ABSTRACT

The purpose of this paper is to measure and discuss the impact and performance of conventional and Islamic Banking in Malaysia during the global financial crisis. Performance is measured in terms of profitability, operational efficiency, liquidity and business growth. The period of study is during the financial crisis 1997 (Asian Financial Crisis) and 2007 (Global Financial Crisis). Several published papers and researches have been used in this study. The comparison is made between the performances of Conventional Banking with Islamic Banking in Malaysia. The findings show that Islamic Banking had performed better than Conventional Banking. Therefore, it can be concluded that the Islamic Banking system is able to sustain, survive and compete with the conventional banking system especially during the Global Financial crisis.

Keywords: Islamic banking, Conventional banking, Islamic nation, Global financial crisis, Asian.
1. Introduction

The World was hit by the global financial crisis in the years 1997 and 2007. Many countries and corporations had to face the consequences of the global financial crisis. Manufacturing companies, oil and gas and the most severely hit was the banking industry.

Currently, there are two types of banking, Conventional and Islamic banking. The World started with conventional banking but after the increasing numbers of Muslims in the world, many Islamic countries changed to the Islamic banking system. Islamic banking started in the Muslim countries where the commercial banks introduced Islamic products in their banks. (Munawar, 2001; Thorsten, Asli, and Ouarda, 2010).

In Malaysia, banks like Maybank, CIMB, HSBC and Alliance have their own Islamic banking systems, which provide Islamic products to their customers. Islamic products get a good response and are accepted by the people, not only Muslim but people from other religions as well. They accept the Islamic financial products because of the features this product offers.

Zaharuddin (2007) and Ariff (1988) stated the difference between Islamic and conventional banks; the following is a comparison:

<table>
<thead>
<tr>
<th>Conventional Banks</th>
<th>Islamic Banks</th>
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<tbody>
<tr>
<td>The functions and operating modes of conventional banks are based on fully manmade principles.</td>
<td>The functions and operating modes of Islamic banks are based on the principles of Islamic Shariah.</td>
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<tr>
<td>The investor is assured of a predetermined rate of interest.</td>
<td>promotes risk sharing between provider of capital (investor) and the user of funds (entrepreneur).</td>
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<td>It aims at maximizing profit without any restriction.</td>
<td>It also aims at maximizing profit but subject to Shariah restrictions.</td>
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<td>It does not deal with Zakat.</td>
<td>In the modern Islamic banking system, it has become one of the service-oriented functions of the Islamic banks to be a Zakat Collection Centre and they also pay out their Zakat.</td>
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<tr>
<td>Lending money and getting it back with compounding interest is the fundamental function of the conventional banks.</td>
<td>Participation in partnership business is the fundamental function of the Islamic banks. The customers’ business has to be understood.</td>
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</table>
It can charge additional money (penalty and compounded interest) in case of defaulters.

Islamic banks have no provision to charge any extra money from the defaulters. Only small amount of compensation and these proceeds is given to charity. Rebates are given for early settlement at the Bank's discretion.

Very often it results in the bank's own interest becoming prominent. It makes no effort to ensure growth with equity.

It gives importance to the public interest. Its ultimate aim is to ensure growth with equity.

The status of a conventional bank, in relation to its clients, is that of creditor and debtors.

The status of Islamic bank in relation to its clients is that of partners, investors and trader, buyer and seller.

A conventional bank has to guarantee all its deposits.

Islamic bank can only guarantee deposits for deposit account, which is based on the principle of al-wadiah, thus the depositors are guaranteed repayment of their funds, however, if the account is based on the mudarabah concept, clients have to share a loss if it occurs.

Islamic banking is more humanizing than conventional banking. (Mohammed, Shamsher, Ariff and Taufiq, 2008). In this paper, it is noted that Islamic banking provides a more human approach. It had been proven that many consumers choose Islamic banking rather than conventional. This paper will look through which banking segment is performing better during the global financial crisis.

There will be many factors to evaluate the performance of the banks during the financial crisis; profit, revenue and sustainability. During the financial crisis, many businesses were unable to sustain and some of them had to shut. The Global financial crisis gave a great blow to the world’s economy.

**1.1 Research objectives:**

This study aims:
- To investigate the performance of Islamic Banking and Conventional banking during the Global Financial Crisis.

**1.2 Research Questions:**
- Is there an impact of Islamic banking on performance variables?
• Is there an impact of Conventional banking on performance variables?

1.3 Significance of study:
The importance of this can be summarized as the following:
• Better performance in terms of returns and stability is highly sought by many banks in order to secure their investment during the financial crisis. Therefore, there is a need to find an alternative banking solution to secure the sustainability of their investment.
• Many researchers wrote about how Islamic banking is a better and more reliable banking system over conventional banking. This review reveals the actual facts of what had been claimed.

2.0 Literature Review

How does the global financial crisis affect Islamic banking compared with the conventional? There are numerous studies that measure the Islamic banking performance during the financial crisis. Back to the early nineties, many conventional banks open or provide Islamic products to their customers such as the Islamic savings, current, loan and unit trust. (Hamim, Naziruddin and Syed, 2006). Shamsher and Mohamed (2008) stated that Muslims and Non-Muslims have positively accepted the Islamic products, which led to the increase of the performance of banks. Islamic financial products especially loan financing gained huge recognition. Rodney, (2007) stated that the benefit and the features of Islamic loan financing are profit sharing (no interest) and the payment will be fixed throughout the tenure. Hence, it will not put a burden on the customer and provides social justice. While, Conventional financial products are based on interests, if the interest increases automatically the installment will increase, loan amount is increased and prolong the tenure which amounts to injustice and oppression to the community as a whole. (Rima, 2007; Khurshid, 2000)

Abdus and Kabir (2008) found that many Islamic countries in the Middle East such as UAE, Kuwait, Jordan, Iran, Iraq, Turkey, Indonesia and Malaysia have already implemented the Islamic banking. In these countries, consumers can choose to use conventional or Islamic banking. Maher and Jemma (2010) found that during the global financial crisis the performance of Islamic banking is only just average. The performance here is measured in terms of profit, equity, efficiency and liquidity. A financial ratio was used in the research to evaluate the performance of the Islamic banks compared with conventional banks in the Islamic countries. (Thorsten, Asli and Ouarda, 2010)

Islamic banking is accepted in the Islamic nations especially in Middle east i.e. Iran, Iraq, Kuwait, Jordan, Turkey and also such as Malaysia and Indonesia. Efficiency of the bank is dependent on the size and location of the bank, for example, Islamic banking in Middle East is more efficient compared to Africa while conventional banking is more efficient in Africa compared to Middle East (Hadeel, 2009). The efficiency of the bank is affected by internal and external factors. Internal factors refer to management and operations while external factors are
competitors and economy (Habib, 2009). The Financial crises actually made an impact on both Islamic and Conventional banks. Islamic banking fixes the rate rather than leave it fluctuating. This resulted in an increase and a high demand of Islamic banking services compared to conventional banking during the financial crisis. (Donsyah, 2003; Thorsten, Asli and Ouarda, 2010)

Saleh and Zeitun (2006) commented that Islamic banking can still survive during the global financial crisis, this indicates that the Islamic financial products are accepted by many, especially in the Muslim countries where the Islamic financial products have overtaken conventional banking systems. Even though both Islamic and conventional were impacted during the financial crisis, Islamic banking actually operated more efficiently. The reason being is because Islamic banking is more liquefied compared with conventional banking. It also shows that Islamic banking is less risky in terms of debt equity in comparison with conventional bank. (Munawar, 2001; Kabir and Rasem, 2009)

Valli and Mokhtarul (2004) concluded that Islamic banking schemes perform better compared with the pure Islamic banks. Islamic banking has increased their dominance in the market especially in financing or loan. Due to the increase in financing and loan from Islamic banks, credit risks have a greater exposure. Islamic banks need to take care and monitor these risks closely. Khalil and Zurina (2012) concluded that the reason Islamic banks could sustain and provide better performance is because the administrators of Islamic banks have a positive attitude toward research and its value in the area of commodity Murabaha. Ariss (2007) pointed that because Islamic banking is becoming the market player in terms of financing and loan. This will lead to increase in credit risk exposure and Islamic banks need to be aware of this.

Patrick and Kangni (2010) found that Islamic banking customers have been increasing and being accepted by non-Muslims because of the just principles that does not put a burden on the customers compared to conventional banking. Umi (2007) concludes that Islamic banking shows a positive performance. Islamic banking has been growing constantly and is more and more stable. Abbas and Noureddine (2010) argued that Islamic finance also gets impacted during the economic crisis. But, the impact is not as huge as the one conventional banking faced because many customers turned to Islamic finance from conventional banking during the global financial crisis.

Islamic banking will definitely grow stronger because it is more humanizing and convincing compared to the conventional. Islamic banking will give a great impact to the financial industry and it will provide a good and effective banking solution. (Kabir and Mervyn, 2007)

2.1 Profitability
One of the performances measure is profitability. Profitability is important as it will show and measure which banking system is doing better during the global financial crisis. Profitability ratios used to measure the performance are Gross Profit ratio and Net Profit ratio. Both ratios are
calculated based on the performance of the banks during the crisis. The calculations show both Islamic and Conventional banking were profitable but Islamic banking profit is much higher compared to conventional. (Khaled, Shamsher & Arif, 2008) (Samad & Kabir, 2009). Canbas, Cabuk, Kilic, (2005), conclude from the multivariate statistical analysis of financial structures that Conventional banks’ profit has decreased during the global financial crisis; some banks needed to close the business or were bankrupt.

2.2 Operation Efficiency
Operation efficiency is also another measure to compare between Islamic and Conventional banking. Donsyah (2003) concluded that Islamic banking show greater efficiency in operation compared to conventional during the global financial crisis. An efficiency ratio has been used to measure the efficiency and that is based on the empirical analysis of 18 selected banks. Even Thorsten, Asli and Quarda (2010) found that Islamic banks have better and efficient operation compared to Conventional banks. This has been proved by using the bank scope to construct and compare the indicator of business orientation, efficiency and asset quality for both Islamic and Conventional. Dr Haron, S & Ahmad, N. (2008) stated that although Islamic banks do not sell with interest to customers deposit but the dividend and the profit sharing methods are not much different from the conventional. Customers who deposit in Islamic products still can gain profit, which is sometimes more than the conventional deposit product.

2.3 Liquidity
Liquidity is also another measurement to compare between Islamic and conventional banking. Liquidity is important to the banking industry because it will show how liquefied the bank is during the crisis. Liquidity here is in terms of cash flow and outflow. Valli and Mokhtarul (2004) conclude that Islamic banking is more liquid compared to conventional banking during the crisis. Ratio calculation and empirical investigation have been done and data was taken from the year 1997 to 2002 from the annual report of 2 Islamic banks, 9 domestic banks and 4 foreign banks that provide Islamic banking services in Malaysia.

2.4 Business
Lastly, business growth has been used to measure the potential growth between Islamic and conventional banking. This is important because it will determine the sustainability and competitiveness of the Banks. Rima (2009) and Kabir & Rasem (2009), found that Islamic Banking has shown growth and competitiveness in the business. The study was done by investigating the competitive condition in Islamic and conventional banks on the global level. Evaluation method was being used to do the comparison and efficiency between Islamic and Conventional banking. Ariff (1988) stated that Islamic banking will expand and grow because of the essential feature of Islamic banking and that is being interest-free.
3. Methodology

The objective of this study is to evaluate the performance of Islamic and conventional banking. Reviewing and studying multiple published papers had been used to evaluate and measure the performance of both Islamic and conventional banking in Malaysia during the global financial crisis. The articles from year 1997 to 2011 had been reviewed on the performance between the Islamic and Conventional banking. Selected Banks in Malaysia, Iran, Iraq, Jordan, Turkey, UAE and Kuwait had been used to do the comparison on the performance. The studies and published papers are based on a few strategies such as Empirical study, Review paper and Financial Ratio analysis had been used to evaluate the performance of Islamic Banks. The conclusion and the results of the study will be from the literature review acquired from the previous studies and articles.

3.1 Research Hypothesis:
Depend on research questions and research objective, the following hypothesizes have been developed:

$H_{1a}$: There is significant relationship between Islamic banking and Profitability during global financial crisis.

$H_{1b}$: There is significant relationship between Islamic banking and Business Growth during global financial crisis.

$H_{1c}$: There is significant relationship between Islamic banking and Liquidity during global financial crisis.

$H_{1d}$: There is significant relationship between Islamic banking and Operation Efficiency during global financial crisis.

$H_{2a}$: There is significant relationship between Conventional banking and Profitability during global financial crisis.

$H_{2b}$: There is significant relationship between Conventional banking and Business Growth during global financial crisis.

$H_{2c}$: There is significant relationship between Conventional banking and Liquidity during global financial crisis.

$H_{2d}$: There is significant relationship between Conventional banking and Operation Efficiency during global financial crisis.

4. Conclusion

Based on the findings and results, it can be proven that Islamic banking performs better than the conventional banking. This is due to the empirical, comparative and exploratory studies that have been done. This proves that Islamic banking performs better than the conventional banking in terms of profit, operation efficiency, liquidity and business growth. Nowadays, Islamic banking
is accepted by not only Muslim countries but also in the western and other Non Muslim
countries. Islamic banking services are more humanized and offer more justice to the customers
compared to the conventional banking. One of the best evidences is the interest rate in which the
Islamic offers fixed interest rate while the conventional interest rate can fluctuate according to
the economic situation. Many customers have suffered loss during the global financial crisis
when they took conventional loans. As a result, many customers have turned to Islamic banking
during the crisis and this has led to the growth of the Islamic banking business, (Hassan & Dridi,
2010). Besides the loans, Islamic banking offers many products such as saving and Current
accounts (Wadiah and Mudarabah) which is similar to the conventional banking. But, dividend is
given to the customers instead of interest and profit sharing deposits. From the review it
anticipated that Islamic banks will sustain, grow and be accepted by others in the future.

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