

Quantitative and Qualitative Analyses of Islamic Banks' Pricing Practices: Factors Explaining the Performance

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Abstract

This paper investigates the quantitative and qualitative approaches of bank pricing determinants practised by the Islamic banking industry in Malaysia. On the quantitative approach, this paper investigates the effects of bank characteristics on bank profit margin, which reflects the intermediary role of Islamic and conventional banks in Malaysia for the period of 2006 to 2014. For Islamic banks, bank size and liquidity ratio have a significant negative relationship with bank profit margin. The management efficiency (vis-à-vis cost to income) and default risk are positively related to bank income margin for Islamic banks. As for conventional banks, besides management efficiency, the non-interest to total asset ratio has a significant positive influence on bank profit margin. Therefore, the results show that there are similarities and differences in terms of determinants of the Islamic and conventional banks. These empirical results suggest an important policy on issues pertaining to how Islamic and conventional banks have to adjust to the changes in the banking environment in terms of

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performance and its comparative advantages, specifically on management efficiency, as both Islamic and conventional banks' performance are affected by it. The management efficiency has more impact on the conventional banks than Islamic banks. For the qualitative approach, the key determinants and pricing approaches were extracted using the verbal protocol. The verbal protocol was followed by in-probing of respondents. Interviews were conducted with Islamic banking experts from Bank Muamalat Malaysia Berhad, CIMB Islamic Bank Berhad, Maybank Islamic Berhad, dan Bank Islam Malaysia Berhad. The analyses suggest some distinct outcomes and results in identifying the determinants and practices of pricing and bank margin for future research. This study provides important insights for Islamic banks to improve their bank margin and profit by considering the significant variables affecting their bank profit margin. Generally, the themes that emerged from the interviews are parallel with findings from the literature. However, the determinants of the pricing that have not been captured by the literature are marketing strategies, which include product risk and financing terms and conditions, and discretionary power. The awareness of Islamic banking products and cost of fund strategy are other important determinants of bank margin and profitability. This research also has the potential to enrich bank margin determinants' concept, theory, and practice.

Keywords: *Keywords - Bank profit margin, Islamic bank performance, Conventional bank performance, Quantitative analysis, Qualitative analysis*

Introduction

The banking system, which is the main part of financial system, plays a vital role in allocating resources by channelling funds from surplus (saving) unit to deficit (lender) unit. The Islamic banking system is different from the conventional banking system because it is based on the shariah principles, while the conventional banking system is based on conventional commercial law. Islamic banks in Malaysia have grown in numbers either in the form of full-fledge or subsidiaries of conventional banks developed from Islamic banking window. In understanding the growth and performance of Islamic banking, the study on how and to what extent it differs from conventional banking in terms of its determination of profit margin will be an important explanation of its role in channelling funds to finance economic activities and its pricing policy. The predetermined policy on financing and investment, and factors such as cost to income, bank risks, bank size, and non-financing income

(non-interest income) will be included in the analysis in determining bank profit margin.

RESEARCH METHODOLOGY

This paper has opted two methods of data acquisition, namely data from the bank scope database and focus group interviews with top officers of two full-fledged Islamic banks and two Islamic subsidiaries of conventional banks. The full-fledged Islamic banks are Bank Islam Malaysia Berhad and Muamalat Malaysia Berhad, while the Islamic subsidiaries of conventional banks are Maybank Islamic Berhad and CIMB Islamic Berhad. For the quantitative method, the study employed static panel analysis to investigate the effects of bank specific characteristics on bank margin in conventional and Islamic banks. The data of the study were gathered from the period of 2006 to 2014.

FINDINGS

QUANTITATIVE FINDINGS

Empirical results

The results of regression analysis on Islamic banks and conventional banks are shown in Table 1. Using static panel analysis, the regressions were run using E-views 8. Bank margin was regressed on 11 independent variables taken from the period of 2006 to 2014.

Table 1: Regression Results for Islamic and Conventional banks

Variable	Fixed Effects				Random Effects			
	Islamic banks		Conventional banks		Islamic banks		Conventional banks	
	Coefficient	P value	Coefficient	P value	Coefficient	P value	Coefficient	P value
Constant	13.215	0.377	17.875	0.013	22.115	0.365	16.378	0.008
CAPAD	0.013	0.833	0.017	0.545	0.093	0.371	0.056	0.014**
COSTOINC	-0.047	0.004***	-0.041	0.024**	0.003	0.814	-0.036	0.012**
DEFRISKFIN	0.095	0.015**	0.009	0.898	0.100	0.018**	0.009	0.892
LIQASSETTOLIAB	-0.023	0.080*	0.013	0.227	-0.006	0.551	0.020	0.167
LOANTODEP	0.003	0.458	-0.001	0.757	-0.004	0.470	-0.003	0.294
NONINTTOTA	-0.704	0.147	0.002	0.030**	-0.122	0.808	0.002	0.037**
LOGTA	-1.057	0.054*	-0.267	0.340	0.854	0.117	-0.005	0.979
GDP GROWTH	0.001	0.998	-0.125	0.209	-0.366	0.261	-0.144	0.051*
MONSUP	0.061	0.964	0.968	0.143	-2.851	0.153	1.168	0.044**
IFR	0.067	0.593	0.163	0.099*	0.468	0.047**	0.206	0.006***
UER	0.605	0.258	0.110	0.790	1.513	0.080*	0.228	0.606
Adjusted R ²	0.664		0.2564		0.3367		0.4374	

*** Significant @ 1% level, ** significant @ 5% level, * significant @ 10% level

The results show that adjusted R^2 for Islamic banks and conventional banks are 0.664 and 0.2564 respectively. The results also show that for Islamic banks, the bank size and liquid assets to total liability ratio have a significant negative relationship with bank profit margin, while management efficiency (*vis-à-vis* cost to income) and default risk have a significant positive influence on bank profit margin. For conventional banks, management efficiency and non-interest income to total assets ratio have a positive significant effect on the bank margin. This regression result of Islamic banks indicates that the bigger the bank size, the lower the bank profit margin. The result is parallel with a previous study by Haron (1996), who found that size has a negative relationship with profitability. The non-interest income of conventional banks which comes from non-loan activities is high enough to be possibly related to management efficiency, which then impacts the bank profit margin. Likewise, the management efficiency has an important role in influencing the bank profit margin and it has more impact on the conventional banks than Islamic banks. This result also indicates that both Islamic banks and conventional banks are not sensitive to the movement of the liquidity risk (loan over deposit).

QUALITATIVE FINDINGS

The recorded interviews were reviewed several times before being transcribed. Subsequently, a phenomenological approach to analyse data was adopted, which involves interpreting and reflecting on the data transcript so as to achieve a holistic understanding of the meaning of the participants' experiences (Othman, 2015). Furthermore, the area of bank margin and its determinants have been thoroughly discussed by various researchers. Hence, this data analysis approach was chosen to allow the Islamic bank experts to express their opinions based on their own experiences. Respondents expressed their thoughts about pricing practices and generally it was parallel with what was found in the literature. There are three main categories of bank determinants as suggested by the literature, namely bank specific characteristics, industry specific indicators, and macroeconomic indicators. The discussion and analysis of this paper will be based on the results acquired from the focus group interviews. Results of the focus group interviews have shown certain themes of guided policies, involved department, pricing practices, overall objectives of profit margin, and price determinants as indicated by being stated repeatedly by the respondents during the interview process. The following detailed discussion of the profit margin and pricing practices will cover the research questions of this paper, namely guided policies, responsible department, pricing practices, and price setting objectives. All

discussions will be based on excerpts from the focus group interviews in the discussion section. Meanwhile, the discussion of banks' determinants of price setting will be elaborated further using Table 2. The discussion of the above intentions will cover the Islamic banks involving the full-fledged Islamic banks, which are Bank Islam Malaysia Berhad and Muamalat Malaysia Berhad, and Islamic subsidiaries of conventional banks, which are Maybank Islamic Berhad and CIMB Islamic Berhad.

Table 2: General Key Attributes of Bank Margin Determinants and Transcription of Bank Muamalat, CIMB Islamic Bank Berhad, Maybank Islamic, and Bank Islam Malaysia Berhad.

Determinants of Bank Margin from the Literature	Definition and Measure (Proxy)	Transcription from Interview: Bank Muamalat	Transcription from Interview: CIMB Islamic Bank	Transcription from Interview: Maybank Islamic	Transcription from Interview: Bank Islam
Bank Specific Characteristics (Internal Factors)					
<i>Management Efficiency</i>	<i>Cost/Income</i>	"of course, you want a growth from year to year. I think the combination of more volume and more business but as well as more efficient". (Bank Muamalat, line 97-98)	(1) "Of course, we have certain target of profit". (CIMB Islamic Bank, line 97) (2) "we look at all factors such as the size and the assets and the percentage of return also must be on par, you cannot compromise on that". (CIMB Islamic Bank, line 99-100)	n.a.	"In terms of Islamic principles, we need to be shariah-compliant but we also need to be competitive as well and in order to be competitive, our pricing needs to follow market trend even though the pricing was computed according to pricing components, but at the end we need to follow market rate in order not to lose market share to competitors". (Bank Islam, line 82-86)

<i>Operating Expenses</i>	<i>Operating Expenses/Total Assets</i>	“it’s not easy to get customers, acquisition cost is very high, advertisement cost, promotion and campaign and all those things...” (Bank Muamalat, line 54-55)		“Operating expenses is same. It’s regarding certain expenses incurred by bank such as IT expenses, infrastructure or to set up branch”. (Maybank Islamic, line 166-167)	n.a.
<i>Bank Size</i>	<i>Total Asset</i>	“Price network which basically economies of scale . If we have bigger reach, so it not much critical to have a network...” (Bank Muamalat, line 53-54)	“we look at all factors such as the size of assets and the percentage of return also must be on par, you cannot compromise on that”. (CIMB, line 99-100)	“For your information, our composition of business within Maybank banking group is about 52% of total loan and we are the biggest contribution. In Islamic banking space, we are already big and sizeable. We are number two in terms of size, number one is Bank Rakyat if we consider them as Islamic institution”. (Maybank Islamic, line 15-19)	“Our MD said, Bank Islam is the smallest among the big banks, but biggest among small banks. Bank Islam is actually competing in retail section, assets compositions of bank Islam is 75% retail and 25% is corporate”. (Bank Islam, line 76-78)

<i>Liquidity Risk</i>	<i>Liquid Asset/Liabilities</i>	“Because fractional banking system, we take in deposit then we lend it to customer. Islamic bank manage liability independently from asset..... The moral hazard is this, if you take some risky financing and you lose money, you tend not to pass on the lost to the customer because we may not get the funding. Then you tend to absorb at the bank level. But when you make a lot of money, you don't have any option, you have to put in your reserve, which may not count for profit and goes to shareholders or	n.a.	“We are governed under Basel III, Basel III is more on liquidity, Basel II is on capital. On liquidity, in order bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered....”. (Maybank Islamic, line 110-113)	“This is the big issue that bank Islam need to be carefully managed. Yes, because of compliance, we monitor maturity mismatch and this matter has been managed by risk department and treasury. Often, we borrow short and then finance long, that the problem facing by retail banking”. (Bank Islam, line 113-116)
	<i>Loans/Customer Deposits</i>				

		you have to distribute as a dividend". (Bank Muamalat, line 2-10)			
Credit Risk	<i>Impaired Loans/Gross Loan or Provision for Loans</i> <i>Operation/Gross Credit Operation or Risk-Weighted Assets/Total Assets</i>	"The BR doesn't change, everybody follow that, right? But the spread change according to rating of the customer. When customer comes to the bank asking for whatever financing, you subject them to the scoring system, the scoring system probably for example, the rating 1 to 10 right? You would aspect rating 1 have smallest spread, the rating 10 would be highest spread". (Bank Muamalat, line 85-89)	"Logically, the system will be pickup one IC, except the person has two identity cards. Except you are in the different working place, perhaps after 6 monthly and then you apply. Maybe credit scoring will be different". (CIMB, line 55-57) (2) "...Every bank has got percentage maybe 50% auto and 40% home finance, 30% credit card. They have risk capital target, no two banks are same. Every bank has their own risk capital	"In our Islamic finance, we have different type of contracts whether using equity based or debt based. In terms of risk it's same for conventional or Islamic financing, the credit risk exposure when customer does not make payment or customer defaulting. In Islamic financing, we have several contracts, for equity based, i.e. Musyarakah Mutanaqisah, Mudharabah and Ijarah, while, for debt based are Ijarah, Murabahah and etc". (Maybank	"Yes, in terms of risk it's the same between Islamic bank and conventional bank. All banks have to follow the Basel requirement as enforced by respective financial regulators. It is the matter of the asset of the bank that makes it different. For example, Bank Islam, we have many market instruments same as conventional bank". (Bank Islam, line 136-139)

			assessment...” (CIMB Bank, line 61-63)	Islamic, line	
<i>Default Risk</i>	<i>Allowance or Reserve for financing Losses/Total Financing</i>	“The BR doesn’t change, everybody follow that, right? But the spread change according to rating of the customer. When customer comes to the bank asking for whatever financing, you subject them to the scoring system, the scoring system probably for example, the rating 1 to 10 right? You would aspect rating 1 have smallest spread, the rating 10 would be highest spread.”. (Bank Muamalat, line 85-89)	“Logically, the system will be pickup one IC, except the person has two identity cards. Except you are in the different working place, perhaps after 6 monthly and then you apply. Maybe credit scoring will be different”. (CIMB, line 55-57)	(i) “Yes, we can. Because the nature of the contract like Musyarakah Mutanaqisah or Wakallah or Ijarah. We can own the asset as opposed to the conventional banking, they cannot own the asset directly unless they set up the special vehicle to run the project. Islamic bank in Malaysia can do everything including investment banking, PE – private equity, the licence allows to do that, but we can’t because of the risk”. (Maybank Islamic, line 86-91)	“the rating of financing is determined by product risk and by customer rating as well. So, they have different rating as well in computing the base rate (BR)”. (Bank Islam, line 29-30)

				(ii) "Diminishing it's ok. We have done that even we have 4.4 billion of MM. But MM has not yet been tested in court. Because of an Ijarah element in the contract. It's normally concerned for property under construction. The risk is more on developer. Should developer fail to accomplish the project, then it will affect the customer financing with the bank. In abandoned project, customer has paid the instalment, then based on MM contract, bank has to pay back customer due to the negligence by developer." (Maybank Islamic, line 150-155)	
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<i>Capital Adequacy Ratio</i>	<i>Total Equity/Total Asset</i>	Imposed by Bank Negara Malaysia and Basel III	Imposed by Bank Negara Malaysia and Basel III	“We are governed under Basel III, Basel III is more on liquidity, Basel II is on capital. On liquidity, in order bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered....”. (Maybank Islamic, line 110-113)	“Central Bank had in stages enforced the requirements. Currently the requirement that in forced is LCR (Liquidity Coverage Ratio) and for the Net Stable Financing Ratio, it will be implemented gradually. For example, for LCR Central Bank has required that requirement has to be fully enforced on 2018, starting with 60% within six months on 2015”. (Bank Islam, line 131-134)
Other Bank Income					
<i>Non-Interest Bearing asset</i>	<i>Non-Interest Income/Total Assets</i>	“Now, if you have operating account and also a financing, so what do you think they going to price the pricing?”	n.a.	“Same. Fee based. No difference between conventional or Islamic banks. My experience is same. As for Maybank	“Yes, and we also have section that manage the sukuk offering”. (Bank Islam, line 109)

		They look at total relationship, everything is going through the bank, so they can optimise the pricing, right?" (Bank Muamalat, line 67-69)		because we ride on parent companies retained. That's why leverage model has lower price due to lower cost of fund obtained from parent company". (Maybank Islamic, line 168-172)	
Industry Specific Indicators (External Factors)					
<i>Market Interest Rate Volatility</i>	<i>Standard Deviation of Market Interest Rate. - Kuala Lumpur Interbank Offer Rate (KLIBOR)</i>	"Now, 80% of FTA is very sensitive, so market interest rate will reflect of whole market funding. "(Bank Muamalat, line 48)	"Let's see, in Islamic bank for example, they fixed at 5 % rate and then the Islamic bank will put on 1% as buffer. Why? The reasons are when the price increases, you cannot say I want to renegotiate the contract, from 6% to 8%". (CIMB, line 41-42).	"My contention is not whether on leverage or stand-alone models. It depends on the rating of the bank. Because, if I want to place money with you, I look at the rating. It's like giving credit. For Islamic banks, we are quite young, our rating is not that good from balance sheet point of view and capital also not that big	"As for base rate components, we cannot simply change without approval from Bank Negara. We need to show that the cost has move in order to increase the base rate. The way we contracted with customer, we say that based on base rate plus certain profit and if base rate moves then instalment amount will move as well.

				enough and because of that the cost of fund will be expensive. When people want to place money, especially foreign institutions, they look at your rating". (Maybank Islamic, line 159-164)	The one that we fix with customer is spread (profit margin) but base rate not fix with customer. Of course, we can change BR anytime but subject to Bank Negara approval". (Bank Islam, line 41-46)
<i>Market Concentration</i>	(i) <i>Ratio of Largest Three Bank's Assets/Total Banking Assets in given year</i> (Nacuer, 2003) (ii) <i>The Summing of Squared Market Shares of all firms in the market. (Herfindahl Hirschman Index – HHI)</i>	"The smaller the bank, the higher the acquisition (acquiring new customer) cost, this cost of investment will go to your cost, I mean in terms of ratio of asset size, they will be very high proportionately and there's nothing new. (Stressed by Prof, no wonder they want to merge)". (Bank	n.a.	n.a.	"Currently in Islamic banking, Bank Islam is ranked third, number one is Al-Rajhi Bank or Kuwait Finance House, but number one in Malaysia is Maybank Islamic Bank Berhad, second CIMB Islamic Bank Berhad and third is Bank Islam Malaysia Berhad". (Bank Islam, line 178-181)

		Muamalat, line 57-60)			
Other Determinant Factors					
General Pricing		"Pricing is actually based on supply and demand equilibrium, yes you can look at the cost factor going into that pricing of the product, but you need to look at market competition of Islamic banks...." (Bank Muamalat, line 31-33)	(i) "That one is campaign, bank may have a campaign. For example, one bank may have a lot of finance. Every bank has been got percentage maybe 50% auto and 40% home finance, 30% credit card. They have risk capital target, no two banks are same. Every bank has its own risk capital assessment." (CIMB, line 60-63). (ii) "Generally, the pricing between Islamic and conventional is very similar. Because the lower price can attract more customers. So, pricing strategic	"Competition is very tensed actually, because all banks have done Islamic financing and they also realised that conventional market is very crowded". (Maybank Islamic, line 190-192)	"All banks have their own base rate, for Bank Islam our base rate is currently at 3.6% (liquidity cost and credit risk cost), and on top of base rate components, we have profit margin that would become our spread, that means BR + 0.6 and that amount of spread is really competitive in such market like Malaysia. Here we try to benchmark to our competitors for example, house financing, if we see the market for certain type of segment, competitors imposed 4.65% overall, so we play with our profit margin".

			depends on the competition in the market. So, if bank A want more targets of mortgage financing, of course they should use the campaign". (CIMB, line 83-86).		(Bank Islam, line 32-38)
Current and Savings Account (CASA) and Fixed Term Deposit Account (FTA)		(1) "Now, I start with liability, the composition of liability is two things, CASA and FTA. CASA mostly coming from corporate sector also have small individual accounts. But for FTA, we have lot from corporate because they have a lot of money, so in our case, our CASA very small and FTA very high with ratio about 80% FTA and 20%	(i) "The differences are only tactical, because market is very competitive and cost of fund is same. Only they look at the deposit side, CASA and today price is on the par and it's only tactical". (CIMB, line 122-123). (ii) "Yes, all include. And also, very straightforward and banks will have their own cost of fund. Some banks may have a lot of CASA and	"On liquidity, in order bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered such as CASA". (Maybank Islamic, line 110-113)	"On the liability side, we have deposits. For asset side the pricing become our income and on liability side certain pricing is become our cost". (Bank Islam, line 13-14)

		CASA". (Bank Muamalat, line 45-49). (2) "...the bigger nature proportionately of FTA and short term and it sensitive to network rate, so when interest rate goes up, the cost of fund will up as well and of course same effect when interest rate goes down. I mean is that the volatility of your cost of fund is a lot higher and it has to be infected into your pricing. Cost of fund is the thing, first, the ratio of CASA and FTA plus behavioural aspect". (Bank Muamalat, line 64-68).	CASA is very cheap". (CIMB, line 141-142).		
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Product Risk		n.a.	“Risk will be incorporate into the product. Every product has its own risk rate”. (CIMB, line 126).	n.a.	“the rating of financing is determined by product risk and by customer rating as well”. (Bank Islam, line 29-30)
Financing Terms and Conditions		n.a.	“Sometimes we can do the marketing. But sometime the spreads are lower but the term is higher. So, we cannot look at the numbers but look at the whole picture”. (CIMB, line 70-72)	n.a.	“owh that as I said included in 1% of profit. For cost that we mentioned just now, it’s under BR. We have committee to cattle down the discretion of profit rate discount to be offered to customer”. (Bank Islam, line 65-67)
Awareness		n.a.	“Prof Fauzias: Supposedly, the Islamic and conventional should be the same. But I try to know, that whether the growth of Islamic product of pricing or the awareness of the people?”	n.a.	“for individual financing, they tend to look at shariah viewpoint than the profit margin of financing, whereas for corporate, they look more on profit margin”. (Bank Islam, line 95-96)

			CIMB bank: Mostly awareness because price is so competitive". (CIMB, line 92-94)		
Discretionary Power (DP)		n.a.	n.a.	"That's we call DP – Discretionary Power. Officer, branch manager, regional manager and upper management have the discretionary to give certain rebate, but that's not the unique selling point. Conventional and Islamic have the same power to give rebate to their customers." (Maybank Islamic, line 67-72)	"Actually, we already have standard rate, but if there is an appeal from customer to reduce the rate, financing committee will look and decide. In terms of procedures, ALCO (assets liability committee) will decide the approval, but the appeal of profit margin will decide by financing committee based on certain threshold and limitations". (Bank Islam, line 67-70)

The ultimate target for the Islamic banks is the profit in their business as this profit will ensure the continuity of the business stream. The bank profitability can generally be defined as the spread of interest income minus interest expenses to total assets (Oliver et al., 2015), whereby the net interest income set by Islamic banks is to cover the cost of intermediaries, and reflects both the volume and mix of assets and liabilities (Jane et al., 2012). Islamic banks cannot predetermine the portion of return to pay the depositors as it violates the shariah rules (riba). Deposit or financing rate of Islamic banks is known as ex-ante, while equity-based product is known as ex-post, and in overall taken together the Islamic banks in nature is ex-post (Erwin & Rahmatina, 2010), thus the net interest margin of Islamic banks is known as ex-post. The following is a detailed discussion of the research questions.

The first research question is regarding the policy that guides the pricing practices. The annual reports and focus interviews have indicated that pricing policy is formulated and governed by bank management under the policy framework set up by the board of directors, which is also reflected under risk management framework. The maximum risk tolerances and financing compositions between retail and corporate must be adhered by bank management. Analysis conducted from the annual reports show that the pricing policies were tied up under the management policy. For example, in terms of financing, results of the interviews show that Islamic banks have to create a pricing policy based on a framework that has been gazetted whether the retail composition is more or less as compared to corporate financing. This approach was taken due to several reasons, but one of it perhaps, is to reduce the displacement risk, whereby big corporations might move the fund to other banks as stressed by the interview statements below:

(i) *“Now we’re talking about the treasury activity, I think normally for conventional banks it’s between 20% to 30% and you find out that Islamic banks contribution probably at the lower end”. (Bank Muamalat, line 17-18)*

(ii) *“Every bank has got percentage maybe 50% auto and 40% home finance, 30% credit card. They have risk capital target, no two banks are same. Every bank has their own risk appetite...” (CIMB Bank, line 61-63)*

(iii) *“Our BOD predominantly focus on retail but we have presence also in the corporate financing. Corporate will increase our growth. Here we manage our risk through 70% retail (less risk) and 30% corporate (more risk), i.e. displacement risk. Thus, retail financing served as the cushion when displacement risk occurred”. (Bank Islam, line 137-140)*

The second research question concerns the departments that handle the pricing practices. These departments are entrusted by the management to formulate, manage,

and control the pricing strategy based on the framework that was set up by the board of directors in order to maximise the profit and minimise the cost involved. Certain Islamic banks such as Bank Muamalat Berhad and Maybank Islamic Berhad have a special department to manage the pricing policy, while Bank Islam Malaysia Berhad has set up a special committee, that is the asset liability management committee (ALCO), to manage the pricing policy. CIMB Islamic Berhad has a different approach to manage the pricing policy whereby the customer financing application is processed by a branch, while the final approval is done by the headquarters. The following are several excerpts concerning the entrusted department for pricing policy:

(i) *"If you don't mind, I tell you a bit about our brand, Bank Islam and Bank Muamalat are the standalone banks and they have dedicated personnel management, risk management, and IT department". (Maybank Islamic, line 10-12)*

(ii) *"Actually, we already have standard rate, but if there is an appeal from customer to reduce the rate, financing committee will look and decide. In terms of procedures, ALCO (assets liability committee) will decide the approval, but the appeal of profit margin will be decided by financing committee based on certain threshold and limitations". (Bank Islam, line 67-70)*

(iii) *"Special committee at HQ level has been entrusted to manage the pricing Policy. Branches will process the financing application but Committee at HQ will assess and approve the application". (CIMB Islamic, line 24-25)*

The third research question is about the pricing practices and overall objectives of price setting respectively. Under the pricing practices, there are several aspects to be investigated through focus group interviews, whether discreet, rigid, or flexible style of pricing practices have been adopted by the Islamic banks. Result of the focus group interviews reveals that overall, Islamic banks have adopted the discreet and also flexible style of pricing practices due to the dynamics of economic volatility, challenging competition, and high expectations and demands from consumers. The following excerpts were expressed by the respondents:

(i) *"ok, different bank has different roadmap, have different role, some as enforcer like policemen. But there are also like muamalat, we try to facilitate the business. The moral hazard is one have capacity to pay the other one willingness to pay". (Bank Muamalat, line 101-103)*

(ii) *"Bank can play with both of the BR and 1%, meaning credit scoring will be reflect within BR and 1%". (Bank Islam, line 72-73)*

(iii) *"Because of the risk exposure, we have cost of fund and credit spread. We apply the same whether for conventional or Islamic financing. Cost of fund follow KLIBOR*

benchmark. For the one year, we follow MGS, while for more than twelve months, we follow KLIBOR". (Maybank Islamic, line 127-130)

(iv) "it's about the market, if your lower base rate, then the spreads will be higher. For example, CIMB Islamic Bank Berhad has base rate of 3% and 1% is spreads. Sometimes we can do the marketing. But sometime the spreads are lower but the term is higher. So, we cannot look at the numbers but look at the whole picture". (CIMB Islamic, line 71-74)

For the fourth research question, in terms of the overall objectives of price setting, this aspect has been pre-ascertained based on the literature, whether Islamic banks apply stable, growth, or positive objective regarding price setting. This aspect was considered as a paramount importance to Islamic banks as it will determine the banks' lifelong economic stream. As per conversation with the Islamic banks' top management, the exponential growth of the bank business is crucial and essential for bank continuity in the long run. Thus, the strategic and holistic efforts towards bank growth are the prime tasks for all bank subordinates. Besides other incomes such as fee-based, the Islamic banks' main business are depositing and financing; this aspect will be formulated, monitored, and evaluated to ensure the growth objective is achieved. The following excerpts emphasised the growth target as explained in the focus group interviews:

(i) "of course, you want a growth from year to year. I think the combination of more volume and more business but as well as more efficient". (Bank Muamalat, line 107-108)

(ii) "We want exponential growth. We want to grow as big as we want". (Maybank Islamic, line 199)

(iii) "Yes, it can be changed, but the retail you cannot increase in one night because of volume and small in size of financing, whereas corporate can increase the business within shorter period of time because of the large size of financing. Our BOD predominantly focus on retail but we have presence also in the corporate financing. Corporate will increase our growth. Here we manage our risk through 70% retail (less risk) and 30% corporate (more risk), i.e. displacement risk. Thus, retail financing served as the cushion when displacement risk occurred". (Bank Islam, line 154-161)

(iv) "Of course, we have certain target of growth". (CIMB Islamic Bank, line 201)

Lastly, the fifth research question concerns the determinants of bank margin. A number of themes that emerged from the interviews were confirmed to the literature. However, there are other themes that are different from the literature and it seems that there are differences between academic theory and the approaches practised by the banking

industry. The following is a detailed discussion about the themes of bank margin determinants that emerged from the interviews which were parallel with the referred literature and followed by a discussion of the new findings from the focus group interviews:

(1) The first theme that was retrieved is management efficiency, which is about the efficiency in managing the business operation. The management efficiency concerns the ability of the management to minimise costs at a given level of income or to maximise income at a reasonable level of cost (Erwin & Rahmatina, 2010). According to the literature, management efficiency is negatively related to bank margin, that is as the efficiency of Islamic banks improves, the banks would be able to reduce the costs and thus will offer relatively lower margin to their customers. Result of the interviews has stressed implicitly that Islamic banks have to be efficient in their banking business in order to achieve the profit target. Below are excerpts from the interviews:

(i) *"of course, you want a growth from year to year. I think the combination of more volume and more business but as well as more efficient". (Bank Muamalat, line 97-98)*

(ii) *"Of course, we have certain target of profit". (CIMB Islamic Bank, line 97)*

(iii) *"we look at all factors such as the size and the assets and the percentage of return also must be on par, you cannot compromise on that". (CIMB Islamic Bank, line 99-100)*

(iv) *"In terms of Islamic principles, we need to be shariah-compliant but we need also to be competitive as well and in order to be competitive, our pricing needs to follow market trend even though the pricing was computed according to pricing components, but at the end we need to follow market rate in order not to lose market share to competitors". (Bank Islam, line 82-86)*

(2) The second theme retrieved from the focus group interviews is operating expenses, whereby Islamic banks incur costs of financial intermediaries such as screening financing applications to assess the risk profile of borrowers, and customer acquisition cost, which are promotion and advertisement.

An increase in the operating cost is expected to have a positive influence on financing rate spread. Higher operating cost will lead to higher financing rate and depressing the deposit rate as expressed by the respondents:

(i) *"it's not easy to get customers, acquisition cost is very high, advertisement cost, promotion and campaign, and all those things..." (Bank Muamalat, line 54-55)*

(ii) *"Operating expenses is same. It regarding certain expenses incurred by bank such as IT expenses, infrastructure or to set up branch". (Maybank Islamic, line 166-167)*

(iii) *“Our MD said, Bank Islam is the smallest among the big banks, but biggest among small banks. Bank Islam is actually competing in retail section, assets compositions of bank Islam is 75% retail and 25% is corporate”. (Bank Islam, line 76-78)*

(3) The third theme that emerged from the interview exercise is bank size, which can be expected that the bigger the banks, the higher the capability to reach the customers. Normally, bigger banks are associated with lower financing rate spread because of economies of scale and the ability to invest in the latest technology that would enhance efficiency. Thus, with the better control of the market, it is not surprising that there is a positive relationship between bank spread and bank size. As stated by the respondents, bank size is significant in improving bank profitability:

(i) *“Price network which is basically economies of scale. If we have bigger reach, so it not much critical to have a network...” (Bank Muamalat, line 53-54)*

(ii) *“we look at all factors such as the size of assets and the percentage of return also must be on par, you cannot compromise on that”. (CIMB, line 99-100).*

(iii) *“For your information, our composition of business within Maybank banking group is about 52% of total loan and we are the biggest contribution. In Islamic banking space, we are already big and sizeable. We are number two in terms of size, number one is Bank Rakyat if we consider them as Islamic institution”. (Maybank Islamic, line 15-19)*

(4) The fourth theme retrieved from the interviews is liquidity risk. This risk involves the Islamic banks, which may not have sufficient cash or borrowing capacity to meet deposit withdrawal or financing demand and it will cause the banks to borrow from emergency funds at higher cost. According to Santiago and Francisco (2007), if the liquidity risk of the banks increases, the banks will ask for higher risk liquidity premium. The banks will increase the finance rate so the Islamic banks' net interest income will increase as well. Hence, the Islamic banks' net interest income will respond positively to liquidity risk. There are a number of proxies to measure liquidity ratio, namely total loan to total asset and total financing to total deposit (Kosmidou et al. 2005; Sufian & Abdullah, 2010). The ratio shows the relationship between liquidity and bank margin. Financing is the biggest component of interest bearing assets of a bank and it is expected to have a positive impact on profitability (Sufian & Abdullah, 2010). Profit is expected to be higher when more deposit is transferred into financing, thus assumed a positive relationship with profitability. The respondents emphasised that Islamic banks are always prudent in handling the deposit side as well as the financing side due to unmatched timing between deposit and financing:

(i) *“Because fractional banking system, we take in deposit then we lend it to customer.*

Islamic banks manage liability independently from asset. In terms of distributing, you always look at whatever you can have from your asset then only you pay your depositors, right?

The moral hazard is this, if you take some risky financing and you lose money, you tend not to pass on the lost to the customer because we may not get the funding. Then you tend to absorb at the bank level. But when you make a lot of money you don't have any option, you have to put in your reserve which may not count for profit and goes to shareholders or you have to distribute as a dividend". (Bank Muamalat, line 2-10)

(ii) *"We are governed under Basel III, Basel III is more on liquidity, Basel II is on capital. On liquidity, in order bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered.....". (Maybank Islamic, line 110-113)*

(iii) *"This is the big issue that Bank Islam need to be carefully managed. Yes, because of compliance, we monitor maturity mismatch and this matter has been managed by risk department and treasury. Often, we borrow short and then finance long, that the problem facing by retail banking". (Bank Islam, line 113-116)*

(5) *The fifth theme is credit risk. If the bank foresees a high risk of operation, then the bank will charge higher risk premium that will subsequently increase the bank margin. The bank will incorporate credit risk into pricing through credit scoring assessment, whereby if there is high risk result, the bank will charge high risk premium. As the respondents expressed:*

(i) *"The BR doesn't change, everybody follows that, right? But the spread change according to rating of the customer. When customer comes to the bank asking for whatever financing, you subject them to the scoring system, the scoring system probably for example, the rating 1 to 10 right? You would aspect rating 1 have smallest spread, the rating 10 would be highest spread". (Bank Muamalat, line 85-89)*

(ii) *"Every bank has got percentage maybe 50% auto and 40% home finance, 30% credit card. They have risk capital target, no two banks are same. Every bank has its own risk appetite..." (CIMB Bank, line 61-63)*

(iii) *"Logically, the system will be pickup one IC, except the person has two identity cards. Except you are in the different working place, perhaps after 6 monthly and then you apply. Maybe credit scoring will be different". (CIMB, line 55-5).*

(iv) *"In our Islamic finance, we have different type of contracts whether using equity based or debt based. In terms of risk it's the same for conventional or Islamic financing, the credit risk exposure when customer does not make payment or customer defaulting. In Islamic financing, we have several contracts, for equity based, i.e.*

Musyarakah Mutanaqisah, Mudharabah and Ijarah, while, for debt based are Ijarah, Murabahah, and etc". (Maybank Islamic, line 75-79).

(v) *"Yes, in terms of risk it's the same between Islamic banks and conventional banks. All banks have to follow the Basel requirement as enforced by respective financial regulators. It is the matter of the asset of the bank that makes it different. For example, Bank Islam, we have many market instruments same as conventional banks". (Bank Islam, line 136-139)*

(6) The sixth theme that emerged from the interviews is default risk. The interviews have stressed that the risks involved in determining the bank margin should be carefully planned in order to minimise the risks. The default risk is the risk of non-repayment on financing due to the inability of the fund's users to fulfil their obligations.

Since financing is the main source of the income to banks, the deterioration of financing quality will affect the bank's ability to give lending to other customers and will definitely affect the bank's profitability and subsequently the bank's viability. As the default risk is higher, the bank will put the higher risk premium on financing, then the price of financing will increase so as the bank profitability. The following are excerpts from the interviews:

(i) *"The BR doesn't change, everybody follows that, right? But the spread change according to rating of the customer. When customer comes to the bank asking for whatever financing, you subject them to the scoring system, the scoring system probably for example, the rating 1 to 10 right? You would aspect rating 1 have smallest spread, the rating 10 would be highest spread.". (Bank Muamalat, line 85-89)*

(ii) *"Logically, the system will be pickup one IC, except the person has two identity cards. Except you are in the different working place, perhaps after 6 monthly and then you apply. Maybe credit scoring will be different". (CIMB, line 55-57)*

(iii) *"Yes, we can. Because the nature of the contract like Musyarakah Mutanaqisah or Wakallah or Ijarah. We can own the asset as opposed to the conventional banking, they cannot own the asset directly unless they set up the special vehicle to run the project. Islamic banks in Malaysia can do everything including investment banking, PE – private equity, the licence allows to do that, but we can't because of the risk". (Maybank Islamic, line 86-91)*

(iv) *"Diminishing it's ok. We have done that even we have 4.4 billion of MM. But MM has not yet been tested in court. Because of an Ijarah element in the contract. It's normally concerned for property under construction. The risk is more on developer. Should developer fail to accomplish the project, then it will affect the customer financing with the bank. In abandoned project, customer has paid the instalment, then*

based on MM contract, bank has to pay back customer due to the negligence by developer.” (Maybank Islamic, line 150-155)

(v) “the rating of financing is determined by product risk and by customer rating as well. So, they have different rating as well in computing the base rate (BR)”. (Bank Islam, line 29-30)

(7) The seventh theme is the capital adequacy ratio. This is the condition imposed by Bank Negara Malaysia and there are also certain guidelines from Basel III (required banks to fund themselves with 4.5% of common equity). The capital ratio is the amount of capital a bank or other financial institution has to hold as required by its financial regulator. This is usually expressed as a capital adequacy ratio of equity that must be held as a percentage of risk-weighted assets. These requirements are put into place to ensure that these institutions do not take on excess leverage and become insolvent. Capital requirements govern the ratio of equity to debt, and recorded on the liabilities and equity side of a firm's balance sheet. They should not be confused with reserve requirements, which govern the asset side of a bank's balance sheet, in particular, the proportion of its assets it must hold in cash or highly-liquid assets. The following excerpts are about capital adequacy:

(i) “We are governed under Basel III, Basel III is more on liquidity, Basel II is on capital. On liquidity, in order for bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered....”. (Maybank Islamic, line 110-113)

(ii) “Central Bank had in stages enforced the requirements. Currently, the requirement that in forced is LCR (Liquidity Coverage Ratio) and for the Net Stable Financing Ratio, it will be implemented gradually. For example, for LCR Central Bank has required that requirement has to be fully enforced on 2018, starting with 60% within six months on 2015”. (Bank Islam, line 131-134)

(8) The eighth theme obtained from the interviews is non-interest bearing asset. This measure effectively captures all sources of the non-interest income generated by diversified Islamic banks. This determinant is also considered as a shift from traditional financial intermediation to other banking activities in order to compensate for declining profitability or as extra income for the Islamic banks. According to Oliver et al. (2015), banks are willing to add the non-interest income activities in order to boost the bank profit and the result shows that the increase in non-interest income will lower the corresponding financing rate charged and subsequently will lower the net interest income. According to the respondent from Bank Muamalat, non-interest activities derived from, for instance an operating Islamic bank account, is considered as collateral for the financing offered to customers. Under operating account, banks

can charge certain fees such as processing fee and maintenance account fee as noted by the theme below:

(i) *"Now, if you have operating account and also a financing, so what do you think they gonna price the pricing? They look at total relationship, everything is going through the bank, so they can optimise the pricing, right?" (Bank Muamalat, line 67-69)*

(ii) *"Same. Fee based. No difference between conventional or Islamic banks. My experience is the same. As for Maybank because we ride on parent companies retained. That's why leverage model has lower price due to lower cost of fund obtained from parent company". (Maybank Islamic, line 168-172)*

(iii) *"Yes, and we also have section that manage the sukuk offering". (Bank Islam, line 109)*

(9) The ninth theme that was derived from the focus group interviews is market interest rate volatility. Concerning the market rate volatility, it was indicated from the literature that generally banks would ask for higher margin when interest rate increases. Unlike before, now Islamic banks in Malaysia are using the floating rate approach in their financing, thus the exposure of rate volatility faced by Islamic banks is similar to conventional banks. That is, as market rate increases, Islamic banks need to increase their financing rate in order to compensate for the higher market rate. Hence, as the market rate swings, no matter whether it increases or decreases, the Islamic banks would have to adjust their rate of financing accordingly. Specifically, for example under Bank Islam Malaysia Berhad, the component that can be re-evaluated if cost increased is bank financing rate (BFR). This adjustment can be done with the approval from Bank Negara Malaysia. The other part of profit margin is bank spread. This part cannot be adjusted once it was sealed with the customers. These issues can be further understood from the following statements:

(i) *"As for base rate components, we cannot simply change without approval from Bank Negara. We need to show that the cost has move in order to increase the base rate. The way we contracted with customer, we say that based on base rate plus certain profit and if base rate moves then instalment amount will move as well. The one that we fix with customer is spread (profit margin) but base rate not fix with customer. Of course we can change BR anytime but subject to Bank Negara Approval". (Bank Islam, line 41-46)*

(ii) *"Now, 80% of FTA is very sensitive, so market interest rate will reflect of whole market funding. (Bank Muamalat, line 48)".*

(iii) *"Let's see, in Islamic banks for example, they fixed at 5 % rate and then the*

Islamic banks will put on 1% as buffer. Why? The reasons are when the price increase, you cannot say I want to renegotiate the contract, from 6% to 8%". (CIMB, line 41-42).

(iv) "My contention is not whether on leverage or stand-alone models. It depends on the rating of the bank. Because, if I want to place money with you, I look at the rating. It's like giving credit. For Islamic banks, we are quite young, our rating is not that good from balance sheet point of view and capital also not that big enough and because of that the cost of fund will be expensive. When people want to place money, especially foreign institutions, they look at your rating". (Maybank Islamic, line 159-164)

(10) The tenth theme that emerged from the interviews is market concentration. There are contrasting views on the relationship between market concentration and net interest margin. Some researchers noted that concentrated market will enhance bank power to increase interest margin (Porter, 1979). Saunders and Schumacher (2000) also found that market concentration had a positive relationship with spread, where the larger the monopoly power of the banks, the higher their spreads. According to Abduh and Idrees (2013), who conducted their research in Malaysia, their empirical result shows that the market is highly concentrated with profitability. But from the interviews, it is not clear as to what the effect of market concentration towards the net interest income is. However, the respondents of Bank Muamalat had implied that banks with smaller capital will have lower power to influence the market, whereas banks with higher market share and more market reach are capable of offering lower financing rate in order to attract customers. Thus, lower financing rate will be able to attract more customers and therefore higher profit to the banks as highlighted by the following statements:

(i) "The smaller the bank, the higher the acquisition cost, this cost of investment will go to your cost, I mean in terms of ratio of asset size, they will be very high proportionately and there's nothing new.

(Stressed by prof, no wonder they want to merge) and it was agreed by respondent".

(Bank Muamalat, line 57-60)

(ii) "Currently in Islamic banking, Bank Islam is ranked third, number one is Al-Rajhi Bank or Kuwait Finance House, but number one in Malaysia is Maybank Islamic Bank Berhad, second CIMB Islamic Bank Berhad and third is Bank Islam Malaysia Berhad". (Bank Islam, line 178-181)

(11) The eleventh theme that emerged from the focus group exercise is competition. This element of pricing is being repeatedly emphasised by the respondents. It is

obvious that competition has a direct impact on pricing structure whereby Islamic banks takes into consideration the element of marketing campaign to promote their financing products. Banks will have to offer special campaigns of financing facilities in order to attract customers.

In certain occasions, normally banks will offer lower financing rate to spur certain financing products such as the balloon schemes offered for auto financing by RHB Islamic Bank Berhad. This campaign offers staggered financing rate starting with lower financing rate for certain years and the financing rate will increase for the subsequent years until the end of the financing period. As stated by the respondents, market competition is very high due to the many players involved in Islamic banking in Malaysia. Each bank will try to attract customers with its own promotion of financing. However, the larger banks will have competitive advantages due to economies of scale with larger network and larger customer reach. Below are excerpts from the interviews with the respondents:

(i) *"Pricing is actually based on supply and demand equilibrium, yes you can look at the cost factor going into that pricing of the product, but you need to look at market competition of Islamic banks..." (Bank Muamalat, line 31-33).*

(ii) *"That one is campaign, bank may have a campaign. For example, one bank may have a lot of finance. Every bank has been got percentage maybe 50% auto and 40% home finance, 30% credit card. They have risk capital target no two banks are same. Every bank has their own risk capital assessment." (CIMB, line 60-63).*

(iii) *"Generally, the pricing between Islamic and conventional is very similar. Because the lower price can attract more customers. So, pricing strategic depends on the competition in the market. So, if bank A want more targets of mortgage financing, of course they should use the campaign". (CIMB, line 83-86).*

(iv) *"Competition is very tensed actually, because all banks have done Islamic financing and they also realised that conventional market is very crowded". (Maybank Islamic, line 190-192)*

(v) *"All banks have their own base rate, for Bank Islam our base rate is currently at 3.6% (liquidity cost and credit risk cost), and on top of base rate components, we have profit margin that would become our spread, that means $BR + 0.6$ and that amount of spread is really competitive in such market like Malaysia. Here we try to benchmark to our competitors for example, house financing, if we see the market for certain type of segment, competitors imposed 4.65% overall, so we play with our profit margin". (Bank Islam, line 32-38)*

New Findings from the Interviews

There are certain themes that are not specifically stated by the literature that emerged from the focus group interviews and appeared in determining pricing structure exercised by Islamic banks. It is paramount for Islamic banks to consider any element that will affect the profit margin of the banks in order to stay alive in business. The following themes are those emerged from the interviews:

(1) First, one of the themes that emerged from the interviews is the liability item under the bank's balance sheet. As pointed out by the respondents, the element of Current Account and Savings Account (CASA) plays an important role in pricing formulation. The percentages of CASA will influence the financing rate offered to customers as it involves the calculation of the cost of fund.

According to Bank Muamalat, the elements of CASA and FTA (Fixed Term Deposit Account) will affect the pricing structure of the banks, but it also depends on the bank size. For smaller banks such as Bank Muamalat, the amount of CASA is small compared to FTA, but for bigger banks such as Maybank Islamic Berhad, CASA's component has a significant effect on pricing structure.

Furthermore, as noted by the respondent from CIMB Bank, the amount of CASA contributes more in terms of the bank capital. CASA is cheaper in terms of cost of fund compared to other sources of funds such as FTA or fund from interbank money market. The following are excerpts from the interviews:

(i) "Now, I start with liability, the composition of liability is two things, CASA (current account and saving account) and FTA (fix terms deposit account). CASA mostly coming from corporate sector also have small individual accounts. But for FTA, we have lot from corporate because they have a lot of money, so in our case, our CASA very small and FTA very high with ratio about 80% FTA and 20% CASA". (Bank Muamalat, line 45-49).

(ii) "... the bigger nature proportionately of FTA and short term and it's sensitive to network rate, so when interest rate goes up, the cost of fund will up as well and of course same effect when interest rate goes down. I mean is that the volatility of your cost of fund is a lot higher and it has to be infected into your pricing. Cost of fund is the thing, first, the ratio of CASA and FTA plus behavioural aspect". (Bank Muamalat, line 64-68).

(iii) "The differences are only tactical because market is very competitive and cost of fund is same. Only they look at the deposit side, CASA and today price is on the par and it's only tactical". (CIMB, line 122-123).

(iv) "Yes, all include. And also, very straightforward and bank will have their own cost of fund. Some banks may have a lot of CASA and CASA is very cheap". (CIMB, line 122-123).

(v) *“On liquidity, in order bank to have enough liquidity, bank need to have enough reserve not just regarding deposit but also the type of deposit need to be considered such as CASA”. (Maybank Islamic, line 110-113)*

(vi) *“On the liability side, we have deposits. For asset side the pricing become our income and on liability side certain pricing is become our cost”. (Bank Islam, line 13-14)*

(2) The second theme that appeared from the interviews is product risk. The product risk premium has been pre-formulated by the banks. According to the respondent from CIMB Bank, each product has its own risk, whereby the banks will have assigned risk rate premium to the particular product. Thus, when the banks have determined the financing rate to their customers, the banks will incorporate the product risk premium according to which financing product is acquired by customers. The following is the theme expressed by the respondents:

(i) *“Risk will be incorporated into the product. Every product has its own risk rate”. (CIMB, line 126).*

(ii) *“the rating of financing is determined by product risk and by customer rating as well”. (Bank Islam, line 29-30)*

(3) The third theme that was retrieved from the interviews is financing term, whereby the term will affect the pricing of product financing. In order to attract customers, Islamic banks will offer special promotions of the margin rate. This offer will be attached to certain conditions. For example, banks will offer lower financing rate when customers apply for a longer period of financing or customers apply for financing exceeding a certain financing amount. As expressed by the CIMB Bank’s respondent in the interviews:

(i) *“Sometimes we can do the marketing. But sometime the spreads are lower but the term is higher. So, we cannot look at the numbers but look at the whole picture”. (CIMB, line 70-72)*

(ii) *“owh that as I said included in 1% of profit. For cost that we mentioned just now, it’s under BR. We have committee to cattle down the discretion of profit rate discount to be offered to customer”. (Bank Islam, line 65-67)*

(4) The fourth theme that emerged from the interviews is awareness of the customers. Excerpts from the interviews show that awareness of the Islamic value is the main factor that the customers wanted to select Islamic banks. Due to the awareness of the Islamic principles, the Muslim customers will certainly choose Islamic banks, even though conventional banks offer similar financing products. Thus, the awareness factor will contribute to the Islamic banks’ growth. The following are excerpts from

the interviews:

(i) *"Prof Fauzias: Supposedly, the Islamic and conventional should be the same. But I try to know, that whether the growth of Islamic product of pricing or the awareness of the people?"*

CIMB Bank: Mostly awareness because price is so competitive". (CIMB, line 92-94)

(ii) *"for individual financing, they tend to look at shariah viewpoint than the profit margin of financing, whereas for corporate, they look more on profit margin". (Bank Islam, line 95-96)*

(5) The fifth theme that was discovered from the interviews is the negotiation power handed down by Islamic banks to their officers. The credit officers can bargain with prospective customers regarding the product price. This is one of the selling points that bank officers can promote and close the deal with customers. Maybank Islamic Berhad has exclusively given the right to their officers to offer certain points of reduction in profit margin as a bargaining tool. This is called Discretionary Power (DP). The following excerpts from the interviews highlighted this point:

(i) *"That's we call DP – Discretionary Power. Officer, branch manager, regional manager, and upper management have the discretionary to give certain rebate, but that not the unique selling point. Conventional and Islamic have the same power to give rebate to their customers". (Maybank Islamic, line 67-72)*

(ii) *"Actually, we already have standard rate, but if there is an appeal from customer to reduce the rate, financing committee will look and decide. In terms of procedures, ALCO (asset liability committee) will decide the approval, but the appeal of profit margin will decide by financing committee based on certain threshold and limitations". (Bank Islam, line 67-70)*

Based on the analysis above, there are certain determinants that emerged from excerpts obtained from the focus group interviews with the respondents from Bank Muamalat and CIMB Bank. The themes that were parallel with the literature are default and credit risk, operating expenses, bank size, market interest rate volatility, and competition, while determinants that were not picked up by the literature are liability items (CASA and FTA), product risk, financing terms, and Discretionary Power (DP). It is apparent that there is a slightly different approach practised by Islamic banks in setting up the price for the financing products as compared to the academic theories. Eventually, the focus group interviews had revealed the real practices by Islamic banks regarding the pricing of financing products in Malaysia.

CONCLUSIONS

The analyses suggest some distinct outcomes and results in identifying the determinants and practices of pricing and bank margin for future research. The results show that for Islamic banks, bank size and liquid assets to total liability ratio have a significant negative relationship with bank profit margin, while management efficiency (vis-à-vis cost to income) and default risk have a significant positive influence on bank profit margin. For conventional banks, management efficiency and non-interest income to total asset ratio have a positive significant effect on the bank margin. This regression result of Islamic banks indicates that the bigger the bank size, the lower the bank profit margin. The non-interest income of conventional banks which comes from non-loan activities is high enough to be possibly related to management efficiency, which then impacts bank profit margin. Likewise, the management efficiency has an important role in influencing the bank profit margin and it has more impact on conventional banks than Islamic banks. This result also indicates that Islamic banks are not sensitive to the movement of the liquidity risk (loan over deposit). As the default risk increases, Islamic banks will also have to increase the default risk premium charged to customer testing, that is the higher the default, the higher the premium based on individual credit scoring, and likewise, the higher the bank margin.

This study provides important insights for Islamic banks to improve their bank margin and profit by considering the significant variables affecting the bank profit margin. Generally, the themes that emerged from the interviews are parallel with findings from the literature. However, the determinants of the pricing that have not been captured by the literature are marketing strategies, which include product risk and financing terms and conditions, and discretionary power. The awareness of Islamic banking products and cost of fund strategy are other important determinants of bank margin and profitability. This research also has the potential to enrich bank margin determinants' concept, theory, and practice.

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