



Volume and Issues Obtainable at Center for Sustainability Research and Consultancy

**Journal of Accounting and Finance in Emerging Economies**

ISSN: 2519-0318 ISSN (E) 2518-8488

Volume 3: Issue 1 June 2017

Journal homepage: [www.publishing.globalcsrc.org/jafee](http://www.publishing.globalcsrc.org/jafee)

## Does Bank Size and Operational Efficiency Matters? An Impact of Financial Gearing and Asset Management on Islamic Bank's Performance in Pakistan

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### ARTICLE DETAILS

#### History

Revised format: May 2017

Available Online: June 2017

#### Keywords

Islamic Banking,  
Return on Assets (ROA),  
Return on Equity (ROE),  
Bank size,  
Asset management

**JEL Codes:** G21, G14, G12

### ABSTRACT

**Purpose:** The persistent growth of Islamic banks has been the distinction of the Muslim world financial background in the 1980s and 1990s. Through a network that spans more than 62 countries and an asset base of more than \$169 billion; Islamic banks are now performing a progressively more significant role in their particular economies. The core objective of this study is to find the impact of some of the key bank-specific factors (internal determinants) on the profitability of Islamic banks in Pakistan. Factors that opted in this study are bank size, operating efficiency, gearing ratio and asset management. Secondary data was obtained from 5 Islamic banks in Pakistan from year 2007 to 2015. The Ordinary Least Square (OLS) was used to analyze the empirical findings. The estimation results show that bank size significantly and positively influence the bank profitability while the asset management inversely affects the bank profitability. For future studies, it is recommended that more sample size and determinant factors can be included in determining the impact on bank's profitability.

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**Recommended citation:** Khalil, R. & Khalil, M.A., (2017). Does Bank Size and Operational Efficiency Matters? An Impact of Financial Gearing and Asset Management on Islamic Bank's Performance in Pakistan. *Journal of Accounting and Finance in Emerging Economies*, 3(1) 63-78. DOI: <https://doi.org/10.26710/jafee.v3i1.160>

## 1. Introduction

### 1.1 Significance & Importance of study

Islamic banks are playing a significant role in banking sector in these days. Islamic banking is growing rapidly in Pakistan now a day. There are now 13 windows of Islamic banking from thirteen conventional banks and 5 full-fledged Islamic banks currently working in Pakistan. Islamic banks are growing rapidly and obtaining huge profits in recent years. As a result, more researchers are interested to start their researches to recognize the elements which are manipulating the profitability of different banks which are working according to Islamic guidelines in different nations.

## **1.2 Background in context of Economy of Pakistan**

Islamic banking and finance has developed promptly and it is initiated in the era of 1970s. Current international Islamic banking assets are reached at more than USD1 trillion. There are almost 300 financial bodies of Islamic institutions around the world in 75 countries. According to Asian Banker research, the international Islamic industry is grown about 15% to 20% yearly.

Islamic Republic of Pakistan was created on the name of Islam. Pakistan has a great responsibility to improve different fields according to Islam to fulfill; Pakistan is doing efforts to increase Islamic banking. The (SBP) State Bank of Pakistan has a Separate section for Islamic banking. SBP is promoting Islamic banking through its regulations and ceasing the promotion of conventional banking. Firstly, Islamic Banking was started in 1970s when Islamic Ideology Council presented a strong case to government, in which they defined that the system based on interest which is working in Pakistan is entirely against the preaching of Islam it called RIBA and it is prohibited and haram in Islam. During 1980's in Pakistani banking industry SBP gave guidelines to banking institutions regarding the range of Islamic banks in different areas of Pakistan to acquire an innovative technique regarding perfection approximately Islamic system of Banking alternatively of a progressive technique. Otherwise it's miles difficult and very hard to make certain the acceptability of Islamic banking and financial merchandise in Pakistan.

This study shows that in which manner the determinants change or influence the profitability for Islamic bank in Pakistan and gave better knowledge about fee and significance of determinants of probability. Countable studies are discovered about Islamic system of banking and Researchers find out that there are several elements which affect the profitability of Islamic banks.

## **1.3 Statement of Problem**

Consolidation between banks, increasing race and endless improvement these all contribute to a grown Islamic banking. Assessing the functioning and performance of Islamic banks is necessary for administration and for regulatory purposes. Managers are eager to decide about the end results and outcomes of earlier management decisions. Banking governing bodies are concerned regarding the reliability of the banking industry, maintaining public confidence along with monitoring banks to discover those institutions which are facing the problems. With no supervision and performance evaluation, prevailing tribulations may stays unobserved plus become cause for financially collapse. Customers are concerned about the progress of their concerned banks because of not allowed getting those fixed profits. Most important, evaluation of performance is required in order to give response to the queries such like: Is that Islamic banking defined or followed the similar form of rules and conventions as traditional or conventional banking followed? Are banks efficient? Are these banks dedicated?

## **1.4 Objective of the study**

The purpose of our research to take a look at objectives to expose an aggressive and hard gap inside the literature by using giving the updated help at the dynamics and versions of profitability and the efficiency of Islamic banks, to evaluate profitability of Islamic system of banking, to become aware of and analyze elements that could possibly will alternate or control the profitability of Banks under Islamic system, to give guidelines for trusting on the knowledge of the author, proofs offered by this study to authorize and declare Islamic banking guidelines and values toward their employees and the all contributors.

## **1.5 Research Question**

In our competent banking sector, which are those factors that influence the Return on Asset (ROA) and (ROE) Return on Equity in Islamic banks of Pakistan?

## **1.6 Hypotheses Development for Study (quantitatively)**

In this research the important hypothesis is to find out and monitor that Is external and internal elements are important in defining Islamic banks' margin. The internal factors are bank size, gearing ratio, asset

management and operating efficiency. This study explains the literature that focus on internal factors as main determinants of banks' profitability.

## **1.7 Chapter Layout**

This paper is distributed into five chapters. First section describes and explains the history, assertion of trouble, objectives of studies, hypotheses and contribution of the research. In second section literature on banks profit and margin determinants is regarded to present justification about decided on inner variables. In chapter 3 we defined method which we used in trying out the impact of inner determinants on financial institution's profitability. In section four, we gave the outline and analysis of the information. In final chapter we define and give an explanation for the outcomes also with the belief and implications for coverage.

## **2. Empirical Review of Literature**

This research describes the basic introduction of Islamic banking and the determinants which impact the Islamic banks to develop swiftly in Pakistan. Right here we discuss approximately the evaluation of the early researches about the internal and outside factor which can be going to be tested in our research. We additionally confer the Pakistan's history in Islamic banking industry as well as how it has become further batter in nowadays.

### **2.1 Islamic Banking Concept**

Islamic system of banking is explained as banking according to the principles of Quran and Sunnah. Moreover it defines the rules for good governance and risk management principles. Islamic banking follows the interest free operations and also it stresses upon the ethical dealings and avoid unethical operations. It actively contributes in completing the objectives of an Islamic economy. It follows the rules laid by the Shariah and avoids all operations which included interest.

Islamic Shariah not allow 'interest' but it does not restrict all advantages on capital. It only restricts the increased amount on the principal which is more than the amount which is borrowed. Islamic standards state that performance and working of capital need to be measured whilst giving praise to the capital.

The foundation of Islamic banking machine is upon threat-sharing, retaining and usage of tangible goods, participation in buying and selling, finance leasing and production contracts the usage of numerous Islamic approaches of finance. Banks under Islamic system are addressing asset management for the objective of earnings generation. They with full care handle the dangers found in management of property by way of following satisfactory corporate governance performances. When banking industry follows strong implementation of Halal returns, investors are receiving unwavering along with Halal revenues. The authorized sorts of industry through Islam which are discovered by using Holy Quran covered: joint ventures mounted on the premise of sharing of risks through buying and selling each coins and credit, and condominium activities.

Revenue is renowned as 'praise' for the usage of capital. Islam sanctions subsidiary usage of surplus belongings for amelioration of their cost. However, together with the privilege of revenue, the prison responsibility of peril of failure on capital, no exceptional detail can also be made to undergo the legal responsibility of the peril of loss. Monetary transactions are allowable if these related with objects, lodgings or blessings. This option of Islamic finance can also be auxiliary in engendering higher area in finishing touch of economic guidelines at macro level.

Besides selling and buying, Islam sanctions leasing of property and getting leases in opposition to the asset taken via manner of the lessee. All these matters can also be leased away aligned with predetermined amount of payment. The possession within leased belongings residues among the lesser can takes up vulnerability and getting reward for his possession. The record has been wrapping up as of Islamic Banking announcement relinquished via means of the Islamic Banking division of State Bank of Pakistan

by the end of June 2011.

Consistent with the Quranic steerage and 1973 charter of Pakistan, Allah has prohibited taking RIBA and has guided all and sundry to do commercial enterprise, exchange and occupation. In this context a few Quranic stanzas are cited below;

“Folks who placed away interest (Riba) cannot situate at the judgment’s day besides as individual placed which is being crushed through devil in to senselessness. This as they are saying “trade dealing is same as interest”. However Allah has forgiven curiosity. So who ever have bought caution from her/his God in addition ceases ought to comprise whatever is purely, and her/his dealings stay upon Allah. However whoever, proceeds to trade in Riba or usury, individuals who are winners of the flames they may be going to be standing in the end therein”. [Al-Quran: 2-275].

## **2.2 Islamic Banking in Pakistan**

Pakistan becomes part of the third global place in the globe that has been searching policies for implement RIBA liberated banking. The Islamization measures containing removing of RIBA as of the functions of precise monetary associations together with NIT, ICP and HBFC by the end of July 1979 that the commercial banks adopts from the start of January 1981 to the end of June 1986. The Pakistan's official legal body of monetary and enterprise mechanism became modify on 26<sup>th</sup> June 1980 to authorize issuance of a fresh Riba free tools of organization investment named as contribution time period credential (p.c). In Ordinance to change into unfold to permit the Mudaraba formation corporations with Mudaraba floatation certificate meant for giving commands on assets based totally on threat. Adjustments were made within banking industry Ordinance, 1962. (The Banking Corporation Ordinance in 1962) and relevant prison guidelines to comprise stipulation of bank funding by way of manner of PLS, gain in worth of prices, renting along with rent buy.

Different counters had been initiated which are hobby loose, operating in the whole industrial banks, and one global economic institution (financial institution from Oman) in 1<sup>st</sup> January, 1981 to utilize deposits from income and failure sharing centered. For the funding of these dollars, bankers have been guided to provide economic accommodation for authorities’ commodity operations consistent with transactions on delayed price with a gain on buy fee. Export expenditures have to be put on trade on the origin of charge gap. In March 5<sup>th</sup>, 1982 one of a kind financials prices of rice trading organization of Pakistan, Export of Cotton organization as well as the shopping for and promoting agency of Pakistan were transferred on the basis of mark-up. whilst, vital modifications had been ended in the relevant laws allowing the home economic group to offer investment towards membership term permit and further duvet proceeds in the direction of promissory notes maintained by using % along with Mudaraba certificate. As of 1<sup>st</sup> July 1982, banks had been licensed to supply investment in order to satisfying the operating capital requirements beneath the technique from Musharaka.

From first April, 1985 all finances to all folks commenced to be made in one of the vital quantified hobby-loose processes. All commercial banks from 1<sup>st</sup> July 1986 a sport in Pakistan Rupee was introduced Riba free system. As of 1986, no economic organization from Pakistan had permission to take delivery of every curiosity-situated deposit with all present investments in a bank been considered at the origin of revenue and sharing of losses. In present bills deposits have been usual however no interest or proportion in income or loss became as soon as allowed to such shape of bills. As remote places in Pakistan forex deposits with on lending of overseas debts persevered like prior they had been dealt with. The national bank of Pakistan has allowed 12 forms of RIBA financing labeled in 3 huge groups. On the other hand, in any specific case, the form of investment to be authorized used in order to be left to the joint decision of the clients and their banks.

The conduct utilized in Pakistan’s banks while you bear in mind that July 1 1985, situated in large part

resting on markup system through or exclusive of buy over again consideration become, though, defined Non-Islamic through the (FSC) Federal Shariat court docket in December 1991. Despite the fact that, petitions were prepared in the (SAB) Shariat Appellate Bench on the best invite docket of Pakistan. The Shariat Appellate Bench furnished her decision on 23<sup>rd</sup> December, 1999 disallowing the appeals by means of guiding that criminal guidelines containing Riba might stop to encompass impact ultimately with the resource of 30<sup>th</sup> July, 2001. Inside the decision, court determined the fact that praise monetary device have to live lain open to fundamental alteration to supply it into compliance with the Shariah Board. It additionally engaged the authorities to build up, inner targeted horizon, the commission for adjustment for the economic method along with two mission services to design as well as placed into impact of the approaching the conversion.

State Bank of Pakistan introduced its former Islamic Banking coverage in 2001 that became its core obvious step above a protracted program language phase of the point. The coverage indicated the verity which was the Islamic Banking have to encouraged aspect-via way of-element through the traditional way of banking. However, at that time Al-Meezan investment bank, become as earliest previously running like an Islamic investment bank of Pakistan be initiate the number one license plus was once, initiated its operational activities as the primary Islamic banks of Pakistan, as a result have become the first and on top Islamic monetary organization in Pakistan. The other all conventional banks had been additionally allowed authorization to provide Islamic Banking products/services like a window or divide branches. At this point, we cannot pick out first-rate Islamic bank because of the truth they may be working consistent with the sharia advisory board regulations.

### **2.3 Review of the literature**

The strong enlargement of Islamic banks had already been the warranty with the perspective of Muslim global monetary panorama inside the Nineteen Eighties and 1990s. Network of Islamic banks spans more than 60 nations and assets greater than \$166 billion; Islamic banks in the meanwhile are taking component in a progressively massive position in their full-size economies. Established in the charters, an Islamic bank has the litheness of fitting stakeholders as well as collectors of groups. With this understanding; Islamic banks are swiftly obtaining marketplace split in their home countries.

From the preliminary tiers of the Islamic finance, Udovitch (1967) provided proofs of the hadith that accepted merchants to make sure their commercial enterprise transactions on credit score. Though, in keeping with Aggarwal and Youssef (1996), Dar and Presley (1999), Ahmad and Hassan (2002) and Rosly (2005), the triumphing exchange credit rating contraptions are essentially money owed devices. Because of this, businessmen who've need of financing facilities from the bank are met with the obstacle both Islamic gadgets are certainly one of a type from the traditional devices or now not.

A study was carried out via Kahf (1999) at the ability of the principle of IF to answer to the wishes of international change, which showed that the Islamic financing methods have been found capable of help exporters, importers and producers. Prior researches about Islamic Banks (in 1981 by Ahmed, in 1982 by Karsen) focused on the theoretical problems essentially RIBA free banking services. The subjects of feasibility of Islamic banking system and its capacity to organize saving, collection to sharing risks and to assist the dealings don't acquire sufficient reporting from the available literature. Smaller amount of critiques, although, enclose concentrated on the rule implementation in order to disposing the interest bills [Khan and Bashir (1986)].

### **2.4 (ROA) Return on Asset**

(ROA)Return on Asset denotes the output at the property of the corporation following subtract every part of the bills and excises (Wachowicz and Van Horne (2005)]. Apart from, some author's careworn the importance of utilizing goes back on Asset (ROA) as a degree of profitability. Alkassim do research in 2005 used return on belongings because the stylish variable in his gain knowledge of productivity of conventional and Islamic banks inside the GCC nations. Moreover, he puts extra substance on return on

assets as the particular procedures asset efficiency inside the banking business.

Similarly, Hassan and Bashir carried research in (2004) and Ben Naceur do research in (2003) have used ROA as overall presentation indicator as well as based totally variables considering the creator thought that ROA determination assist in order to establish the efficiency of financial organization resources. Bashir and Hassan concerned each ROA and ROE as procedures of common evaluation of performances looking at the profitability determinants of Islamic banks. Hassan claims that the consideration of return on asset may specifically mirror the administration capability for the mobilization of the financial institution's and actual investment sources to produce earnings. Subsequently, a lot of supervisory bodies assumed that ROA is the amazing measure of banking competence.

## **2.5 Bank's Size**

Considering financial institution size many of the many variables for define banks' profitability. Boyd and Runkle done research in (1993) defined that size of an economic institution can also be related to the thought of economies of scale. In line with Idris et al carried research in (2011) and Bahsir (2003), they established that the financial organization dimension is an awfully effective variable which will definitely have an effect on the stage of profitability. Idris et al believed that the higher amount of the financial organization could have a gain in negotiating the fee of enter, and it could simply decrease economic institution's everyday fee. For this reason, the banks are competent to get the economies of scale and can advance their profits.

Nonetheless, Tarmizi and Wasiuzzaman carried research in (2010) and [Athanasoglou, Brissimis and Delis (2005)] have found the dimension of Islamic banking are unimportant and it's not foremost to influence the profitability of banks. Tarmizi and Wasiuzzaman revealed that the size of bank is totally connected with the capital ratio as well as they accomplished that in Malaysia profitability of Islamic banks are simply by not encouraged the financial institution dimension. Haron in (1996) said that the higher the economic group length is not important increases the profitability of a monetary group, above all the economic organization net sales inside the take a look at positioned that there's a horrible courting between the economic group size and profitability.

Rhoades who have done research in (2002) argue that positive association of the scale with the profitability of banks. The monetary institution-dimension additionally used by the jogging performance. Molyneux and Seth carried research in (1998); Ramlall do research in(2009); Sufian do research in (2009) get the assured courting of banks measurement and take a look at the economic institution dimension be decided through the EOS (economies of scale) given that the advanced banks be more worthwhile compare to smaller size banks. The significance of capital is worthwhile for the group shape as well as size of the concerned bank. Hassan, Mohamad and Bader who dne research in (2009) said that as average effects, banks are capable in mobilizing their assets in compare to their capacity to deliver profits and sales even as studying approximately a flow-kingdom degree in 11 institution of Islamic convention (OIC) nations for the duration 1990-2005.

The dimensions is calculated because the ordinary logarithms of whole assets. Kosmidou, Pasiouras and Tanna who carried study in (2002), Alper and Anbar who done research in (2011) and Khrawish who do study in (2011) get confident relationship between ROA and monetary group length.

Economic institution size is a number of the internal elements due to the fact a company growth are the obstacle of financial group's control. In step with Boyd and Runkle's conclusion (1993), the scale of an economic organization are in most instances linked with the idea of economic scale. Economic system idea defined that if an agency is regarding economic of scale, university might be greater green by using manner of doing construction at reduce back rate. it is envisioned that monetary organization measurement is definitely related to financial institution's prosperity. To evaluate small banks with large

banks size, large size banks are speculated in experience economics of scale, these banks might generate a greater variety of services/products inexpensively and professionally. As a result, huge banks capable to get a higher charge of go back than small banks.

Bashir observed length to negatively have an effect on profitability Islamic banks of middle Japan. This courting furthermore studied via manner of Sufian and Habib-ullah for commonplace banks. However, Haron et al (2005) searched dimension to undoubtedly have an impact on the profitability of the banks studied.

## **2.6 Operational Efficiency**

Operational efficiency is generally measured through using charge over profits. Although, because of loss of records on value to sales ratio in financial organization scope, this have a look at makes use of internet interest periphery proportion of all banks that are studied. Bank scope categorizes the ratio as the currency go together with the float gains interest-loose lending. The higher the ratio the monetary institution might be tons less dicy, so one may be openly affecting the economic group's profitability. So, here is a integrate courting among operation effectiveness and the profitability of Islamic banks. Haron, Wasiuzzaman, Bashir &Tarmizi get a giant assured dating among the ratios, even as Srairi located a massive terrible relationship. The research of Hussain and Hassan, Khrawish and Syafrri communicate approximately that there's a vast terrible have an effect on of inflation on profitability. On the alternative factor, there is a wonderful have an effect on of inflation on risk. Researches thru Wallich, Vongand Chan and Tan and Floros display that high inflation premiums get within the course to extra financial organization profitability. Inflation is ideal-mentioned as a upward push within the diploma of prices of products and services in an economic system, and it would replicate the shopping for power of money. Whilst inflation takes place, the shopping energy of cash will emerge as weaker.

## **2.7 Asset Management**

Most customarily, operations of Islamic banks are focused through the use of an excessive level of monetary uncertainties. within the lack of assured profits on investments, banks under islamic system begin risky operations on the way to be in a position to generate compativite returns to their customers. For this purpose they used their property in wonderful methods. To decide their asset mangementsevices we have used the walking revenue to complete property ratio. it will outline an appropriate have an effect on of asset administration on the profitabilty measures like ROA and ROE.

## **3. Source of the Data, Model Specification and Research Methodology**

### **3.1 Data Source**

This chapter will provide the know-how with respect to the methodology of the study. We will discuss about information of data collection methods; we have used secondary resource of data set in our analysis. The information about data acquires from Islamic Bank's financial statements, International Monetary Fund (IMF), world economic Outlook (WEO). Results have been statistically analyzed with the resource of using E-view software with (OLS) Ordinal Least Squares Regression.

### **3.2 Research Methodology**

The ordinary least square approach has used for this study to evaluate the results. Application of this technique is sensible and appropriate located at the provision of some of previous stories that are taken as a whole in order to examine the profitability of banking industry. Furthermore, for explanation and analyzing the outcomes, secondary resources of data which includes; journal papers, books and legitimate publications have possibly employ for the support of the theory in order to estimate the parameters accurately.

In our work, we studied the articles and annual statements on the predicament to the Islamic banks in Pakistan. The secondary statistics that is used on this research are included in the nine years annual experiences of each one Islamic bank from 2007 to 2015.

### 3.3 Target Population

The brief understanding on the variables is analyzed on this research to carry the look at on profitability of Banks under Islamic Banking system in Pakistan. Therefore, the information from five Islamic Banks in Pakistan from 2007 to 2015 was collecting from following banks:

- Meezan Bank Limited
- BankIslami Pakistan Limited
- Dubai Islamic Bank (Pakistan) Limited
- Burj Bank
- Al Barka Bank

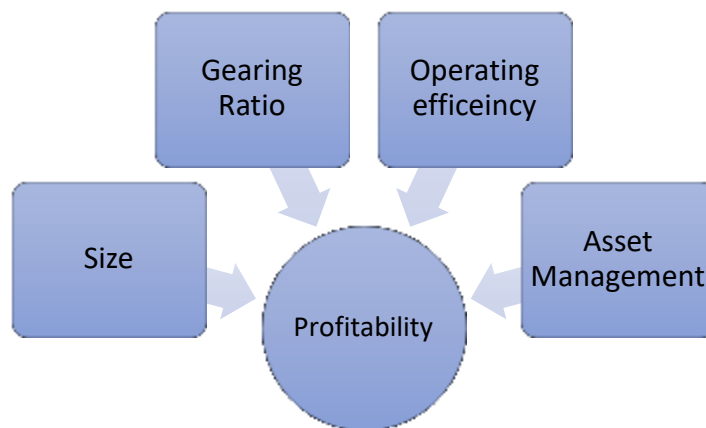
### 3.4 Data Analysis

The accrued facts were statistically analyzed through utilizing E-view program with the aid of Ordinally Least Squares regression (OLS). E-view has used to evaluate and describe the information comprehensively and it resources the effect on the association between economic institution determinants and profit margin of banks under Islamic system. A panel proceedings system were also be accomplished to extend our analysis with a view to carry out a accurate and reliable results.

The hypotheses were establish positioned on the fetch about OLS regression. The huge scale is arranged at zero.05, and on this approach, the variable with a profit margin of t-statistic lower than zero.05, it certainly reflects the substantial effect on the profitability of Islamic banks.

### 3.5 Model Specification

**Figure 1.**



This diagram indicates the determinants of profit margin of Islamic banks. Those are the explanations which we're utilizing to in our work educated to examine the explanations with empirical evidences. This to learn includes industries centered warning signs and symptoms that could have an effect on Islamic banks profitability. They're internal banking factors like length, gearing ratio, jogging efficiency and asset administration. Profitability is used as stylish variable and measured in terms of ROA and ROE. The inner elements are convenient and the experimental evidence suggests one and all these variables and their courting by means of profitability and the impartial change takes place because of these kinds of variables (Sufian&Habibullah, Ramlall, Sayilgan&Yildirim, conducted research in 2009). The dimensions of the banks are tremendously more predominant variables for the reason that greater banks recompense lots much smaller due to provision of their constant price and it additionally worthwhile for the banks to get significant market percentage and elevate profitability [Koasmidou (2008)].

The macroeconomic elements and variable without strain can affect the profit of the banks externally. The macroeconomic variables take a look at in this paper is financial progress and inflation. Both of the



variables have effect on the profitability of banks consistent with the economic occasions of any country and undoubtedly influence the profitability (Alexiou&Sofoklis carried study in 2009).

### 3.6 Description of dependent and independent variables

Following is the table expressing the brief description of variables.

**Table:1**

<b>Variables</b>	<b>Variable's Names</b>	<b>Measuring Tools</b>
<b>Dependent Variable</b>	ROA (Return on Asset)	Net-Operating Income/Total Assets
	ROE (Return on Equity)	EACS /Common Stock Equity
<b>Independent Variable</b>	Bank's Size	Logarithm of Total Assets
	Gearing Ratio	Total Debts/Equity
	Operating Efficiency	Total Operating Expenses/Total Assets
	Asset Management	Operating Income/Total Assets

### 3.7Hypotheses Development

The crucial hypothesis of this research gain understanding of is to set up the value of internal variables in clarifying Islamic banks' profitability in Pakistan. Go back on Asset and go back on fairness (ROE) turned into taken on as banks profitability size and dependent variable. Inner determinants encompass monetary institution measurement, operational performance and gearing ratio and asset control. In this study, speculation test is inspected to search out any exquisite relationship among independent variables and the fashionable variable.

#### 3.7.1 Bank Size

When an economic institution size is larger, it's competent the financial organization to craft the products and offerings successfully. The speculation of economies of scale used to be initiated with the useful resource of (Boyd and Runkle) to subordinate definitely with bank's profitability. They mentioned that bigger financial group may experience greater value powerful gathering and processing price. As a result of this dimension, huge banks will earn better revenue than small sized banks. It's predicted to have a constructive relationship between monetary organization size and banks' profitability that is supported by way of manner of Idris et al and Bahsir. As a result, hypotheses were designed between monetary organization size and return of Asset (ROA) and ROE.

**Ho:** There is no significant relationship between bank size and Return of Asset (ROA).

**H1:** There is significant relationship between bank size and Return of Asset (ROA).

**Ho:** There is no significant relationship between bank size and Return of Equity (ROE).

**H1:** There is significant relationship between bank size and Return of Equity (ROE).

#### 3.7.2 Operating Efficiency

Running earnings to whole property is an additional sign of efficiency which demonstrates how nicely the banks operate their assets. It is integrated in the model just like as an impartial variable to understand it's have an effect on financial overall performance and effectiveness. It's far predicted to have an admirable association with profitability.

Ho: There is no significant relationship between operating efficiency and Return of Asset (ROA).

H1: There is significant relationship between operating efficiency and Return of Asset (ROA).

Ho: There is no significant relationship between operating efficiency and Return of Equity (ROE).

H1: There is significant relationship between operating efficiency and Return of Equity (ROE).

### 3.7.3 Gearing Ratio

A gearing ratio is describing a financial ratio that compares a few kind of owner's fairness (or capital) to cash borrowed with the useful resource of the organization. Gearing ratio mentions to the most analysis ratio of a company's diploma of lengthy-term debt in comparison to its equity capital. As low gearing is probably an end result of a low degree of borrowings, this will showcase that the organization is growing via way of reinvestment of income, reducing threat. However low gearing may also just factor out that an organization simply isn't always aggressive enough to survive, and is probably no longer looking for opportunities for increase.

Ho: there's no gigantic relationship between Gearing Ratio and Return of Asset (ROA).

H1: there is significant relationship between Gearing Ratio and Return of Asset (ROA).

Ho: there's no gigantic relationship between Gearing Ratio and Return of fairness (ROE).

H1: there is enormous relationship between Gearing Ratio and Return of equity (ROE).

### 3.7.4 Asset Management

Asset management refers to any technique that video display units and maintains things of price to an entity or crew. It'll locate directly to each tangible belonging similar to homes and to intangible belongings like human capital, mental property, and goodwill and economic assets. Asset control is a prepared method of organizing, working, preserving, upgrading, and putting of belongings fee-effortlessly. It also has an impact on the profitability of banks as its miles taking element in a primary position inside the profits of banks.

Ho: there's no gigantic relationship between Asset management and Return of Asset (ROA).

H1: there may be big relationship between Asset administration and Return of Asset (ROA).

Ho: there's no giant relationship between Asset management and Return of equity (ROE).

H1: there is large relationship between Asset management and Return of fairness (ROE).

## 4. Results and Discussion

This chapter indicates the empirical outcomes of research hypothesis, the effect of financial institution's traits on monetary efficiency (ROA, ROE) from 2007 to 2015. The pattern of this research is contained of five Pakistani Islamic banks. The method used to assess the hypothesis is panel data regression.

### 4.1.1: R<sup>2</sup> (Coefficient of determination)

Coefficient of choice of the model is 0.536261. On distinct hand, it approach fifty three.6261% of the version in stylish variables can be defined through the variation in the impartial variables.

### 4.1.2: F-statistics

Ho = All independent variable will not be primary in explaining the based variables.

H1 = as a minimum one independent variable is essential in explaining the dependent variables.

**Levels of significance is 5%**

Reject Ho if the probability value of F assessments is not up to 0.05; if no longer, we do not reject Ho. Reject Ho seeing that the chance price of F test is 7.3237 greater than zero.05 and it concludes that at the least one impartial variable is predominant in explaining the elegant variable.

Additional variables are explained through the following tables.

Dependent Variable: ROA

Method: Panel Least Squares

Date: 10/20/16 Time: 19:44

Sample: 2007 2015

Periods included: 9

Cross-sections included: 5

Total panel (balanced) observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.704509	1.158738	1.471004	0.1495
SIZE	-0.235234	0.092377	-2.546458	0.0151
ASSET_MGT_OPERATING_INCO	18.45114	7.937812	2.324462	0.0255
OPERATING_EFFICIENCY	-30.98319	10.48178	-2.955908	0.0053
GEERING_RATIO	0.051034	0.031833	1.603163	0.1172
R-squared	0.536261	Mean dependent var		0.014167
Adjusted R-squared	0.463039	S.D. dependent var		1.063709
S.E. of regression	0.779461	Akaike info criterion		2.481607
Sum squared resid	23.08726	Schwarz criterion		2.762643
Log likelihood	-48.83615	Hannan-Quinn criter.		2.586374
F-statistic	7.323765	Durbin-Watson stat		1.325920
Prob (F-statistic)	0.000030			

**4.1.3 Bank Size**

Ho: There is no significant relationship between bank size and Return of Asset (ROA).

H1: There is significant relationship between bank size and Return of Asset (ROA).

Reject Ho when probability for t- statistic is less than 5% level of significance. Otherwise, do not reject Ho.

Reject Ho because t- statistic is 0.0151 which is less than 0.05. it shows that there is a significant impact of bank size on the ROA and the profitability of Islamic banks.

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**4.1.4 Gearing Ratio**

Ho: There is no significant relationship between Gearing Ratio and Return of Asset (ROA).

H1: There is significant relationship between Gearing Ratio and Return of Asset (ROA).

Accept Ho because t- test value is 0.1172 which is greater than 0.05. This value shows that there is no significant relationship between gearing ratio and return on assets. And it has no effect on the profitability of Islamic banks.

#### 4.1.5 Asset management

Ho: There is no significant relationship between Asset Management and Return of Asset (ROA).

H1: There is significant relationship between Asset Management and Return of Asset (ROA).

In the case of asset management, we will accept Ho because t- statistic value is 0.0255 and this is less than 0.05.

It shows that there is a strong relationship of asset management on the profitability of Islamic banks.

#### 4.1.6 Operating efficiency

Ho: There is no significant relationship between Operating efficiency and Return of Asset (ROA).

H1: There is significant relationship between Operating efficiency and Return of Asset (ROA).

According to the panel test which we have used to test the hypothesis, we will accept Ho because its value 0.0053 is less than the level of confidence 0.05. It describes that there is positive effect of operating efficiency on the Islamic bank's profitability.

According to the second model of determinants of profitability of banks with respect to ROE is shown in the following table.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	17.19109	10.17644	1.689303	0.0994
SIZE	-2.814922	0.811287	-3.469700	0.0013
ASSET_MGT_OPERATING_INCO	129.0695	69.71260	1.851451	0.0719
OPERATING_EFFICIENCY	-202.6774	92.05465	-2.201707	0.0338
GEERING_RATIO	0.830641	0.279571	2.971130	0.0051
R-squared	0.598696	Mean dependent var		2.915504
Adjusted R-squared	0.535332	S.D. dependent var		10.04231
S.E. of regression	6.845496	Akaike info criterion		6.827094
Sum squared resid	1780.711	Schwarz criterion		7.108130
Log likelihood	-146.6096	Hannan-Quinn criter.		6.931861
F-statistic	9.448542	Durbin-Watson stat		1.037655
Prob(F-statistic)	0.000002			

#### 4.2: R<sup>2</sup> (Coefficient of determination)

Coefficient of determination of the model is 0.598696. It means 59.8696% of the variation in dependent variables can be explained by the variation in the independent variables.

##### 4.2.1: F-statistics

Ho = All independent variable is not important in explaining the dependent variable of ROE.

H1 = At least one independent variable is important in explaining the dependent variable of ROE.

Level of significance is 5% for the testing of the model. Reject Ho if the probability value of F tests is less than 0.05; if not, we do not reject Ho. Reject Ho since the probability value of F test is 9.448542 more than 0.05 and it concludes that at least one independent variable is playing important role in explaining the dependent variable.

#### 4.2.2 Financial Institution's Size

Ho: there's no significant relationship between financial institution dimension and Return of equity (ROE).

H1: there is enormous relationship between bank dimension and Return of equity (ROE).

Reject Ho when likelihood for t- statistic is less than 5% stage of significance. Otherwise, do not reject Ho.

Reject Ho considering that t- statistic is 0.0013 which is less than 0.05. It shows that there is a huge affect of bank dimension on the ROE and the profitability of Islamic banks.

#### 4.2.3 Gearing Ratio

Ho: there's no gigantic relationship between Gearing Ratio and Return of fairness (ROE).

H1: there may be significant relationship between Gearing Ratio and Return of equity (ROE).

Accept Ho in view that t- experiment value is 0.0051 which is less than zero.05. This price suggests that there's huge relationship between gearing ratio and return on equity. And it has no result on the Islamic bank's profitability.

#### 4.2. (4) Asset management

Ho: there is not any gigantic relationship between Asset management and Return of fairness (ROE).

H1: there may be giant relationship between Asset management and Return of equity (ROE).

Within the case of asset management, we can be given Ho for the reason that t- statistic value is zero.0719 and that is more than 0.05.

It indicates that there is a no relationship of asset administration on the profitability of Islamic banks.

#### 4.2.5 Running Effectively

Ho: there's no significant relationship between working effectivity and Return of fairness (ROE).

H1: there is tremendous relationship between running efficiency and Return of equity (ROE).

In keeping with the panel test which we've got used to test the hypothesis, we can be given Ho for the reason that it's worth zero.0038 is less than the extent of self-assurance zero.05. It describes that there's optimistic outcomes of operating efficiency on the profitability of Islamic banks.

### 5. Conclusion and Policy Suggestions

The empirical indication shows that the two variables that have been employed to determine the profitability i.e. set off (ROA) Return on Assets and (ROE) Return on equity in this study (Sufian&Habibullah, 2009; Ramlall, 2009; Sayilgan&Yildirim, 2009; Koasmidou, 2008). Each profitability determinant gives away to variety of incomes form best use of assets.

Financial institution measurement of the banks used to be denoted by the logarithm of complete asset of the financial institution. We identify a tremendous constructive relationship between financial institution measurement and profitability of Islamic banks. Financial institution measurement is a considerable variable in defining the profitability in Islamic banks. According to the gearing Ratio it has no huge outcomes on profitability of banks in case of ROA. At the same time gearing Ratio has positive relationship with ROE. In accordance t earlier researches ROA is extra suitable to determine profitability as we don't forget gearing ratio as no outcome on profitability. Asset management working earnings ratio also has a bad effect on ROE and robust relationship with ROA. It shows that asset management can also be a giant determinant of profitability of Islamic banks. Running efficiency has a strong constructive have an impact on profitability of Islamic banks, in step with our statistical analysis with jointly ROE and ROA. The coefficient of running effectively is statistically most important at the 5% stage of all requirements.

The study was used to establish the financial institution special elements that manipulate the profitability of Islamic Banks. We now have used the data from 2007-2015 to provide evidence to our assumptions. This study suggests that financial institution size and running efficiency play primary role in this regard. On the other hand, asset management is shows massive results as significant in table 1 and insignificant in mentioned table 2.

This study permits the researchers to use more time frame and extra unbiased variables to identify the special implications. Critical steps are required to be taken through the State bank of Pakistan so that we can build a nation on the footings of powerful rules/implications defined by the way of Islamic Shariah employed in banking industry.

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