FACTORS AFFECTING THE PROFITABILITY OF ISLAMIC BANKS IN GCC COUNTRIES

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ABSTRACT

This study investigates the impact of internal and external factors on Islamic bank's profitability in GCC countries for a year period from 2006 to 2012. The study used three profitability measures namely, ROA, ROE and NIM. The study used a balanced panel data set of 175 observations of Islamic banks in 5 countries from the GCC. Seven independent variables are used in this study. These are divided into internal variables (size, management efficiency, loan, asset management and capital) and external variables (inflation and GDP). The results of the study indicate that management efficiency, loan, and GDP have positive and significant relationships with ROE. The study also finds that asset management and capital are positive and statistically significant with ROA, ROE and NIM. Inflation has a positive influence on bank's profitability as measured by ROA and NIM. The study shows that size has a significant negative impact on bank's profitability. Overall, the study finds that all internal variables and macroeconomic variables tested have significant impacts on bank's profitability. The findings from this study provide valuable information not only to bank managers, but also to other parties such as government, shareholders, and potential investors with a better guideline and understanding to enhance Islamic bank's profitability in the GCC.

Keywords: bank size, management efficiency, loan, asset management, capital, gross domestic products, inflation, bank profitability, GCC Islamic banks.

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LIST OF ABBREVIATIONS

Abbreviation	Description of Abbreviation
AM	Asset Management
BAJ	Bank Al-Jazira
CPI	Consumer Price Index
DIB	Dubai Islamic Bank
GDP	Gross Domestic Product
INF	Inflation
KSA	Kingdom of Saudi Arabia
LNTA	Natural Logarithm of Total Assets
MGTEFF	Management Efficiency
NIM	Net Non-Interest Margin
PLS	Profit-Loss Sharing
QIB	Qatar Islamic Bank
ROA	Return On Asset
ROE	Return On Equity
SEE	South East Europe
UAE	United Arab Emirates
UUM	Universiti Utara Malaysia

CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

Banking system has changed since the last few decades from general conventional banking to Islamic banking as it fulfills the needs and requirements of riba (interest) free society according to the Islamic teaching. Islamic economics is followed under the principle of Islamic law or “Shari’ah”. Shari’ah is the Islamic law that governs a Muslim daily life. It is derived from Al-Quran (The Holy Book) and Al-Hadith (the sayings of Prophet Mohammed Peace been upon him). The main important tenet of Sari’ah in doing business or economy is prohibition of riba (interest).

Islamic banks are known as financial institutions are also operated under the Islamic law. The most significant code that differentiate the profitability or losses and abort the collection (giving and charging) Interest or “riba”. The traditional banking system are those financial institutions which are offering their services such as debit and credit of customer cash flows, providing long and short term loans to their customers and other business services. These conventional banks are basically governed by the strategy to maximize their profitability on the basis of interest is not acceptable in Islamic way of operations as it is prohibited in Islam.

According to the Islamic principle of financial institutions, all the investments and trading on the basis of riba are prohibited. Under the Shari’ah ethical code of conduct, riba in any case should not be included as a profit. The investments can only be allowed

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