

CHAPTER FIVE CONCLUSION AND RECOMMENDATION

5.1 Conclusion

In this research paper, the main determinants of Islamic banks' asset growth have been analysed using Vector Autoregression (VAR), Vector Error Correction Model (VECM) procedures with analyses of Impulse Response Function (IRF) and Forecast Error Variance Decomposition (FEVD). The IRF and FEVD analysis confirm the finding of Granger Causality Test on bi-directional causality between asset growth and industrial production index, with the following conclusions:

- a. There is one bi-directional causality variable found in the test such as inflation and interest rate but it does not answer the hypothesis that states industrial production index has bi-directional causality with asset growth. None shows there exist bi-directional causality between LNIP and ASSETG, therefore, the conclusion is to reject alternative hypothesis 1 and accept null hypothesis. This phenomenal finding is perhaps explained by the fact that market share of Islamic banks' asset of 2.5% is too small to give impact to production output in the country. Likewise, the production output does not really give impact to asset growth of Islamic banks because Islamic bank is still considered as a new alternative compared to the conventional one to finance economic activities in the country.
- b. VECM confirms that number of office branch and channelling affects asset growth positively and the most stable variable when interacts with asset growth compared to other variables. Although its contribution is insignificant (1%) but it promises long term impact. Therefore, the Islamic banks should expand their outlets by launching more office branch and channelling.
- c. VECM confirms that number of human capital affects asset growth positively. Although it is not significant (2%) but it promises long term impact the same as number of office branch and channelling. Thus, to

support the growth, preparation for more human capital is required.

- d. VECM confirms that inflation contributes major negative impact to asset growth by 20%. This certainly explains the impact of increasing trend of inflation that occurred during the period of observation especially after the crisis in 2008. Price distortion affects income distribution and leads uncertainty for investment thus reduce asset growth of Islamic banks.
- e. VECM confirms that interest rate also contributes negative impact to the asset growth by 9% at the end of the period of analysis and it is recorded as the variable that is not stable when interacts with asset growth in the longest period compared to other variables. As inflation serves as factor to interest rate, the finding on interest rate leads to the same conclusion. Although the interest rate has become one benchmark for Islamic banks in determining margin and profit sharing ratio, the bank has its own way to apply margin and profit sharing mechanism in Islamic banking transactions. Thus, with decreasing trend of interest rate in 2009, it was not too sensitive for Islamic banks and customers to respond.
- f. VECM confirms that industrial production index contributes positively to asset growth by 17%. Although both industrial production index and asset growth show no relationship in Granger Test but IPLN shows positive impact in IRF and FEVD. It explains that Islamic banks interact with real sectors in their banking transaction and promises long-term positive impact.

All identified factors (number of office branch and channelling, number of human capital, and industrial production index) are concluded to influence the Islamic banks' asset growth positively while interest rate and inflation are concluded to influence the Islamic banks' asset growth in negative way. Therefore, the conclusion is to reject null hypotheses and accept H_2 , H_3 , H_4 , H_5 and H_6 . From IRF and FEVD analyses, all variables are ranked from the most to the least in their impact to asset growth, such as 1) inflation, 2) industrial production index, 3) interest rate, 4) number of human capital, 5) number of office branch and channelling.

5.2 Recommendation

The findings of the research suggest some recommendation to several concerned parties mentioned in Chapter One such as:

- a. Opening more office branch and channelling is one strategic plan to accelerate the growth of Islamic banks. Concurrently, more capable human resources to run Islamic banks are absolutely required. The tools have been provided but lack of human resources to operate Islamic banks may lead to ineffectiveness and hinder the Islamic banks' asset to grow. The initiatives to set up educational institutions that offer special skills in Islamic banks should be welcomed. There should be more government incentive especially from Ministry of Education and Ministry of Religious Affairs to facilitate the opening of institutions that offer Islamic economics studies or in particular Islamic banking studies. In addition, standard of curriculum and educational quality management system to ensure eligible and capable graduates are also required.
- b. Islamic banks should offer more variety of products to attract real sectors as they promise growth for Islamic banks. To date, consumptive financing is more dominant than productive financing, and that does not count yet contribution of Islamic banks to real sectors or national industries at large.
- c. With accounting background employed, it is expected that the research finding will provide more perspectives for the sake of development of accounting standards particularly on the issues of asset. Some variables used in the research are macro indicators therefore it is appropriate to relate the nature of Islamic accounting standard i.e. asset to the issues of IFRS convergence in lieu of globalization of accounting.

5.3 Limitations of Research

- a. This research does not take into consideration of two dummy variables such as government support and product development due to a short period of observation. The issuance of Islamic Banking Act that is labelled as government support occurred in 2008 while iB logo that is associated as product development launched at the end of 2008. These two dummy variables may provide more complete analysis on the factors affecting the asset growth. Since these two variables are excluded from this present research, any judgement made should demonstrate limitation. In other words, for decision-making process, the impact of these two dummy variables must be taken into consideration and not only from the variables as recommended from this research.
- b. This research works on aggregate total of Islamic banks thus conclusion and recommendation from this research may not apply similarly to individual bank.