EVALUATION OF ISLAMIC BANKS' PERFORMANCE IN MALAYSIA:

FOREIGN VS DOMESTIC BANKS

A Thesis submitted to the Center of Graduate Studies in partial
fulfillment of the requirement for the degree
Master of Science (Banking)
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by

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ABSTRACT

This study evaluates the performance of Islamic banks and analyzes the determinants of their profitability and performance as measured by return on assets (ROA), return on equity (ROE) and profit margin (PM). Using financial ratios as a proxy for internal bank characteristics, and utilizing bank level data, this study examines the performance indicators of foreign and domestic Islamic banks in Malaysia during 2006-2007. Regression results show that Islamic bank profitability measures respond positively to total core deposits, and total assets; and negatively to capital adequacy ratio. Ratios of operating expenses to assets and financing provisions to total financing positively affect Islamic bank's ROE and PM, while negatively affect ROA. Regression and correlation results reveal no significant relationship between the type of Islamic bank (foreign or domestic) and the profitability measures. The *t*-test for equality of means results shows that domestic Islamic banks are more profitable and more efficient, but riskier and less liquid than foreign Islamic banks. Asset quality indicators for foreign Islamic banks are better than those of domestic Islamic banks.

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LIST OF ABBREVATIONS

ATMs	Automatic Teller Machine
BIMB	Bank Islam Malaysia Berhad
BNM	Bank Negara Malaysia
CAGR	Compound Annual Growth Rate
CAMEL	Capital adequacy, Asset quality, Management quality, Earnings, Liquidity
CTA	Cash to Assets
CTD	Cash to Deposits
DEA	Data Envelopment Analysis
DTA	Deposits to Assets
EA	Equity to Assets
EM	Equity Multiplier
EPS	Earnings Per Share
ETD	Equity to Deposits
FIBS	Faisal Islamic Bank of Sudan
GCC	Gulf Cooperation Council
IFBS	Interest-Free Banking System
KFH	Kuwait Finance House
LR	Loan Ratio
LTD	Loans to Deposits
MDA	Multiple Discriminant Analysis
OEA	Operating Expense to Assets
OER	Operating Expenses to Revenues
OLS	Ordinary Least Squares
ORA	Operating Revenues to Assets
PE	Profit to Operating Expenses
PEA	Provision to Earning Assets
PLS	Profit/Loss Sharing
PM	Profit Margin
ROA	Return On Assets
ROD	Return On Deposits

ROE	Return On Equity
ROSC	Return On Shareholder Capital
RPTA	Retained Profits to Total Assets
SE	Staff Expenses
SEA	South East Asia
SFA	Stochastic Frontier Analysis
TA	Total Assets
TLE	Total Liabilities to Equity
TLSC	Total liabilities to shareholder capital
UTI	Unit Trust of India
WRL	Write-off Loan Ratio

CHAPTER ONE

INTRODUCTION AND BACKGROUND FOR RESEARCH

1.0 Introduction

In recent years, many banking systems in emerging markets have experienced a deep transformation under the pressure of internal financial liberalization, increased openness to international capital flows, and technological and financial innovation. Banking crises, often requiring large-scale government intervention and bank closures, also opened the way for structural change. Among these transformations, an important one has been the increasing presence of foreign banks in the domestic banking system. While foreign bank entry in emerging markets has been substantial overall, it has also been uneven; with some countries maintaining substantial barriers and others allowing foreign banks to achieve a dominant position (International Monetary Fund, 2000).

In today's world, bankers and their competitors are under great pressure to perform well all the time. In this case, performance refers to how adequately a financial firm

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should also be investigated. Other aspects such as marketing, services and products development could be considered in the performance analysis.

The scope of the analysis could be broadened to consider Islamic investment banks in Malaysia in addition to consider the central bank of Malaysia-BNM Islamic money market operations. The scope of the analysis could also be broadened to consider Islamic banks in other Muslim countries and to make comparisons between Islamic banks across countries.

Finally, because in today's world the global financial system, in particular, the global banking system extremely suffers from the financial turmoil and crisis, it would be interesting to examine whether the financial ratios presented in this research could be used for risk assessment, forecasting bank profitability, or providing early warning signals of banking problems in various countries.

5.4 Summary

This chapter reviewed and summarized the findings of the research. The findings are outlined into descriptive statistics findings, correlation analysis findings, regression analysis findings, and findings on comparison between foreign and domestic Islamic banks. Recommendations as well as suggestions to further refine future research are mentioned this chapter.

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