UNIVERSITI TEKNOLOGI MARA

THE DETRMINANTS OF ISLAMIC BANKING'S PROFITABILITY

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ABSTRACT

The credit crisis of 2007-2009 provided a once-in-a-lifetime opportunity for Islamic banks to establish themselves over the world. Malaysia was one of the countries that escaped the brunt of the financial crisis. The early emergence of Islamic finance, many observers think, is the explanation for this. The notion of Islamic banking was first introduced in Malaysia in 1983. Nevertheless, a parallel Islamic banking industry exists alongside conventional banks. Due to the various challenges that Islamic banks face, such as the current economic situation and the lack of sufficient capital, their profitability will be affected. High levels of credit risk, poor loan quality, insufficient or inadequate capitalization, operational efficiency, and a high degree of credit risk will all have an impact on bank profits. The objective of this paper is to examine the profitability of Islamic banks by examining the various factors that affect it. The study will then reveal the various factors that affect it. The study investigates the various factors that affect banks profitability. It is expected that these factors will lead to banks` profitability. This study aims to provide a guideline for financial analysts and policymakers in analyzing the various factors that affect the profitability of Islamic banks in Malaysia.
Keywords: Islamic banking, banks` profitability, fixed effect model, banks performance, Malaysia.

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CHAPTER ONE INTRODUCTION

1.1 Introduction

Islamic banking is one of the fastest-growing financial industries in the world. In the future, Islamic banking will continue to promote itself as a viable and cost-effective funding alternative for Malaysia's robust economic growth. The Islamic revival in the late 1960s and early 1970s aided in the development of a financial system that allows Muslims to deal in accordance with their religious convictions (Bank Negara Malaysia, 2007). As a result, Islamic bank performance is recognised as one of the main indicators in assisting the economy's growth and expansion in a positive direction.

Early on, Islamic banking in Malaysia offered basic banking services and products, such as accepting deposits and allocating loans, that were devoid of the riba' element, which is prohibited in Islam. As the sector expands, the products provided change to satisfy the needs of both consumers and businesses. Malaysia's Islamic banking sector has expanded its services and products by foraying into Islamic insurance (Takaful), Islamic pawnbroking, and Sukuk underwriting. In general, the Islamic financial sector has become more vibrant in terms of providing services and products that adhere to Islamic principles, such as Islamic securities, Islamic unit trust funds, stock broking, and financial derivatives.

The Malaysian government's commitment to Islamic banking growth was demonstrated by the enactment of the Islamic Banking Act 1983 and the Government Investment Act 1983. As a result, the Bank Islam Malaysia Berhad became the first Islamic bank to be established (BIMB). Total assets climbed sixfold from RM325.5 million in 1984 to RM1,890.6 million in 1993, with deposits increasing from RM241.4 million to RM1,611.7 million and loans increasing from RM161.1 million to RM996.4 million. However, Islamic banking's contribution to the wider financial system has remained modest, and its reach among the general public has been restricted.

The purpose of this study is to assess the performance of Islamic banks in Malaysia and determine the major variables of Islamic bank performance in Malaysia. This research paper's overall attributes investigate the history of Islamic banking in Malaysia, the literature review, research methodology, and findings analysis. The study's ultimate