DETERMINANTS OF PROFITABILITY OF ISLAMIC FINANCIAL INSTITUTIONS IN KENYA

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D63/84391/2016

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF SCIENCE FINANCE, UNIVERSITY OF NAIROBI

NOVEMBER 2020

DECLARATION

This research project is my original work, and it has never been presented in any other university for the award of any degree

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ACKNOWLEDGEMENT

DEDICATION

I dedicate this project to my parents, Hooyo Nuria Abdi Ali & Abo Musa Issa for their full support and constant encouragement throughout my education and more specifically during my higher education. I also dedicate it to my Uncle Somane Ismail who has been of constant help during my Degree program. God bless them abundantly.

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ABBREVIATIONS AND ACRONYMS

CBK   Central Bank of Kenya

CMA   Capital Market Authority

IRA   Insurance Regulation Authority

KCB   Kenya Commercial Bank

MM   Modigliani–Miller

SPSS   Statistical Package for Social Sciences

ABSTRACT

Compared with their conventional counterparts, majority of the Islamic financial institutions do encounter challenges with their profitability. Such challenges are characterized by a relatively higher proportion of operating expenses relative to their net income. Hence, the motivation of this study is to seek and establish the determinants of profitability of these Islamic financial institutions in Kenya. The study adopted descriptive survey design targeting 7 Islamic financial institutions in Kenya. Census was used and thus all the 7 firms were covered. Primary and secondary data was collected covering a period of 2010-2019. Descriptive statistics covering means and standard deviations helped to summarize the data. For drawing of relevant inferences, factor analysis was used. The study noted that majority of the Islamic financial institutions are posting financial losses and this is attributed to the following six factors: firm specific factors; regulatory factors & competition; size, religiosity & regulations; nature of market; investment framework; and tax regime against zakat. The study concluded that firm specific factors had the largest contribution towards profitability of the Islamic financial institutions while tax regime had the least effect. The study recommended that policy makers at the Central Bank of Kenya should establish regulations and guidelines for Islamic financial institutions that are separate from the other conversional institutions. In designing investment regulations and policies, the Capital Market Authority (CMA) should consider the fact that interest (riba) is forbidden Islamic financial institutions. The Kenya Revenue Authority should give special consideration to these Islamic financial institutions in regard to taxation since they pay Zakat (which is compulsory) besides the normal tax that is paid to the government resulting into an incident of double taxation of their incomes. The various practitioners including Islamic banking scholars should establish a lobby for representation on the boards of the regulatory bodies in the financial sector in Kenya. The senior management team of the Islamic financial institutions should capitalize on firms' specific factors to enhance profitability of their institutions. The management of the Islamic financial institutions should work to improve on their firm specific factors like the level of management efficiency and the amount of Nonperforming loans. The study was limited to a smaller sample size of 7 firms which were the Islamic financial institutions. The study recommended further studies to be undertaken focusing on the variables covered but in relation to financial performance unlike profitability.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Profitability is an important construct that has gained relevance in the corporate finance literature (Köhler, 2019). Since financial performance had been over-emphasized in corporate finance, much of the focus has presently turned to profitability (Chakraborty & Das, (2018). The two important proxies of profitability are returns the firm generates on its assets (ROA) and equities (ROE). Given its growing recognition, the current policy debate in corporate finance has shifted to establishing the determinants of profitability of the firm. Establishing such determinants of profitability of the firm would guide policy formulation for even better performance of the enterprises (Singh & Singhi, 2017).

The financial intermediation theory, modern portfolio theory and Modigliani and Miller (MM) theory provided anchorage to the study. The financial intermediation theory acknowledges the role played by financial institutions in allowing people to access credit facilities in the economy (Allen & Santomero, 1997). This means that improving profitability of the financial institution would enable them to effectively carry out their intermediation role in the economy. On the other hand, the MM theory is premised on the fact that there are no taxes in the economy (Modigliani & Miller, 1958) and this probably enhances operational performance of the firm. On the other hand, the portfolio theory by Markowitz (1952) provides the rationale as to why investors hold on their portfolio so as minimize risk exposure and maximize on returns generated and thus better profitability.

Islamic financial institutions cover four fully fledged Islamic commercial banks, the other conventional commercial banks that offer Islamic banking through window and the Islamic insurance firm (Takaful Insurance) (Saida, 2014). These institutions are shown in appendix II. The prohibition of interest (riba) and other unique and Sharia requirements have been key pillars guiding the Islamic financial institutions around the world. However, compared with their conventional counterparts, majority of these Islamic financial institutions do encounter challenges with their profitability (Mutai, Namusonge & Sakwa, 2018). Such challenges are characterized by a relatively higher proportion of operating expenses relative to their net income. Hence, the motivation of this study is to seek and establish the determinants of profitability of these Islamic financial institutions in Kenya.

1.1.1 Profitability

Profitability is determined by the value of net income once the expenses have been netted from the value of gross profit of the enterprise (Supiyadi, Arief & Nugraha, 2019). Profitability is a construct of financial performance of the firm that gauges the extent which the entity is able to maximize the wealth of its shareholders (Singh, Darwish & Potočnik, 2016). The ultimate goal of the firm is to maximize the wealth of the shareholders which is reflected in profitability. An organization is said to be profitable when it generates value that exceeds the related expenses.

The information for determining profitability of the entity can be obtained from financial statements that are prepared at the end of the financial year (Ullah, Uddin & Ahmad, 2020). Such statements include the income statements and the statement of financial position of the entity. Profitability of the entity can be determined based ion different indicators like gross profit or net profit. The use of ratio is the best way of determining profitability of the enterprise (Khan, Ijaz &

Aslam, 2014). This study operationalized profitability by use of the rations of the returns generated by the firm on assets (ROA) and equities (ROE).

1.1.2 Determinants of Profitability

Profitability of the firm is an important construct that is affected by various determined according to different authors. For instance, Insani and Muflih (2019) identified these determinants of profitability to include size of the entity, diversification of income, the level of liquidity and the costs incurred in their operations. Samail, Zaidi, Mohamed and Kamaruzaman (2018) identified liquidity, capital adequacy and the asset quality of the firm. Khan, Ijaz and Aslam (2014) identified the size of the enterprise, gearing, the level of non-performing loans, the operational efficiency and the amount of deposits.

Kyzy, Thim and Choong (2012) suggested credit risk, the rate of liquidity and the concentration of the firm. Guyo (2013) established interest spread capital adequacy, size, liquidity, management efficiency and asset quality. The other important factors that may have an effect on operational performance of the firm include the investment framework, tax system, the nature of the market and competition (Omar, 2016). All the reviewed determinants of profitability of the firm can be broadly categorized as either internal or external determinants.

1.1.3 Islamic Financial Institutions in Kenya

Islamic financial institutions deal in Sharia compliant products (Ullah, Uddin & Ahmad, 2020). Sharia rules prohibit charging interest (riba) on financial products that the Islamic institutions offer to their customers. As such, neither is the loans taken or issued to customers on interest basis (Gekara, 2019). Rather, these institutions carry out their operations in the same way as a trading entity that engage in buying, selling and entering in various forms of contract like Mudharaba and

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Musharaka. Furthermore, all unlawful sources of revenues like engagements giving interests or gambling cannot be used to financing the investments or profit of these institutions (Kasmani, 2013).

In Kenya, these Islamic financial institutions cover the fully fledged Islamic commercial banks, the other commercial banks that offer Islamic banking products across the window systems and the Islamic insurance institutions (Mohamed & Kwasira, 2012). Relative to their conventional counterparts, the Islamic financial institutions have been facing challenges in regard to their profitability. This is seen in their limited expansion ability with most of them having limited branch networks (Ashraful, Chowdhury, Haque & Masih, 2017). One would expect profitability of the Islamic financial institutions to be at par with the growing Muslim population in Kenya. Hence, the motivation of this study is to establish the determinants of profitability of these Islamic financial institutions in Kenya.

1.3 Research Problem

Profitability is an important goal that drives existance of the firm. Covering constructs like ROA and ROE, profitability has emerged as an important goal of the enterprises (Gólcher-Barguil, Nadeem & Garza-Reyes, 2019). Because of its increased importance in corporate finance, most scholars are increasingly seeking to bring out the factors that inform profitability of the enterprise. There are so many determinants that can have an influence profitability of the firm which can broadly be classified into internal as well as external factors (Köhler, 2019). The modern portfolio theory argues that firms exist to minimize on risks and maximize on returns hence profitability (Markowitz, 1952). The financial intermediation theory on the other hand indicates that enhancing profitability of a financial institution is among the means of boosting its intermediation role in the

economy (Allen & Santomero, 1997). The MM theory on the other hand focuses on taxes and their effect on profitability of the entity (Modigliani & Miller, 1958).

In Kenya, there is wide range of Islamic financial institutions covering the fully fledged Islamic commercial banks, the other commercial banks that offer Islamic banking products on a window basis and the insurance firms (Mohamed & Kwasira, 2012). The unique feature of all these Islamic financial institutions is that they specifically deal in products that are Sharia compliant. Such are the products that do not attract interest (riba). In comparison to their conventional commercial banks, these Islamic financial institutions have been facing challenges with their operational performance that have probably limited their ability to expand the branch network (Nawaz & Haniffa, 2017).

Globally, the study by Insani and Muflih (2019) focused on determinants of performance of the Islamic banks using Indonesia as the case where inflationary pressure, the costs of operation and liquidity risk was seen to predict the ability of the Islamic banking entities to perform. Samail, Zaidi, Mohamed and Kamaruzaman (2018) conducted a study in Malaysia to bring out the determinants of financial performance of the Islamic entities where management of liquidity was identified as one of the determinants. The study conducted by Khan, Ijaz and Aslam (2014) focused on Pakistan to bring out the determinants of profitability of the Islamic banking entities. Among the identified determinants include the banking size, the ratio of no performing loans and adequacy of capital.

Locally in Kenya, Omar (2016) looked at Islamic banking and its linking with ability of the institutions to financially perform. It was noted that liquidity and the size of the banking entities have direct link with financial performance. Saida (2014) focused on the determinants of Islamic

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banking as a practice. Kasmani (2013) looked at the determinants of growth of the Islamic banks while Mutua (2017) and Njagi and Gekara (2019) focused on fully fledged Islamic banks alone.

Therefore, in as much as there is plenty of literature Islamic banking, these studies have failed to link the identified determinants with operational performance but instead focus on the general performance, financial performance or growth. Much of these studies focus on Islamic banks with little focus on Islamic financial institutions which include insurance firms like Takaful besides the banks. Thus, the current study sought to expound on the available little while bridging the conceptual and contextual gaps from the previous studies to relate some of these determinants with profitability of the Islamic financial institutions in Kenya. Therefore, in addition to the Islamic banks, the study will also cover the insurance firm referred to as Takaful Insurance unlike majority of the previous studies that largely focused on Islamic banks in isolation.

13 Research Objective

To establish the determinants of operational performance of Islamic financial institutions in Kenya

1.4 Value of the Study

The Central Bank of Kenya would rely on the findings of the study to formulate sound policies that would promote Islamic banking in Kenya. The Insurance Regulatory Authority would be able to establish relevant policies and regulations to guide insurance firms dealing in Sharia compliant products. The Capital Market Authority would be able to strengthen the investment framework that is aligned with the sharia compliant products.

The management of the respective Islamic financial institutions would be able to focus on the identified factors so as to enhance profitability of their institutions. The practitioners including

Sharia scholars would be able to understand the salient factors determining profitability of the Islamic financial institutions in Kenya. The study would contribute towards the knowledge and theories on determinants of profitability with reference to Islamic banks.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter is set out to review information on theories that will provide anchorage to the study. The empirical literature is also provided. A summary of the reviewed literature is provided with the associated gaps.

2.2 Theoretical Review

This section reviews the theories that shall inform the current study.

2.2.1 Financial Intermediation Theory

Allen and Santomero (1997) formulated the theory showing that financial institutions with intermediaries are able to minimize the costs of transactions by exchanging information with lenders, financial institution to borrowers, from the clients who are the financial institutions. Financial intermediaries include elements such as of the agents of the banks, customer service, brochures, and booklets that influence the functioning of the market, credit networks, and economic effects. These intermediaries have liquidity, and make changes in asset characteristics, according to Jensen and Meckling (1976). The task of the financial intermediaries is to inform the customers about the available financial product and services and which they qualify to access. These intermediaries help in improving the consumers' financial literacy on goods and services which would help them and boost their financial standings.

Financial institutions have clear information in an ideal and efficient market, and engage in sharing this information with their clients. As such, they help in boosting their financial literacy and awareness that they used to earn large payoffs in both short-term and long-term investments. The

theory was used to anchor the dependent variable profitability since enhancing performance of Islamic banks helps them to realize their financial intermediation role.

2.2.2 Modern Portfolio Theory

Harry Markowitz introduced the theory of portfolios in the year 1952. The theory was based on two key principles: each investor has an objective of maximizing his return for any degree of risk to which the company is exposed. The second principle is that a diversification of unrelated securities will reduce risks. The theory is based on the assumption of investors preferring to invest in a portfolio with minimum risk for a given level of return. This is an indication that investors will invest in high-risk business only when they are in a position of expecting high returns. The theory assumes that there are two types of risks; systematic risk of the market that cannot be minimized through diversification, and the unsystematic risk specific to certain stocks implying that it can only be diversified as an investor increases the number of portfolio stocks.

This theory has been applied by most of the researchers for example; Obed (2018) extended the portfolio theory to the strategic allocation of Pension Funds in Kenya. Through looking at the active and passive management, Markowitz presented a solution to the risk problem through the mean-variance model. According to Markowitz model for optimization of portfolio, there is optimal assets allocation as per the need of investors. Lubatki and Chatterjee (1994) applied the principle of portfolios to the domain of corporate diversification and suggested that by risks can be reduced by diversifying into similar types of business. Kristian, Carl and Jakob (2006) applied the portfolio theory and gathered evidence that active portfolio management outperforms the passive benchmark during the time frame selected.

The portfolio theory has earned many critics e.g. Kritzman (2001) pointed out three criticisms while marking 60 years of Mean optimization and variance. Kritzman claims that the theory has been used by old technology investors as a garbage critics out of Portfolio theory model that optimization does not turn implausible inputs into superior out of sample portfolio. The theory's critics further argue that optimizing maximizes errors, so optimizing mean-variance is hypersensitive to input errors.

2.2.3 Modigliani and Miller Theory

The Modigliani–Miller (MM) theorem was developed in 1958 by Franco Modigliani and Merton Miller. This theory, similar to the approach to net operating income, forms the basis for modern capital structure thinking. The MM approach argues that capital costs are independent of the degree of leverage at any portion of debt-equity. The theorem provides operational justification for constant capital costs at any given degree of leverage. The MM theory notes that in the absence of tax, bankruptcy costs, asymmetric knowledge and agency costs in a firm's productive market value are not influenced by the firm's level of investment in any price mechanism of a firm. The theory further stresses the idea of irrelevance of capital structure; such that a company's dividend strategy and the way companies raise capital do not matter.

According to the approach MM, the value of the firm and the overall cost of the company is constant at any degree of leverage, so the degree of leverage is independent of the capital structure. The approach of MM further implicates that capital costs are equivalent to the capitalization rate of a financial risk premium and a pure equity stream, the minimum cut-off rate is entirely independent of how the firm's ventures are financed. Many researchers have applied the Modigliani – Miller theorem theory to encourage and extend the use of leverage. However, if the

principle is misinterpreted in practice it may be used to explain unrestricted financial leverage but does not take into account the risks posed by excessive leverage ratio.

2.3 Determinants of Profitability of Islamic Financial Institutions in Kenya

There are other underlying factors like the investment framework, the tax system versus Zakat, the nature of the market and competition which are evident in Kenya.

2.3.1 Investment Framework

All financial institutions have a goal and usually develop investments strategies that yield assets to generate good real returns both in short and long term while adhering to risks. This makes those investments that are less risky with good market returns more attractive, long term in nature and competitive unlike those of the opposite (Al-Homaidi, Tabash & Ahmad, 2020). Most of those investments are usually designed in such a way that they are a factor of interest rate and a time bond. A good example is the government bonds that are a less risky and considered as a risk-free investment but makes margin based on a certain rate as an interest. Interest (Riba) is forbidden (Haram) in Islam this closes the investment opportunity for fully fledged Islamic institutions to trade on those bonds (Olweny & Chiluwe, 2012).

2.3.2 Tax Regimes against Zakat

Zakat is an Islamic term and refers the obligation that an individual/firm must donate a certain proportion (Usually 2.5% of the total wealth) each financial year to charitable individuals/institutions e.g. needy people whose worth does not reach the Nisab (minimum amount that a Muslim must have before being obliged to give Zakat, estimated as 3 Ounces/87.48 grams of standard or cash equivalent per the market value of gold) threshold (Asnita, Zulham & Nasir, 2019). It is mandatory and a pillar of Islam. On the other side (in Kenya) tax being a compulsory

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financial charge, a legal obligation imposed upon to every citizen as a taxpayer (Individual or firms) that must be paid to the government with specific timeliness per the law; Islamic financial institution being legal entities and are obliged to settle taxes they should on the other hand pay Zakat for it to fully comply as fully fledged Islamic institution. This results a double taxation and a burden to those institutions unlike the conventional financial institutions. This in long run affects its value, profitability as well as its share price value, among others (Zapor, 2016).

2.3.3 Nature of the Market

Population size is a factor of demand and thus market size. Kenya being majorly a Christian nation with high number in terms of population size might not care much on the difference of the financial institutions and its religious permissibility (Halaal or Haram) rather based on financial gains (Demirguc-Kunt & Huizinga, 2001). Also, since deposits/investments are taken/invested with presumption to predetermined yield as an interest most of the population will invest or deposit on gain making available institutions (Yusaf & Aziz, 2015). Since interest is not permissible in Islam fully fledged institutions cannot take as a deposit or as investment assets with expectations on predetermined gains. This makes them unattractive to the majority. The lower the value of investment or deposit, the higher the effect of operational costs and thus the reduction in profits generated (Hassan& Bahsir, 2003).

2.3.4 Competition

With less competitive advantage over the conventional competitors and with small market share, many of conventional institutions have and are developing a strategies to compete in what they call "Islamic Finance Window" this is branding a section of the conventional institution to Islamic practicing side (Rasiah, 2010). Example includes Barclay's Islamic sharia banking, KCB Sahl banking, and Standard Chartered Islamic banking. This reduces the chances for market penetration

as well as market survivability of the Islamic financial institutions in Kenya due to the operational costs that are involved.

2.3.5 Macro-economic Level Factors

These factors include the rate of inflation, the national GDP, the supply of money, interest rates, the rates of employment and levels of income of the customers. Sufian and Habibullah (2010) noted that GDP has a direct link with profitability. However, Naceur and Goaied (2006) failed to establish a link between GDP and profitability of the banking entity. Boyd, Levine and Smith (2000) noted that there exists a link between inflationary pressure and profitability. Izhar and Asutay (2007) and Haron and Azmi (2004) noted a direct link between inflationary pressure and profitability of the banking entity. Molyneux and Thornton (1992) noted a direct link between the supply of money and profitability of an entity. Similarly, Haron and Azmi (2004) noted a direct link between supply of money and profitability.

2.3.6 Firm Specific Factors

Vong and Chan (2009) noted that capital of the bank will have a direct link with its profitability. On the contrary, Pramato and Ismail (2006) noted that the capital of the entity is negatively linked with profitability. Bahsir (2003) identified that the size of the banking entity directly impacts on its profitability. On the contrary, Wasiuzzaman and Tarmizi (2010) noted that size has no significant link with profitability of the entity. Sufian and Habibullah (2010) shared that liquidity has a direct link with profitability. Haron and Azmi (2004) also noted a direct link between liquidity and profitability. Awan (2009) shared that majority of the Islamic banks have more asset quality as compared to conventional banks.

2.4 Empirical Review

A study conducted in Indonesia by Insani and Muflih (2019) looked at the determinants of performance of the Islamic banks. The adopted methodologies include time series covering a time horizon from 2013 all through to 2017. In total, 12 financial institutions were covered. ROA was used as a proxy of gauging performance of the entity. The study noted existance of an inverse link between the level of inflation, the costs of operation, liquidity and the ability of the financial entities to perform. Samail, Zaidi, Mohamed and Kamaruzaman (2018) conducted an inquiry into Malaysian Islamic banks to bring out the determinants of their financial performance. ROA was used as one of the proxies of gauging the ability of the entity to perform. For the independent study variables, the management of liquidity, the quality of assets and capital adequacy were used. The period of consideration by the inquiry was from 2010 all through to 2016. It was shown that the management of liquidity and the quality of the assets has significant interaction with financial performance. Khan, Ijaz and Aslam (2014) did an inquiry into the determinants of profitability focusing on the Islamic banking sector in Pakistan. The period of consideration of the inquiry was 2007 to 2014 with the indicators of profitability covering ROE, ROA and the earnings per share of the entity. The bank's relative size, non-performing loans, ratio of gearing and the adequacy of capital were taken as the independent study variables. It was noted that the bank specific indicators like the management of assets and gearing ratio do shape how the banking entities perform.

The study by Raissi (2015) focused on the internal factors that predict performance of Islamic finance. The inquiry entailed comparison of the conventional against Islamic banking entitie4s covering the GCC Region. The period of consideration was from 2010 all through to 2014. In total, 20 banking entities were covered by the inquiry. It was shown that the key factors that shape the ability of Islamic entities to perform include investments and credits distributed. On the other hand,

performance of the conventional banks was shaped by the quality of the deposits and the portfolio. Kyzy, Thim and Choong (2012) covered the Islamic banking entities in Malaysia to bring out the key factors that shape their ability to perform. Both ROE and ROA were used as the proxies of gauging the ability to perform. Empirically, it was shared that credit risk shape the ability of performance of the Islamic banking entities. Furthermore, the level of liquidity and the concentration of the institutions were seen to shape performance.

Supiyadi, Arief and Nugraha (2019) identified the determinants to include the size of the assets, the credit risk and adequacy of capital as having an inverse link with profitability. The inquiry was however conducted in Indonesia covering a time horizon from 2010 all through to 2017. Khan, Ijaz and Aslam (2014) noted that the specific items to the banking entity like the deposits, NPLs and gearing have an influence on profitability. The inquiry was however conducted in Pakistan context. Another investigation in Pakistan by Asadullah (2017) did identify liquidity and the size of the entity as shaping the profitable record of the entity. Al-Harbi (2019) identified that ownership by foreigners; the rates of interest rates all have an influence on profitability. Alzoubi (2018) identified the determinants of profitability to include the size and the deposits. Akhtar, Ali and Sadaqat (2011) noted that the adequacy of capital and gearing all have a direct link with profitability of the entity. Kok, Tan, Yong and Tan (2012) shared that the size of the entity and supply of money have a direct link with profitability while the quality of assets and management of expenses have an inverse link. Abduh and Issa (2018) noted that credit risk, the degree of liquidity have direct link while inflation had an inverse link with financial performance unlike the GDP.

Omar (2016) did an inquiry into Islamic banking and its link with ability of conventional banks to perform financially. In total, 6 conventional banking entities that offer Islamic banking services

were targeted. The data for the inquiry was collected covering the time frame from 2009 all through to 2015. It was noted that some of the Islamic banking contracts, their relative sizes and liquidity all have direct link with ability of the institutions to financially perform. Guyo (2013) focused on bringing out the key factors that shape how the Islamic entities perform in relation to the conventional entities. The analysis was correlational and regressional in nature. It was shown that the specific items of the banking entity have a significant contribution towards the ability of the institution to perform. A direct link was noted between the quality of the assets, the efficiency of management and the ability to financially perform. Inyangala (2014) noted that majority of the Islamic banking entities have adequate capital and quality of the assets in place.

Ahmed (2015) did an inquiry into the contacts of Islamic banking and the role they play as far as financial performance was concerned. The information for the inquiry was obtained from auxiliary sources in the effort to realize the stated objectives. The period of consideration of the inquiry was 2009 all through to 2013. It was shown that the contracts of Islamic banking and the ability of the entity to financially perform are significantly linked with each other. Talam (2014) looked at Islamic banking and its link with the ability of the Kenyan entities to financially perform. The period of consideration of the inquiry was 2009 all through to 2013 where a total of 13 banking entities were covered. It was shared that the management of efficiency, liquidity and capital ratios all have a direct link with the ability of the Islamic banking entities to perform in financial terms. Aden (2014) looked at factors that shape the ability of Islamic banking entities in Kenyan context to perform. The key emphasis of the inquiry was to bring out the factors that inform the customers to take up the Islamic banking products and services. It was noted that the religious affiliation of the customers inform their choice of using Islamic banking products.

2.5 Summary of Literature and Gaps

Table 2.1 gives a summary of the reviewed literature with the gaps.

Table 2.1: Summary of Literature and Gaps

Author	Study	Findings	Gaps	Focus of the Current Study
Insani and Muflih (2019)	The determinants shaping the ability of Islamic banks to perform	An inverse link noted between ROA and liquidity	The study was conducted in Indonesia	The present inquiry was done in Kenya
Samail et al. (2018)	Determinants of ability of Malaysian Islamic banks to perform financially	The quality of assets and management of liquidity were the identified determinants	The focus of the inquiry was on Malaysian banking industry	The present inquiry was done in Kenya
Khan, Ijaz and Aslam (2014)	The determinants of profitability of the Islamic banks in Pakistan	The specific factors of the banking entity like NPLs and gearing ratio shape profitability	The study was done in Pakistan hence creating a contextual gap	The present inquiry was done in Kenya

Raissi (2015)	Internal determinants of the ability of Islamic banking entities to financially perform	Investments were seen to shape how the Islamic banking entities perform	The focus of the inquiry was on financial performance	The present study was conducted on profitability
Omar (2016)	Islamic banking and its link with the ability of conventional banks to perform	The Islamic banking contracts were seen to adversely affect the ability of conventional banks to perform	The study focused on general performance	The present study focused on profitability
Guyo (2013)	The factors shaping financial performance of Islamic against conventional banks in Kenya	The adequacy of capital and size were seen to positively linked with ability of the banking entities to perform	The study merely focused on Islamic banks in Kenya	The present study covered the general Islamic financial institutions in Kenya

Source: Author (2020)

2.6 Conceptual Framework

Figure 2.1 is the conceptual framework of the study.

INDEPENDENT VARIABLE		DEPENDENT VARIABLE

Determinants of profitability

- Investment Framework
- Tax Regimes
- Nature of the Market
- Competition
- Macro-economic Level Factors
- Firm Specific Factors

Profitability
- ROE
- ROA
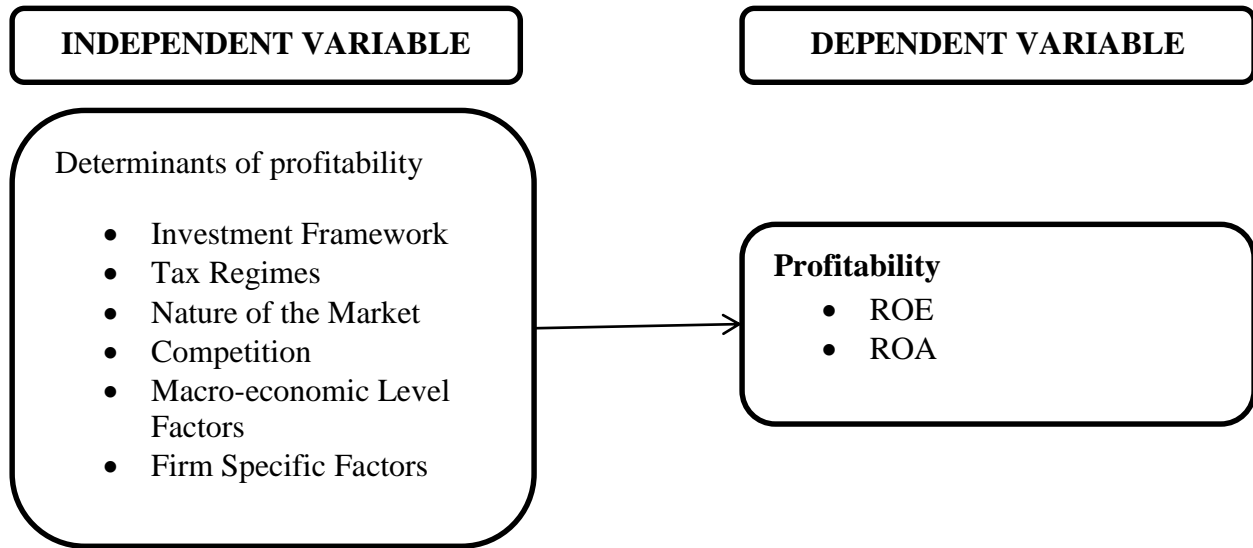
Figure 2.1: Conceptual Framework

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter focuses on the targeted respondents and how the data was collected from them. The means of analyzing the collected data and the presentation are also detailed. The methodologies selected are in line with the objective of the study.

3.2 Research Design

The study adopted a descriptive survey design covering quantitative methods. A descriptive design helped to bring out the determinants of profitability with reference to Islamic financial institutions in Kenya. The use of survey ensured that information is obtained from all the Islamic financial institutions in Kenya.

3.3 Population

The study targeted 7 Islamic financial institutions in Kenya as shown on appendix II. Since the population was relatively small, census was adopted and thus all the 7 institutions were covered. Through census, the study was able to collect information from all the Islamic financial institutions for generalization of the findings.

3.4 Data Collection

The study collected both primary and secondary data and factor analysis was conducted to establish the determinants of profitability of Islamic financial institutions. Questionnaire was used to collect primary data while financial statements and publications by the Central Bank of Kenya, the Insurance Regulation Authority and financial statements from the respective institutions were used as sources of secondary data. Secondary data was collected on a period of ten years (2010-2019).

3.5 Data Analysis

The collected data underwent cleaning through excel before being exported to SPSS tool for analysis. The descriptive statistics covering means and standard deviations were generated to summarize the data. In order to draw relevant inferences and deductions, factor analysis was adopted to establish the determinants that influence profitability of Islamic banks. The outputs from factor analysis were interpreted appropriately to draw inferences and deductions. The results were presented using tables and figures.

3.5.1 Steps in Carrying out Factor Analysis

The study adopted explanatory factor analysis (EFA) during processing of the data from the field. EFA was conducted through the SPSS tool. Once from the field, the data underwent cleaning through excel. Thereafter, the data was exported to SPSS where factor analysis was conducted. The communalities produced from factor analysis were interpreted accordingly with items having values above 0.4 being retained. The total variance explained and the factor loading were also interpreted appropriately as the outputs of factor analysis.

3.5.2 Operationalization of Variables

Table 3.1 gives a breakdown of the variables and how they were operationalized:

Table 3.1: Operationalization of Variables

Variable	Indicators	Measurement	Scale	Data Collection	Data Analysis
Independent determinants	-	-	Ordinal	Questionnaire section C	• Descriptive statistics • Factor analysis
Dependent profitability	• ROE • ROA	Net Income/Total equities Net Income/Total assets	Ratio	Questionnaire section B	• Descriptive statistics • Trend analysis

CHAPTER FOUR: RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter is set out to present the findings of analysis from the primary and secondary data that was collected. The sections in this chapter include the response rate, the general information, descriptive statistics as well as the findings of factor analysis. Table and figures were utilized in presenting the findings in this chapter.

4.2 Response Rate

The researcher administered 6 questionnaires to the Islamic financial institutions in Kenya (appendix II). All these firms responded by dully filling in the questionnaire and returning it back. This was equivalent to a response rate of 100%. This was consistent with the assertion of Babbie (2010) that a response rate of above 70% if excellent for analysis and presentation of the findings.

4.3 General Information on the Firms

The study sought to establish the general information of the firms that were covered. In regard to years of their operation, the study noted that majority had been in operation for over 16 years. The implication of this finding was that most of the studied firms had probably operated in the market for a relatively longer period of time and thus the respondents from these institutions were well versed with the determinants that influenced profitability of their firm. The study sought further to establish the number of branches of the studied institutions across Kenya. It emerged that majority of the studied institutions had an average of 7-9 branches although others had over 10 branches like KCB and Standard Chartered Bank. Besides the branch network, the study sought further to establish the number of staff in the institutions that were covered. The results showed that majority of the studied institutions had over 151 staff. These findings imply that majority of

the studied institutions were relatively larger in size on the basis of the staff capacity and branch network coverage.

4.4 Descriptive Statistics

This section is set out to present the findings of descriptive statistics covering means and standard deviations and trend analysis determined through graph.

4.4.1 Analysis of Profitability

Profitability was the dependent variable covered in this study. The findings of the descriptive statistics covering means and standard deviations on this variable are as indicated in Table 4.1.

Table 4.1: Analysis of Profitability

	Minimum	**Maximum**	**Mean**	**Std. Dev**
ROA (%)	-.72	.42	.0088	.13082
ROE (%)	-.66	.55	.1138	.22614

Source: (CKK, 2020 & IRA, 2020)

From Table 4.1, the maximum value of ROA was 0.42 with the minimum value being -0.72, a mean of 0.0088 and standard deviation of 0.13082. There are several implications that can be drawn from this finding. First, it can be implied that on average, majority of the Islamic financial institutions in Kenya do generate 0.88% of their net incomes (profits) through utilization of their assets that are in place. The second implication of this finding is that some of the Islamic financial institutions in Kenya are facing challenges with their profitability as shown by a negative minimum value. It implies that there are some Islamic financial institutions in Kenya that are posting losses as far as their profitability is concerned. It is therefore against this backdrop that the present study will seek to explore the salient factors that determine profitability of these Islamic financial institutions in Kenya.

The results in Table 4.1 further indicate that the highest value of ROE was 0.55 with the lowest value being -0.66 and an average of .1138 with standard deviation of .22614. This means that majority of the Islamic financial institutions in Kenya do generate 11.38% of their profits by utilizing the equities in place. It also imply that some of the Islamic financial institutions are facing challenges in relation to their profitability as shown by a negative minimum value and this justifies the need for this present study to establish the factors that would explain this scenario. The inference drawn from the findings in Table 4.1 is that the Islamic financial institutions in Kenya are doing well in terms of ROE as compared to ROA.

4.4.2 Trend Analysis of Profitability

Trend analysis was used to describe the movement and pattern of the data across the period of consideration (2010-2019). Figure 4.1 is the trend analysis for ROA as an indicator of profitability of the studied institutions.
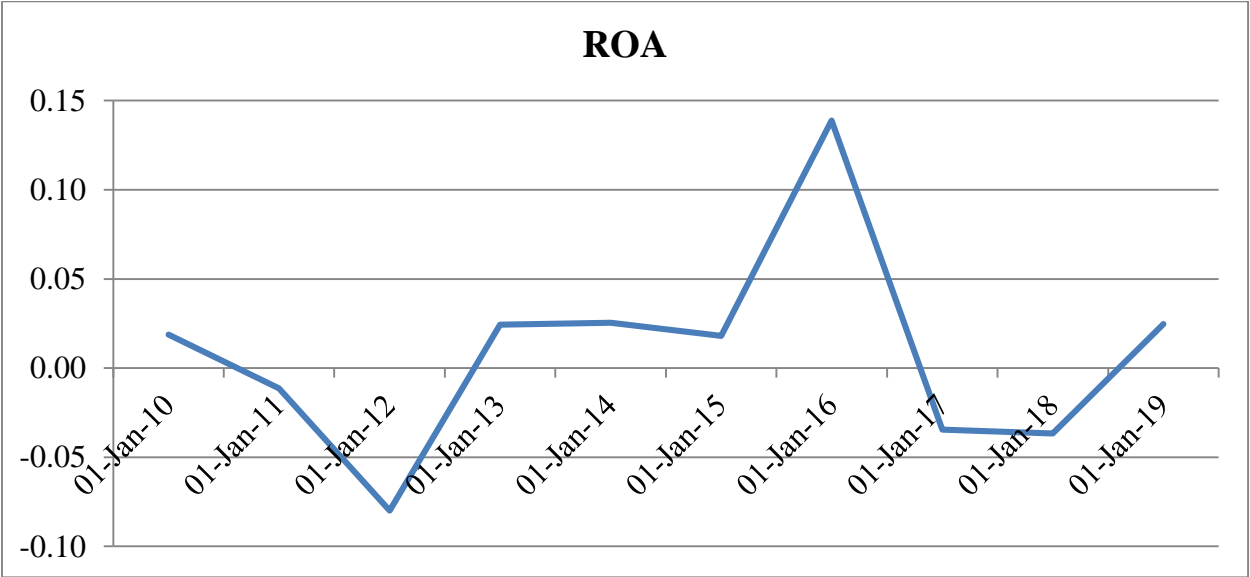
Figure 4.1: Trend Analysis for ROA

Source: (CBK, 2020 & IRA, 2020)

Based on the results in Figure 4.1, it can be noted that the movement in ROA as a measure of profitability among Islamic financial institutions in Kenya was erotic and thus unstable. In other words, there was fluctuation in the profitability of the studied institutions across the studied period. This fluctuation in profitability denotes challenges in profitability which formed the basis for the present study.

ROE was another indicator of profitability of the studied institutions. The findings of trend analysis on ROE are as indicated in Figure 4.2.
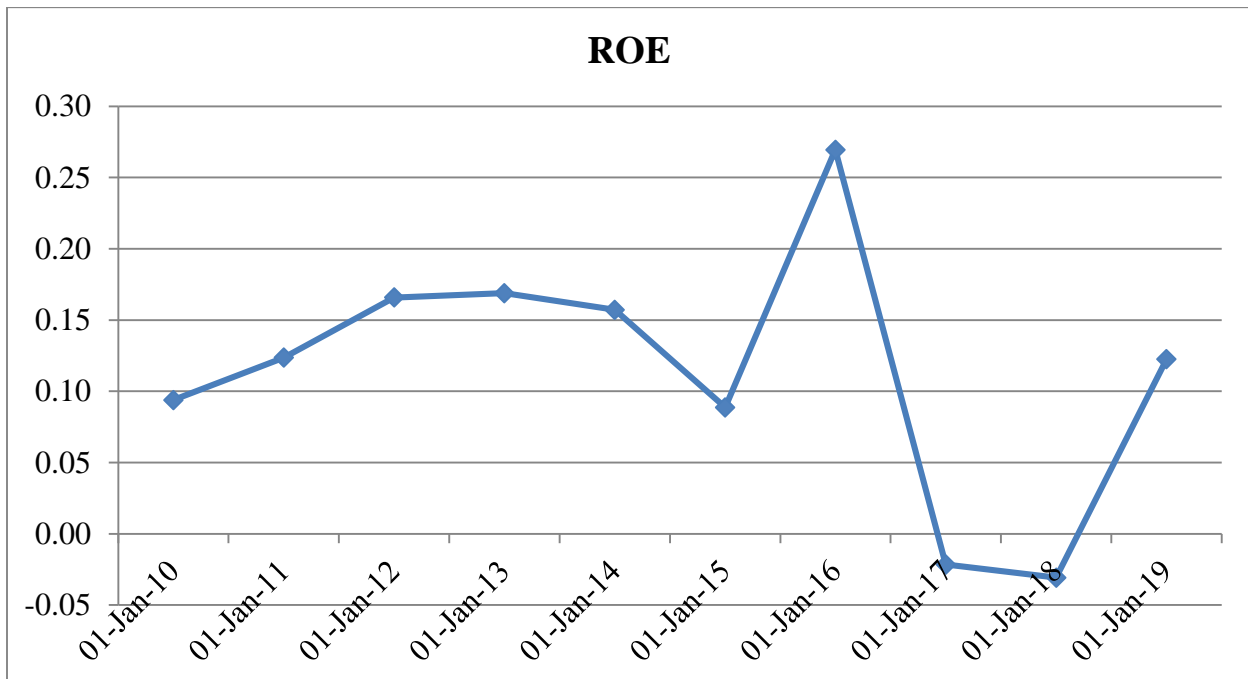
Figure 4.2: Trend Analysis for ROE
Source: (CBK, 2020 & IRA, 2020)

The results in Figure 4.2 indicate that there was fluctuation in ROE as a measure of profitability in the studied firms. This means that profitability of the studied institutions was not stable across the period of consideration. The provided the rationale for the present study that sought to establish the determinants of profitability of these institutions.

4.4.3 Determinants of Profitability of Islamic Financial Institutions

Table 4.2 gives the descriptive statistics findings on determinants of profitability of the Islamic financial institutions in Kenya.

Table 4.2: Determinants of Profitability of Islamic Financial Institutions

|	Mean	Std. Dev
Zakat as an expense paid to charitable organizations	4.00	.577
Tax expense paid to the government from the revenues generated	3.85	.690
High population of Christians in Kenya as opposed to Muslims	3.71	.487
Existance of conventional financial institutions that offer Sharia compliance products through window system	3.85	.377
Limited market share that has been taken up by conventional financial institutions operating on window system	4.14	.690
Religious affiliations of the customers	4.42	.534
Interest rate charged on some government bonds which is against Sharia requirements	3.85	.377
Interest rate charged on some time bonds which contravene Sharia regulations	3.85	.690
Concentration of Islamic financial institutions in the market	3.57	1.133
Liquidity management	3.71	.951
Credit risk	3.85	.690
Capital adequacy of the Islamic financial institutions	4.00	.577
Managerial efficiency	3.57	.975
Inflationary pressure	3.57	.786
Non-performing loans (NPLs)	3.57	.786
Foreign ownership	3.71	.951
The Gross Domestic Product	4.00	.816
The size of the market	3.57	1.272
Money supply	3.57	.975
Expense management practices	3.71	.755
The size of the financial institution	4.00	.816
Existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya	3.85	1.069
Overall Score	**3.81**	**0.772**

Source: Field Survey Data (2020)

The results in Table 4.2 indicate an overall; score (M=3.81, SD=0.772), which is interpreted to mean that the identified determinants were rated to a great extent by the respondents. In other words, the determinants in Table 4.2 were evident as far as the profitability of the Islamic financial institutions was concerned.

4.5 Factor Analysis

Factor analysis was conducted to establish the determinants of profitability of Islamic financial institutions in Kenya. This section seeks to detail the results obtained from factor analysis including the communalities, the total variance explained, the scree plot and the factor loading shown on the component matrix.

4.5.1 Communalities

Table 4.3 gives the summary of the communalities extracted through factor analysis.

Table 4.3: Communalities

	Initial	Extraction
Zakat as an expense paid to charitable organizations	1.000	.839
Tax expense paid to the government from the revenues generated	1.000	.988
High population of Christians in Kenya as opposed to Muslims	1.000	.979
Existance of conventional financial institutions that offer Sharia compliance products through window system	1.000	.998
Limited market share that has been taken up by conventional financial institutions operating on window system	1.000	.986
Religious affiliations of the customers	1.000	.794
Interest rate charged on some government bonds which is against Sharia requirements	1.000	.989
Interest rate charged on some time bonds which contravene Sharia regulations	1.000	.904
Concentration of Islamic financial institutions in the market	1.000	.829
Liquidity management	1.000	.944
Credit risk	1.000	.990
Capital adequacy of the Islamic financial institutions	1.000	.553
Managerial efficiency	1.000	.780
Inflationary pressure	1.000	.835
Non-performing loans (NPLs)	1.000	.990
Foreign ownership	1.000	.995
The Gross Domestic Product	1.000	.981
The size of the market	1.000	.987
Money supply	1.000	.946
Expense management practices	1.000	.911
The size of the financial institution	1.000	.893
Existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya	1.000	.768

Extraction Method: Principal Component Analysis.
Source: Field Survey Data (2020)

Table 4.3 indicates that the lowest communality was .553 on the factor of capital adequacy of the Islamic financial institutions while the highest value was 0.998 on the factor of existance of conventional financial institutions that offered Sharia compliance products through window system. Thus, all the factors had communality values above 0.4, thus they were retained for further analysis of the total variance and their loading in the subsequent sections.

4.5.2 Total Variance Explained

The findings on the total variance explained are as indicated in Table 4.4.

Table 4.4: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	9.893	44.969	44.969	9.893	44.969	44.969
2	4.127	18.757	63.726	4.127	18.757	63.726
3	3.800	17.273	80.999	3.800	17.273	80.999
4	2.060	9.363	90.363	2.060	9.363	90.363
5	1.249	5.678	96.041	1.249	5.678	96.041
6	.871	3.959	100.000	.871	3.959	100.000
7	1.137E-15	5.168E-15	100.000			
8	9.190E-16	4.177E-15	100.000			
9	6.286E-16	2.857E-15	100.000			
10	5.575E-16	2.534E-15	100.000			
11	3.419E-16	1.554E-15	100.000			
12	2.224E-16	1.011E-15	100.000			
13	1.423E-16	6.469E-16	100.000			
14	7.344E-17	3.338E-16	100.000			
15	-5.132E-18	-2.333E-17	100.000			
16	-7.225E-17	-3.284E-16	100.000			
17	-1.008E-16	-4.582E-16	100.000			
18	-2.000E-16	-9.090E-16	100.000			
19	-4.660E-16	-2.118E-15	100.000			
20	-5.288E-16	-2.404E-15	100.000			
21	-5.910E-16	-2.686E-15	100.000			
22	-1.443E-15	-6.559E-15	100.000			

Extraction Method: Principal Component Analysis.
Source: Field Survey Data (2020)

The results in Table 4.4 indicate that all the 22 factors covered by the study were reduced into six components that cumulatively explained 100% variation in profitability of the Islamic financial institutions. The first component extracted by the study explained the highest variation in profitability of Islamic banking by 44.969%, followed by the4 second component at 18.757%, the third component at 17.273%, the fourth component at 9.363%, with the fifth and sixth component being equivalent to 5.678% and 3.959 respectively. Thus, the six components extracted by the study explained the entire concept of profitability of the Islamic financial institutions in Kenya.

4.5.3 Scree Plot
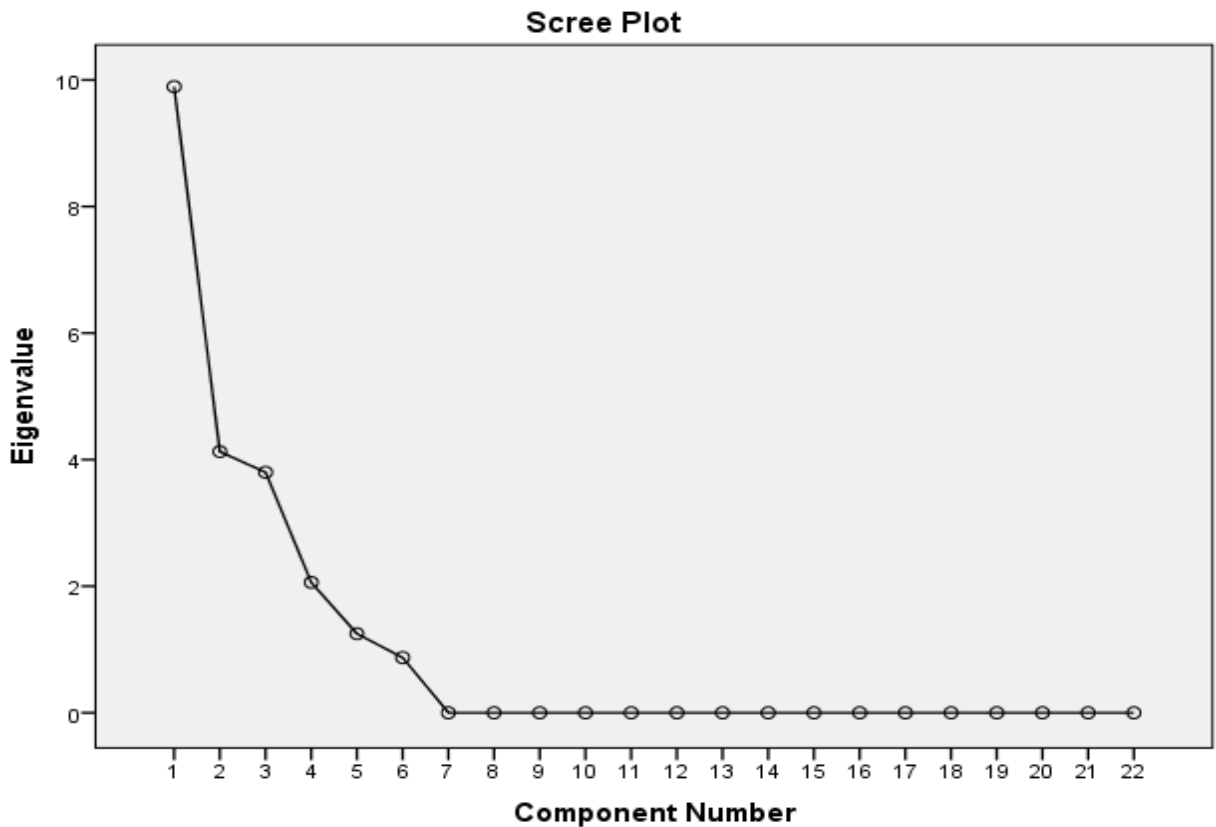Figure 4.3 is a summary of the findings of the scree plot.

Figure 4.3: Scree Plot
Source: Field Data (2020)

Figure 4.3 indicates the six components that were extracted through factor analysis. It can be noted that the first component explained the highest variation in profitability of the Islamic financial institutions.

4.5.4 Component Matrix

Table 4.5 shows the component matrix with factor loading.

Table 4.5: Component Matrix

	Component					
	1	2	3	4	5	6
Zakat as an expense paid to charitable organizations	-.738					.547
Tax expense paid to the government from the revenues generated	.738			.571		
High population of Christians in Kenya as opposed to Muslims	-.690			.656		
Existance of conventional financial institutions that offer Sharia compliance products through window system		.902				
Limited market share that has been taken up by conventional financial institutions operating on window system	.526	-.572	-.605			
Religious affiliations of the customers	.438		.763			.448
Interest rate charged on some government bonds which is against Sharia requirements	-.976				.542	
Interest rate charged on some time bonds which contravene Sharia regulations	.664	-.470	.451			
Concentration of Islamic financial institutions in the market	.627	.499		.431		
Liquidity management	.687	.508	.413			
Credit risk	.856	.416				
Capital adequacy of the Islamic financial institutions	.692				-.426	.515
Managerial efficiency	.672	.418				
Inflationary pressure	.864				.402	
Non-performing loans (NPLs)	-.793	.597				
Foreign ownership	.741	.661				
The Gross Domestic Product	.684	.505	-.410			
The size of the market	-.546		.570	.558		
Money supply	-.562	.621	-.438			
Expense management practices			-.881			
The size of the financial institution	.423		.554	-.526		
Existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya	-.763		.420		.404	

Extraction Method: Principal Component Analysis.
a. 6 components extracted.
Source: Field Data (2020)

Table 4.5 gives a summary of the factor loading on each of the 6 components that were extracted. The six components include the firm specific factors, Regulatory factors & competition, Size and Religiosity & Regulations, Nature of Market, Investment Framework and the Tax regime against Zakat.

Firm Specific Factors: These include the tax expense paid to the government from the revenues generated, limited market share that has been taken up by conventional financial institutions operating on window system, interest rate charged on some time bonds which contravene Sharia regulations, concentration of Islamic financial institutions in the market, liquidity management, credit risk, capital adequacy of the Islamic financial institutions, managerial efficiency, inflationary pressure, foreign ownership and the   Gross Domestic Product

Regulatory factors & competition: This component include three factors covering the money supply, existance of conventional financial institutions that offer Sharia compliance products through window system and the non-performing loans (NPLs)

Size, Religiosity & Regulations: Some of the factors that were extracted for this component include religious affiliations of the customers, the size of the financial institution, existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya and the size of the market

Nature of Market: This component had just a single factor which was the high population of Christians in Kenya as opposed to Muslims

Investment Framework: There was one factor within this component which was the interest rate charged on some government bonds which is against Sharia requirements

Tax regime against Zakat: Zakat as an expense paid to charitable organizations

4.6 Discussion

The results indicate that majority of the Islamic financial institutions are not performing well in terms of profitability. In fact, some of these Islamic financial institutions have consistently been posting financial; losses which has adversely affected their profitability position. This assertion is supported by the minimum values of ROA and ROE being negative with the trend analysis pointing at fluctuations. This assertion is supported by Ashraful *et al.,* (2017) who shared that relative to their conventional counterparts, the Islamic financial institutions have been facing challenges in regard to their profitability and this is seen in their limited expansion ability with most of them having limited branch networks.

The study had identified 22 factors from the literature as having an effect on profitability of the Islamic financial institutions. These 22 factors were subjected to factor analysis where they were reduced into 6 key components that cumulatively explained 100% variation in profitability of these institutions. The first component was the firm specific factors covering tax expenses, limited market share, interest rate, the concentration of Islamic financial institutions in the market, liquidity management, credit risk, capital adequacy of the Islamic financial institutions, managerial efficiency, inflationary pressure, foreign ownership and the Gross Domestic Product. These findings are empirically supported by Vong and Chan (2009) who noted that capital of the bank will have a direct link with its profitability. On the contrary, Pramato and Ismail (2006) noted that the capital of the entity is negatively linked with profitability. Bahsir (2003) identified that the size of the banking entity directly impacts on its profitability. Sufian and Habibullah (2010) shared that liquidity has a direct link with profitability. Haron and Azmi (2004) also noted a direct link between liquidity and profitability. Awan (2009) shared that majority of the Islamic banks have more asset quality as compared to conventional banks. Regulatory factors & competition was the

second component covering three factors including the money supply, existance of conventional financial institutions that offer Sharia compliance products through window system and the non-performing loans (NPLs). Rasiah (2010) noted that with less competitive advantage over the conventional competitors and with small market share, many of conventional institutions have and are developing a strategies to compete in what they call "Islamic Finance Window" this is branding a section of the conventional institution to Islamic practicing side.

The third component that was extracted by the study was size, religiosity & regulations: This component covered the factors like religious affiliations of the customers, the size of the financial institution and the existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya and the size of the market. The finding on size is supported by Wasiuzzaman and Tarmizi (2010) who noted that size has no significant link with profitability of the entity. Nature of market was the fourth component extracted covering the factor of high population of Christians in Kenya as opposed to Muslims. This finding is consistent with Demirguc-Kunt & Huizinga (2001) who shared that Kenya being majorly a Christian nation with high number in terms of population size might not care much on the difference of the financial institutions and its religious permissibility (Halaal or Haram) rather based on financial gains.

Investment framework was the fifth component from factor analysis and it covered the fact that the interest rate charged on some government bonds which is against Sharia requirements. This is consistent with Olweny and Chiluwe (2012) who shared that interest (Riba) is forbidden (Haram) in Islam this closes the investment opportunity for fully fledged Islamic institutions to trade on those bonds. Tax regime against Zakat was the last component with one factor focusing on Zakat as an expense paid to charitable organizations. Asnita et al. (2019) noted that Zakat is a mandatory obligation that an individual/firm must donate a certain proportion (usually 2.5% of the total

wealth) each financial year to charitable individuals/institutions e.g. needy people. This Zakat is in addition to the normal tax that paid to the government, which implies double taxation of these Islamic financial institutions. Consistent with these views, Zapor (2016) noted that this double taxation becomes a burden to the Islamic financial institutions unlike the conventional financial institutions and this in long run affects its value, profitability as well as its share price value, among others.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is set out to present a summary of the analyzed findings based on the analysis. The conclusion is provided linking the findings with the reviewed theories. The recommendations are also provided with limitations and areas that require further research.

5.2 Summary of the Findings

From the findings of descriptive analysis, both ROE and ROA as the indicators of profitability had negative minimum values. This means the Islamic financial institutions in Kenya are facing challenges with regard to their profitability. This assertion is in sync with the findings of the trend analysis that showed fluctuation in the pattern of ROA and ROE recorded by these Islamic financial institutions. The results of descriptive statistics further indicate that respondents agreed to a great extent on the identified determinants of profitability of their institutions.

Based on the reviewed literature, the study identified 22 factors as having an effect on profitability of Islamic financial institutions. These 22 factors were subjected to factor analysis where they were reduced into 6 components that cumulatively explained the entire variation in profitability of the Islamic financial institutions in Kenya. These first factors include the firm specific factors; regulatory factors & competition; size, religiosity & regulations; nature of market; investment framework; and tax regime against Zakat.

5.3 Conclusion

The study concludes that some of the Islamic financial institutions are facing issues and challenges with regard to their profitability. The poor profitability of these institutions contravenes their intermediation role established on the basis of the financial intermediation theory. Ideally, any challenges with regard to profit would compromise this theory since that would mean that the institution would not be able to play its intermediation role effectively. There are various factors that determine profitability of the Islamic financial institutions. These include the firm specific factors; regulatory factors & competition; size, religiosity & regulations; nature of market; investment framework; and tax regime against Zakat.

The firm specific factors have the largest contribution towards profitability of the Islamic financial institutions while tax regime had the least effect. Some of these firm specific factors include the issues of liquidity management, credit risk, capital adequacy, managerial efficiency and foreign ownership. The fact that tax regime also affect profitability is consistent with the Modigliani and Miller theory which is premised on the fact that there are no taxes in the economy which may affect profitability of the entity.

5.4 Recommendations for Policy, Practice and Management

The policy makers at the Central Bank of Kenya (CBK) should establish regulations and guidelines for Islamic financial institutions that are separate from the other conversional institutions. In designing investment regulations and policies, the Capital Market Authority (CMA) should consider the fact that interest (riba) is forbidden Islamic financial institutions. The Insurance Regulation Authority (IRA) should come up with separate regulations governing Islamic insurance firms like Takaful so as to enhance profitability. The Kenya Revenue Authority should give special consideration to these Islamic financial institutions in regard to taxation since they pay Zakat

(which is compulsory) besides the normal tax that is paid to the government resulting into an incident of double taxation of their incomes.

The various practitioners including Islamic banking scholars should establish a lobby for representation on the boards of the regulatory bodies like CBK, IRA and CMA. This will help in formulation of laws and regulations that take care of the Islamic faith. The senior management team of the Islamic financial institutions should capitalize on firms specific factors to enhance profitability of their institutions. The management of the Islamic financial institutions should work to improve on their firm specific factors like the level of management efficiency and the amount of Nonperforming loans. There is need for the managers of these Islamic financial institutions to heavily invest in marketing of their products so as to increase their market share.

5.5 Limitations of the Study

The study was limited to a smaller sample size of 7 firms. These firms were the Islamic financial institutions. The only unique thing about this study as opposed to the previous empirical studies was that it covered both conversional commercial banks offering Islamic banking through window systems, the fully fledged Islamic banks as well as the insurance firms (Takaful) that offer sharia compliant products. However, the 7 firms were relatively smaller sample size that limited the generalization of the findings to the other firms.

Methodologically, the study was a survey covering a period of 2010-2019, which was equivalent to 10 years. This period was long enough to collect the relevant secondary on the profitability of these firms so as to carry out trend analysis. The study utilized both primary as well as secondary data. Questionnaires facilitated the collection of primary data while the publications by the CBK and the IRA helped in collection of secondary data. Both descriptive statistics covering means and

standard deviation were utilized during the analysis. In order to draw relevant inferences on the variables of the study, factor analysis was utilized. Regression analysis was excluded during the analysis because the firms were too few for running this inferential statistic. Ideally, over 30 units are required for one to conduct regression analysis as compared to the 7 units covered in the present study.

5.6 Suggestions for Further Research

The study recommends further studies to be undertaken focusing on the variables covered but in relation to financial performance unlike profitability. Future studies can extent to cover a wider geographical scope of say the entire East African Community or even across major countries in Africa that have huge population of Muslim or Islamic financial institutions. This will give room for comparison of the findings across different geographical regions. '

Future studies should increase the sample size so as to accommodate the use of regression analysis. It is only through such analysis that it is possible to infer on the significance of the identified factors as they interact with profitability of the firm. Apart from increasing the firms, the sample size can also be increased by covering a relatively longer time frame of say 30 years. Definitely, if the study was to restrict itself on secondary data with such a relatively larger period, the sample size would also increase which may support the use of panel data methodologies so as to draw meaningful inferences.

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APPENDICES

Appendix I: Questionnaire

I am Omarmahat Musa Issa, a student at the University of Nairobi currently undertaking a study on **DETERMINANTS OF PROFITABILITY OF ISLAMIC FINANCIAL INSTITUTIONS IN KENYA.** You are therefore requested to fill in this questionnaire with appropriate responses so that I am able to provide answers to the aforementioned study. Note that all information you share will only be used for academic purpose. Any information you share will be treated with utmost confidence. Thank you.

SECTION A: GENERAL INFORMATION

1. Kindly indicate the number of years your institution has been in operation

       Less than 5 years   [ ]

       6-10 years   [ ]

       11-15 years   [ ]

       Over 16 years   [ ]

2. Kindly indicate the number of branches your institution has across Kenya

       Less than 3 branches   [ ]

       4-6 branches   [ ]

       7-9 branches   [ ]

       Over 10 branches   [ ]

3. Kindly indicate the number of staff in your institution

Less than 50 staff   [ ]

51--100 staff   [ ]

101-150 staff   [ ]

Over 151 staff   [ ]

SECTION B: PROFITABILITY

4. Kindly indicate value of total assets, total equities and net income recorded by your firm for the last ten years. Indicate your responses in Table below.

Name of Institution……………………………………………………………………..			
Year	**Total Assets**	**Total Equity**	**Net Income**
2010			
2011			
2012			
2013			
2014			
2015			
2016			
2017			
2018			
2019			

SECTION C: DETERMINANTS OF PROFITABILITY OF ISLAMIC FINANCIAL INSTITUTIONS IN KENYA

5. Based on literature review, the following were established as determinants profitability of Islamic financial institution. Kindly rate each of these factors on a scale of 1-5 where 1=not at all, 2=little extent, 3=moderate extent, 4=large extent and 5=very large extent.

Statements on the determinants of profitability of Islamic financial institution	1	2	3	4	5
Zakat as an expense paid to charitable organizations					
Tax expense paid to the government from the revenues generated					
High population of Christians in Kenya as opposed to Muslims					
Existance of conventional financial institutions that offer Sharia compliance products through window system					
Limited market share that has been taken up by conventional financial institutions operating on window system					
Religious affiliations of the customers					
Interest rate charged on some government bonds which is against Sharia requirements					
Interest rate charged on some time bonds which contravene Sharia regulations					
Concentration of Islamic financial institutions in the market					
Liquidity management					
Credit risk					
Capital adequacy of the Islamic financial institutions					
Managerial efficiency					
Inflationary pressure					
Non-performing loans (NPLs)					

Foreign ownership					
The Gross Domestic Product					
The size of the market					
Money supply					
Expense management practices					
The size of the financial institution					
Existance of banking regulations that cut across Islamic and non-Islamic financial institutions in Kenya					
Others……………………………………………… kindly specify					

Appendix II: Islamic Financial Institutions in Kenya

1. SBM Bank Kenya Ltd
2. Gulf African Bank Ltd
3. First Community Bank Ltd
4. DIB Bank Kenya Ltd
5. Standard Chartered Bank Kenya Ltd
6. KCB Bank Kenya Ltd
7. Takaful Insurance

Source: CBK (2020) & IRA (2020)

Appendix III: Secondary Data

Bank	Year	ROA	ROE
SBM	2010	0.046	0.471
Gulf Africa	2010	0.005	0.038
First Community Bank	2010	-0.025	-0.283
DIB Bank Kenya Ltd	2010	0.000	0.000
Standard Chartered Bank	2010	0.054	0.379
Kenya Commercial Bank	2010	0.052	0.052
Takaful Insurance	2010	0.000	0.000
SBM	2011	0.028	0.296
Gulf Africa	2011	0.012	0.118
First Community Bank	2011	0.013	0.133
DIB Bank Kenya Ltd	2011	0.009	0.029
Standard Chartered Bank	2011	0.050	0.401
Kenya Commercial Bank	2011	0.050	0.312
Takaful Insurance	2011	-0.241	-0.424
SBM	2012	0.009	0.086
Gulf Africa	2012	0.028	0.240
First Community Bank	2012	0.030	0.273
DIB Bank Kenya Ltd	2012	-0.012	-0.033
Standard Chartered Bank	2012	0.059	0.376
Kenya Commercial Bank	2012	0.052	0.298
Takaful Insurance	2012	-0.724	-0.079

SBM	2013	0.025	0.224
Gulf Africa	2013	0.027	0.162
First Community Bank	2013	0.018	0.165
DIB Bank Kenya Ltd	2013	0.005	0.015
Standard Chartered Bank	2013	0.060	0.370
Kenya Commercial Bank	2013	0.055	0.284
Takaful Insurance	2013	-0.019	-0.038
SBM	2014	0.018	0.174
Gulf Africa	2014	0.031	0.195
First Community Bank	2014	0.007	0.067
DIB Bank Kenya Ltd	2014	0.002	0.007
Standard Chartered Bank	2014	0.064	0.354
Kenya Commercial Bank	2014	0.059	0.310
Takaful Insurance	2014	-0.003	-0.006
SBM	2015	-0.018	-0.159
Gulf Africa	2015	0.037	0.236
First Community Bank	2015	0.007	0.001
DIB Bank Kenya Ltd	2015	0.000	0.000
Standard Chartered Bank	2015	0.038	0.219
Kenya Commercial Bank	2015	0.050	0.290
Takaful Insurance	2015	0.013	0.034
SBM	2016	0.028	0.172
Gulf Africa	2016	-0.003	-0.026

First Community Bank	2016	0.000	0.000
DIB Bank Kenya Ltd	2016	0.051	0.291
Standard Chartered Bank	2016	0.056	0.352
Kenya Commercial Bank	2016	0.420	0.549
Takaful Insurance	2016	0.420	0.549
SBM	2017	-0.031	-0.225
Gulf Africa	2017	0.008	0.057
First Community Bank	2017	0.012	0.126
DIB Bank Kenya Ltd	2017	-0.321	-0.661
Standard Chartered Bank	2017	0.033	0.213
Kenya Commercial Bank	2017	0.049	0.309
Takaful Insurance	2017	0.007	0.029
SBM	2018	0.014	0.138
Gulf Africa	2018	0.009	0.065
First Community Bank	2018	-0.016	-0.219
DIB Bank Kenya Ltd	2018	-0.166	-0.449
Standard Chartered Bank	2018	0.040	0.252
Kenya Commercial Bank	2018	0.050	0.321
Takaful Insurance	2018	-0.187	-0.324
SBM	2019	0.012	0.120
Gulf Africa	2019	0.010	0.072
First Community Bank	2019	0.005	0.079
DIB Bank Kenya Ltd	2019	0.140	0.221

Standard Chartered Bank	2019	0.027	0.149
Kenya Commercial Bank	2019	0.028	0.287
Takaful Insurance	2019	-0.048	-0.070

Source: (CBK, 2020 & IRA, 2020)

DETERMINANTS OF PROFITABILITY OF ISLAMIC FINANCIAL INSTITUTIONS IN KENYA

by Omarmahat Musa Issa

DETERMINANTS OF PROFITABILITY OF ISLAMIC FINANCIAL INSTITUTIONS IN KENYA

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