PERFORMANCE OF ISLAMIC BANKS IN COMPARISON
WITH CONVENTIONAL BANKS IN MALAYSIA

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Abstract

This paper explores the comparative performance of Malaysia's interest-free Islamic banks (including foreign players) against the interest-based conventional banks for the period 2005 - 2008 with respect to their business volume and performance. This study is conducted in response to pessimistic feedback about Islamic banks' performances that are not only required to comply both conventional business laws and Islamic laws, but also need to forgo business opportunities that are against with laws of Islam. At the same time, the business performance of these banks is questioned due to stiff competition in the market.

This study divided the Islamic banks into three (3) categories i.e. local Islamic full-fledge banks, local Islamic subsidiary banks and foreign Islamic banks.

Based on descriptive analysis, the study found that local conventional banks in group are relatively performing better than the rest of Islamic banks in terms of business volume. Nevertheless, upon applying t-test analysis to six selected financial ratios, this study revealed that, in general, the performances of both local and foreign Islamic banks are at par and competitive with local conventional banks.
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LIST OF ABBREVIATIONS

BIMB       Bank Islam Malaysia Berhad
BNM        Bank Negara Malaysia
CDR        Cash Deposit Ratio
CTI        Cost to Income Ratio
EQL        Equity to Net Loan Ratio
LDR        Loan Deposit Ratio
ROA        Return on Assets
ROE        Return on Equity
SPI        “Skim Perbankan Islam” (Islamic Banking Scheme)
SPTF       “Skim Perbankan Tanpa Faedah” (Interest-free Banking Scheme)
CHAPTER 1

BACKGROUND TO THE STUDY

1.1 INTRODUCTION

This preliminary chapter of the thesis gives a general introduction to the research study. The aim of the chapter is to provide a general overview and background of the study, which will serve as the fundamentals for other subsequent chapters, and for the study as a whole. The chapter first provides the research background and elaborates on the subject of the study, that is, the presence of Islamic Banks in our banking industry. The next sub-section highlights the problem statement, followed by the research objectives of this study. Then the rationale for undertaking the research study is explained. The chapter ends with the overall structure of the thesis.

1.2 RESEARCH BACKGROUND

Banking system in Malaysia is unique in the sense that both conventional and Islamic banks are currently operating side-by-side. The first full-fledged Islamic bank established in the country was Bank Islam Malaysia Berhad (BIMB), which commenced its operations on 1 July 1983.

Recognising the increasing demand for Islamic products and services, Bank Negara Malaysia (BNM) has introduced a scheme known as ‘Skim
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