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DETERMINANTS OF ISLAMIC BANKS PERFORMANCE IN GULF COOPERATION COUNCIL REGION

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ABSTRACT

This study analyzed the performance of Islamic banks in Gulf Cooperation Council over the period of 2004-2014. This study has investigated the influence of external characteristics such GDP and inflation, and internal characteristics such as total capital ratio, non-interest-margin, profit-margin, consumer and short term fund to total asset, total loan to total assets and overhead to total assets on the performance of Islamic banks. The performance metrics used are return on assets (ROA) and return on equity (ROE). A cross-sectional time series (panel data) of 37 Islamic banks was used. For data analysis, regression analysis was applied on the selected sample of banks to test the influence of the identified variables on Islamic bank performance. The test result of the models indicate that there is positive relationship between GDP, non interest margin, profit-margin, loan to total assets, have significant positive impact on the performance of Islamic bank in GCC. Total capital ratio, consumer and short term fund to total asset, overhead to total assets and inflation did not have significant impact on the performance of Islamic bank in GCC.

INTRODUCTION

The Gulf Cooperation Council (GCC) includes six countries situated in the Middle East. These countries include United Arab Emirates, Bahrain, Qatar, Saudi Arabia and Kuwait. The financial banking division in the GCC nations is generally possessed by local people because of passage hindrances and authorizing confinements for outside proprietorship [2]. The banking division commonly rules the budgetary frameworks in the GCC nations and assumes a fundamental job in financing monetary exercises [3]. Moreover, GCC nations have two financial frameworks; the ordinary banking framework and the Islamic banking framework, which works as per Islamic law [4].

Islamic banking is another development that has occurred in numerous Islamic and non-Islamic nations. The first establishment of Islamic bank was at the beginning of the 1970s and has rapidly grown over the last 40 years [5]. Islamic bank started as a small bank in the remote villages in Egypt, and surprisingly over time, Islamic bank have spread all over the world from East to the West and achieved a respectable position in the international banking system [5]. Furthermore, Islamic banking has assumed a significant job in financing and adding to the advancement of various monetary and social divisions in the Muslim nations [6].

The financial areas in the GCC nations were reinforced by high benefits and capital. Having a solid and productive financial framework adds to the steadiness of the budgetary framework. The GCC nations have the biggest level of the Islamic money related establishments and it has the essential wellspring of financing for Islamic financial activity [7]. Hence, the determinants of Islamic banks execution have pulled in light of a legitimate concern for scholastic scientists, bank administration, and financial specialists.

Various works have been reported in analyzing the determinants of Islamic banking performance. Waemustafa et al. [8] investigated the macroeconomic and bank explicit determinants of credit risk in Islamic and traditional banks, and found that the banks explicit determinants of credit hazard are remarkably impacted by the credit risk arrangement of Islamic and traditional banks. Johnes et al. [9] analyzed at the effectiveness of Islamic and regular banks, and found that Islamic banks are normally on a matching standard with ordinary banks in terms of gross productivity. Rashid et al. [10] investigated the macroeconomic determinants of execution of Islamic and ordinary banks in Pakistan, and found that working effectiveness and market focus are significant in clarifying the execution of Islamic banks. Nawaz et al. [11] examined the determinants of financial related execution of Islamic banks, and found a critical positive connection between bookkeeping execution of Islamic budgetary organizations and capital proficiency and human capital productivity.

Tarek Al-Kayed et al. [12] evaluated the impact of capital structure on Islamic banks execution, and found that Islamic bank performance reacts certainly to an increase in capital value. Setyawati et al. [13] scrutinized components influencing the execution of Islamic banking in Indonesia, and found that the execution of Islamic banks is fundamentally influenced by non-performing monetary and market expansion. Daly et al. [14] analyzed the determinants of Islamic financial execution in Bahrain, and found that expansion in size of Islamic banks and the quick development in the clients' deposits were the significant elements of execution. Erol et al. [15] evaluated the execution of Islamic banks against regular banks in Turkey, and found that Islamic banks in Turkey perform better in asset management and profitability. Al-Tamimi et al. [16] investigated the connection between budgetary risk and execution of GCC Islamic banks and found that there exists a noteworthy negative connection between Islamic banks' execution with capital risk and operational hazard.

In the context of the GCC countries, previous studies on the performance of Islamic banks have used internal variables like non-interest margin, before tax profit, loan to total assets, and external variables like inflation and GDP [16, 17]. To the best knowledge of the author, previous studies have not applied consumer and short term fund to total asset and overhead to total assets and profit margin in analyzing performance of Islamic banks in GCC. Hence, this study aims are reducing the gap in literature on the performance of Islamic banks in GCC by investigating the relevance of these variable to the performance of Islamic banks.

Thus, this work has examined the effect of banks characteristics on the financial performance of GCC Islamic banks. The study of performance has looked at different internal and external characteristics of the banks. The internal characteristics used are total capital ratio, overhead to total assets, total loan to total assets, non-interest-margin, profit margin, consumer and short-term fund to total asset, and the external characteristics used are GDP and inflation.

METHODOLOGY

This study was done to examine the effect of banks characteristics on the financial performance of GCC Islamic banks over the period of 2004- 2014. Thus, this study has used a cross-sectional time series (panel data) of 37 Islamic banks. Regression analysis was applied on the selected sample of banks to test the influence of the identified variables on Islamic Bank performance. There are ten variables used in the regression. These variable are Return on Asset (ROA), Return on Equity (ROE), profit margin (before tax profit to total assets), non-interest margin (total non-interest operating income to total assets), total capital ratio, total loans to total assets (LONTA), consumer and short-term funds to total assets (CSTFTA), ratio of overhead to total assets (OVRHD), gross domestic product (GDP) and inflation. The following hypothesis was analyzed in this work. H10: Non Interest Margin has no impact on the performance of Islamic banks in GCC. H11: Non Interest Margin has a positive impact on the performance of Islamic banks in GCC. H20: Total Capital Ratio has no effect on the performance of Islamic banks in GCC. H21: Total Capital Ratio has a positive effect on the performance of Islamic banks in GCC. H30: Consumer and total short fund to total assets has no impact on the performance of Islamic banks in GCC. H31: Consumer and total short fund to total assets has a negative impact on the performance of Islamic banks in GCC. H40: Total loans to total assets have no relation on the performance of Islamic banks in GCC. H41: Total loans to total assets have a positive relation on the performance of Islamic banks in GCC. H50 overhead to total assets has no impact on the performance of Islamic banks in GCC. H51: overhead to total assets has a negative impact on the performance of Islamic banks in GCC. H60: Profit Margin has no effect on the performance of Islamic banks in GCC. H61: Profit Margin has a positive effect on the performance of Islamic banks in GCC. H70: GDP has no relation on the performance of Islamic banks in GCC. H71: GDP has a positive relation on the performance of Islamic banks in GCC. H80: Inflation has no impact on the performance of Islamic banks in GCC. H81: Inflation has a negative impact on the performance of Islamic banks in GCC. This study used multivariate model,

to captures the relationship between dependent and independent variables, two models based on the dependent variables, ROA and ROE are used.

RESULT AND DISCUSSION

Descriptive Statistic

Table 1 indicates the descriptive statistics results. Based on Table 1, the results showed that the annual average of the dependent variables ROA and ROE is 2.15 and 8.46 respectively. The average of independent variable is 0.69 for CSTFTA, 52.52 for LONTA, 2.04 for Non-Interest margin, 0.40 for OVRHD, 4.13 for profit margin, and 21.01 for total capital ratio. For the external variables, LONTA was 5.23 for GDP and 4.19 for Inflation. The standard deviation of a variable measures the dispersion of its observations from its mean. The dependent variables show a value of 15.06 for ROE and 4.97 for ROA. The independent variables show 21.15 for LONTA, 15.10 for profit-margin, 14.90 for total capital ratio, 6.17 for Inflation, 4.69 for GDP, 4.39 OVRHD 2.66 for Non- interest-margin and 0.21 for CSTRTA. On the other hand, the Skewness result shows that ROA has a skewness of 2.61, ROE skewness was -0.78, CSTFTA skewness was -1.60, GDP skewness was 0.42, Inflation skewness was -0.13, LONTA skewness was -0.75, Non-Interest-Margin skewness was 2.68, OVRHD skewness was 11.96, Profit-Margin skewness was 6.50 and Total- Capital-Ratio skewness was 2.96. The Kurtosis result shows that it is 19.75 for ROA, 8.18 for ROE, 4.83 for CSTFTA, 5.91 for GDP, 5.09 for Inflation, 2.87 for LONTA, 12.25 for Non-Interest- Margin, 144.94 for OVRHD, 52.41 for Profit-margin and 13.47 for Total- Capital-Ratio. Jarque-Bera test for all variables shows probability value of 0.00 less than 5%. Hence, the data does not follow a normal distribution.

Table 1: Descriptive Statistics test result.

Variable	Mean	S.D	Skewness	Kurtosis	Jarqu-Bera probability
ROA	2.15	4.97	2.61	19.75	0.00
ROE	8.47	15.06	-0.78	8.18	0.00
CSTFTA	0.69	0.21	-1.60	4.83	0.00
LONTA	52.52	21.15	-0.75	2.87	0.00
NON-INTEREST-MARGIN	2.04	2.66	2.68	12.26	0.00
OVERHD	0.40	4.39	11.96	144.94	0.00
PROFIT-MARGIN	4.13	15.10	6.50	52.41	0.00
TOTAL-CAPITAL-RATIO	21.01	14.90	2.96	13.47	0.00
GDP	5.23	4.69	0.42	5.91	0.00
INFLATION	4.19	6.17	-0.13	5.10	0.00

Stationarity Test

Table 2 shows the Augmented Dickey Fuller Unit Root test results. Based on Table 2, the result shows that P-Value for all variables is 0.0000 which is less than 5%. Hence, it is deduced that the distribution of data is stationary or does not have a unit root.

Table 2: Augmented Dickey Fuller Unit Root test

Variables	t-Stat	Prob.
ROA	-6.46	0.00
ROE	-10.22	0.00
GDP	-11.19	0.00
INFLATION	-18.05	0.00
CSTFTA	-6.04	0.00
LONTA	-5.68	0.00
NIM	-8.88	0.00
OVRHD	-13.85	0.00
PORFIT MARGIN	-6.39	0.00
Total Capital Ratio	-5.89	0.00

Model Test Result: Return on Assets (ROA)

Table 3 shows the t-test statistics for the variable used in this work in analyzing the relationship between dependent variable return on assets (ROA) and independents variable which were GDP and inflation, total capital ratio, non interest margin, profit margin, consumer and short term fund to total asset, total loan to total assets and overhead to total assets.

Based on Table 3, CSTFTA is a measured of liquidity. The coefficient of CSTFTA is 2.85 with t-statistic of 1.53. The test result is not significant because the P-value of the t-statistics is 0.1283 more than 0.05. Hence, the null hypothesis is there is no relationship between CSTFTA and ROA, thus the null hypothesis is not rejected. It is deduced that CSTFTA does not have an impact on ROA.

In Table 3, LONTA is a measure the liquidity of bank assets tied to loans and it also measure of risk. The coefficient of LONTA is 0.04 with t-statistic of 3.15. The test result is significant because the P-value of the t- statistics is 0.0018 less than 0.05. Hence, the null hypothesis is there is no relationship between LONTA and ROA is rejected. Thus, it is deduced that LONTA have strong positive and statistically significant relationships with Islamic bank performance.

Table 3: T-test result of ROA

Variable	Coefficient	Std. Error	t-Statistic	Probability
C	-5.32	2.01	-2.65	0.01
GDP	0.22	0.06	3.68	0.00
INFLATION	0.01	0.05	0.28	0.78

CSTFTA	2.85	1.87	1.53	0.13
LONTA	0.05	0.02	3.16	0.00
NON_INTEREST_MARGIN	0.29	0.12	2.47	0.01
OVRHD	-0.04	0.06	-0.68	0.50
PROFIT_MARGIN	0.05	0.02	2.65	0.01
TOTAL_CAPITAL_RATIO	0.05	0.03	1.73	0.09
R-squared	0.15			
Adjusted R-squared	0.13			
F-statistic	6.12			
Prob(F-statistic)	0.00			

Based on Table 3, NIM is measure of profitability. The coefficient of NIM is 0.28 with t-statistic of 2.47. The test result is significant because the P-value of the t- statistics is 0.014 less than 0.05. Hence, the null hypothesis is there is no relationship between NIM and ROA is rejected. Thus, it is deduced that there is statistically positive significant relationship between NIM and Islamic bank performance.

In Table 3, OVRHD ratio is the measurement of the variation in operation costs across the banking system. The coefficient of OVRHD is -0.04 with t-statistic of -0.67. The test result is not significant because the P-value of the t- statistics is 0.49 more than 0.05. Hence, the null hypothesis is there is no relationship between OVRHD and ROA, thus the hypothesis is not rejected. Thus, it is deduced that OVRHD does not have an impact on ROA.

As shown in Table 3, profit-margin measures the banks' ability to generate higher profits by diversifying their portfolios. The coefficient of profit-margin is 0.05 with t-statistic of 2.64. The test result is significant because the P-value of the t- statistics is 0.008 less than 0.05. Hence, the null hypothesis is there is no relationship between profit-margin and ROA is rejected. Thus, it is deduced that there is statistically positive significant relationship between profit-margin and Islamic bank performance.

According to Table 3, Total-capital ratio measures the strength of a bank and its ability to meet its obligations in a crisis. The coefficient of Total-Capital ratio is 0.04 with t-statistic of 1.72. The test result is not significant because the P-value of the t- statistics is 0.08 more than 0.05. Hence, the null hypothesis is there is no relationship between total-capital ratio and ROA is rejected. Thus, it is deduced that total-capital ratio has an impact on ROA.

Based on Table 3, GDP is a measured the economic conditions. The coefficient of GDP is 0.22 with t-statistic of 3.678. The test result are significant because the P-value of the t- statistics is 0.0003 less than 0.05. Hence, the null hypothesis is there is no relationship between GDP and ROA is rejected. Thus, it is deduced that GDP have strong positive and statistically significant relationships with Islamic bank performance.

In Table 3, the coefficient of Inflation is 0.01 with t-statistic of 0.27. The test result is not significant because the P-value of the t- statistics is 0.78 more than 0.05. Hence, the null hypothesis is there is no relationship between Inflation and ROA, thus the null hypothesis is not rejected. Hence, it is deduced that inflation does not have an impact on ROA.

Based on Table 3, in the ROA model, R-Squared is 0.149 this mean the independent variables explain about 14% of independent variable. Also, the probability of F-statistic is 0.0000 which is less than 5%. Hence, the null hypotheses; all the independent variable jointly cannot influence the dependent variable is rejected.

Model Test Result: Return on Equity (ROE)

Table 4 shows the t-test statistics for the variable used in this work in analyzing the relationship between dependent variable return on equity (ROE) and independents. Based on Table 4, the coefficient of CSTFTA is 2.53 with t-statistic of 0.48. The test result is not significant because the P-value of the t- statistics is 0.63 more than 0.05. Hence, the null hypothesis is there is no relationship between CSTFTA and ROE, thus the null hypothesis is not rejected. Thus, it is deduced that CSTFTA does not have an impact on ROE.

Table 3: T-test result of ROE

Variable	Coefficient	Std. Error	t-Statistic	Probability
C	-10.02	5.66	-1.77	0.08
GDP	1.05	0.17	6.08	0.00
INFLATION	0.10	0.13	0.80	0.42
CSTFTA	2.53	5.25	0.48	0.63
LONTA	0.15	0.04	3.63	0.00
NON_INTEREST_MARGIN	0.86	0.33	2.62	0.01
OVRHD	-0.16	0.15	-1.04	0.30
PROFIT_MARGIN	0.24	0.05	4.42	0.00
TOTAL_CAPITAL_RATIO	0.00	0.08	0.04	0.97
R-squared	0.27			
Adjusted R-squared	0.25			
F-statistic	12.74			
Prob(F-statistic)	0.00			

Based on Table 4, the coefficient of GDP is 1.04 with t-statistic of 6.08. The test result are significant because the P-value of the t- statistics is 0.0000 less than 0.05. Hence, the null hypothesis is there is no relationship between GDP and ROE is rejected. Thus, it is deduced that GDP have strong positive and statistically significant relationships with Islamic Bank performance.

In Table 4, the coefficient of Inflation is 0.10 with t-statistic of 0.79. The test result is not significant because the P-value of the t- statistics is 0.42 more than 0.05. Hence, the null hypothesis is there is no relationship between

Inflation and ROE; therefore the null hypothesis is not rejected. Thus, it is deduced that inflation does not have an impact on ROE.

Based on Table 4, the coefficient of LONTA is 0.15 with t-statistic of 3.63. The test result is significant because the P-value of the t- statistics is 0.0003 less than 0.05. Hence, the null hypothesis is there is no relationship between LONTA and ROE is rejected. Thus, it is deduced that LONTA have strong positive and statistically significant relationships with Islamic bank performance.

As shown in Table 4, the coefficient of NIM is 0.86 with t-statistic of 2.61. The test result is significant because the P-value of the t- statistics is 0.0093 less than 0.05. Hence, the null hypothesis is there is no relationship between NIM and ROE is rejected. Hence, it is deduced that there is statistically positive significant relationship between NIM and Islamic Bank performance.

According to Table 4, the coefficient of OVRHD is -0.15 with t-statistic of -1.04. The test results are not significant because the P-value of the t- statistics is 0.29 more than 0.05. Hence, the null hypothesis is there is no relationship between OVRHD and ROE, thus the null hypothesis is not rejected. Thus, it is deduced that OVRHD ratio does not have an impact on ROE.

Based on Table 4, the coefficient of profit-margin is 0.23 with t-statistic of 4.42. The test results are significant because the P-value of the t- statistics is 0.000 less than 0.05. Hence, the null hypothesis is there is no relationship between profit-margin and ROE is rejected. Thus, it is deduced that there is statistically positive significant relationship between profit-margin and Islamic bank performance.

In Table 4, the coefficient of total-capital ratio is 0.00 with t-statistic of 0.03. The test result is not significant because the P-value of the t-statistics is 0.97 more than 0.05. Hence, the null hypothesis is there is no relationship between total-capital ratio and ROE, thus the null hypothesis is not rejected. Thus, it is deduced that total-capital ratio does not have an impact on ROE.

Based on Table 4, in the ROE model, R-Squared is 0.26 this mean the independent variables explain about 26% of independent variable. In addition, the probability of F-statistic is 0.0000 which is less than 5%. Hence, the null hypotheses; all the independent variable jointly cannot influence the dependent variable is rejected.

Overall Discussion

Based on the analysis done, the results showed that GDP is significant in its impact on both ROA and ROE. This outcome is consisted with the work of Trad et al. [18] and Muda et al. [19] where it was stated that ROA and ROE are significantly related to GDP, which indicates that a upsurge in GDP of a country increases the execution of banks operating in that country. In addition, the results of this work showed that LONTA is significant in its impact on both ROA and ROE. This outcome is consistent with the work of Kadioglu et

al. [20] and Ahamed [21] where it was stated that total loans to total assets or loan ratio is significant and it increases with GDP and it determines the banking performance. Furthermore, the result of this work has shown that non-interest-margin is significant in its impact on both ROA and ROE. This outcome is consistent with the work of Khedir et al. [22] where it was reported that non interest margin has significant influence on ROA and it contributes to the bank performance. Moreover, the outcome of this work has shown that profit margin: is significant in its impact on both ROA and ROE. This is consistent with the work of Khadafi et al. [23] where it was confirmed that profit margin is related to ROA and ROE, as an increase in ROA and ROE with coherently increase the profit margin, and it contributes to the performance of the bank. On the other hand, the impact of CSTFTA, Inflation, OVRHD, and total-capital-ratio variables are not significant for both dependent variables ROA and ROE. This outcome was consistent with the work of Zeitun [24].

CONCLUSION

This work has analyzed the determinants of performance for Islamic banks operating in GCC region between years 2004-2014 by utilizing a cross-sectional time series data. The key finding of this work has shown that GDP, LONTA, non-interest-margin and profit margin has significant impact on ROA and ROE. On the other hand, result has shown that CSTFTA, Inflation, OVRHD, and total-capital-ratio variables do not have significant impact on ROA and ROE. For future works, the authors recommend to include more variables such as interest rate borrowing, total deposit and total expenditure as a percentage of total assets and analyze the differences in the determinants of performance between small and large banks.

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