



Efficiency of Islamic and conventional banks in Malaysia

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Abstract

Purpose – The main purpose of this paper is to examine cost efficiencies of the selected Islamic and conventional commercial banks over the period of 2006 to 2009 in Malaysia.

Design/methodology/approach – Data envelopment analysis (DEA) was initially used, to investigate the cost efficiency of the Malaysian banking sector and followed by Tobit regression analysis determine factors influencing the efficiency of Islamic and conventional banks in Malaysia.

Findings – The DEA results reveal technical efficiency as the main contributor of cost efficiency for conventional commercial banks and allocative efficiency as the main contributor for cost efficiency of Islamic commercial banks. This indicates conventional commercial banks have been efficient in utilizing information technology and electronics. Islamic commercial banks conversely have been efficient in allocating and utilizing their resources. Additionally, scale efficiency is found to be the main source of technical efficiency for both Islamic and conventional commercial banks, denoting that size is important in improving bank efficiency. The results of Tobit regression analysis are twofold. First, it documents capitalization and bank sizes are positively and significantly associated to efficiency. Secondly, loan quality is found to be negatively and significantly associated to efficiency.

Originality/value – This paper contributes to the body of knowledge through its literature discussions on the efficiency of both Islamic and conventional banks and the effect of banks' specific characteristics on their efficiency.

Keywords Efficiency, DEA, Tobit, Islamic, Banking, Malaysia

Paper type Research paper

1. Introduction

The Malaysian banking system comprises commercial banks, investment banks, and Islamic banks. The banking institution is the primary mobiliser of funds and the main source of financing, which supports economic activities in Malaysia. Today, Malaysia has been successful in implementing a dual banking system and has emerged as the first nation to have a full-fledged Islamic banking system operating on a parallel basis with the conventional banking system.

Islamic banking refers to a system of banking that complies with Islamic law, also known as *Shari'ah* law. The underlying principles that govern Islamic banking are mutual risk and profit sharing between the provider of capital (investor) and the user

