THEFACTORS AFFECTING PERFORMANCE OF ISLAMIC BANKS IN MALAYSIA

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TABLE OF CONTENT

ABSTRACT

Malaysia is one of countries that implemented dual banking systems in the world which are Islamic and conventional. Malaysia became one of the main hubs for Islamic banking in Southeast Asia because of development of the Islamic banking system. Due to the intense competition among Islamic banks, the introduction of more innovative products is projected to tap investment opportunities not only for Malaysia but also for the rapidly growing Southeast Asian region. The purpose of this study is to examine and identify the factors that will significantly affect Islamic performance of banks. This research will be focusing on eight (8) Islamic banks that based in Malaysia. Secondary quarterly data will be gathered for the period of 2011 to 2015 and the data is collected from several published sources such as Bankscope and websites. The explanatory of variables in this study are divided into two categories which is internal and external factors. Capital adequacy, operational efficiency and bank size is the internal factors or bank-specific variables while the external factors or macroeconomic variables are inflation and economic growth. From the finding indicates that two of five independent variables have significant with the dependent variable or profitability of 6 Islamic banks in Malaysia and. All microeconomic or internal variables are not significant toward profitability and performance of Islamic banks. Besides that, this research carry out the inflation rate is negative relationship with bank's performance and economic growth rate shows have positive relationship with performance of the Islamic banks in Malaysia.

CHAPTER 1: INTRODUCTION

1.1. Background of study

Banks are channeling the funds from depositors or know as surplus fund units to the borrowers or deficit fund units and offering many banking products to satisfy the economic demands in most countries. Banking industry serves as the most essential financial intermediary by conducting the primary functions in the global economy.

Banking profitability was divided into two perspectives which are microeconomic view or bank-specific determinants and macroeconomic view or industry-specific determinants. Return on Asset (ROA) and Return on Equity (ROE) as for the profitability measures. Large group of researchers use Return on Asset (ROA) as the most common profitability indicators but in a few case, Net Interest Margin (NIM) also used to measure the bank profitability as well. How effective the bank management in producing income from the management of its assets that reflect ROA is generally the best indicators of bank performance (Sharma &Ravichandran, 2013). Previous researchers such as Rivard and Thomas (1997) is widely adopted this indicator to proxy for banking profitability.

From views of microeconomic point, important part for profitability of banks is to sustain in the increasingly competition banking industry such as promotes expansion of bank as well as improve prospect and stakeholder's confidence on the banking industry (Jamal et al., 2012). Considering the microeconomic variables that included in the past studies (Ameur&Mhiri, 2013) capital adequacy, bank size and operational efficiency is the primary bank-specific factors. The major internal determinants of the bank's profitability is capital