

**PERFORMANCE OF SELECTED ISLAMIC BANKS IN  
MALAYSIA : A COMPARATIVE STUDY**

By

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## **ABSTRACT**

The objective of this paper is to examine the performance of selected Islamic banks in Malaysia which are Bank Islam Malaysia Berhad (BIMB), RHB Islamic Bank Berhad (RHB Islamic) and Bank Muamalat Malaysia Berhad (BMMB) in the period between year 2005 until 2012. A comparative study is undertaken based performance indicators such as return on assets (ROA), return on equity (ROE), profit generated by each year and Islamic modes of finance such as mudarabah, musharakah, murabahah, ijarah and istisna. The methodology that use in this study are descriptive analysis, one way ANOVA and Kruskal Wallis for parametric test as well as T-Tests and Wilcoxon for non-parametric test using data from annual reports of the banks. All the analysis are used in determining their significance. The study found that there are no differences in performance and profit of Bank Islam, RHB Islamic and Bank Muamalat. However, the study finds that there are significant differences in Islamic modes of finance except for Istisna contract.

**Keywords:** Islamic Banking, Return on Assets, Return on Equity, Profit, Islamic Mode of finance.

## **ABSTRAK**

Kajian ini adalah bertujuan untuk mengkaji prestasi sistem perbankan Islam yang terpilih di Malaysia iaitu Bank Islam Malaysia Berhad (BIMB), RHB Islamic Bank (RHB Islamic) dan Bank Muamalat Malaysia Berhad (BMMB) dalam tempoh antara tahun 2005 hingga 2012. Satu kajian perbandingan dijalankan berdasarkan petunjuk prestasi seperti pulangan ke atas aset, pulangan ke atas ekuiti, keuntungan yang dijana pada setiap tahun dan kontrak pembiayaan Islam seperti mudarabah, musharakah, murabahah, ijarah dan istisna. Kajian ini telah menggunakan metodologi analisis deskriptif, one way ANOVA dan Kurskal Wallis untuk analisis parametrik manakala T-Test dan Wilcoxon untuk analisis bukan parametrik menggunakan data daripada laporan tahunan di bank-bank tersebut. Keputusan kajian menunjukkan bahawa tiada perbezaan dalam prestasi dan keuntungan bagi Bank Islam, RHB Islamic dan Bank Muamalat. Bagaimanapun, kajian menunjukkan bahawa terdapat perbezaan yang signifikan dalam kontrak-kontrak pembiayaan Islam kecuali bagi kontrak Istisna.

Kata Kunci: Perbankan Islam, Pulangan atas Aset, Pulangan atas Ekuiti, Keuntungan, Kontrak Pembiayaan Islam.

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AITAB	Al Ijarah Thumma Al Bay’
ATM	Automated Teller Machine
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
IBS	Islamic Banking System
IBs	Islamic Banks
IFI	Islamic Financial Institutions
IFSF	Islamic Financial Stability Forum
IFSPs	Islamic Financial Service Providers
KIBOR	Karachi Interbank offered Rate
KLSE	Kuala Lumpur Stock Exchange
Lebanese SME	Lebanese Small Medium Enterprise
LIBOR	London Interbank offered Rate
LOFSA	Labuan Offshore Financial Services Authority
MIFC	Malaysian International Islamic Financial Centre
OIC	Organization of Islamic Conference
PER	Profit Expenses Ratio
PLS	Profit Loss Sharing
ROA	Return on Assets
ROAA	Return on Average Assets
ROAE	Return on Average Equity
ROE	Return on Equity

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## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of the Study**

During the last decades, the financial systems have played undisputed role in the development of the world economic growth (Chapra, 2008). Both of the bank sectors either Islamic or conventional system were the central factor of these economic development. According to Chapra (2008), the ongoing financial crisis is not first of its kind. Based on some estimation, there were around 100 crises over the last four decades. Those crises gave a big impact to all geographical areas and countries. In early 2007, financial institutions all over the world were shaken up by the global crisis and it was getting worse with the collapse of Wall Street Investment Banking giant, Lehman Brothers in September of 2008. This followed with a recession to reach through 2009 before recovery began (Memon, 2013). This global crisis was described as the worse financial crisis and witnessed by financial sectors and countries experienced a severe recession.

While many western banks defaulted during that period, no major Islamic bank default was reported during the crisis (Addawe, 2012). Islamic banking system engaged in the same banking activities with conventional banking system. The main difference between both systems is an element of riba. In Islamic system, an element

of riba (interest) is prohibited while in conventional system, interest is a key driver for profit. Islamic banks utilized other modes of finance to make their practice profitable rather than charging or paying interest. Nobel Prize Winner, French economist Maurice Allais believes that the best solution to this crisis is by adjusting the rate of interest to 0 percent and the tax rate will be revising about 2 percent. Islamic economist believes that this is the core of Islamic economic by promoting non interest based system (Alasrag, 2010).

The first attempts in Islamic finance can be traced in Malaysia and Egypt in the early 1960s. The first institutions that involved in Islamic finance in Malaysia was the Muslim Pilgrim's Savings Corporation set up in 1963 to help people save on a regular basis to pay for their pilgrimage to Mecca while Islamic banking in Egypt traces its roots back in July 1963 when a bank in the Egyptian town of Mit Ghamr was established as a rural saving bank, based on German local savings bank. However, the actual development of Islamic financial institution occurred in 1980s (ISRA, 2012). According to Almsafir, Al-Smadi and Balfaqih (2013), in 1985, the board of OIC (Organization of Islamic Conference) announced that the Islamic insurance or Takaful is Sharia compliant. Islamic finance also covers capital markets including other financial instruments as well as intermediaries and not only focusing to Islamic banking activities.

Recently, there are more than 300 Islamic financial institutions and 80 takaful operators with assets over US\$1 trillion worldwide (Ngadimon, 2009). According to

Ab-Rahim, Kadri and Ismail (2013), Malaysia is one of the Islamic countries that contribute about 13 percent (US\$38 billion) in the Islamic banking asset growth worldwide. This phenomenon has been contributed by Malaysia's long track record of over 30 years to build a successful domestic Islamic banking. Statistics from Bank Negara Malaysia (2012) shows that at December 2011, Malaysia's total Islamic banking assets has reached RM335 billion with an average growth rate of 16.07 percent over the period of 2002 until 2011.

The establishment of the first Islamic bank which is the Dubai Islamic bank in 1975 was initiated by a group of Muslim businessman based on special law that allowed them to engage in business while accepting deposits. Since then, most of the formations of Islamic banks around the world were private initiated. However, the establishment of Islamic banking in Malaysia is different compared to the Islamic banking in the Gulf and the rest of the world. The first Islamic bank in Malaysia which is Bank Islam Malaysia Berhad (BIMB) was set up because of government initiated (Samad, 2004). The establishment of BIMB in July 1983 under the Islamic Banking Act 1983 has marked the new era in Malaysia Islamic banking. Meanwhile, Malaysia also among the first nation in the world that allowed a full-fledged Islamic banking institution (Islamic bank) to operate side by side with the conventional banks after the government introduced the "Interest-Free Banking Scheme" a decade ago. From that, the conventional banks are allowed to offer Islamic banking products or services to customers and it is called as conventional bank's Islamic windows (Ab-Rahim et al., 2013).

The “Interest-Free Banking Scheme” was introduced to promote and encourage Islamic banking to be more efficient and effective mode in order to increase the number of institutions that offered Islamic banking services at lowest cost at the short time (Bank Negara Malaysia, 1994). The first local based banking group that launched Islamic subsidiary was RHB Group, which opened RHB Islamic Bank Berhad followed by Commerce Group that launched the Commerce Tijari Bank Berhad and the third was Hong Leong Group which set up the Hong Leong Islamic Bank. However, in July 1993, the scheme was extended to all conventional banks and the second full-fledged Islamic bank which is Bank Muamalat Malaysia Berhad (BMMB) was established in October 1999. All the Islamic banks transactions must be based on Shariah principles. The Shariah principles and requirements must followed by Islamic finance market such as prohibition of activities with elements of interest or riba. Prohibition of activities with elements of gharar, prohibition of gambling activities and prohibition of the production and sale of goods and services that are prohibited in Islam for example selling pork, liquor and etc.

Hence, in order to practice banking and other finance institutions without interest, Islamic banks have adopted Sharia compliant modes of finance. Islamic Finance modes can be divided into two types. The first type is direct finance as capital funds through partnership (Mudarabah and Musharakah). The second type is indirect finance through leasing and sale contracts such as Murabaha, Salam and Istisna’.



In mudarabah, investors supply a capital to financial institution for a specified project and the financial institution contributes skills and knowledge to the investors. Musharakah is contracts of partnership between two or more parties to invest in certain project by contributing the capital. Murabaha can also be defined as cost plus profit. It is refer to a contract when a bank act on behalf of a customer to purchases certain good with a request from client at certain price. The customer will pay back the actual amount plus agreed profit margin to the bank on deferred payments. Murabaha mode is most dominant in Islamic finance especially in trading (Khan, 2010). Ijarah or leasing means capitalist purchase a property and lease it to an enterprise without transfer the ownership. The lessor responsible to pay rental payment to the owner of the property while Salam refer to selling of certain good with a full payment of price but deferred in delivery of goods. Lastly, Istisna is a contract for a product that is still under construction by specification.

With all the facilities and incentives extended by Bank Negara Malaysia to the full-fledged Islamic banks, Islamic window and conventional banks, it has create curiosity whether the Islamic bank have performed well. Many are skeptical about Islamic bank's performance as new comers to the market. There are several reasons for this. Firstly, Islamic banks are non-conventional financial institution. In conventional banking system interest is a key driver for profit while in Islamic banking system it is completely prohibited. Second, Islamic bank required to follow two rules which are conventional business law and also the Islamic Law. Many profitable investment opportunities have to be sacrificed by Islamic banks because those are not permitted under the divine laws of Islam (Samad, 2004).

## **1.2 Problem Statement**

Malaysia's Islamic banking assets reached USD65.6 billion with an average growth rate of 18 percent to 20 percent annually. The statistic showed that Islamic Banking industry is growing on track in Malaysia. Malaysia has placed a strong emphasis on human capital development together with the development of the Islamic financial industry to ensure the availability of Islamic finance ability. These have transformed Malaysia into one of the most developed Islamic Banking Markets in the world. However, the growth of the Islamic banking and their performance also being questioned whether it is performed well or not.

Based on the previous studies conducted by IFSB-IRTI-IDB (2010), the combination of market capitalisation of top 10 conventional banks showed a declination of capital at 42.8 percent while Islamic banks decline in market capitalisation at 8.5 percent during the period between December 2006 until May 2009. Besides that, conventional banks also fell dramatically in an aggregate net profits from USD116 billion in year 2006 to a net loss of USD42 billion in year 2008. In contrast, Islamic banks experienced increasing in net profit at 9 percent during the same period from USD4.2 billion to USD4.6 billion while the other four of the conventional banks experienced the losses. Between year 2006 and 2008, total assets of the conventional banks grew by 36 percent to USD17.4 trillion while the assets of the Islamic banks grew by 55 percent from USD94 billion to USD147 billion. The growth in total equity during this period was 24 percent and 36 percent for conventional and Islamic banks respectively. Furthermore, conventional bank's leverage ratio also increased from 16.6 times in year 2006 to 18.2 times in year 2008. This was nearly three times

the leverage ratio of Islamic banks, which was 5.8 times in year 2006 and 6.5 times in 2008. Meanwhile, from the top 10 conventional banks, five are received government financial assistance to the extent of USD163 billion in aggregate or 26 percent of the affected bank's combined equity. However, only one Islamic financial institution required government assistance to restructure and trading of its shares was suspended. As at end 2009, none of the Islamic banks needed any government rescue scheme.

According to Wasiuzzaman and Ahmad Tarmizi (2010), most of the local commercial banks had implemented the Syari'ah law as a window of their Islamic banking products in the early 2000. Statistically, the market share of Malaysia's Islamic banks boomed from 3.37 percent in 1998 to 22.8 percent in 2007 with Islamic banking assets reaching USD65.6 billion. Currently, Maybank is the country's largest Islamic banking service provider with USD6.4 billion in Shariah-compliant assets followed by Bank Islam Malaysia, the second largest bank in the region. Other Malaysian banks include Hong Leong Islamic Bank, HSBC Malaysia, EON Bank, Affin Bank, Alliance Bank, OCBC Malaysia, Southern Bank, SME Bank, Standard Chartered Bank Malaysia, CIMB Group and Kuwait Finance House Malaysia (Choong, Thim and Kyzy, 2012). Previous studies shows that the full-fledged Islamic banks are more efficient than Islamic window banks nevertheless domestic Islamic banks (full-fledged and Islamic window) are more efficient than foreign Islamic banks (Ab-Rahim, 2013). Thus, this study aims to look at the profitability performance and contracts in the selected Islamic banks in Malaysia to see the differences between them.

Previous research also shows that most of the empirical studies about Islamic banking performance in Malaysia are limited to Bank Islam Malaysia Berhad (BIMB). The track record of BIMB during the first six years of its operation was fairly impressive and Bank Islam also has been suggested to develop institute research and development to serve the ummah (Samad, 2004). Furthermore, Rosly and Bakar (2003) found in their studies that Islamic bank has the ability to maintain the viability and growth in a capitalistic financial environment. Bank Islam Malaysia Berhad enjoyed relatively higher managerial efficiency than the conventional bank in year 1992 until 1996. Besides that, during year 1984 until 1997, Bank Islam also was more liquid compared to conventional bank and exposed to less liquidity risk (Samad and Hassan, 2000).

However, the studies done by Masruki, Ibrahim, Osman and Abdul Wahab (2012) found that conventional banks have a good return on assets compared to Islamic banks. The return on average assets (ROAA) for conventional banks is 1 percent while Islamic banks making a loss is at -0.7 percent. This is because of the losses incurred by Bank Islam Malaysia Berhad in year 2005 until 2006. Similarly with Bank Muamalat Malaysia Berhad that also incurred a net loss of RM26.3 million in year 2004. It is increase about 121 percent from the previous financial year. On the other hand, Bank Muamalat is more profitable and liquid compared to Bank Islam even though they are not significantly different. For efficiency measure, Bank Islam is much more profit efficient than Bank Muamalat in sense that they managed to earn higher profit rate and profit margin relative to average assets.

Islamic banks enter into different financing modes which have a distinct characteristics dictated by the underlying principles. Previous research shows that non-profit loss sharing is the most dominant financing. It is because of the prevalence of information asymmetry, moral hazard and adverse selection (Khan, 2010). According to Almsafir et al., (2013), among all Islamic finance modes, murabaha has the best performance. The data analysis shows that the highest mean value among Islamic finance modes was murabaha with RM874, 656.30. It is clearly proved this mode is the most favorable compare to the other modes of finance such as ijarah, Mudarabah and Musharakah. Murabaha is the most widely used mode by Islamic banks with about 75 percent of all businesses. It is used in loaning money for goods and can mitigate risk due to the fixed fee because of the riskiness on loan (Memon, 2013). However, the studies by Chong and Liu (2009) found that the most recommended theoretical models of Islamic banking are mudarabah and musharakah. These models or concepts are based on profit loss sharing (PLS). There are also other modes of Islamic financing that are permissible in Islam but they are not based on PLS. They are murabaha, ijarah, bai' salam, bai' muajjal and istisna'.

### **1.3 Research Questions**

- a. How is the performance of BIMB, RHB Islamic and BMMB?
- b. What are the patterns of the performances of Islamic banking?
- c. What are the differences between profitability performance and contracts in BIMB, RHB Islamic and BMMB?

## **1.4 Research Objectives**

The objectives of this study are:

- a. To investigate the profitability performance of BIMB, RHB Islamic and BMMB.
- b. To investigate the pattern of performance of BIMB, RHB Islamic and BMMB.
- c. To evaluate the differences between profitability performance and contracts in BIMB, RHB Islamic and BMMB.

## **1.5 Significance of the Study**

The outcome of this research will have an impact on Malaysian Islamic financial market, Islamic bank and academicians as well as to the society. It is of great interest to Islamic banking and finance institutions to improve the performance of Islamic banking systems as well as the performance of Islamic finance modes. It can also increase the percentage usage of Profit Loss Sharing instruments. Besides that, this study also can give an interest to a researcher to pursue a further research in this area. The expected result of this study is hoped to provide a better understanding to a reader about the previous performance of Islamic banking system and the potential growth in this industry. On the other hand, it also can provide the understanding in terms of the theory and concept of Islamic mode of Finance. This study also can

encourage and improve the practice and applications of certain mode of Islamic finance.

### **1.6 Scope of the Study**

The purpose of this study is to compare the performance of selected Islamic banking in Malaysia by using the time series data. The data collected is based on annual reports from Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad (BMMB) as a full-fledged local Islamic bank and from RHB Islamic bank as a conventional bank's which offer Islamic Windows. The comparison of the performance of selected Islamic bank in Malaysia is made from year 2005 to 2012 which is 8 years.

### **1.7 Limitation of the Study**

There is no problem regarding the availability of the data sources. This is because the data and information that is required is in the form of secondary data. This data can be obtained directly from the annual report of Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad (BMMB) and RHB Islamic Bank. However, this study is limited only on a similar Islamic mode of Finance which is practiced in Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad and RHB Islamic Bank. The entire three selected Islamic bank will not offer all the Islamic Finance modes and this may have an impact on the outcomes of the research.

## **1.8 Structure of the Study**

The study is divided into five sections. Firstly, Chapter One presents the background, research questions, and research objectives, purpose of the study, significant and the limitation of the study. In Chapter Two, literature on the background of selected Islamic banks, bank's profitability ratio and Islamic modes of finance are reviewed to justify the dependent and independent variables. The methodology used is explained in Chapter Three. Next in Chapter Four, the description and analysis of the data are provided. Lastly, the elaboration of the results in Chapter Five comes along with the conclusion and recommendations of the study.



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter analyzes important keys played in the performance of selected Islamic bank in Malaysia. As a quick idea, it will focus on the review of selected Islamic bank in Malaysia. The selected Islamic banks are Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad (BMMB) and RHB Islamic Bank Berhad (RHB Islamic). The last part will define Islamic mode of finance, general concept of profit, the profitability performance of return on assets (ROA) and return on equity (ROE) ratio.

#### **2.2 Unit Analysis**

The unit analysis of this study explained about the types of selected Islamic banks in Malaysia which are Bank Islam Malaysia Berhad (BIMB), RHB Islamic Bank Berhad and Bank Muamalat Malaysia Berhad (BMMB). Even though, all these three banks are Islamic banking, every one of them has a different characteristic. Bank Islam Malaysia Berhad can be classified as “government bank” and the biggest standalone Islamic bank by financial asset size in the country compared to Bank Muamalat. Meanwhile, Bank Muamalat Malaysia Berhad is the second full-fledged Islamic bank and also known as corporate bank. RHB Islamic bank is one of the best

conventional bank's subsidiary that offered Islamic bank services in Malaysia. The performance of these three banks will be compared in this study in order to find out if there any differences between Islamic banks. BIMB, RHB Islamic and BMMB have been selected based on the availability of data for the period of analysis and these three banks offer the same contracts in their operations and services.

### **2.2.1 Bank Islam Malaysia Berhad (BIMB)**

Bank Islam began operation as Malaysia's first full-fledged Islamic bank on 1<sup>st</sup> July 1983. Its establishment was primarily to fulfill the financial needs of Muslims in the country and to further extend its services to the whole population at large. Besides that, Bank Islam also is the first bank in Malaysia that fully based on Shariah principles (Abdul Rahman, 2000). Parallel with a vision to be "A Global Leader in Islamic Banking", Bank Islam Malaysia Berhad plays the role to realize Malaysia's dream of setting up and developing an Islamic financial system which is modern and competitive as well as being a viable alternative to the more established conventional system. The introduction of Islamic banking, a crucial component of an Islamic financial system and is also the first step towards realizing the nation's ambitions (Bank Islam, 2014).

In Bank Islam, the Malaysian government entrusted the responsibility of spearheading the advancement of Islamic banking and also an extensive spectral range of other specific Islamic financial services in Malaysia. This was done through the incorporation of its subsidiaries. Among others, Bank Islam Malaysia Berhad was

directly involved in developing financial sectors dealing in banking, takaful, stock broking, leasing, research and training and other related services. The cooperation between Bank Islam and its subsidiaries dealing with these services has completed the overall development of the whole Islamic financial system in Malaysia. On the other hand, Bank Islam was set up with an initial authorized capital of RM500 million and a paid up capital of RM79.9 million. The bank's paid up capital was increased to RM133.4 million in year 1991 to accommodate the growth of its asset and to better position itself in meeting future expansion and growth. The Bank was listed on the Main Board of the Kuala Lumpur Stock Exchange (KLSE) on 17 January 1992 (Abdul Rahman, 2000).

While Bank Islam is growing at a rapid pace, so too does the Islamic banking and finance sector. The bank's achievement in the local banking scene has forced their conventional competitors to imitate their achievement with the setting up of Islamic banking counters, windows and branches within their conventional set up beginning 1993. Since of that, Bank Islam undertook a restructuring exercise in 1997. The restructuring entails the incorporation of a new company that is BIMB Holdings Berhad that in the place of Bank Islam. Subsequently, BIMB Holdings was listed on the Main Board of the KLSE on 16 September 1997 in the place of Bank Islam (Bank Islam, 2014).

Based on Sabaruddin (2013), Bank Islam has developed into one of the respectable financial institutions in the country. Now, Bank Islam presently has network of 133 branches and more than 1200 self-service terminals nationwide. More over, Bank

Islam parades a comprehensive list of more than 70 innovative and sophisticated Islamic banking products and services, comparable to those of their conventional counterparts.

From the traditional financing, savings and investments types of products wholly for individual customers during the early years of establishment, the range of Bank Islam's Shariah based financial products, services and business solutions have significantly expanded to provide to the fast changing financial needs of customers from all categories including those related to micro financing, wealth management, capital market, treasury and structured products (Bank Islam, 2014).

According to Abdul Hamid and Azmi (2011), they found that most of the empirical studies on Malaysia Islamic banking are limited to Bank Islam Malaysia Berhad (BIMB). The track record of Bank Islam Malaysia Berhad during the first year of its establishment was fairly impressive and they also recommended that Bank Islam Malaysia Berhad must institute research and development to serve the Ummah. Besides that, based on the studies conducted by Samad and Hassan (2000), they found that Bank Islam Malaysia Berhad obtained the higher managerial efficiency compared to the conventional banks. These bank also more liquid and less liquidity of risk.

On the other hand, Bank Islam Malaysia Berhad (BIMB) also more efficient in obtaining the profit compared to Bank Muamalat in the sense that they managed to

earn higher profit rate and profit margin relative to average assets (Masruki et al., 2012). However, based on the 5 years analysis from year 2005 to 2009, it shows that in particular 2005 and 2006, BIMB made significant losses due to higher provisioning on non-performing financings. For the interbank analysis, BIMB also attained the same results when it does not show any difference in profitability performance compared to conventional banks. BIMB only obtained the differences in ROE performance and it revealed that BIMB is lagging behind the eight selected conventional banks (Abdul Hamid and Azmi, 2011).

### **2.2.2 Bank Muamalat Malaysia Berhad (BMMB)**

Bank Muamalat has been well known by Muslims in Malaysia as one of the pioneers of Islamic sharia banking services. It was established in 1<sup>st</sup> October 1999 from the Islamic banking components of the Bank Bumiputera, Bank of Commerce Malaysia and BMMB Kewangan. Conglomerate DRB HICOM Group owns 70 percent of the bank while Khazanah Nasional Berhad owns the remaining shares. Bank Muamalat already given Islamic banking services to meet the needs of consumers for more than 14 years. Bank Muamalat is a full-fledged Islamic institution that operates under the Islamic Banking Act (1983). The headquarters was in Kuala Lumpur and is a leading financial institution that offering Shariah based financial services and products (Bloomberg BusinessWeek, 2014).

Besides that, Bank Muamalat Malaysia Berhad (BMMB) is the second largest full-fledged Islamic bank and is envisaged to play its role in providing Shariah compliant

banking products and services to Malaysians, regardless of race or religious beliefs, therefore contributing to the growth of modern Malaysia. Bank Muamalat is committed to supporting the development of the national economy by providing Islamic banking services that can strengthen the economic foundations of the people. Meanwhile, Bank Muamalat also tries their best in order to pursuit of economic growth in the current era of the free market. Furthermore, Bank Muamalat is very innovative and creative in offering financial products and services to the consumers. There are about 59 branches across the country, 5 services centers and a Labuan Offshore branch. The Bank has staff strength of about 1,400 employees (Sabaruddin, 2013).

Bank Muamalat Malaysia Berhad provides Islamic banking and related financial services in Malaysia. Its consumer banking products include deposits such as savings, current and general accounts, financing products comprising mortgage, home financing, shophouse financing, land financing, personal financing, hire purchase and vehicle financing products. Besides that, they also provides Islamic wealth management, internet and electronic banking and other services. The company's wholesale banking products consists of corporate banking products that include financing and trade finance products, investment banking products such as Islamic capital market instruments and corporate advisory and consultancy services, treasury and capital market products and commercial banking and trade finance products. The bank also helps Muslims meet their zakat obligations by setting up accounts and providing calculators for that purpose (Bloomberg BusinessWeek, 2014).

Based on the studies conducted by Masruki et al., (2012), they found that the profitability and liquidity of Bank Muamalat is more profitable and liquid than Bank Islam even though statistically they are insignificantly different. The higher profitability of Bank Muamalat owed to the increased in financing and higher asset quality such as the financing quality compared to Bank Islam. Furthermore, Bank Muamalat also is less risky than Bank Islam. It is because of the strong equity cushion to cover liability, short term funding and assets.

### **2.2.3 RHB Islamic Bank (RHB)**

RHB Islamic Bank established on 1<sup>st</sup> March 2005 when RHB Banking Group officially received the license for its Islamic Banking subsidiary. RHB Islamic become as the first commercial banking group in Malaysia to have its full-fledged Islamic Bank. That year, the Governor of Bank Negara Malaysia, Tan Sri Dr. Zeti Akhtar Aziz officially handed over the Islamic Bank's operating license to RHB Banking Group. The based was in Kuala Lumpur, Malaysia and RHB Islamic bank is a subsidiary of RHB Bank Berhad (RHB Banking Group, 2014).

Based on Bloomberg BusinessWeek (2014), RHB Islamic Bank Berhad provides Islamic banking products and services in Malaysia. The company offers savings and current accounts, term deposits, home, property, vehicle and personal finance. Besides that, they also offered credit and debit cards, wealth management including will writing services, estate administration, trusteeship, declaration of "Harta Sepencarian", declaration of Hibah, Wakaf documentation and Hibah services,

privilege ladies banking and pawn broking services. On the other hand, it also provides private debt securities issuances, financings restructuring and syndication, general and project advisory services, term, revolving and hire purchase financing services, remittance services and investment products, cash management, collection and payment services as well as is engaged in money market operation and securities trading. The company operates a network of around 180 branches and 500 ATM's. It serves public listed corporations and its related entities, multinational corporations, financial institutions, government and state owned entities, high net worth individuals, small and medium enterprises and individual customers.

In year 2012, income from RHB Islamic Bank increased rapidly to RM438.9 million up 31.5 percent from the previous year. This is because of the higher net profit income on the back of strong Islamic financing growth and higher net gains on disposal of financial assets or investments portfolio. The amount of pre-tax profit also increased compared to the last year and RHB Bank has injected RM250 million capitals into RHB Islamic Bank. During the year, total asset obtained by RHB Islamic expanded from 72.7 percent to RM22.6 billion as at December 2011(RHB Bank Group, 2012).

According to RHB Bank Group (2013), it shows that the income of Islamic banking in RHB Islamic bank were increased by 24.2 percent to RM278.0 million, driven mainly by higher net funding income on the back of a 21.5 percent increase in financing based to RM17.9 billion from a year ago. Moreover, RHB Islamic Bank



also attained a pre-tax profit at RM93.8 million for the first half year 2013, marginally lower from RM94.2 million recorded a year ago.

## **2.3 Variables**

The variables used in this studies such as Islamic modes of finance (mudarabah, musharakah, murabahah, ijarah and istisna), profit generated by each year, return on assets (ROA) and return on equity (ROE).

### **2.3.1 Mudarabah mode**

Mudarabah is one of the Islamic Finance mode offered by Islamic banking. It is also known as a profit sharing. Literally, the word mudarabah is derived from the phrase “al-darb fi al-ard” which means to make a journey. This meaning related to this type of partnership because normally it requires, particularly in the past, travelling to do business. Some jurists like Hanafi and Hanbali scholars used the term mudarabah while Maliki and Shafi’i scholars defined it as qirad (ISRA, 2012).

According to Ahmad, Raashed and Ali (2013), Mudarabah is a business venture when two partners enter into a contractual arrangement and agreed to do a business under certain terms and conditions. Then, another studies also shows that two parties are involve in Mudarabah financing. One of the parties can be called as Rab-ul-Mal or financier who is act as a capital provider while the other one is the Mudarib that provides the expertise and effort to run the business. The profit will be divided

among them based on mutually agreed ratio and the losses will be borne by the capital provider as well as the labor will lose his effort (Almsafir et al., 2013).

Scholars of all known fiqh schools are of the view that mudarabah is a valid and legal contract. This view is based on evidences from the Quran, Sunnah and Ijma'. A clearer proof on the legality of mudarabah from the Sunnah is the act of the Prophet (peace be upon him) himself who used to work as a mudarib for Khadijah.

The best and the most profitable way in the condition of sharing with the worker in expected profit (mudarabah) since it is not always possible for the owner to employ a skilled person on regular wages to efficiently conduct trade on his behalf. Offer in mudarabah is done by saying the terms of mudarabah or any other terms to that effect (Almsafir et al., 2013). Addawe (2012), found in his studies that the project manager will be only cover for the losses of reward if the losses is not because of his negligent since their liability is only limited to the effort. So it is clearly shows that the bank will only enjoy the profit if a surplus exists.

Then, in the form of mudarabah which can play a role of a catalyst for transforming society into prosperity by extending capital facility to skillful persons lacking capital. Under mudarabah mode of financing, partnership between capital and skill is formed hence it can be used to provide self-employment to jobless skillful citizens (Hanif,

2011). According to Chammas (2007), the Lebanese SME sector will benefit from mudarabah financing as opposed to conventional high interest rate loans.

Another study by Chong and Liu (2009) shows that the mudarabah deposits, in practice are similar to conventional banking deposits and therefore should not be treated differently. Hanif (2011) also mentioned that it is difficult to expand business finance through mudarabah, because of limited opportunities to re-invest retained earnings or raising additional funds. Other than that, Mudarabah, a major Islamic mode of financing, provides limited control rights to shareholders and creating an imbalance in the governance structure of PLS as proposed in Islamic banking system. Besides that, the modern used this contract to require more than such preliminary specification of rights and responsibilities. There is a need for construction of standardized PLS contracts, or by laws, in the light of the legal frameworks of Muslim countries (Dar and Presley, 2000).

According to Hasan (2002), Mudarabah is the most sparingly used tools of financing in Islamic banking. There is a declining trend in most cases. For example, in the case of Bank Islam Malaysia Berhad the proportion of mudarabah or musharakah investment almost regularly declined from 4.3 percent in 1984 to 0.04 percent in 1994 while that of deferred sales went up from 86.3 percent to 90.2 percent during the same period. Furthermore, the failure of Islamic banking deposits to share in the losses of the bank is the best highlighted in the case of Bank Islam Malaysia Berhad in 2006 when the bank continued to pay out RM0.371 billion in “profit sharing” to its depositors even though experiencing a loss of RM1.3 billion. Besides that, Abu

Dhabi Islamic Bank financed through mudarabah not more than 1 percent compared to murabahah during the years 2000 and 2002. There is no declaration for mudarabah in the activities of the Kuwait Finance House during the years 2000 and 2001 (Kayed, 2012).

In 2009, mudaraba financing was 5.5 percent of the total but it accounts for more than 3.3 percent in Islamic Finance in Afrika (Duran and Lopez, 2012). Compared to interest finance, mudarabah leaves the bank in a state of uncertainty both with reference to the earnings and the return of money advanced, let alone the difficulties concerning the determination of the profit sharing ratio (Hasan, 2002).

### **2.3.2 Musharakah mode**

Musharakah comes from the root word sharakah which means sharing and mixing shares between two or more than two parties to make them interchangeable. In other words, musharakah also can be mention as profit and loss sharing. According to Almsafir et al., (2013), musharakah is an agreement between two or more parties to involve and conduct the business by joint investment. In musharakah contract, the financier provides a portion of capital while all the partners will contribute in management. The profit will be divided based on pre agreed ratios and the losses are based on proportion of capital contributions (Khan, 2010).

On the other hand, Hasan and Dridi (2010) mentioned that musharakah contract is suitable for various types of financing. The Islamic bank and a customer can provide capital to the enterprise. It can be a new project or by providing fund for the existing project, to the ownership of real estate or a moveable asset. The legality of musharakah contract is confirmed in the Qur'an, Sunnah and Ijma'. In the Qur'an, the concept of musharakah is mentioned in the verse related to the distribution of inheritance.

Musharakah can be divided into two categories which are Sharikah al-milk (ownership) and Sharikah ikhtiyar (optional). Shirkat-ul-milk can be defined as a form of partnership in which one of the partners' promises to buy the equity share of the other partner gradually until the title of the equity share is completely transferred to him. The basic element of Sharikah al-milk is the mix of ownership either by choice or mandatorily. In Shirkah ikhtiyar, the ownership is established based on the acts of the partners such as asset that has been jointly purchased by them or they became new owners of an asset as a result of a will or a gift (Almsafir et al., 2013).

According to Ahmed (2008) musharakah is the most preferable mode. In spite of the high risk of musharakah mode of finance and the high management skills needed, most of the respondents prefer musharakah as their mode of finance in dealing with their customers. Therefore, almost 60 percent of the sample respondents preferred musharakah and only 35 percent of them selected murabahah, whereas the remaining choose the salam, murabahah, istisna', muzarahah and mosagah. It is showed that the banks' employees more preferred in musharakah contract.

Meanwhile, Islamic finance operates a system called musharakah to make sure that any of inequalities do not occur. Musharakah lies at the heart of the Islamic financing philosophy, where the notion of sharing in risk and return between investors and entrepreneurs finds its natural home (Farooq, 2007). Besides that, Islamic bank also can advance money to a client using the contract of musharakah. Normally the bank will use the option of being sleeping partner. The contract can be more widely used by Islamic funds whereby the unit holders can assume the role of sleeping partners. The contract can also be used in securitized assets (Iqbal, 2013).

However, Ahmad and Shahed (2010) found that IFSPs in Australia invest only a small portion of their portfolio in PLS transactions (musharakah) and a very large margin of their assets in murabahah and ijarah modes of finance. According to Kayed (2012) the use of musharakah as a financing instrument by Saudi banks has decreased from 3.1 percent in the year 2000 to 1.1 percent in the year 2005. Musharakah represents around 6 percent of the total financing, 18 percent in Afrika and 2.3 percent in Europe (Duran and Lopez, 2012). There are practical problems in using the musharakah as a mode of financing, especially in the current economic situations where the Islamic banks are working in isolation, and mostly without the support of their respective governments. The fact, that the Islamic banks should look forwards of musharakah in gradual phases and should have increased the size of musharakah financing (Farooq, 2007).

Profits produced in musharakah is not guaranteed, as a result, the entrepreneur does not assure or secure profits. Fundamentally, no collateral is needed. Musharakah

does not require strict collateral guarantees and does not leave the partner (entrepreneur) with a heavy burden of debts, post-dated cheques or any kind of obligations compared with debt finance in the conventional system (Ahmed, 2008).

### **2.3.3 Murabahah mode**

Another Islamic Finance mode is Murabahah which means cost plus profit contract where parties, buyers and sellers agree on certain price without declared the amount of profit or loss (Ahmad et al., 2013). Besides that, Almsafir et al., (2013), define murabahah as an additional profit of trading. This instrument can be used to finance the purchasing of goods and services with the bank purchase these on behalf of customer and customer can pay it back to the bank on cash or either by installment. However, Usmani (1998) mentioned that Murabahah is not one of the Islamic Finance modes and its only particular types of sale. Because of certain difficulties having by using mudarabah and musharakah instruments in some area of financing, the expert scholars allowed to use Murabahah contract on deferred payment followed by certain condition.

The legality of the murabahah can be traced from the Qur'an, the Sunnah of the Prophet Muhammad (p.b.uh.) and the consent of the majority of Muslim jurists. In the Qur'an, Allah (s.w.t) has generally legalized sale contracts, one of which is the murabahah sale contract. He says: "And Allah has permitted trade and prohibited usury" (2.282). In this regard, a murabahah contract is a contract concluded on the

basis of mutual consent, and it falls under the general permission of acquiring wealth (ISRA, 2010).

Murabahah has the best performance among other mode of Finance. The study found that the highest mean value of Islamic Finance modes was murabahah with RM874, 656.30. Murabahah also significantly influences the probability (Almsafir et al., 2013). According to Kayed (2012), the share of murabahah has reached 65.3 percent of funding activities of Islamic Bank of Bangladesh and this bank did not utilize mudarabah mode of finance in its financing activities. Furthermore, Murabahah is chosen overwhelmingly by the banks even though it is not resell-able (liquidate-able) before maturity, it lends itself to any fixing of maturity at the time of contract. This is a feature which is not possible in mudarabah or musharakah contracts where accrual of profit to the bank is tied with the timing of the project cycle.

Futhermore, Murabahah financing is very useful for short to medium term financial requirements of business or nonprofit organizations and individuals. Murabahah financing is an asset based financing and anyone can request to an IFI for provision of an asset generally used for Halal purpose. By default under Islamic financial system, IFIs cannot lend cash for interest. One of the features of Murabahah is in case of delay in payment by customer IFI cannot ask for extra amount as time value of money like conventional banks. However penalty is imposed on defaulter if stipulated in original contract of Murabahah accordingly signed by the customer but cannot be included in the income of IFI. This penalty must be spent for charitable



purposes. Under murabahah scheme of financing facility is linked with assets which leads to economic stability and creates linkage between real and financial sector (Hanif, 2011).

According to Farooq (2007), Murabahah transactions are not accepted by devout Muslim and supposedly all the types of murabahah investment should move away. Al-Rajhi Bank, al-Baraka, and the Government of Sudan are among the institutions that have declared to phase out murabahah deals. This development creates difficulty for Islamic banking operations because murabahah trade financing is an indispensable tool.

The murabahah deals offer enough flexibility to be used in real estate and project financing, but factually it has been used primarily for trade finance. This instruments accounts for more than 77 percent of the total Islamic modes of finance in 2009 (more than 88 percent in Middle East and more than 76 percent in Asia). Then, the creation in 2004 of Islamic Bank of Britain, being the first Islamic institution in the world to offer Murabahah treasury deposit accounts, proved that dynamic economies have innovative financial sectors (Duran and Lopez, 2012).

#### **2.3.4 Ijarah mode**

Ijarah or lease means as an agreement between lessee and lessor. The lessee gains a long term contract for the use of an asset while the lessor enjoy the rental payments for a specified number of years and it is allowed under the Sharia but must be free from riba (Addawe, 2012). According to Hussain (2011), ijarah is the contract when the owner will rent the goods to other people for agreed rental rate and period of time. The ownership of the goods still belongs to the owner. Alasrag (2010) mentioned leasing as a popular instrument's for financing vehicles, machinery, equipment, and aircraft. Ijarah also can be defined as giving something on rent and it is also can refer to wages paid to a person in consideration of the services rendered by him.

According to Hanif (2011), Ijarah is a rental contract whereby IFI leases an asset for a specific rent and period to the client. Ownership risks of the asset are born by IFI while expenses relating to use the asset are the responsibility of client. The difference between ijarah and sale is that ownership in ijarah remains with lesser while in case of sales it is transferred to purchaser. Termination of ijarah in sale of asset is allowed by IFA through a separate contract at completion of term of lease. Contract can be executed prior to purchase and possession of asset. The asset cannot be leased out. Right of lessee to use the asset is restricted to lease agreement or as per normal course of business. Lessee is liable for any harm to the asset caused by any misuse or negligence on his part. Rentals of joint property are shared according to equity. A joint owner can rent his share only to the co-partner. Inter Bank Rate can be used as a

benchmark for amount of rentals. At the completion of ijarah term either asset is returned to IFI or purchased by client (Sharia Standard 9). Ijarah has replaced successfully the facility of leasing under conventional financial system.

Besides that, Duran and Lopez (2012) mentioned that the Ijarah contract similarly with conventional operating lease, where in an Islamic bank (lessor) leases the asset to a client (lessee) for agreed on lease payments for a specified period of time, but with no option of ownership for the lessee. The maintenance and insurance of the leased asset is under the lessor responsibility. Leasing in Islamic banking explains about 15 percent of the total Islamic finance in 2009 but near 35 percent in Europe.

On the other hand, ijarah or lease was a popular mode of financing in Islamic banking. Based on the studies by Ramli and Onn (2007), they describe the characteristic of ijarah thumma al-bay' (AITAB) from the shariah perspective. Meanwhile, Osmani and Abdullah (2010) also illustrated the application of AITAB, the mode of operations and legal restrictions in Malaysia. Based on the studies conducted by Said and Grassa (2013), they found that the ijarah sukuk is the most global sukuk issuance by sukuk structure during the period 2003 to 2012. The total issuance is about 37 percent.

Besides that, Ijarah also is one of the solutions that can be used to minimize the use of credit for personal consumption. The tools and equipment can be provided based on credit through the ijarah contract rather than in the form of cash while the raw materials and merchandise needed by them may be provided on the basis of

murabahah, salam and istisna' modes. If they also need some working capital, it may be provided as qard Hassan from the zakah fund (Chapra, 2008).

However, the divergence of Australian IFSPs' contracts of al- Ijarah wa al-Iqtina and al-Ijarah al-Muntahiyah bi al-Tamlik for Islamic housing finance it was not clear whether it was a lease, purchase or a combination of the two contract. It can be considered as valid when it was taken individually (Ahmad and Shahed, 2010). While the sukuk al-Ijarah modes of financing have commonly used in various global and local sukuk issues, it also has been criticized. This is because the sale and lease-back arrangement being close to the Bai al-Inah and the non-acceptance of major schools of thought except for the Shafi'i and secondly the fixed rent paid which is benchmarked to the conventional inter banks rates like LIBOR and KIBOR (Jabeen and Javed, 2007).

### **2.3.5 Istisna mode**

Chong and Liu (2009) defined istisna as contracts based on the concept of ordered or contract manufacturing whereby a party undertakes to produce specific good for future delivery at a pre-determined price. It can be used in the financing of manufacturing goods, construction and infrastructure projects. Besides that, Usmani (1998) mentioned that the contract of istisna creates a moral obligation on the manufacturer to manufacture the good. Any one of the parties can cancel the contract before the manufacturer start to making an order. However, once the manufacturer in progress of making the work, the contract cannot be cancelled unilaterally. This

mode of financing can be used for providing the facility of financing in certain businesses especially in the sector of house financing (Alasrag, 2010).

According to Iqbal (2013), istisna is similar to salam in the sense that both are exceptions to some general conditions of sale which prohibit selling of something which is not owned and is not in the possession of the seller at the time of sale. However, there are some differences between the two which are:

- i) The subject of istisna is always a thing which needs manufacturing, while salam can also be produced on things that do not include manufacturing.
- ii) The full payment of price in salam contract is necessary while in the case of istisna, the payment can be delayed.
- iii) The time of delivery in case of salam must be specified at the time of the contract but it is not necessary for istisna.

In a different study, Duran and Lopez (2012) find that Istisna as a pre-delivery financing and leasing structured mode that is used mostly to finance long-term large-scale facilities involving, for example, the construction of a power plant. So, this instrument of financing is useful for infrastructure projects. The Islamic Institution could own the plant, charge the lessee (Project Company) a fee based on profits, or sell the plant to the project company on a deferred basis with a profit mark-up similarly with murabahah transaction. However, there are certain expenses that cannot easily be reflected in a sale and purchase agreement can be included in the fees to be paid to the Islamic institution by the project company.

In early January 2005, Durrat Al Bahrain project issued US\$120 million of Islamic Istisna Ijarah based sukuk and has been oversubscribed by US\$32.5 million. The issuances of corporate sukuk as of 2008 are 55 percent for musharakah, 20 percent for ijarah, 11 percent for murabahah, 6 percent for mudharabah, 5 percent for istisna and 3 percent for BBA (Jalil and Rahman, 2012).

### **2.3.6 Concept of Profit**

According to Irfan (2008), profit reflected in all names given to it for the purpose of gain, benefit, advantage and others but it almost exactly the same. However, in present era of subject specialism the capitalist, economist and accounting, people will define “profit” from their own perspectives of subjects and use their own measures for profit measuring and estimation. For example, wealth, types for banking interest and etc.

Panel survey data shows bank profitability is very important to appraise at the micro and macro level of the economy. Profit is the essential of competitive banking institutions at micro stage and the lowest priced supply of funds. In a competitive environment, company need profit to attract external money to meet its set investment target. Thus, the bank’s management priority is to achieve an increased profit for doing any business. More over, profits are also essential in persuading depositors to provide their funds in term of bank deposit. Futhermore, sound bank with impressive profit figures can help reassure a bank’s other shareholders (Buyinza, 2010).

The essence of the Qur'anic theory of profit, whether in banking or the non banking organization, is the concept of equivalent countervalue ('iwad). Any profit created from a industry and commerce (al-bay') should include an equivalent countervalue. In realistic phrases, through 'iwad profit creation should embrace risk-taking (ghurmi). Work and effort must be apparent in trading as a trader is expected to exert his skills and know-how (ikhtiyari) in fulfilling his business obligations. He must offer warranties on items sold (daman) such that the welfare of clients isn't undermined when goods sold are found faulty and useless. When these conditions are met, trade and commerce should eliminate social imbalances as both seller and consumer have fulfilled their respective moral obligations, thus bringing both self and public interest into harmony (Rosly and Bakar, 2003).

Rosly and Bakar (2003) also determined that profits derived from fixed income instruments however are created without 'iwad, since loss are collateralized and contractual interest earned implies that banks hold no obligation to compensate losses of the borrowing party. In addition, banks add no value to the financial contract. They are prudent in debt collections and charge customers on all overhead expenses incurred such as expenditure on computer and security systems, checking accounts and credit card facilities. These charges, known as resource cost constitute a component of the interest rate on loans.

### **2.3.7 Return on Assets (ROA)**

According to Van Horne and Wachowicz (2005), Return on Assets (ROA) can be defined as profitability on the assets of the firm after all the expenses and taxes will be deducted. It measures an earning receives by the firms after tax for each dollar invested in assets of the firm. A firm or bank is said to have good performance when the ROA ratio increases. The higher the ROA ratio, the higher the profit obtained by the firm or bank. On the other hand, the lower the ROA ratio, the lower the firm or bank capability and the worse the performance of the bank (Hussain, 2011).

Several studies have used Return on Asset as dependent variable in explaining bank's profitability. According to Ben Naceur (2003), ROA is a ratio designed as net income over total assets and it is used to measure the profit earned per dollar of assets. It shows how well bank management use the bank's real investments resources to generate profits. For instances, he used this ratio in his study to determine the Tunisian banking industry profitability. Other studies by Akther, Raza, Orangzab and Akram (2011) also used Return on Assets as one of the ratio to measure the efficiency and performance of banks in Pakistan.

On the other hand, Samad (2004) find out in his study that all the average of ROA and ROE of Islamic banks are not significant difference between conventional banks. Another studies by Abdul Hamid and Azmi (2011), also found that all three measures of profitability such as return on asset (ROA), return on equity (ROE) and



profit expenses ratio (PER) are not statistically significant. The Return on Average Assets (ROAA) for Islamic banks is -0.7 percent while for conventional is 1.0 percent. This indicates that conventional banks have a healthy return on assets compared to Islamic banks (Masruki et al.,2012).

Based on the studies done by Samad and Hassan (2000), they found that the examination of various performance measure and the inter-temporal comparison of BIMB's performance reveal that Islamic bank made significant progress on return on assets (ROA) and return on equity (ROE) during 1984 until 1999. The average ROA, PER and ROE in this period were 0.43, 21.5 and 8.07 respectively. The comparison between BIMB and the conventional bank doesn't show any difference in performance. On the other hand, IBS also shows the higher value of ROA compared to mainstream banks. The ROA for IBS is 1.16 percent while mainstream banks at 0.41 percent. The difference is statistically significant with p-value 0.0111 (Rosly and Bakar, 2003).

According to Siraj and Pillai (2012), the ROA value of Islamic banks during 2005 until 2010 is about 2.63 percent while conventional banks obtained ROA value at 1.61 percent. The Islamic banks performance over last five years showed decreasing trend of ROA, hence needs to be improved in the long run.

### **2.3.8 Return on Equity (ROE)**

According to Hussain (2011), Return on Equity (ROE) is an indicator of profits. This ratio can be used to measure how efficient a firm uses assets to generate profits. Besides that, it also measures the return on the ownership of the owners of common shares and the efficiency of a company to generate profits from each unit of equity. Just like ROA, ROE shows how well a firm uses an investment fund to generate profit growth. If the ROE ratio for a bank is high, it is an indication that the bank has high return on its equity capital. If its ROE ratio is low, the return on its equity capital is also low (Ross, Westerfield and Jaffle, 2010).

Previous research examined, ROE as dependent variable against probability (Bashir and Hassan, 2004). ROE will show how efficient a bank's management in using capital from their shareholders. Besides that, ROE also will be used as one of the subject to analyses trend of probability (Mat Zam, 2011). Based on the studies conducted by Akhter et al., (2011), they found that the ROE value for Islamic bank, National and Private Bank are 18.26 percent, 317.81 percent and 86.31 percent respectively. The performance of the Islamic Bank is not remarkable while national banks reveal the outstanding performance. According to Samad (2004), there is no significant different between conventional and Islamic banks in Bahrain in terms of performance of ROE. The ROE value for Islamic banks is at 7.1 percent while conventional banks at 8.57 percent.

Meanwhile, Masruki et al., (2012) examine that in terms of Return on Average Equity (ROAE) which is the amount of profit the banks generate with the money shareholders have invested, the Islamic Banks recorded less ROAE than conventional at the average of 0.70 percent compared to conventional at 13.7 percent. Conventional banks obtained the higher value of ROAE due to the higher net financing and better asset quality that they have.

## **2.4 Summary**

As a conclusion, the previous point in this chapter mainly concentrated on the details about the selected Islamic banks and also followed by the Islamic modes of finance which are mudarabah, musharakah, murabahah, ijarah and istisna. Then, continued with the general explanation about the concept of profit and profitability performance (ROA and ROE). The next chapter three will discussed the details about methodology used in this study.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1 Introduction**

A research methodology is a basic guide in the data collection and analysis phases for a research paper. It is a framework that specifies the type of information to be collected, the source of data, data collection and procedures towards the finding based on the data collected.

#### **3.2 Research Design**

Research designed is the overall plan or structure that is used to conduct an entire study. This study is to determine the performance of selected Islamic banks in Malaysia and quantitative research method is found to be more appropriate for this study. It will be focused in the descriptive / exploratory method. These methods help tremendously in gathering information due to their advantages. Besides that, it is generally the best ways for collecting information that will demonstrate relationships and describe the world as it exists. This effort to obtain accurate, factual, systematic data that can provide an actual picture of the data set.

### **3.3 Measurement of Variables**

In this study, assessment on the probability performance in selected Islamic bank in Malaysia is done using financial ratios. Bank's profitability performance is measured using financial ratios such as Return on Assets (ROA), Return on Equity (ROE), profit generate by each year for three selected Islamic bank and also total of Islamic mode of finance offered for every year.

#### **3.3.1 Profitability Performance**

There are several financial measures for evaluating performance of firm. In this study, the three types of variables will be used. They are:

- a) Profit
- b) Return on Assets (ROA)
- c) Return on Equity (ROE)

##### **3.3.1.1 Profit**

This is designed in order to find out the total net income or loss generated by each bank for every year.

Formula for profit:

$$\text{Profit} = \text{Net Profit} / \text{Loss after Tax}$$

It is important to show how profitable the bank is over a period of time. The higher the profit, the better the firm / bank is. The lower the profit, the less efficient the operation of a firm / bank.

### **3.3.1.2 Return on Assets (ROA)**

Return on Assets (ROA) is the most comprehensive measure in overall performance accounting in a bank. It can be as an indicator to show how profitable a firm is relative to its total assets. Then, ROA is usually presented in percentage form and this percentage shows the total profit earned by its assets. Profitability depends on the available assets in a bank. The higher the ROA ratio, the higher the capability of the bank, and the better the performance and management efficiency of the bank. While, the lower the ROA ratio means the worse the performance and management efficiency of the bank.

Formula for ROA calculation:

$$\text{Return on Assets (ROA)} = \frac{\text{Net Income}}{\text{Total assets}}$$

Return on Assets (ROA) is effective management in order to generate profit from each investment (Hussain 2011). According to Mat Zam (2011), ROA also has been used as dependent variable to measure profitability in the study. It also can help to identify the effectiveness of a bank's assets. Besides that, Samad (2004) find out in his study that all the average of ROA and ROE of Islamic banks are not significantly different between conventional banks. Hamid and Azmi (2011) argues that all three measures of profitability such as return on asset (ROA), return on equity (ROE) and profit expenses ratio (PER) are not statistically significant.

### **3.3.1.3 Return on Equity (ROE)**

Return on Equity (ROE) presents the total returns earned for each shares owned. Besides that, it also can be defined as net income divided by total equity. The function of ROE is to measure how profitable a shareholder's investment is. Higher level of ROE will achieves a higher return on equity capital. Then, a lower level of ROE shows a bank does not earn a high return on its capital equity. Futhermore, this ratio is also used to measure the efficiency of a firm or a bank in generating profit from each unit of equity. It will show the total of bank's profit has been generated by shareholders.

Formula for ROE calculation:

$$\text{Return on Equity (ROE)} = \frac{\text{Net Income}}{\text{Total Equity}}$$

According to Bashir and Hassan (2004), ROE can be as dependent variable in their study of profitability. This variable will show how efficient a bank's management in using capital from their shareholders. Besides that, Return on Equity (ROE) also will be used as one of the subject to analyse trend of profitability (Mat Zam, 2011).

### **3.4 Research Hypothesis**

According to Zikmund (2010), hypothesis is a statement of the relationship between two or more variables. It is usually always in declarative sentence form, and they relate variable to variable. They are guides for the investigation in the entire process of a research endeavor and they keep the research on the main line of study. It is importantly seen as the beacon that lights the path for the research work. In view of the above, hypotheses have been developed as the following:

#### Hypothesis 1

Ho: There are no differences in profitability performance of BIMB, RHB Islamic bank and BMMB.

H1: There are differences in profitability performance of BIMB, RHB Islamic bank and BMMB.

#### Hypothesis 2

Ho: There are no differences of Islamic Mode of finance (contracts) offered by BIMB, RHB Islamic bank and BMMB.

H1: There are differences of Islamic Mode of finance (contracts) offered by BIMB, RHB Islamic bank and BMMB.



### **3.5 Data Collection Technique**

The data of this study will be collected by using secondary data. According to Malhotra and Birks (1999), secondary data can be defined as data collected for some purposes other than the problem in hand. Then, the secondary data was collected from the already existing annual reports, journals, published magazines, company records and the internet. Besides that, this type of data has been used to supplement on primary data because it was already available and was less costly than other sources of data.

In this research, the data are collected in annually performance of return on assets (ROA), return on equity (ROE), and profits generated for each of the banks as well as the total sales of each modes of Islamic finance such as mudarabah, musharakah, murabahah, ijarah and istisna from year 2005 to 2012. This period covers 8 years of analysis and representing 3 phases of pre-crisis, crisis, and post-crisis years. All the data are collected from Annual Reports of Bank Islam Malaysia Berhad, RHB Islamic bank and Bank Muamalat Malaysia Berhad.

### **3.6 Population of interest**

The proposed population of interest for this study will be the total of Islamic banks in Malaysia. This research intends to compare the performance of selected Islamic banks in Malaysia.

### **3.7 Target Population**

The target population chosen in this study is the total of full-fledged local Islamic bank and conventional bank's Islamic Window in Malaysia.

### **3.8 Sampling Size**

The three selected Islamic banks which are Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad (BMMB) as a full-fledged local Islamic bank and RHB Islamic bank (RHB) as a conventional bank's Islamic Windows.

### **3.9 Data Analysis Techniques**

In this study, SPSS (The Statistical Package for the Social Sciences) version 19.0 and Microsoft excel will be used to analyze all related data and interpret the result findings. The specific method is used to accomplish this study. There are several analysis techniques involved such as descriptive analysis, parametric test (one-way ANOVA and T-Test) and non-parametric test (Kruskal Wallis and Wilcoxon rank Sum W Test). However, due to small sample of this study, non-parametric will used to compare and support the results of parametric test.

All the result will be presented in table and graphical forms and follows with full explanations.

### **3.9.1 Descriptive Analysis**

According to Sekaran (2009), descriptive analysis is the transformation of raw data into a form that will make the researcher easy to understand and interpret, rearranging, ordering, and manipulating data to provide descriptive information. This analysis is useful to describe data or to see characteristics of the data. Besides that, descriptive analysis also is analysis of statistics such as frequencies, mean and the standard deviation which provide descriptive information of a set of data (Segaf, 2009).

### **3.9.2 One-Way ANOVA and Kruskal Wallis**

According to Zikmund (2010), one-way ANOVA can be defined as the analysis of the effects of one treatment variable on an interval scaled or ratio scaled for dependent variable. It used to test if any of few variable means are different from each other. Coakes and Steed proposed Kruskal Wallis as the analysis of variance by ranks. It is used to compare three or more sets of scores that come from different groups. Besides that, it also used as a technique to determine if statistically significant differences in means occur between two or more groups. When there are more than two groups and to compare their performance across a dependent variable, then it is suitable to use ANOVA or Kruskal Wallis test.

### **3.9.3 T-Test and Mann-Whitney U Test (Wilcoxon rank Sum W Test)**

T-Test and Wilcoxon are used to determine if there is significant relationship between the independent variables and the dependent variables. Then, this analysis is used to measure of how extreme a statistical estimate is. This statistic can be computed by subtracting the hypothesized value from the statistical estimate and then dividing by the estimated standard error. In many, but not all situations, the hypothesized value would be zero. Correlation analysis is concern with the study of the relationship between two variables. By using SPSS, the hypothesis is accepted when p-value is less than 0.05 because level of significance is tested at 0.05.

According to Wasiuzzaman and Nair Gunasegavan (2013), t-test can be used to determine if there is a significant relationship difference between all the variables. Independent t-test were carried out on each variables in the study. Besides that, independent t-test is also used to test the null hypothesis of the equality of means in all three stages of comparison. This analysis compares the mean scores of the two groups on a given variable (Abdul Hamid and Azmi, 2011). Similarly with t-test, Wilcoxon test also used to test the null hypothesis that two populations are the same against an alternative hypothesis, especially that a particular population tends to have larger values than the other (Cooper and S.Schindler, 2006).

### **3.10 Summary**

The methodology used in this study is explained in this chapter together with the theoretical framework and the variables selected. Other than that, the hypothesis to be tested in this study is also explained. The next chapter, chapter four incorporates the empirical presentation of the pattern of data analysis results which is also relevant to research questions and hypothesis.

## **CHAPTER FOUR**

### **FINDINGS AND DISCUSSIONS**

#### **4.1 Introduction**

This chapter presents the findings and analysis of the research. The method of analysis uses three methods, the first one is descriptive analysis, then the second is One-Way ANOVA and Kruskal Wallis and the last one is T-Test and Wilcoxon analysis. The whole sample period of the study is from year 2005 to 2006 which is during pre-crisis period, crisis period from year 2007 to 2009 and post crisis period in year 2010 to 2012.

The aim of the analysis is to determine the performance of selected Islamic banking system and to investigate the pattern of the performance from the year 2005 to 2012. Data were analyzed using variables such as profit generated by selected Islamic banks for each year, Return on Assets (ROA), Return on Equity (ROE) and Islamic mode of finance (contracts) offered by these banks. The method of analysis for assessing the performance and pattern of analysis in selected Islamic banking system is presented in the forms of diagrams, specifically charts, graphs and tables. This facilitates analysis to compare the performance of banks comprising the selected Islamic banking system.

In order to find out the relationship between the variables, the hypothesis for the performance, Islamic mode of finance (contracts) and profits among these selected Islamic banks will be test by using parametric test (One-Way ANOVA and Kruskal Wallis) and non-parametric test (T-Test and Wilcoxon). Then, the findings are presented in table forms.

## **4.2 Performance of Selected Islamic Banks System**

In this study, the performance between selected Islamic banks in Malaysia which are BIMB, RHB Islamic bank and BMMB has been descriptively compared in terms of profit, Return on Assets (ROA) and Return on Equity (ROE) generated by all these three banks.

### **4.2.1 Profit**

This is designed in order to find out the total net income or loss generated by each bank for every year.

Formula for profit:

$$\text{Profit} = \text{Net Income or Loss after Tax}$$

It is important to show how profitable the bank is over a period of time. Table 4.2.1 shows the value of profit for BIMB, RHB Islamic Bank and BMMB from 2005 to 2012.

Table 4.2.1: *Profit for three selected Islamic banks from 2005 to 2012*

<b>Year / Bank</b>	<b>RHB</b>	<b>BIMB</b>	<b>BMMB</b>
<b>2005</b>	41,484	(507,807)	32,328
<b>2006</b>	86,362	(1,296,789)	73,889
<b>2007</b>	118,278	251,288	49,442
<b>2008</b>	85,886	384,117	30,295
<b>2009</b>	63,469	160,607	82,273
<b>2010</b>	67,489	411,778	97,528
<b>2011</b>	97,854	359,159	134,014
<b>2012</b>	155,896	430,785	84,370

BIMB obtained negative profit for two consecutive years, 2005 with profit of (-RM507,807) and 2006 at (-RM1,296,789) while RHB Islamic Bank obtained the highest profit for three consecutive years, 2005, 2006 and 2007 at RM41,484, RM86,362 and RM118,278 and BMMB also got the highest value of profit at RM32,328 and RM73,889 respectively.

However, the profit for RHB Islamic Bank started to decrease from year 2008 to 2009 at RM85, 886 and RM63, 469. In contrast with RHB Islamic, BIMB profit performance keeps increasing from year 2007 to 2008 at RM251, 288 and RM384, 117 but drops in 2009 at RM 160,607. Meanwhile, BMMB's profit also started to decrease in year 2007 to 2008 at RM49, 442 and RM30, 295 and increased again in year 2009 at RM82, 273.



After the financial crisis in year 2010, all the banks' profit increased in profit. The highest profit for this year is BIMB at RM411, 778 followed by BMMB at RM97, 528 and RHB Islamic at RM67, 489. In year 2011, the profit for RHB Islamic and BMMB keep increasing at RM97, 854 and RM134, 014 while BIMB drops the profit to RM359, 159. However, the highest value of profit for 2011 belongs to BIMB.

For the last year of analysis (2012), BIMB obtained the highest value of profit compared with RHB Islamic and BMMB. The value is RM430, 785 and followed by RHB Islamic at RM155, 896 and BMMB at RM84, 370. BMMB drops the value of profit for this year.

#### **4.2.2 Return on Assets (ROA)**

Return on Assets (ROA) is designed as net income over total assets. This ratio is a good indicator of a bank's financial performance and managerial efficiency (Ross et al., 2010). Besides that, it also shows the competency of the management in allocating asset into net profit.

Formula for ROA:

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

A bank is said to have good performance when the ROA ratio increases. The higher the ROA ratio, the higher the profit obtained by the bank. On the other hand, the lower the ROA ratio, the lower the bank capability and the worse the performance of the bank (Hussain, 2011).

Table 4.2.2 shows the ROA percentage obtained by three banks in the Islamic banking systems which are Bank Islam Malaysia Berhad (BIMB), RHB Islamic Bank and Bank Muamalat Malaysia Berhad (BMMB) from the year 2005 to 2012.

Table 4.2.2: *ROA in three selected Islamic Banks from 2005 to 2012*

<b>Year / Bank</b>	<b>RHB</b>	<b>BIMB</b>	<b>BMMB</b>
<b>2005</b>	1.05	-3.02	0.45
<b>2006</b>	1.55	-8.74	0.87
<b>2007</b>	1.97	1.4	0.47
<b>2008</b>	1.27	1.45	0.31
<b>2009</b>	0.84	0.91	0.73
<b>2010</b>	0.75	1.16	0.73
<b>2011</b>	0.55	1.57	1.17
<b>2012</b>	0.65	1.72	0.64

BIMB obtained negative value for two consecutive years which is from 2005 to 2006 at -3.02 percent and -8.74 percent while RHB Islamic and BMMB obtained positive value for this period. The ratio value is at 1.05 percent and 1.55 percent for RHB Islamic and 0.45 percent and 0.87 percent for BMMB.

In the early of year 2007, when financial institutions all over the world were shaken up by global financial crisis, RHB Islamic bank obtained the highest value for ROA, which is at 1.97 percent. Besides that, it is also the highest value of ROA for this year and for the eight years period of analysis compared to BIMB at 1.4 percent and BMMB at 0.47 percent. Based on this table, it looks like BIMB increase the ROA value by 7.34 percent while BMMB decreased the value by 0.4 percent.

However, in year 2008, the ROA value for RHB Islamic decreased from 1.97 percent to 1.27 percent and the same goes to BMMB when it decreased from 0.47 percent to 0.31 percent. BIMB experienced increasing value of ROA for this year at 1.45 percent. Then, from year 2009, ROA value for RHB Islamic started to decrease and obtained the lowest value for year 2011. The value is at 0.84 percent, 0.75 percent and 0.55 percent. In year 2012, the ROA value increase back at 0.65 percent.

On the other hand, ROA value for BIMB also decreased at 0.91 percent in year 2009 and keeps increasing until at the end of year 2012 at 1.16 percent, 1.57 percent and 1.72 percent while BMMB's value remained constant for year 2009 to 2010 at 0.73 percent. Then, it increased to 1.17 percent in year 2011 and drops again to 0.64 percent in year 2012.

### 4.2.3 Return on Equity (ROE)

Return on Equity (ROE) is designed as net income over total equity. This ratio will shows a rate of return based on capital such as equity capital.

Formula for ROE:

$$\text{ROE} = \frac{\text{Net Income}}{\text{Total Equity}}$$

If the ROE ratio for a bank is high, it is an indication that the bank has high return on its equity capital. If its ROE ratio is low, the return on its equity capital is also low (Ross *et al*, 2010). Previous research examined, ROE as dependent variable against probability (Bashir and Hassan, 2004). ROE will show how efficient a bank's management in using capital from their shareholders. Besides that, ROE also will be used as one of the subjects to analyse the trend of probability (Mat Zam, 2011).

Table 4.2.3 shows the ROE percentage obtained by three banks in the Islamic banking systems that are Bank Islam Malaysia Berhad (BIMB), RHB Islamic Bank and Bank Muamalat Malaysia Berhad (BMMB) from the year 2005 to 2012.

Table 4.2.3: *ROE in three selected Islamic banks from 2005 to 2012*

<b>Year / Bank</b>	<b>RHB</b>	<b>BIMB</b>	<b>BMMB</b>
<b>2005</b>	13.62	(65.7)	8
<b>2006</b>	20.01	(460.0)	16.72
<b>2007</b>	23.31	23.33	8.86
<b>2008</b>	14.46	26.54	6.12
<b>2009</b>	9.96	16.48	11.24
<b>2010</b>	9.64	16.54	11.24
<b>2011</b>	8.45	18.51	15.24
<b>2012</b>	10.3	20.35	8.9

In the first year of analysis which is 2005, RHB Islamic obtained the highest value of ROE at 13.62 percent compare to BIMB and BMMB. BMMB obtained the ROE value for year 2005 at 8 percent. Meanwhile BIMB experienced a negative value of ROE in year 2005 and 2006 at (65.7 percent) and (460.0 percent).

On the other hand, in year 2006, RHB Islamic bank and BMMB obtained positive value and increased from the previous year. The highest value of ROE belongs to RHB Islamic at 20.01 percent and followed by BMMB at 16.72 percent. The value of ROE drastically increases in year 2007 for BIMB even though it is in time of financial crisis. Similarly with RHB Islamic bank, ROE value in year 2007 increased to 23.33 percent. However, ROE for BMMB decreased from 16.72 percent to 8.86 percent.

In year 2008 to 2011, the ROE value for RHB Islamic start to decrease 14.46 percent, 9.96 percent, 9.64 percent and 8.45 percent. The lowest value for RHB Islamic is in year 2011 at 8.45 percent. In the last year of 2012, this value increased again to 10.3 percent. In contrast with RHB Islamic, BIMB's ROE increased in year 2008 at 26.54 percent but dropped to 16.48 percent. Meanwhile, the ROE value for BMMB decreased at 6.12 percent and increased in year 2009 at 11.24 percent and remains constant until year 2010.

Furthermore, in year 2011 and 2012, BIMB increased the value of ROE to 18.51 percent and 15.24 percent. Similarly with BMMB that also increase the value in year 2011 to 20.35 percent except in year 2012 that decreased to 8.9 percent.

#### **4.3 Pattern of the Performance of Selected Islamic Banks in Malaysia**

Trend analysis is the practice of collecting information and attempting to spot a pattern or trend in the information. This often involves comparing the same metric historically either by examining it in tables or charts. Often this trend analysis is used to forecast or inform decisions around future events but it also can be used to estimate uncertain events in the past.

### 4.3.1 Trend analysis of profit

In general trend analysis of profit performance, RHB Islamic bank score the highest level of profit from year 2005 until 2007 compared to BIMB and BMMB. However, RHB show the pattern of decreasing in year 2008 until 2009 and increased in year 2010 until 2012. BMMB also increase the value of profit from year 2005 to 2006 and maintain the fluctuated trend until year 2012. On the other hand, BIMB begin with negative value of profit for two consecutive years. Drastically increased in year 2007 and overtook RHB Islamic bank and BMMB. In year 2008 until 2012, BIMB shows the increasing pattern in profit performance except for year 2009. BIMB is leading in a profit with a large gap compared to RHB Islamic and BMMB.

For the detail analysis of profit for three selected Islamic banks, the results were discussed below:

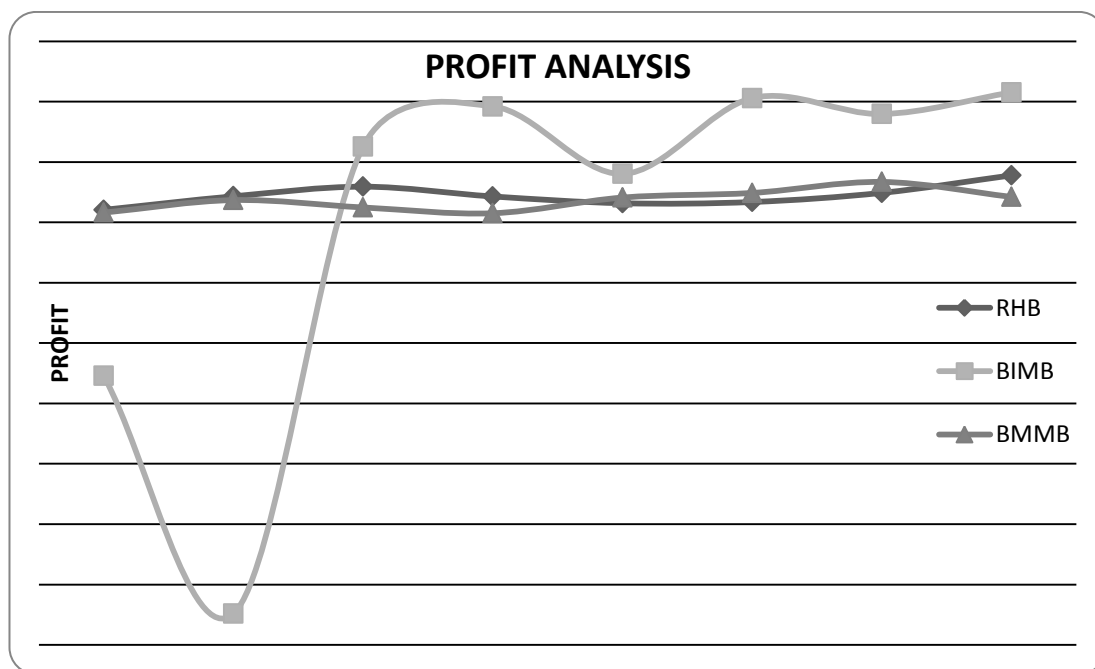


Figure 4.3.1: *Trend Analysis of the Profit*

In an early entrance in the banking industry, RHB Islamic bank already gains positive value of profit which is RM41, 484, RM86, 362 and RM118, 278 in year 2005 to 2007. Similarly with RHB Islamic bank, BMMB also experienced positive value of profit for year 2005 until 2006. However, BIMB suffered hefty losses of RM507, 807 and RM1, 296,789 in year 2005 and year 2006 respectively due to sizeable financing-loss charges.

By looking at the year 2007, BIMB drastically increased the value of the profit performance and obtained the highest value of profit for this year compared to RHB Islamic and BMMB. In contrast with BIMB and RHB Islamic, BMMB decreased the profit value from the previous years and obtained the lowest value of profit for year 2007 at RM49, 442.

In the three years up to 2010, the BIMB's profits have been trending upwards. The value of profit had continued increasing except in year 2009. Similarly with BIMB, BMMB also experienced increasing trend until year 2011 except year 2008. However, the RHB Islamic bank's profits have been trending downwards from year 2008 until 2009 and increased again in year 2010. BIMB score the highest value of profit in year 2010 followed by BMMB and RHB Islamic bank. The increasing trend for all banks in year 2010 can be related with the recovery of economic after the global financial crisis period.



The profit value keeps increasing in year 2011 for RHB Islamic bank and BMMB but not for BIMB. In the last year of 2012, the two of selected Islamic bank experienced increasing trend again with the highest score of BIMB and then followed by RHB Islamic bank while BMMB decreased at RM84, 370.

#### **4.3.2 Trend analysis of ROA**

In general trend analysis of ROA, RHB Islamic bank scored the highest level of ROA from year 2005 until 2007 compared to BIMB and BMMB. However, RHB Islamic show the pattern of decreasing of ROA begin in year 2008 until the year 2012. On the other hand, BIMB begin with negative value of ROA for the two consecutive years (2005 to 2006). Drastically increased in year 2007 and overtook BMMB and RHB Islamic bank in year 2008 then continues the increasing trend until year 2012. Meanwhile BMMB maintain the fluctuated trends until year 2012.

For the detail analysis of ROA of three selected Islamic banks, the results were discussed below:

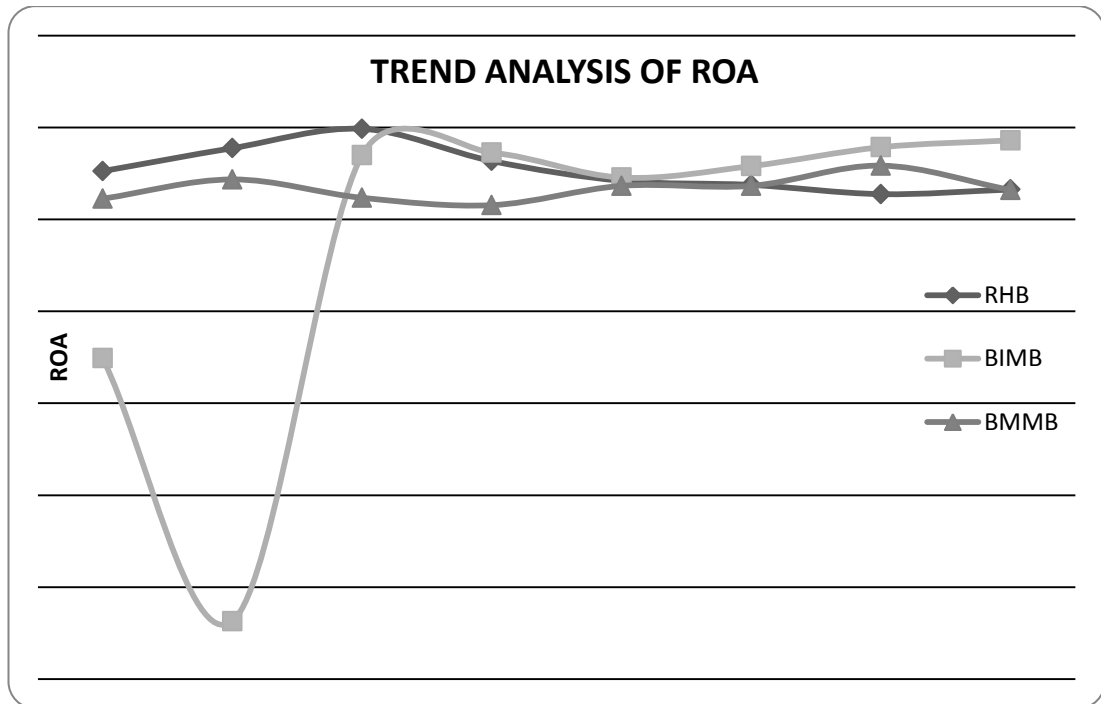


Figure 4.3.2: *Trend Analysis of ROA*

It shows the movements of ROA level in three selected Islamic banks in Malaysia from year 2005 until 2012. The ROA level has been fluctuating over the period for all banks. RHB Islamic bank scored high ROA from year 2005 until 2007 compared to BIMB and BMMB. However, BMMB also obtained positive value for these two years while BIMB experienced negative value for ROA in two consecutive years at (3.02 percent) and (8.74percent).

In year 2007, the figure shows that RHB Islamic hit the highest point of ROA compared to BIMB and BMMB. The increase in the ROA ratio of RHB Islamic for this year due to the total assets and total profits increases compared to the previous years. Meanwhile, BIMB drastically scored 1.4 percent of ROA value followed by BMMB at 0.47 percent.

However, in year 2008, RHB Islamic bank shows decreasing trend of ROA at 1.27 percent. This trend continuously decreased until the year 2011. Similarly with BMMB, the value of ROA also drops in the year 2008 while BIMB slightly increased the value at 1.45 percent in year 2008. The decreasing trend is basically caused by the effect of the financial crisis. Meanwhile, the decrease in the ROA ratio for the banks is due to the fact that even though the total profits and total assets for the banks increase for each year. However the increases in assets overshadow the increase in profits for certain years. Then, the result tends to decrease in ROA ratio.

On the other hand, in year 2009, BIMB started to decrease the ROA value at 0.91 percent while BMMB increased the value at 0.73 percent and it remains constant till year 2010. In year 2010, BIMB hit the highest value of ROA at 1.16 percent comparing to RHB Islamic bank and BMMB. Furthermore, in year 2012, RHB Islamic increased again the value of ROA at 0.65 percent and same with BIMB that experiences upwards trends of ROA ratio from year 2011 to 2012 at 1.57 percent and 1.72 percent. The increase in ratio can be said because of many types of products and services offered by the banks in order to attract peoples doing their transaction in the bank and at the same time can increase the profit and asset value. However, in year 2012, ROA value for BMMB was drops to 0.64 percent and it reaches the lowest point in this period compared to BIMB and RHB Islamic bank.

### 4.3.3 Trend Analysis of ROE

In general trend analysis of ROE, RHB Islamic bank scored the highest level of ROE from year 2005 until 2006 compared to BIMB and BMMB. However, RHB Islamic show the pattern of decreasing of ROE begin in year 2008 until the year 2012. On the other hand, BIMB begin with negative value of ROE for the two consequences year of 2005 until 2006. Drastically increase in year 2007 and overtook BMMB and RHB Islamic bank in year 2008 then continuous the increasing trend until year 2012 except year 2009. Meanwhile BMMB maintain the fluctuated trends until year 2012.

For the detail analysis of ROE of three selected Islamic banks, the results were discussed below:

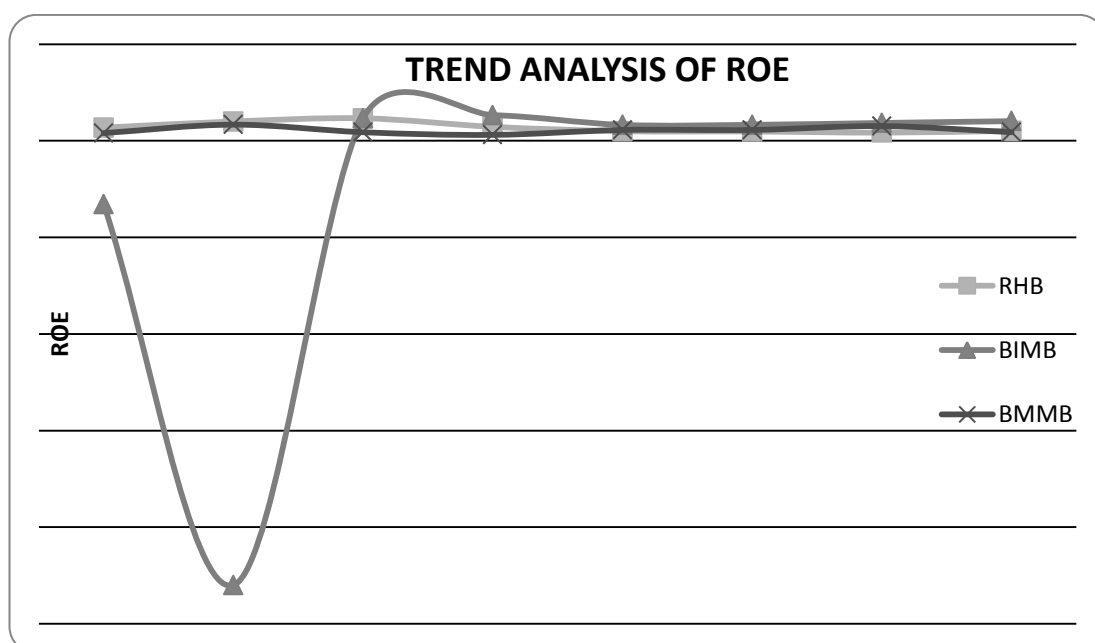


Figure 4.3.3: *Trend Analysis of ROE*

It shows the movements of ROE level in three selected Islamic banks in Malaysia from year 2005 until 2012. The ROE level has been fluctuating over the period for all banks. RHB Islamic bank scored high ROE from year 2005 until 2006 compared to BIMB and BMMB. Meanwhile, BMMB also obtained positive value for these two years. However, BIMB experienced negative value for ROE in two consecutive years at (65.7 percent) and (460 percent). The differences of ROE value in BIMB in year 2005 and year 2006 is very large.

In year 2007, the figure shows that RHB Islamic hit the highest point of ROE compared to BIMB and BMMB. However, in year 2008, RHB Islamic bank shows decreasing trend of ROE at 14.46 percent. This trend continuously decreased until the year 2011. Meanwhile, BMMB also started to experience backward trends in year 2007 until 2008. On the other hand, BIMB drastically increased the score of ROE at 23.33 percent in year 2007 and at 26.54 percent in year 2008. The decreasing trend is basically because of the effect from financial global crisis.

On the other hand, in year 2009, BIMB's ROE decrease in value to 16.48 percent while BMMB's ROE increase in value to 11.24 percent and it remains constant till year 2010. In year 2010, BIMB hit the highest value of ROE comparing to RHB Islamic bank and BMMB. The ROE value for all banks continuously increased from year 2011 until year 2012 except BMMB's ROE decrease in value in 2012.

#### **4.3.4 Islamic Mode of Finance (Contracts)**

Islamic modes of finance are generally used for similar purposes as their conventional counterparts. The fundamental difference between the two types of financial modes / instruments is the underlying shariah-compliance applicable to Islamic financial products. The Islamic banks can use contracts such as mudarabah, musharakah, murabahah, ijarah, istisna and many more.

##### **4.3.4.1 Murabahah Contract**

Generally, trend analysis of murabahah contract shows the pattern of increasing in RHB Islamic bank started from year 2005 until year 2012 except in year 2006 and 2009. On the other hand, BIMB has the highest score of murabahah contract in year 2005 compared to RHB Islamic bank and BMMB. However, BIMB show the pattern of decreasing of murabahah in year 2006 until year 2007. Meanwhile BMMB also experienced positive value in year 2005 until year 2007. BIMB and BMMB maintain the fluctuated trends until year 2012.

For the detail analysis of murabahah contract of three selected Islamic banks, the results were discussed below:

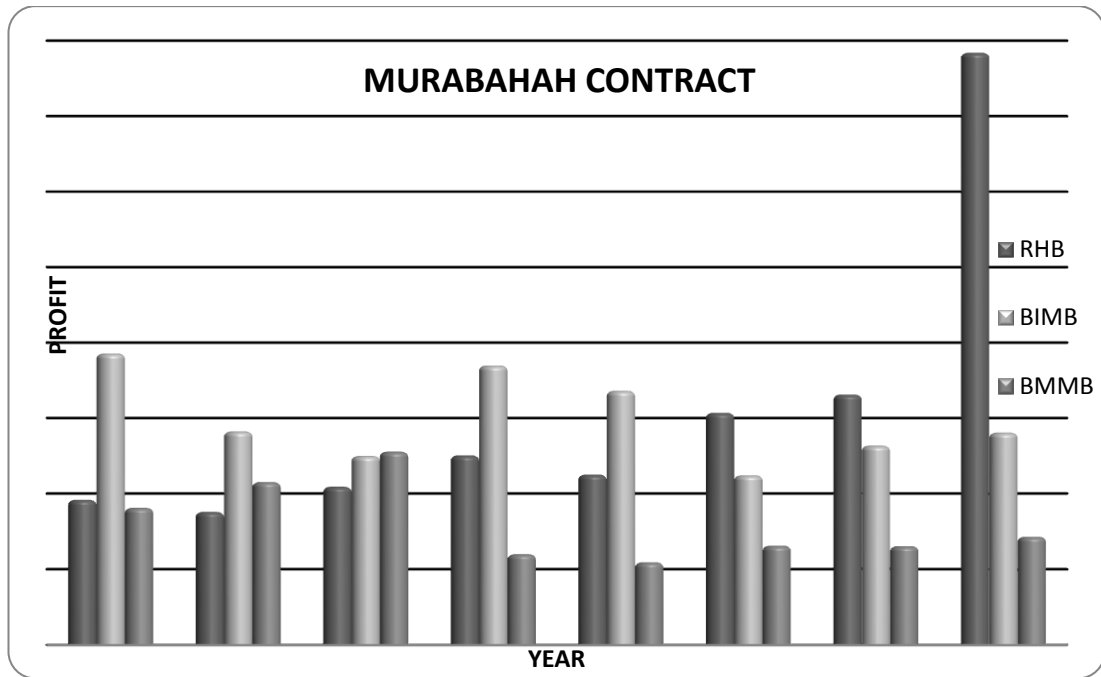


Figure 4.3.4.1 (a): *Trend analysis of Murabahah contract*

Figure 4.3.4.1(a) shows the total of murabahah contract offered by three banks, BIMB, RHB Islamic Bank and BMMB from year 2005 to 2012. In year 2005, BIMB obtained the highest value of murabahah contract at RM1, 927,568 and followed by RHB Islamic bank at RM958, 647 and then BMMB at RM90, 534. All the banks experienced positive value for the first year of analysis.

In year 2006, BIMB once again obtain the highest value of murabahah contract but the total profit of this contract decreased from the previous year while BMMB increased to RM1, 075,754 and the lowest value for this year is RHB Islamic bank. Other than that, in year 2007, the three selected Islamic banks show slightly different in the trend when BMMB scored the highest value for murabahah contract. Meanwhile, RHB Islamic bank increases the murabahah contract. The performance of murabahah contract in year 2007 which is during financial crisis gives an impact to BIMB but not for RHB Islamic bank and BMMB.

In the five years up to 2012, the murabahah contracts for RHB Islamic bank have trending upwards except in year 2009. RHB Islamic bank hit the highest score of murabahah contract in year 2012 at RM3, 919,949 compared to BIMB and BMMB. On the other hand, BIMB also increased the value of this contract in year 2008 but decreased again in year 2009. In contrast with RHB Islamic bank and BIMB, BMMB experienced backwards trend in year 2008 until 2009.

In year 2010, RHB Islamic obtained the highest value of murabahah contract at RM1, 534,782 followed by BIMB at RM1, 120,380 and BMMB at RM655, 260. Meanwhile, in year 2011 until year 2012, all the three Islamic banks keep increasing their performance in murabahah contract.

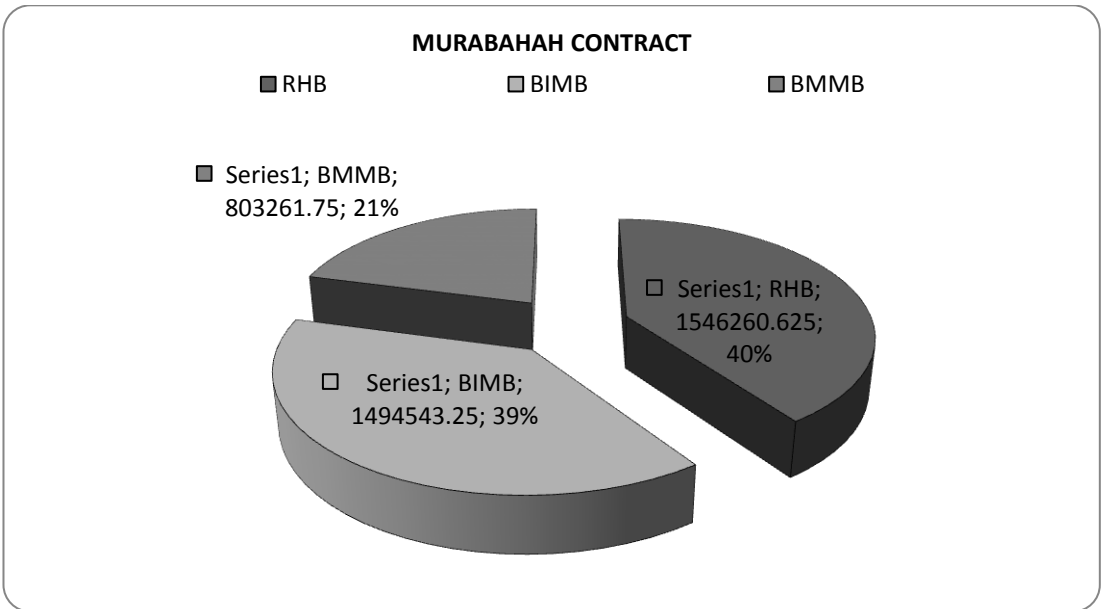


Figure 4.3.4.1 (b): Average performance of Ijarah contract



Figure 4.3.4.1 (b) shows the average value for murabahah contract in a three selected Islamic banks in Malaysia. This average value consists of the eight years period of analysis from 2005 to 2012. 40 percent from the total of murabahah contract offered by RHB Islamic bank followed by BIMB at 39 percent and BMMB at 21 percent. So, from this analysis we can see that RHB Islamic bank is the more influence and aggressively offering murabahah contract comparing to BIMB and BMMB.

#### 4.3.4.2 Ijarah contract

In general, all the three selected Islamic banks which are BIMB, RHB Islamic bank and BMMB experienced increasing trends from year 2005 until year 2012. However, in year 2011 until 2012, the value of ijarah contract in BIMB started to decrease.

For the detail analysis of ijarah contract of three selected Islamic banks, the results were discussed below:

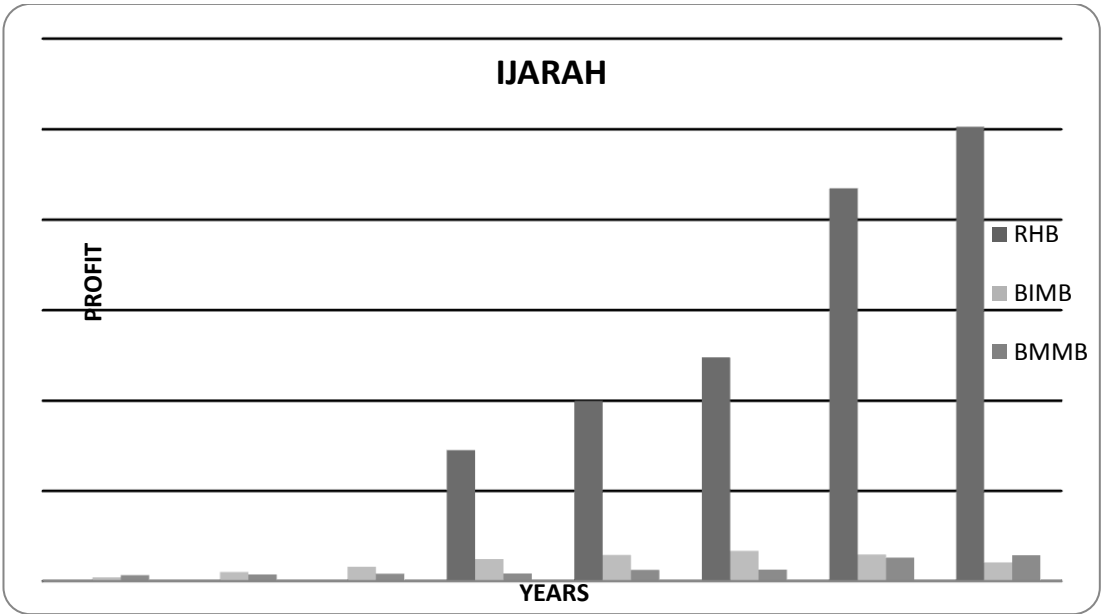


Figure 4.3.4.2 (a): Trend analysis of Ijarah contract

It shows the trend of ijarah contract in the three selected Islamic banks in Malaysia which are RHB Islamic bank, BIMB and BMMB. All the three banks experienced increasing trends of analysis. In the early entrance of RHB Islamic bank in the market from year 2005 to 2007, RHB Islamic bank is not yet offering ijarah contract while BIMB and BMMB consistently increase their performance in ijarah contract.

From the year 2008 until 2012, RHB Islamic bank and BMMB share the same trend comparing to BIMB. RHB Islamic bank's Ijarah contract aggressively increase in the market at RM1,451,681, RM1,996,943, RM2,478,851, RM4,346,614 and RM5,027,745 while BMMB consistently increased at RM85,068, RM123,959, RM126,525, RM260,690 and RM287,697 respectively. In contrast with RHB Islamic bank and BMMB, BIMB increased the performance of ijarah in year 2008 to 2010 at RM243,063, RM289,200 and RM334,106. However, in year 2011 to 2012, BIMB experienced decreasing trends of ijarah contract at RM295,881 and RM206,889.

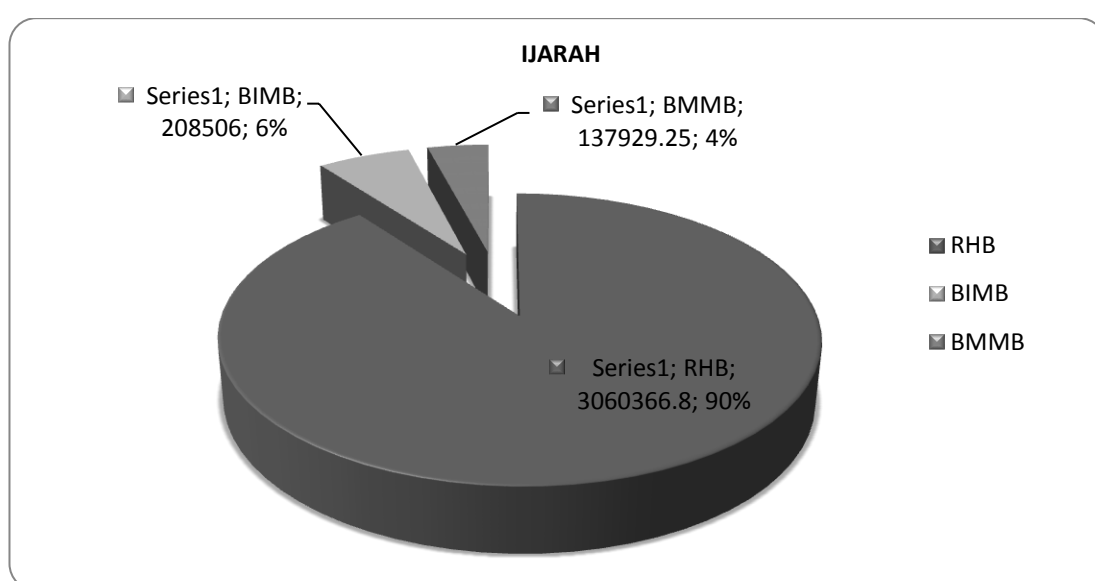


Figure 4.3.4.2 (b): Average performance of Ijarah contract

Figure 4.3.4.2 (b) shows the average value for ijarah contract in a three selected Islamic bank in Malaysia. This average value consists of the eight years period of analysis from 2005 to 2012. 90 percent from the total of ijarah contract offered by RHB Islamic bank followed by BIMB at 6 percent and BMMB at 4 percent. So, from this analysis we can see that RHB Islamic bank is having more influence and more aggressive in offering ijarah contract comparing to BIMB and BMMB.

#### **4.3.4.3 Istisna contract**

Generally, trend analysis of istisna contract shows the pattern of increasing in RHB Islamic bank from year 2007 until 2010. However, in year 2010 until 2012, RHB Islamic bank starts to decrease the value of istisna contract. On the other hand, BIMB has the highest score of istisna contract in year 2005 compared to BMMB. However, BIMB and BMMB show the pattern of decreasing of istisna contract in year 2008. BIMB and BMMB maintain the fluctuating trends until year 2012.

For the detail analysis of istisna contract of three selected Islamic banks, the results were discussed below:

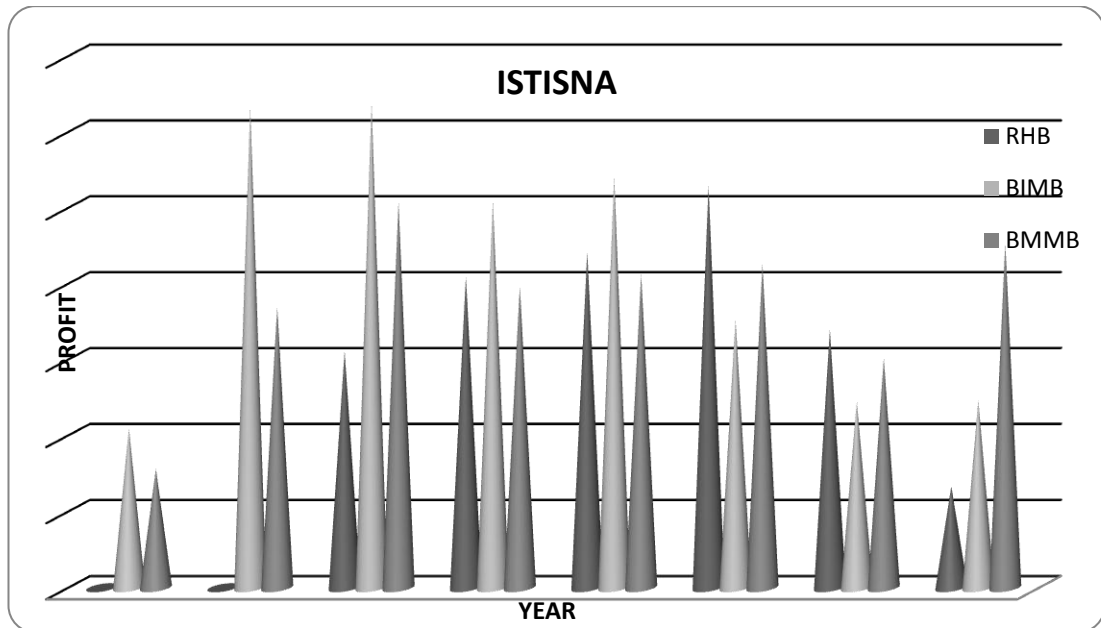


Figure 4.3.4.3 (a): *Trend analysis of Istisna contract*

The trends of istisna contract for all banks have been fluctuating over the period. In the early entrance of RHB Islamic in year 2005 to 2006, they still did not offer istisna contract while BIMB and BMMB has positive value for istisna contract for three consecutive years. Comparing BIMB to BMMB, BIMB is more aggressive in offering istisna contract.

In year 2007, BIMB obtained the highest scored of istisna contract at RM638,984 followed by BMMB at RM508,219 and then RHB Islamic bank at RM311,258. However, in year 2008, BIMB and BMMB experienced decreasing trend at RM509,988 and RM396,829 while RHB Islamic bank continuously increase from year 2008 until year 2010.

On the other hand, the value of istisna contract in BIMB increased again in year 2009 but decreased in year 2010. Similarly with BMMB that also shows increasing in trend until year 2010. However, in year 2011, all the three banks are experiencing a decrease in istisna contract. The highest score obtained by RHB Islamic bank followed by BMMB and BIMB. RHB Islamic bank's istisna contract continuously decreased until year 2012. In contrast with RHB Islamic bank, BIMB have a slightly increased in the value of istisna contract in year 2012 while BMMB increased in year 2012.

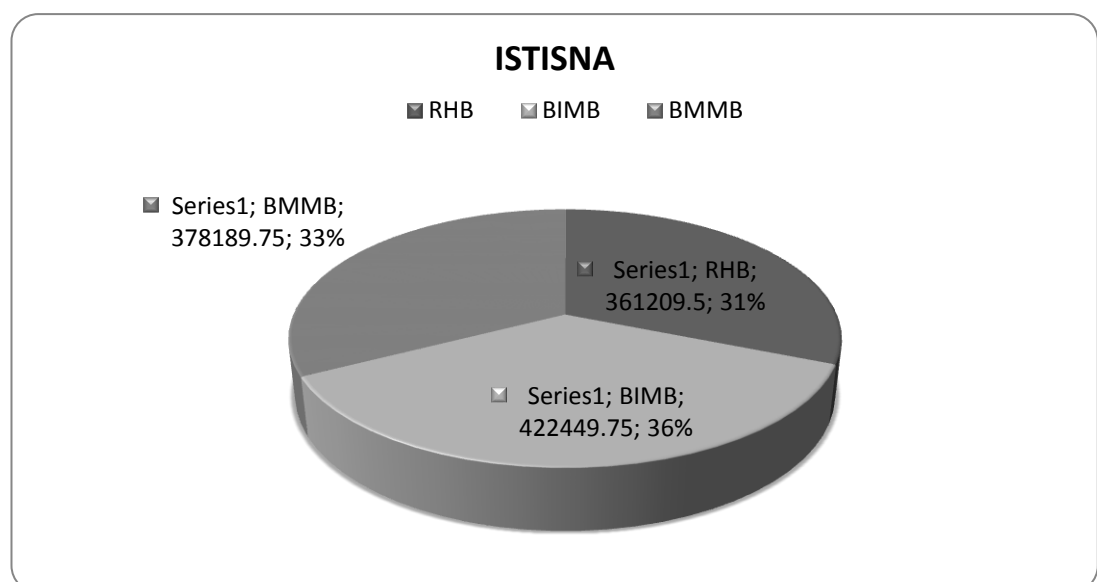


Figure 4.3.4.3 (b): *Average performance of Istisna contract in selected Islamic bank*

Based on the figure above, it shows the average performance value for istisna contract in a three selected Islamic bank in Malaysia. This average value consists of the eight years period of analysis from 2005 to 2012. The highest value of istisna is 36 percent belongs to BIMB and followed by BMMB at 33 percent and then RHB Islamic bank at 31 percent. So, from this analysis we can see that BIMB is more

influence and aggressively offering istisna contract even though there are not much difference in term of percentage between BMMB and RHB Islamic bank.

#### 4.3.4.4 Mudarabah contract

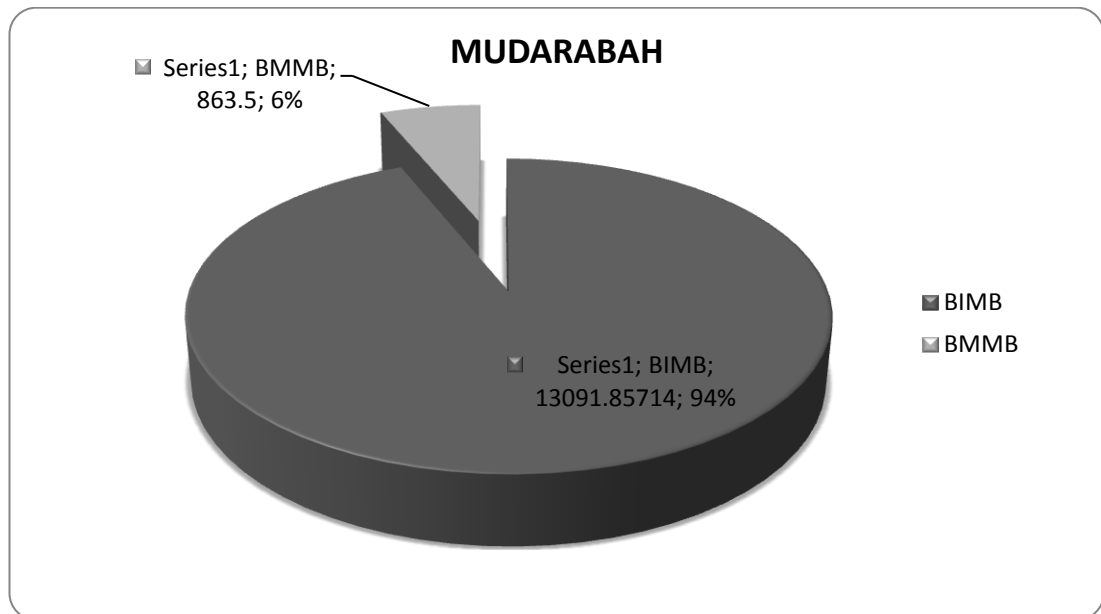


Figure 4.3.4.4: Average performance of mudarabah contract for selected Islamic bank

Based on the figure above, it shows that only BIMB and BMMB offered mudarabah contract from 2005 to 2012. The total percentage of mudarabah contract consists of eight years analysis. 94 percent of mudarabah contract offered by BIMB while 6 percent is belong to BMMB. So, BIMB is more aggressive in offering mudarabah contract.

#### 4.3.4.5 Musharakah contract

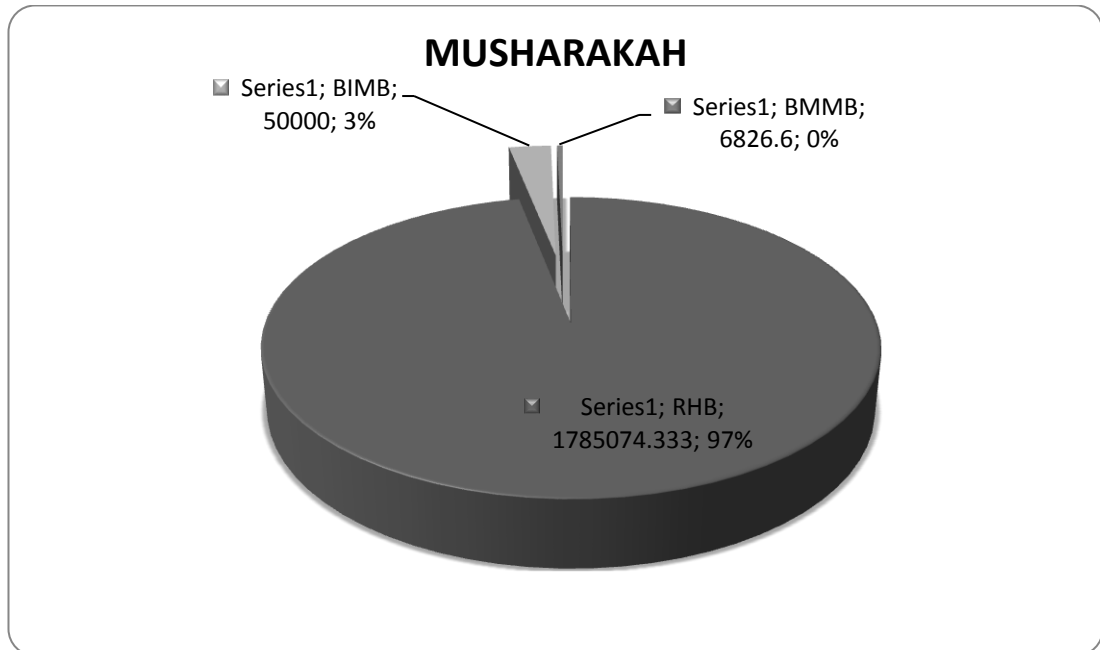


Figure 4.3.4.5: Average performance of musyarakah contract in selected Islamic banks

It shows the percentage of musharakah contract offered by BIMB, BMMB and RHB Islamic bank throughout the years from 2005 to 2012. The total of musharakah contract offered by RHB Islamic bank is 97 percent followed by BIMB at 3 percent and BMMB is 0 percent. As a comparison, RHB Islamic is more aggressive in offering musharakah contract.

#### **4.4 One-Way ANOVA and Kruskal Wallis**

ANOVA is used to compare between three groups and to determine the relationship between variables. According to Zikmund (2010), one-way ANOVA can be defined as the analysis to examine means of two or more populations. Nominal scale is used to measure independent variable while interval scale is for dependent variable. Meanwhile, Kruskal Wallis can be defined as the analysis of variance by ranks. It is used to compare three or more sets of scores that come from different groups (Coakes and Steed, 2007). However, due to small sample of their study, Kruskal Wallis test will primarily used in comparing the performance of Islamic modes of finance.

##### **4.4.1 To determine the differences in profitability performance for selected Islamic bank**

In this study, the test of hypothesis is examined to find out if there are any significant relationships between the variables. The variables for this test are profitability performance which is consisted of profit, ROA and ROE.

For the analysis, the hypothesis of this study is developed as below:

##### Hypothesis 1

Ho: There are no differences in profitability performance of BIMB, RHB Islamic and BMMB.



H1: There are differences in profitability performance of BIMB, RHB Islamic and BMMB.

Table 4.4.1 (a) : *Comparison of profit for selected Islamic bank*

	<b>RM Mean</b>	<b>Std. Deviation</b>	<b>Sig ANOVA</b>	<b>Sig Kruskal Wallis</b>
<b>Profit</b>				
Bimb	24142.25	615918.02	.930	.114
Rhb Islamic	89589.75	35449.90		
Bmmb	73017.38	34996.52		

The result of the analysis for the profit's performance for selected Islamic banks in Malaysia that are BIMB, RHB Islamic bank and BMMB are shown in Table 4.4.1(a). A closer look at the mean shows that RHB Islamic bank has the highest profit (89589.75) followed by BMMB (73017.38) and BIMB has the lowest amount of profit (24142.25).

The analysis showed that the significant level of ANOVA for profit test is 0.930. It means that the significant level for profit is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows there are no differences of profit in BIMB, RHB Islamic bank and BMMB.

Besides that, the significant level of Kruskal Wallis also showed the same result as ANOVA when the profit is also not significant at 0.114. It means the profit value is greater than 0.05 and the null hypothesis is failed to reject.

As conclusion, there are no differences of profit in BIMB, RHB Islamic bank and BMMB.

Table 4.4.1 (b) : *Comparison of ROA and ROE for selected Islamic bank*

	<b>RM Mean</b>	<b>Std. Deviation</b>	<b>Sig ANOVA</b>	<b>Sig Kruskal Wallis</b>
<b>ROA</b>				
Bimb	-.44	3.69	.362	.146
Rhb Islamic	1.08	.49		
Bmmb	.67	2.16		
<b>ROE</b>				
Bimb	-50.49	168.21	.347	.251
Rhb Islamic	13.72	5.38		
Bmmb	10.79	3.63		

The result of the analysis for the performance of ROA and ROE for selected Islamic banks in Malaysia that is BIMB, RHB Islamic bank and BMMB are shown in Table 4.4.1(b). It shows that mean of the ROA in RHB Islamic bank is the highest (1.08) followed by BMMB (.67) and the lowest is BIMB (-.44). Similarly for ROE, it shows that RHB Islamic bank has the highest value for this ratio (13.72) followed by BMMB (10.79) and BIMB (-50.49).

Besides that, the analysis shows that the significant level of ANOVA for ROA test is 0.362. It means that the significant level for ROA is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows there are no differences of ROA on BIMB, RHB Islamic bank and BMMB. Meanwhile, the test of ROE showed that the significant level is 0.347 which is greater than 0.05.

Similarly with ROA, the null hypothesis is failed to reject and it also shows there are no differences of ROE on BIMB, RHB Islamic bank and BMMB.

On the other hand, by looking at the significant level using Kruskal Wallis test, it is also shows the same result as ANOVA. Both ROA and ROE are not significant at 0.146 and 0.251. So, it means ROA and ROE value is greater than 0.05 and the null hypothesis is failed to reject.

As conclusion, there are no differences in performance of BIMB, RHB Islamic bank and BMMB.

#### **4.4.2 The differences of Islamic Mode of finance (contracts) offered by BIMB, RHB Islamic and BMMB.**

In this study, there are five types of Islamic mode of finance (contracts) has been choosed to make a comparison between BIMB, RHB Islamic bank and BMMB. The types of this contracts such as mudarabah, musyarakah, murabahah, ijarah and istisna. The hypothesis are developed to find out the differences of Islamic mode of finance (contracts). The general hypothesis for this study is there are no differences of Islamic Mode of finance (contracts) offered by BIMB, RHB Islamic and BMMB. For this analysis, the hypothesis will be breaking down into each mode of finance.

The hypotheses are as below:

#### Hypothesis 2

Ho: There are no differences of musharakah contract offered by BIMB, RHB Islamic and BMMB.

H1: There are differences of musharakah contract offered by BIMB, RHB Islamic and BMMB.

#### Hypothesis 3

Ho: There are no differences of murabahah contract offered by BIMB, RHB Islamic and BMMB.

H1: There are differences of murabahah contract offered by BIMB, RHB Islamic and BMMB.

#### Hypothesis 4

Ho: There are no differences of ijarah contract offered by BIMB, RHB Islamic and BMMB.

H1: There are differences of ijarah contract offered by BIMB, RHB Islamic and BMMB.

#### Hypothesis 5

Ho: There are no differences of Istisna contract offered by BIMB, RHB Islamic and BMMB.

H1: There are differences of Istisna contract offered by BIMB, RHB Islamic and BMMB.

The analysis of the hypotheses are tested by using ANOVA due to the independent variables which are types of bank in the group of nominal against dependent variables which are contracts that are means using ratio scale. The result then summarising in table 4.4.2 (a) and the detail result are attached at appendix c.

Table 4.4.2 (a): *Comparison of Islamic mode of finance for selected Islamic bank*

	<b>RM Mean</b>	<b>Std. Deviation</b>	<b>Sig ANOVA</b>	<b>Sig Kruskal Wallis</b>
<b>Musharakah</b>				
Bimb	50000.00	.000	.000	.012
Rhb Islamic	1785074.33	686048.29		
Bmmb	6826.60	7599.58		
<b>Murabahah</b>				
Bimb	1494543.25	291321.54	.045	.003
Rhb Islamic	1546260.63	996627.13		
Bmmb	803261.75	258949.31		
<b>Ijarah</b>				
Bimb	208506.00	102385.55	.000	.002
Rhb Islamic	3060366.80	1547732.99		
Bmmb	137929.25	87270.29		
<b>Istisna</b>				
Bimb	422449.75	179804.05	.713	.772
Rhb Islamic	361209.50	135987.55		
Bmmb	378189.75	108006.74		

#### **i. Musharakah contract**

It shows that the means of the musharakah contract in RHB Islamic bank is the highest (RM1, 785,074.33) followed by BIMB (RM50, 000.00) and then BMMB (RM6, 826.60). The analysis shows the significant level of ANOVA for musharakah contract is 0.000. It means that the significant level for musharakah is lower than 0.05. So, the alternative hypothesis is failed to reject. Therefore, the hypothesis shows that there are differences of musharakah contract offered by BIMB, RHB Islamic and BMMB.

The highest score in musharakah contract that is RHB Islamic bank compared to BIMB and it shows a significant relationship between RHB Islamic and BIMB. It means that there are differences of musharakah contract offered by RHB Islamic and BIMB. Then, RHB Islamic bank compared to BMMB. Yes, it is also significant and there are differences of musharakah contract offered by RHB Islamic and BMMB.

The lowest score in musharakah contract that is BIMB compared to BMMB shows that there are not significant and there are no differences of musharakah contract offered by BIMB and BMMB.

Besides that, the significant level of Kruskal Wallis also shows the same result as ANOVA when the musharakah contract is significant at 0.012. It means the musharakah value is lower than 0.05 and the alternative hypothesis is failed to reject.

As conclusion, there are differences of musharakah contract offered by BIMB, RHB Islamic bank and BMMB.

## **ii. Murabahah contract**

A closer look at the mean shows that RHB Islamic bank has the highest value of murabahah contract (RM1,546,260.63) followed by BIMB (RM1,494,543.25) and the lowest is BMMB (RM803,261.75). The analysis shows a significant level of ANOVA for murabahah contract is 0.045. It means that the significant level for murabahah is lower than 0.05. So, the alternative hypothesis is failed to reject. Therefore, the hypothesis shows that there are differences of murabahah contract offered by BIMB, RHB Islamic and BMMB.

The highest score in murabahah contract that is RHB Islamic bank compared to BIMB and it shows no significant relationship between RHB Islamic and BIMB. It means that there are no differences of murabahah contract offered by RHB Islamic and BIMB. Then, RHB Islamic bank compared to BMMB. Yes, it is significant and there are differences of murabahah contract offered by RHB Islamic and BMMB.

The lowest score in murabahah contract that is BMMB compared to BIMB shows that there are significant and there are differences of murabahah contract offered by BMMB and BIMB.

On the other hand, the significant level of Kruskal Wallis has been tested and it also shows the same result as ANOVA when the murabahah contract is significant at 0.003. It means the murabahah value is lower than 0.05 and the alternative hypothesis is failed to reject.

As a conclusion, there are differences of murabahah contract offered by BIMB, RHB Islamic bank and BMMB.

### **iii. Ijarah contract**

It shows the mean of the ijarah contract in RHB Islamic bank is the highest (RM3, 060,366.80) followed by BIMB (RM208, 506.00) and then BMMB (RM137, 929.25). The analysis shows the significant level of ANOVA for ijarah contract is 0.000. It means the significant level for ijarah is lower than 0.05. So, the alternative hypothesis is failed to reject. Therefore, the hypothesis shows there are differences of ijarah contract offered by BIMB, RHB Islamic and BMMB.

The highest score in ijarah contract that is RHB Islamic bank compared to BIMB and it shows significant relationship between RHB Islamic and BIMB. It means there are differences of ijarah contract offered by RHB Islamic and BIMB. Then, RHB Islamic bank compared to BMMB. Yes, it also shows a significant relationship and there are differences of ijarah contract offered by RHB Islamic and BMMB.



The lowest score in ijarah contract that is BMMB compared to BIMB shows that there are not significant and there are no differences of ijarah contract offered by BMMB and BIMB.

On the other hand, the significant level of Kruskal Wallis has been tested and it also shows the same result as ANOVA when the ijarah contract is significant at 0.002. It means the ijarah value is lower than 0.05 and the alternative hypothesis is failed to reject.

As a conclusion, there are differences of ijarah contract offered by BIMB, RHB Islamic bank and BMMB.

#### **iv. Istisna contract**

A closer look at the mean shows that BIMB has the highest value of istisna contract (RM422, 449.75) followed by BMMB (RM378, 189.75) and the lowest is RHB Islamic bank (RM361, 209.50). The analysis showed the significant level of ANOVA for istisna contract is 0.713. It means that the significant level for istisna is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows that there are no differences of istisna contract offered by BIMB, RHB Islamic and BMMB.

On the other hand, the significant level of Kruskal Wallis has been tested and it also showed the same result as ANOVA when the istisna contract is significant at 0.772. It means the ijarah value is greater than 0.05 and the null hypothesis is failed to reject.

As conclusion, there are no differences of istisna contract offered by BIMB, RHB Islamic bank and BMMB.

Table 4.4.2 (b) below showed the summary of the significant level of Islamic mode of finance (contracts) offered by BIMB, RHB Islamic bank and BMMB.

Table 4.4.2 (b): *Significant level of Islamic mode of finance based on LSD Post Hoc Test*

	BIMB	RHB Islamic	BMMB
<b>Musharakah</b>			
Bimb	-	Yes	No
Rhb Islamic	Yes	-	Yes
Bmmb	No	Yes	-
<b>Murabahah</b>			
Bimb	-	No	Yes
Rhb Islamic	No	-	Yes
Bmmb	Yes	Yes	-
<b>Ijarah</b>			
Bimb	-	Yes	No
Rhb Islamic	Yes	-	Yes
Bmmb	No	Yes	-

#### **4.5 Comparison of mudarabah contract offered by BIMB and BMMB**

T-test is generally performed to examine any significant differences between the two banks. Then, a comparative analysis between these two banks will be done. According to Wasiuzzaman and Nair Gunasegavan (2013), t-test can be used to determine whether there are significant relationship differences between all the variables. Independent t-test were carried out on each variable in the study. However, due to small sample of their study, Wilcoxon rank test will primarily used in comparing the mudarabah performance.

In this study, there are only two banks which are BIMB and BMMB offered mudarabah contract. So, the t-test analysis is examined to find out if there are any significant relationship between variables . The variables for this test is performance which is consisting mudarabah contract while the unit analysis is the types of banks.

For the analysis, the hypothesis of this study is developed as below:

##### Hypothesis 6

Ho: There is no significant difference of mudarabah contract between BIMB and BMMB.

H1: There is significant difference of mudarabah contract between BIMB and BMMB.

Table 4.5: *Comparison of mudarabah contract for selected Islamic bank*

	<b>RM Mean</b>	<b>Std. Deviation</b>	<b>t-value</b>	<b>Sig</b>	<b>Sig Wilcoxon</b>
<b>Mudarabah</b>					
Bimb	13091.86	7131.08	4.49	.004	.008
Bmmb	863.50	508.41			

From the table above, it is showed that the means of the mudarabah contract in BIMB is the highest (RM13, 091.86) and followed by BMMB (RM863.50). By comparing between BIMB and BMMB, the significant level of mudarabah contract is at 0.004. It means the mudarabah contract is significant at alpha 0.05. So, the alternative hypothesis is failed to reject. Therefore, the hypothesis shows that there is a significant difference of mudarabah contract between BIMB and BMMB.

On the other hand, the significant level of Wilcoxon has been tested and it also shows the same result as t-test analysis when the mudarabah contract is significant at 0.008 and significant at alpha 0.05.

As conclusion, there is a significant difference of mudarabah contract offered by BIMB and BMMB.

## **4.6 Summary**

In Chapter Four there are basically the discussion of empirical results and major findings. Besides, the discussion of empirical results also include descriptive analysis, One-Way ANOVA and T-Test analysis of each variables. The next chapter will discuss in depth of the major findings and conclusion of the study.

## **CHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter will conclude all important findings of the study. Finally, it is also includes the recommendations for future research.

#### **5.2 Conclusion**

The study was designed to determine the profitability performance and Islamic modes of finance in the three selected Islamic banks in Malaysia. These banks are Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad (BMMB) and RHB Islamic Bank Berhad (RHB Islamic). Comparison of the performance among the three selected Islamic banks has been measured based on profits, Return on Assets (ROA) and Return on Equity (ROE). Data used in the analysis were taken from the annual reports of all these banks for the years 2005 to 2012. The analyses are presented in the form of tables and diagrams.

### **5.2.1 Pattern of the profitability performance of BIMB, BMMB and RHB Islamic**

The result of the studies shows the trend analysis for profitability performance (profit, ROA and ROE) and Islamic mode of finance (contracts) for BIMB, BMMB and RHB Islamic.

#### **i. Trend analysis of Profit**

Trend analysis of profit performance shows that the RHB Islamic bank scores the highest level of profit during year 2005 until 2007 compared to BIMB and BMMB. However, RHB Islamic start to decreased in year 2008 until 2009 and increased again in year 2010 to 2012. Similarly with RHB Islamic, BMMB also increased in year 2005 to 2006 and maintain the fluctuated trend until year 2012. On the other hand, BIMB begin with negative value of profit for two consecutive years. Drastically increase in year 2007 until 2012 in a profit performance except for year 2009. BIMB is leading in a profit with a large gap compared to RHB Islamic and BMMB.

#### **ii. Trend analysis of ROA and ROE**

Trend analysis of ROA shows that RHB Islamic bank scored the highest level of it from year 2005 until 2007 compared to BIMB and BMMB. However, RHB Islamic experienced decreasing trend of ROA begin in year 2008 until 2012. On the other hand, BIMB begin with negative value of ROA for the two consecutive years which is in year 2005 until 2006. Drastically increased in year 2007 and overtook BMMB and RHB Islamic in year 2008 then continues the increasing trend until year 2012. Meanwhile, BMMB maintain the fluctuated trends from year 2005 until 2012.

For ROE, it shows that RHB Islamic bank experienced the similar trend with the ROA performance when scored the highest level of ROE in year 2005 until 2007 but start to show the decreasing trend of ROE begin in year 2008 until 2012. On the other hand, BIMB begin with negative value of ROE for the two consecutive years of 2005 and 2006. Drastically increase in year 2007 and overtook BMMB and RHB Islamic bank in year 2008 then continuous the increasing trend until year 2012 except year 2009. Meanwhile BMMB also obtained positive value of ROE in first two years (2005–2006). The BMMB start shows backward trend in year 2007 until 2008 and drastically increased again in year 2009 until 2011. However, BMMB's ROE drops again in last year of analysis (2012).

### **iii. Trend analysis of Islamic mode of finance**

Islamic modes of finance offered by three selected Islamic banks in Malaysia can be divided into five types which are mudarabah, musharakah, murabahah, ijarah and istisna. The trend analysis of murabahah contract shows the pattern of increasing in RHB Islamic bank started from year 2005 until 2012 except in year 2006 and 2009. On the other hand, BIMB has the highest score of murabahah contract in year 2005 compared to RHB Islamic bank and BMMB. However, BIMB show the pattern of decreasing of murabahah in year 2006 until year 2007. Meanwhile BMMB also experienced positive value in year 2005 until year 2007. BIMB and BMMB maintain the fluctuated trends until year 2012.



Meanwhile, for ijarah contract, all the three selected Islamic banks which are BIMB, RHB Islamic bank and BMMB experienced increasing trends from year 2005 until year 2012. However, in year 2011 until 2012, BIMB's value of ijarah contract started to decrease. On the other hand, istisna contract shows the pattern of increasing in RHB Islamic from year 2007 until 2010 but decrease the value of istisna contract in year 2010 until 2012. Moreover, BIMB has the highest score of istisna contract in year 2005 compared to BMMB. However, BIMB and BMMB show the pattern of decreasing of istisna contract in year 2008. BIMB and BMMB maintain the fluctuating trends until year 2012.

In contrast for mudarabah contract, it shows that only BIMB and BMMB offered mudarabah contract from 2005 to 2012. The total percentage of mudarabah contract consists of eight years analysis. 94 percent of mudharabah contract offered by BIMB while 6 percent is belong to BMMB. So, BIMB is more aggressive in offering mudarabah contract. For musharakah contract, it shows that RHB Islamic offered 97 percent of the contract followed by BIMB at 3 percent and BMMB is 0 percent. As a comparison, RHB Islamic is more aggressive in offering musyarakah contract.

### **5.2.2 The differences of profitability performance and Islamic mode of finance (contract) in BIMB, RHB Islamic and BMMB.**

In order to examine the differences of profitability performance and Islamic mode of finance (contracts) in three selected Islamic banks in Malaysia which are BIMB, RHB Islamic and BMMB, One Way ANOVA and T-Test analysis were carried out. The result for profitability performance analysis shows that the significant level for ROA and ROE is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows there are no differences of ROA and ROE on BIMB, RHB Islamic and BMMB. Similarly with ROA and ROE, the result for profit analysis also shows the significant level for profit is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows there are no differences of profit in BIMB, RHB Islamic bank and BMMB.

For Islamic modes of finance, the analysis shows the significant level for musharakah, murabahah and ijarah contract are lower than 0.05. So, the alternative hypotheses are failed to reject. Therefore, the hypothesis shows that there are differences of musharakah, murabahah and ijarah contract offered by BIMB, RHB Islamic and BMMB. In contrast with istisna contract, it shows that the significant level is greater than 0.05. So, the null hypothesis is failed to reject. Therefore, the hypothesis shows there are no differences of istisna contract offered by BIMB, RHB Islamic and BMMB.

Meanwhile, t-test analysis for mudarabah contract showed that the means of the mudarabah contract in BIMB is the highest (RM13, 091.86) and followed by BMMB (RM863.50). By comparing between BIMB and BMMB, the significant level of mudarabah contract is at 0.004. It means the mudarabah contract is significant at alpha 0.05. So, the alternative hypothesis is failed to reject. Therefore, the hypothesis shows that there is a significant difference of mudarabah contract between BIMB and BMMB.

### **5.3 Recommendations**

Islamic banks (IBs) nowadays are facing many challenges in adapting its new customer perception and environment as it is supposed to be functioning as full fledged Islamic bank. The main competitors of Islamic banks are conventional banks. Through the scholars criticize they have found that Islamic banking practice currently are still mimicking to the conventional bank in a few segment since conventional bank have been in industry for a many years rather than Islamic bank establishment. However, as the bank had a sharia fundamental include sharia council and sharia supervisory board as assistant, they are responsible to monitor all the Islamic banking activities and operations are comply with sharia based.

Islamic banking should strengthen and develop its capability and the potency of its institution and operation so they will operate successfully in a situation of tight global competition. Furthermore, it should improve its efficiency and effectiveness in order to be at par with well-known international players, it must boost its research

and in Islamic financial product innovation. Follow up and analysis of access to common performance indicators is also needed to ensure the quality of financial products used in Islamic banks. On the other hand, all the parties especially the Islamic banks themselves and the government must play their roles in enhancing competition between the Islamic and the conventional banking systems.

The government should implement steps and initiatives which can enhance the country's position as an global financial hub. The Malaysia government has launched the Malaysia International Islamic Financial Centre (MIFC) with the aim to boost the operations of Islamic banking. There's also collective efforts by Bank Negara Malaysia (BNM), Securities Commission, LOFSA, and the Malaysia bourse. Moreover, the Malaysia government had established the Islamic Banking and Institute of Malaysia in 2001 with the goal to be a one stop centre to provide education, training and research about Islamic financial services. Other than that, the government also should establish the Islamic Financial Stability Forum (IFSF) to serve as a platform for the deliberation of issues relevant for ensuring financial stability in the Islamic financial system. Though it will represent an important platform for addressing such challenges confronting Islamic finance, the establishment of the IFSF could also allow for an interface process with the international financial community in the conventional finance given the common interest of global financial stability. At the same time, Malaysia should set up a strong research and development institute to produce innovative products and services that could encourage Islamic banking in Malaysia.

There are three areas of priority warrant greater policy attention to strengthen and enhance the entire Islamic finance ecosystem:

- a. Strengthening the infrastructural building blocks of the Islamic financial services industry to further enhance the industry's resilience.
- b. Accelerating the effective implementation of Shariah and prudential standards and rules to facilitate the creation of a more stable, efficient and global integrated Islamic financial services industry.
- c. Making a common platform for the regulators of the Islamic financial services industry to improve constructive dialogue.

Perhaps this alternative could be a positive way for Islamic banking to grow in industry differently from conventional practice and capture the market stronger with fully Islamic identities.

#### **5.4 Recommendations for Future Research**

For future studies, as the time passes, when there will be more Islamic banks to study and longer time period, a similar study would generate better insight on the issue of performance comparison and provide solid evidence one way or another. It would be better if the study could compare between three types of Islamic banks which are full-fledged, conventional bank's Islamic windows and foreign Islamic banks. It can be useful to see whether there are any differences between the profitability amongst these three types of Islamic banks.

Other than that, because of not all Islamic banks are offering the same Islamic contracts, the researchers could modify the prominence to a single Islamic finance mode to narrow the range to get more precise evidence regarding the performance in each Islamic mode finance.

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