Which is more important in terms of Profitability of Islamic Banks: Bank Specific factors or Macroeconomic factors? An Empirical Study on Malaysian Islamic Banks

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Abstract—**Studies of Islamic banks' profitability are an important tool towards improving performance, evaluating bank operations and determining management plan to help in increasing the chance for the banks to survive in competitive markets. The present study seeks to fill a demanding gap in the literature by providing new empirical evidence on the factors that influence the profitability of the Islamic banking sector in Malaysia. The research thus conducts a comparative analysis of the determinants of the profitability of Islamic banks operating in Malaysia. The Pooled Ordinary Least Square method is employed using annual data from the period 2007 to 2013 on 11 Islamic banks in Malaysia. In order to evaluate the financial performance of these Islamic banksthe profitability are measured using the Return on Assets (ROA) indicator. The empirical findings of study reveals that bank-specific factors such as the efficiency ratios (overhead costs) is negatively and statistically significant to the profitability of the Islamic bank's performance, while equity financing is positive and statistically significant to the profitability of Islamic banks. The Credit risks and Liquidity risks factors are insignificant on the performance of the Islamic banks. On the other hand, macroeconomic factors such as inflation have a positive and statistically significant impact on the return on assets whereas savings on gross national income has a statistically significant and *negative impact on the performance of Islamic banks.***

Keywords-*Bank-specific, Macroeconomic, Determinants, Islamic Banks, ROA, Efficiency ratios, Equity finance, credit risk, Liquidity risk, inflation, gross savings on national income.*

I. INTRODUCTION

Islamic finance is getting widespread acceptance all over the world and is nowadays regarded as a serious competitor to "conventional finance". During the last three decades, Islamic banking matured into a viable alternative model of financial intermediation and gained credibility as witnessed by the establishment of a large number of Islamic financial institutions all over the world. (Karim*et.al.*, 2010). In service providing economies, the banks play very key role as a financial intermediaries and also considered very important for economic developments. Over the last twenty years, market conditions in banking have undergone extensive changes on both demand and supply sides (Sufian&Habibullah, 2009). On the demand side, customers have become more sophisticated, value-oriented and price sensitive. On the supply side, the globalization of financial markets has been accompanied by government deregulations, financial innovation and automation. These two factors have resulted in an increase in the number of competitors, followed by cost reductions and profit declines. It is reasonable to assume that these forces have posted great challenges to the Islamic banks as the environment in which they are operating has been changing rapidly. This could reasonably be expected to have an impact on the determinants of their performance. Despite considerable development in the Islamic banking sector, empirical work on Islamic banks performance is still its infancy. To date, empirical studies on the performance of the banking sector in the both developed and developing countries focused on the conventional interest based banking system, while there has been almost no conclusive research done on the performance of the Islamic banking sector.

II. OBJECTIVES OF THE STUDY

1. Main objective:

The main objective of the proposed study is to identify main determinants and discrepancies of the Islamic banks performance in Malaysia and to find out to what extent these discrepancies in the banks' profitability are due to variations in endogenous factors under the control of the bank management and to what extent of external factors.

2. Specific Objectives:

1. To analyze and compare the financial performance of all Islamic banks in Malaysia from 2007 to 2013.
2. To investigate and identify the differences in the determinants of bank's profitability in Malaysia.

III. LITERATURE REVIEW

Existing literature groups the determinants (factors) of banks financial performance into two types (Haron, 2004): the first is the macroeconomic determinants are those factors that are considered to be away from the control of bankadministration such as gross domestic product, conventional banks interest rates, competition, regulation,concentration, market share, ownership and inflation.In the literature, empirical studies on profitability of Islamic banks have paidattention on specific and some concentrated on the panel of countries. The studies usedin the literature aimed at explaining the profitability of Islamic banks includesMalaysia (Asma et al., 2011; Ahmad and Ahmad, 2004), Indonesia (Izhar and Asutay,2007), Bahrain, Egypt, Sudan, and Saudi Arabia (Al-Jarrah and Molyneux, 2003).These studies inspect theprofitability determinants of Islamic banks.

The second type of the determinants is the bank-specific factors, where the size of banks, capital adequacy, liquidity, and credit risk and expenses management effect were examined. The researchers found that only the variable size of banks statistically affects the profitability of Islamic banks in the Malaysia (Asma et al., 2011). An Indonesian study conducted by Izhar and Asutay (2007) with aimed to determine Islamic banks profitability determinants. The results of the study conclude that service activities have no effect on profitability of Indonesia Islamic banks and were statistically insignificant. The study results has support the positive relationship and statistically significant between inflation and Islamic banks profitability.

A study conducted by Ahmad and Ahmad (2004) that affect Malaysian Islamic banks credit risk. The study concludes that assets size, risky assets ratio and Islamic banks management efficiency effect found statistically significant on Islamic banks credit risk. In the Middle East, a study conducted by Bashir (2003) examined the internal variables and economic environment impact on the performance of Islamic banks. The statistically significant and positive relationship founds between capital adequacy and profitability of Islamic banks. The researcher also concluded from the study, foreigners owned Islamic banks have ability to attain higher profit ratio then the banks locally owned. The positive impact and statistically significant relationship of inflation founds on the profitability of Middle East Islamic banks.

A study conducted by Al-Jarrah and Molyneux (2003) on the banks and banks sample are taken from Bahrain, Egypt, Sudan, and Saudi Arabia. The researchers found that in their selected sample Islamic banks are most efficient. They also concluded that Islamic banks funds cost is lower comparatively to other financial institutions cost. A study by Hassan and Bashir (2003) examine the impact of factors on profitability of Islamic banks. Hassan and Bashir found the statistically significant and positive effect for the loans activities ratio and capital adequacy on the Islamic banks profitability.

The few internal and external determinants of profitability of Islamic banks wereexamined by Haron (1996). The researcher concluded from his study that deposits like(current, savings, and investment) alongside capital adequacy, total expensesand liquidity shows statically significant effect on the profitability of Islamicbanks, and his study conducted in 2004, Haron examined the Islamic banks internalvariables and conclude that variables are statistically significant effect on theprofitability of Islamic banks, and also concluded that the management of Islamicbanks is more efficient in the competitive environment in comparison with itscompetitors.

The result differ significantly in different studies due to the variation in the data and environment used in the analysis. Even though there are numerous factors affect the profitability which acknowledged by the researchers. Previous studies remain in focus for the continuation of this study but differ from many aspects. The study differs because of time of the study and the used variables in the model of study and the study population. So as far as the study concern, this is the first study in its kind in the selected countries and region.

IV. ISLAMIC BANKING INDUSTRY IN MALAYSIA:

In Malaysia, the first Islamic bank, Bank Islam Malaysia Berhad (BIMB), operated as the only Islamic bank for 10 years since July 1983 before the government allowed other conventional banks to offer Islamic banking services using their existing infrastructure and branches in 1993 [Bank Negara Malaysia (BNM), 1994 and 1999]. The history of Islamic banking in Malaysia can be traced back to 1963 when TabungHaji (the Pilgrims Management and Fund Board) was

established by the government. It is a specialized financial institution that provides a systematic mobilization of funds from Muslims to assist them perform pilgrimage in Makkah as well as encourages them to participate in

	Bank Name	Country rank by assets	World rank by assets,	Total Assets mil USD 2013	Total Assets mil USD 2012	Total Assets mil USD 2011
1.	Maybank Islamic Berhad	6	539	38,110	29,896	23,769
2.	CIMB Islamic Bank Berhad	16	1065	15,061	16,750	13,567
3.	Bank Islam Malaysia Berhad	18	1178	13,046	12,237	10,138
4.	AmIslamic Bank Berhad	20	1329	10,773	10,525	8,321
5.	Public Islamic Bank Berhad	22	1351	10,505	9,582	9,268
6.	RHB Islamic Bank Berhad	23	1474	8,877	8,374	7,129
7.	Hong Leong Islamic Bank Berhad	24	1721	6,836	6,858	n.a.
8.	Bank Muamalat Malaysia Berhad	25	1831	6,138	6,823	6,683
9.	HSBC Amanah Malaysia Berhad	26	2185	4,438	3,972	3,287
10.	Affin Islamic Bank Berhad	31	2387	3,758	3,834	3,315
11.	OCBC Al-Amin Bank Berhad	32	2652	3,086	2,276	1,801
12.	Kuwait Finance House (Malaysia) Berhad	33	2752	2,880	2,885	3,186
13.	Standard Chartered SaadiqBerhad	36	3003	2,499	2,397	1,873
14.	Alliance Islamic Bank Berhad	38	3180	2,261	2,210	2,134
15.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	39	3329	2,058	2,245	1,930
16.	Asian Finance Bank Berhad	56	5177	885	919	769
17.	Alkhair International Islamic Bank Berhad	62	11549	132	187	189

Table1: status of Islamic banks in Malaysia (source: Bank scope database)

investmentopportunities and economic activities. In fact, due to its uniqueness, TabungHaji is considered to be the first of its kind in the world (Mohammed Seidu, 2002). Based on the experience of TabungHaji, the government of Malaysia then introduced a well-coordinated and systematic process of implementing the Islamic financial system. The process can be divided into three phases. The first phase is considered as the period of familiarization (1983-1992) when BIMB was established and the Islamic banking operations were initiated in accordance with Shariah principles, and is also the period when Islamic Banking Act (IBA) was officially enacted. The second phase, from 1993 to 2003, was aimed at creating a more conducive environment for competition among the banks. The third phase that commenced from 2004 was the period of further financial liberalization (BNM, 2004). During that period, the Central Bank paved the way for new foreign Islamic banks to operate in Malaysia by issuing licenses. The brief status of all Islamic banks is given below:

V. METHODLOGY

A. Data Collection:

To conduct this research work, we collect the bank specific variables of 11 Islamic banks operating in Malaysia for year 2007-2013 from Bankscope database of Bureau Van Dijk Company by using random sampling method. Meanwhile, the Industry and macroeconomic variables data of corresponding countries have been collected from World Bank and IMF financial statistics (IFS) database. The following equations are used for the purpose of the study and estimated based on 'Pooled ordinary Least Square Method.

No.	Name	Year of establishment
1	Affin Islamic Bank Berhad	2006
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	2006
3	Bank Islam Malaysia Berhad	1983
4	Bank Muamalat Malaysia Berhad	1999
5	CIMB Islamic Bank Berhad	2005
6	Hong Leong Islamic Bank Berhad	2005
7	Kuwait Finance House (Malaysia) Berhad	2005
8	Maybank Islamic Berhad	2007
9	OCBC Al-Amin Bank Berhad	2008
10	RHB Islamic Bank Berhad	2005
11	Standard Chartered Saadiq Berhad	2008

Table 2: List of the Malaysian Islamic Banks Included in the Data Sample

B. Model Specifications:

The panel data is used in analyzing the bank's portability determinants. In the panel data, the used model consists n cross-sectional units, denoted n=1, ...,N, observed at each of T time periods, t=1, ...,T. In data set, the total observation is n × T. The basic framework for the panel data is defined as per the following regression model :

$$Ynt = \alpha + \beta Xnt + \varepsilon nt$$

Here, The functional form of Profitability= *f (Bank specific variables, Macro-economic Variables)*

Econometric specifications:
Return on Asset (ROA) = α+β1 LLP/TL +β2EQASS+β3NIE/TA +β4LOANS/TA+ β5LNGDPgr+β6 INFLI+β7 M2 +β8Savings to GNI+ ε

Where Y represents the dependent variable (Return on assets (ROA),

Independent variables:

LLP/TL = Loan loss provisions / Total Assets,
EQASS = Equity/Total assets,
NIE/TA = Noninterest Expenses/Total Assets reflects the operation function
LOAN/TA= Total loan/Total Asset
GDPgr = Annual GDP growth rate
INFLI = Inflation rate
M2 = Money supply
Savings to GNI = Savings to gross national Income
ε = Error term

C. Dependent Variable:

1. Return on Asset (ROA):

Following among others, Ben Naceur and Goaied (2008), Kosmidou(2008), the dependent variable used in this study is ROA which shows the profit earned per dollar of assets and most importantly and reflects management ability to utilize the banks financial and real investment resources to generate profits(Hasan and Bashir, 2003). For any bank , ROA depends on the banks policy decisions as well as uncontrollable factors relating to the economy and government regulations. Rivard and Thomas (1997) suggest that bank profitability is measured by ROA, as ROA is not distorted by high equity multiplier and represents a better measure of the ability of the firm to generate returns on its profitability of assets.

D. Independent Variables:

1. Bank-specific determinants:

i) Asset Quality ratio (Loans loss provisions divided by the total loans):

The ratio of loan loss provisions to total loans (LLP/TL) is incorporated as an independent variable in the regression analysis as a proxy for credit risk. The co-efficient of LLP/TL is expected to be negative because bad loans are expected to reduce profitability. Miller and Noulas (1997) suggest that the greater the exposure of the banks to high risk loans, the higher the accumulation of unpaid loans would be and lower profitability would be.

ii) Capital adequacy ratio-Total equity by total assets ratio**:**

The EQASS variable is included in the regression to examine the relationship between profitability and bank capitalization, strong capital structure is essential for banks in developing economics, since it provides additional strength to withstand the financial crises and increased safety for depositors during unstable macroeconomic conditions. Furthermore, lower capital ratio in banking implies higher leverage and risk therefore greater borrowing cost. Thus, the profitability level should be higher for better capitalized bank.

iii) NIE/TA(Total overhead expenses divided by total assets):

The ratio of overhead expenses to total assets, NIE/TA, is used to provide information on the variations in bank operating costs. The variable represents the total amount of wages and salaries as well as the cost of running branch office facilitates. The relationship between the NIE/TA variable and profitability level is expected to be negative, because banks that are more productive and efficient should keep their operating cost low.

iv) LOANS/TA (Total loans divided by total assets):

The ratio of the total loans to total assets (LOANS/TA) is used as a measure of liquidity risk. It is the risk of not having cash or borrowing capacity to cover deposit withdrawals or new loan applications, which forces banks to borrow emergency funds at excessive cost. Thus, when the proportion of funds invested in cash or equivalent cash increases, liquidity of bank of the bank decreases. So, a negative relationship between liquidity risk and profitability is expected. In banking literature, KyriakiKosmidou, SaleishTanna and Pasioras (2005) found a positive relationship between the liquidity risk and profitability whereas Hassan and Bashir (2003)

founds negative association between the liquidity risk and the profitability.

2. Macro-economic factors:

i) Gross domestic product (GDP) growth rate:

A gross domestic product (GDP) is the amount that most commonly used macroeconomic indicators to measure economic activity within an economy. The GDP is expected to influence numerous factors related to the supply and demand for loans and deposits. Empirical results show that GDP has a positive and significant effect on the performance of Islamic banks (Bashir, 2003; Wasiuzzaman&Tarmizi, 2010), because favorable macroeconomic conditions within the country create a good environment for the banking sector.

ii) Inflation-INFLI:

Another important macroeconomic condition which may affect both the costs and revenues of banks is the inflation (INFL). Staikouras and Wood (2003) point out that inflation may have direct effects (i,e increase in the price of labor) and indirect effects (I,e increase in asset prices) on the profitability of banks.

iii) Money Supply-M2:

Money supplyrepresents the amount of money in the country, and how it affects the performance of Islamic banks. It could be used as a proxy for macroeconomic conditions in the Malaysian economy (Kok et al., 2012). Kok et al. (2012) and Srairi (2009)found a positive and statistically significant effect of this variable on the performance of Islamic banks. The same positive effect of the money supply is expected here, and will therefore be included in this study as an external variable because money supply reflects the macroeconomic conditions within a country, which influences the performance of Islamic banks by affecting the financial situation of customers.

iv) Savings on GNI:

Adjusted Net Saving (ANS) as a percentage of Gross National Income (GNI) is derived from the standard national accounting measure of gross saving by making four adjustments: (i) consumption of fixed capital is deducted to obtain net national saving; (ii) current public expenditure on education is added to account for investment in human capital; (iii) estimates of the depletion of a variety of natural resources are deducted to reflect the decline in asset values associated with extraction and depletion; (iv) deductions are made for damages from carbon dioxide and particulate emissions. The indicator is then computed by dividing ANS by GNI. Adjusted net saving measure the change in value of a specified set of assets, excluding capital gains. If a country's net saving is positive and the accounting includes a sufficiently broad range of assets, economic theory suggests that the present value of social welfare is increasing. Conversely, persistently negative adjusted net saving indicates that an economy is on an unsustainable path. Bernheim and Shoven (1991) have found there is a positive relationship between Adjusted Net Saving (ANS) as a percentage of Gross National Income (GNI).

Variables	Positive Significant	Negative Significant	Insignificant	Hypothesized Relationship
Bank-specific determinants				
Capital Adequacy Ratio	KyriakiKosmidou, SaleishTanna and Pasioras (2005); Goddard, Molyneux and Wilson (2004)	Hassan and Bashir (2003)	Short (1979) Chirawa (2003)	Positive/ Negative
Liquidity Ratio	KyriakiKosmidou, SaleishTanna and Pasioras (2005); Maghyereh and Shammout (2004)	Bashir (2000); Hassan and Bashir (2003)		Negative
Overhead Expenses ratio	Ben Naucer and Goaied (2001); Hasasn and Bashir (2003)	KyriakiKosmidou, SaleishTanna and Pasioras (2005); Guru er al. (2005)		Negative
Asset Quality Ratio		Miller and Noulas (1997)		Negative
Macroeconomic determinants				
GDP Growth Rate	Sauders et al., (1990); Baerger et al., (1995)			Positive/ Negative
Inflation	Staikouras and Wood (2003)			Positive
Money Supply (M2)	Kok et al (2012); Srairi (2009)			Positive/ Negative
ANS by GNI	Bernheim and Shoven (1991)			Positive/ Negative

Table 3: Sketch of literature review

VI. RESULTS & ANALYSIS:

The study tries to find the impact of internal factors and external factors of the performance of return on assets (ROAA) in the following manner:

A. Descriptive Analysis:

To analyze the result of the study, first it is useful to comment on some preliminary features of our data. Table 4 shows descriptive statistics for the profitability (ROAA) and the bank-specific, industry-specific and macroeconomic variables used in our model. In average, the return on average asset of 10 Islamic bank used in this study are 0.48 However, the mean of all other independent variables are positive.

Table 4: Descriptive statistics

Notes: The dependent variable is ROA is calculated as net profit divided by total assets. LLP/TL is a measure of credit risk calculated as the ratio of total loan loss provisions by total assets. EQASS is a measure of capitalization, calculated as book value of shareholders equity as a fraction of total assets. CIR is proxy measure for the operating efficiency of management quality, calculated as personnel expenses divided by total assets; Loans/TA is used as a proxy measure for credit risk, calculated as total loans divided by total assets. GDPgr is the GDP growth rate. INFLI is the inflation rate. Here all the variables are in ratio form except the GDPgr and inflation rate where these two are in percentage form.

	ROA	CIR	LOANS/ TA	Capital	LLP/TL	GDP gr.	INFL	M2	Savings on GNI
Mean	0.47	1.69	51.81	7.70	3.46	3.70	2.79	122.0	36.54
Median	0.62	1.52	54.97	6.96	2.43	4.13	2.70	125.3	36.64
Max.	2.00	9.24	77.74	19.65	18.80	7.23	5.44	144.1	42.12
Min.	-6.84	-0.41	6.33	1.000	0.65	-9.63	0.58	64.37	30.82
Std. Dev.	1.19	1.53	13.81	3.72	3.01	3.799	1.32	20.2	3.081
Skew.	-4.59	2.33	-0.511	1.392	2.87	-2.13	0.36	-1.81	-0.0928
Kurto.	26.71	11.85	3.24	4.80	12.70	7.72	2.30	5.85	2.1081

The mean of liquidity ratio is the largest (51.81) and varies greatly across banks (max = 77.74 and min = 6.33). In average total equity over total assets is 7.7 and standard deviation is 3.72. As of credit ratio, and operation efficiency shows a mean of 3.46 and 1.69 respectively. Over the period the average gross domestic product growth rate of Malaysia is 3.70%, while inflation is 2.80%. from the macroeconomic perspective, the average of GDP growth rate , inflation, money supply and savings on the gross national income are 3.7%, 2.8%, 122.03% and 36.54% respectively. In terms of standard deviation,liquidity risk is the highest from bank-specific factors and Money supply is the highest from the macro-economic factors.

B. Regression Results:

This section shows the regression analysis of Islamic bank's profitability and its internal variables and external variables. Using fixed effect model, the regression are run using E-views 8. Return on average assets are regressed with 8 independent variables taken from the period of 2007-2013. The table below shows the result:

Variables	Coefficient	Standard error	P-value
Bank specific variable:			
Asset Quality(Loan loss provision/Gross Loan)	0.048689	0.064734	0.4636
Capital (Operational risk)	0.120792**	0.053717	0.0400
Liquidity (Capital Adequacy)	0.006702	0.013801	0.6343
Operation(CIR)	-0.9261***	0.122912	0.0000
Macroeconomic variable:			
GDP growth rate (Liquidity Risk)	0.009044	0.057956	0.8781
Inflation rate	0.183693**	0.191948	0.0537
Money supply (M2)	-0.000667	0.012986	0.9597
Savings on GNI	-0.195026**	0.079424	0.0268
Constant	6.798651	2.51496	
No. of observations		79	
F-test		11.75 (P=0.000)	
R-square		0.86	
Adjusted R-square		0.78	

Table 5: Regression model

Notes: The dependent variable is ROA is calculated as net profit divided by total assets. LLP/TL is a measure of credit risk calculated as the ratio of total loan loss provisions by total assets. EQASS is a measure of capitalization,calculated as book value of shareholders equity as a fraction of total assets. CIR is proxy measure for the operating efficiency of management quality, calculated as personnel expenses divided by total assets; Loans/TA is used as a proxy measure for credit risk, calculated as total loans divided by total assets. LNTA is a proxy measure of size, calculated as a natural logarithm of total bank assets. GDPgr is the GDP growth rate. INFLI is the inflation rate.

Notes 2: Values in parenthesis are t statistics, (***), (**),(*) indicates significance at 1, 5, and 10% level respectively.

The results in Table 5 relate to regressing ROA on both the set of bank-specific variables and macroeconomic variables. From the table, R-squared is 0.86, which shows that about 86% ofindependent variables explain the dependent variable ROAA. The adequacy of a model as predicting isvalidated by the F-test. As indicated in Table 6, the value of F-stats is statistically significant which hasconfirmed that the models applied are useful for measuring the relationship between ROAA and independentvariables. Since the data has been normality distributed and there is no multicollinearity, it can be be said that the hypothesis testing based this model are correct. As it is mentioned early 4 bank-specific variables are used in this study. However, the result shows that capital adequacy ratio i,e equity to total asset ratio and operational efficiency ratio (i,e Non interest expense/total assets) have a significant impact on the profitability of Islamic banks in Malaysia. The other two variables such as liquidity and asset quality have no statistically significant relationship with dependent variable ROA at 5% and 10% significant level.

Referring to the impact of overhead costs on Islamic bank profitability, NIE/TA exhibit negative and significant impact on the profitability of Islamic banks even at 1 % significant level. This result implies that increase (decrease) in these expenses reduces (increases) the profits of Islamic banks operating in the Malaysian banking sector. Pasiouras and Kosmidou(2007) and Kosmidou(2008) among others have also found poor expenses management to be among the main contributors to poor profitability. Clearly, efficient cost management is prerequisite for improved profitability of the Islamic banks.

The level of capitalization (EQASS) is positively related to Islamic bank's profitability. It indicates if there is 1% increases in the level of capitalization, the level of ROA will be increased by 0.12%. This empirical finding is consistent with Berger(1995), Goddard *et al.* (2004) and supports the argument that well-capitalized banks face lower cost of going bankrupt and thereby reduce their cost of funding. Strong capital structure is essential for banks in developing economies, since it provides additional strength to withstand financial crisis and increased safety for depositors during unstable macroeconomic conditions. Furthermore, lower capital ratios in banking imply higher leverage and risk, and therefore greater borrowing cost. Thus it is reasonable to expect that the profitability level should be higher for better capitalized Islamic banks.

In addition, based on the two macroeconomic variables used in this study GDP growth rate and inflation, only inflation has a significantrelationship with profitability. Here, Inflation is positively related to Islamic banks profitability, implying that during the period under study the levels of inflation were anticipated by the Islamic banks. Perry (1992) suggests that the effect of inflation levels on banking performance is positive if the rate of inflation is anticipated. Anticipating inflation levels gave the banks the opportunity to adjust the profit rates accordingly and consequently to earn higher profits.

The results about GDP growth rate and Islamic banks profit ability are consistent with the results of Hasan and Bashir(2003)supports the arguments for a positive association between growth and banking sector performance . However, this study shows a positive but insignificant relationship.

VII. CONCLUDING REMARKS & FUTURE IMPLICATIONS:

The Islamic banking sectors in Malaysia have undergone noteworthy reforms. Despite considerable development in the Islamic banking sector, empirical work on Islamic bank's performance is still in fancy. The empirical findings of this study suggest that bank specific characteristics , in particular capital adequacy i,e equity financing has a positive and significant impact on the banks performance, while operational efficiency such as overhead expenses are negatively related to Islamic bank's profitability. In this case the Islamic banks should increase the portfolio of equity financing rather than the debt financing. It means Islamic banks should increase the partnership contract like mudaraba, musharaka contract where risk sharing principle can be established. Islamic banks in Malaysia are ought to reinforce their equity in order to decrease the likelihood of bankruptcy and increase their size to benefit from the economies of scale. Moreover, banks should improve the management of their loans with respect to total assets via better screening and monitoring of credits. Islamic banks should manage their costs efficiently with respect to income to get the best return on asset. As we have found that the macroeconomic factors such as inflation and savings to GNI plays an important role in the profitability of Islamic banks. This is why; Islamic banks should also concentrate on the exogenous factors so that they can earn more profits. Finally, Future research could include more variables such as taxation and regulation indicators, exchange rates as well as indicators of quality of the offered services. Another possible extension could be the examination of differences in the determinants of profitability between small and large or high and low profitability banks.

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