

# Factors Affecting Bank-specific and Macroeconomic profitability Determinants of Islamic and Conventional Banks in Pakistan

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## Abstract

This empirical research aims to look at the factors that mark the financial performance of Islamic and traditional banking sector in Pakistan. The results of the data signify that gross domestic product and inflation is connected to the financial performance of Islamic banks in all aspects of profitability ratios and gross domestic product has insignificant relation with the return on equity and assets of conventional banks. Inflation has a weighty effect on return of assets of conventional banks. Further results indicate a negative impact of bank size on return of assets Islamic and positive impact on conventional banks. A negative impact of bank size on return on equity of Islamic and positive impact on conventional banks. There is no performance impact of bank size on price earnings ratio. Results also indicate that a negative performance impact of age of bank on return on assets of Islamic and traditional banks.

**Keywords:** Islamic Banks; Conventional banks; Performance Ratios JEL Classification: G21

## Introduction

A financial system is expected to work on two grounds. First is saving mobilization and second is providing services like transfer of funds, facility in international trade and trade consultancy services. Saving mobilization is a process in which the traditional banking system introduces credit facility in return for interest. Conventional banks provide loan for a fixed reward whereas Islamic Financial Institutions (IFI's) cannot charge interest. The main objective of banks is to earn a profit for which it establishes different projects and the basic focus of a bank remain profitability (Murthy & sree 2003), (Alexandru et al., 2008).

The performance of Banks have been measured through financial ratios and common ratios are; ROA (Return on asset), ROE (Return on equity), and PER (Price earnings ratio). ROA ratio is high, it is indicates that company has utilized the resources in most appropriate ways (Khrawish, 2011). It is just like a valuation of the effective management of the commercial bank to make a maximum profit (Khrawish, 2011). In positive GDP growth, it is common that credit goes higher naturally due to the demand on the business cycle. During recession demand for credit is lower and during the boom it goes higher (Athanasoglou et al. 2005). There Is always debate for the classification and the relation of inflation level and banks profitability (Vong and Clan, 2009)

Islam brought revolution in different fields of life like political, economic, social and judicial

spheres in 7<sup>th</sup> century AD and these revolutionary changes took the followers of Islam far off places for trade and international commerce. Lieber (1968) explore that “Among Muslims international trade was particularly stimulated by the pilgrimage to the Holy place Kaba in which a great body of men converged each year from all over the world. Writers on this era like De Roover (1954) and Udovitch (1979) mention that there was no specific institution to proceed the process give and take systemically and it was believed that no exact bank existed in median age Islamic world and no sign of documents as required documents in banking system keeps its appearance on the record but there are certain historical facts (Al-Qalqashandi, 1913), (Al-kubaisi 1979), (AlSa’di 1985), (Fischel 1992), (Pellat and Schacht 1965), (Al-Hamdani 2000) and (Chapra & Ahmed 2002) showed that at that time bankers called sayarifah or sarraffeen or jahabidhah whereas banks called dawawin al-jahabidhah. The *suftaja* (Bill of Exchange) and the *hawala* (credit guarantee or credit transfer) usually occurred as a written obligation, and were thus the first and most important forms of commercial credit papers in the Medieval Near East” (Udovitch 1979). In the given circumstances Muslim world was deprived of such technology and economic activities replaced by Western institutions in financial matters (Issawi, 1966; Lewis, 1970; Chapra, 2000; Chapra & Khan 2000).

Quran, Sunnah, Ijmah and Qiyas are basic and primary sources of Islamic banking. Muslim economist is of the view that interest based banking system spreads inflation because money producing process has no concern whether a business is productive or not (Ashraf 2013).

Islamic banking system derived its roots from Islamic laws of Shari’ah. Its purpose is to remove the conceptions of interest from transactions to purify the financial system as Shari’ah demands. In Islam, word ‘Riba’ is used for the interest which means a predetermined extra amount charged from loanee which keeps on increasing with increase in credit period. This interest is strictly prohibited in Islam and it is clear from many verses of Holy Quran. A verse of Surah Al-i-’Imran 3:130 states "O those who believe do not eat up Riba doubled and redoubled." Similarly, another verse states: "Those who take an interest will not stand but as stands whom the demon has driven crazy by his touch. That is because they have said: 'Trading is but like Riba'. And Allah has permitted trading and prohibited Riba. So, whoever receives an advice from his Lord and stops, he is allowed what has passed, and this matter is up to Allah. And the ones who revert back, those are the people of Fire. There they remain forever” (Surah Al-Baqarah 2:275).

Riba which is commonly used in two senses: First, Riba al-Nasiah defines that there is not exact increase in money which has been predicted but if there is a proper utilization of money. On such people truly believe and appreciate the work of the bank and such sort of profit comes under of spare of Second, Riba al-Fadl in Riba al-Fadl justice and fair play is given worth in the cases of the transaction in which maximum effort are used to avoid any sort of exploitation an unfair or crook exchange.

Conventional banks are playing their role towards the economic growth of a country (Hassan et al. 2009) by enabling the flow of money from those who have access to it to those who are in need of it (Ayub et al. 2012).they gather up the money from various savers and then distribute it to those who can use it in various productive activities. Thus conventional banks play an important role in society by on one hand discouraging the practice of hoarding money which proves useless and on the other hand becoming a source of financing for the various productive projects.(Hassan et al. 2009). Another way in which conventional banks are facilitating the people of the country is through the provision of their services which includes a letter of credit and guarantees (Ayub et al. 2012).

In the 1950s there were the strong motivation in Muslim countries for Islamic banks and interest-free banking after the independence from the colonized system (Vogel and Hayes 1998). In this era first attempt was made to open such banks as Wilson (1983) pointed out that

in 1963 first Islamic Mit Ghamr Saving Bank was established in Egypt (Ashraf 2013). Naggar (1974) mention its role in as efficient as intermediate between supply and demand. IDB (Islamic development bank) was established in 1945. In a report of General Council of an Islamic bank and financial institution (GCIBFI, 2001) it has been mention that there were 270 Islamic financial institutions which has assets over 300 billion US\$, Deposit over 200 Billion US\$ and investment over 160 billion US\$.

Now Islamic banks exist in Denmark, England, Switzerland, and Luxembourg are coping with non-Islamic banks like HSBC, Citibank and other in this fast growing sector. The available data shows that in ranking either assets deposits of investment some Islamic banks are considered among the 100 largest Arab banks (Chachi 2005). There are fundamental differences in Shari’ah based and Shari’ah complaint mode of financing in Islamic and conventional banks and all of the are of significant and cannot be ignored.

***The difference between Shari’ah based and Shari’ah compliance products Shari’ah Based***

Shari’ah based products are built on classical Islamic contracts and have no fundamental flaw in the formation and no imitation of conventional banking products such as Mudarab’ah and Mushark’ah. There are possibilities to form more complex products from the original contract. Shari’ah based products are approved form its original source and free from the risk of Shari’ah. Shari’ah compliance products are not purely base on Shari’ah rather they similar to the products of conventional counterparts and the differences are so small that might be ignorable. Here financial engineers break down the conventional products by adding few features of Shari’ah in that product. These reverse engineered products are main source of confusion among Muslims and other people. Unlike Islamic banks, conventional banking have only one way of doing financing, which is the provision of interest based loan.

***Current scenario: Growth of Islamic and Conventional Banks in Pakistan***

Table 1: Rupees in Billion by June 2019

	Conventional Banks	Islamic Banks
Assets	12949	2992
Branches	10485	2685

Source: SBP retrieved on June 2019

Above table mentions the financial assets and branches of Islamic and Conventional banks. The study under investigation highlighted the features that affect the financial performance of banks. Impact of determinants like bank size, age of bank, GDP growth rate and inflation rate all are studied in various combinations on ROA and ROE by many researchers (Ongera and kush, 2013; Naceur and Imran, 2011; Zeitun 2012; Sufian & Habibullah, 2009). But so far no research has been conducted which has used PER as measure of profitability in this context. Moreover, the majority of such researches were done for the period till 2010. Thus no one has attempted to study the impact of bank size, age, credit risk, GDP growth rate, inflation on ROA, ROE, and PER in one model for the period of 2011-2015 worldwide nor has compared Islamic and conventional banks through this model.

**Literature Review**

Supiyadi et al., (2019) examined the influence of internal and external causes on the profitability of Indonesian Shariah based banking system for the period of 2010 to 2017. On internal side profitability has a pointedly positive influence whereas capital Adequacy, credit risk and bank size all have significantly negative impact. And on external side inflation has

positive effect and GDP has negative effect on the profitability of Islamic banks.

Ali (2018) signified the importance role of banks in a capitalist society like Pakistan where traditional banks and Islamic banks are working side by side. The effectiveness of both types of banks was checked from 2008 to 2012. The results implies that liquidity is not a factor of profitability in both cases whereas traditional banks are better in managing the credit risk because of their size and numbers and Islamic banks are more effectual in managing their resources and earnings.

Rahaman and Akhter (2015) investigate the profitability factors of Islamic banks. Bank size had significant negative effect on ROA. Hamilton (2010) examined Jordanian bank profitability. In internal detriments like liquidity, capital structure, Deposit structure, asset structure, expenditure structure and size whereas external factors are market share, money supply, interest rate and inflation and it was found the Islamic banks are less cost efficient and more profit efficient . Rachdi (2013) conducted the study on the profitability of bank before and after financial crisis, this was conduct in Tunisia for the period of 2000 to 2010. Before the crisis, he found the capital adequacy is highly substantial and positive relation with ROA and Net Interest Margin (NIM) whereas the negative coefficient is negative during the crisis. Almazari (2014) directed research to discovery the factors which affect the profitability of Saudi and Jordan banks. It was found that the profitability of Saudi banks is higher as compare to Jordanian bank. Bukhari et al., (2012) observed the profitability of Islamic banks. Credit risk and advance had positive and interest had a negative impact on the profitability.

Maqbool (2014) investigate the liquidity and profitability of Islamic banks in Pakistan and it was found that if the bank invests more on the asset, then liquidity will be low and profitability will be higher. Khan et al. (2015) studied the financial performance and liquidity of Pakistani and Malaysian Islamic banks for the period of 2006 to 2012 and the Malaysian banks were found more profitable. Masood and Ashraf (2012) studied the impact of macro-economic and bank-specific determinants on the effectiveness of Islamic banks in twelve selected countries of different regions. The results were estimated through balanced panel data regression. The estimations reveal that the larger size of assets and efficient management play a major role in the profitability of banks.

Al-Qudah and Jaradat (2013) found the effect of macroeconomic variables and bank representative on the profitability of Jordanian Islamic banks this study performed the cross section and time series penal data regression analysis. Samhan & Al-Khatib (2015) found the positive relation and significant level between ROA and inflation, equity ratio, and bank size. Masood & Ashraf (2012) dignified the profitability of Islamic banks in different countries. Penal data was used from the 25 Islamic banks and 12 countries 2006 to 2010 positive relation was found. Abduh and Idress (2013) investigated the Islamic bank profitability in Malaysia. This research used cross sectional penal data regression techniques they also selected industry specific indicators which are financial market development and bank concertation. Usman & Khan (2012) directed the financial performance of Islamic and traditional banks for the period of 2007 to 2009 the profitability of conventional was much better than Islamic banks.

Ramadan (2011) examined the bank specific facts effect on the profitability of Jordanian banks. Results directs that the credit risk, effective management lead to greater ROA and positive affect to profit edge. Al Taleb et al. (2015) conducted a study to examine variables which are affect the Islamic banks, a negative significant relationship between Earning per share and Gross national income.

Khan et al., (2014) determine the profitability of Islamic banking industry in Pakistan and found that the GDP and loan composition had insignificant relation with banks profitability. Ijaz et al., (2015) examined the internal factors of Islamic banks and the base of profitability

of Islamic banking is determined by the asset management, operating efficiency, and bank size. Choong et al., (2012) conducted the study is to analyze the performance of Islamic commercial banks in Malaysia. Capital had insignificant positive relation with ROE. Concentration had a positive and insignificant impact on ROE.

Ramadan et al., (2011) examined that profitability and asset composition had a positive important impact on Return on Assets. Shahid et al., (2010) found that the Islamic better performed than traditional banks in Pakistan. Kouser & Saba (2012) examined the performance of pure Islamic, Islamic conventional and conventional banks using the CAMEL model in Pakistan. The earning of Islamic banks were found less than the conventional Islamic bank's branches and traditional. Islamic banking has a good rising setup. Jaffar (2011) found that the conventional banks earning more profit and had better investment, Islamic banks had poor earning on asset record. Sabir et al. (2014) investigate and that the commercial banks are higher and better in term of return on the asset as compare to Islamic banks.

**Conceptual Framework:**

Current study involves in the identifying of impact of Bank size, Age of Bank, GDP Growth and inflation on three profitability measures ROA, ROE and PER separately for Islamic and conventional banks.

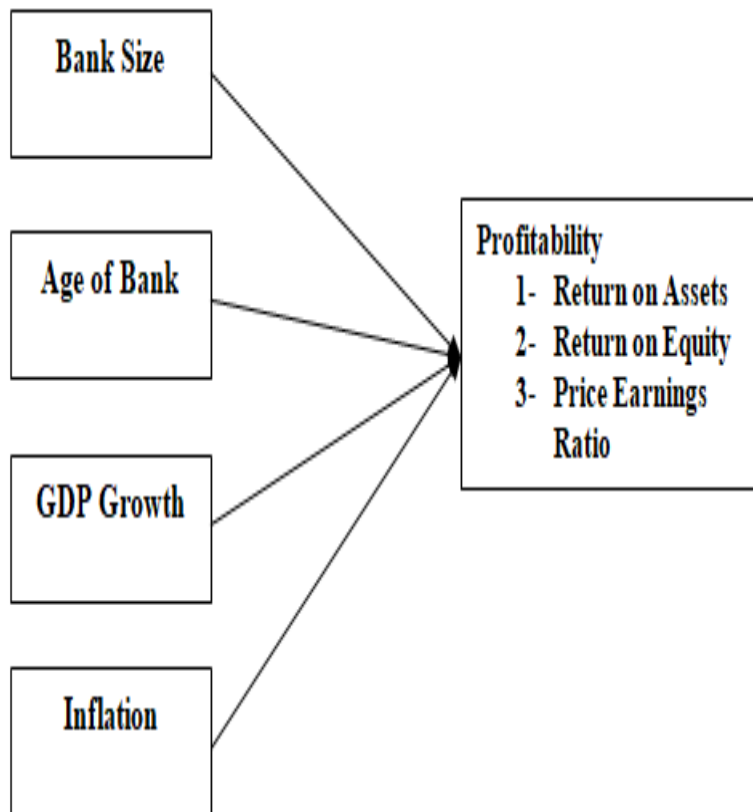


Figure 1: Conceptual framework (Islamic and Conventional) developed by the Authors

Table 2: List of Dependent and Independent Variables

Criterion Variables			
Variables	Symbols	Measure	Reference
Return on assets	ROA	Net Income/Total Assets	Ongore, V. O., & Kusa, G. B. (2013). Determinants of financial performance of commercial banks in Kenya. <i>International Journal of Economics and Financial Issues</i> , 3(1), 237.
Return on equity	ROE	Net Income after Taxes /Total Equity	Ongore, V. O., & Kusa, G. B. (2013). Determinants of financial performance of commercial banks in Kenya. <i>International Journal of Economics And Financial Issues</i> , 3(1), 237.
Price Earnings Ratio	PER	Current value Per share/earning per share	Developed by the Authors

Independent variables Bank-specific factors			
Bank Size	Size	Log of Total Assets	Zeitoun, R. (2012). Determinants of Islamic and Conventional banks performance in GCC countries using panel data analysis. <i>Global Economy and Finance Journal</i> , 5(1), 53-72.
Age of bank	Age	Number of Years	Zeitoun, R. (2012). Determinants of Islamic and Conventional banks performance in GCC countries using panel data analysis. <i>Global Economy and Finance Journal</i> , 5(1), 53- 72.
Macro-Economic Factors			
Gross domestic product Growth	GDP	Annual Real GDP Growth Rate	Muthini, G. (2013). The determinants of banks profitability in Kenya (Doctoral dissertation, school of economics, University of Nairobi).
Inflation	INF	Annual Rate of Inflation	Muthini, G. (2013). The determinants of banks profitability in Kenya (Doctoral dissertation, school of economics, University of Nairobi).

### ***Hypotheses development***

To check the significant and insignificant relationship of bank size, age of bank, GDP and Inflation on the profitability ratios like ROA, ROE and PER following hypotheses are developed.

H1a: Bank size has positive effect on ROA (Islamic)

H1b: Bank size has negative effect on ROA (Conventional) H2a: Bank size has positive effect on ROE (Islamic)

H2b: Bank size has positive effect on ROE (Conventional) H3a: Bank size and PER has positive relationship (Islamic)

H3b: Bank size and has positive relationship PER (Conventional) H4a: Bank has positive effect on ROA (Islamic)

H4b: Bank has positive effect on ROA (Conventional) H5a: Age of bank has positive/negative on ROE (Islamic)

H5b: Age of bank has positive impact on ROE (Conventional) H6a: Bank size and PER has positive connection (Islamic)

H6b: Age of bank and PER has positive connections (Conventional) H7a: GDP Growth has positive/negative effect on ROA (Islamic)

H7b: GDP Growth has positive effect on ROA (Conventional) H8a: GDP Growth has positive/negative effect on ROE (Islamic) H8b: GDP Growth has positive effect on ROE (Conventional) H9a: GDP Growth and PER have positive connections (Islamic)

H9b: GDP Growth and PER have positive connections (Conventional) H10a: Inflation has positive effect on ROA (Islamic)

H10b: Inflation has positive/negative effect of on ROA (Conventional) H11a: Inflation has positive effect of on ROE (Islamic)

H11b: inflation has positive/negative effect of on ROE (Conventional) H12a: Inflation and PER have positive connections (Islamic)  
H12b: Inflation and PER have positive connections (Conventional)

### Methodology

Current research aims to compare factors moving profitability of Islamic and traditionally banks. The sample of current study is reserved from the population of scheduled traditional and Islamic banks operating in Pakistan. As per Hyndman (2008) population means a complete collection of objects which are the focus of interest for researchers. Polit and Beck (2003) suggested that collecting data from a population is less practical and more expensive as compared to sample. Thus in order to bring out this study a sample of four banks namely Muslim Commercial bank (MCB) and Bank of Punjab (BOP) from conventional banks and Meezan bank and Bank Islamic Pakistan Limited from Islamic banks are taken. In current study judgmental sampling is used Judgmental sampling is also known as purposive or expert sampling and belongs to non-probability sampling (Lavrakaz 2008). Judgmental sampling involves selecting a sample by using expert knowledge which appears to be representative of the population. In the current study, secondary data collection method is used. Data for bank variables like bank size, the age of bank, ROA, ROE and PER are taken from official annual reports of banks while data of GDP and inflation are acquired from the website of SBP and World Bank from 2011 to 2015.

### Results and Discussion

The analysis is done by inferring from gathered data by measuring correlation and regression between variables. For correlation, Pearson’s correlation is applied which as per Pallant (2005) is suitable when two variables are continuous in nature. Moreover, to identify the cause-effect relationship, multiple linear regressions are used. For regression analysis, multiple linear regression is used which helps in studying the effect of more than one independent variables on a dependent variable (Faraway 2002).

Table 3: Summary of Hypotheses

Sr. No	Variables	Value of $\beta$	Value of p	Decision
H1a	Impact of Bank size on ROA (Islamic)	-0.662	0.005 < 0.05	Accepted
H1b	Impact of Bank size on ROA (Conventional)	0.866	.044 < 0.05	Accepted due to cultural difference
H2a	Impact of Bank size on ROE (Islamic)	-0.222	.004 < 0.05	Accepted
H2b	Impact of Bank Size on ROE (Conventional)	0.487	.049 < 0.05	Accepted due to cultural Difference
H3a	Effect of Bank Size on PER (Islamic)	-54.2	.267 > 0.05	Rejected
H3b	Effect Bank Size on PER (Conventional)	-3.899	.800 > 0.05	Rejected
H4a	Effect of Age of Bank on ROA (Islamic)	-0.18	.005 < 0.05	Accepted due to cultural Difference
H4b	Effect of Age of Bank on ROA (Conventional)	0.045	.045 < 0.05	Accepted
H5a	Effect of Age of bank on ROE (Islamic)	-0.743	.005 < 0.05	Accepted due to cultural



				difference
<b>H5b</b>	Effect of Age of bank on ROE (Conventional)	0.402	.059 < 0.05	<b>Accepted</b>
<b>H6a</b>	Effect of Age of Bank on PER (Islamic)	-4.93	.369 > 0.05	<b>Rejected</b>
<b>H6b</b>	Effect of Age of Bank on PER (Conventional)	-0.074	.926 > 0.05	<b>Rejected</b>
<b>H7a</b>	Effect of GDP Growth on ROA (Islamic)	-0.323	.014 < 0.05	<b>Accepted due to cultural difference</b>
<b>H7b</b>	Effect of GDP Growth on ROA (Conventional)	0.067	.179 > 0.05	<b>Rejected</b>
<b>H8a</b>	Effect of GDP growth on ROE (Islamic)	-0.021	.030 < 0.05	<b>Accepted due to cultural difference</b>
<b>H8b</b>	Effect of GDP growth on ROE (Conventional)	0.479	.085 < 0.10	<b>Accepted</b>
<b>H9a</b>	Effect of GDP growth on PER (Islamic)	-3.996	.712 > 0.05	<b>Rejected</b>
<b>H9b</b>	Effect of GDP growth on PER (Conventional)	0.268	.856 > 0.05	<b>Rejected</b>
<b>H10a</b>	Effect of Inflation on ROA (Islamic)	0.081	.005 < 0.05	<b>Accepted</b>
<b>H10b</b>	Impact of Inflation on ROA (Conventional)	-0.022	.011 < 0.05	<b>Accepted due to cultural Difference</b>
<b>H11a</b>	Impact of Inflation on ROE (Islamic)	0.805	.001 < 0.05	<b>Accepted</b>
<b>H11b</b>	Impact of Inflation on ROE (Conventional)	-0.671	.032 < 0.05	<b>Accepted due to cultural difference</b>
<b>H12a</b>	Impact of Inflation on PER (Islamic)	2.952	.201 > 0.05	<b>Rejected</b>
<b>H12b</b>	Impact of Inflation on PER (Conventional)	0.086	.812 > 0.05	<b>Rejected</b>

\*Significant at the 0.05 level.

***Bank size and its effect on ROA, ROE and PER of Islamic and conventional banks***

Above given estimated results indicate that one unit change in Islamic bank size can result in 66.2% change negatively on ROA of Islamic banks. Result also designates that p value is 0.005 which is < 0.01 so the hypothesis of the effect of Islamic bank size on ROA is accepted. In case of conventional bank size one unit change brings 86.6% change positively; results also indicate that p value is .044 which is < 0.05, so hypothesis of the impact of conventional bank size on ROA is accepted. The ROE of one unit change in Islamic bank size can result in 22.2% change negatively on ROE; results also indicate that p value is .004 which is < 0.05 so the hypothesis is accepted. In case of traditional banks, one unit change in bank size brings 48.7% change positively on ROE, and results also indicate that p value is .049 which is < 0.05 so the hypothesis is accepted. In case of PER one unit change in size of Islamic bank brings 54.200 negatively on PER and the p value is 0.267 which is > 0.01, 0.05 and 0.20 respectively so the hypothesis is rejected. This finds that there is no substantial effect of bank size on PER Islamic, this relationship is first time purposed by the researcher there is no previous study available about this relationship. So, this is result of this research that Bank size has no impact on PER Islamic. Similarly, a result of conventional bank points out that p is .800 which is > 0.01, 0.05 and 0.20 so the hypothesis is rejected. This mean there is no substantial impact of bank size on PER of conventional bank and this is finding of this research that bank size has no impact on PER of conventional banks.

***Bank age and its impact on ROA, ROE and PER of Islamic and conventional banks***

Estimated results of bank age indicate that one unit change in the age of bank brings an 18% change negatively on ROA of Islamic banks, Results also indicate that p value is .005 which is  $< 0.05$  and hypothesis is accepted. One unit change Age of bank can result in 45% change on ROA conventional, Results indicate that p value is .045 which is  $< 0.05$  and hypothesis are accepted. In case of ROE one unit change in the age of bank brings 74.3% change negatively on ROE of Islamic banks further result indicates that p value is .005 which is  $< 0.05$  and hypothesis is accepted. One unit change in age of bank can result in 40.2% change positively on ROE of conventional banks; result indicates that p value is .059 which is  $< 0.10$ , so the hypothesis is accepted. Results indicate that p value is .369 which is  $> 0.01$ , 0.05 and 0.10 respectively so hypothesis is rejected. This means that there is no significant impact of age of bank on PER of Islamic banks. This is finding of this research that age of bank has no impact on PER Islamic. Results also designate that p is .926 which is  $> 0.01$ , 0.05 and 0.10, so the hypothesis is rejected. This means that there is no significant impact of age of bank on PER of conventional banks and this is the findings of this research that age of bank has no impact on PER conventional.

***GDP and its effect on ROA, ROE and PER of Islamic and traditional banks***

Estimated results indicate that one unit change in GDP growth brings 32.3% change negatively on ROA Islamic, result indicates that p value is .014 which is  $< 0.05$  and hypothesis are accepted. One unit change in GDP growth can bring 6.7% change positively on ROA conventional, results also indicate that p value is 0.179 which is  $> 0.05$ , so the hypothesis is rejected this means that there is no substantial impact of GDP growth on ROA conventional. Assessed results indicate that one unit change in GDP growth brings 2.1% change negatively on ROE Islamic. The result indicates that p value is .030 which is  $< 0.05$  and hypothesis is accepted. One unit change in GDP growth can result in 47.9% change positively on ROE conventional. Results indicate that p value is 0.85  $< 0.10$  so hypothesis is accept. Estimated results indicate that value of p is .712 which is  $> 0.01$ , 0.05 and 0.10 so hypothesis is not accepted. This means there is no substantial impact of GDP growth on bank PER Islamic and this is the findings of this research that GDP growth has no impact on PER Islamic. Results show that p is .856 which is  $> 0.01$ , 0.05 and 0.10 so the hypothesis is rejected this means that there is no significant impact of GDP growth bank on PER conventional and this is our conclusion of this research that GDP growth has no effect on PER conventional.

***Inflation and its effect on ROA, ROE and PER of Islamic and traditional banks***

Estimated results indicate that one unit change in inflation can outcome in 8.1% change positively on ROA Islamic, the result also indicates that p value .005 which is  $< 0.05$  so the hypothesis is accepted. One unit change in inflation brings 2.2% change negatively on ROA conventional, result indicates that p value is .011 which is  $< 0.05$  and hypothesis are not accepted.

Estimated results indicate that one unit change in inflation can result in 80.5% change positively on ROE of Islamic banks, results also indicate that p value is .001 which is  $< 0.05$  so, the hypothesis is accepted. One unit change in inflation brings 67.1% change negatively on ROE Islamic; result indicates that value of p is .032 which is  $< 0.05$  so the hypothesis is rejected. Results indicate that p is .201 which is  $> 0.01$ , 0.05 and 0.10 so hypothesis is rejected. This means that there is no significant impact of inflation bank on PER Islamic. This is finding of this research that inflation has no effect on PER Islamic. Results show that p value is .812 which is  $> 0.01$ , 0.05 and 0.10 so the hypothesis is rejected and there is no substantial

impact of inflation bank on PER conventional. This is the finding of this research that inflation has no impact on PER of traditional banks.

### ***Discussion***

This study examined the independent variables bank size, the age of bank, and inflation has a significant impact on ROA (Islamic and Traditional) and ROE (Islamic and Conventional) but GDP growth had no substantial effect on ROA (Conventional). Bank size, the age of bank, inflation and GDP Growth has no significant impact on PER (Islamic and Conventional). The One limitation of price earnings ratio is related to its formula there are two components of this formula one is the market value of share and other is earning per share. The market value of share can be accurately known from many trustworthy sources but as the earnings are known only to the company so they can easily change them for their own benefit and thus the price over earnings ratio is mostly misrepresentative. It is observed that sometimes high and low P/E ratios do not depict that company is the over value or under value respectively. They, in fact, appear low or high because of some other reasons. A low P/E ratio appears because of the market perception that the particular is going to face some financial trouble in future and high P/E appear because of the companies' high expectation about their growth in future. P/E tends to be lower in the times of high inflation so during that bear phase investor do have a clear picture of stocks. Manipulation in accounts can distort EPS and P/E as well. Past earnings are considered in Trailing P/E so such way of calculation won't provide future earnings of any company. So, we can say that P/E ratios cannot be trusted completely for identifying the over and under value condition of the company.

### **Conclusion and Policy Recommendations**

In this study, we investigate the factors affecting the financial performance of banks a comparison is made between Islamic and Conventional banks. Where profitability is measured through the Dependent variables those are ROA, ROE and PER and the independent variables like Bank size, Age of Bank, GDP growth and Inflation. First variable, bank size has a negative impact on ROA and ROE of Islamic banks and positive effect on the ROA and ROE of traditional banks the bigger size of Islamic banks is not an emblem of profitability. Secondly, a negative effect on ROA of Islamic banks and positive effect on ROA of traditional banks. The third is GDP growth, there is the negative effect of GDP Growth on ROA and ROE of Islamic banks and has positive but not substantial impact on ROA and ROE for Conventional banks. Fourth assessed results of Inflation shows that the inflation has a positive effect on ROA of Islamic banks and has negative on ROA of traditional banks. Financial Ratios like ROA, ROE and PER are dependent on the accounting figures and those are subject to deficiencies and approximation. Miscellany where similar companies may employ different methods of accounting and the results would be different if one company using FIFO and another is using LIFO. Keeping these all in minds, we suggest that if accounting body like The International Accounting Standards Board (IASB) develops the same standards for companies. And secondly, Securities and Exchange Commissions (SECP) can play an active and stringent role for monitoring of companies so that the companies present real data to their investors

The study is confined with short duration of the period; long period may give some changed results and due to time limitation the study is based only on a comparison of four Islamic and conventional banks in Pakistan. Moreover, the comparison is restricted to a period of five years long period may bring sensible change in results.

For future research, it is suggested to conduct the same study by extending the range of years. Similarly, the study can be repeated by increasing number of banks. This will give a more

deep understanding of role various factors play in influencing bank's profitability. Moreover, analyze the impact of other internal and external factors like credit risk, loan, market structure behavior etc. on ROA, ROE, and PER of banks. A comparison of different Islamic countries can also be made regarding profitability determinants of their Islamic and conventional banks.

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