THE IMPACT OF LIQUIDITY RISK DETERMINANTS ON PROFITABILITY: AN EMPIRICAL STUDY ON ISLAMIC BANKS IN THE KINGDOM OF BAHRAIN

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By

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ABSTRACT

The sustainability of the banking system depends on the profitability and capital adequacy. Practically, profitability and liquidity are effective indicators of the corporate health and performance of not only the Islamic commercial banks but all profit-oriented ventures. Therefore, liquidity risk is considered as one of the serious concerns and challenges for modern era banks. As the global financial crisis spread, Islamic banks in Kingdom of Bahrain began to be affected; all of a sudden, some of the biggest Islamic banks, such as the Bahrain Islamic Bank, the Gulf Finance House and the Ithmar Bank, ended up with net losses. The aim of this study is to investigate the impact of the significant determinants of liquidity risk on the profitability of Islamic commercial banks in Bahrain during the 2007-2013 periods as well as to assess the impact of the global financial crisis on the profitability of these banks during the recovery period. Multiple regressions analysis was applied.

By using Ordinary Least Squares (OLS) the results revealed that all the independent variables are significant with both models ROA and ROE except financial leverage and deposits have a statistically insignificant impact on ROA- Capital adequacy, financial leverage, deposits and GDP have a positive and significant impact; whereas bank size and the global financial crisis have a negative impact and are statistically significant.

From these results, it is recommended that these banks control and manage properly these variables in order to create a high level of liquidity in the banks which would achieve a good profitability, leading to the sustainability of the financial banking system.

Keywords: Capital Adequacy, Financial Leverage, Maturity, Non-performing Loans, Takaful and Re-Takaful.
ABSTRAK


Analisis regrasi telah digunakan. Menggunakan Ordinary Least Squares (OLS), keputusan mendapati bahawa semua pembolehubah bebas adalah signifikan dengan kedua-dua model ROA dan ROE kecuali pembahagian kewangan dan deposit yang tidak signifikan terhadap ROA- Capital, pembahagian kewangan, deposit dan KDNK mempunyai positif dan kesan yang signifikan; manakala saiz bank dan krisis kewangan global memberi kesan negatif dan statistik yang signifikan dari segi statistik.

Daripada keputusan ini, adalah disyorkan bahawa bank mengawal dan mengurus dengan baik pembolehubah ini bagi mewujudkan tahap kecairan yang tinggi di bank-bank yang akan mencapai keuntungan yang baik, yang membawa kepada kemampuanan sistem perbankan kewangan.

Kata kunci: Kecukupan Modal, Pembahagian Kewangan, Simpanan, Tempoh Matang, Pinjaman Tidak Berbayar, Takaful dan Takaful Semula.
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<tr>
<td>AAOIFI</td>
<td>The Accounting and Auditing Organization for Islamic CBs</td>
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<td>CBs</td>
<td>Conventional Banks</td>
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<td>CR</td>
<td>Credit Risk</td>
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<td>CAP</td>
<td>Capital Adequacy</td>
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<td>CBB</td>
<td>Central Bank of Bahrain</td>
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<tr>
<td>DTA</td>
<td>Deposits ratio</td>
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<td>DUM</td>
<td>Dummies Variable of Banks</td>
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<td>DVs</td>
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<td>EQTA</td>
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<td>Gross Domestic Product growth Rate</td>
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<td>Islamic Banks</td>
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<td>IFSB</td>
<td>Islamic Financial Services Bank</td>
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<td>IIFM</td>
<td>International Islamic Financial Market</td>
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<td>Description</td>
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<tr>
<td>IIRA</td>
<td>Islamic International Rating Agency</td>
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<td>International Monetary Fund</td>
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CHAPTER ONE
INTRODUCTION

1.1 Background and Motivation of the Study

Strengthening the financial sector is a pivotal concern for any economy (Paul et al., 2013). Banks are the main participants in any economy and perform important activities on both sides of the balance sheets: they enhance the flow of funds by lending cash to short-term users on the assets side; and provide liquidity on the liability side (Arif et al., 2012). The role of banks can be diversified into financial intermediaries as it channels the financial resources from surplus economic units to deficit economic units, i.e., as facilitator and supporter (Tesfaye, 2012). Financial institutions are effective mediators between savers and borrowers, like investment banks, central banks, development banks and commercial banks, while performing this financial intermediary role.

Commercial banks have become the main institutions with the passage of time, because banks work as retail banking units and facilitate the transfer of financial assets that are required from lenders to other financial assets that are desired by the public. So, considering the fact that the activities of commercial banks affect the greater part of society, they have been selected as the major focus of this study. The financial intermediary role of commercial banks is the bedrock for two essential functions, namely, deposit mobilization and credit extension. An adequate financial intermediation requires the purposeful attention of the bank management to
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