Efficiency Performance of Malaysian Islamic Banks

Rossazana Ab-Rahim, Norlina Kadri & Farhana Ismail
Faculty of Economics & Business, Universiti Malaysia Sarawak
Email: rossazana@gmail.com

ABSTRACT This study examines the efficiency performance of the full-fledged Islamic banks in Malaysia for the period of 2006 to 2011. The Malaysian Islamic banking industry has grown tremendously in terms of assets, deposits and total financing over the study period. Data Envelopment Analysis is employed in this study to measure the cost efficiency as well as the technical efficiency and its decompositions. The results show that, on average the main contributor of cost efficiency for Islamic domestic and foreign banks in Malaysia is allocative efficiency. In addition, the results find that Islamic foreign banks are more efficient than domestic banks with respect to pure technical efficiency and allocative efficiency.

INTRODUCTION

Islamic banking has been one of the fastest-growing sectors across the global banking industry. The global Islamic banking assets and assets under management have reached US$750 billion and is expected to hit US$1 trillion in 2010 (Mckinsey, 2007); however, International Monetary Fund (IMF) postulates that with the total assets of Islamic banking is at USD$250 billion, it will reach US$1 trillion by 2016 (Bloomberg, 2009). There are over 300 Islamic financial institutions worldwide across 75 countries and the world's 100 largest Islamic banks target an annual asset growth rate of 26.7 percent (%) while the global Islamic finance industry is experiencing average growth of 15-20% annually (McKinsey, 2007). Ernst and Young (2011) in a report entitled 'World Islamic Banking Competitiveness Report 2011-2012' outline that the global Islamic banking assets to reach US$1.1 trillion in year 2012, an increment of 33% from US$826 billion in year 2010. They add that Malaysia will contribute about 13% (US$38 billion) of the Islamic banking asset growth worldwide. This phenomenon has been contributed by Malaysia's long track record of over 30 years to build a successful domestic Islamic banking. As at December 2011, Malaysia's total Islamic banking assets has reached RM335 billion with an average growth rate of 16.07% over the period of 2002-2011 (Bank Negara Malaysia, 2012).

The establishment of the first Islamic bank, the Dubai Islamic Bank in 1975 was initiated by a group of Muslim businessmen; under a special law that allowed it to engage in business while accepting deposits. Since then, most of the formations of Islamic banks worldwide were private initiated. However, the establishment of Islamic banking in Malaysia is different than Islamic banking in the Gulf and the rest of the world (Samad, Gardner and Cook, 2005); it was because the first Islamic bank in Malaysia, Bank Islam Malaysia Berhad (BIMB) was government initiated. The establishment of BIMB in July 1983 under the Islamic Banking Act 1983 has marked the new era in Malaysian Islamic banking. A