THE RELATIONSHIP BETWEEN RISKS AND EFFICIENCY OF ISLAMIC BANKS IN MALAYSIA

By

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ABSTRACT

Malaysia is a country known as the Islamic financial hub which plays an important role in its economic growth. Given the situation and the development of positive economic growth in Malaysia, Islamic banking needs to improve their performance in terms of efficiency in order to follow the current circumstances. However, Islamic banking is not spared from dealing with certain risks which will impact on their efficiency. Thus, the main objective of this study was to examine the efficiency level of Islamic banks in Malaysia and their relation to credit risk, liquidity risk and operational risk from the period of 2008 to 2013. Twelve Islamic banks were chosen as samples for this study which were taken by the availability of data, through each banks' annual report from 2008 to 2013. This study was conducted by applying the Data Envelopment Analysis (DEA) and Multiple Regression Analysis to achieve its objectives. The finding shows that Islamic banks in Malaysia exhibited a total of 77.1% of overall efficiency of technical (OTE), 83.1% of Pure Technical Efficiency (PTE) and 92.6% of Scale Efficiency (SE). Despite the global financial crisis that occured during the middle year of 2007 to the end of 2009 which slightly affected Asian countries such as Malaysia, nevertheless, Islamic banks seem to be more robust during the crisis than conventional banks. This is because of its basic nature which prohibited interest payments (riba) in all transactions. This study shows that credit risk has a negative significant relationship with efficiency of Islamic banks, while liquidity was found to be positive related to efficiency of Islamic banks. This study also found that the size of the bank has positive significant relationship to efficiency. Finding from this study give contribution to the policy makers and regulators as well as to the managers of Islamic banks by providing empirical evidence on the performance of the Islamic banks in Malaysia towards the efficiency level and risks relationship.

Keywords: Efficiency, credit risk, liquidity risk, operational risk, Islamic banks.

ABSTRAK

Malaysia merupakan negara yang terkenal sebagai hab kewangan Islam dan memainkan peranan penting bagi pertumbuhan ekonomi negara. Prestasi sistem perbankan Islam perlu ditingkatkan dari segi kecekapan memandangkan situasi pembangunan dan pertumbuhan ekonomi yang positif di Malaysia. Walau bagaimanapun, Perbankan Islam tidak terlepas daripada berhadapan dengan risiko-risiko tertentu yang akan memberi kesan terhadap tahap kecekapan sistem ini. Justeru itu, tujuan utama kajian ini dijalankan adalah untuk mengukur tahap kecekapan bank-bank Islam di Malaysia dan hubungannya dengan risiko kredit, risiko kecairan dan risiko operasi bagi tempoh 2008 hingga 2013. Sampel kajian terdiri daripada 12 buah bank Islam di Malaysia yang diambil berdasarkan kesahihan data dan juga kebolehdapatan data melalui laporan tahunan bagi setiap bank dari tahun 2008 sehingga 2013. Secara khususnya, kajian ini mengguna pakai Data Envelopment Analysis (DEA) dan Analisis Regresi Pelbagai (Multiple Regression Analysis) bagi mencapai objektif kajian. Dapatan kajian menunjukkan bahawa bank-bank Islam di Malaysia mencapai sebanyak 77.1% kecekapan teknikal keseluruhan (OTE), 83.1% daripada kecekapan teknikal tulen (PTE) dan 92.6% daripada Kecekapan Skala (SE). Walaupun krisis kewangan global yang melanda dunia pada pertengahan tahun 2007 hingga akhir tahun 2009 menjejaskan sedikit negara-negara Asia seperti Malaysia, tetapi bank-bank Islam kelihatan lebih kukuh untuk pulih dalam krisis kewangan berbanding dengan bank-bank konvensional kerana sifat semulajadinya yang melarang bayaran faedah (riba) dalam semua transaksi. Hasil dapatan kajian telah menunjukkan bahawa risiko kredit mempunyai hubungan negatif yang signifikan terhadap kecekapan bank-bank Islam, sementara risiko kecairan mempunyai hubungan positif yang signifikan terhadap kecekapan bank-bank Islam. Selain itu, kajian juga mendapati saiz bank mempunyai hubungan positif yang signifikan terhadap kecekapan. Dapatan kajian ini dapat memberi sumbangan kepada pembuat dasar dan pengawal selia dan juga kepada pengurus bank-bank Islam dengan menyediakan bukti empirikal mengenai prestasi bank-bank Islam di Malaysia dari segi tahap kecekapan dan hubungannya dengan risiko-risiko.

***Kata Kunci**: Kecekapan, risiko kredit, risiko kecairan, risiko operasi, Bank-bank Islam.*

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LIST OF ABBREVIATIONS

ATM	Automated Teller Machines
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
CRS	Constant Return to Scale
DEA	Data Envelopment Analysis
DFA	Distribution Free Approach
DMU	Decision Making Unit
DRS	Decreasing Return to Scale
IBA	Islamic Banking Act
IRS	Increasing Return to Scale
MENA	Middle Eastern and North African
OBS	Off-Balance Sheet
OTE	Overall Technical Efficiency
PLS	Profit and Loss Sharing
PTE	Pure Technical Efficiency
RM	Malaysian Ringgit
SE	Scale Efficiency
SFA	Stochastic Frontier Approach
TFA	Thick Frontier Approach
VIF	Variance Inflation Factors
VRS	Variable Return to Scale

CHAPTER ONE

INTRODUCTION

1.0 Introduction

The banking industry is the backbone and major component of the financial system. Thus, it will give impact to the stability of an economy. Any problems and interference that happen in the banking system will give implications for the economic conditions of a country (Akkizidis & Khandelwal, 2008). It means the good economic conditions are resulted from good strategies and good management in handling and controlling any problems that occur around the country.

According to Ayub (2007), the word 'bank' is derived from an Italian word 'banco' which means shelf or bench. It is used to display coins and for trading money. Therefore, a bank is an institution authorized to take deposits from customers for their financial purposes in expanding their short term and long term finance facilities. He also described that the role of a bank is to keep money which is received from ordinary people, organizations, state or surplus units which is in circulation of economy in a country. Then, the bank will use this pooled money for making advances to others to get a return. The return can be in the form of interests, dividends or others.

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