

**COMPARATIVE PERFORMANCE OF ISLAMIC
BANK OF THAILAND AND PIONEERING
ISLAMIC BANKS IN INDONESIA AND
MALAYSIA: MULTIDIMENSIONAL
PERFORMANCE MEASURES
AND COMPLIANCE TO IFSB
PRUDENTIAL STANDARDS**

By

Hj Besar bin Hj Ngah

M1410618P01

DOCTOR OF PHILOSOPHY in Islamic Banking and Finance

Kulliyah of Muamalat

INSANIAH UNIVERSITY COLLEGE

1438H/2016

ABSTRACT

Islamic Bank of Thailand (IBank) operates as a single Islamic bank since 2003 in a Muslim minority country where domestic regulatory and supervisory frameworks are based on conventional banking system. This study aimed at comparing the performance of IBank with other pioneering Islamic banks in Indonesia and Malaysia during their early years of operations as well as during the recent 6 years from 2009-2014. Performance dimension employed in this study is a combination of profitability measure, efficiency measure, and achievement of Maqasid al-Shari'ah, blended together to reflect the multidimensional perspective of Islamic banking. The study also uses IFSB prudential standards on corporate governance, Shari'ah governance, credit risk management and liquidity risk management to evaluate the levels of compliance among the banks aimed at determining the effects of governance compliance to their financial performance. The study employed a combination of financial ratio analysis, DEA methodology, and Maqasid Index measurement of PMMS model (developed earlier by Mustafa & Taib, 2009). Using panel data analysis and structured interview methods the study discovers that the performance of IBank are the poorest among the 3 banks on all the performance dimensions. Poor performance of IBank compared to Bank Muamalat Indonesia and Bank Islam Malaysia is due to its lowest level of compliance with IFSB prudential standards. This study on IBank reflects a typical performance problems faced by Islamic banks in Muslim minority countries due to the main issue of unsuitable domestic regulatory and supervisory frameworks, and lacking in Islamic financial infrastructure.

Keywords: Islamic banking, Profitability, Efficiencies, Shariah Compliant, Maqasid al-Shari'ah, IFSB frameworks.

JEL Classification: G2, G21, G210

ABSTRAK

Islamic Bank of Thailand (IBank) beroperasi sebagai bank Islam tunggal semenjak 2003 di negara minoriti Islam yang peraturan perbankan adalah berasaskan sistem konvensional. Kajian ini bertujuan membanding prestasi IBank dengan bank-bank Islam terawal di Indonesia dan Malaysia sewaktu di peringkat awal operasi masing-masing dan juga di 6-tahun selepasnya dari 2009 hingga 2014. Dimensi prestasi yang diukur merangkumi kombinasi aspek keuntungan, kecekapan serta pencapaian Maqasid al Shari'ah yang digabung bagi mencerminkan operasi perbankan Islam yang multi-dimensi. Kajian ini juga mengguna-pakai piawaian IFSB bagi urustadbir korporat, urustadbir Shari'ah, pengurusan risiko kredit, dan pengurusan risiko kecairan bertujuan menilai kesan kepatuhan terhadap prestasi bank-bank berkenaan. Kajian ini menggunakan kaedah rasio kewangan, kaedah DEA dan ukuran indeks Maqasid berpandukan Model PMMS yang dipelupori Mustafa & Fauziah Taib (2009). Menggunakan analisis panel data dan temuduga berstruktur kajian mendapati IBank mengalami prestasi paling rendah dalam semua dimensi berbanding Bank Islam Malaysia dan Bank Muamalat Indonesia. Kelemahan prestasi IBank tersebut dapat dikaitkan dengan kerendahan pematuhan terhadap piawaian IFSB yang diukur. Keadaan ini boleh mencerminkan situasi prestasi rendah di kalangan bank Islam di negara minoriti Muslim yang mana peraturan perundangan nya adalah tidak sesuai dengan operasi perbankan Islam.

TABLE OF CONTENTS

DECLARATION		ii
PERMISSION TO USE		iii
ABSTRACT		iv
ACKNOWLEDGEMENT		v
TABLE OF CONTENT		vi
LIST OF TABLES		vii
LIST OF ATTACHMENTS		viii
LIST OF ABBREVIATIONS		ix
CHAPTER ONE: INTRODUCTION		
1.1	Background of the Study	1
1.2	Development in Islamic Banking Industry: An Overview	5
1.3	Islamic Banking in Muslim Minority Countries	10
1.4	Islamic Banking & Finance in Thailand	15
1.4.1	Ownership and Governance Structure of IBank	15
1.5	Banking Industry Compliance to International Prudential Standards	18
1.5.1	Conventional Standard Setting Bodies	20
1.5.2	Prudential Standard Setting Bodies for Islamic Banking	22
1.5.3	Linking Islamic Banking Performance to IFSB Standard	24
1.6	Problem Statement	24
1.7	Research Questions	27
1.8	Research Objectives	27
1.9	Significance & Benefits of Study	28
1.10	Scope & Limitations of Study	31
1.11	Organisation of Study	33

CHAPTER TWO: LITERATURE REVIEW		
2.1	Performance of Islamic Banking	35
2.2.1	Islamic Banking in Muslim Minority Countries	36
2.2.2	Islamic Banking in Muslim Majority Countries	39
2.2	Islamic Banking Development in Indonesia	41
2.3	Islamic Banking Development in Malaysia	44
2.4	Islamic Banking Development in Thailand	46
2.5	Importance of Islamic Banking Compliance to IFSB Prudential Standards	49
2.5.1	What is Islamic Finance Services Board (IFSB)?	50
2.5.2	IFSB Publications and Prudential Standards	51
2.5.3	Why IFSB Prudential Standards are Important?	55
2.5.4	Evidence of Compliance to IFSB Prudential Standards	61
2.6	Literatures on Measuring Banking Performance and Profitability	63
2.7	Literatures in Measuring Banking Efficiency	71
2.8	Literatures in Measuring Maqasid Performance of Islamic Banks	77
CHAPTER THREE: RESEARCH DESIGN & METHODOLOGY		
3.1	Performance Framework	82
3.2	Theoretical Framework	82
3.3	Measuring Profitability Using Conventional Ratios	84
3.3.1	Return on Total Assets	84
3.3.2	Return on Equity	85
3.4	Measures of Efficiency Using DEA Methodology	87
3.4.1	Inputs and Output Specifications	90
3.4.2	Efficiency Model	91
3.4.3	Constant Return to Scale	92
3.5	Measure of Maqasid Achievements	94
3.6	Compliance with IFSB Governance Standards	99
3.6.1	Compliance to IFSB Guiding Principles on CG	99

3.6.2	Compliance to IFSB Principles of Shari'ah Governance	101
3.6.3	Compliance to IFSB Principles of Credit Risk Management	102
3.6.4	Compliance to IFSB Principles of Liquidity Management	104
3.7	Methods of Determining Levels of Compliance	106
3.7.1	Questionnaires Design	107
3.7.2	Structured Interviews	108
3.7.3	Developing Structured Questionnaires	109
3.7.4	Measurement of Structured Interview Responses	110
3.8	Lists of Questionnaires	111
3.9	Sample Banks and Population of Study	117
3.10	Data Collection and Data Sources	118
3.11	Chapter Summary	120
CHAPTER FOUR: RESEARCH FINDINGS-1ST OBJECTIVE		
4.1	First Objective of the Study	121
4.2	Comparative Profitability	121
4.2.1	Overall Profitability of IBank	121
4.2.2	Comparative Profitability of IBank with other Pioneer Islamic Banks	125
4.3	Efficiency of IBank (2004-2008)	133
4.4	Achievement of Maqasid al Shari'ah	136
4.5	Chapter Summary	141
CHAPTER FIVE: RESEARCH FINDINGS -2ND OBJECTIVE		
5.1	Second Objective of the Study	142
5.2	Effects of Non Compliant to Prudential Standards	142
5.3	Issues in Islamic Bank of Thailand (IBank)	146
5.4	Research Approach in Evaluating Banking Compliance	148
5.5	Outcomes of Previous Literatures on Good Governance	148
5.6	Compliance to IFSB Prudential Standards	152
5.6.1	Compliance to IFSB Corporate Governance Standards	152

5.6.2	Governance Compliance to IFSB Principles of Shari'ah	155
5.6.3	Compliance to IFSB Principles of Credit Risk Management	157
5.6.4	Compliance to IFSB Principles of Liquidity Risk Management	160
5.7	Summary of Comparative Compliance for all Banks	162
5.8	Linking Islamic Banking Performance to Compliance with IFSB Standards	163
5.9	Prudential Principles, Structure, & Mechanisms in Three (3) Islamic Banks	164
5.10	Comparative Prudential Practices Among the Three (3) Islamic Banks	190
5.11	Chapter Summary	190
CHAPTER SIX: CONCLUSION & RECOMMENDATIONS		
6.1	Performance Issues in Islamic Banking & Finance	192
6.2	Comparative Financial Performance of IBank	193
6.3	Comparative Levels of Compliance to IFSB Governance Practices	194
6.4	Linkages between Compliance to Prudential Standards and Good Performance on Islamic Banks	195
6.5	Causes of Poor Performance of IBank	196
6.6	Achievement of Objectives by IBank	198
6.7	Answering the Research Questions	198
6.8	Recommendations to IBank	199
6.9	Theoretical Contributions	200
6.10	Practical Contributions	202
6.11	Limitations of the Study	203
6.12	Suggestions for Future Research	204
6.13	Summary of Study	205
	List of References	207