"A Comparative study of Islamic banking services and Conventional banking services using CAMELS Analysis in Indonesia"

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Abstract: Islamic banking seems to be a new concept in the Conventional banking world of India. Despite its impressive growth in other parts of the world, such as the Middle East, Southeast Asia and Europe. Islamic banking is based on the dual principle of Islamic law (sharia) and Islamic economics, which promotes profit sharing but prohibits the charging and payment of interest. Islamic banking is also known as interest-free banking. Currently, Islamic banking services are present in more than 75 countries worldwide. D. Shubharao, the former governor of the RBI, proposed the introduction of Islamic banking in India and wrote to the government to amend the law to make it easier. I hope the new RBI governor will consider controlling liquidity and inflation. The purpose of this article is to see the Islamic banking world and the Conventional banking scenario, the difference between Islamic banking and Conventional banking, and the CAMELS analysis of different Indonesian banks to identify the financial performance between the two banking systems.

Keywords: Islamic Banking, Conventional banking, Shariah's law governance, CAMELS analysis.

I. INTRODUCTION: AN OVERVIEW

Banking is a financial institution that has a strategic role and function in the economic life of a country. Banking institutions are intermediaries between parties who have excess funds (surplus of funds) and those who lack and need funds (lack of funds).

Indonesia started Islamic banking industry in 1992, almost a decade behind Malaysia through the establishment of Bank Muamalat Indonesia (BMI). The growth has not been too bad since then and in 2015 the Islamic banking industry of Indonesia comprised of 12 general sharia banks, 22 shariah business units of conventional banks and 161 sharia people's credit banks (rural Islamic banks) with significance growth in capital. Indonesia as a giant with over 270 million people and over 90% are Muslims.

What is Islamic Banking?

Islamic banking, also referred to as Islamic finance or Shariah-compliant finance, refers to finance or banking activities that adhere to Shariah (Islamic law). Two fundamental principles of Islamic banking are the sharing of profit and loss, and the prohibition of the collection and payment of interest by lenders and investors.

The Mit-Ghamr Savings Bank, established in 1963 in Egypt, is commonly referred to as the first example of Islamic banking in the modern world. When Mit-Ghamr loaned money to businesses, it did so on a profit-sharing model. The Mit-Ghamr project was closed in 1967 due to political factors but during its year of operations the bank exercised a great deal of caution, only approved about 40% of its business loan applications. However, in economically good times, the bank's default ratio was said to be zero.

What is Conventional banking?

The term commercial bank refers to a financial institution that accepts deposits, offers checking services, makes various loans, and offers basic financial products such as certificates of deposit (CDs) and savings accounts to individuals and small businesses. A commercial bank is where most people do their banking. Commercial banks earn money by giving interest and repaying loans such as mortgages, car loans, corporate loans, and personal loans. Customer institutions provide banks with the capital to make these loans.

The oldest bank in the world is either Banca Monte dei Paschi di Siena or Berenberg Bank. Banca Monte dei Paschi di Siena was founded in its present form in 1624, but traces its history to a mountain of piety founded in 1472. The Berenberg Company was founded in 1590 and has since operated continuously with the same family as owners or large cows. -owners. Banca Monte dei Paschi di Siena is today a large Italian retail bank, while Berenberg Bank is mainly involved in investment banking and private banking for wealthy customers; in any case, Berenberg Bank is the oldest commercial or investment bank in the world. The oldest central bank in the world is the Sveriges Riksbank, which was founded in 1668.

How Islamic Banks differs from Conventional banks?

Particulars	Islamic banks	Conventional banks
Functions and operating modes	Fully based on manmade principles.	Must be based on Shariah principles.
Investor assurance	Predetermined rate of interest.	Investor as capital provider and management as entrepreneur share the risk, hence profit rates are only indicators.
Aims	Maximizing profit without any restrictions.	Maximizing profit subject to Shariah restrictions.
Rules of accounts	Governed by product terms and conditions.	Governed by undertaking contracts, determining the terms and conditions.
Fundamental function	Lending and borrowing with compounding interest.	Participation in partnership business. Important to understand the customer's business.
Relationship	Creditors and debtors.	Could be: Partners, Investors and traders, Buyers and sellers.
Deposits rate and guarantee	Fixed interest rates and deposits are fully guaranteed.	Non-guaranteed return may be given as hibah (gift) and rate of return must be indicative rate. Only wadiah (safekeeping) deposit accounts are guaranteed.
Loan and financing rate	Usually based on floating rates, BLR+/- rates.	Fixed profit markup (BaiBithaminAjil, Murabaha) Floating profit rates (Musharakah, Ijarah)

II. OBJECTIVES OF THE STUDY

- ➢ To compare the performance of Islamic banks and Conventional banks in terms of CAMELS rating model.
- ➢ To know about Islamic banking system and Conventional banking system.
- ➢ To explore the financial terms and concepts in Islamic banking and Conventional banking.

III. LITERATURE REVIEW

↳ The Old Testament in Deuteronomy teaches interest free loans to the poor **(Stein, 1956).**

↳ The Islam as a comprehensive way of life has its own broad and flexible economic principles **(Siddiqi, 1970)**.

↳ The Judeo - Christian thought views loans with interest as doing little for the economic brotherhood **(Malooney, 1971).**

↳ Mohsin has presented a detailed and elaborate framework of Islamic banking in a modern setting **(Mohsin, 1982).**

↳ Chapra envisaged Islamic banks whose nature, outlook and operations could be distinctly different from those of conventional banks **(Chapra, 1985).**

↳ Here are also some case studies of Islamic banks operating in Bangladesh **(Huq, 1986).**

↳ Islamic banking is based upon the principle that the use of Riba (Interest) is prohibited which is based upon Sharia'h ruling. Since Muslims cannot receive or pay interest, they are unable to conduct business with conventional banks **(Gerrad and Cunningham, 1997).**

↳ **(Iqbal M., 2001)** Islamic banking and conventional banking in Nineties.

↳ **(Bakshi, Rajni, 2002)** Interest free Lending.

↳ **(Ust Hj Zaharuddin Hj Abd Rahman, 2007)** Difference between Islamic banking and Conventional banking.

↳ In 2013, Mohammad Faisal had researched on Challenges and opportunities for Islamic banking and in Apr 2013, Jeet Singh had covered Growth and Potential of Islamic banks **(Mhd.Faisal & Jeet Singh, 2013)**.

IV. RESEARCH METHODOLOGY

The study is mainly based upon the collection of secondary data. The secondary data was collected from various sources of publications such as journals, research articles, magazines, internet portals, newspapers and unpublished thesis.

To gain practical data regarding Islamic banking and conventional banking we browse for financial statements & annual reports of various banks which adopts Islamic banking services and conventional banking services.

1) **Research Design**
   → In this research, we have applied qualitative research design because our main aim is to study the difference of Islamic banking and conventional banking & explore the concepts regarding Islamic banking scenario.

2) **Sources of data**
   → The exposure of financial statements which will shows the practical data of Islamic banking and conventional banking collected from official bank sites such as bankofsaudiarbia.com , islamicbankinst.com , RBI , etc.

3) **Data Collection Method**
   → For this research we used only secondary data method for data collection.

4) **Research Type**
   → We have been used Exploratory and Descriptive research.

5) **Data Collection Instrument**
   → In Data collection instrument we refer journal, articles, some case lets, research papers, blogs, etc. to collect the data.

V. ANALYSIS OF DATA

We conduct this study under the umbrella of the digital paradigm, which plays an important role in assessing the reliability of financial institutions through the CAMELS assessment model. The system was approved by the National Credit Union Administration (NCUA) in October 1987. The Bank of North America has introduced the CAMELS methodology to measure the financial and management soundness of commercial credit institutions. To examine the CAMELS system, it is necessary to obtain information from a variety of sources, including financial statements, funding sources, macroeconomic information, budgets, cash flow projections, and staffing / operations. This model assesses the general condition, strengths and weaknesses of the bank. CAMELS stands for Asset Sufficiency, Asset Quality, Management, Revenue, Liquidity, and Market Risk Sensitivity. The CAMELS rating system is rated on a scale of one to five in ascending order.

The combined evaluation of the CAMELS model is classified from 1 to 5 as shown in the Table below.

1	Strong
2	Satisfactory
3	Fair
4	Marginal
5	Unsatisfactory

CAMELS rating applied to sample banks (financial year ended December 2019)

Bank	Capital adequacy		Assets quality ratio		Management quality		Earnings efficiency				Liquidity				Sensitivity to market risk	
	CAR	Rating	AQR	Rating	MQR	Rating	EE1	Rating	EE2	Rating	L1	Rating	L2	Rating	Sens.	Rating
Muamalat Bank	14.54	1	2.45	2	285.88	5	0.45	5	6.68	5	66.50	3	18.77	1	17.57	1
Dubai Islamic Bank	12.34	1	2.63	2	-758.31	1	-0.20	5	-3.02	5	45.46	1	49.66	1	35.19	1
Hong Leong Islamic Bank	18.06	1	0.16	1	-162.14	1	-1.44	5	-10.45	5	70.52	4	13.78	1	20.32	1
Bank of Panin Shariah	9.75	2	0.57	1	286.58	5	0.55	5	9.23	4	76.75	4	18.96	1	11.79	1
Bank of Victoria Sharia	10.98	2	0.11	1	75.62	5	1.74	1	33.65	1	43.99	1	42.37	1	14.46	1
Alliance Islamic Bank	182.41	1	0.00	1	134.92	5	0.53	5	0.53	5	2582.05	5	81.20	5	6.17	1

VI. CONCLUSION

It is concluded that all of the banks are showing good progress in Indonesia banking sector, however, there is a big room available for growth of these banks. CAMELS rating reflect that Dubai Islamic Bank, Hong Leong Islamic Bank and Bank of Victoria Sharia are showing satisfactory position, while rest of the other banks are showing fair position. The result of the study shows that Islamic banks have been efficient in term of returns as compared to conventional banks of the same size. Islamic banks have been earning higher spreads and also share of distribution of profits for the depositors is far less. Islamic banks advances practices are better as compared to conventional banks. The reason might be that Islamic banks financing modes are based on assets and there are no consumption loans which gives an advantage to Islamic banks to have less non-performing assets.

VII. LIMITATIONS

- Since the topic is very peculiar, the secondary data was very difficult to gather.
- Still the awareness in Islamic banking is in infant stage.
- The time period of study is limited.

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