

THE IMPACT OF PRODUCT DIVERSIFICATION
STRATEGY ON THE FINANCIAL PERFORMANCE OF
ISLAMIC BANKS IN MALAYSIA.

BY

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ABSTRACT

Banks are increasingly diversifying their income streams to include a greater portion of non-interest income-earning products. This is supported by deregulation in the banking industry. This change in the product mix offered by banking institutions renders them to be more competitive and able to generate more stable and sustainable income. Hence banking institutions are encouraged to develop and promote new products that boost their financial performance. The growing demand for Islamic banking products has increased the competitive market for the products in the commercial banking industry and facilitating the need for banks' product diversification strategy. Islamic banking operates according to the principles of the Shariah, and their products are Shariah-compliant. However, there is a lack of information and understanding concerning the specific contracts or products offered by Islamic banks. This research investigates the impact of product diversification strategy on the financial performance of Islamic banks in Malaysia using the Prudential and Structural Islamic Financial Indicators (PSIFIs) data established by the Islamic Financial Services Board (IFSB). This research applied the Autoregressive Distributed Lags (ARDL) model to examine the products that contributed to the banks' performance for the period starting from January 2014 up to June 2018 using quarterly frequency data. The results of the bounds test indicated that there is a cointegration relationship between banks' assets classification, banks' liabilities classification and capital with banks' financial performance in the long-run for Islamic banking institutions in Malaysia. In particular, banks' financial performance, which is measured through Return on Asset (ROA), Return on Equity (ROE), Financing-based Income (RFIN), Investment-based Income (RINV), Fee-based Income (RFEE), Gross Non-Performing Financing (GNPF) and Net Profit Margin (NPM), reveals the existence of a long-run equilibrium relationship with the banks' products, namely financing assets (FA), investment assets (IA), liabilities (LI) and capital (CAP) in Islamic banks in Malaysia but with different signs. The positive and negative signs in both the long-run and the short-run relationships indicate that different products have different impacts on the level of performance, which should guide the diversification strategy of Islamic banks in Malaysia. These results can be used to guide banks' management, policy makers or regulators, and potential or existing investors, to create an efficient investments portfolio that generates high levels of return with low levels of risk.

مُلخَّصُ البَحْثِ

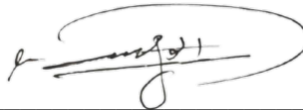
تُعَدُّ الإيرادات المصرفية غير المتصلة بالفوائد ظاهرةً متناميةً في المؤسسات المصرفية؛ بسبب تخفيف الضوابط في الصناعة المصرفية في جميع أنحاء العالم، ومن المتوقع أن تتيح هذه النشاطات للمؤسسات المصرفية قدرة أكبر على المنافسة وتوليد فوائد الإيرادات المصرفية واستقرارها، مما دفع المؤسسات المصرفية إلى أن تعمل على إنشاء المنتجات الجديدة وترويجها، لتعزز أداءها المالي، وقد أدى ازدياد الطلب على المؤسسات المصرفية الإسلامية إلى تهيئة بيئة تنافسية في الصناعة المصرفية، ولا سيما ما يتعلق بمزايا إستراتيجية تنوع المنتجات المصرفية عامة؛ إذ تعمل الصيرفة الإسلامية وفق مبادئ الشريعة الإسلامية وأحكامها؛ لتكون المنتجات متفقة مع الشريعة الإسلامية، وعلى الرغم من هذا؛ لا يزال التفاهم على المنتجات التي تقدمها المؤسسات المصرفية الإسلامية في بلد معين؛ مفتقرًا إلى المناقشة، ومن ثم؛ يهدف هذا البحث إلى التحقق من تأثير خصائص أصول المصارف، وإستراتيجية تنوع المصرفية؛ على الأداء المالي للمؤسسات المصرفية الإسلامية في ماليزيا؛ باستخدام مؤشرات المالية (PSIFIS) التي أنشأها مجلس الخدمات المالية الإسلامية (IFSB)، وقد توسَّل البحث أنموذج الانحدار التلقائي الموزع (ARDL)؛ لفحص المنتجات التي أسهمت في أداء المصارف ما بين ٢٠١٤-٢٠١٨م؛ باستخدام بيانات التردد الفصلية، وتشير النتائج الإجمالية إلى أن هنالك علاقة تكامل مشترك بين تصنيف أصول المصارف وتصنيف الالتزامات المصرفية ورأس المال مع الأداء المالي للمصارف على المدى البعيد للمؤسسات المصرفية الإسلامية في ماليزيا، ولا سيما الأداء المالي للمصارف الذي يقيس العائد على الأصول (ROA)، والعائد على الملكية (ROE)، وإيرادات القائمة على التمويل (RFIN)، والإيرادات القائمة على الاستثمار (RINV)، والإيرادات القائمة على الرسوم (RFEE)، وإجمالي التمويل المبعثر (GNPF)، وصافي الأرباح (NPM)، ويكشف عن علاقة توازن طويلة الأمد مع منتجات المصارف، وهي أصول التمويل (FA)، والأصول الاستثمارية (IA)، وديون المصرف (LI)، ورأس المال (CAP)؛ في المصارف الإسلامية في ماليزيا، ولكن بمؤشرات مختلفة، فالمؤشرات السلبية والإيجابية في كل من النتائج طويلة الأمد والقصيرة؛ تشير إلى أن المنتجات يختلف تأثيرها على مستوى قياس الأداء الذي قد يوحي بفرض إستراتيجية التنوع في المؤسسات المصرفية الإسلامية في ماليزيا، ومن ثم؛ يمكن استخدام هذه النتائج توجيهًا لإدارة المصارف، وصانعي السياسات، والمنظمين، والمستثمرين الحاليين؛ في تطوير المصرفية الإسلامية، وإنشاء استثمارات مؤثرة في الحوافظ المالية التي تؤدي إلى توليد مستوى عالٍ من العوائد؛ لانخفاض مستوى المخاطرة.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degree at IIUM or other institutions.

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*This thesis is dedicated to
My Beloved Family Members,
My Friends, Brothers & Sisters.
May Allah Blessed You All.*

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ADF	Augmented Dickey-Fuller
AMA	Advanced Measurement Approaches
ARDL	Autoregressive Distributed Lag
ASEAN	Association of Southeast Asian Nations
BBA	Bai Bithaman Ajil
BCBS	Basel Committee on Bank Supervision
BNM	Bank Negara Malaysia
CAP	Capital
FA	Financing Assets
G-8	The Group of Eight
G-10	The Group of Ten
GCC	The Cooperation Council for the Arab States of The Gulf region
GNPF	Gross non-performing financing
IA	Investment Assets
IFSB	Islamic Financial Services Board
IIFS	Institutions Offering Islamic Financial Services
IJR	Ijarah
IRB	Internal Rating Based
ISN	Istisna
ITB	Interbank Fund
LI	Liabilities
MDB	Mudharabah
MPT	Modern Portfolio Theory
MRB	Murabahah
MSY	Musarakah
NPM	Net Profit Margin
NREM	Non-Remunerative Fund
OSC	Other Shariah-Compliant
OTH	Others
PP	Phillip-Perron
PSI	Profit-sharing Investment
PSIFIs	Prudential and Structural Islamic Financial Indicators
REM	Remunerative Fund
RFEE	Fee-based Income
RFIN	Financing-based Income
RINV	Investment-based Income
ROA	Return on Assets
ROE	Return on Equity
RWA	Risk-Weighted Approach
SKK	Sukuk