Musharakah or Conventional Financing: Zamzam and Awash Banks' Financial Ratio Analysis

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Abstract

Authors Note: This article is derived from research questions 1 and 2, and hypotheses 1 and 2 of my doctoral dissertation "An Assessment of the Financial Efficacy of Musharakah Contracts in Comparison with Conventional Finance Structures" (2026, June 9) accepted by AITU.

Introduction:

Literature Review: Norman, Shakeel and Tehseen (2017) compared financing and trade modes of Islamic banking profitability using SEM model. Syahri and Harjito (2020) measured profitability using ROE multilinear regression of banks' musharakah product. Hanafi (2021) analyzed ROA and revenue from financial statements of commercial banks offering musharakah contracts. Alnabulsi, Kozarevic and Hakimi (2023) measured Islamic bank profitability using NIM through SGMM and PSTR models. Othman and Gabbori (2024) studied non-performing loan determinants using secondary sources.

Methods: Quantitative analysis of financial ratios CAR, ROA, ROE, Net Profit Margin, LDR, and NPF using financial reports from a conventional bank, Awash, and an Islamic bank, Zamzam.

Findings: The Islamic bank had higher liquid assets, higher liabilities with customer deposits making up a larger percentage, more new shareholders, higher profitability, higher EPS, more diaspora accounts, higher income from financing and investing activities, and a higher CAR than the conventional bank. The conventional bank had more total assets, higher ROA, higher ROE, higher net profit margin and a higher LDR than the Islamic bank. NPF was the same for both banks, but increased by a higher percentage for the conventional bank when the Islamic bank had a small percentage decrease.

Conclusions: H_1 results show Musharakah financed assets outpaced the conventional bank's risk adjusted returns. H_2 results show greater resilience in banks using Musharakah, based on lower default rates and higher capital buffers than conventional banks.

Keywords: Capital Adequacy Ratio, Diaspora, Earnings per Share, Loan to Deposit Ratio, Musharakah, Net Interest Margin, Net Profit Margin, Non-Performing Financing, Non Performing Loan, Return On Assets, Return On Equity, Shari'ah

Introduction

Musharakah contracts are Islamic profit and loss sharing partnership contracts (Saleem, 2013, pp. 104-105). In addition to musharakah partnership contracts, there are also diminishing musharakah contracts, which are used by Islamic banks to finance housing for retail home buyers or for larger investment projects where the financing partners wish to sell their equity in the project over time back to the entrepreneur who will own and operate the finished project (Saleem, 2013, pp. 104-106).

Musharakah, as a profit-and-loss sharing contract, has a theoretical basis in "fairness and justice in wealth creation and income distribution," (Gholami, et al., 2021, p. 382). Interest-based financing developed theoretically into the conventional financial system through speculation in the financial markets causing instability and separating the financial sector from real economic production, since interest was collected instead of profiting from productive business (Gholami, et al., 2021, p. 383). The current debates on whether musharakah financing or conventional financing has better financial performance looks at financial ratios for return on equity and operating expenses, profit to expense ratio and solvency and risk measurements (Latif, et al., 2016, p. 29). Islamic banks had lower profitability and liquidity ratios; however, Islamic banks had better performance in ratios related to risk, solvency and efficiency (Latif, et al., 2016, p. 30).

This study asks the following questions: how do financial performance indicators differ between musharakah-financed firms and conventionally financed firms? What risk-return patterns are associated with Musharakah financing model compares to conventional financing model? What is the extent that profit-and-loss sharing influences financial outcomes?

RQ1: To what extent do musharakah-based financing structures deliver superior financial outcomes for Islamic banks and their stakeholders compared to conventional financing structures, based on revenue, profitability, and asset growth? The rationale for this research question will analyze financial data, including financial statement data such as revenue, earnings per share and total assets.

RQ2: How does the profitability of musharakah-based financing compare with that of conventional financing structures when measured using standard financial performance indicators? This research question will analyze return on assets, return on equity, profit margins and project returns.

H_1: Musharakah-financed assets demonstrate higher risk-adjusted returns than conventional loans during economic expansions.

H_2: Musharakah-based institutions show greater resilience, as seen in lower default rates and higher capital buffers, during economic downturns.

Literature Review

The study by Norman, Shakeel and Tehseen (2017) "compare[d] both modes of finance and mode of trade adopted by full-fledged Islamic banks" and evaluated the effect of each mode on profitability. The sample was made up of 19 banks from 8 countries were between 2004 and 2014 looking at assets and equity in murabaha, ijarah, musharakah, and mudaraba. Financing products had a positive impact on the growth of assets and equity of Islamic banks, but trade products had a negative impact. The limitation is that the SEM Model was used to estimate the effect of banking instruments on performance. The relevance of this study is that "[t]here are few studies which empirically tested the macroeconomic environment on the banking profitability", including the impact on profitability and comparing different instruments.

The study by Syahri and Harjito (2020) focused on the effect of profit and loss sharing financial products on Islamic bank profitability as measured by ROE from mudarabah and musharakah. Multilinear regression analysis was used on purposive sampling from Sharia Bank between 2012 and 2016. The findings of the study showed musharakah and mudarabah profit and loss sharing financial products significantly affected profitability, with musharakah having a negative impact, and mudarabah having a positive impact.

The study by Hanafi (2021) "examine[d] if profit-sharing characteristic contributes to performance of Islamic commercial banks". Profit-sharing musharakah, mudarabah and murabahah affects performance as analyzed through secondary data of financial statements between 2015 to 2019 for ROA and revenue. The "profit-sharing characteristic […] is proven to be effective in improving [Islamic banks'] performances", and it improves performance. The study does not "systematic[ally] review" Islamic banks' performances in relation "to ethical statement and sustainability […] on sharia banking system." Previous studies focused on "Non Performing Finance (NPF), Capital Adequacy Ratio (CAR), and Fixed Deposit Receipt (FDR)".

The study by Alnabulsi, Kozarevic and Hakimi (2023) "[analyzed] the linear and non-linear relation between non-performing loans and bank profitability measured by [NIM]. The study sampled 74 banks across 11 countries between 2005 and 2020. The study measured profitability through NIM instead of ROA or ROE. The study used System Generalized Method of Moments (SGMM) and Panel Smooth Transition Regression (PSTR) model. The SGMM showed that the "ratio of NPLs negatively affects bank profitability. […] PSTR model confirmed the existence of a threshold effect." NPLs negatively affect profitability under 4.42%, but not significantly. Bank size "positively and significantly" affected profitability. There is a "positive and significant impact" by GDP and negative impact caused by inflation. "Limitations regarding the social, economic, and financial differences of the whole sample" including MENA banks. Prior studies were based on linear "OLS regression, fixed effect models, random effect models and dynamic panel data models," and few empirical studies considered non-linear analysis.

The study by Othman and Gabbori (2024) was to study "determinants of non-performing loans" through bank specific macroeconomic factors effecting environment, product development and credit risk. The methodology was to analyze secondary data from the World Bank database, Refinitiv Eikon, FitchConnect, AAOIFI and annual institutional reports between 2008 and 2022 for credit risk using ROA, ROE, NIM, CAP, Net charge-off ratio, loan loss provision, loan to deposit ratio, liquidity ratio and loan growth. The study found that ROA, liquidity ratio, net interest margin and net charge-off ratio (NCOFF) "are significant bank-specific determinants of NPLs. Higher ROA and [liquidity ratio] reduce credit risk, while higher NIM and NCOFF increase [credit risk]." Macroeconomics, such as GDP and inflation increases credit risk, while political stability minimizes credit risk. Sector concentration increases NPLs. Compliance challenges were indicated by a positive relationship between AAOIFI and NPL.

Methodology

In this quantitative study, the annual reports of an Islamic bank, Zamazam bank, and a conventional bank, Awash bank, were analyzed for financial ratios. This quantitative analysis used financial ratios for risk and profitability, specifically CAR, LDR, NPF, ROA, ROE, and net profit margin.

Findings

The financial ratios revealed that Zamzam bank's total assets grew by 39% in 2025, liquid assets grew by 52%, liabilities grew by 77%, customer deposits made up 89% of total liabilities, there were 2,667 new shareholders showing a growth of 16.9%, profitability grew by 162%, EPS grew from 5.9% to 41.4%, or 601.7%, and achieved 157% of its targeted diaspora enrollment which brought in $65 million USD. Income from financing activities increased by 39%, income from investing activities increased by 192%, ROA was 2.8%, ROE was 3.5%, net profit margin was 2.47%, CAR decreased by 4% to 31%, NPF decreased by 1.25% to 2.23%, and LDR decreased by 12.09% to 55.24%.

The financial ratios revealed that Awash bank's total assets grew by 57%, liquid assets grew 49%, liabilities grew by 54%, customer deposits made up 86.63% of total liabilities, there were 1,028 new shareholders showing a growth of 9.79%, profitability grew by 137.9%, EPS grew by 60.78%, increased diaspora enrollment by 32.23% which brought in $2.01 billion USD. Income from financing activities decreased by 44.89%, income from investing activities increased by 188.3%, ROA was 5.8%, ROE was 44.04%, net profit margin was 28.9%, CAR increased by 54% to 14%, NPF increased by 78.4% to 2.23%, and LDR decreased by 15% to 66%.

Discussion

The Ethiopian Islamic bank, Zamzam bank, marketed to the Ethiopian diaspora within the United States offers musharakah financing, and Zamzam bank's financing and investment income grew approximately 150% based on Zamzam bank's annual financial statement (Zamzam, 2025, p. 23). Zamzam bank's diaspora accounts allow Ethiopians to investment with the bank through musharakah financing (Zamzam, 2025, p. 23). Increasing income from musharakah financing has improved the operating income and ultimately the earnings per share of Zamzam bank (Zamzam, 2025, 82).

Zamzam bank was shown to perform on par with the Awash Bank, a conventional bank, based on many of the financial ratios. However, Awash bank performed significantly higher in overall revenue and profitability, by operating with a higher LDR and a lower CAR.

The first hypothesis was that musharakah-financed assets demonstrate higher risk-adjusted returns than conventional loans during economic expansions. Zamzam bank's financial reports show that musharakah financed assets outpaced Awash bank's risk adjusted returns.

The second hypothesis was that musharakah-based institutions show greater resilience, as seen in lower default rates and higher capital buffers, during economic downturns. Zamzam bank had a higher capital adequacy ratio than Awash bank, but both Zamzam bank and Awash bank maintained the same percentage of non-performing loans, but while Zamzam bank decreased their non-performing loans, Awash bank increased its nominal non-performing loans to achieve the same percentage.

Musharakah financing is a more financially beneficial mechanism than conventional financing. Zamzam bank's financial performance against Awash bank showed that musharakah financing did not produce extraordinary profits or the massive accumulation of assets under management; however, Zamzam bank was able to generate comparable returns on equity and assets. Zamzam bank's income from investing activities was over 10% higher than Awash bank; however, Awash bank generated significant income from financing activities. Zamzam bank was able to increase new shareholders by 16%; however, Awash bank was only able to increase new shareholders by 9%.

The hypotheses of musharakah-financed assets demonstrate higher risk-adjusted returns than conventional loans. Musharakah-based institutions show greater resilience, as seen in lower default rates and higher capital buffers. The financial performance gap between musharakah and conventional financing is seen in Zamzam bank being unable to generate outsized profits compared to Awash bank, but Zamzam bank was able to outpace Awash bank in many financial ratios including capital adequacy, income from investing activities, new shareholders and compete in return on assets and equity.

The theory that Islamic banking performs better, because it is based on real economics as opposed to the financialized economics of conventional banking has shown that competitive outcomes are possible based on the research. Islamic financing is more stable than conventional financing is shown based on the capital adequacy ratios. Islamic financing has community buy-in as shown by the higher percentage of shareholders as compared to conventional financing, and it generates comparable returns on equity and assets, but higher income from investing activities.

Conclusion

Investors and depositors have been shown to benefit from profit and loss sharing models based on the findings comparing Islamic financing by Zamzam bank with Awash bank's conventional financing. The findings of the study showed that while Zamzam bank had significantly less assets under management, and achieved lower earning per share, than Awash bank, Zamzam bank was able to outpace Awash bank on new shareholders, net income, income from investment and income from financing activities. Awash bank achieved significantly higher return on assets, return on equity and net profit margin.

The theoretical implication of this study furthers the discussion on the practical impact of musharakah financing. Musharakah financing can achieve financial efficacy as shown by the high growth and sustainability allowing Islamic financing to compete with conventional financing for those looking for ethical alignment, stability and financial inclusion. Conventional financing benefits those looking for pure cost efficiency and scale within a mature secular market. The comparison of musharakah financing and conventional debt financing is not just a question of “which is better”, but “which is efficacious for what and for whom”.

The practical implication of this study is that the ability to reach diaspora communities in countries where Islamic financing is limited is achievable through fintech solutions and financial products aimed at meeting the needs of diaspora communities (Zamzam, 2025, p. 12).

Further research into diaspora demographics, and the different madhahib, should be pursued to increase the field’s understanding of their effects on Islamic financing compared to conventional financing.

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