

## Islamic bank's performance: a comparative study between Qatar, Bahrain, and Indonesia

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### Abstract

This study aims to evaluate and compare the performance of Islamic Banks in two different countries complying two different accounting standards, namely Qatar International Islamic Bank (QIIB), Bahrain Islamic Bank (BIB) and Bank Muamalat Indonesia. It used quantitative method with secondary data from the annual report of QIIB, BIB, and BMI. It sheds light on the financial performance of QIIB, BIB, and BMI as well as the difference among them. Additionally, it provides a picture for the Islamic Finance industry regarding the performance of these two banks and what the implication of adopting different accounting standard on this case. This study also helps to raise the awareness of society about the existence of Islamic banks and how well they have performed. As far as we are concerned, there is only small number of research on finding the significance of accounting standard adoption toward performance of Islamic banks, although the urgency is increasingly growing for a better convergence and significant development of Islamic banks. This work is an attempt to fill in this gap.

Key words: Performance, QIIB, BIB, BMI, Islamic Bank

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### Abstrak

Penelitian ini bertujuan untuk mengevaluasi dan membandingkan kinerja Bank Islam di dua negara berbeda yang memenuhi dua standar akuntansi yang berbeda, yaitu Qatar International Islamic Bank (QIIB), Bahrain Islamic Bank (BIB) dan Bank Muamalat Indonesia. Ini menggunakan metode kuantitatif dengan data sekunder dari laporan tahunan QIIB, BIB, dan BMI. Ini menyoroti kinerja keuangan QIIB, BIB, dan BMI serta perbedaan di antara mereka. Selain itu, memberikan gambaran bagi industri Keuangan Islam mengenai kinerja kedua bank ini dan apa implikasi dari penerapan standar akuntansi yang berbeda pada kasus ini. Studi ini juga membantu meningkatkan kesadaran masyarakat tentang keberadaan bank syariah dan seberapa baik kinerjanya. Sejauh yang kami ketahui, hanya ada sedikit penelitian tentang menemukan pentingnya adopsi standar akuntansi terhadap kinerja bank syariah, meskipun urgensi semakin tumbuh untuk konvergensi yang lebih baik dan pengembangan signifikan bank syariah. Karya ini merupakan upaya untuk mengisi celah ini.

Kata kunci: Kinerja, QIIB, BIB, BMI, Bank Islam

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### Introduction

The growth of Islamic finance industry is getting better in the world; it brings about business opportunity for various industries, particularly in the terms of Sharia-compliant banking and capital market sector. In 2015, global Islamic financial industry consisted of Sharia-compliant banking accounting for US\$ 1496.5 million or 80 percent of total global Islamic financial asset, and sukuk (sharia-compliant bond) for US\$ 290.6 million or 15.45 percent of total global Islamic

financial asset. Over the years, Islamic banking contributes the largest chunk of the global Islamic finance industry. In 2023, the world Sharia-compliant financial industry will predictably have assets up to US\$ 8.6 trillion. Even Indonesia is predicted to lead the world sharia-compliant financial industry in 2023 with total asset of US\$ 1.597 trillion.

For every organization including Islamic Bank, performance measurement systems are necessary tools used in the strategic process to evaluate the accomplishment of its vision and mission over a period of time. With the increased level of globalization, strong competition, and technology development, many organizations have started to use a blend of financial and non-financial measures for their performance (Kaplan & Norton, 1996; Raphael & Man, 2013). Kaplan and Norton (1992, 1996) pointed out that the financial measures of performance are not enough to capture a full picture of a company's performance. Stakeholders who rely only on financial performance measures usually end up with an incomplete view of what happened inside the company and then failed to predict what will happen in the future. On the other hand, the use of balanced performance measures that mix financial and non-financial measures can serve as a focal point of the organization's efforts defining and communicating its priorities to different groups of stakeholders (e.g., managers, employees, investors, customers, and the public).

Traditional approach of financial performance analysis includes financial ratios (Eljelly and Elobeed, 2013) and the modern approach, includes the CAMEL rating system (Alani, Yacoob, Hamdan, 2013). These measures help to evaluate the financial soundness and safety of entities within a particular industry. Olson and Zoubi, (2008) classify the financial ratios into five groups, i.e. profitability, efficiency, asset quality, liquidity and risk and find that these ratios provide valuable insight into the financial health of an organization. On the other hand, the CAMEL ratings system examines capital adequacy, asset quality, management, earnings, and liquidity and is widely used by supervisory bodies around the world to rate financial soundness of banking institutions. The CAMEL ratings allow identification of banks that may need additional capital or alternative arrangements to continue their operations. Besides regulatory bodies, many researchers have also opted to use the CAMEL ratings to evaluate and rank the performance of banks; both conventional and Islamic (for example Khouaja and Lotfi Boumediene, 2014; Jaffar and Manarvi, 2011; AlGindi et al. 2009).

This essay will critically analyse and compare the performance of three Islamic Banks which comply different accounting standards namely Bahrain Islamic Bank (AAOIFI standard), Qatar International Islamic Bank (IFRS), and Bank Muamalat Indonesia from 2013 to 2015.

## **Literature Review**

International Association of Islamic Banks (IAIB) defined the Islamic banking as “the Islamic Bank basically implements a new banking concept in that it adheres strictly to the rules of Islamic Shariah in the fields of finance and other dealings. Therefore, the point is obviously clear that Islamic banking differentiate from conventional banking in terms and conditions of its mission and objectives and duties toward society. The Islamic bank takes all these duties and responsibilities greater than conventional banks (Hassan & Adnan, 1998).

Bashir (2000) examined the performance of Islamic Banks in the Middle-Eastern region between 1993 and 1998. To measure profitability, he used Non-Interest Margin (NIM), Before Tax Profit (BTP), Return on Assets (ROA), and Return on Equity (ROE). The results confirm previous findings and show that Islamic Banks' profitability is positively related to equity and loans. The results also indicate that favorable macroeconomic conditions positively impact profitability. According to, Hassoune (2002) examined the Islamic bank profitability in an interest rate cycle. This paper states that Islamic banks operate on a profit and loss sharing basis compared to conventional bank's operations which are based on interest. Hassoune also

compares ROE and ROA Volatility for both Islamic and conventional banks in three GCC region, Kuwait, Saudi Arabia, and Qatar. He states that since Islamic banking is based on profit and loss sharing, managements have to generate sufficient returns for investors given that they are not willing accept no returns (Hassoune, 2002).

According to Sanullah Ansari and Atiqa Rehman (2010) the performance of first Islamic bank in Pakistan i.e. Meezan bank was compared with a group of 5 conventional banks. The study evaluated the performance in terms of or Profitability, liquidity, risk, and efficiency for the period of 2003-2007. Twelve financial ratios such as Return on Asset (ROA), Return on Equity (ROE), Loan to Deposit ratio (LDR), Loan to Assets ratio (LAR), Debt to Equity ratio (DER), Asset Utilization (AU), and Income to Expense ratio (IER) were used as variables to assess banking performances. T-test and F-test were used to measure the significance difference of these Performances. The study found that MBL is less profitable, more solvent (less risky), and also less efficient comparing to the average of the 5 Conventional banks. However, there was no significant difference in liquidity between the two sets of bank (Moin, 2008).

Islamic bank business development framework is not working efficiently as compared to conventional banks (Farrooq, 2007). In addition to the studies that had been done, Mahmood (2005), by using banks in Pakistan as a case study, compared the financial performance of Islamic banking against conventional banking. He found that, almost in all ratios, Islamic banks were superior to conventional banks during the four year period, from 2000 to 2004. Similar studies in other Middle East countries were also conducted, as evident in the research of Kader, et al. (2007), where comparative financial performance of Islamic banks and conventional banks in the UAE was also examined.

## **Research Method**

By its explanation level, this research belongs to a comparative–associative (causal) study. A comparative study is a research form or method conducted to compare a variable (Supriyanto, 2009: 117); this current study compares efficiency value of Sharia-compliant public banks in Qatar and Bahrain. Associative (causal) study is the one conducted to find out the effect or the relationship between one variable and another (Supriyanto, 2009:118), in this case to find out the factors affecting the efficiency value of data processed using DEA. Hence, it can be said that this research, by its explanation level, is a combined comparative and associative causal study (Supriyanto, 2009:118).

This study employed a quantitative data analysis by processing data of financial and non-financial performance of these two banks. Quantitative data is data in numerical form. In line with its form, quantitative data can be processed or analysed using statistic calculation technique (Siregar, 2013:23). Data source employed in this research was secondary data, the one obtained in the finished form, collected and processed by other parties, usually in publication and documented form (Suryani, 2015:171). Data obtained derived Islamic bank's financial performance in 2013–2015 published by the official website of each Islamic bank being the sample of this research.

The sampling technique method employed in this research was non-probability sampling, the one not giving equal opportunity to every element or member of population to be selected as the sample. From various non-probability sampling techniques, the author implemented the purposive sampling technique, the technique of selecting the sample based on certain criteria corresponding to the research objective (Sugiyono, 2007:66-67). The criteria of sampling in this research is the best Sharia-compliant public bank operated in two different countries adopting two different accounting standards which present financial statements during observation period of 2013–2015 available in the official website of corresponding Sharia-compliant public bank.

## **Result and discussion**

### **Financial Performance**

#### a. CAMEL Ratio

CAMEL ratio which involves capital adequacy, asset quality, management quality, earnings, and liquidity is widely used by supervisory bodies around the world to rate financial soundness of banking institutions (Gasbarro, 2002). It provides valuable insight into the financial health of an organization and also allows identification of banks that may need additional capital or alternative arrangements to continue their operations (Merchant, 2012). The data (see Appendix 1) is obtained from various reliable sources such as Bank's Annual Report, Orbis Bank Focus, and Eikon Thomson Reuters.

#### i. Capital Adequacy

As regulated by Basel II, in order to calculate their capital adequacy ratio, banks are required to calculate their Risk Weighted Assets (RWA) in respect of Credit, Market and Operational Risks. Then, RWA will be used to calculate total capital ratio (Total Capital / Total RWA) which could reflect Bank's capital adequacy. Capital adequacy is developed to ensure that banks can withstand with a reasonable level of operational losses which might occur in the future (Ferrouhi, 2014). During 2013 and 2014, Qatar International Islamic Bank and Bahrain Islamic Bank fulfilled the minimum capital ratio requirement of 8% as regulated by Basel II which also adopted by Central Bank of Qatar and Bahrain. Then started in 2015, as Basel III was adopted by both Central Banks, the minimum capital ratio requirement turns to be 10% which both Banks fulfilled it as well. On average, during the three years, Bank Muamalat Indonesia had the least CAR among other banks, around 13%, which is still above the minimum capital ratio requirement from Basel II and Basel III.

#### ii. Asset Quality

One way to measure asset quality is by calculating Loan Loss Provision to Net Interest Revenue (Sarker, 2006). High asset quality ratio is indicative of lower asset quality. Figure 2 (Appendix 1) depicts that BIB had a slight upward trend in 2014 before fell down quite drastically in 2015. On the other hand, QIIB has an exactly opposite trend to BIB. Despite the fluctuations experienced by both Banks, during these 3 years, BIB always had much greater asset quality ratio than QIIB, while Bank Muamalat Indonesia on average had the lowest asset quality ratio among the other two Islamic banks.

#### iii. Management Capability

Cost to Income ratio utilized to measure management capability will shed light on the superiority of the management (Ahsan, 2016). Although QIIB never experienced decrease from 2013 to 2015, it had always been lower than BIB (see Figure 3, Appendix 1). However both Banks (QIIB and BIB) never reached the average ratio of Islamic Banks' worldwide, while Bank Muamalat Indonesia was constantly getting higher ratio than the worldwide benchmark during the three years.

#### iv. Earnings Ability

There are several measurements that can illustrate the bank's earnings ability, but in this study we use Return on Average Asset (ROAA). As Figure 4 (Appendix 2) shows, NIM of both Banks experienced an upward trend although never touched the rate of average Islamic Banks' worldwide. On the opposite, ROOA and ROOE of both banks always lie above the average worldwide rate, except for ROOA and ROOE of BIB in 2013.

Meanwhile for Bank Muamalat Indonesia, on average during 2013-2015, Bank Muamalat Indonesia ranks in between QIIB and BIB.

v. Liquidity

To assess the liquidity of the banks, we will calculate it by dividing the net loan to total assets (NLTA). It will reflect how much assets that have been engaged in loans. In addition to that, it aids Banks in observing the risk of unforeseen circumstances which potentially lead to insolvency and bankruptcy (Reddy & Prasad, 2011). We expect this ratio to be as low as possible. However, unexpectedly, both Banks are engaged highly in lending with the ratio above 50% which also higher than the average Islamic Banks worldwide (Figure 5, Appendix 1). Moreover in Bank Muamalat Indonesia, it shows the highest ratio among the other two Islamic Banks as well as higher than the worldwide benchmark.

b. Earnings Quality

As what depicts in Picture 1 (Appendix 2), BIB obtains high earnings quality score of 68 which is higher than the industry median and model benchmark. On the other hand, QIIB obtains low score of 17 which lies far below the industry median and model benchmark (Picture 2, Appendix 2).

c. Accounting Policy and Standard

QIIB, BIB, and BMI declared that they fully comply with AAOIFI standards, however for matters which are not regulated by AAOIFI, they use the relevant International Financial Reporting Standards (IFRS). As a matter of fact, if we take a look at the financial report, we may conclude that Bahrain comply with AAOIFI better than QIIB and BMI. Nonetheless, in 2014 Annual Report, there was a restatement on their previous year financial statement due to the change on measurement basis of the investment in real estate from fair value to historical cost basis less accumulated depreciation and any impairment losses according to FAS 26 (see Notes to The Consolidated Financial Statements 2014 point 1 (d)). As the change is not considered to have a material impact on financial statement, both Banks always acquire unqualified opinion from the auditor every year.

## Conclusion

Based on discussion and results of data analysis described in the previous chapter, it can be concluded that Qatar International Islamic Bank has outperformed Bahrain Islamic Bank and Bank Muamalat Indonesia. It shows that the application of IFRS is still relevant to Islamic banking operation since there are several similarities between IFRS and AAOIFI such as the measurement of assets using present value (IFRS term) or current value (AAOIFI term). Moreover, in this study we use the mainstream approach to measure the financial performance which is by CAMEL ratio. This approach is basically built by the underlying assumption and objective of IFRS (profit-oriented) which might differ with that of AAOIFI (profit and social oriented). Further research is suggested to have another indicator of financial performance for Islamic banks and to cover more Islamic banks worldwide with the data from recent years.

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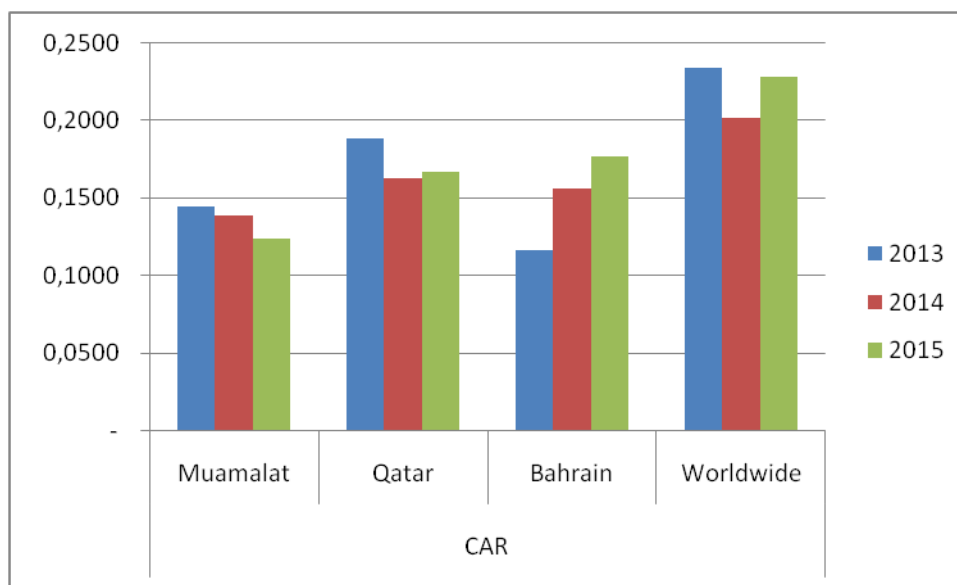
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## Appendix 1

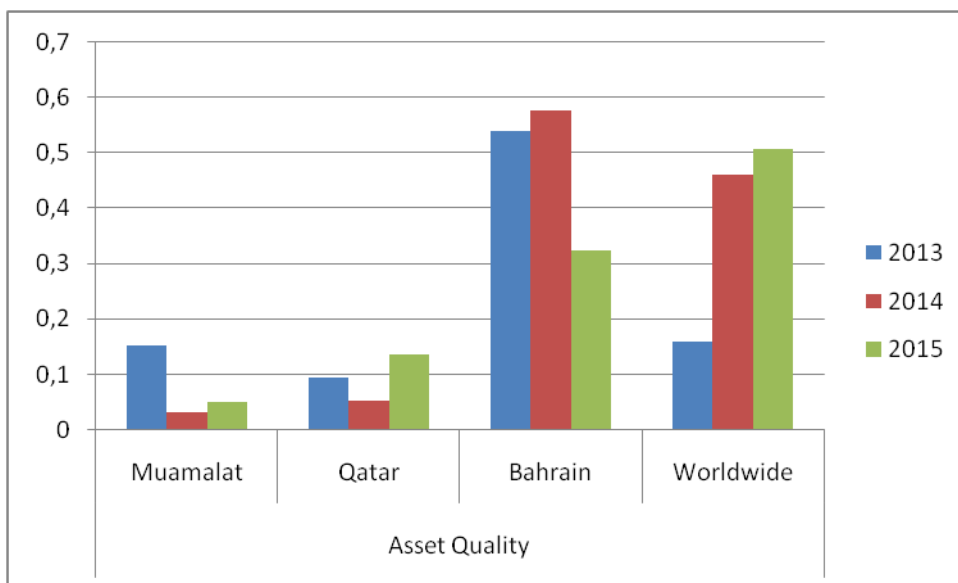
**Table 1.** (CAMEL Ratio)

Ratio	Islamic Bank Worldwide (Average)				Qatar International Islamic Bank				Bahrain Islamic Bank				Bank Muamalat Indonesia			
	2015	2014	2013	Avg	2015	2014	2013	Avg	2015	2014	2013	Avg	2015	2014	2013	Avg
<b>Capital Adequacy</b>																
Total Capital Ratio	22.83	20.2	23.45	22.16	16.71	16.27	18.86	17.28	17.73	15.61	11.61	14.98	12.36	13.91	14.43	13.57
<b>Asset Quality</b>																
Loan Loss Prov/Net Int Rev	50.79	46.18	16.08	37.68	13.67	5.39	9.55	9.54	32.37	57.77	54.12	48.09	5.11	3.32	15.30	7.91
<b>Management Capability</b>																
Cost to Income Ratio	71.78	73.81	76.17	73.92	31.61	29.72	26.23	29.19	51.21	48.37	55.23	51.60	97.41	97.38	93.78	96.19
<b>Earnings Ability</b>																
Net Interest Margin	6.06	5.46	4.37	5.2967	2.38	2.13	2.41	2.31	3.55	2.92	3.18	3.22	4.09	3.4	4.66	4.05
Return on Avg Assets	1.03	0.69	1.31	1.01	1.99	2.28	2.40	2.22	1.29	1.23	0.56	1.03	0.2	0.17	0.27	0.21
Return on Avg Equity	8.29	7.71	8.3	8.1	14.39	15.72	14.75	14.95	12.64	13.99	6.64	11.09	2.78	2.2	3.87	2.95
<b>Liquidity</b>																
Net Loans/ Total Assets	51.43	49.81	49.01	50.08	61.61	56.88	55.88	58.12	64.02	61.52	51.30	58.95	71.24	69.04	77.78	72.69

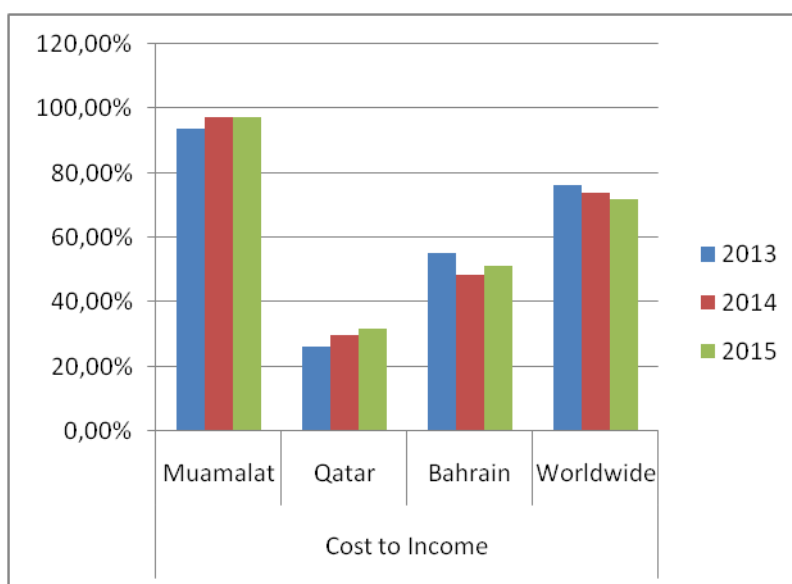
Source: Annual Report, Orbis Bank Focus, and Eikon



**Figure 1.** (Capital Adequacy Ratio)  
Source: Annual Report & Orbis Bank Focus

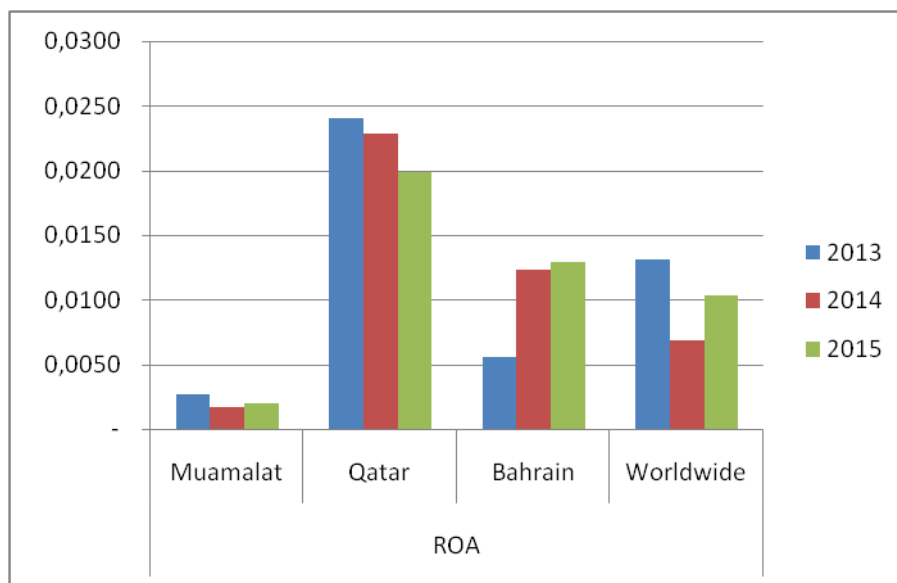


**Figure 2.** (Loan Loss Provision/Net Int Revenue)  
Source: Annual Report & Orbis Bank Focus

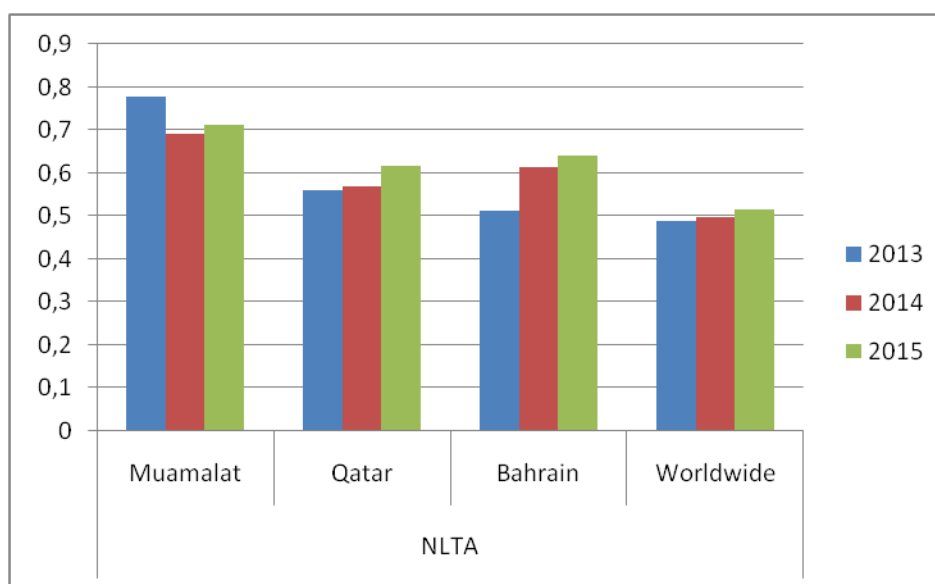


**Figure 3.** (Cost to Income Ratio)  
Source: Annual Report & Orbis Bank Focus





**Figure 4.** (Return on Average Asset)  
Source: Annual Report & Orbis Bank Focus

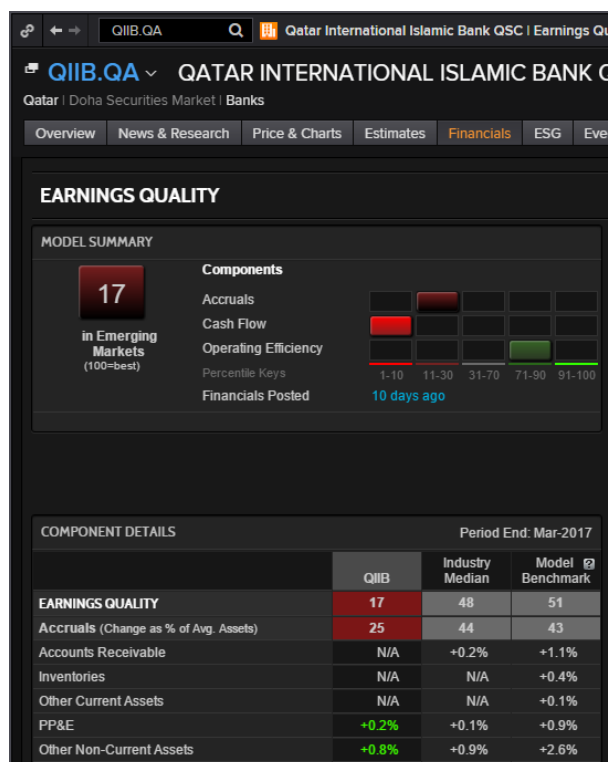


**Figure 5.** (Net Loans/ Deposit & Short Term Funding)  
Source: Annual Report & Orbis Bank Focus

## Appendix 2



Picture 1. (BIB Earnings Quality)  
Source: Eikon Thomson Reuters



Picture 2 (QIIB Earnings Quality)  
Source: Eikon Thomson Reuters