UNIVERSITI TEKNOLOGI MARA

PREDICTING RETURN ON EQUITY BASED ON SIGNIFICANT DETERMINANTS FOR ISLAMIC BANKS IN MALAYSIA

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ABSTRACT

The existence of Islamic banks that grow rapidly in every corner of the world has caused strong competition among them and other conventional banks in Malaysia. This requires the banks management to choose wisely on the determinants that make them to remain strong and relevant in the Islamic banking sector. The main purpose of this study is to predict the return on equity of some Islamic banks in Malaysia using forecast value of significant banking determinant. The significant banking determinants selected for the study include deposit ratio, operating efficiency and market concentration. The study utilized secondary data from year 2010 until year 2016 for 13 Islamic banks in Malaysia. Principal Component Analysis was applied in order to get internal and external significant determinants. The internal and external significant determinants are Bank Size and Gross Domestic Product. Then, Multiple Linear Regression was used to formulate the Bank Profit Model which shows the relationship between the Bank Size and GDP with Return on Equity. Next, Geometric Brownian Motion used to forecast the value of Bank Size and GDP. The forecast value was substitute into Bank Profit Model to calculate the Return on Equity for each bank. From the results of the study, management of bank can have focused on Bank Size and Gross Domestic Product in order to gain more profit. Besides, the Return on Equity for Islamic banks in this study in a range of 3 percent to 23.82 percent.

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CHAPTER 1
INTRODUCTION

1.1 INTRODUCTION

This section includes examining the background of an Islamic bank, dependent variables, independent variables and previous methods used in the study. The following discussion cover the subtopics of problem statement, objective of the research, scope and limitation of the study and also the significance of the study.

1.2 BACKGROUND OF STUDY

There are two type of banking system around the world which are Islamic and conventional banking. Conventional banking system refers to the interest-based banking, whereas Islamic banking system is an interest-free banking. Both banking systems compete with each other to fulfill customer satisfaction and expectation as well as ensure long term benefit of the economy. In Malaysia, there are 16 Islamic banks, 26 commercial banks, three international Islamic banks, 11 investment banks and two financial Institutions are currently operating in Malaysia (Bank Negara Malaysia, 2016).

Since more than 50 percent of the population in Malaysia are Muslims, the Islamic banking system which subscribes to Syariah principles is operating alongside the conventional banking system. It offers an alternative to the customers to conduct syariah compliant commercial banking transactions. In order to regulate Islamic banking, the Islamic Banking Act 1983 was legislated and came into effect on April 7, 1983 (Ramlan & Adnan, 2016).

The example of concepts for product that is provided by an Islamic bank is Mudarabah, Musharakah, Murabahah and Salam concept. Mudarabah is a profit sharing involves a financier as rabbulmal, who provides a specific amount of capital and acts as a sleeping partner and an entrepreneur as mudarib, who acts as a trustee or a business agent (Sapuan, 2016). Besides, Musharakah in simple word means partnership. Jalil and Rahman (2012) states that "musharakah is a form of financing