

The Impact of Adoption of Islamic Instruments (Ughods) on Profitability: the Case of Islamic Banks in Malaysia

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Abstract

Currently many Islamic Banks started on the development of new products the Islamic Instrument (Ughod) such as of Ijarah, Mudharabah, Murabahah and Musharakah. The main aim of this paper is to know the effect of the application of Islamic Instruments (Ughod) and their diversity in improving the profitability rates of Malaysian Islamic banks. This study was confined to two banks of Hong Leong Islamic and HSBC Amanah Islamic Bank, during the period 2009-2013. The sample-included data collected from the actual financial reports and the financial statements issued by chosen the Banks. The study was adopted in order to achieve the objectives and reach the results on the descriptive and analytical method, where used the simple linear regression and multiple to test the hypothesis of the study and answer the questions of the study. The results of the analysis of both banks showed that adoption Islamic instruments (Ughods) in banking transactions. Our results also showed the existence of a statistical impact of the application of Islamic Instruments (Ughod) on the profitability rates of Islamic Banks, despite the Global Financial Crisis that stroked many conventional banks. This emphasized on the efficiency of the Islamic banking system for Risk Management during the financial crises. The adoption of the application of Islamic instruments in banking transactions which provided by the Islamic banking system would enhance the profitability of banks and making the banks in a safe status during financial fluctuations.

Keyword: Islamic Bank, HSBC, Hong Leong, Mudharabah, Musharakah, Ijarah and Murabahah

1. Introduction

Islamic banking has earned the attention of the Western world due to its turbulent growth in recent years [1]. According to (Union of Arab Banks, 2015), Islamic financial assets have increased significantly, rising from \$ 800 billion in 2009 to about \$ 2 trillion in 2014, an increase of 250 percent in just five years. The assets of Banks account for about 80% of the total assets of Islamic finance which follows with Islamic bonds (Sukuk) by 15%, Islamic investment funds by 4% and finally Islamic insurance (Takaful) by 1%. Islamic Banks apply a lot of Ughods or Islamic concept which are based on principle Islamic (Shariah), the key feature of Islamic banks are developing banking activities and diversification in accordance with the principles of Sharia, there are several types of Islamic instruments (Ughods), such as Mudharabah, Musharakah, Ijarah, Wadiah, Bai Bithaman Ajil and many more, which contributed increasing the profitability of Islamic banks by attracting to customers and investors [2,3]. The emergence of the Islamic banking system in Malaysia was relatively late, but witnessed a rapid and notable development early on, Malaysia has introduced a large number of banking services, which has contributed to the rapid growth of the Islamic finance industry and the attracted of the world's largest financial institutions, making it a choice for Islamic banking [4]. In this paper, we find the effect of Islamic Instruments (Ughods) adoption on the profitability of Islamic banks of Hong Long and HSBC in Malaysia.

2. Literature Review

2.1. Financing Instruments in Islamic Banks

Despite, the relatively short history of Islamic Banks compared to conventional banks, Islamic finance is one of the fastest growing financial industries in the world [5]. Islamic banks, the funds are use through multiple and legitimate financing instruments, where Islamic products and services offered by Islamic banks are characterized by flexibility and appropriateness that are suitable for all activities, whether commercial, industrial, agricultural, real estate. There are several types of Islamic financing, which contributed significantly to enhancing the profitability of Islamic banks and reduced risks, such as Murabaha, Musharaka, Mudaraba, Istisna'a, Peace financing, Ijarah, and Tawarruq [6]. Profit in Islamic banking is substantial because if the bank earn higher profits, it shows that the bank has sophisticated and is able to compete with conventional banking, there is empirical evidence proved by many studies that Islamic banks have made significant profits through apply of Islamic Instruments (Ughod), compared to of conventional banks [7]

2.2 Performance of Islamic Banks

The Islamic finance industry is one of the most dynamic and fastest-growing financial sectors in the global financial system. Over the past decade, Islamic banking has developed significantly and achieved growth rates that clearly exceeded the growth rates of conventional banks. According to [11], the annual growth rate

during the period 2009-2012 was 11%, Compared to 8.6% for traditional, the total return on assets during the period 2009-2012 was 51.1% in Islamic banks compared to 12.2% in conventional banks in the same countries, in 2012 averaged return on equity in the top 20 Islamic banks% 6.12 compared to 15% in the 20 largest banks traditionally. However, restructuring projects (launched in 2011) in a number of prominent Islamic banks are expect to boost the Islamic banking sector and increase profits.

2.3 Malaysian Banks with Islamic (Ughods)

Malaysia, having acquired knowledge and experience through actively pioneering initiatives and providing solutions in the Islamic banking industry, is indisputably making inroads into becoming the global center for Islamic funding, which expect outgrowth of domestic Islamic funding to continue outpacing that of conventional loans – with a four-year compound annual outgrowth rate (CAGR) of 12% over FY 2015-2020 F, compared to 2% for conventional loans (Bank Negara Malaysia, 2016). This is mainly underpinned by the efforts of Malaysian banks to fulfill Bank Negara Malaysia's (BNM) target to have Islamic financing make up 40% of total system loans. Further upside could come from improvement in financial inclusion and regionalization of Islamic finance [18, 19, 20].

3. Methodology

This study based on the analytical descriptive approach to identify the theoretical aspects of the research subject through a detailed

description of the concepts related to Islamic contracts in Islamic banks. For the analytical approach, this study was based on interviews, financial statements and annual reports, the concentrate on of the financial indicators used in the assessment of the profitability of Islamic Banks, and then determined the calculated values of these indicators through use of financial ratios, which is the most methods of financial analysis used on based of the financial statements [8,9, 10, 12,13,14, 15, 16, 17]. The study done on two Islamic banks in Malaysia of Hong Leong Islamic Bank and HSBC Amanah bank. The two banks were chosen as the sample in this research as the two banks apply many types of Islamic Ughods.

4. Data Analysis and Findings

Currently, Hong Leong Islamic Bank is starting on the expansion of modern products using the Islamic instruments such as of Mudharabah, Ijarah, Bai Bithaman Ajil, Ijarah Muntahia Bittamlik, Wadiah, and Murabahah. These initiatives are consider as a strategically move to boost the Hong Leong's brand status to gain better access to the global Islamic financial services market. From following table, we could see the diversity in the adoption of Hong Leong Islamic Bank for Islamic instruments (Ughods) and through which he earned significant profits with taking into account the global financial crisis in that period.

Table 1: Islamic Bank

Types of Ughod	2009 (RM'000)	2010 (RM'000)	2011 (RM'000)	2012 (RM'000)	2013 (RM'000)
Bai Bithaman Ajil (BBA)	1,602,357	1,941,026	3,028,703	7,781,477	8,764,050
Ijarah	15,895	11,689	4,436	106,341	100,264
Ijarah Muntahia Bittamlik (AITAB)	2,254,935	2,171,901	2,265,295	3,859,798	3,795,214
Murabahah	46,206	103,135	181,210	646,402	997,112
Mudharabah:					
1) Demand deposits	-	-	-	52,006	52,221
2) Saving deposits	569,093	636,172	723,078	1,051,193	1,145,208
3) General investment deposits	1,864,865	2,287,927	2,255,524	5,220,673	3,435,430
4) Special investment deposits	3,373,275	2,468,418	2,734,397	5,028,696	1,221,619
Wadiah					
-Total finance income and hibah	207,388	183,607	217,254	336,140	371,983
Number Of Ughods	6	6	6	7	7
Net profit (RM '000)	74,353	84,188	67,478	149,700	226,700

Source: Hong Leong Islamic Bank Berhad's annual report

From above table, we can conclude that the net profit from 2009 to 2010 and from 2011 to 2013 was increased. The net profit for the year 2010 was RM 84,188 compared to the year 2009 was RM 74,353, growth rate exceed 13%. The bank's profits increased from 74,353 in 2009 to 226,700 in 2013, a growth rate of 258% with an increase in the types of Islamic instruments (Ughods) used compared to 2009. Hence it shows that when Hong Leong Islamic Bank using more Islamic Ughod, the bank gets higher profit. As an example, in the year 2013, the Islamic instruments (Ughods) is increasing from 6 to 7 as the profit also increasing from RM 226,700 million compared to only RM 67,478 million in 2011.

HSBC had Islamic banking without been branded yet. However, after 10 years, HSBC decided to brand HSBC Amanah as its Islamic bank. HSBC Amanah practices 11 types of Islamic instruments. The bank uses variety method to keep its profit increasing and makes a good image for the bank itself. On the other hand, according to the annual report of HSBC Amanah Bank, we can see that the range of Islamic Ughods applied is between 9 to 11 types between 2008 and 2012. In 2008, the types

of Islamic Ughods that applied by this bank are Murabahah (cost plus), Bai Bithaman Ajil (deferred payment sale), Ijarah Thumma Al-Bai (ITAB) (hire,purchase), and Ijarah (lease), Bai Al-Inah (sell and buy back), Qard (benevolent financing), Mudharabah , Wadiah and others. Below is the table for profit of Islamic Ughods for HSBC Amanah Bank between 2009 and 2013:

From above table, we can conclude that the net profit from 2009 to 2013 was increased. The net profit for the year 2010 was RM 57,486 compared to the year 2009 was RM 22,721, growth rate exceed 101%. The bank's profits increased from 22,721 in 2009 to 133,240 in 2013, a growth rate of 486% with an increase in the types of Islamic instruments (Ughods) used compared to 2009.

5. Conclusion

Islamic finance is growing rapidly as it has many ingredients that ensure safety and risk reduction. Islamic banks provide a platform for Justice and fair distribution of wealth in Islam if they apply

correct Islamic Principles. Malaysia has introduced a large number of banking services, which has contributed to the rapid growth of the Islamic finance industry and the attraction of the world's largest financial institutions, making it a choice for Islamic banking. Based on the annual reports of Hong Leong Islamic Bank and HSBC Amanah Bank, We can conclude that the two banks achieved a significant growth rate 285% and 486%, respectively.

This showed that when of two banks using more Islamic Instruments (Ughods) the banks got higher profit. The above explanations reveal that products and services provided by the Islamic banking system have attracted depositors, customers and investors, and achieved, remarkable successes through applying some of Islamic Instruments (Ughods), where continued to grow even during the Global financial crisis.

Table.2: Islamic Bank annual data

Types of Ughod	2009 (RM'000)	2010 (RM'000)	2011 (RM'000)	2012 (RM'000)	2013 (RM'000)
Bai Bithaman Ajil	960 382	835 091	762 967	496 370	386 505
Ijarah	262	250	173	123	2777
Ijarah Thumma Al-Bai	250745	2 015 357	161 735	2 34 425	269 517
Murabahah,	692905	840 687	1 410 169	2 660 992	3 044 272
Musyarakah	-	46 143	552 958	1 707 395	3 255 938
Bai Al-Inah,	913 274	1 048 312	1 234 198	1 573 752	875 477
Bai Al-Dayn	-	112 504	267 797	292 850	259 995
Ujrah	-	168 041	358 786	765 008	561 630
Qard	953	388	6	-	-
Wadiah:					
-General Investment deposit	84 405	182 140	214 464	322 302	439 599
-Specific investment deposit					
-Other deposits	8 455	18 099	22 332	32 076	40 780
-Shareholder's fund					
	13 794	42 312	69 074	76 082	87 850
	17884	48 457	43 406	42 853	53 011
Number Of Ughods	9	11	11	11	11
Net profit (RM '000)	22,721	57,486	44,413	78,564	133,240

Source: HSBC Amanah's annual report

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