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ISLAMIC BANK ASSETS MANAGEMENT PERFORMANCE: AN EMPIRICAL EVALUATION

Mohd Afandi Abu Bakar, Abdul Malek A Tambi, Mohd Fauzi Mohd Harun

ABSTRACT

This paper evaluates the performance of Islamic bank's assets management for the period of 1996 to 2008. The study also evaluates the impact of the interest rate movement on the Islamic bank's performance. To reflect the managerial efficiency, the study adopted the financial ratio approach. The study discovered that the Islamic banks on giving return to their shareholders and depositors are relatively indifference to conventional banks. In portfolio management, however, Islamic bank is less efficient compared with the conventional banks as shown by lower asset utilization and investment margin ratios. The Islamic bank investment margin fluctuates more than that of its counterpart during an upswing and downswing event of interest rate. This shows that the Islamic bank investment returns is sensitive to the interest rate fluctuation. Efficiency of Islamic bank asset management given by return on asset (ROA) shows that it is significantly influenced by the bank's capability in managing its assets and investment policy given by AU ratio and IM ratio.

Keywords: Islamic bank; assets, management, performance,

Correspondence Author: Mohd Afandi Abu Bakar, Faculty of Business Management, Universiti Teknologi MARA (Perak). Email: mohda254@perak.uitm.edu.my

Abdul Malek A Tambi, Faculty of Business Management, Universiti Teknologi MARA (Perak)
Mohd Fauzi Mohd Harun, Faculty of Business Management, Universiti Technologi MARA (Perak)

INTRODUCTION

The introduction of the Interest-Free Banking Scheme on March 4, 1993 marked that Islamic banking (IB) operations are open to competition. This event provides more depth to the IB operations in Malaysia and keeps the participating banks on guard to improve performance.

The fundamental objective of a firm is to maximise shareholders' wealth. Thus, it is crucial to evaluate the Islamic banking system in terms of its assets management. Monitoring the bank's performance is essential for managerial as well as regulatory purposes. For managers, they are keen to determine the outcomes of their management decisions whilst bank regulators are concerned about the safety and soundness of the banking system itself. Depositors' reason for their interest in the bank's performance is since they are not entitled to fixed returns and the nominal values of their deposits are not guaranteed.

Without persistent monitoring of performance, existing problems can remain unnoticed and could lead to financial failure in the future. With this in mind, the research attempts to evaluate the Islamic Bank assets management performances in a given period. This study will:

1.assess the assets management performance of the Islamic bank since its introduction.

2.investigate the impact of interest rate movement on the Islamic bank profitability performance

This study looks into the IB profitability performance compared to conventional banks (CB) in Malaysia. The purpose is to look at whether there is any significant progress of the IB industry since its introduction in the banking industry. The second objective checks whether the IB is able to profit and protect itself from the economic cycle and volatile interest rate movement.

Based on available literature, most of the previous studies on IB are descriptive in nature. The topic discussed is important as an empirical analysis on the performance of the IB industry is limited compared to study on conceptual issues underlying the system. The conclusion of this study might be useful in gauging the financial standing of the IB industry, which in turn can serve as a basis for decision-making. More importantly, the conclusion of this study might be useful in the IB model building and policy making particularly in a dual banking system and in a volatile economy condition.

LITERATURE REVIEW

A number of studies was conducted on the Malaysian Islamic banking system but the attempts focused primarily on the conceptual issues underlying the interest-free banking, among others are studies by Ismail (1983), Ariff (1989), Anwar

(1991), Nawawi (1995) and Yackop (1995 and 1997). Since this study is an empirical one, this section will only concentrate on empirical studies done previously.

Among the studies on the Islamic banking that can be observed are by Yusoff et.al. (2001). By utilising the overnight and 3 month Klibor data from May 1999 to August 2001 and applying the regression analysis they explore the effect of interest rate fluctuation on loan supply of the IB and CB system. Their finding shows that the IB loan growth of merchant bank is significantly positive related to overnight Klibor.

By using the ratio analysis, Samad (1999) evaluated BIMB's productivity and managerial efficiency in the sources and the uses of the bank's fund from the year 1992 until 1996. From his study he stated that the managerial efficiency and profitability indexes of CB is higher than that of BIMB while the productivity efficiency test shows mixed result. His finding indicates that weaker productivity efficiency position of BIMB compared to its rival. But the productivity test by loan recovery criterion indicates that the efficiency position of BIMB seems to be higher than that of CB.

Rosly (1998) studied the possible outcomes of dual-banking system on IB performance and its benefit to customers from a fluctuation of interest rate. In his study, he evaluated the impact of 1996/97 interest rate hike on BIMB profit margin compared to various CB in Malaysia. He finds that the latter's profit margin was reduced during that period compared to the CB. In his study, Rosly's also manipulated the ratio analysis method in looking for the possible performance outcome of IB in a volatile interest rate environment.

By using the BIMB data as a proxy, Dirar (1996) evaluated the Islamic banking performance and compared it with Maybank Berhad and BSN Commercial. In his study, he compared the growth, profitability, liquidity and capital adequacy ratio of the three banks. He finds that BIMB's major financing is concentrated on trade-based investment compared to the other two banks.

Wong (1995) also evaluated the performance of BIMB after ten years of its operation by concentrating on BIMB's deposits and total assets growth, profits and returns to its depositors and shareholders, BIMB's modes of financing and usage of funds, and lastly how the BIMB discharges its social obligation as an Islamic bank. The conclusion of his study was BIMB's achievements are commendable for a bank that has only been operating for ten years although there are shortcomings in its modes of financing. His study has proven that IB has the ability to maintain its viability and growth in a capitalistic financial environment.

From the literature review, it is evident that previous studies are limited to the performance of BIMB as the pioneer to IB operation in Malaysia except for the study done by Yusoff (2001). Studies on the performances of the IB are scant. IB has been in the market for almost 30 years since 1983. Therefore, it is timely to evaluate its profitability performances involving the IB operation provided by conventional banks.

METHODOLOGY

This research focuses on the IB assets management performances. The evaluation is by using the widely used indicators in measuring a firm's performance, that is, the financial ratio analysis. The ratio analysis includes the return on equity, return on assets, return on deposits, profit margin, assets utilisation, net operating margin, operating efficiency ratio and investment margin.

From the profitability ratios, to determine the association between the return on asset with asset utilization and investment margin, the study applied multiple regression analysis. The analysis involved estimating the ROA degree of association to its determinants namely the AU, OER and IM ratio. The estimation procedure is based on the following equation:

$$\sum_{t=1}^{n} ROA = \alpha + \sum_{t=1}^{n} \hat{\beta}_1 AU + \sum_{t=1}^{n} \hat{\beta}_2 NOM + \sum_{t=1}^{n} \hat{\beta}_3 OER + \sum_{t=1}^{n} \hat{\beta}_4 IM + \hat{\varepsilon}$$

Where ROA_t *is return on asset at time t*
AU_t *is asset utilization at time t*
NOM_t *is net operating margin at time t*
OER_t *is operating expenses ratio at time t*
IM_t *is the investment margin at time t*
ε_t *is the error terms*

The data comes from the institution's annual reports from the year 1996 to 2008. The commercial banks considered in the study are Maybank Berhad, Public Bank Berhad, Hong Leong Bank Berhad, Affin Bank Berhad, RHB Bank Berhad, AMBank Berhad, Hong Kong and Shanghai Bank Berhad, Standard Chartered Bank Berhad, OCBC Bank Berhad, Citibank Berhad and Bank Islam Malaysia Berhad.

EMPIRICAL EVIDENCE AND ANALYSIS

For the managerial efficiency, as measured by the ROA, ROE and ROD, it shows that the profitability ratios of IB are averagely higher than the CB. The profit ratios in Table 2.1b shows that the average return earned for each Ringgit on assets, equity and deposits by IB is 1.01%, 14.96% and 1.42% compared to 0.89%, 12.42% and 1.25% of CB. The differences in the average ROA, ROE and

ROD are statistically insignificant at 5% level. Thus, the null hypothesis on ROA, ROE and ROD cannot be rejected at 5% level of significance (ρ-value of ROA = .451; ROE=.216; ROD = .453). At 95% confidence interval the average managerial efficiency range given by ROA is within -.28% to .44%; ROE within -1.49% to 6.55% and ROD from -0.28% to 0.64%. The effect size of ROA = .006 < 0.015; ROE = .007 < 0.015 and ROD = .004 < 0.015.

Table 2.1a: Managerial Efficiency (1996 – 2008)

bank		N	Mean	Std. Deviation	Std. Error Mean
ROA	Islamic Bank	122	.010082	.0136803	.0012386
	Conventional Bank	110	.008854	.0107470	.0010247
ROE	Islamic Bank	120	.149562	.1560881	.0142488
	Conventional Bank	109	.124237	.1520174	.0145606
ROD	Islamic Bank	122	.014233	.0173081	.0015670
	Conventional Bank	110	.012479	.0182093	.0017362

Source: SPSS generated

Table 2.1b: Independent Samples t-test on ROA, ROE and ROD (1996 – 2008)

		Levene's Test for Equality of Variances		t-test for Equality of Means						
									95% Confidence Interval of the Difference	
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
ROA	Equal variances assumed	1.013	.315	.755	230	.451	.0012281	.0016274	-.00198	.00443
ROE	Equal variances assumed	.036	.850	1.241	227	.216	.0253246	.0203985	-.01487	.06552
ROD	Equal variances assumed	.745	.389	.752	230	.453	.0017543	.0023326	-.00284	.00635

Source: SPSS generated

The IB management on average has shown commendable performance compared with CB in terms of their ability to control the expenses. Based on Table 2.1c, the profit margin of IB and CB sector is 24.48% and 13.56% respectively. This means that the IB management has been able to increase its earnings by 24.48% for each Ringgit of cost reduced. In other words, the higher PM ratio of the IB indicates that they are more effective in reducing its operation expenses compared to its rival. The t-test supports this finding. The differences in the means under study are statistically significant at 5% level (ρ-value < .001). Statistically the average range of difference falls between 6.18% and 15.66% at 95% confidence interval. The effect size is small given by $\eta^2 = .076 < 0.15$ but with high power of test (0.98 > 0.8).

Table 2.1c: Expens es Management and Service Pricing Policies (1996 – 2008)

Profit Margin	N	Mean	Std. Deviation	Std. Error Mean
Islamic Bank	121	.244760	.2092299	.0190209
Conventional Bank	110	.135597	.1544301	.0147243

Source: SPSS generated

Table 2.1d: Independent Samples t-test on Profit Margin (1996 – 2008)

	Levene's Test for Equality of Variances		t-test for Equality of Means						
								95% Confidence Interval of the Difference	
Profit Margin	F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
Equal variances not assumed	4.651	.032	4.538	219.96	.000	.1091622	.0240541	.06176	.15657

Source: SPSS generated

In terms of portfolio management, the CB is more effective compared with IB with higher AU ratio of CB (6.86%) compared to IB (4.63%). This indicates that the CB is relatively more capable in utilising its assets for income earning compared to the IB. This is largely due to its historical background and the market size of the CB. It is also interesting to note that the independent t-test supports this finding. The differences in the means under study are statistically significant with the ρ-value < .001 and 95% confidence level the average falls within the range of -2.75% and -1.72%. With the effect size η^2 = .240 we can say it has a large effect size and high power of test (99% > 80%).

Table 2.1e: Portfolio Management Policies (1996 – 2008)

Asset Utilisation	N	Mean	Std. Deviation	Std. Error Mean
Islamic Bank	12 2	046303 .06863	.022853 2	002069 0
Conventional Bank	11 0	3	.015821 6	.001508 5

Source: SPSS generated

Table 2.1f: Independent Samples t-test on Asset Utilisation of (1996 – 2008)

	Levene's Test for Equality of Variances		t-test for Equality of Means						
								95% Confidence Interval of the Difference	
Asset Utilisation	F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
Equal variances assumed	2.467	.118	-8.563	230	.000	-.0223302	.0026078	-.027468	-.01719

Source: SPSS generated

In terms of the efficiency in managing the growth of revenues ahead of rising costs, the IB management on average has shown commendable performance compared with the CB sector. The average net operating margin (NOM) ratio of the IB is 1.39%, which is higher than that of the CB (1.37%). And for the measurement of effort in maximizing the profit and the value of the shareholder's investment in the institutions, indicated by the operating expenses ratio (OER), it is found that the IB is able to increase its operation income at a lower expense compared to the CB. The IB average OER was 66.68% compared to 79.86% of the CB.

In testing the null hypothesis for equality of means, the t-test only supports the finding on OER, which is statistically significant at 5% confidence level (ρ-value < .001) with the effect size is large (.77) and power >80% (.991). Therefore, the null hypothesis on NOM cannot be

rejected. (NOM ρ-value > .903; 95% confidence interval is in the range of -.34% to .39%. The effect size is small η^2= .000; and power of test is = .052).

Table 2.1g: Growth of Revenues (1996–2008)

NOM	N	Mean	Std. Deviation	Std. Error Mean
Islamic Bank	122	.013918	.0138879	.00125 74
Conventional Bank	110	.013692	.0143654	.00136 97

Source: SPSS generated

Table 2.1h: Cost and Productivity Management (1996 – 2008)

OER	N	Mean	Std. Deviation	Std. Error Mean
Islamic Bank	122	.666752	.2488222	.02252 73
Conventional Bank	110	.798628	.1890283	.01802 31

Source: SPSS generated

Table 2.1i: Independent Samples t-test on NOM and OER (1996 – 2008)

		Levene's Test for Equality of Variances		t-test for Equality of Means						
									95% Confidence Interval of the Difference	
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
NOM	Equal variances assumed	.226	.635	.122	230	.903	.0002260	.0018560	-.00343	.00388
OER	Equal variances not assumed	7.876	.005	-4.571	223.72	.000	-.1318766	.0288498	-.18879	-.07502

Source: SPSS generated

Investment Policy Management

In order to evaluate the bank's ability in protecting itself due to interest rate movement, the management of investment policy is crucial. It is observed that interest rate volatility was evident during the period of study. From 1996 to 1998, on average the interest rate was on a rising note and declined sharply from 1999 to 2004. During the period of 1995 to June 1998, the interest rate was on the rising note. The commercial bank's lending rate has been increasing from an average of 9.28% in 1995 to 12.13% in 1998 before decreasing to an average of 8.56% in 1999 to 5.98% in 2004. It has started to increase again since then.

To look into the effects of the interest rate movement on the IB earning, a return measure, namely the investment margin for the IB (IBIM) and interest margin for the CB (CBIM) are used. Interest margin is a suitable indicator since it shows whether a bank has positioned its assets and liabilities to take advantage of or protect itself from interest rate movement. In other words, interest margin will show to what extent the bank has profited or lost when interest rates rise or fall.

In CB, the net interest margin is a summary measure of net interest returns on income to producing assets. The measurement is important to evaluate the bank's ability to manage interest rate risk. As for the IB, the interest margin is replaced by the investment margin, which is the difference between the bank's income that is derived from the investment of fund and expenditure.

Referring to table 5.0 for the CB, the interest margin mean is 3.17% higher than IB with 2.53%. The higher interest margin shows that the CB was able to protect itself when the interest rate increased during that period. The higher interest margin was because of its floating rate loans that could automatically adjust the contractual loan rates upwards and downwards when interest rates changed. The finding is significant at 5% level of confidence with the ρ-value = .025 and at 95% confidence level the mean falls within -1.19% and -.08 %. On the other hand, the effect size is small (.18) and the power is also weak (53.8%)

It is also important to observe that the investment margin ratio of IB is fluctuating more

than that of its counterpart, this shows that IB return from its investment is more sensitive to interest rate volatility compared to CB. One factor can explain this fact is because of too much dependence on the fixed rate financing which concerns with the application of BBA financing. For example, declining interest rates will mean a higher margin for IB since they cannot revise the profit rate downwards, as it will alter the existing selling price of BBA assets thus breaking down contract. To avoid further decline in earning, IB must seek diversification into equity-based financing, to open up floating rate option for IB.

On the other hand, CB was able to raise interest rates on loans and consequently rates of deposits. Since profits remained unchanged in IB, returns on Islamic deposits were lower than fixed deposits.

Table 5a: Interest Rate Risk Management (1996 – 2007)

Bank	N	Mean	Std. Deviation	Std. Error Mean
Islamic Bank	122	.025340	.0301155	.00272 65
Conventional Bank	110	.031717	.0072839	.00069 45

Source: SPSS generated

Table 5b: Independent Samples t-test on IB Investment Margin vs. CB Interest Margin

	Levene's Test for Equality of Variances		t-test for Equality of Means						
								95% Confidence Interval of the Difference	
Investment Margin	F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
Equal variances not assumed	29.307	.000	-2.267	136.57	.025	-.0063774	.0028136	-.0119	-.0008

Source: SPSS generated

DISCUSSION

The performance as measured through the average profitability ratios shows that the PM for the past twelve years for the IB is higher than CB except for the AU and IM. This is supported by the t-test. The result is explained based on the low operating expenses of the IB sector compared with the conventional sector. This is related to the decision of the monetary authority for allowing the CB sector to offer the Islamic banking services under one roof. The decision is the most efficient and effective way in expanding the Islamic banking system. The CB sector already has a wide network of branches. By using the existing infrastructure, it could offer Islamic banking services throughout the country at a minimal additional cost. As a result, a higher percentage of return was manageable by the Islamic banking sector. This can be seen from its higher NOM and lower OER compared to the CB.

Although the overall performance of Islamic banking has shown an improvement, one important aspect that deserves attention is the weakness in its portfolio management policies. Ratio analysis results showed that the Islamic bank has lower AU and IM compared to the CB. An efficient portfolio management is essential to generate higher earnings. From this evidence, it shows that the commendable performance of Islamic banks from 1996 to 2007 was contributed by low operating expenses and not from efficient investment policies. In order to generate a higher AU and IM it should consider implementing equity-based investment. At present, it only consists about 10 percent of its operations.

If we analyse the movement pattern of investment margin over the year, we can see that the interest margin of the CB was superior to the IB investment margin in terms of its performance ratio stability (Table 5.0). The difference of mean of the IB and CB was supported by the statistically t-test on equality of mean. The lower investment margin ratio indicates that the IB was less effectual in its portfolio management policies compared to the conventional bank, as shown by lower asset utilization. If this pattern continues, the tendency to gain higher income compared to the CB will not be realized.

However, from the above evidence and analysis, the overall achievements of the IB are commendable, although there are shortcomings in its investment methods. From the overall profitability performance test, the IB has begun to show some significant changes in its structures. The significance of this research finding proves that the IB is in a sound position and more than able to compete with its rival the CB.

Econometric Estimation

ROA seems correlated well with NOM, OER, IM and OER. The correlations are significant at 5% level given by the Pearson correlation output. From the coefficient of determinations, 93.2% of the variation in ROA is explained by changes in the independent variables. From the Durbin-Watson table we observed that for n=100 and four explanatory variables, the d critical value are 1.592 and 1.758 (5% level of significant). Since the computed d value = 1.508 is lower than the d_L limit we can conclude that there is no evidence of first-order autocorrelation.

From the ANOVA table the ρ-value is less than .001, which means that at least one of the explanatory variables can determines the ROA. The VIF values are below 5 indicating that there is no major problem of multicollinearity, asset utilization (VIF = 1.362), the net operating margin (VIF=2.521), operating expenses ratio (VIF=1.371) and for investment margin (VIF=1.587).

All of the predictors follow the economic theory sign as predicted and significant at 95% confidence level as a determinant of ROA. The asset utilization has the ρ-value > .01, net operating margin (ρ < .001), operating expenses ratio (ρ < .001) and for investment margin (ρ < .001). It shows that an efficient management of each ringgit of assets or portfolio management policies will increase the ROA by .083% holding others determinant constant. For every per cent increase in NOM, ROA will increase by 1.003% holding others determinant constant. For every per cent increase in the efficiency in managing the operating expenses (OER), ROA will increase by .01%, holding others determinant constant. Moreover, every per cent increase in the efficiency in managing investment (IM), ROA will increase by .052%, holding others determinant constant. Based on the standardized Beta coefficient, it shows that NOM (1.019) contributed the highest effect on ROA, followed by OER (.172), AU (.142) and IM (.121).

Table 6a: Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
Cons	-.007	.001		-4.988	.000					
AU	.083	.017	.142	4.823	.000	.368	.423	.121	.734	1.362
NOM	1.003	.039	1.019	25.518	.000	.938	.927	.642	.397	2.521
OER	-.010	.002	-.172	-5.839	.000	.298	-.492	-.147	.729	1.371
IM	.052	.014	.121	3.813	.000	.655	.346	.096	.630	1.587

a. Dependent Variable: ROA

Table 6b: Correlations

		roa	au	nom	oer	im
Pearson Correlation	roa	1.000	.368	.938	-.298	.655
	au	.368	1.000	.494	-.131	.230
	nom	.938	.494	1.000	-.466	.575
	oer	-.298	-.131	-.466	1.000	-.112
	im	.655	.230	.575	-.112	1.000
Sig. (1-tailed)	roa	.	.000	.000	.001	.000
	au	.000	.	.000	.085	.007
	nom	.000	.000	.	.000	.000
	oer	.001	.085	.000	.	.121
	im	.000	.007	.000	.121	.

Table 6c: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.966[a]	.932	.930	.00353	1.508

a. Predictors: (Constant), IM, OER, AU, NOM
b. Dependent Variable: ROA

Table 6d: ANOVA[b]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	.018	4	.005	368.468	.000[a]
Residual	.001	107	.000		
Total	.020	111			

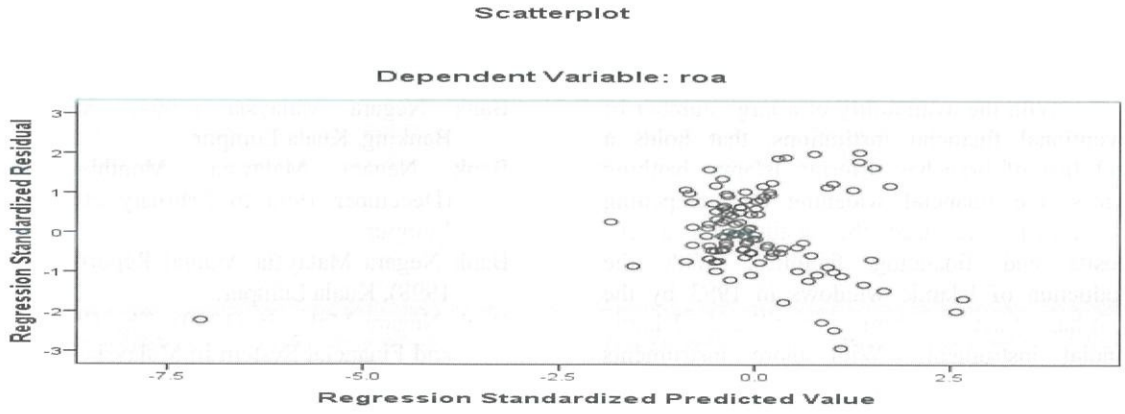
a. Predictors: (Constant), IM, OER, AU, NOM
b. Dependent Variable: ROA

Based on the residual plot and Table 7 the maximum and minimum residual are within ± 3 with no definite pattern. For the test of normality, both Kolmogorov-Smirnov and Shapiro-Wilk ρ-value are more than .05. Thus, normality of residuals can be assumed.

Table 7: Residuals Statistics[a]

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	-.0809	.0443	.0100	.01285	112
Std. Predicted Value	-7.077	2.665	.000	1.000	112
Standard Error of Predicted Value	.000	.003	.001	.000	112
Adjusted Predicted Value	-.0592	.0448	.0102	.01163	112
Residual	-.01030	.00712	.00000	.00346	112
Std. Residual	-2.921	2.019	.000	.982	112
Stud. Residual	-4.310	2.289	-.022	1.079	112
Deleted Residual	-.02957	.00915	-.00022	.00463	112
Stud. Deleted Residual	-4.719	2.336	-.027	1.105	112
Mahal. Distance	.049	80.651	3.964	8.997	112
Cook's Distance	.000	10.332	.111	.978	112
Centered Leverage Value	.000	.727	.036	.081	112

a. Dependent Variable: ROA



Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Unstandardized Residual	.051	112	.200*	.986	112	.283

a. Lilliefors Significance Correction

*. This is a lower bound of the true significance.

CONCLUSION

Apparently, the Malaysian Islamic bank business appears to have made its mark in the financial sector. The profitability performance test on the IB shows that the IB management on average has shown commendable performance compared with CB. The superior performance of the IB sector is explained by the lower operating expenses incurred by the IB as it uses existing CB facilities in running its Islamic banking services.

From the findings of this research, it is proven that the IB has the ability to maintain its viability and growth in a capitalistic financial environment. With the systematic and an open-minded approach in implementation of an Islamic finance in Malaysia is proven to be the most efficient and effective way. At least half of the problems, particularly the factors related to the financial widening arising from having only one Islamic banking institution, that is, the BIMB. Through this initiative, the Islamic banks assets, deposits and financing have increased at a faster rate during the period of 1993 to 2008.

The strategy to allow the CB to offer Islamic banking services has stimulated the financial development of the Islamic banking system. With more of conventional financial institutions providing the Islamic banking services, the physical size of the Islamic banking sector has expanded as the number of Islamic financial institutions rises and there is a smaller ratio of population to the Islamic financial institutions.

With the availability of a large number of conventional financial institutions, that holds a broad line of branches offering Islamic banking services, the financial widening and deepening have directly increased the institution's assets, deposits and financing facilities. With the introduction of Islamic windows in 1993 by the CB, it has attracted customers to utilise the Islamic financial instruments. With more instruments introduced in the market, this has improved the mobilisation and utilisation of deposits and trade financing facilities.

One important finding of this study involved the utilisation of assets in Islamic banking, which was found to be less efficient. The lower average AU and IM ratio shows this compared with CB. The need for a more efficient management in asset utilisation is an important factor to boost the earnings. One suggestion is diversification that is placing more funds into Mudharabah and Musharakah financing.

Despite the promising progress of Islamic banking, especially after establishing the IBD, the Islamic banking still has a long way to go to make a break through into the financial sector. With a marginal share of total shares of assets, deposits and financing, the impact of Islamic banking to the financial and economic system will not show a substantial challenge to conventional banking. Nevertheless, with the good-recorded annual growth, there is a good chance that the Islamic banking can make new inroads in the Malaysian banking system in the near future. The pattern of financial activity in Malaysia is likely to change significantly in the next few years as the Islamic banking institutions become more established and ready to diversify beyond the al-Murabahah and al-Bay-bithaman ajil framework.

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