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# Impact of Firm Size on Profitability: A Comparative Study of Islamic Bank and Commercial Bank in Pakistan

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*Keywords:* *profitability, commercial bank, islamic bank, firm size.*

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# Impact of Firm Size on Profitability: A Comparative Study of Islamic Bank and Commercial Bank in Pakistan

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*Keywords: profitability, commercial bank, islamic bank, firm size.*

## I. Introduction

This study was conducted to provide experimental results & theoretical research on the topic of the firm size profitability: a comparative study of Commercial Banks Vs Islamic Banks. In earlier there have been a lot of researches conducted regarding the firm size profitability. But the aim of this study is to analyze the size of firms on profitability, Commercial Banks vs. Islamic Banks in Pakistan. The first Islamic Bank started in Egypt in 1959 then Islamic Banking was grown and was introduced in more than 60 countries. In Pakistan, Islamic Banking was introduced during the year of general Zia in 1980 and then a lot of local and foreign Commercial Banks have started Islamic Bank operation in Pakistan. Rabia is Arabic word which means raise, accumulation, growth. Islamic Banking usually works as interest free Banking and main purpose of Islamic Bank is interest prohibition and avoids transaction. However, interest is the basic part in Commercial Banking transactions. Commercial Banking is the most popular and prevalent Banking in all civilized countries. In Pakistan Banks are established in form of partnership and Joint Stock Company, the kind of scheduled Banks and non-scheduled Banks. Quaid-e-Azam ordered to establish state Bank of Pakistan on 12th may 1948 and he inaugurated it on first July 1948 in Karachi when Pakistan was facing serious financial crisis.

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## II. Background of the Study

Normally, firm size of the Banks and other financial institutions is measured by using a combination of financial ratio analysis, benchmark rate, performance against the budget and the mix of these methodologies. The relationship between the size and productivity for U.S. firms from 1970 to 1989, essentially finds the reverse relationship between the size and profitability of the firms (Dhawan, 2001).

Researchers revealed the coefficient of the growth rate of sales suggesting that factors on the demand side had a greater impact on profitability of the firm than any other supply side. There are a lot of predefined methods for the performance measures of firms, but the problem in relying on these measures is that the difference in measures of performance can clash (Lumpkin & Dess, 1996).

Dess & Robinson (1984) reported the strong statistically significant relationship between the subjective & comparative assessment of five years performance of 18 businesses by the top management against other comparable business in the industries, the objective was to measure the return on assets & the sales growth. Generally the profitability of the firms depends upon the organizational growth. Whereas the growth had been considered the most significant measures of performance in small firms, it has furthermore been argued that financial performance is multinational in nature and the measure of financial performance & growth rate are diverse phase of performance that needs to be considered. It has to argue if the firms grow in many ways, such as the firm's growth patterns are inter related to age, size and industry.

The first Islamic Bank was established in Egypt in 1963; later on many Islamic Banks were established in Middle East and Asia. The growth of Islamic Banks not only increased in terms of number of countries but it's operating in terms of areas of finance too. Within the



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three decades the Islamic Banking has increased in numbers and exhaustive size globally. Several countries such as Iran and Sudan have renewed their entire Banking into Islamic Banking system. Islamic Banking operates in more than 60 countries. Islamic Banking finance increased by 10 to 15 percent per annum, it worldwide assets exists round about $1 trillion and more than 160 financial institutions (Dar, 2003).

Commercial Banking are comparatively older and has been focused both extensively and intensively on literature as compared to the modern Islamic Banking which was started before 4 decades but at a standstill, lacks in level of extensive and intensive literature. So that's way the center of the discussion and focus of the study is Islamic Banks and Commercial Banking.

## III. Research Objectives

1. Investigate the impact of Bank size and Gross domestic product on the profit of Commercial Bank and Islamic Bank in Pakistan
2. Find when firm size raise and how use assets to achieve maximum profit.
3. To determine the structural impact on profitability of Commercial and Islamic Banks of Pakistan

## IV. Scope of the Study

This study is beneficial for economist, this research find the gap between the firm size and profitability. Banking sector play the vital role in the economic development of any country. M Financial ratio is the financial strength of any sector. This ratio is not only for depositor people even in future routine for improvement of management activities plus point is to show full information and image about Banking position to investor, management and shareholders.

This study will help to not only the Banking sector but also those who lend or financial institutions, because Banking sector of Pakistan has been growing slightly despite its social and economic problems. However not only customers perceive which made efforts to determine the crucial factors that in their choice Banks but institutions.

## V. Literature Review

Empirical investigation of the link between firm size and gain in industrial economies within the past has given variable outcome. Many studies have gotten either week negative relationship or none in any respects (Marcus, 1969).

Decision making utility maximization may be a byproduct of the separation of possession from management in gift business. This division will rise through firm size creating giant firm a lot of susceptible social control utility maximization than minor companies. Decision making utility maximization provides abstract frame work for negative relationship between firm size and profit. The connection between firm size and profit is also positive over some firm size range (Wilder, 1985).

Another study has examined Profitability and marketability of Commercial Banks by applying data envelopment investigation (DEA) model. The method of data analysis was based on two stages. On the base of this study it was completed large Banks performed better with respect to profitability than small size Banks, while small size Banks have better characteristic of marketability as compare to large Bank size (Seiford, 1999).

Researchers also observed the factor that affected the profitability of Banks in USA for the amount of 1985 to 1990 during which the quantity of the Banks was found to be negatively related with productivity, the negative relationship of the dimensions indicate the diseconomies of scale (Noulas, 1997).

The performance of special kinds of Chinese Banks for the amount 1999 and 2006 has observed. The end result counsel economic price added and therefore the web interest margin do improved than a lot of standard measure of profitableness, name come on the average quality and on the average equity and economics variable and money ratio square measure important with the predictable symbols. The sort of Bank is powerful, Bank volume isn't neither the proportion of foreign possession Bank listing contains a visible impact (Heffernan& Fu, 2008).

The Bank with higher total capital, deposit and credit or whole quality doesn't continuously mean that there will be a higher profit routine. Money performance of the Banks was powerfully and completely influenced by the operational potency and quality management and addition to the Bank size (Tarawneh, 2006).

A study divided the Bank in class. With the victimization statistical procedure analysis, the following result were determined of the plus management, operational effectiveness, and Bank size on the money performance concerning industrial Banks with twenty branches, the finding was; higher total capital, deposits, credit, or total assets don't forever stand a stronger profit performance (Akhigbe & McNulty, 2005).

A study find the some vital issue influence performance of the UAE Muslim and standard national Banks kind 1996-2008 using the multivariate analysis, especially ROE and ROA as variable, investigator show the result liquidity and concentration were the foremost vital determinant of typical nation Banks. Range of branches and value were the foremost powerful issue of Muslim Bank performance (Al-Tamimi, 2010).

Researchers investigated the potency of Greek Banks against size. They used their study multi criteria methodology to classify Greek Banks in step with the come back and performance issue, show the distinction of the Bank gain and potency between tiny and huge Banks through this study (Spathis, Kosmidou & Doumpos, 2002).



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A study was conducted in Kuwait to see the important factor employed in Kuwait business consumer in domestic and foreign Banks. Result show the best ranking Bank in Kuwait by house size of Bank assets, personal potency and Banking expertise, friendliness of staff and reputation, goodwill and handiness of branches in foreign country (Edris, 1997).

Researchers studied the performance of Islamic and conventional Banks through CAMEL test during the time of 2005 to 2009. They use sample for research 5 Islamic and 5 conventional Bank and found the Islamic Bank performed better and high liquidity as compare to Commercial Banks and realized the Commercial Bank have strong in the management with high quality earning capacity (Jaffar & Manarvi, 2011).

Some studies have also conducted to gauge the perceptions of employees regarding Islamic products and services. It has found that Islamic Banking employers has more positive perception about the Islamic products and services (Arshad et al, 2011).

Researchers also observed the strong relationship between rates of interest on deposits at Commercial Bank with rate of profit of deposit cash in Islamic Bank and realized the effect of interest rate on deposit cash at Commercial Bank and Islamic Bank through adaptive expectation model. They found negative relationship between rates of interest of Commercial Bank with the interest free Bank (Haron & Ahmad, 2000). Interest rates also have some relation with ROE and ROA (Ali et al., 2012a).

A study measure the performance and market power of the Saudi Banking sector. They use market concentration ratio and explain the structure performance. They collect data form monopolistic competitive market and apply regression model for the independent variable. Their result from this model business risk and Bank size were main variable determine Bank profitability (Ahmad & Khababa, 1999). A study also revealed the positive relation of Bank's profitability with Equity and number of shares (Ali et al., 2012b).

## VI. Data and Methodology

In this research use secondary data for measure the firm size and profitability. Data and financial statement collected form websites of all Bank and state Bank of Pakistan. During this study 5 Commercial Bank and 5 Islamic Banks are selected for the period of 2008 to 2012. Data process and measure result by using software "statistical package for social science" and in excel sheet. Dependent variable use return on assets and independent variable is firm size. Some test and Techniques use for outcome purpose. Regression and T-Test run for checking the independent variable on dependent variable and comparison of both Bank plus descriptive statistics. Regression shows relationship between the independent variables and dependent variables. Return on assets use as a dependent variable and firm size use as an independent variable. When only one dependent variable run is called regression analyses-Test use for comparison of Commercial and Islamic Bank by using data and then compare of both Bank.

## VII. Empirical Results

*a) Commercial Bank*

*Table 4.1.2:* Coefficients[a]

| Model | | Un-Standardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .559 | .189 | | 2.953 | .007 |
| | Firm Size | .001 | .000 | .678 | 4.424 | .000 |

a. *Dependent Variable: ROA*

*b) Islamic Bank*

*Table 4.1.4:* Coefficients[a]

| Model | | Un-Standardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -1.318 | .535 | | -2.463 | .022 |
| | Firm Size | .014 | .009 | .303 | 1.526 | .141 |

a. *Dependent Variable: ROA*

Regressions coefficients model explanation is given blow. The hypothesis of this study with the two variables is significant and insignificant results. Commercial Banks value of B is 0.678, Std. Error 0.189 but Islamic Banks Beta 0.303 STD 0.535 but there are significant and insignificant relations between Commercial Bank and Islamic Bank.



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*c) T-Test*

*Table 4.2.1:* Group Statistics

| | Codes | N | Mean | Std. Deviation | Std. Error Mean |
|---|---|---|---|---|---|
| Firm Size | Commercial | 25 | 7.8352E2 | 401.47884 | 80.29577 |
| | Islamic | 25 | 55.0000 | 25.51797 | 5.10359 |
| ROA | Commercial | 25 | 1.30800 | .565847 | .113169 |
| | Islamic | 25 | -.57480 | 1.137542 | .227508 |

T-Test shows the size of the firm has greater impact on profitability in Commercial Banks rather than Islamic Banks. The positive or greater values of Commercial Banks express the positive impact on profitability of firm's size. The negative ROA express the insignificant impact of size on profitability of Islamic Banks. The firm size has impact on profitability of Commercial Banks but not on Islamic Banks profitability.

*Table 4.2.2:* Independent Samples Test

| | Levene's Test for Equality of Variances | F | Sig. | t-Test for Equality of Means | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | t | df | Sig. (2-tailed) | Mean Difference | Std. Error Difference |
| Firm Size | Equal Variances Assumed | 96.35 | 0 | 9.055 | 48 | 0 | 728.52 | 80.4578 |
| | Equal Variances Not Assumed | | | 9.055 | 24.194 | 0 | 728.52 | 80.4578 |
| ROA | Equal Variances Assumed | 12.26 | 0.001 | 7.41 | 48 | 0 | 1.8828 | 0.254101 |
| | Equal Variances Not Assumed | | | 7.41 | 35.192 | 0 | 1.8828 | 0.254101 |

The result of this table show that the relationships between firm size and profitability significant in case of Commercial Bank but insignificant in case of Islamic Bank. Only one variable has significant impact of Commercial Bank. The significant result of Commercial Bank is 48 but 24.194 of Islamic which show that the relationship has a positive impact on the profitability.

In ROA of the Commercial Bank are 48 but Islamic Banks 35.192 which is smaller than Commercial Banks. That's mean the firm size has greater impact on Commercial Banks but not on Islamic Banks profitability, so that way the values of Commercial Banks are greater or positive.

## VIII. Conclusion

In this study we use five year data from 2008 to 2012. The data used of 10 Banks by which 5 Commercial Banks and 5 Islamic Banks. The result shows that Commercial Banks have significant impact and Islamic Banks insignificant impact of firm size on profitability. This research show the sound effects of the firm size on profitability of Commercial Bank Ltd and Islamic Bank in Pakistan. Regression analysis shows that, there is positive effect of Firm size on Profitability in Commercial Bank., but there was no effect between firm size and Profitability in Islamic Banks.

Regression test express the significant impact (Commercial Bank) and insignificant impact (Islamic Bank) of firm size on Banks profitability, but the firm size's greater impact on Commercial Banks profitability than Islamic Banks. The relationship between firm size and profitability are significant or positive. T-test shows larger impact of firm size on Commercial Banks profitability but have no effect on Islamic Banks profitability. Negative value of ROA describes the insignificant on Islamic Bank, in Islamic Banking size or number of branches doesn't have impact on profitability but in Commercial Banking size or number of branches have positive impact on Bank profitability.

## IX. Recommendations

The model size can be increased of all Banks like increase the Bank for finding the empirical result in this sector. In Pakistan full-fledged Islamic Bank is low and initial stage as compare to Commercial Bank, require more research about banking performance for taking correct decision on the right time in Pakistan. This study is restricted only five Commercial Bank and Islamic Bank, it is recommend the all Commercial Bank and all Islamic Bank be carry out or analysis Islamic and Commercial Banks with collect more data, and then find result and compare with each other in the country, because the outcome and finding is not provide full information to investors and not help for decision making. Investors also check each and every think like fact and figure before deal and investment.

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