



## A Cross-Country Analysis of Islamic Bank's Performance in Malaysia and Indonesia

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### ABSTRACT

#### Keywords:

*Islamic Bank;*  
*Return on equity;*  
*Return on assets;*  
*Gross Domestic Product*

This study aims to examine the financial performance of Islamic banks in Indonesia and Malaysia, with a specific focus on optimizing shareholder value. The assessment includes efficiency, market share, interest rates, inflation and economic growth as crucial criteria in comprehending the success of Islamic banks in each country. The secondary data is derived from the annual reports of 25 Islamic banks in Indonesia and Malaysia, with a focus on characteristics pertaining to operational efficiency and market share. Furthermore, data is obtained from Bank Indonesia (BI) to gather statistics regarding inflation, interest rates, and GDP growth from the years 2018 to 2021. The study used panel data regression with a random effects model as the most accurate estimator. The results of the panel data regression analysis suggest that inflation has a favorable effect on return on equity (ROE), while GDP growth has a beneficial impact on return on assets (ROA). This research highlights the importance of enhancing inflation risk management and making strategic adaptations to the business plans of Islamic banks in Malaysia and Indonesia. This research enhances the scholarly comprehension of the variables affecting the efficiency of Islamic banks in diverse economic conditions.

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## INTRODUCTION

The Islamic banks in Malaysia and Indonesia have made a notable impact by promoting Shariah-based economic development in their respective nations (Sholihin, et al., 2021). According to the Islamic Finance Development Indicator, Malaysia is the top performer in the Islamic banking sector. The assets of Islamic banks in Indonesia experienced 17% growth in 2021, while net income witnessed a remarkable surge of 290% (IFDI, 2022). It achieves excellent scores in all indicators, with a special emphasis on awareness, knowledge, and sustainability (Alam, et al., 2022; Naja, et al., 2023). Khalifaturofi'ah et al., (2022) revealed that both internal and macroeconomic factors become a critical process when assessing the performance of Islamic banks in Indonesia. Yoon et al., (2023) revealed strong relationship between GDP growth and the performance of Islamic banks for Islamic banks in Indonesia and Malaysia.

Haddad, et al., (2020) and Setyaningrum et al., (2022) revealed that the use of agency theory in the context of shariah-compliant banking performance have a correlation between managers and owners or investors. The presence of conflicts of interest is recognized as a potential detriment to performance (Fidanoski et al., 2018; Al Umar & Haryono, 2022); Al Sharif, 2023; O'Connell, 2023). While Chowdhury & Haron (2021) argued that operational efficiency is a key component for managing resources of Islamic bank in Indonesia and Malaysia. Samarasinghe & Uylangco (2021) argued that by utilizing operational efficiency as a measure of a company's financial performance was strongly associated with the company's profit earnings. On the other hand, it was also depend on the suggesting a substantial cause-and-effect connection between efficiency and return on assets (ROA) and return on equity (ROE) of Islamic bank (Abbas & Arizah, 2019; Derbali, 2021; Albusheekh & Alaallah, 2022; Faryal & Tikhomirov, 2022).

Various studies have examined and contrasted the performance of Islamic banks in Malaysia and Indonesia. Disparities in the operational efficiency of Islamic banks in both nations have been discovered (Saleh, et al., 2020; Parsa, 2022). On the other hand, the Islamicity Performance Index (IPI) was employed to assess the performance of Islamic banks in Indonesia and Malaysia that indicate variations in the average values of certain ratios pertaining to Islamic and non-Islamic income (Kristianingsih et al., 2021). In line, other research conducted by Chairunesia (2023) using direct analysis and comparison of the performance of Islamic banks in Malaysia and Indonesia, employing the Islamic Performance Index methodology. The research findings suggest a notable disparity in the performance of Islamic banks, as measured by the Equitable Distribution Ratio-Qardh, specifically the performance of Islamic banks in Malaysia surpasses that of Islamic banks in Indonesia. Further, the RGEK approach has been

utilized to assess financial performance, uncovering disparities in the mean values of several financial parameters among Islamic banks in Indonesia and Malaysia (Azzahra & Sholahuddin, 2023). In addition, a separate study discovered that the attributes of Islamic supervisory boards (SSB) had an influence on the performance of Islamic banks in relation to Islamic maqashid (MSP) in both nations (Taufik et. al., 2023).

Several prior studies have focused on comparing the performance of Islamic and conventional banks with a particular emphasis on specific factors (Bougatef, 2017; Majumder, et. al., 2018). Majeed & Zainab (2021) revealed that Islamic banks in Pakistan exhibit superior capitalization, reduced risk, and increased liquidity in comparison to conventional banks. On the other hand, Abdulla & Ebrahim (2022) conducted a found that Islamic banks exhibited superior resilience in comparison to conventional banks in Saudi Arabia and the United Arab Emirates. Islamic banks with strong government ties, substantial size, and a high ratio of loans to assets experienced a greater impact. While Ghouse et. al., (2022) and Sobol et. al., (2023) found that Islamic banks exhibited superior performance compared to conventional banks during pandemic Covid-19 in Organization of Islamic Cooperation (OIC) countries.

From the discussion above, this paper assesses the efficacy of Islamic banks in Malaysia and Indonesia and proposes potential avenues for enhancement. Nevertheless, previous research has not adequately addressed the limitations in studying the performance and factors influencing the profitability of Islamic banks in Malaysia and Indonesia, specifically with regard to internal and macroeconomic variables. Hence, the objective of this study is to address this deficiency and make a substantial impact on enhancing the efficiency of Islamic banks in Malaysia and Indonesia.

These research critically significance due to the constantly changing dynamics in the Islamic banking industry in Malaysia and Indonesia. It is particularly relevant to evaluate the influence of macroeconomic policies on the performance of Islamic banks. Hence, the objective of this study is to examine the performance of Islamic banks in Malaysia and Indonesia by considering internal characteristics and macroeconomic conditions as a proactive response to fluctuations in the global economy.

## **RESEARCH METHOD**

This study utilizes a quantitative methodology by employing the data panel method (Mohajan, 2020). The utilized data comprises secondary data in form of financial reports obtained from Islamic banks in Malaysia and Indonesia. The official websites of each bank provide information on internal factors, while data on macroeconomic variables is collected from Bank Indonesia's report. In this research,

purposive sampling technique used in which the researcher chooses samples based on specific criteria, determines the sample selection for this study (Amin et. al., 2023).

This study examines the performance of Islamic banks by analyzing two primary indicators namely: return on assets (ROA) and return on equity (ROE) as variables that are reliant on other factors. The independent variables included in this analysis encompass operational efficiency, market share, interest rates, inflation, and economic growth. The study used specific indicators or ratios as proxies to quantify various variables, reflecting the distinct characteristics of each component. The subsequent proxies are frequently employed to quantify these variables in the table 1.

**Table 1.** The Independent variables

Variable	Proxy	Abbreviation
Profitability	Return on Asset	ROA
	Return on Equity	ROE
Efficiency	Cost to Income Ratio	CIR
Marketability	Market Share	MS
Inflation	Inflation rate	LN_INF
Interest rate	Interest rate	Sin_IR
Economic growth	GDP Growth	LN_GDP

Profitability is determined through the utilization of two proxy methods, which involve the calculation of revenue divided by total assets (ROA) and revenue divided by total equity (ROE) (Buallay, 2019; Ur Rehman et. al., 2022). While bank's efficiency often known as the cost-to-income ratio (CIR) which determined by comparing bank's operating costs to its operational income (Lee & Isa, 2017; O'Connell, 2023). On the other hand, the size of a bank's market share determines its marketability. Market share is determined by comparing the total assets of individual banks to the total assets of all banks included in this study (Abbas et. al., 2022; Molla & Rahaman, 2022). While the external factors affecting banks such as interest rates, inflation rates, and GDP growth, are transformed into natural logarithms specifically by: LN\_INF, Sin\_IR, and LN\_GDP (Abaidoo & Anyigba, 2020; Buallay et. al., 2021).

The data analysis method used by EViews 13 software. Next, a set of standard tests are run, including tests for normality, multicollinearity, autocorrelation, and heteroskedasticity. The stages of this research conducting by examining on several models to ascertain the optimal regression model for the analysis of panel data. The three panel regression models under consideration are: common effects, fixed effects, and random effects. On the other hand, the Hausman test was conducted to aid in the choice of the given methodologies and to test the following hypotheses below:

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- $H^0$  : *Random Effects model is consisten*  
 $H^1$  : *Fixed Effects model is consisten*

Panel data regression analysis techniques used in this research to estimate a combination of time series and cross-sectional data. [Gujarati & Porter \(2009\)](#) stated that the null hypothesis should be rejected when the p-value is below 0.05. Thus, the hypothesis that the consistent random effects model is rejected necessitates the utilization of random effects estimators. On the other hand, if the p-value is greater than 0.05 it means that the result reject the null hypothesis. Therefore random effects estimators are considered more suitable for doing panel data regression analysis. Following the completion of model testing, the subsequent task involves assessing the outcomes of panel data regression analysis on the most appropriate model, be it fixed effects or random effects ([Gujarati & Porter, 2009](#))

## RESULT AND DISCUSSION

In this section, an analysis of the results and discussion was carried out. The standard assumption test in regression analysis comprises four essential components namely: the normality test, the autocorrelation test, the heteroscedasticity test, and the multicollinearity test. [The normality test is employed](#) to assess the degree to which the distribution of independent variables or model error adheres to a normal distribution. If the probability value of the test result is more than 0.05, it can be inferred that the normalcy assumption is satisfied. Conversely, if the probability value is less than 0.05, the normality assumption is deemed unsatisfactory ([Hamid, 2020](#)).

The autocorrelation test is designed to identify any correlation between the error values of a model at different points in time. If the Durbin-Watson statistic test result is more than 0.05, it indicates the absence of autocorrelation. Conversely, if the probability is less than 0.05, it suggests the presence of autocorrelation. The heteroscedasticity test is employed to evaluate if the variability of the model error remains consistent across time. A chi-square test result greater than 0.05 suggests the lack of heteroscedasticity, but a probability less than 0.05 suggests the presence of heteroscedasticity ([Hamid, 2020](#)).

Based on the table 2, the result implied that the probability value Durbin-Watson statistic, and chi-square probability are all higher than 0.05. Therefore the assumptions of normality, autocorrelation, and heteroscedasticity are satisfied.

**Table 2.** The result of durbin-watson test

Test	Measurement Items	Result Value
Normality	Probability	0,134573

Autocorrelation	Durbin-Watson stat	1.814680
Heteroscedasticity	Prob chi-square	0.9113

Based on the table 3, the multicollinearity test is used to determine the degree of correlation between the independent variables in the model. The result of multicollinearity can be accomplished by examining the value of the Variance Inflation Factor (VIF). From the test result of the Variance Inflation Factor (VIF), can be classified that lower than a value of 10, which means that multicollinearity no need to develop (Ghozali, 2013).

**Table 3.** The result of the value of the Variance Inflation Factor (VIF)

Variabel Independen	VIF Value
CIR	1.238901
SIN_MS	1.528531
SIN_IR	1.251610
LN_INF	1.228196
LN_GDP	1.123410

### The Result of The Hausman test and Panel Regression Analysis

Based on the result of Hausman test analysis in the table 4, it indicates that the p-value for the random cross-section probability was higher than the significance level ( $0.6926 > 0.05$ ). Therefore, it may be inferred that the selected model is the random effect model. The random effect model was selected as a better fit for the data and research objectives.

**Table 4.** The result of p-value test

Test	Probability Value	Result
Chow Test	P-value $0.0000 < 0,05$	Fix Effect Model
Hausman Test	P-value $0.6926 > 0,05$	Random Effect Model

Further, after the completion of the Hausman test, the panel regression analysis proceeds using the optimal estimator, specifically the random effect model. The estimation results of the random effect model described in the table 5 which encompass the impact of efficiency, market share, interest rates, inflation, and economic growth on the performance of Islamic banks in Indonesia and Malaysia. The variables examined in this analysis are return on assets (ROA) and return on equity (ROE).

The choice to use the random effect model is justified by the outcomes of the preceding Hausman test which the main objective is to explore a more in-depth examination of the estimation results is to examine the impact of efficiency, market

share, interest rates, inflation, and economic growth on the performance of Islamic banks in Indonesia and Malaysia.

Based on the table 5, the result of t test for the dependent variable Return on Equity (ROE) indicate that the inflation variable is the sole independent variable that exhibits a significant value of 0.0004 which is less than the threshold of 0.05. Therefore, it may be inferred that the inflation variable has a substantial impact on the return on equity (ROE). Further analysis suggests that fluctuations in the inflation rate adversely affect the return on equity (ROE). The negative coefficient on the inflation variable indicates that there is an inverse relationship between inflation and ROE, meaning that as inflation increases, ROE decreases. This result significantly enhances our comprehension of the influence of fluctuations in inflation rates on performance and profitability particularly within the framework of return on equity (ROE).

**Table 5.** The result of Hausman panel regression test

Variables	Coefficient	t-Statistic	Prob	R-squared	Sig	F
Constant	0.858163	4.825905	0.0000	0.85421	0.000616	0.434666
CIR	-0.006246	-0.811798	0.4188			
MS	-0.001697	-1.037310	0.3020			
INF	-0.036328	-0.443677	0.6582			
IR	-0.546718	-3.660234	0.0004			
LN_GDP	0.033884	0.426778	0.6704			

This result in line with [Altahtamouni, et. al., \(2022\)](#), [Akhtar, et. al., \(2022\)](#), [Jitmaneroj & Ogwang \(2023\)](#), and [Rumaly \(2023\)](#) which found that asset size, operating cost to loans ratio, total equity to debt ratio, and inflation exert a significant negative impact on ROE, highlighting the challenges associated with growth, cost efficiency, leverage, and inflationary pressures. In contrast, [Sobol et. al. \(2023\)](#) revealed that inflation does not exert a substantial impact on the performance of Islamic banks.

On the other hand, the F test conducted on the dependent variable Return on Equity (ROE) indicates a significance value of 0.000616 which is less (<) than the threshold of 0.05. Therefore, it can be inferred that the variables of efficiency, market share, interest rate, inflation, and economic growth have a substantial impact on the return on equity (ROE) of Islamic banks in Malaysia and Indonesia. The result in line with [Al Sharif \(2023\)](#) and [Maria & Hussain \(2023\)](#) which revealed that there were significant relationship between macroeconomic variables and the performance of Islamic banks.

Further, the result of adjusted R-squared value of 0. 85421 indicates that the efficiency variable, market share variable, interest rate variable, inflation variable, and economic growth variable collectively account for approximately 85 % of the variability in the performance of Islamic banks in Malaysia and Indonesia. Conversely, it amounts

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to around 15% of the model does not account for other factors that can influence variability.

On the other hand, the F test conducted on the dependent variable return on assets (ROA) indicates a significance value of 0.434666, which is less than the threshold of 0.05. Therefore, it can be inferred that the efficiency, market share, interest rate, inflation, and economic growth variables have a substantial impact on the return on assets (ROA) of Islamic banks in Malaysia and Indonesia. This result in line with [Sakti, et. al., \(2020\)](#), [Ibrahim \(2020\)](#), and [Rehman, et. al., \(2022\)](#) that economic growth variables have a substantial impact on the return on assets (ROA) of Islamic banks in Malaysia and Indonesia.

Additional analysis suggests that fluctuations in the GDP level have a favorable influence on the return on assets (ROA). The positive coefficient on this variable indicates that there is a direct relationship between an increase in GDP and an increase in ROA. This result significantly enhances our comprehension of the influence of fluctuations in economic growth on performance and profitability, particularly in relation to return on assets (ROA). This result in line with [Al Sharif \(2023\)](#) and [Sobol et. al., \(2023\)](#) which found that that GDP exerts a favorable influence on banking performance.

## CONCLUSION

The performance of Islamic banking in Malaysia and Indonesia can be inferred from the test results of return on equity (ROE) and return on assets (ROA) in these nations' Islamic banks. The inflation variable is recognized as a determinant that affects performance measures, with variations in the inflation rate exerting a detrimental effect on return on equity (ROE). Conversely, it has been demonstrated that the economic growth variable, specifically the gross domestic product (GDP), has a favorable impact on return on assets (ROA). This highlights the intricate nature of the connection between economic circumstances and the profitability of Islamic banks.

However this research acknowledge the limitation. Especially on the model of research. For further research, it is suggested to extend the sample by comparing with more other countries in the region, by incorporating other important macroeconomic variables and firm-specific indicators.

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