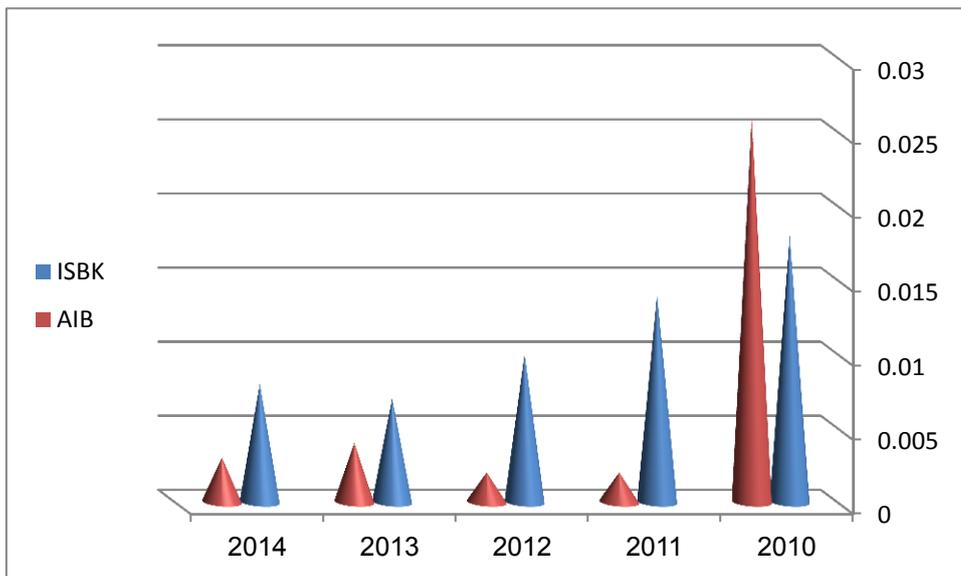


15. APL

Chart(8.29) APL for conventional banks

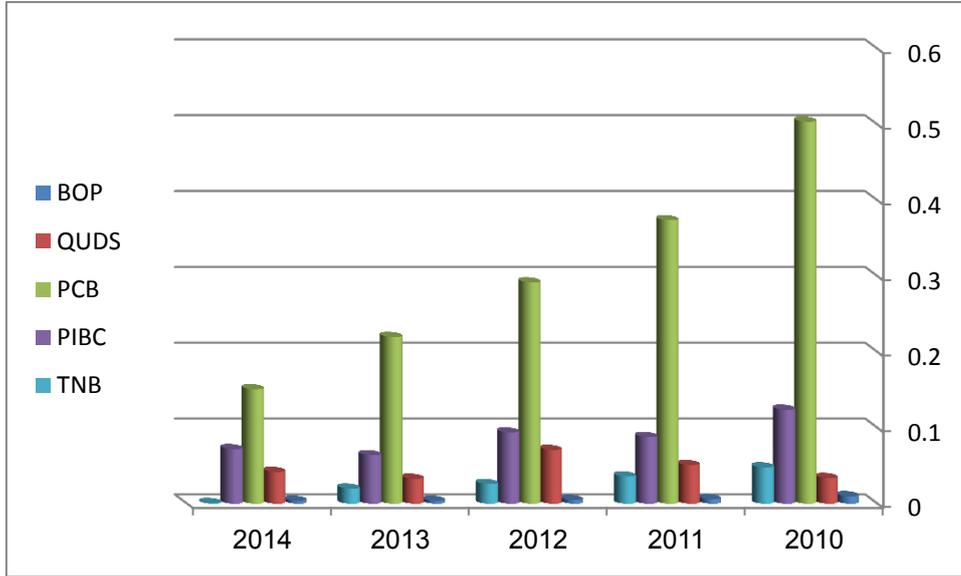


Chart(8.30) APL for Islamic banks

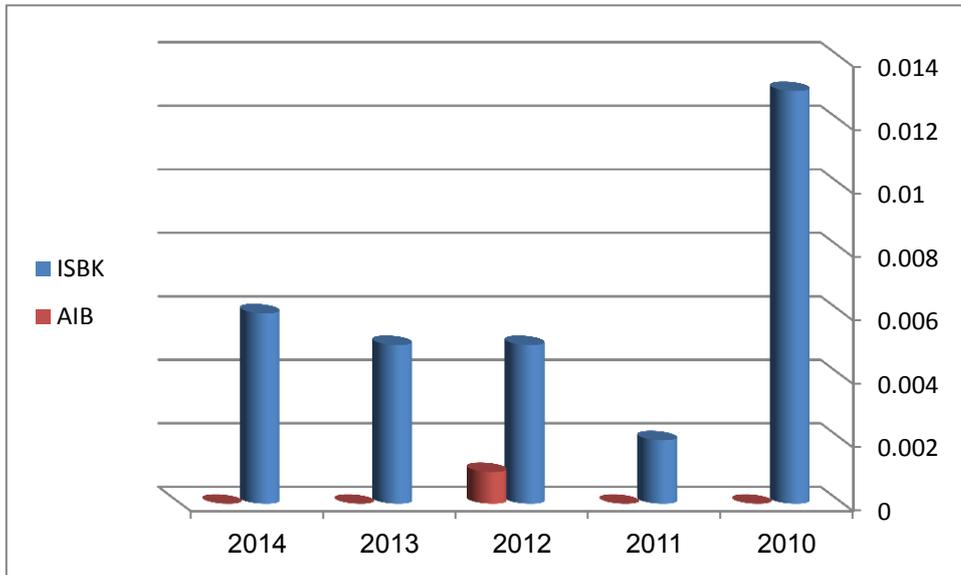


16. WRL

Chart(8.31) WRL for conventional banks

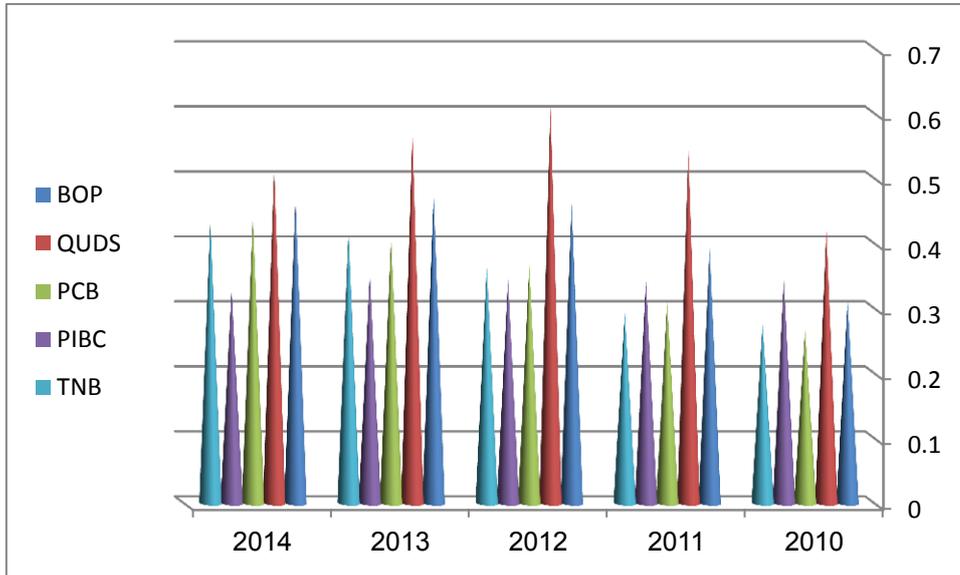


Chart(8.32) WRL for Islamic banks

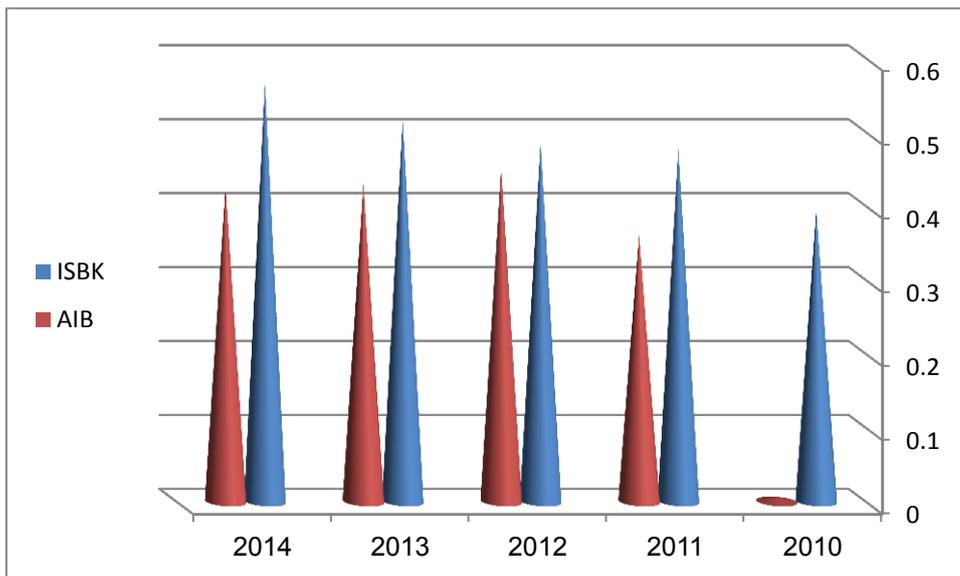


17. LR

Chart(8.33) LR for conventional banks

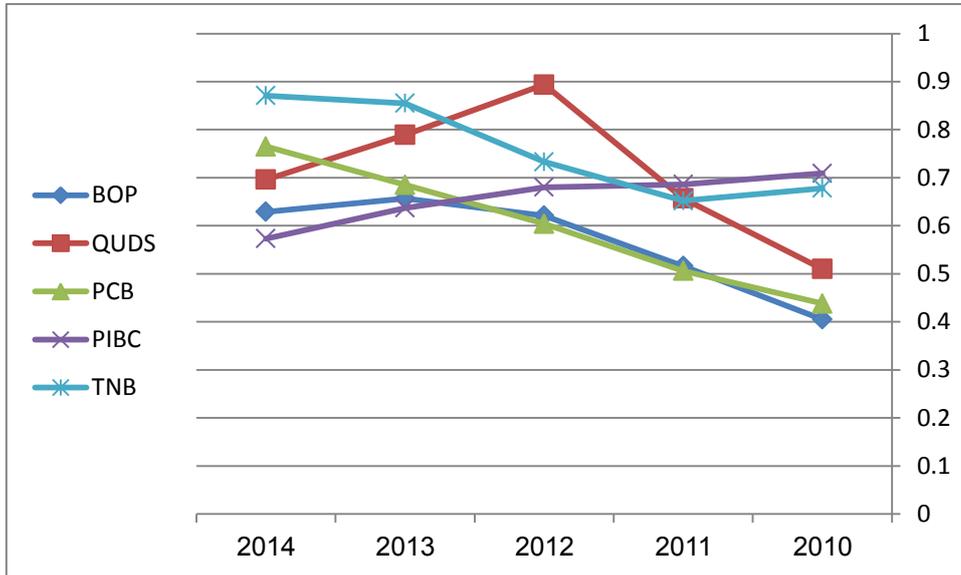


Chart(8.34) LR for Islamic banks

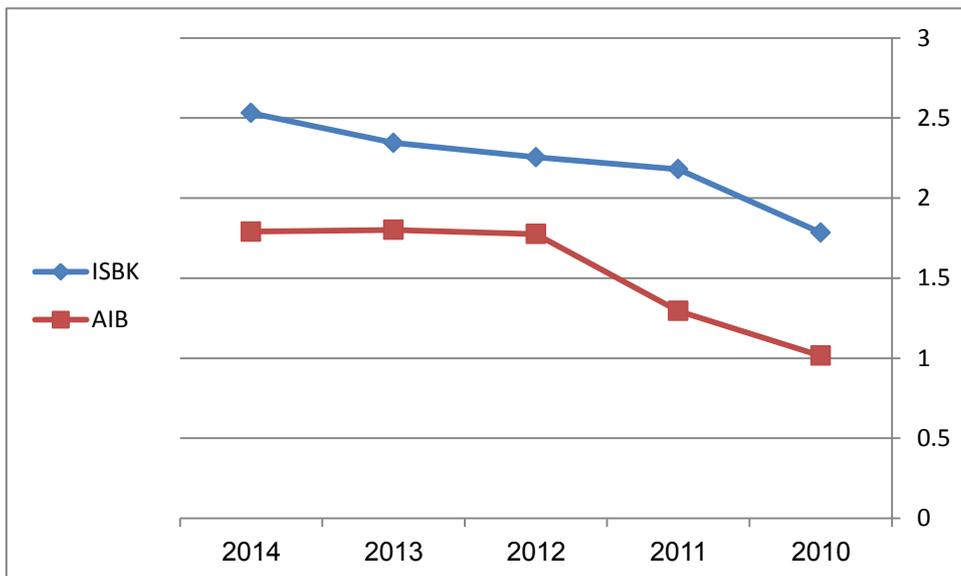


18. LTD

Chart(8.35) LTD for conventional banks

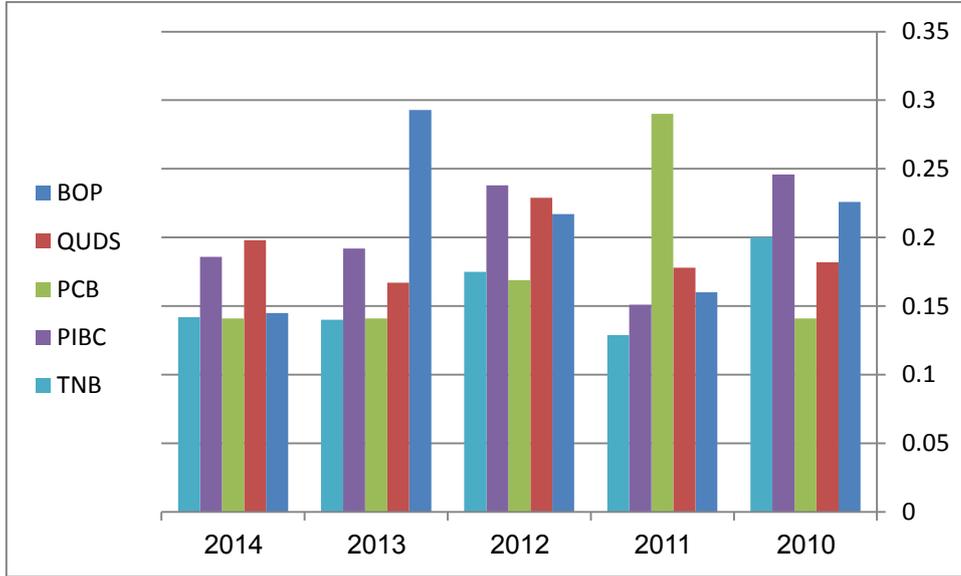


Chart(8.36) LTD for Islamic banks

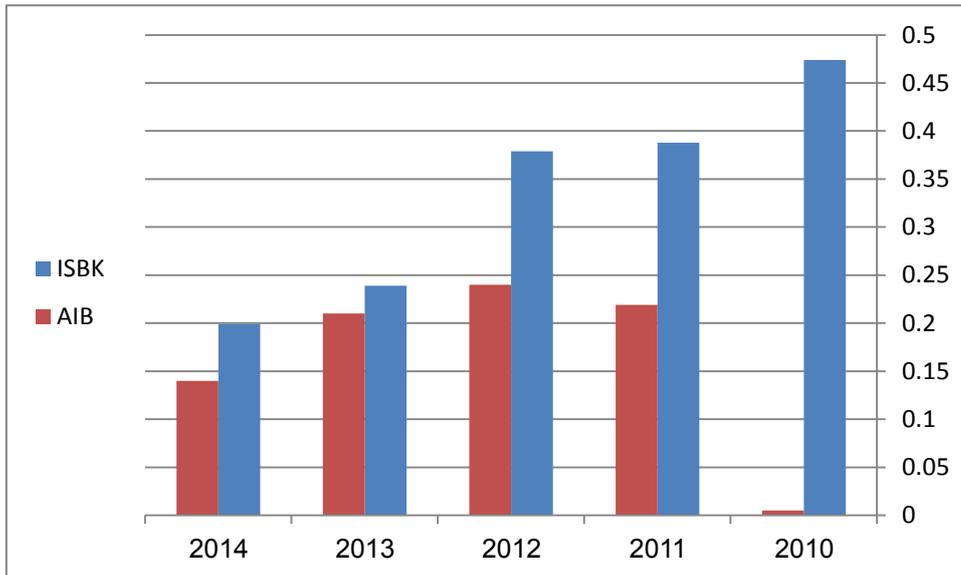


19. CTA

Chart(8.37) CTA for conventional banks

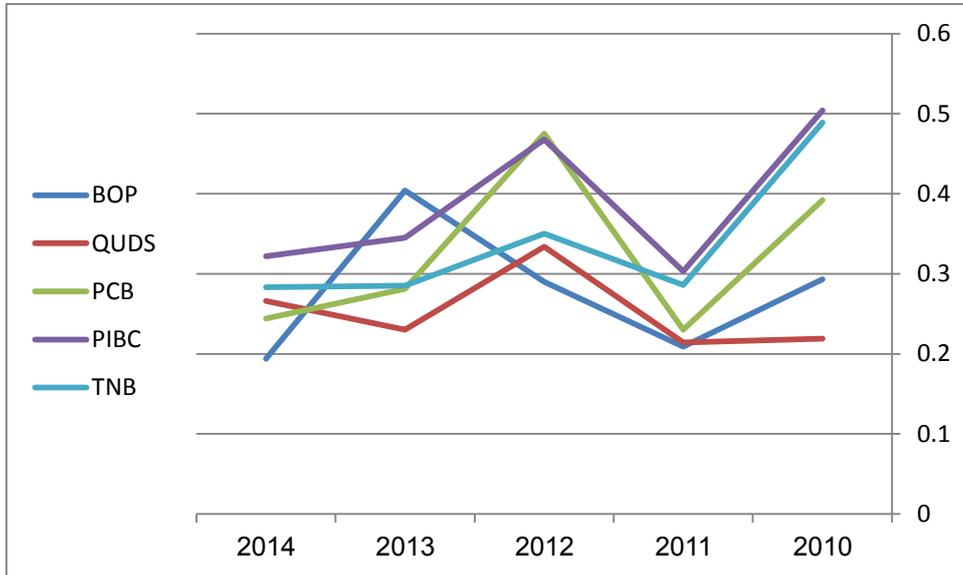


Chart(8.38) CTA for Islamic banks

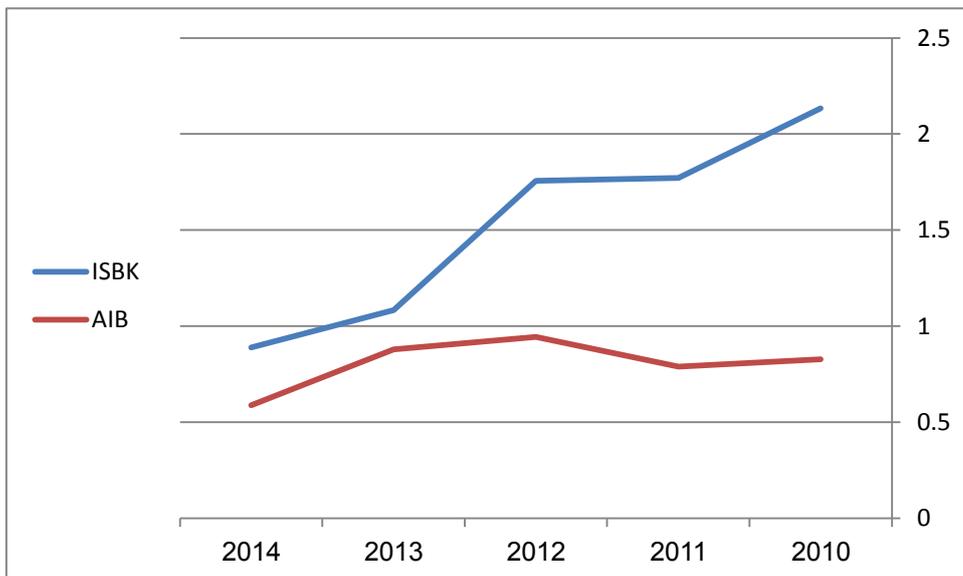


20. CTD

Chart(8.39) CTD for conventional banks

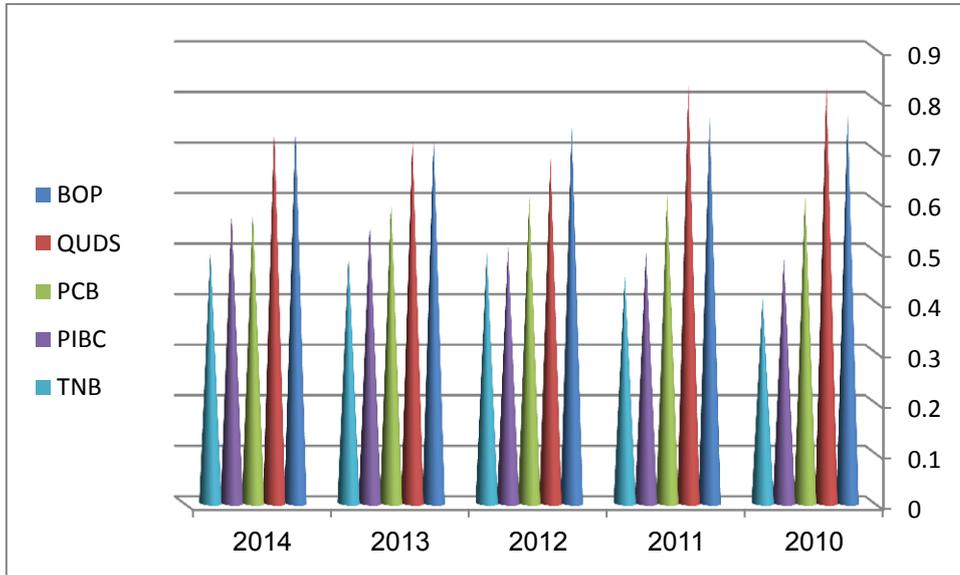


Chart(8.40) CTD for Islamic banks

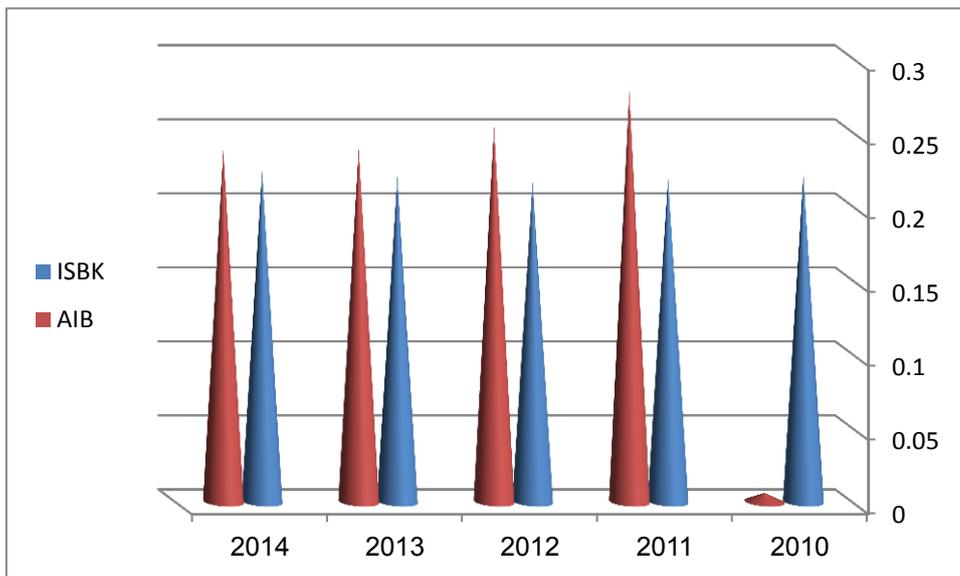


21. DTA

Chart(8.41) DTA for conventional banks

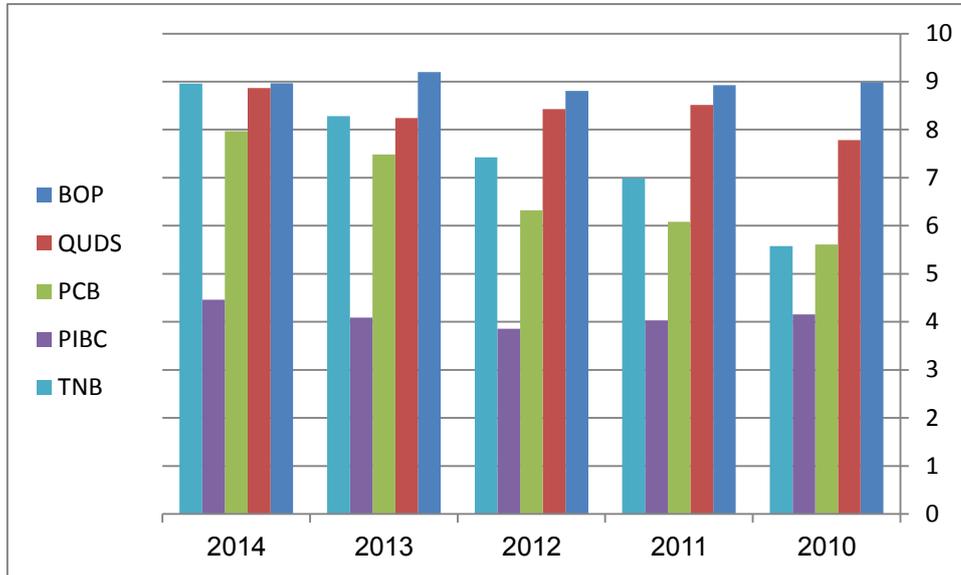


Chart(8.42) DTA for Islamic banks

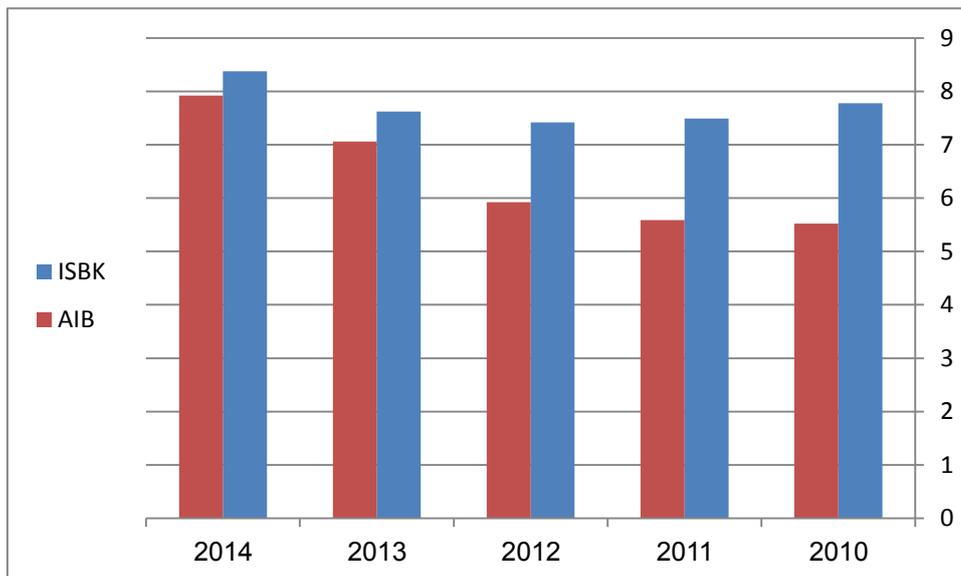


22. EM

Chart(8.43) EM for conventional banks

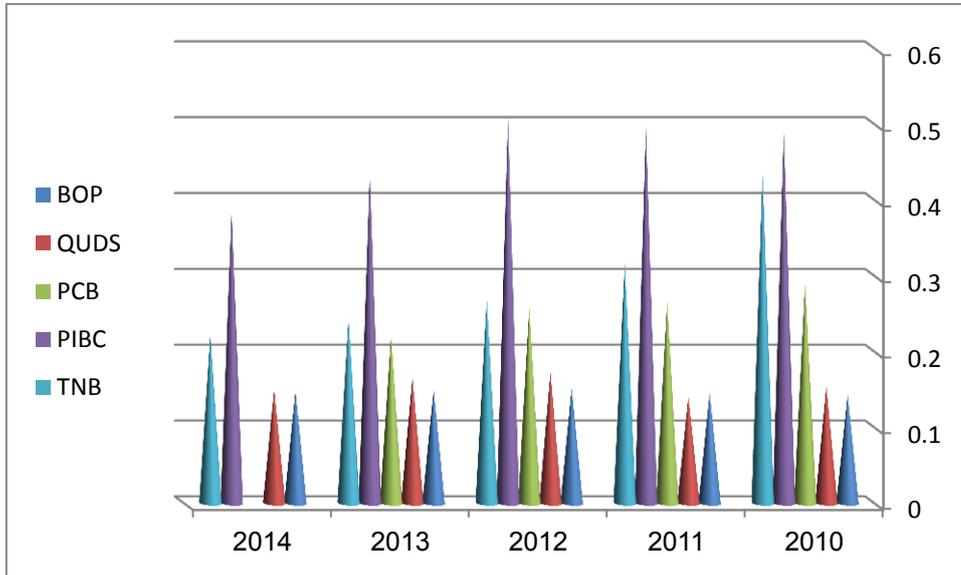


Chart(8.44) EM for Islamic banks

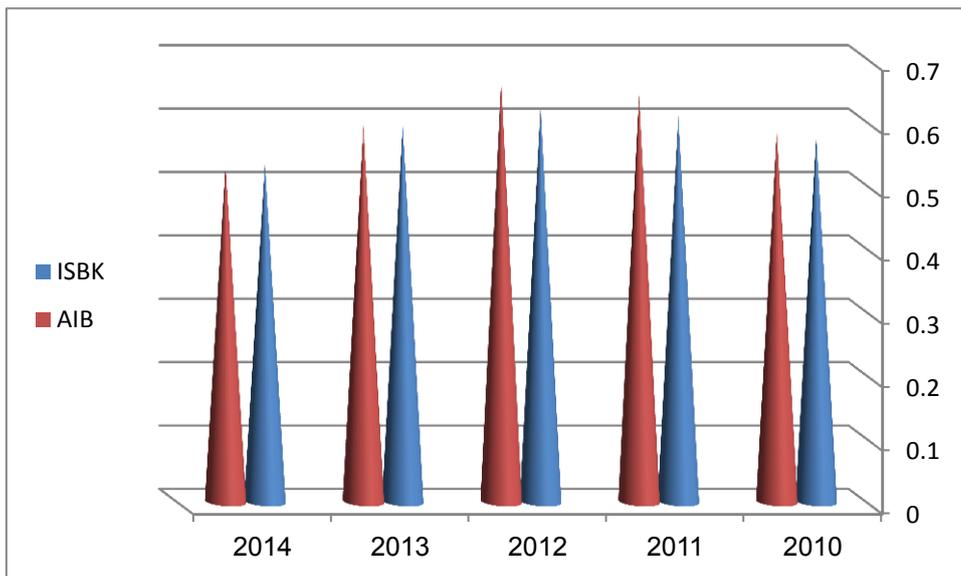


23. ETD

Chart(8.45) ETD for conventional banks

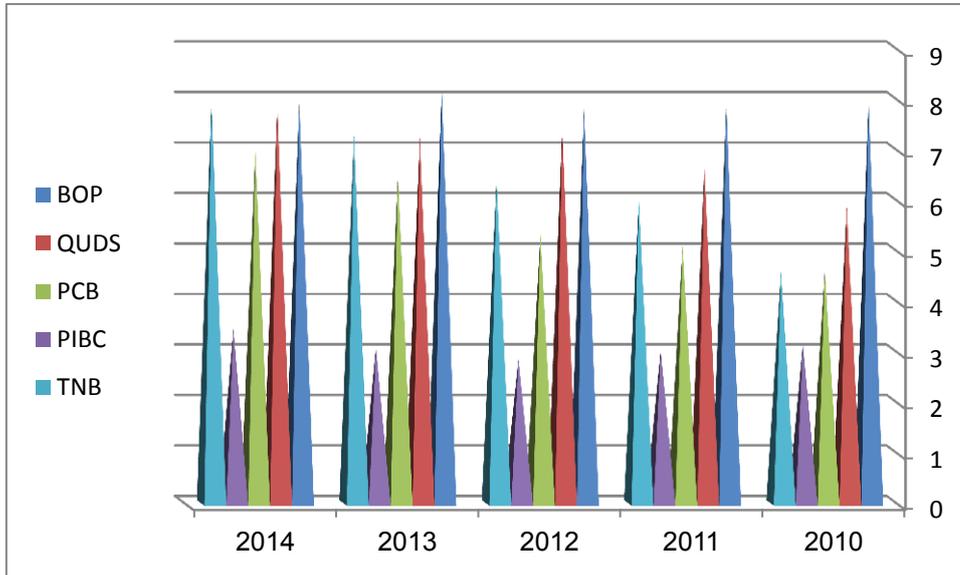


Chart(8.46) ETD for Islamic banks

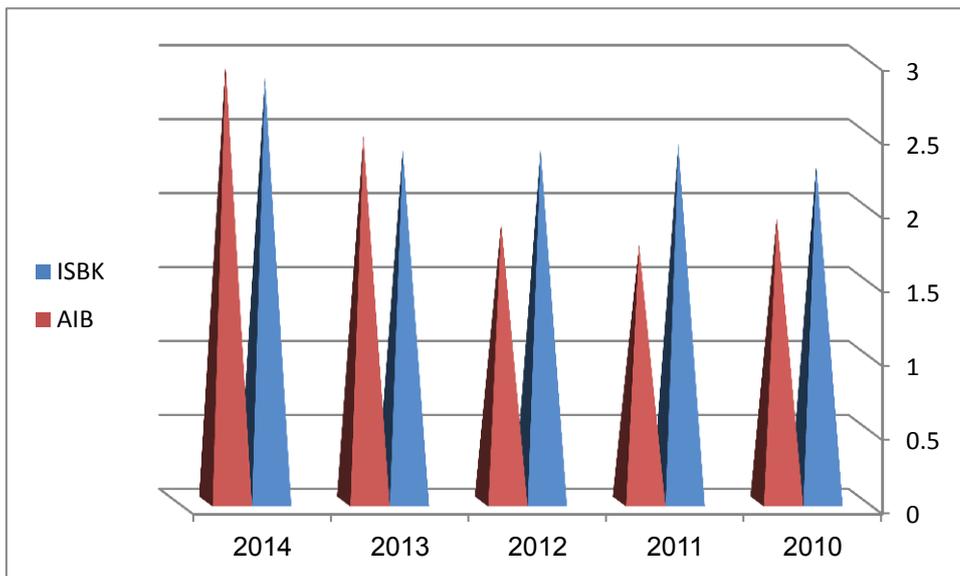


24. TLE

Chart(8.47) TLE for conventional banks



Chart(8.48) TLE for Islamic banks



25. TLSC

Chart (8.49): TLSC for conventional bank

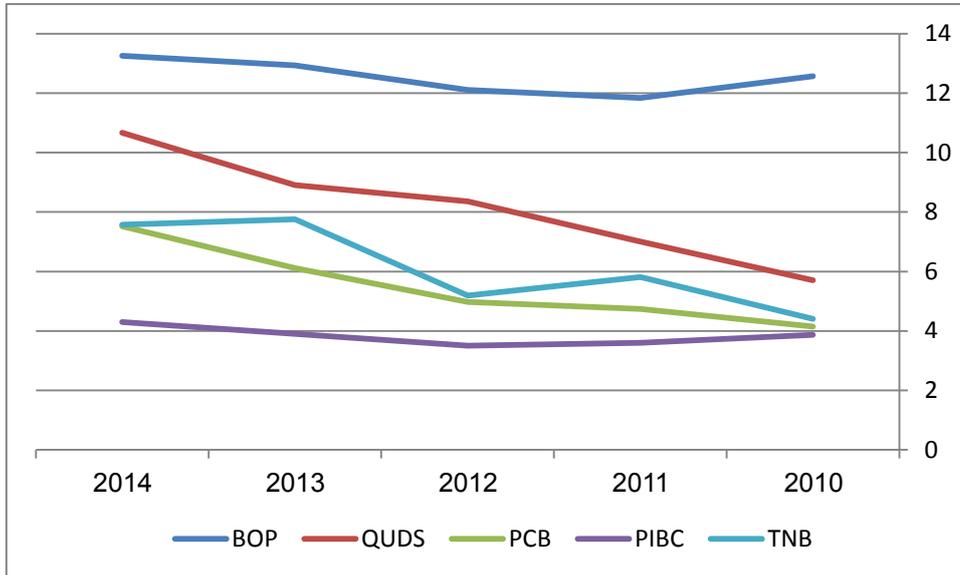
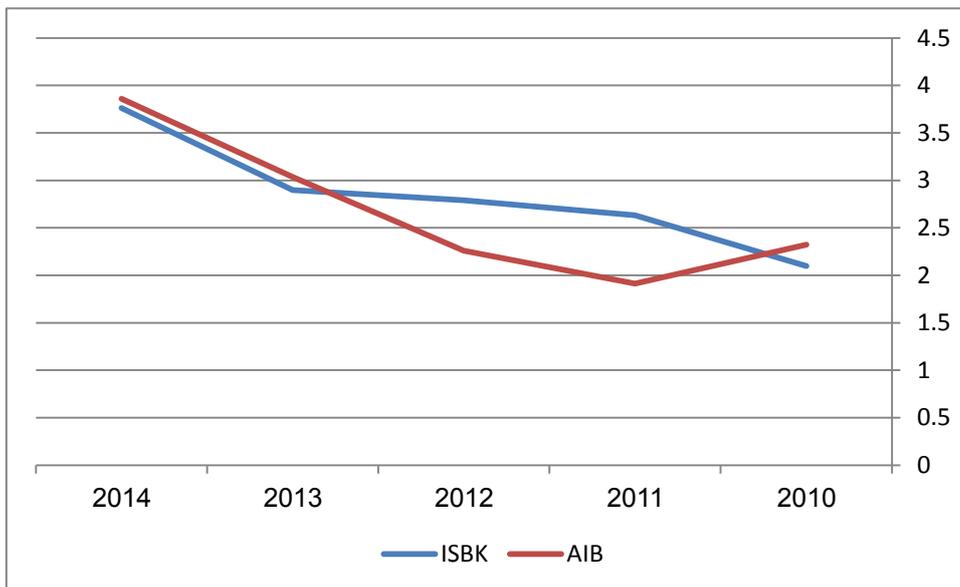


Chart (8.50): TLSC for Islamic bank



26. RETA

Chart (8.51): Reta for conventional bank

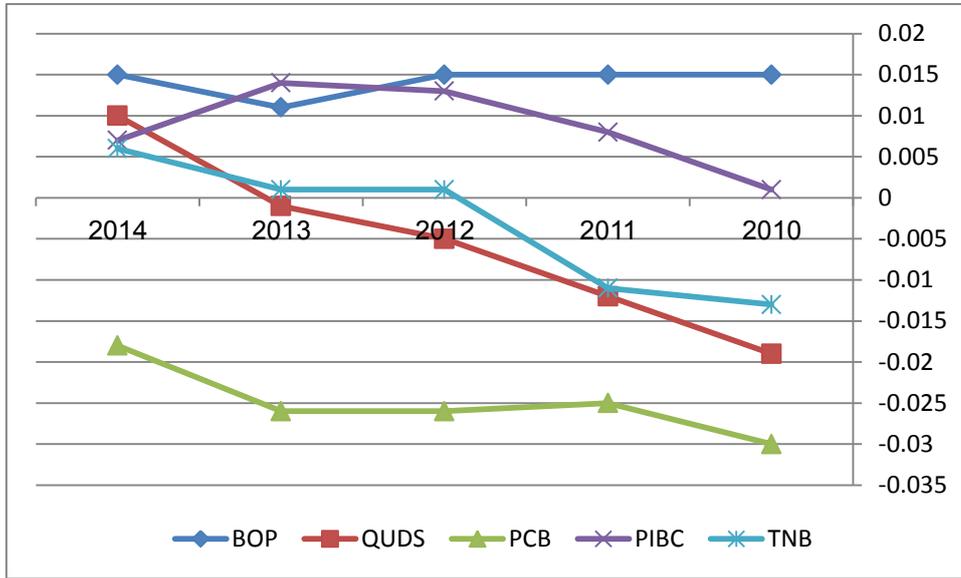


Chart (8.52): Reta for Islamic bank

