A Comparative Analysis of Profit Rates on Deposits in Islamic and Conventional Banks in Pakistan

Shar Zaman1* Atiq-ur-Rehman2* Farooq Ahmad3* Atiq Uz Zafar Khan4*

Abstract

This study used data from five Islamic banks (IBs) and four conventional banks (CBs) operating in Pakistan. Monthly data ranging from 2008 to May 2022 was collected through the websites of these banks. The study examined if there is a difference in the respective profit rates and interest rate offered by Islamic and conventional banks to their customers, respectively. The aim was to determine whether Islamic or conventional banks offer a higher return rate to their customers on deposits. It also aimed to analyze the relationship between inflation and profit rates on deposit, whether customers are in profit or loss in real terms. The analysis was carried out on saving account and one-year term deposit account of both types of banks, keeping in view the inflation rate in the economy. Moreover, t-test was used to check whether there was a significant difference in the monthly profit rates of Islamic and conventional banks. The study revealed that conventional banks offer higher returns to their customers on saving accounts, while Islamic banks offering higher returns to their customers on one-year term deposit accounts. The comparison of profit rates with inflation rate showed that both Islamic and conventional banks offer low returns on saving account to their customers. However, as far as on one-year term deposit account is concerned, IBs offer higher returns than the inflation rate, while CBs offer slightly lower returns than the inflation rate.

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Keywords: conventional banking, Islamic banking, inflation, interest rate, profit rate

1. Introduction

New techniques of business and marketing are rapidly evolving due to the expansion of financial services. The financial sector reformed and got rid of the physical existence of businessman and geographical location of the markets to detach the business. Banking sector has transformed the dynamics for growth and administration of the economy all across the globe. Before 1975, the financial sector functioned entirely on interest basis, which contradicted Islamic injunctions and was particularly displeasing for Muslims (Hanif et al., 2012).

In Pakistan, a Muslim majority country with 97% Muslim population, there has been a long debate among scholars about bank interest. The matter was also debated in the Federal Shariat Court in 1991 to determine whether or not bank interest constitutes Riba. The court, in its historical judgment, acknowledged that bank interest constitutes Riba and henceforth is prohibited in the Shariah. Afterwards, this decision was opposed in the Shariat appellate bench of the Supreme Court of Pakistan (SCP).

In 1999, Shariah appellate bench of SCP declared that bank interest is Riba, which is prohibited. However, instead of implementing the decision in its true spirit, the government of Pakistan managed to refer this case again to the Federal Shariat Court, where it is still pending. Based on the judgement of SCP given in 2002, Islamic banking was initiated in Pakistan. The first license to conduct Islamic banking was issued to Meezan Bank, which started Islamic banking with only 5 branches.

Islamic banking has gained considerable traction and popularity in Pakistan during the past 20 years. According to the Islamic Banking Bulletin Report 2021, 19.4% percent of total banking is
carried out under the principle of *Shariah* complaint Islamic banking⁵. Islamic banks (IBs) claim to exercise all their business functions without involving *Riba*. They use trade-based, leasing-based, and partnership-based modes and avoid loan-based activities. There are three main types of accounts used by IBs, namely current account, profit and loss account, and term deposit account.

However, it has been claimed that in practice, IBs follow a system which allows them to align their profit rate with the interest rate offered by conventional banks (CBs). IBs try to manipulate the depositor’s share in profit in a manner that their return on deposit remains closer to the interest rate of CBs. IBs accept deposit on *Mudaraba* basis. However, instead of sharing the actual returns, they write off some amount in Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) to balance the profit/loss situation in order to compete with CBs. When IBs earn more profit, they transfer a particular percentage of profit to PER and IRR accounts. Similarly, when loss occurs, they transfer some amount as gift (*hiba*) from these accounts to mitigate the risk of return. This is based on *Maslaha* (public interest), a secondary source of the *Shariah*.

Such amalgamation/alignment of the profits of IBs with interest rate creates doubt about the legality of Islamic banking and provides the challengers an opportunity to claim that there is no difference between Islamic and conventional banking, as it has been observed that there is no difference in the profitability and liquidity of Islamic and conventional banks (Samad, 2004).

In light of the above discussion, an effort is made in this study to measure the performance/impact of two different types of profit rates on two different types of deposit accounts (saving and one-year term deposit accounts) and to determine which type of bank offers a higher return rate to its customers.
depositors in different months. Furthermore, real return rate is also calculated keeping inflation rate in view.

There is no comprehensive comparative study available regarding profit distribution in Islamic and conventional banks in Pakistan. Past studies investigated profit and loss distribution separately in either Islamic or conventional banks, while some studies analyzed data on the basis of performance indicators including Return on Assets (ROA) and Return on Equity (ROE), such as Javaid et al. (2011), Anbar and Alper (2011), and Bader et al. (2008). The current study is an attempt to fill the research gap by comparing the profit rate (distributed by IBs) and interest rate (offered by CBs) with inflation rate and to check the long-run relationship among them.

The study is divided into the following chapters: Chapter 1 comprises the introduction, Chapter 2 discusses the literature review, Chapter 3 presents the methodology and data analysis, Chapter 4 showcases the results and discussion and finally, Chapter 5 concludes the current research.

2. Literature Review

Several studies have compared the profitability of IBs and CBs by using ROA and ROE. Although, these variables do not identify the amount of the profit distributed to investors. However, we didn’t find any study that compared the rates of return on investment of both types of banks. Both IBs and CBs provide different rates on different types/amounts of deposits. Our study compares the profit rates for comparable slabs of deposits.

The studies that explored the profitability of two types of banks and their mutual relationship are discussed below. A study was conducted in Bangladesh on 7 full-fledged Islamic banks using secondary data to examine the differences in return on deposits and to find out if there is any relationship between the profit rate on deposits and inflation rate. It was found that there is a
significant difference in the returns of IBs in Bangladesh. However, an insignificant relationship was determined between inflation and profit rate in case of Mudaraba saving deposits, while it was significant in case of Mudaraba term deposits and rate of inflation (Kabir & Chowdhury, 2014).

Many empirical studies concluded that banks with a larger asset size remain more profitable (Ray & Das, 2010). These results are supported by Haron and Azmi (2008), who suggested that larger deposits of IBs are significantly correlated with higher profits and lower interest rate. Similarly, a study conducted by (Hassoune, 2002) concluded that IBs are more profitable in gold countries than CBs.

There is a significant difference in the profitability of Islamic and conventional banks Usman and Kashif (2012) in Pakistan. The authors selected three Islamic and three conventional banks for the period 2007-2009. On the other hand, no significant difference was found in both banking systems in terms of their profitability and efficiency by Bader et al. (2008) using Data Envelopment Analysis (DEA). The sample size used in the said study comprised forty-three (43) Islamic and thirty-seven (37) conventional banks in 20 countries operating over the period 1990-2005. (Berger et al., 1993) recommended that to improve their profitability, the banks need to be more efficient. Similarly, Awan (2009) analyzed the performance of Islamic and conventional banks g data for the years 2006-08. They selected six (6) IBs and six (6) CBs of similar sizes. The banks were selected from KPMG survey. The study concluded that IBs fare better in terms of profitability than CBs.

Haron and Azmi (1996) suggested that IBs earn more than CBs in competitive market. They found that the profit and loss sharing principle in IBs is advantageous for both banks and depositors. The
above study was cross-sectional and pooled time series data was taken from the annual reports of the banks operating in different countries. External factors such as size, inflation, and interest rate were found to have a significant positive effect on the profitability of both Islamic and conventional banks.

Hanif et al. (2011) examined and compared the performance of IBs and CBs operating in Pakistan. The sample for the above study comprised twenty-two (22) CBs and five (5) IBs. External factors included behavior and customer perception about Islamic banking, while internal factors included liquidity risk, credit, and solvency. To determine the solvency, Bank-o-meter model was used. The study found that CBs dominate in profitability and liquidity, while IBs lead in solvency and credit risk. For CBs, the size of products and services is an encouraging factor, while Shariah compliance remains the motivating factor for IBs.

There is a negative relationship of inflation rate with both profit rate and interest rate in Islamic and conventional banking, respectively. An increase in inflation rate leads to reduced lending activities and market sector growth (Boyd et al., 2001). The GMM panel estimates prove the inverse of inflation rate. Inflation rate determines interest rate. According to Fisher’s theory (1930), a one percentage point increase in inflation rate increases the interest rate of CBs by 1% as well. This study was conducted in Turkey they also study nonlinearity from 2002 to 2011. They concluded that a one percentage point change in inflation rate leads to an increase in interest rate of more than 11% (Teker et al. 2012).
3. Methodology and Data

3.1 Sample Selection

The sample comprised five (5) IBs and four (4) CBs. The data used was secondary data, collected on a monthly basis for the period January 2008-May 2022. Profit rate and interest rate are monthly annualized rates. We transformed the data to monthly data by dividing it with 12 in order to make a series of data. CBs were selected based on their assets equal to the five (5) IBs through KPMG survey, which ranks the banks according to their market asset size. The main sources of data were the websites and the head offices of the selected IBs and CBs situated in Pakistan.

The list of five (5) Islamic Banks (IBs) is as follows:

- Meezan Bank Ltd.
- Dubai Islamic Bank
- Al Baraka Bank
- Bank Islami Pakistan
- Bank of Khyber

The list of four (4) Conventional Banks (CBs) is as follows:

- Askari Bank
- Bank of Khyber Conventional
- Soneri Bank Limited
- Summit Bank
3.2 Variables and Data Sources

For comparison, we used two types of accounts, namely saving account and one-year term deposit account of Islamic and conventional banks collected from their websites and inflation rate from the website of state bank of Pakistan. These are the following banks variables are used for Saving account (SA) and One-Year Term Deposit Account (TD), Islamic Banks selected variables are (Meezan IB, Khyber IB, Barakah IB, Islami IB, Dubai IB) and for Conventional Banks (Khyber CB, Askari CB, Soneri CB, Summit CB) and for inflation Inf MoM.

The number is annualized for example Meezan Bank profit rates is mentioned in 365 days.

Similarly, if a person invests Rs. 500000 in Meezan Bank saving account and the bank offers 3% profit rate, that particular person will be eligible for Rs. 1232.87 for the first 30 days (500000*3%*30/365 = Rs. 1232.87), as calculated by Mujaddidi (2017). We have transferred it in 30 days.

3.3 Statistical Tools Used

To measure the performance of profit rate, Savings Account and Term Deposit Account Equality test technique was used. One sample t-test was applied to check the statistical difference between the returns of Islamic and conventional banks. For all statistical calculations, computer aided E-View software was used.

4. Results and Discussion

The core objective of the current study is to measure and compare the profit rates offered by Islamic and conventional banks of Pakistan. Table 1 compares the average return rates of Islamic and conventional banks with inflation rate.
It can be seen the average return rate of Meezan bank in column 2 row 1 is 0.34% and in column 1 row 2 average return rate by SA Khyber CB is 0.44% and the difference on return rate of SA Khyber CB is 0.10% high, SA Askari CB is 0.10% high, SA Summit CB is 0.09% high rate than SA Meezan IB and the difference is statistically significant at 1% evident from t-statistics column 2 row 2 to 5 from the table. Whereas in row 4 column 1 average return rate of SA Soneri CB is 0.34 same as SA Meezan IB and the statistically insignificant evident from row 4 column 1 evident from t-statistics.

Overall, the results show that all CBs offer a higher return rate than SA Meezan IB, except SA Soneri CB that offers almost the same rate.

It can also be seen the average return rate of SA Khyber IB in column 3 row 1 is 0.36% and in column 3 average difference on return rate of SA Khyber CB is 0.08% high, SA Askari CB is
0.08% high, SA Summit CB is 0.07% high return rate and the difference is statistically significant at 1% evident from t-statistics column 3 from the table. Whereas in row 4 column 1 average return rate of SA Soneri CB is same as SA Khyber IB and the statistically insignificant row 4 column 1 evident from t-statistics.

Overall, the results show that SA Khyber IB offers a lower return rate on saving account as compared to all CBs, except SA Soneri CB.

Moreover, average return rate of Al Barakah IB column 4 row 1 is 0.35% and in column 1 average difference on return rate of SA Khyber CB is 0.09% high, SA Askari CB 0.09% high and SA Summit CB is 0.08 high rate of return rate than SA Barakah IB and the difference is statistically significant at 1% evident from t-statistics column 4 from the table. Similarly, in row 4 column 1 concluded that SA Barakah IB is offering 0.01% high return rate and the difference is statistically insignificant as evident from t-statistics row 4 column 4 from the table, which mean there is no major difference in return rate of both banks.

Overall, the results show that SA Al Barakah IB offers a lower return rate on saving account as compared to all CBs, except SA Soneri CB.

Besides that, average return rate of SA Islami IB kept in column 5 row 1 is 0.31% and in column 5 average difference on return rate of SA Khyber CB is 0.13% high, SA Askari CB 0.13% high, SA Soneri CB 0.03% high and SA Summit CB is 0.12% high rate of return than the SA Islami IB and the difference is statistically significant at 1% evident from t-statistics column 5 from the table.

Overall, the results show that four (4) pairs of CBs and SA Islami IB offer a lower return rate on saving account as compared to all other CBs.
Similarly, average return rate of SA Dubai IB kept in column 6 row 1 is 0.30% and in column 6 average difference on return rate of SA Khyber CB is 0.14% high, SA Askari CB 0.14% high, SA Soneri CB 0.04% high and SA Summit CB is 0.13% high rate of return than the SA Dubai IB and the difference is statistically significant at 1% evident from t-statistics column 5 from the table.

In column 1 row 6 shows the relationship of Islamic Banks with inflation rate, which means that inflation rate is 0.56%. which reflects that average inflation rate is very high in stated period and statistically significant at 1% level of significance.

Overall, the results show that SA Dubai IB offers a lower return rate on saving account as compared to CBs. Moreover, all IBs offer a lower return than the inflation rate to their customers.

**Table 2.** Average Return Rates of all IBs and CBs and Inflation Rate on Saving Account

<table>
<thead>
<tr>
<th>Variables (Mean)</th>
<th>Islamic Banks</th>
<th>Inf MoM</th>
<th>Conventional Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.33</td>
<td>0.56</td>
<td>0.41</td>
</tr>
</tbody>
</table>

Overall, the results show that all selected IBs offer 23% lower return rate than the inflation rate and 0.15% lower return rate as compared to all CBs on saving account.

The profit rate on saving account offered by IBs and interest rate offered by CBs are lower than the inflation rate. It indicates that the depositors are in loss in real terms with respect to the inflation rate. However, the comparison of IBs’ saving account return rates with CBs’ interest rate shows that interest rate is higher than return rates.

**Diagram 1.** Relationship between Average SA IBs with Average SA CBs
The graph shows the relationship between average return rate of all IBs with average return rate of all CBs. Monthly returns of all IBs were added and divided by the number of banks to get the average return of all IBs on saving account. Similarly, the average was calculated for all CBs. It was found that on average, CBs offer higher return over time as compared to IBs.

**Diagram 2.** Relationship between Average SA IBs with Inflation Rate

The above graph shows the relationship of average return rate of all IBs on saving account with inflation rate. The central bold line shows the average return of IBs, while the fluctuated line shows the inflation rate (MoM). It clearly indicates that on average, inflation rate is higher over the month
as compared to the profit rate offered by IBs on saving account. It implicates that in real term customers are in loss.

**Table 3.** Which Islamic Bank is Offering High Profit on Saving Account.

<table>
<thead>
<tr>
<th>Variables</th>
<th>SA Meezan IB (0.34)</th>
<th>SA Khyber IB (0.36)</th>
<th>SA Barakah IB (0.35)</th>
<th>SA Islami IB (0.31)</th>
<th>SA Dubai IB (0.30)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SA Meezan IB (0.34)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SA Khyber IB (0.36)</td>
<td>-2.04 (0.042) **</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SA Barakah IB (0.35)</td>
<td>-0.54 (0.588)</td>
<td>1.29 (0.197)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SA Islami IB (0.31)</td>
<td>3.79 (0.000) ***</td>
<td>5.40 (0.000) ***</td>
<td>3.75 (0.000) ***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SA Dubai IB (0.30)</td>
<td>4.31 (0.000) ***</td>
<td>5.84 (0.000) ***</td>
<td>4.31 (0.000) ***</td>
<td>0.74 (0.459)</td>
<td></td>
</tr>
</tbody>
</table>

***= Significant at 1%, **= Significant at 5% and *= Significant at 10%
P-value in parenthesis

Row 1 in the table lists various kinds of profit rates/return rates and their average values for the sample period. The row 2 and onward summarize the t-statistics testing the difference between the variables listed in corresponding row and column. Therefore, row 3 in column 2 indicate that t-statistics for the difference in the average for SA Meezan IB and SA Khyber IB is -2.04 with P-value 0.04. Therefore, the results indicate that the difference between average of SA Meezan IB and SA Khyber IB is statistically significant and SA Meezan IB offers 0.02% lower returns than the SA Khyber IB. In column 1 row 4 indicates the average returns on SA Barakah IB is 0.35% which is 0.01% higher than SA Meezan IB. However, T-value as indicated in row 4 column 2 shows that the results are statistically insignificant. The result shows that the difference between
both banks is insignificant which mean there is no major difference in return of both Islamic banks. But return rate of SA Barakah IB is 0.01% high than SA Meezan IB. Similarly, in row 5 and 6 for SA Islami IB and SA Dubai IB the T-value 3.70 and 0.29 and P-value is 0.00 indicates that the difference is statistically significant at 1% evident from the table. Which mean that SA Meezan IB is offering 0.03 and 0.04 percent high return rate.

Besides that, SA Khyber IB in column 3 shows the mean value is 0.36 whereas t-value in row 4 column 3 is 1.29 and P-value is 0.197 insignificant. Which mean that there is no major difference in return rate of SA Barakah IB and SA Khyber IB, but SA Khyber IB is offering 1 percent high return rate. Similarly, in same row column 5 and 6 shows the relationship of SA Islami IB and SA Dubai IB t-value is 5.4 and 5.8 and p-value shows the difference 0.05 and 0.06 percent low at 0.00 significant level. SA Khyber IB offering high return rate than both Islamic banks.

In column 4 and row 5 and 6 shows that average return rate kept by SA Barakah IB is 0.36, whereas SA Islamic IB and SA Dubai IB is 0.31 and 0.30 while t-value is 3.75 and 4.31 and p-value is 0.00 showing that both banks are offering low return rate and the difference is 0.06 and 0.07 percent low and is statistically insignificant at 1% level of significance.

In column 5 row 6 shows the t-value 0.74 and p-value is 0.45 against mean value of SA Islamic IB is 0.31 and SA Dubai IB is 0.30 shows insignificant which mean there is no major difference in both banks in term of return rates. But SA Islami IB is offering 0.01 percent high return rate.

Overall, the results show that SA Khyber IB offers a higher return rate on saving account and SA Dubai IB offers a lower rate of return among all five (5) IBs.
Table 4. Which kind of Bank offers High Return rate, Islamic or Conventional in Term Deposit

<table>
<thead>
<tr>
<th>Variables</th>
<th>TD Meezan IB (0.58)</th>
<th>TD Khyber IB (0.47)</th>
<th>TD Barakah IB (0.63)</th>
<th>TD Islami IB (0.64)</th>
<th>TD Dubai IB (0.58)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TD Khyber CB (0.51)</td>
<td>8.75 (0.000) ***</td>
<td>1.29 (0.196)</td>
<td>8.67 (0.000) ***</td>
<td>-8.38 (0.000) ***</td>
<td>4.85 (0.000) ***</td>
</tr>
<tr>
<td>TD Askari CB (0.43)</td>
<td>5.58 (0.000) ***</td>
<td>-1.75 (0.081) *</td>
<td>7.00 (0.000) ***</td>
<td>-9.52 (0.000) ***</td>
<td>3.24 (0.001) ***</td>
</tr>
<tr>
<td>TD Soneri CB (0.54)</td>
<td>1.72 (0.086) *</td>
<td>-3.14 (0.001) ***</td>
<td>3.92 (0.000) ***</td>
<td>-3.1 (0.002) ***</td>
<td>1.32 (0.188)</td>
</tr>
<tr>
<td>TD Summit CB (0.51)</td>
<td>3.02 (0.002) ***</td>
<td>-1.43 (0.153)</td>
<td>4.51 (0.000) ***</td>
<td>-7.06 (0.000) ***</td>
<td>2.07 (0.039) **</td>
</tr>
<tr>
<td>Inf MoM (0.56)</td>
<td>0.49 (0.621)</td>
<td>-0.86 (0.389)</td>
<td>0.51 (0.608)</td>
<td>1.22 (0.222)</td>
<td>0.51 (0.608)</td>
</tr>
</tbody>
</table>

***= Significant at 1%, **= Significant at 5% and *= Significant at 10%
P-value in parenthesis

The given table row 1 consist of mean value of 5 Islamic bank and column 1 consist of the mean value of the 4 conventional banks and inflation rate (Inf MoM).

It can be seen the average return rate of TD Meezan IB in column 2 is 0.58% and in row 2 column 1 average return rate of TD Khyber CB is 0.51%, which shows that TD Meezan IB is offering 0.07% high rate and the difference is statistically significant at 1% evident from t-statistics row 2 column 2 from the table.

In row 3 column 1 average return rate of TD Askari CB is 0.43%, which mean that TD Meezan IB is offering 0.15% high rate and the difference is statistically significant at 1% as evident from t-statistics row 3 column 2 from the table.
In row 4 column 1 average return rate of TD Soneri CB is 0.54%. which mean that TD Meezan IB is offering 0.04% high rate and the difference is statistically insignificant at 10% as evident from t-statistics row 4 column 2 from the table.

In row 5 column 1 average return rate of TD Summit CB is 0.51%. which mean that TD Meezan IB is offering 0.07% high rate and the difference is statistically significant 1% as evident from t-statistics row 5 column 2 from the table.

Overall, the results show that TD Meezan IB offers a higher return rate on one-year term deposit account as compared to all CBs.

It can be seen the average return rate of TD Khyber IB in column 3 is 0.47% and in row 2 column 1 average return rate of TD Khyber CB is 0.50%. which shows that TD Khyber IB is offering 0.03% low rate and the difference is statistically insignificant as evident from t-statistics row 2 column 3 from the table.

In row 3 column 1 average return rate of TD Askari CB is 0.43%, which mean that TD Khyber IB is offering 0.04% high rate and the difference is statistically significant at 10% as evident from t-statistics row 3 column 3 from the table.

In row 4 column 1 average return rate of TD Soneri CB is 0.54%. which mean that TD Khyber IB is offering 0.07% low as TD Soneri CB and the difference is statistically insignificant as evident from t-statistics row 4 column 3 from the table.

In row 5 column 1 average return rate of TD Summit CB is 0.51. which mean that TD Khyber IB is offering 0.04% low rate and the difference is statistically significant 1% as evident from t-statistics row 5 column 3 from the table.
Overall, the results show that TD Khyber IB offers a lower return rate on one-year term deposit account as compared to all CBs except TD Askari CB.

It can be seen the average return rate of TD Barakah IB column 4 is 0.63% and in row 2 column 1 average return rate of TD Khyber CB is 0.50%. which shows that TD Barakah IB is offering 0.13% high rate and the difference is statistically significant at 1% evident from t-statistics row 2 column 4 from the table.

In row 3 column 1 average return rate of TD Askari CB is 0.43%, which mean that TD Barakah IB is offering 0.20% high rate and the difference is statistically significant at 1% as evident from t-statistics row 3 column 4 from the table.

In row 4 column 1 average return rate of TD Soneri CB is 0.54%. which mean that TD Barakah IB is offering 0.09% high as TD Soneri CB rate and the difference is statistically significant as evident from t-statistics row 4 column 4 from the table.

In row 5 column 1 average return rate of TD Summit CB is 0.51%. which mean that TD Barakah IB is offering 0.12% high rate and the difference is statistically significant 1% as evident from t-statistics row 5 column 4 from the table.

Overall, the results show that TD Al Barakah IB offers a higher return rate on one-year term deposit account as compared to all CBs.

It can be seen the average return rate of TD Barakahah IB column 4 is 0.64% and in row 2 column 1 average return rate of TD Khyber CB is 0.50%. which shows that TD Islami IB is offering 0.14% high rate and the difference is statistically significant at 1% evident from t-statistics row 2 column 5 from the table.
In row 3 column 1 average return rate of TD Askari CB is 0.43%, which mean that TD Islami IB is offering 0.21% high rate and the difference is statistically significant at 1% as evident from t-statistics row 3 column 5 from the table.

In row 4 column 1 average return rate of TD Soneri CB is 0.54%. which mean that TD Islami IB is offering 0.10% high rate and the difference is statistically significant at 1% as evident from t-statistics row 4 column 5 from the table.

In row 5 column 1 average return rate of TD Summit CB is 0.51%. which mean that TD Islami IB is offering 0.13% high rate and the difference is statistically significant 1% as evident from t-statistics row 5 column 5 from the table.

Overall, the result show that TD Islami IB offers a higher return rate on one-year term deposit account as compared to all CBs.

It can be seen the average return rate of TD Dubai IB in column 6 is 0.58% and in row 2 column 1 average return rate of TD Khyber CB is 0.50%. which shows that TD Dubai IB is offering 0.08% high rate and the difference is statistically significant at 1% evident from t-statistics row 2 column 6 from the table.

In row 3 column 1 average return rate of TD Askari CB is 0.43%, which mean that TD Dubai IB is offering 0.15% high rate and the difference is statistically significant at 1% as evident from t-statistics row 3 column 6 from the table.

In row 4 column 1 average return rate of TD Soneri CB is 0.54%. which mean that TD Dubai IB is offering 0.04% high as TD Soneri CB rate and the difference is statistically insignificant as evident from t-statistics row 4 column 6 from the table.
In row 5 column 1 average return rate of TD Summit CB is 0.51%. which mean that TD Dubai IB is offering 0.07% high rate and the difference is statistically significant at 5% as evident from t-statistics row 5 column 6 from the table.

In row 6 column 1 the comparison of average inflation rate with all 5 Islamic banks shows that on average 4 Islamic banks offering high return rate than the conventional banks and one Islamic bank TD Khyber IB is offering low return rate. which means that on one-year term deposit account IB are preferable and sounder in profitability than conventional banks.

Overall, the results show that TD Dubai IB offers a higher return rate on one-year term deposit account as compared to CBs.

**Table 5.** Average Return on One-Year Term Deposit of IBs, CBs, and Inflation

<table>
<thead>
<tr>
<th>Variables (Mean)</th>
<th>Islamic Banks 0.58</th>
<th>Inf MoM 0.56</th>
<th>Conventional Banks 0.51</th>
</tr>
</thead>
</table>

Overall, the results show that IBs offer 0.02% higher return than inflation rate and 0.07% higher return than CBs on one-year term deposit accounts.

IBs offer a higher return rate than CBs in terms of one-year term deposit account. Hence, in this regard, IBs are better off than CBs for investment. With respect to inflation rate, they offer 2% higher than average return rate. As far as CBs are concerned, they offer a lower return rate and inflation rate than IBs on one-year term deposit (on average). Thus, it is not a good option for investors to invest in CBs as they offer 4% percent less return than the inflation rate. It indicates that the depositors are in loss in one-year term deposit if they invest in CBs.

**Diagram 3.** Relationship between Average TD IBs with Average TD CBs
The graph shows the relationship of Average TD of IBs with Average TD of CBs. Average return comprises the monthly return of IBs and CBs divided by the number of banks. The upper bold line shows the average return of IBs on one-year term deposit which reflects that on average, IBs offer a higher return than CBs.

**Diagram 5.** Relationship of Average TD IBs with Average Inflation rate

The graph shows the relationship of average TD IBs with inflation rate. One-year term deposit shows that IBs offer slightly higher return on investment in one-year term deposit.
Table 6. Which Islamic Bank is Offering High Profit on Term Deposit

<table>
<thead>
<tr>
<th>Variables (Mean)</th>
<th>TD Meezan IB (0.57)</th>
<th>TD Khyber IB (0.47)</th>
<th>TD Barakah IB (0.63)</th>
<th>TD Islami IB (0.64)</th>
<th>TD Dubai IB (0.58)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TD Meezan IB</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TD Khyber IB</td>
<td>6.01 (0.042) **</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TD Barakah IB</td>
<td>-3.39 (0.000) ***</td>
<td>-7.72 (0.000) ***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TD Islami IB</td>
<td>-4.86 (0.000) ***</td>
<td>-8.73 (0.000) ***</td>
<td>-0.60 (0.544)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TD Dubai IB</td>
<td>-0.31 (0.753)</td>
<td>-4.23 (0.000) ***</td>
<td>2.02 (0.044) **</td>
<td>2.47 (0.014) **</td>
<td></td>
</tr>
</tbody>
</table>

***= Significant at 1%, **= Significant at 5% and *= Significant at 10%
P-value in parenthesis

It can be seen the average return rate of TD Meezan bank IB in column 2 is 0.57% and in row 3 column 1 average return rate of TD Khyber IB is 0.47%. which shows that TD Meezan IB is offering 0.10% high rate and the difference is statistically significant at 5% evident from t-statistics row 3 column 2 from the table.

Similarly, in row 4 column 1 average return rate of TD Barakah IB is 0.63%, which mean the TD Barakah IB is offering 0.06% high rate and the difference is statistically significant at 1% as evident from t-statistics row 4 column 2 from the table.

In row 5 column 1 average return rate of TD Islamic IB is 0.64%, which mean that TD Islamic IB is offering 0.07% high rate and the difference is statistically significant at 1% as evident from t-statistics row 5 column 2 from the table.
In row 6 column 1 average return rate of TD Dubai IB is 0.58%, which mean that TD Dubai IB offering 0.01% high rate and the difference is statistically insignificant as evident from t-statistics row 6 column 2 from the table. Which shows that there is no major difference in return rate of both banks.

Overall, the results show that TD Islami IB offers a higher return rate on one-year term deposit account and TD Khyber IB offers the lowest rate of return among all five (5) IBs.

5. Conclusion

Islamic banking and finance industry has made considerable progress during the last 30 years. It fulfills the basic need of the Muslim community to have a Shariah compliant banking and financial system, distinct from the interest-based banking system. In Pakistan, the first scheduled Islamic financial institution (IFI) started working in 2001 with the name of Meezan Bank Limited. Afterwards, many IBs and other IFIs started their operations in the country.

The study and analysis of IBs is vital and significant. It was deemed necessary to study, analyze, and compare the profit rates of IBs with those offered by CBs SA and TD of Conventional banks. Moreover, the current study also found that the depositors were well compensated in real terms, keeping in view the inflation rate and interest rate. Inflation is also an important factor in determining whether or not Islamic or conventional banks offer equal rates in real term profit to their investors. To determine which bank offers a higher return rate, we applied the equality test for the analysis of the average return rate of banks and t-test to check whether the difference was statistically significant or not?

According to the best of my knowledge this is unique type of study in Pakistan using monthly data from 2008 to May 2022. Existing studies compared Islamic banks with conventional banks
based on annual data using most common variables, Return on Assets (ROA), Return on Equity (ROE) and some other macroeconomic variables, Hassan and Bashir (2003), and Anbar and Alper (2011).

5.1 Key Findings
We examined the long-run relationship and average return rate of Islamic and conventional banks (on saving account and one-year term deposit).

The comparison of the average return rate of IBs with interest rate offered by CBs shows that the Bank of Khyber Islamic Bank (SA Khyber IB), on average, offers a significantly higher return rate (which is 0.36%) among all five IBs, while Dubai Islamic Bank (SA Dubai IB) offers the lowest return rate (which is 0.30%).

The comparison of the average return rate on saving account offered by Islamic and conventional banks shows that CBs offer statistically 0.08% higher return rate than IBs. Inflation rate is also higher which indicates that both Islamic and conventional banks offer a lower return rate on saving account deposits (Moin, 2008).

The results also show that on one-year term deposit account, IBs offer a higher return rate than the inflation rate, on average. Although, the difference is statistically insignificant, which indicates that there is no major difference between the average return rate of IBs and inflation rate.

The comparison among IBs on one-year term deposit account shows that Bank Islami (TD Islami IB) offers a significantly higher return rate on one-year term deposit, while Khyber Islamic (TD Khyber IB) offers a significantly lower return rate among all five (5) IBs.

Similarly, a comparison of IBs with CBs in terms of return rates on one-year term deposit shows that, on average, IBs offer a significantly higher return rate (.07%) than CBs. Interestingly, CBs
offer a lower return rate than inflation (0.02%). It indicates that in saving account or one-year term deposit, CBs offer a lower rate of return than the inflation rate. In both cases, the investors are in loss. The findings are in line with the findings of Usman and Kashif (2012) and Hassoune (2002).

5.2 Policy Implications and Recommendations

The Islamic banking industry, a fast-growing financial industry, has played a significant role in financial market since the global financial crisis (2008-09). The relationship of IBs with benchmark interest rates and CBs is obvious.

The current study suggests various policy implications for policy makers.

1. Depositors are unaware about PER and IRR account. Hence, IBs must disclose information about their PER and IRR accounts in account opening forms or on their websites.

2. IBs must distribute profit at least equal to or more than the inflation rate on saving account to their depositors.

3. Real return rates are negative and it gives a bad impression to investors. Moreover, profit should be fairly distributed among depositors.

4. IBs offer lower profit to their depositors than CBs on saving account, which acts as a deterrent for them.

5. IBs offer a higher return rate than CBs on one-year term deposit account which also exceeds the inflation rate. So, the profitability of IBs may attract more customers to invest in one-year term deposit account.
REFERENCES


