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The Impact of Financing Revenues of the Banks on their Profitability: An Empirical Study on Local Jordanian Islamic banks

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Abstract

The purpose of the study is to identify the impact of some financing revenues of Islamic banks operating in the Jordanian economy, represented in Murabaha (Cost plus), Mudaraba(Profit sharing) and Bai Ajil (deferred sale), on the profitability of these banks during the period (2006-2014).

The study' s population consists of all local Islamic banks operating in the Jordanian economy while the sample of the study includes both the (Jordan Islamic Bank for Finance and Investment as well as the Islamic International Arab Bank). To achieve the goal of the study, the different statistics methods and Multiple Linear Regression for Hypotheses testing has been used through the (E-views) program, the results of the study indicated to:

1. There is an impact of each of Murabaha, Mudaraba and Deferred Sale , all combined, on the profitability of the local Islamic banking sector in Jordan for the years of the study, under examination and analysis.

2. There is an impact of Murabaha, solo, on the profitability of the local Jordanian Islamic banking sector during the years of the study under examination and analysis.

3. There is an impact of Mudarabah, solo, on the profitability of the local Jordanian Islamic banking sector during the years of the study under examination and analysis.

4. There is an impact of the Deferred Sale, solo, on the profitability of the local Jordanian Islamic banking sector during the years of the study under examination and analysis.

Keywords: Murabaha, Mudaraba, Deferred Sale, Jordan Islamic Banks.

1. Introduction

Different results of financial crises, that occurred in many countries of the world and had had an impact, whether on the short or long term, on the economies of developed and developing countries, have shown that the weak disposition of investment and financial tools in the financial and investment institutions, such as Islamic and commercial banks, leads to inconsistency in achieving balance of liquidity, profitability and safety on one hand, and achieving growth and continuity of the financial sector in a shape that benefits all of shareholders and stakeholders on the other hand.

The Islamic banking sector is considered as one of the pillars of the financial sector, which affects and gets affected by local and global economic conditions. So, the work mechanism of this sector depends on applying the Islamic sharia law in all of its works, which means not to deal with interest, neither paying nor receiving.

Out of this principle, the Islamic banking sector gained a clear attention after the failure of many financial companies and institutions that stray far away from applying the principles of Islamic Sharia law.

This attention was demonstrated in the diversity of tools and modes of the Islamic finance as: Murabaha, Musharakah (joint venture), Mudarabah, BaiSalam (a contract in which advance payment is made for goods to be delivered later on) Ijara (Leasing) and Leasing ended with ownership, Deferred sale, Istisna'a (Manufacturing Finance), Muzara'hor Musaqah or Mugharasah (crop-sharing contracts) as well as unnamed contracts that do not contradict with Islamic Sharia law. The attention was also demonstrated in monitoring risks resulting from these tools, something that is reflected positively on the profitability of this sector.

2. Objectives of the study

1. Stand on the basic concepts of the finance revenues of the Islamic banks.

2. Acknowledge the impact of Murabahah on the profitability of the local Jordanian Islamic banking sector.

3. Acknowledge the impact of Mudarabah on the profitability of the local Jordanian Islamic banking sector.

4. Acknowledge the impact of deferred sale on the profitability of the local Jordanian Islamic banking sector.

3. The importance of the study

Many studies have addressed the issue of Islamic banking in multiple ways and methodologies in developed countries due to the emergence of the Islamic work there a long time ago and due to its rapid development, especially following the financial crises in many countries of the world. Then, these studies continued in less-developed countries, mainly in the Arab world in general, and in Jordan in particular, due to the newness of working in this sector and in some Islamic financing formulas.

So, the importance of the study lies in its attempt to acknowledge the impact of each of (Murabaha, Mudaraba and Deferred sale) on the profitability of this sector, which is characterized by not-using traditional methods for achieving profits, which include usury. So, the financing revenues in Islamic banks are a worth studying phenomenon in order to identify the sources that are adopted by these banks to maximize profitability.

4. The problem of the study

The problem of the study lies in the difficulties that the Islamic banks face, which are represented in the drop of the conceptual awareness among individuals regarding formulas of the Islamic finance and the shortage of these tools in comparison with the various tools of the commercial banking business, on one hand .And on the other hand, the sources of finance in the financial institutions are divided into: sources of debt and sources of possession. Islamic banks do not deal with debt because it is inconsistent with the provisions of the Islamic Sharia law.

Out of this emerges the importance of this study, which is to identify some of these resources, represented in Murabaha, Mudaraba and Deferred sale, and to clarify whether they do or don't affect the profitability of the Islamic banks for the period from 2006 – 2014.

The problem of the study can be summarized in the following main question:

Is there an impact of each of Murabaha, Mudaraba and Deferred sale on the profitability of the Jordanian Islamic banking sector for the period from2006-2014 ?

5. Literature review and Previous studies

The definition of the Islamic Bank, in general, indicates that it is the Islamic framework through which banking and financing businesses are organized, and thus achieve the mean that attracts resources from members of the community and administrate them effectively to meet the goals of the economic and social development. (Ajlouni, 2008) (AbulHawel, 2012).

Islamic banks offer many banking services, (Shehadeh, 2002) has pointed out to examples of such services:

1. Open current accounts, cheques payment and clearing and collecting commercial papers.
2. Open letters of credit, purchase and sale of travelers cheques.
3. Prepare necessary studies, provide various consultations and act as a marketing intermediary.
4. Provide banking facilities (such as the issuance of letters of guarantee), buy and sell securities and use bank cards according to their own legitimacy controls.

5.1 Islamic banks' profits

Companies, including banks, seek to achieve the target of profit in addition to liquidity and safety targets, where the profit is considered one of the essential goals for survival, growth and continuity on one hand, and an important indicator for the stakeholders on the other hand. (Haddad, 2010).

(Al-Hamdani, 2003) indicated that the profit is the increase in the capital as a result of working with it and administrating it. The case for banks is the same. First, the profit is a way to develop the capital as a source of self-financing, and secondly, it is an important indicator of the success of the bank's management in meeting the goals and facing the risks which the bank faces and thus achieve growth and continuity.

But there are some factors that affect achieving this target (Abu Hamad and Qaddouri, 2005) :

1. The desire to back the financial position by supporting the free reserves and allocation to face potential risks.

2. The desire to have liquidity to meet the withdrawals and any contingent liabilities, and thus reinforce the clients' confidence of the bank.

5.2 The Financing revenues in the Islamic banking sector

The Islamic banking sector has many investment tools through which it achieves profits , for example:

1. Murabaha (cost plus): is considered an Islamic term for selling an item at a price, that covers the costs in addition to the profit margin, and is being agreed upon by the seller and the buyer (Azzazi 0.2012).

(Thani et al, 2003) said it is a cost that is added to the sale, where the buyer may ask the seller for an item he wishes to get, and after the seller prepares it, the negotiating process over the profit begins.

2. Musharakah(Joint venture): is one of the important methods used by the Islamic bank to achieve profits. It is financing style based on the Islamic rule that considers work as the only source of wealth, and that the capital represents a value of a stored, previous work(Azzazi, previous reference .2012) .

(Chapra, 2004), meanwhile, defined it as a joint project agreement between the financier and the project's owner, where the participation percentage's predetermined and the profits would be distributed according to what was agreed upon. While bearing the loss would be according to per share.

3. Mudarabah (profit sharing): is an agreement between two parties, in which one party provides capital and that is called (RabAlmal , the Financier) , while the other party offers work. Profits would be divided according to proportions agreed upon during the session of conducting the contract. Mudarabah is different from Riba (Usury) , because the income in Mudarabah is pre-determined as a percentage of the profits not as a percentage of the capital (al-Hiti, 1998).

(Hawary et al, 2004) defined Mudarabah as a finance contract, where the first party provides the necessary funding, the Financier, and the second party provides its skill and experience, and is called Mudareb (the Entrepreneur).

Profits would be divided according to a fixed rate while the loss would be borne by the Financier.

4. The Deferred sale: is to finance on the basis of the profit margin. There are different shapes of the deferred sales such as: installment sales, Bai Salam, and Ijara (Leasing). Leasing is divided into: (operational leasing and leasing ended with ownership) (Ajlouni, previous reference , 2008).

5. Muzara'h (planting), Musaqah (irrigation) and Mugharasah (seeding) : through these tools, the owner of an agricultural land agrees with a farmer to plant, seed and irrigate the land in exchange of getting part of the fruits. (Al-Hiti, 2006).

6. Istisna'a (Manufacturing Finance): is a contract under which the bank commits to establishing installations (houses, roads, bridges ...) for the benefit of someone in exchange of a bonus that includes the cost of the facility, added to it a profit margin. The Islamic Bank entrusts a contractor to carry out the works. (Kuwait Finance House, 1992).

5.3 Previous studies

The subject of the Islamic banking business and sources of its financing revenues has been discussed in many studies, both locally and non-locally.

(Tamimi, Hamadi, 2014) study pointed out that the Deferred sale formed 5.7% of the total investment revenues in Islamic banks. (Sulaihat, Manaseer, 2015)study indicated that there is an effect of the Deferred sale on the profitability of Jordan's Islamic banking sector and the absence of such effect in the leasing ended with ownership .

Meanwhile, (Al-munshed, al-Saadi, 2013) study said that the Islamic banks have an efficiency in administrating their resources and they significantly rely on Murabaha, as its relative weight reached 40% compared to the total investments.

(Zaytoun, 2010) study urged the Islamic banks in Jordan to diversify investment methods, so they won't focus on a single source without the other . It also urged them to necessarily develop long-term saving methods to help increase their deposits and achieve a growth in the economic development and thus support the finance process of these banks.

On the non-local level, (Izhar and Asutaya 2007) study suggested that administrating the funds, that don't include interests, has no impact on the profitability but the study found an impact of the inflation on the profitability of the Islamic banks .

While (Tuli and Tilva) study stressed that the traditional banking system did not provide a climate that recognizes and acknowledges the restrictions brought by the Holy Koran to establish an economic system free from all forms of exploitation. Therefore, the Islamic banking work gained a broad acceptance in Muslim countries where the percentage of growth in the previous twenty years reached about 15%.

The study of (Tlemsani and Matthews) has shown that (Murabaha, Leasing and the Diminishing Musharakah) lie in totally owning it or in participating with the client. While the finance in the traditional system is a pure lending process . The study also ruled out the possibility of the success of applying an ideal Islamic system in a world that aims at achieving the maximum amount of profit.

6. Study Hypothesis

Through the main question of the study, the following main hypothesis can be formulated:

The main Null Hypothesis: there is no effect of a statistically significance, for each of the Murabaha, Mudaraba and Deferred sale on the profitability of the Jordanian Islamic banking sector for the period under examination and analysis.

The main Alternative Hypothesis: there is a statistically significant effect for each of the Murabaha, Mudaraba and Deferred on the profitability of the Jordanian Islamic banking sector for the period under examination and analysis.

7. Methodology and Study Population

7.1 Methodology

The study depended on the analytical method through doing the statistical analysis of the independent variables on the dependent variable related to the subject of the study in order to cover the analytical part of the study, in addition to the descriptive method through relying on books, periodicals, previous studies and financial reports of the banks of the study' sample, whether the direct or the indirect ones, to cover the theoretical part.

7.2 Study Population and Sample

The study population consisted of islamic banks operated in the Jordan. The study sample were choosen intentionaly included (2) banks namely Jordan Islamic Bank for Finance and Investment as well as the Islamic International Arab Bank.

8. Results and Discussion

8.1 Data Presentation

The descriptive variables of the study's variables were calculated as in table (1), where the arithmetic mean and the standard deviation of each of the (Deferred Sale, Murabaha, Mudaraba, profitability of the Jordanian Islamic banking sector) were calculated.

Table (1) descriptive analysis of the study's variables

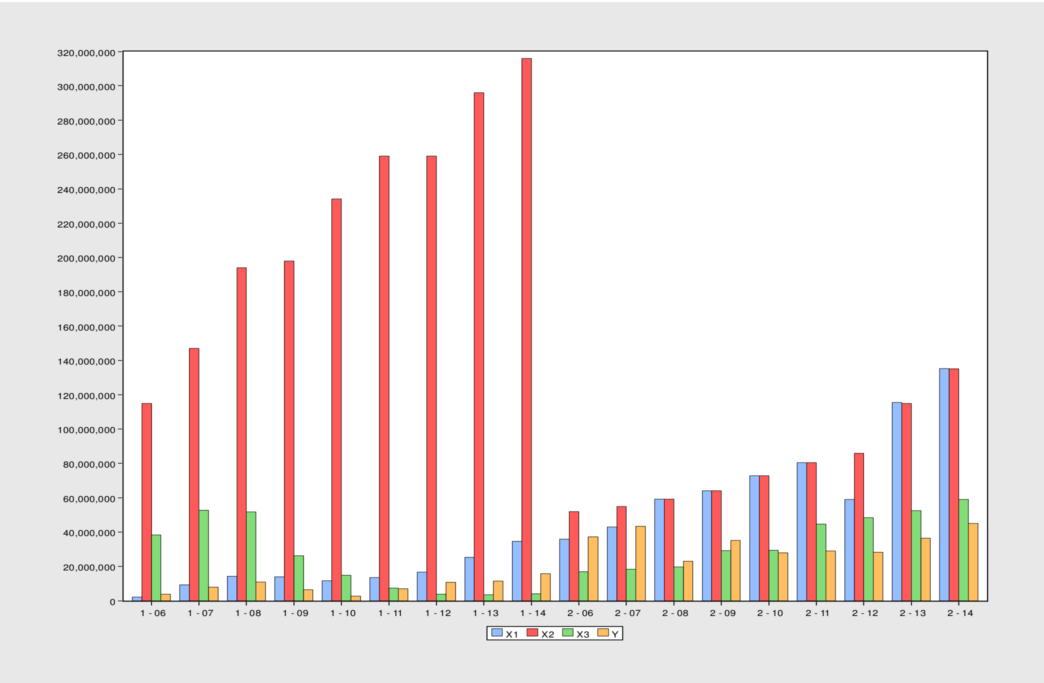
Y1	X3	X2	X1	
6758616	14375754	170500000	12543124	**Median**
9206664	16833491	93939992	11762779	**Std. Dev.**
2.20799	1.08265	0.09662	0.77181	**Skewness**
7.54104	2.80557	1.63130	2.55698	**Kurtosis**
23.40452	2.75703	1.11455	1.50446	**Jarque-Bera**

X1:Deferred sale X2:Murabaha X3:Mudarabah Y1: the profitability of the Islamic banking

Through the table (1), you can see that the arithmetic mean of the independent variables of the study, represented in Deferred sale, Murabaha, Mudaraba, amounted respectively (12,543,124 million JDs, 170,500,000 million JDs,14,375,754 millionJDs), and with a standard deviation that amounted respectively (11,762,779 million JDs , 93,939,992 million JDs dinars, 14,375,754 million JDs).

Through that, you can see that there is a consensus in the study' sample in granting each of the Deferred sale, Murabaha and Mudarabah, in a way that maintain a balance between the targets of profitability and liquidity on one hand, and maintaining safety in administrating these moneys on the other hand. The dependent variable of the study, represented in the profitability of the study' sample, has amounted on the arithmetic mean (6,758,616 million JDs) and on the standard deviation it reached (9,206,664 million JDs). This indicates that there are differences in the profitability of the Islamic banking sector due to the performance of these banks from one year to another on one hand, and the differences between the size and the structure of the bank on the other hand.

Figure (1) shows the independent and dependent variables combined for the study' sample and for the period under examination and analysis.



x1: Deferred sale x2: Murabaha x3:Mudarabah y1: the profitability of the Islamic banking sector

Figure (1) indicates that the finance tool, represented in the Murabaha, has gained the largest share among the rest of the financing tools in the investment processes of the Jordan Islamic Bank for Finance and Investment .While you can notice stability of this tool in the Islamic International Arab Bank due to the age and size of the bank. And for the rest of the other tools, you can notice stability and convergence regarding the sample.

8.2 The Pearson correlation matrix

Table (2) displays the Pearson correlation matrix which makes it clear that correlation coefficients between the independent variables (deferred sale, Murabaha, Mudarabah) and the dependent variable (the profitability of the Islamic banking sector) were varying in terms of power, and were all linked by proportional relationships.

Table (2) Pearson correlation matrix

Y1	X3	X2	X1	
0.8385	0.2496	0.5154	1	**X1**
0.0189	0.2521	1	0.5154	**X2**
0.0449	1	0.2521	0.2496	**X3**
1	0.0449	0.0189	0.8385	**Y1**

x1: Deferred salex2: Murabaha x3:Mudarabah y1: the profitability of the Islamic banking sector

From table (2)you can see a strong, positive correlation between the deferred sale and the profitability of Jordan's Islamic banking sector that reached (0.83). And there is a strong, positive correlation between Murabaha and profitability of the Jordanian Islamic banking sector that reached (0.71). While there is a weak, positive correlation between Mudarabah and the profitability of Jordan's Islamic banking sector that amounted to (0.24). This was due to the fact that these variables are originally one unit but were divided for the purposes of this study.

8.2 Hypotheses Testing

Table (3) displays the results of the multi-test that is related to the study's main hypothesis.

Table (3) results of testing the study's main hypothesis

Dependent Variable (Y 1)			
Method: Panel ELS Least Squares			
P- Value(Probability)	T-Test	Coefficient	Variables
0.000	17.10203	0.837276	X1
0.002	8.994738	0.045123	X2
0.008	6.286508	0.227900	X3
(R^2) :96 %			
Test) DW :(2.312957			
Probability0.0000 :			

x1: deferred sale x2: Murabaha x3: Mudarabah y1: the profitability of the Islamic banking sector

According to to table (3) the results which show that the value of (Durbin-Watson) has pointed out that there is no (Autocorrelation) between the error terms in the regression equation, which valued (2.312957). Accordingly, the multi-test results reject the Null hypothesis and accept the main Alternative hypothesis that states that there is an impact of the Murabaha, Mudaraba and Deferred sale, all combined, on the profitability of the Jordanian Islamic banking sector for the period under examination and analysis.

Also, the impact of the independent variables indicated that there is a high explanatory power of the independent variables on the dependent variable, the profitability of the Jordanian Islamic banking sector. The value of the coefficient of determination R2 reached (96%). Which means that it explained 96% of the change in the profitability of the Jordanian Islamic banking study' sample.

Regarding the test results, shown in table (3), in an individual shape of the independent variables and their impact on the dependent variable, you will notice that there is an effect of the Islamic Murabaha on the profitability of the banking sector, where the significance level reached (0.000) and this means rejecting the Null hypothesis, which states that there is no effect of a statistical significance of Murabaha on the profitability of the Islamic banking sector, and accepting the Alternative hypothesis that says there is an effect of Murabaha on the profitability of the Jordanian Islamic banking sector for the period under examination and analysis.

You can also notice that there is an effect of Mudarabah on the profitability of the Jordanian Islamic banking sector, where the significance level reached (0.002), while the significance level of the Deferred sale on the profitability of Jordan's Islamic banking sector reached (0.008).

This sub-hypothesis also rejects the Null hypothesis and accepts the Alternative hypothesis due to the existence of an impact of the Deferred sale on the profitability of the Jordanian Islamic banking sector for the period under examination and analysis.

8.3 Discussing results of the hypotheses

Results of testing the study's main hypothesis, as described in table (3), have shown that there is an impact of each of Murabaha, Mudaraba and deferred on the profitability of the Jordanian Islamic banking sector during the period from 2006 until the year 2014.

These results indicate that the Jordanian Islamic banking sector depends on an investment policy based on diversification, moderately, through using all available and various tools which comply with principles of Islamic law as Murabaha, Mudaraba, deferred sale and other tools of financing revenues, in a way that reflects on achieving profitability.

Since the financing revenues are considered an important source for achieving profits in different economic sectors in general, and the Islamic banking sector in particular, you can notice an increase in the investment in these tools by the Islamic banks in order to achieve the perfect administration of the resources and thus increase the market share.

Meanwhile, the results of testing the sub-hypotheses that are related to Murabaha, Mudarabah and Deferred sale, as described in table (3),indicate that the Jordanian Islamic banks move towards intensifying efforts for more investment in these tools, supporting strategies for developing them and attracting individuals to invest in these tools. So, You can see that the Islamic banks had simplified and clarified procedures related to Murabaha, and kept the promise in these contracts.

In Mudarabah, the banks bear the loss (loss to the financier),on condition not to exceed the entrepreneur. While in the Deferred sale, the Islamic banks works on the basis of Musawamah (bargaining) with the installments.

Thus, all these measures indicate that the boards of directors of this sector move towards supporting the mechanism of dealing with these tools in order to achieve a positive return reflected on their profitability and market value.

9. Conclusions:

1. Through the descriptive analysis of the variables of the study, as they appear in figure (2), you can notice that there is a kind of moderation in the banking sector's administration of its funds, excluding Murabaha, averting them liquidity and credit risks.

2. Due to the difference in the age and size of the study' sample, you can notice a difference in the profitability of the Islamic banking sector during the years of the study.

3. There is an impact of the investment tools, represented in Murabaha, Mudarabah and Deferred sale, which the Islamic banks depend on for their profitability.

10. Recommendations:

1. The banks need to increase the exerted efforts to raise awareness of investing in these tools, especially in light of the increased competition on the local and regional levels.

2. Seeking to increase the market share by targeting a new class of clients and other market segments, that are originally not targeted.

3. Developing and enhancing the quality of provided services to keep pace with the tremendous developments in the field of business and finance.

4. Clarifying and unifying the fatwas (Islamic term of legal opinions) for these transactions.

5. Training and improving the performance of employees in the Islamic banking sector, which will reflect positively on attracting more individuals.

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