

COMPARATIVE EVALUATION OF CREDIT RISK DETERMINANTS BETWEEN
ISLAMIC AND CONVENTIONAL BANKING

By

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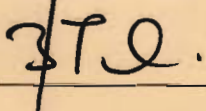
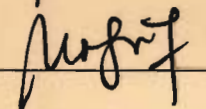
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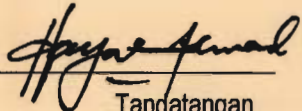
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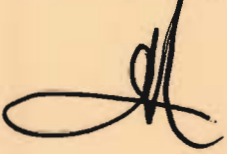
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ABSTRAK

Kejayaan kewujudan bersama sistem perbankan berkembar di Malaysia menimbulkan beberapa dakwaan bahawa pendekatan operasi perbankan Islam dan konvensional terhadap risiko perbankan adalah sama. Kajian ini bertujuan untuk menyiasat isu tersebut melalui objektif kajiannya, iaitu (a) untuk mendokumentasikan falsafah risiko Islam yang wujud dalam al-Quran dan Hadis, dan menentukan perbezaannya dengan perspektif konvensional; (b) untuk menjalankan siasatan empirikal pada tahap risiko-kredit dan menentukan pengaruh tertentu empat belas buah bank dan enam pemboleh ubah makroekonomi yang mempengaruhi risiko kredit daripada dua aliran perbankan dan (c) untuk mewujudkan perbezaan statistik antara penentu risiko-kredit daripada bank Islam dan bank konvensional. Kajian ini menggunakan data kewangan daripada laporan tahunan 15 buah bank Islam dan 13 buah bank konvensional bagi tempoh 11 tahun dari 2000 - 2010. Dapatan kajian menunjukkan bahawa risiko dalam perbankan Islam merujuk kepada tafsiran lebih luas yang meliputi konsep *gharar*, *mysir*, *mukhatarah*, *al ghunm bil ghurm* dan *al kharaj bil daman* berbanding elemen ketidakpastian dalam perbankan konvensional. Tahap risiko-kredit didapati lebih tinggi dalam perbankan konvensional pada awal kajian, tetapi secara beransur-ansur menurun kepada tahap yang hampir sama untuk kedua-dua aliran perbankan pada akhir kajian, dengan latar belakang prestasi ekonomi yang lebih baik, kualiti aset yang bertambah baik dan pengurusan risiko. Tiga penentu iaitu pembiayaan sektor berisiko, modal kawal selia, dan kontrak Islam didapati menjadi penyumbang utama kepada risiko kredit bank-bank Islam dengan kontrak Islam sebagai penyumbang terbesar. Bagi bank konvensional, set pemboleh ubah yang berbeza seperti peruntukan kerugian-pinjaman, nisbah aset hutang kepada jumlah, modal kawal selia, saiz, pengurusan pendapatan dan kecairan adalah faktor penting yang mempengaruhi risiko kredit. Pada peringkat makro, hanya inflasi dan bekalan wang signifikan kepada risiko kredit bagi bank-bank Islam dan konvensional. Walau bagaimanapun, hasil menunjukkan struktur pelaburan yang unik oleh bank-bank Islam menyediakan penampakan yang lebih baik kerana kurang terjejas oleh faktor-faktor ekonomi. Oleh kerana faktor-faktor yang dikaji menunjukkan kesan yang berbeza pada risiko kredit bank-bank Islam dan konvensional, penemuan menunjukkan bahawa strategi pengurusan risiko yang berbeza perlu digunakan oleh setiap jenis bank untuk mencapai prestasi yang lebih baik. Manakala bank-bank konvensional pula perlu melibatkan diri dalam lebih banyak perkara di luar lembaranimbangan sebagai sebahagian daripada strategi kepelbagaian risiko, bank-bank Islam perlu mempelbagaikan tumpuan pembiayaan mereka di *Bai-Bhithaman Ajil* (BBA) dan kontrak *Murabahah* untuk projek-projek yang bersandarkan aset berkualiti tinggi.

Kata kunci: Penentu Risiko Kredit, Perbankan Islam, Perbankan Konvensional, Kontrak Islam.

ABSTRACT

The successful co-existence of the dual banking system in Malaysia poses several claims that the Islamic and conventional banking operations are the same in their approach towards banking risks. This study aims to investigate this issue through fulfilling the research objectives, namely (a) to document the Islamic philosophy of risks that exists in the *Quran and Hadith*, and establish the differences from the conventional perspectives; (b) to conduct an empirical investigation on the credit- risk level and to determine the influence of fourteen bank specifics and six macroeconomic variables affecting the credit risk of the two banking streams and (c) to establish statistical difference between the credit- risk determinants of the Islamic and conventional banks. The study employs financial data from the annual reports of 15 Islamic banks and 13 conventional banks for the period of 11 years from 2000 – 2010. The finding reveals that risk in Islamic banking refers to a wider interpretation covering the concepts *gharar*, *mysir*, *mukhatarah*, *al ghum bil ghum* and *al kharaj bil daman* than the element of uncertainty as in the conventional finance. The credit- risk level was found higher in conventional banking in the early years of the study but gradually decreased to almost the same level for both banking streams in the later part of the study, against a backdrop of better economic performance, improved asset quality and risk management. Three determinants, namely risky sector financing, regulatory capital, and Islamic contract are found to be significant contributors to the credit risk of Islamic banks with the Islamic contract being the largest contributor. For conventional banks, a different set of variables such as loan- loss provision, debt-to-total asset ratio, regulatory capital, size, earning management, and liquidity are significant factors influencing their credit risk. At the macro level, only inflation and money supply are significant to credit risk for both the Islamic and conventional banks. However, the result shows that the Islamic banks' unique investment structure provides a better buffer against risk since they are less affected by the economic factors. Since the factors examined showed different impacts on the credit risk of the Islamic and conventional banks, the findings imply that different risk - management strategies should be applied by each type of bank for better performance. While conventional banks engage in more off-balance sheet items as part of their risk-diversification strategy, Islamic banks should diversify their financing concentration in *Bai-Bhithaman Ajil* (BBA) and *Murabahah* contracts to high quality assets- backed-based projects.

Keywords: Credit risk determinants, Islamic banking, Conventional Banking, Islamic Contracts.

TABLE OF CONTENTS

	Page
TITLE	
DECLARATION	ii
PERMISSION TO USE	iii
ACKNOWLEDGEMENT	iv
TABLE OF CONTENT	vii
LIST OF TABLES	xv
LIST OF FIGURES	xvi
ABSTRAK	v
ABSTRACT	vii
CHAPTER 1 BACKGROUND OF THE STUDY	
1.0 Introduction	1
1.1 Background	1
1.2 The Emergence of Islamic banks	5
1.3 Sources of Banks' Credit Risk	7
1.3.1 Conventional Banks' Credit Risk	8
1.3.2 Islamic Banks' Credit Risk	8
1.3.3 Debt Based Funding as Dominant Sources of Credit Risk	9
1.4 Challenges of Islamic Banks	10
1.5 Challenges of Conventional Banks	11
1.5.1 Significant Increase in Credit Risk	12
1.5.2 To Revive from Banking Failures	12
1.5.3 Erosion in the Integrity of Conventional Banks	13
1.6 Problem Statements	13
1.7 Research Objective	15
1.8 Research Questions	16
1.9 Significant of the Research	17
1.10 Organization of study	18

CHAPTER 2 OVERVIEW OF MALAYSIAN ISLAMIC FINANCIAL AND BANKING SYSTEM

2.1 Overview of Malaysian Islamic Financial and Banking System	19
2.2 Financial Sector Master Plan (FSMP)	23
2.2.1 Sustainable and Resilience of Financial institutions	23
2.2.2 Strengthening the Domestic Financial Infrastructure	24
2.2.3 Improving Bank Negara Malaysia's Financial Stability Framework	24
2.2.4 Development of Islamic Banking in Malaysia	27
2.2.5 Islamic and Conventional Banking Systems	28
2.2.6 Interest-Free Banking Scheme or Islamic Banking	30
2.2.7 Product Development Chronology	30
2.2.8 Regulators	31
2.2.9 Islamic Mode of Financing in Malaysia	31
2.3 Nature of Islamic Banking	33
2.3.1 Development Role of Banking Institutions	35
2.3.2 Economic Role of Banking Institutions	35
2.3.3 Social Welfare Role of Banking Institutions	36

CHAPTER 3 REVIEW OF RELATED LITERATURE AND THEORIES OF RISK FROM ISLAMIC AND CONVENTIONAL BANK'S PERSPECTIVE

3.0 Introduction	37
3.1 Islamic Banking Theory	38
3.2 Risks	39
3.3 Free from <i>Al-Batil</i> (الباطل) Elements	41
3.3.1 Limits of Freedom in Validating Contract in Islam Philosophy	42
3.4 Islamic Philosophy of Risk	45
3.4.1 Literal Meaning or " <i>Lughah</i> " of Risk or " <i>Mukhatarah</i> " in Islam	45
3.4.2 General Concept of Risk in Islam	46
3.4.3 Specific Rule of Risk in Islamic Perspectives	47
3.4.4 Authentic <i>Hadith</i> and Justification on Prohibition of <i>Gharar</i>	48
3.5 Theoretical Literature of Risks in Islamic Perspectives	50
3.5.1 <i>Gharar</i> (Uncertainty)	51
3.5.2 Past Studies on Definition of Risk in Islamic Framework	54
3.6 Definition of Risk in Conventional Finance Philosophy	55

3.6.1 Definition of Credit Risk in Conventional Finance Philosophy	55
3.6.2 Literature on Credit Risk in Islamic Banking Perspective	56
3.6.3 Risk Origination in Financial Institutions	57
3.7 Theories on Risk	57
3.7.1 Agency Theory in Financial Intermediation	58
3.7.2 Risk Formation in Conventional Banking Institutions	59
3.7.3 Information Asymmetry and Moral Hazard in Banking Institution	60
3.7.4 Moral Hazard and Adverse Selection from Islamic Banking Perspectives	61
3.7.5 Adverse Selection and Risks in Banking Institutions	62
3.7.6 Structure of Risk and Diversifications	62
3.7.7 Theories on Internal Determinants of Risk in Conventional Finance Philosophy	63
3.8 Empirical Review on Factors Affecting Credit Risk in Islamic Banking	64
3.8.1 Regulatory Capital	65
3.8.2 Loan Loss Provision/ Financing Loss Provisions	68
3.8.3 Risk Weighted Asset Risk	69
3.8.4 Finance	70
3.8.5 Risky Sectors Concentration	71
3.8.6 Size	72
3.8.7 ROA	74
3.8.8 MGT	75
3.8.9 LEV	75
3.8.10 DTAR	76
3.8.11 DER	77
3.8.12 Liquid	78
3.8.13 ISCON	80
3.9 Systematic Risks	81
3.9.1 Macroeconomic Variables Affecting Credit Risk	81
3.9.2 GDP	82
3.9.3 CPI	83
3.9.4 Output Gap	84
3.9.5 Yield Curve	85
3.9.6 Islamic Interbank Rate (IIR)	86
3.9.7 M3	87
3.10 Islamic Risk Management in Islamic Banking Mode of Financing and their Unique Risks	88
3.10.1 Nature and Characteristic of Islamic Banks' Mode of Financing	89
3.10.2 Islamic Mode of Financing and Underlying Risks	90
3.10.3 Mudarabah Mode of Financing	90

3.10.4 Musharakah Mode of Financing	91
3.10.5 Murabahah Mode of Financing	92
3.10.6 Agent and Principle Relationship in Risk Formation	92
3.10.7 Sources of Risk at Capital Formation Level	93
3.10.8 Risk Formation on Debt Based Mode of Financing	93
3.10.9 Deferred Payment (Bai-Bithaman-Ajil) with Cost plus Sale (Murabahah) Facility	94
3.10.10 Deferred Delivery Sale (Salam) Facility	94
3.10.11 Repurchase (Bai-al-Einah)	94
3.10.12 Bill Discounting (Bai-al-Dayn)	95
3.10.13 Tripartite Resale (Tawarruq)	95
3.10.14 Leasing Ijarah (Ijarah) Facility	96
3.10.15 Equity Based Mode of Financing and Associated Risks	97
3.10.16 Debt Based Risk and Associated risks	97
3.11 Risk Management from the Holy Quran and Authentic <i>Hadith</i>	98
i) Risk Control	98
ii) Risk Avoidance	99
iii) Risks Diversification	100
iv) Risk Preventions	100
3.12 Gap in Literature	104
3.13 Chapter Summary	106

CHAPTER 4 RESEARCH METHODOLOGY

4.0 Introduction	107
4.1 Research Question	107
4.2 Hypothesis Development	108
4.3 Data and Variables	113
4.3.1 Data	113
4.3.2 Population and Sampling	113
4.3.3 Outliers	114
4.3.4 Normality	115
4.3.5 Linearity	115
4.3.6 Data Transformations	116
4.3.7 Multicollinearity	116
4.3.8 Homogeneity of Variance	117
4.4 Variables Definition	118
4.4.1 Dependent Variable	118
4.4.2 Independent Variable	119
4.4.2.1 Bank Specific Risk Variables	119
4.4.2.2 Macro Economic Variables Affecting Credit Risk	133
4.4.2.3 Operational Definition of bank specific and Macroeconomics Variables for Islamic and Conventional Banks.	140

4.5 Content Analysis	147
4.6 Statistical Analysis	147
4.6.1 Assumption of Multiple Linear Regression	148
4.6.2 Multivariate Regression Analysis	148
4.6.3 Tested model	148
4.6.4 Regression Model	149
4.6.4.1 Internal Determinants of Credit Risk Model	149
4.6.4.2 External Determinants of Credit Risk Model	150
4.6.4.3 Internal and External Determinants of Credit Risk Model	151
4.7 T-test	152
4.7.1 Independent Sample <i>T</i> -test	152
4.7.2 Hypothesis for the Independent-Sample <i>T</i> -test	152
4.8 Pearson Correlation	153
4.9 Chapter Summary	154

CHAPTER 5 RESULTS FOREXTERNAL AND INTERNAL DETERMINANTS OF CONVENTIONAL BANKS CREDIT RISK

5.0 Introduction	156
5.1 Objective One	157
5.2 Objective Two	161
5.2.1 The Level of Credit Risk Creation of Conventional Banks	162
5.2.1.1 Credit Risk of Conventional Banks	162
5.2.1.2 Descriptive Statistics	162
5.3 Objective Three	191
5.3.1 Regression Models	191
5.3.2 Internal Determinants of Credit Risk Model	191
5.3.3 Results on Regression Analysis	192
5.4 Objective Four	198
5.4.1 External Determinants of Credit Risk Model	198
5.5 Objective Five	201
5.5.1 Credit Risk	201
5.5.2 External and Internal Determinants of Credit Risk Pooled Model	202
5.5.1 Regression Pooled Model Summary	204
5.7 Chapter Summary	211

CHAPTER 6 RESULTS FOR EXTERNAL AND INTERNAL DETERMINANT OF ISLAMIC BANKS CREDIT RISK

6.0 Introduction	218
6.1 Objective One	219
6.1.1 Bank Specific Factors and Credit Risk of Islamic Banks	219
6.1.1.1 Descriptive Statistics of Bank Specific Factors	219
6.1.1.2 Descriptive Statistics of External Factors	233
6.2 Objective Two	239
6.2.1 Internal Factors of Credit Risk	239
6.2.2 Regression Results – Islamic Banks	239
6.3 Objective Three	245
6.3.1 External Determinants of Credit Risk Model	245
6.4 Objective Four	249
6.4.1 Internal and External Determinants of Credit Risk (Pooled Model)	249
6.4.2 Regression Finding for Pooled Model	250
6.4.3 Credit Risk and Internal Factors Variables	250
6.4.4 Credit Risk and External Factors Variables	253
6.5 Chapter Summary	255

CHAPTER 7 COMPARISON BETWEEN CREDIT RISK DETERMINANTS OF ISLAMIC BANKS AND CONVENTIONAL BANKS

7.0 Introduction	256
7.1 Objective Six	257
7.1.1 Descriptive Statistics	257
7.1.2 Descriptive Statistics of Islamic and Conventional Banks	257
7.2 Comparison between Credit Risks Determinants of Islamic and Conventional Banks in Malaysia	273
7.3 Regression Model	277
7.3.1 Internal Determinants of Credit Risk Model of Islamic Banks and Conventional Banks	277
7.3.2 External Determinants of Credit Risk Model	285
7.3.3 Pooled Model of Conventional Banks and Islamic Banks	287
7.4 Chapter Summary	294

CHAPTER 8 CONCLUSION, RECOMMENDATION AND FUTURE RESEARCH

8.1 Objective One: Concept of Risk	296
8.2 Objective Two: Credit Risk Level	298
8.3 Objective Three: Banks Specific Determinants of Credit Risk of Islamic Banks' Credit Risk	298
8.3.1 Bank Specific Determinants of Conventional Banks' Credit risk	299
8.3.2 External Determinants of Credit Risk for Islamic Bank	303
8.3.3 External Determinants of Credit Risk Conventional Banks	304
8.4 Objective Four: The Relationship between Internal and External Factors Affecting Credit risk of Islamic Bank (Pooled Model)	305
8.4.1 The Relationship between Internal and External Factors Affecting Credit Risk of conventional banks	305
8.4.2 Differences between Bank Specific Factors Based on Independent <i>T</i> -test of Islamic and Conventional Banks	308
8.5 Objective Five and Six: The result of Credit Risk Determinants Comparison between Islamic Banks and Conventional banks	308
8.5.1 Difference in Bank Specific Factors affecting Credit Risk for Islamic and Conventional Banks	297
8.5.2 The Unique Influence of Bank Specific Factors on Credit Risk of Islamic Banks and Conventional Banks	310
8.6 Implication of the Study	314
8.6.1 Practical Implications	314
8.6.2 Policy Implications	317
8.7 Contributions of the Study	319
8.7.1 Theoretical contributions	319
8.7.2 Major Contributions	319
8.8 Recommendations and Future Research	322

REFERENCES

APEENDICES

Appendix A: Sources of Contract Law in Islam

Appendix B: SPSS Results on Bank Specific and Macroeconomics
Determinants of Credit Risk of Islamic Banks.

Appendix C: SPSS Results on Bank Specific and Macroeconomic
Determinants of Credit Risk of Conventional Banks.

LIST OF TABLES

	Page
CHAPTER 2	
Table 2.1 Development of Banking and Financial Systems in Malaysia	22
Table 2.2 Evolution of the Malaysian Financial Sector	25
CHAPTER 4	
Table 4.1 Sample of Islamic Banks and Conventional banks	114
Table 4.2 Operational Definitions of Conventional Banks’ Credit Risk Determinants	141
Table 4.3 Operational Definitions of Islamic Banks’ Credit Risk Determinants	144
CHAPTER 5	
Table 5.0(a) Finding on Concept of Risk from Islamic Perspectives	158
Table 5.0(b) Finding on Concept of Risk from Islamic Perspectives	159
Table 5.0(c) Type of <i>Gharar</i>	160
Table 5.1 Descriptive Statistics Bank Specific Variables	162
Table 5.2 Loan Growth and Credit Risk for 11 Years	177
Table 5.3 Credit Risk and Profitability of Conventional Banks	183
Table 5.4 Descriptive Statistics of External Factors Variables and Credit Risk	183
Table 5.5 Correlation Matrix for Internal Factors of Conventional Banks	189
Table 5.6 Correlation Matrix of External Factors for Conventional Banks	190
Table 5.7 Regression Result of Banks Specific Variable on Credit Risk for Conventional Banks	192
Table 5.8 Regression Result of External Factors Variables on Credit Risk for Conventional Banks	199
Table 5.9 Model Summary of Regressions Results	204
CHAPTER 6	
Table 6.1 Descriptive Statistics of Bank Specific Factors Variable	220
Table 6.2 Descriptive Statistics of External Factors Variable	233
Table 6.3 Correlation Matrix for Internal Factors of Islamic Banks	236
Table 6.4 Correlation Matrix of External Factors for Islamic Banks	237
Table 6.5 Regression Result of Bank Specific Variables on Credit Risk for Islamic Banks	240
Table 6.6 Regression Results of External Factor Variables on Credit Risk for Islamic Banks	245
Table 6.7 Bank Specific Factors and External Factors Determinants Of Credit Risk in Islamic Bank (Pooled Model)	251
Table 6.8 Summary of R^2 Changes According to Each Model	254

CHAPTER 7

Table 7.1 Descriptive Statistics of Internal and External Variables in Islamic Banks and Conventional Banks	258
Table 7.2 Results of Independent <i>T</i> -test of Banks Specific Variables Affecting Credit risk	273
Table 7.3 Regression Results of Banks Specific Variables on Credit Risk for Conventional Bank And Islamic Banks	277
Table 7.4 Regression Results of External Factor Variables on Credit Risk for Islamic Banks and Conventional Banks	285
Table 7.5 Bank Specific and External Factors Determinants of Credit Risk (Pooled Model)	288

LIST OF FIGURES

CHAPTER 2

Figure 2.1 Structure Financial Systems in Malaysia	21
Figure 2.2 Structure of the Malaysian Financial System Has Evolved to Become Less Fragmented Through Consolidation & Rationalization	27
Figure 2.3 Islamic Banking System in Malaysia	28
Figure 2.4 Conventional Interest Based System	28
Figure 2.5 Islamic Banking Systems	29
Figure 2.6 Risky Sector Finance to Total Finance	33

CHAPTER 5

Figure 5.0 Credit Risk by Bank (Conventional Banks)	163
Figure 5.1 Credit Risk and Output Gap	164
Figure 5.2 Non-Performing Loans and Total Loans	164
Figure 5.3 Risky Sectors Loan	165
Figure 5.4 Risky Sector Loans to Total Loans and Credit Risk	166
Figure 5.5 Risky Sectors Loans to Total Loans and Output Gap	166
Figure 5.6 (a) Economic Growth	167
Figure 5.6 (b) Loan Loss Provision	168
Figure 5.7 Conventional Bank Solvency Ratio	169
Figure 5.8 Conventional Bank Leverage Ratio	170
Figure 5.9 Conventional Bank Leverage and Credit Risk	171
Figure 5.10 Leverage and Credit Risk for 11 Years Period	171
Figure 5.11 Regulatory Capital Ratio	172
Figure 5.12 Regulatory Capital and Credit Risk	173
Figure 5.13 Conventional Banks Size and Loan Size	174
Figure 5.14 Asset Growth of Conventional Banks Size	175

Figure 5.15 Conventional Banks Solvency in Respect to Debt to Equity Ratio	175
Figure 5.16 Loans Growth	176
Figure 5.17 Conventional Banks Loan Growth and Credit Risk	177
Figure 5.18 Leverage Using Equity Multiplier Ratio	178
Figure 5.19 Management Efficiency Ratio	179
Figure 5.20 Management Efficiency and Risky Sector Loans	179
Figure 5.21 Conventional Banks Liquidity Ratio	180
Figure 5.22 Conventional Banks Profitability	181
Figure 5.23 Conventional Bank Profitability Ratio and Credit Risk	182
Figure 5.24 Inflation Rate and Credit Risk	184
Figure 5.25 Malaysian House Price Index	185
Figure 5.26 Money Supply and Credit risk	185
Figure 5.27 Interest Rate and Credit Risk	186
Figure 5.28 Economic Growth and Credit Risk	187
Figure 5.29 Inflation Rate and Output gap	188
Figure 5.30 Economic Growth and Credit Risk	188

CHAPTER 6

Figure 6.1 Regulatory Capital and Non-Performing Financing	221
Figure 6.2 Credit Risk of Islamic Banks According to Banks	222
Figure 6.3 Financing Loss Provision and Credit Risk On Individual Banks	222
Figure 6.4 Financing Loss Provision and Credit Risk for Islamic Banks	223
Figure 6.5 Solvency and Credit Risk for Islamic Banks	224
Figure 6.6 Leverage and Credit Risk	225
Figure 6.7 Equity Multiplier of (EM) of Islamic banks	225
Figure 6.8 Solvency, Equity and Total Finance of Islamic Banks	226
Figure 6.9 Size and Finance of Islamic Banks	227
Figure 6.10 Finance and Credit Risk of Islamic Banks	227
Figure 6.11 Risk Weighted Asset and Size	228
Figure 6.12 Regulatory Capital and Credit Risk	229
Figure 6.13 Management Efficiency and Credit Risks of Islamic Banks	230
Figure 6.14 Liquidity and Credit Risks	230
Figure 6.15 Islamic Concept and Size of Islamic Banks	231
Figure 5.16 Profitability and Credit Risk of Islamic Banks	232
Figure 6.17 Economic Growth and Credit risk (Islamic Banks)	233
Figure 6.18 Output Gap and Credit risk	234
Figure 6.19 Islamic Interbank Rate and Credit Risk	235
Figure 6.20 Money and Credit Risk	235
Figure 6.21 Statutory Reserve Ratio	246
Figure 6.22 Islamic Interbank Rate (IIR) and Output Gap	247
Figure 6.23 Islamic Interbank Rate (IIR) and Interest Rate	248

CHAPTER 6	
Figure 7.1 Credit Risks of Islamic Banks and Conventional Banks	259
Figure 7.2 Risk Sectors Concentration of Islamic Banks and Conventional Banks	260
Figure 7.3 Leverage Capital of Islamic Banks and Conventional Banks	262
Figure 7.4 Solvency Risk of Islamic Banks and Conventional Banks	263
Figure 7.5 Equity Multiplier of Islamic Banks and Conventional Banks	264
Figure 7.6 Management Efficiency of Islamic Banks and Conventional Banks	265
Figure 7.7 (a) Profitability of Islamic Banks and Conventional Banks	266
Figure 7.7 (b) Conventional Banks Interest Income and Non-Interest Income	266
Figure 7.7 (c) Islamic Banks Finance Income and Non-Finance Income	267
Figure 7.8 Size of Islamic Banks and Conventional Banks	268
Figure 7.9 Regulatory Capital Ratio of Islamic banks and Conventional Banks	268
Figure 7.10 Loan Loss Provision of Islamic Banks and Conventional Banks	270
Figure 7.11 RWA of Islamic Banks and Conventional Banks	271
Figure 7.12 Liquidity of Islamic Banks and Conventional Banks	272
Figure 7.13 Leverage of Islamic Banks and Conventional Banks	273

CHAPTER ONE

1.0 INTRODUCTION

This Chapter presents the overview and issues of credit risk of Islamic banks and conventional banks. The first section highlights the background of conventional banks and Islamic banking development in Malaysia. The issues and challenges facing Islamic banks and conventional banks in term of credit risk formation were discussed. These present the problems statement of the study while the last section of this Chapter provides research objectives, significant of the study and the organization of this thesis.

1.1 Background

The primary function of banks in the economy is to accommodate capital growth through an effective allocation of resources to productive sectors of the economy. Through the role of intermediation in the economy, banks facilitate the surplus and deficits units in term of lending and borrowing activities in a more systematic manner. According to Dalgaard (1987) the role of banks is also to determine interest rate that associate with the movement of funds. The delegated monitoring role of financial intermediation of banks makes them more economic to perform the monitoring function compared to monitoring directly by the lender on its borrowers (Diamond, 1984). Though at the same time, banks bear risk on behalf of depositor especially in globalization and liberalization environment. Hence, appropriate and effective risk management systems become vital to manage all banking risks, ensuring stability and growth of the banks as financial intermediaries. The risk and return need also to be evaluated from the present portfolio of asset and liabilities of

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