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Impaired Financing Determinants of Islamic Banks in Malaysia

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Abstract

Despite commendable growth of Islamic banking on a macro level, impaired financing is an issue among Islamic banks at the micro level. The 2008 Global Financial Crisis shows large credit risk was largely attributable to staff inefficiency. This study investigates the moderating effect of staff efficiency on determinants of credit risk or impaired financing of sixteen Islamic banks in Malaysia over the 2005-2013 periods. The determinants include new variables such as political stability index and corruption index besides GDP, inflation, finance to deposit, loan loss provisions, liquidity, capital, net interest margin, profitability, loan growth and net charge offs. The study highlights new findings where impaired financing reduced with higher political stability index and corruption index. Loan loss provision has significant positive whilst loan growth has negative impact on impaired financing. Staff efficiency significantly moderates the impaired financing relationship with capital ratio, profitability and loan growth. This relationship yields model fit of 0.889. The results support Resourced - based Theory and provide statistical evidence of the importance of staff efficiency in managing banks' credit risk. None of the external factors had significant influence on impaired financing, which statistically proved that the profit and loss sharing concept of Islamic banking provides effective tool to mitigate external risks.

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