



UNIVERSITI TEKNOLOGI MARA

**DETERMINANTS OF ISLAMIC BANKS'
PERFORMANCE IN MALAYSIA**

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ABSTRACT

In 1983, Malaysia's first Islamic bank was created. Commercial banks, merchant banks, and finance organisations were granted authority to offer Islamic banking products and services under the Islamic Banking Scheme (IBS). Malaysia's Islamic finance industry is thriving. The main purpose of this study is to investigate the determinants that affect Islamic bank performance in Malaysia between 2016 and 2020. The study investigates whether the drivers of Islamic banks' performance in Malaysia contribute to Islamic banks' return on assets. The independent factors in this study are the Capital Adequacy Ratio (CAR), Bank Size, Liquidity, Inflation, and Gross Domestic Product (GDP), while the dependent variable is the Return on Asset (ROA). To acquire these variables, the financial ratios approach will be employed, and the regression model will be run using Ordinary Least Squares (OLS). The information will be gathered from the financial reports of Islamic banks, the World Bank, and Knoema. Overall, the findings show that GDP have a significant relationship with Islamic banks' return on assets in Malaysia. During the study period, the researchers discovered no significant relationship between ROA and CAR, Liquidity, Bank Size and Inflation. As a result of the findings, policymakers in Malaysia can pay more attention to the profitability of Islamic banks.

Keywords: Return on Asset, Capital Adequacy Ratio, Bank Size, Liquidity, Inflation, Gross Domestic Product, Malaysia

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Islamic banking is a type of banking that follows to Islamic law. The main concepts that regulate Islamic banking are mutual risk and profit sharing, the assurance of fairness for all, and the fact that transactions are based on an underlying economic activity or asset. Malaysia's nearly 30-year track record of building a strong domestic Islamic finance industry provides the country with a solid foundation - a financial bedrock of stability that adds depth, diversity, and maturity to the financial system. Malaysia's Islamic banking assets stood at USD 254 billion as of December 2019, with total money placed with Islamic banks accounting for 38.0 percent of total banking sector deposits.

Malaysia now boasts a huge number of full-fledged Islamic banks, as well as foreign-owned corporations, conventional institutions with Islamic subsidiaries, and entities that deal in foreign currency. Malaysia continues to improve and expand the business by inviting multinational Islamic banking institutions to establish operations in Malaysia to conduct foreign currency transactions (Bank Negara Malaysia, 2016).

The Islamic banking sector's roles are based (implicitly) on the assumption that if Islamic banks outperform their conventional counterparts, for example, by being more efficient, profitable, or having better credit quality, then the Islamic banking sector contributes positively to the banking sector's soundness and, by extension, to the economy's health. (Imam & Kpodar, 2015). Malaysia is a key player in Islamic finance, with Iran and Saudi Arabia. Though there are various opportunities to grow the Islamic finance industry, long-term success will require keeping a focus on risk management procedures and regulatory standards (Arabia, 2010).

Profits being an important factor of growth and employment, a big number of Islamic banks in Malaysia have been urged to look for alternatives and ways to boost their profitability over time. Profitability fluctuations can have a significant impact on the economy because they can be a significant contributor to progress. Banks may usually impact earnings through influencing investment and saving decisions. Increased