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**THE IMPACT OF INTERNAL AND EXTERNAL FACTORS ON PROFIT  
EFFICIENCY OF ISLAMIC BANKS IN MALAYSIA**



**MASTER IN ISLAMIC FINANCE AND BANKING  
UNIVERSITI UTARA MALAYSIA  
April 2021**

**THE IMPACT OF INTERNAL AND EXTERNAL FACTORS ON PROFIT  
EFFICIENCY OF ISLAMIC BANKS IN MALAYSIA**

**By**



**Thesis Submitted to  
College of Business Universiti Utara Malaysia,  
in Partial Fullfillment of the Requirement for the  
Master in Islamic Finance and Banking**



**Pusat Pengajian Perniagaan Islam**  
ISLAMIC BUSINESS SCHOOL  
كلية إدارة الأعمال الإسلامية  
**Universiti Utara Malaysia**

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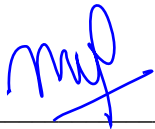
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## **ABSTRACT**

The sustainability of the banking system depends on the profit efficiency of the banks. The profit efficiency of Islamic banks in Malaysia shows a fluctuating trend from the period of 2014 to 2018. This study aims to analyse the post Global Financing Crises (GFC) period and examines the impact of external and internal factors on the profit efficiency of Islamic banks in Malaysia covering the period of 2014 to 2018. In this study, profit efficiency was measured using net income (NI). The secondary data involved 320 observations on 16 Islamic banks in Malaysia. The external factors tested in this study were Gross Domestic Product (GDP) and Inflation (INF), while the internal factors were Loan Loss Provision (LLP), Net Interest Margin (NIM) and Staff Efficiency (STAFFX). This study used panel data obtained from Fitch Connect database. The results of the study found that INF, LLP and STAFFX showed a significant negative effect while NIM showed a positive and significant effect on profit efficiency of Islamic banks in Malaysia. GDP was found to be insignificant towards profit efficiency. Findings from this study provides a better understanding of the impact of external and internal factors on the profit efficiency of Islamic banks that is useful for policy makers and banks management. This study is important as to determine the impact of these external and internal factors on banking system, in particular Islamic banks which possibly affects the banks performance and generally on the economic growth in Malaysia.

**Keywords:** Profit efficiency, Islamic banks, external and internal factors



## ABSTRAK

Kemampuan sistem perbankan bergantung kepada keuntungan sesuatu sistem perbankan itu. Kecekapan keuntungan bank-bank Islam di Malaysia didapati menunjukkan corak berubah-ubah dari tempoh 2014 hingga 2018. Tujuan kajian ini dijalankan adalah untuk menganalisis tempoh waktu selepas krisis kewangan global serta untuk mengkaji kesan faktor luaran dan faktor dalaman ini ke atas kecekapan keuntungan bank-bank Islam di Malaysia meliputi tahun 2014 hingga 2018. Kecekapan Keuntungan dalam kajian ini diukur menggunakan pendapatan bersih bank. Data sekunder melibatkan 320 pemerhatian atas 16 bank-bank Islam di Malaysia. Faktor luaran yang diuji didalam kajian ini adalah Keluaran dalam Negeri kasar (GDP) dan Inflasi (INF), manakala faktor dalaman adalah Peruntukan Kerugian Pinjaman (LLP), Margin Pendapatan Bersih (NIM) dan Kecekapan Kakitangan (STAFFX). Kajian ini menggunakan data panel yang diperoleh daripada pengkalan data Fitch Connect. Hasil kajian mendapati INF, LLP dan STAFFX menunjukkan kesan negatif yang signifikan terhadap kecekapan keuntungan, sementara NIM menunjukkan kesan positif dan signifikan terhadap kecekapan keuntungan bank-bank Islam di Malaysia. Selain itu, GDP menunjukkan kesan yang tidak signifikan terhadap kecekapan keuntungan. Kajian ini memberikan pemahaman yang lebih baik kepada pihak yang merangka polisi dan pengurusan bank berkenaan kesan faktor luaran dan dalaman terhadap keuntungan bank-bank Islam di Malaysia. Kajian ini penting untuk menentukan faktor-faktor luaran dan dalaman yang memberi impak ke atas sistem perbankan, khususnya bank-bank Islam yang berkemungkinan memberi kesan kepada prestasi perbankan dan secara umum terhadap pertumbuhan ekonomi di Malaysia.

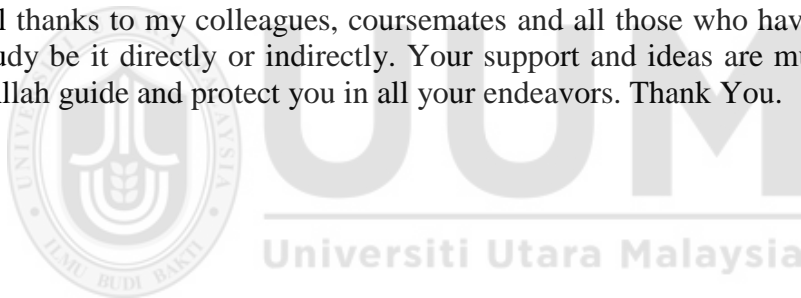
**Kata Kunci:** Kecekapan keuntungan, Bank-bank Islam, faktor luaran dan faktor dalaman.

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## TABLES OF CONTENTS

PERMISSION TO USE .....	iii
ABSTRACT .....	iii
ABSTRAK .....	v
ACKNOWLEDGEMENT .....	vi
TABLES OF CONTENTS .....	vii
LIST OF TABLE .....	xi
LIST OF FIGURES .....	xii
LIST OF ABBREVIATION .....	xiii
CHAPTER ONE .....	1
INTRODUCTION .....	1
<b>1.0 Introduction</b> .....	1
<b>1.1 Background of Study</b> .....	2
<b>1.2 Bank Performance</b> .....	3
<b>1.3 Problem Statement</b> .....	5
<b>1.4 Research Questions</b> .....	9
<b>1.5 Research Objectives</b> .....	10
<b>1.6 Significance of Study</b> .....	10
<b>1.7 Contribution to the Body of Knowledge</b> .....	11
<b>1.8 Organisation of the Study</b> .....	11
<b>1.8.1 Chapter 1: Research Overview</b> .....	12
<b>1.8.2 Chapter 2: Literature Review</b> .....	12
<b>1.8.3 Chapter 3: Methodology</b> .....	12
<b>1.8.4 Chapter 4: Results, Analysis and Discussion</b> .....	12
<b>1.8.5 Chapter 5: Conclusion and Recommendations</b> .....	12
CHAPTER TWO .....	13
LITERATURE REVIEW .....	13
<b>2.0 Introduction</b> .....	13
<b>2.1 Profit Efficiency</b> .....	13
<b>2.2 External Factors</b> .....	15
<b>2.2.1 Gross Domestic Products (GDP)</b> .....	15
<b>2.2.2 Inflation</b> .....	16
<b>2.3 Internal Factors</b> .....	17
<b>2.3.1 Net Interest Margin (NIM)</b> .....	17

2.3.2	Loan Loss Provision.....	18
2.3.3	Staff Efficiency .....	20
2.4	Related Theories .....	21
2.4.1	Financial Intermediation.....	21
2.4.2	Agency Theory .....	23
2.5	Chapter Summary .....	24
<b>CHAPTER THREE .....</b>		<b>25</b>
<b>RESEARCH METHODOLOGY .....</b>		<b>25</b>
3.0.	Introduction .....	25
3.1.	Research Framework .....	25
3.2.	Hypothesis Development.....	26
3.2.1.	External Factor .....	26
3.2.1.1.	Gross Domestic Product (GDP) .....	26
3.2.1.2.	Inflation.....	26
3.2.2.	Internal Factors.....	27
3.2.2.1.	Net Interest Margin (NIM).....	27
3.2.2.2.	Loan Loss Provision (LLP) .....	27
3.2.2.3.	Staff Efficiency (STAFFX) .....	27
3.3.	Research Design.....	28
3.4.	Operational Definition and Measurement .....	28
3.5.	Data Collection .....	30
3.5.1.	Data Sources.....	30
3.5.2.	Population.....	30
3.5.3	Estimation Model.....	31
3.5.3.1.	Multiple Regression .....	32
3.6	Data Analysis .....	33
3.6.1	Diagnostic Test .....	33
3.6.1.1.	Detecting Outlier .....	33
3.6.1.2.	Multicollinearity Check.....	33
3.6.1.3.	Normality Test.....	34
3.6.1.4.	Heteroscedasticity Test .....	34
3.6.1.5.	Autocorrelation Test .....	34
3.6.2	Random Effect Model.....	35
3.6.3	Multiple Regression Analysis.....	35
3.7	Chapter Summary .....	35

<b>CHAPTER FOUR</b> .....	36
<b>RESULT, ANALYSIS AND DISCUSSION</b> .....	36
<b>4.0. Introduction</b> .....	36
<b>4.1. Descriptive Statistics of Variables</b> .....	36
<b>4.2 Multicollinearity Check</b> .....	37
<b>4.3. Normality Test</b> .....	38
<b>4.4 Diagnostic Test</b> .....	39
<b>4.4.1 Heteroscedasticity Test</b> .....	40
<b>4.4.2 Autocorrelation Test</b> .....	40
<b>4.6 Multiple Regression Analysis</b> .....	40
<b>4.6.1 External Factors for Islamic Banks in Malaysia</b> .....	42
<b>4.6.1.1 Gross Domestic Products (GDP)</b> .....	42
<b>4.6.1.2 Inflation</b> .....	42
<b>4.6.2 Internal Factors for Islamic Banks in Malaysia</b> .....	42
<b>4.6.2.1 Net Interest Margin</b> .....	42
<b>4.6.2.1 Loan Loss Provision</b> .....	43
<b>4.6.2.3 Staff Efficiency</b> .....	43
<b>4.6.3 The Summary of the Outcome of the Connection between Independent Variables and Profit Efficiency of Islamic Banks in Malaysia.</b> .	43
<b>4.7 Analysis of External Factors</b> .....	44
<b>4.7.1. Gross Domestic Product (GDP)</b> .....	44
<b>4.7.2 Inflation</b> .....	44
<b>4.8 Analysis on Internal Factors.</b> .....	45
<b>4.8.1 Net Interest Margin</b> .....	45
<b>4.8.2 Loan Loss Provision</b> .....	45
<b>4.8.3 Staff Efficiency</b> .....	45
<b>4.9 Conclusion</b> .....	46
<b>CHAPTER FIVE</b> .....	47
<b>CONCLUSION AND RECOMMENDATIONS</b> .....	47
<b>5.0. Introduction</b> .....	47
<b>5.1. Recapitulation of the Findings</b> .....	47
<b>5.1.1. Objective 1</b> .....	47
<b>5.1.2. Objective 2</b> .....	48
<b>5.2. Contribution of the Study</b> .....	49
<b>5.2.1. New Findings - Empirical Contributions</b> .....	49

<b>5.2.2. Theoretical Contribution .....</b>	<b>50</b>
<b>5.3. Limitations of the Study.....</b>	<b>50</b>
<b>5.4. Suggestion for Future Research.....</b>	<b>51</b>
<b>5.5. Conclusion.....</b>	<b>52</b>
<b>REFERENCES.....</b>	<b>53</b>
<b>APPENDIX I .....</b>	<b>58</b>
<b>APPENDIX II.....</b>	<b>59</b>
<b>APPENDIX III .....</b>	<b>60</b>
<b>APPENDIX IV.....</b>	<b>61</b>



## LIST OF TABLE

<b>TABLE</b>		<b>Page</b>
3.1	The Summary of Variables Definition and Measurement	43
3.2	The Summary on Measurement of Variables	44
3.3	List of Islamic Banks in Malaysia	45
4.1	Statistics of the dependent variables and the independent variables for the Malaysian Islamic banks.	50
4.2	Multicollinearity Diagnostic test for Islamic Banks in Malaysian variables	51
4.3	Correlation Matrix for Islamic Banks in Malaysia	52
4.4	Skewness and Kurtosis Test for Islamic Banks in Malaysia	53
4.5	Diagnostic Test for Islamic Banks in Malaysia	53
4.6	Hausman test for Profit Efficiency of Islamic Banks in Malaysia	54
4.7	External and Internal factors on Profit Efficiency of Islamic Banks in Malaysia	55
4.8	Summary of Multiple Regression Results of external and Internal factors on Profit Efficiency for Islamic Banks in Malaysia	58



## LIST OF FIGURES

FIGURE		PAGE
Figures 3.1	Conceptual Framework of the Study.	39



## LIST OF ABBREVIATION

BIMB	Bank Islam Malaysia Berhad
BNM	Bank Negara Malaysia
DEA	Date Envelopment Analysis
GDP	Gross Domestic Product
INF	Inflation
LLP	Loan Loss Provision
MENA	Middle East and North Africa
NIM	Net Interest Margin
OIC	Organization of Islamic Organization Conference
PE	Profit Efficiency
SPSS	Statistical Package for the Social Sciences
STAFFX	Staff Efficiency
VIF	Variance Inflation Factor



# CHAPTER ONE

## INTRODUCTION

### 1.0 Introduction

By establishing the Islamic Banking Act that has come into force in 1983, Malaysia has succeeded in its way towards being a modern and vibrant Islamic banking and financial sector over the last three decades. Leading this effort, increased market share of services and products to the banking and financial system, infrastructure development and institutional capacity, the design of legal frameworks and standards, quality of educational and training facilities and the development of Islamic banks and financial institution assets and so on are part of it.

Islamic banking industry acted as an alternate outlet for Muslims during the early stages to conduct banking and financial transactions in compliance with Islamic practices which means avoiding elements that are forbidden in Islam. Islamic banking's rise is often linked to Islam's rebirth and Muslims' urge to live according to Islamic teachings in all aspects of their lives (Bank Negara Malaysia, 1994). However, all Malaysians have now commonly embraced and used the Islamic banking and financial industry; transforming the industry into a global model for a new, competitive industry.

Presentation of this chapter offers; 1.0 introduction 1.1 background of the study, 1.2 bank performance 1.3 problem statement, 1.4 research questions, 1.5 research objective, 1.6 significance of the study, 1.7 contributions to the body of knowledge and 1.8 organisation of the study.

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## APPENDIX I

### List of Islamic Banks in Malaysia

No	Islamic Banks
1	Affin Islamic Bank Berhad
2	Alliance Islamic Bank Berhad
3	OCBC Al-Amin Bank Berhad
4	AmBank Islamic Berhad
5	Kuwait Finance House (Malaysia) Berhad
6	RHB Islamic Bank Berhad
7	CIMB Islamic Bank Berhad
8	Public Islamic Bank Berhad
9	MBSB Bank Berhad
10	Al Rajhi Banking and Investment Corporation (Malaysia) Bhd
11	Maybank Islamic Berhad
12	Hong Leong Islamic Bank Berhad
13	Bank Muamalat Malaysia Berhad
14	Standard Chartered Saadiq Berhad
15	Bank Islam Malaysia Berhad
16	HSBC Amanah Malaysia Berhad



## APPENDIX II

### Statistic of Variables for Islamic Banks in Malaysia

Variable	Obs	Mean	Std. Dev.	Min	Max
year	320	27016	11197.85	12014	42018
bank	0				
code	320	8.5	4.616992	1	16
llp	320	.2930312	.5558945	-2.86	3.11
nim	320	2.28675	.5102548	1.24	4
peo	320	31.36941	23.92203	1.84	69.47
roe	320	8.814375	4.696123	-7.99	19.67
gdp	320	5.16	.7504398	4	6.5
inflation	320	2.375	1.136623	.2	4.1



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### APPENDIX III

#### Correlation Matrix for Islamic Banks in Malaysia

	llp	nim	peo	gdp	inflat~n
llp	1.0000				
nim	0.2678	1.0000			
peo	-0.0961	0.2027	1.0000		
gdp	0.0154	0.1093	0.0085	1.0000	
inflation	0.0476	0.0041	-0.0202	0.5328	1.0000

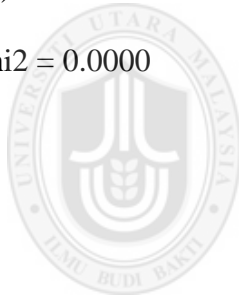
- xttest3

Modified Wald test for groupwise heteroskedasticity in fixed effect regression model

H0:  $\sigma(i)^2 = \sigma^2$  for all i

chi2 (16) = 1170.60

Prob>chi2 = 0.0000



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## APPENDIX IV

### Results of the Multiple Regressions for Islamic Banks in Malaysia

Dependent Variable: ROE Method: Panel EGLS (Cross-section random effects) Date: 02/20/20 Time: 13:59 Sample: 1 320 Periods included: 80 Cross-sections included: 16 Total panel (unbalanced) observations: 320 Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.482319	1.340865	3.342855	0.0009
GDP	0.145060	0.130813	1.108916	0.2683
INFLATION	-0.195924	0.085689	-2.286458	0.0229
LLP	-2.663192	0.183325	-14.52715	0.0000
PEO	-0.070338	0.019266	-3.650855	0.0003
NIM	3.076740	0.266770	11.53331	0.0000
<b>Effects Specification</b>				
			S.D.	Rho
Cross-section random			3.998876	0.8846
Idiosyncratic random			1.444678	0.1154
<b>Weighted Statistics</b>				
Root MSE	1.430399	R-squared	0.499770	
Mean dependent var	0.709737	Adjusted R-squared	0.491805	
S.D. dependent var	2.025593	S.E. of regression	1.444001	
Sum squared resid	654.7333	F-statistic	62.74236	
Durbin-Watson stat	1.559298	Prob(F-statistic)	0.000000	
<b>Unweighted Statistics</b>				
R-squared	0.253232	Mean dependent var	8.814375	
Sum squared resid	5253.578	Durbin-Watson stat	0.194329	