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Profitability Determinants of Islamic Banks in Bahrain Using the Panel Data Analysis

Table (4) Regression Results of Islamic Banks' Profitability Determinants Using the ROA Measure

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Decision
DEP?	0.006	0.001	5.03	0.0000	H_1 is accepted.
CAP?	0.05	0.011	4.48	0.0000	H_2 is accepted
EFF?	-0.01	0.008	-15.63	0.0000	H_3 is accepted
RIS?	-0.001	0.001	-1.14	0.2548	H_4 is rejected
LIQ?	-0.005	0.00	-1.05	0.2936	H_5 is rejected
SIZ?	0.21	0.04	4.42	0.0000	H_6 is accepted
INF?	1.39	0.31	4.43	0.0000	H_7 is accepted
GDP?	1.25	0.20	6.11	0.0000	H_8 is accepted.
R-squared	0.84	Mean dependent var		0.54	
Adjusted R-squared	0.83	S.D. dependent var		2.56	
S.E. of regression	0.98	Sum squared resid		79.83	
DurbinWatson stat	1.80				

9. Conclusion

The objective of this study is to investigate some influential factors in Bahraini Islamic banks during the period 2000-2014. The data obtained from Bahraini official sources regarding the regression model used of which two dependent variables, the ROA and ROE, were used alternatively with eight independent variables. The panel data regression model is used to test the study hypothesis the results reveal that:

First, individual bank characteristics explain a substantial part of the within-country variation in bank profitability. High profitability tends to be associated with banks that hold a relatively high amount of capital, and with large overheads. Other important internal determinant of bank's profitability is bank loans which have a positive and significant impact. The results reveal that all banks specific profitability determinants, with the exception of liquidity and risk, significantly affect the Islamic banks profitability using both measures (ROE and ROA) in the study period

Second, the paper finds that the macro-economic indicators such inflation and GDP have a significant impact on Islamic bank's profitability.

Third, turning to financial structure and its impact on bank's profitability, the researcher finds that size is beneficial to the Bahraini Islamic banks.

Overall, these empirical results provide evidence that the profitability of Bahraini Islamic banks is shaped by bank-specific factors (that are affected by bank-levelmanagement) and macroeconomic, control variables that are not the direct result of a bank'smanagerial decisions. In addition, industry structure seems to significantly affect banks' profitability. The approach followed in this paper may well have considerable potential as a tool for exploring bank profitability determinants with the purpose of suggesting optimal policies to bank management.

Among the limitations of this study is the data availability, as the longer the data coverage (e.g. quarterly or monthly) the better results can be obtained. The other limitation is the lack of similar study for countries having the same features of Bahrain economy. Further research can be conducted by using monthly or quarterly data with different set of dependent and independent variables.

In addition, as it was expected, *total equity-to-total assets ratio* (CAP), trails behind a positive and significant effect on Islamic banks ROA, with a 1% change in total equity to total assets ratio triggering about 5 % change in Islamic banks' return on assets. This result is consistent with the previous findings of Vong and Chan, 2008 and this means that H_2 is accepted.

On the other hand, the *total overheads-to-total assets ratio* (EFF), has a negative sign indicating the negative effect on ROA as expected, and this effect is statistically significant. Furthermore, a 1% change in *total overheads to total assets ratio* triggering about 1 % change in profitability, which means that efficient banks tend to be more profitable than inefficient ones. These results don't support the earlier finding of Hassan and Bashir (2003) this means that H_3 is accepted.

The *net loans-to-total assets ratio* (RIS), has a negative but statistically insignificant impact on Islamic banks return on assets (ROA) and this result is inconsistent with the findings of the following previous studies Bashir (2003) who found a positive and significant effect this means that H_4 is rejected.

Moreover, *Net loans-to-total deposits ratio* (LIQ) has a negative but statistically insignificant effect on the Islamic banks' return on assets (ROA) this insignificant effect is inconsistent with the finding Bashir (2003) accordingly H_5 is rejected.

The Islamic banks' *size* has a positive and statistically significant effect at on Islamic banks' return on assets and this result do not stand in line with the empirical findings of Hassan and Bashir (2003) Furthermore, a 21% change in *banks size* triggering about 1 % change in profitability this means that H_6 is accepted.

The *inflation (INF)* was regressed to the Islamic banks' return on assets in regression (2) as a macroeconomic variable, and the results indicate that the inflation has a positive and statistically significant effect, on the profitability of Islamic banks expressed by the return on assets. High inflation rates are generally associated with high interest rates which increase banks' profitability. This is under the competition circumstances and whether banks can pass-through increase in costs (high deposit rates) to customers (clients). Demerguc-kuant and Huisinga (1999) found a positive relationship between inflation and banks profitability using an international data set. Similarly, Bashir (2001) founds a positive relationship between inflation and Islamic banks profitability this means that H_7 is accepted.

The *GDP* was regressed to the Islamic banks' return on assets in regression (2) as a macroeconomic variable, and the results indicate that the GDP has a positive and statistically significant effect, on the profitability of Islamic banks expressed by the return on assets this means that H_8 is accepted.

The Islamic banks' *size* has a positive and statistically significant effect at on Islamic banks' return on equity, Furthermore, a 1% change in *banks size* triggering about 275 % change in Islamic banks profitability which means that H_6 is accepted.

The *inflation (INF)* was regressed to the Islamic banks' return on assets in regression (1) as a macroeconomic variable, and the results indicate that the inflation has a positive and statistically significant impact, on the profitability of Islamic banks expressed by the return on equity. High inflation rates are generally associated with high interest rates which increase banks' profitability. This is under the competition circumstances and whether banks can pass-through increase in costs (high deposit rates) to customers (clients). Demerguc-kuant and Huisinga (1999) found a positive relationship between inflation and banks profitability using an international data set. Similarly, Bashir (2001) founds a positive relationship between inflation and Islamic banks profitability which means that H_7 is accepted.

The *GDP* was regressed to the Islamic banks' return on equity in regression (1) as a macroeconomic variable, and the results indicate that the GDP has a positive and statistically significant effect, on the profitability of Islamic banks expressed by the return on equity which means that H_8 is accepted.

Table (3) Regression Results of Islamic Banks' Profitability Determinants Using the ROE Measure

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Decision
DEP?	0.08	0.02	3.90	0.0002	H_1 is accepted.
CAP?	0.41	0.14	2.84	0.0056	H_2 is accepted
EFF?	-0.04	0.001	-21.20	0.0000	H_3 is accepted
RIS?	-0.01	0.002	-0.75	0.4532	H_4 is rejected
LIQ?	-0.038	0.068	-0.56	0.5714	H_5 is rejected
SIZ?	2.75	1.04	2.63	0.0102	H_6 is accepted
INF?	27.03	6.11	4.41	0.0000	H_7 is accepted
GDP?	13.87	3.71	3.73	0.0003	H_8 is accepted.
R-squared	0.92	Mean dependent var		0.14	
Adjusted R-squared	0.91	S.D. dependent var		2.81	
S.E. of regression	0.77	Sum squared resid		49.73	
Durbin-Watson stat	2.12				

Regression (2)

In regression (2), ROA is regressed against all bankspecific structural and macroeconomic variables of Jordanian Islamic banks and the results are explained as follows:

The total deposit growth ratio (DEP), as it was expected has a positive and statistical significant effect on Islamic banks profitability represented by the ROA measure, with a 1% change in total equity to total assets ratio triggering about 0.6 % change in Islamic banks' return on assets. And this result is consistent with the earlier works of Vong and Chan (2008) this means that H_1 is accepted.

$$ROE_{i,t} = \alpha_0 + \beta_1 CAP_{i,t} + \beta_2 EFF_{i,t} + \beta_3 DEP_{i,t} + \beta_4 LIQ_{i,t} + \beta_5 RIS_{i,t} + \beta_6 SIZ_{i,t} + \beta_7 INF + \beta_7 GDP + \varepsilon_{it} \quad \textbf{(2)}$$

In regression (2) that is represented by equation (3), Islamic banks' ROA is regressed against all bankspecific, structural and macroeconomic variables:

$$ROA_{i,t} = \alpha_0 + \beta_1 CAP_{i,t} + \beta_2 EFF_{i,t} + \beta_3 DEP_{i,t} + \beta_4 LIQ_{i,t} + \beta_5 RIS_{i,t} + \beta_6 SIZ_{i,t} + \beta_7 INF + \beta_7 GDP + \varepsilon_{it} \quad \textbf{(3)}$$

It can be seen from tables (3 and 4) that the explanatory power of the R^2 explained about 92% from the variation, of Islamic banks' profitability when ROE is used as dependent variable and 99 % when ROA is used. The adequacy of the models as predicting is validated by the F-test. As indicated in tables (3 and 4), the values of all F-ratios are statistically significant at 5% for all profitability models. The results of these tests confirmed that the models applied are useful for measuring the relationship between internal and external variable items and the profitability ratios.

Regression (1)

In regression (1), ROE is regressed against all bankspecific, structural and macroeconomic variables of Jordanian Islamic banks and the results are explained as follows:
The total deposit growth ratio (DEP), as it was expected has a positive and statistical significant effect on Islamic banks profitability represented by the ROE measure, with a 1% change in total equity to total assets ratio triggering about 8 % change in Islamic banks' return on equity. And this result is consistent with the earlier works of Vong and Chan (2008) which means that H_1 is accepted.

In addition, as it was expected, *total equity-to-total assets ratio* (CAP), trails behind a positive and significant effect on Islamic banks ROE, with a 1% change in total equity to total assets ratio triggering about 41 % change in Islamic banks' return on equity. This result is consistent with the previous findings of (Vong and Chan, 2008; Bashir, 2003) which means that H_2 is accepted.

On the other hand, the *total overheads-to-total assets ratio* (EFF), has a negative sign indicating the negative effect on ROE as expected, and this effect is statistically significant at (1 percent) significance level. Furthermore, a 1% change in *total overheads to total assets ratio* triggering about 4 % change in profitability, which means that efficient banks tend to be more profitable than inefficient ones. This results support the earlier finding of Hassan and Bashir (2003) which means that H_3 is accepted.

The *net loans-to-total assets ratio* (RIS), in contrast to what it was expected has a negative but statistically insignificant impact on Islamic banks return on equity (ROE) and this result is similar to what Vong and Chan (2008) has found in his study which means that H_4 is rejected.

Moreover, the Estimation results reveal that *net loans-to-total deposits ratio* (LIQ) as it was expected, has a negative but statistically insignificant effect on Islamic banks' return on equity (ROE) which means that H_5 is rejected.

8.1 Descriptive Statistic

Table 1 presents a summary statistics of the variables used in this study

Table (1) The Descriptive Statistics

	ROA?	ROE?	CAP?	DEP?	RIS?	EFF?	SIZ?	LIQ?	INF?	GDP?
Mean	1.72	-19.840	38.99	41.780	381.74	144.03	12.28	90.24	1.84	5.01
Median	1.30	5.000	25.20	14.94	120.50	56.10	13.39	82.40	2.20	5.30
Maximum	38.30	40.400	99.50	630.10	6963.2	4648.9	15.47	1174.6	3.50	8.34
Minimum	-59.00	-2683.0	0.15	-94.22	0.27	-351.80	4.30	7.65	-1.20	2.10
Std. Dev.	11.80	242.75	30.86	100.18	968.37	492.03	2.71	101.53	1.47	1.83
Skewness	-1.66	-10.703	0.96	3.03	5.24	7.37	-1.25	9.86	-0.91	0.06
Kurtosis	11.28	117.77	2.39	15.14	32.14	62.55	3.83	105.82	2.39	1.83
Jarque-Bera	415.28	71003.6	21.27	960.40	4996.3	19607.	36.49	57096.	19.39	7.11
Probability	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.000	0.0000	0.0000	0.02
Obs.	125	125	125	125	125	125	125	125	125	125

8.2 Unit Root Test Results

The unit root test results applying LLC test with 4 lags, are reported in table (2), these results show that the null hypotheses of the *unit root* existence (non- Stationarity) are rejected at 1% level, which indicate that all the study variables are stationary at the level during the study period. These findings imply that the study's variables show a degree of time dependency that allows applying the Pooled Least Square method.

Table (2) Unit Root Test Results for Islamic Banks

	Islamic banks		
Variable	**T-Statistic**	**Probability**	**Decision**
ROE	-4.1178	0.0000***	Reject H_0. There is no unit root
ROA	-2.6599	0.0039***	Reject H_0. There is no unit root
LIQ	-12.5658	0.0000***	Reject H_0. There is no unit root
EFF	-4.6257	0.0000***	Reject H_0. There is no unit root
RIS	-34.4113	0.0000***	Reject H_0. There is no unit root
CAP	-9.8526	0.0000***	Reject H_0. There is no unit root
DEP	-7.2161	0.0000***	Reject H_0. There is no unit root
SIZ	-4.2912	0.0000***	Reject H_0. There is no unit root
GDP	-3.4089	0.0000***	Reject H_0. There is no unit root
INF	-4.4819	0.0000***	Reject H_0. There is no unit root

"***", Significant at 1% level

8.3 Regression Results of Profitability Determinants for Islamic Banks

Table (3) shows the statistical outcomes of the regression analysis for profitability models concerning Islamic banks. Two regression analyses are utilized to determine the factors that have an important effect on Islamic bank's profitability.

In regression (1) that is represented by equation (2), Islamic banks' ROE is regressed against all bank specific, structural and macroeconomic variables:

total liabilities over total assets, while the following internal characteristics have a negative and significant impact on banks' profitability: non-interest earning, loan to total assets and customer and short term funding to total assets.

6.2 Single Country Studies

Al-Tamimi (2010) "Factors Influencing Performance of the UAE Islamic and Conventional National Banks" The main purpose of this paper was to examine the influencing factors on the performance of Islamic banks compared with conventional banks during the period 1996-2008. Whereas, ROE and ROA were used alternatively as dependent variables, a set of internal and external factors were considered as independent variables including: GDP per capita, size, financial development indicator, liquidity, concentration, cost and number of branches.
The results indicated that the significant determinants of conventional national banks' performance were liquidity and Concentration. Conversely, cost and number of branches were the most significant determinants of Islamic banks' profitability.

7. Methodology and Model Specification

The variables affecting Islamic banks profitability and the equation relating ROE and ROA and their determinants that will be tested are as following:

$$\boldsymbol{PROF_{i,t}= \alpha_0+\beta_1\, CAP_{i,t}+ \beta_2\, EFF_{i,t}+ \beta_3\, DEP_{i,t}+\beta_4\, LIQ_{i,t}+ \beta_5\, RIS_{i,t}+ \beta_6\, SIZ_{i,t}+ \beta_7\, GDP_{i,t} +\beta_8\, INF_{i,t}+ \varepsilon_{it}} \quad \textbf{(1)}$$

Where:$PROF_{i,t}$ represents two alternative profitability measures (ROA or ROE) for the bank *i* during the period *t*. $CAP_{i,t}$ is capital ratio of bank *i* at time *t*; $SIZ_{i,t}$ the size of bank *i* at time *t*; $DEP_{i,t}$ the annual deposit growth for bank *i* between period *t* and *t-1*. $LIQ_{i,t}$ the liquidity ratio for the bank *i* during the period *t*. $RIS_{i,t}$ the loan-to-total assets ratio that represent the risk born by the bank *i* during the period *t*. $EFF_{i,t}$, the bank' *i* efficiency during the period *t*. $INF_{i,t}$, is the inflation rate, however the $GDP_{i,t}$ growth is a measure of economic conditions, α_0 is a constant; β_i $(i = 1\ to\ 8)$ is variable coefficient; while ε_{it} is an error term.

8. Empirical results

This study uses a panel analysis method to investigate the profitability determinants of 9 Bahraini Islamic banks spanning the period 2000–2014.

variable is expected to have a positive impact on banks' profitability for both Islamic as well as traditional banks.

5.2.2 The Structural Variables

The Bank Size (SIZ) The natural logarithm of the bank total assets is used in this study as a measure of bank size. This variable is included to control for cost differences relating to bank size and to the greater ability of larger banks to diversify. The first factor may lead to positive effect if there are significant economies of scale while the second may have negative effects, if increases diversification leads to lower risk and lower returns. It is argued that bank size is positively related to bank profitability since increasing in bank's size may reduce cost. In this study this variable is expected to have a positive impact on banks' profitability for both Islamic as well as traditional banks.

6. Literature Review

The researcher distinguishes these studies into panel country studies and single country studies as follows:

6.1 Panel Country Studies

Bashir (2003) "Determinants of Profitability in Islamic Banks: Some Evidence from the Middle East"

The researcher in this study examined the determinants of Islamic banks' profitability across eight Middle Eastern countries between 1993 and 1998. Three measures of profitability were used in this study: Before Tax Profit, returns on assets, and returns on equity, seven bank characteristics are used as internal determinants of profitability. They comprised fund source management; funds use management, capital and liquidity ratios, risk and a dummy variable for ownership. Four sets of control variables were expected to impact performance: the macroeconomic (The GDP per capita, The GDP Growth and inflation) environment, the financial, market structure, the regulation indicators (required reserves of the banking system and taxation), and country (dummy) variables.

The results of analyses indicated that high leverage and large loans to asset ratios led to higher profitability. In addition foreign-owned banks were more profitable than their domestic counterparts; also the study concluded that implicit and explicit taxes affected the bank profitability measures negatively. Finally, favorable macroeconomic conditions impacted profitability measures positively.

Hassan and Bashir (2003) "Determinants of Islamic Banking Profitability" The researchers examined the relationship between the profitability of Islamic banks and a set of internal and external characteristics. Whereas capital, leverage, overhead, loan and liquidity ratios were used as proxies for the bank's internal measures, macroeconomic indicators, taxation, financial structure, and country dummies were used to represent the external measures. A cross-country bank level data of 43 Islamic banks for 21 countries during 1994 to 2001 was used.

The regression results indicated that the following internal characteristics have a positive and a significant relation with Islamic banks profitability: the capital assets ratio, the overhead ratio of

environment. The efficiency of financial institutions is relatively difficult to be measured since their products and services are of intangible nature. Therefore, in this study the ratio of overheads-to-total assets is used to provide information on the variation in operation costs across the banking system. In addition this ratio reflects employment, total amount of wages and salaries as well as the cost of running branch office facilities. Hence, the expected effect of this variable on banks profitability is negative.

Liquidity: total loans over total deposits (LIQ), is a liquidity indicator, the higher Total Loans to Total deposits, the less liquid the bank will be. Since banks' operations rely heavily on loan, loans to total deposits ratio is included in the study. Previous studies show positive relationship with profitability. Therefore, it is expected to have a positive relationship with profitability measures.

Deposit Growth: deposit growth (DEP) is another leverage indicator it is included in this study to examine the influence of liability on profitability and how well the banks use it. Moreover, deposits are considered to be the main source of banks funding. Thus, deposits are included as independent variable, and can be compared by the other used ratios. As it is shown before, many researchers included this ratio in their studies and found a positive relationship with profitability. It is therefore expected to have positive relationship with profitability.

5.2 The External Determinants of Banks' Profitability

The second set of variables represents the factors that are beyond the control of banks' managers. For this study, these factors are named as external determinants.

5.2.1 The Macro Economic Variables

In terms of external determinants, two sets of variables have been considered in this study, indicating financial structure and macroeconomic conditions. The macroeconomic variables used are GDP growth and inflation (INF):

Gross domestic product growth rates (GDP) is a measure of the total economic activity and is expected to have an impact on numerous factors related to the supply and demand for loans and deposits. A positive relation is expected between the performance of the banks and this variable. Inflation may affect both the costs and revenues of any organization including the banks. Perry (1992) points out that the effect of inflation on bank performance depends on whether the inflation is anticipated or unanticipated. In this study this variable is expected to have a positive impact on banks' profitability for both Islamic as well as traditional banks.

Inflation (INF) high inflation rates are generally associated with high loan interest rates and if inflation is fully anticipated and interest rates are adjusted accordingly, a positive impact on profitability will result. Alternatively, unexpected rises in inflation cause cash flow difficulties for borrowers, which can lead to premature termination of loan arrangements and precipitate loan losses. Indeed, if the banks are sluggish in adjusting their interest rates, there is a possibility that bank costs may increase faster than bank revenues (Vong and Chan, 2008). In this study this

Bahrain has a mixed economy, with government control of many basic industries, including the important oil and aluminum industries. Between 1981 and 1993, Bahrain Government expenditures increased by 64%. During that same time, government revenues continued to be largely dependent on the oil industry and increased by only 4%. Bahrain has received significant budgetary support and project grants from Saudi Arabia, Kuwait, and the United Arab Emirates (The World Factbook, U.S. Department of State, 2001).

Bahrain's development as a major financial center has been the most widely heralded aspect of its diversification effort. Bahrain is a regional financial and business center; international financial institutions operate in Bahrain, both offshore and onshore, without impediments, and the financial sector is currently the largest contributor to GDP at 23% in 2010. Between 2002 and 2010, the industry tripled in size to $224 billion. With over 13,000 people employed in this sector, financial services remain a pillar of Bahrain's economy.

Over 152 offshore banking units and representative offices are located in Bahrain, as well as 65 American firms. Bahrain has also made a concerted effort to become the leading Islamic finance center in the Arab world, standardizing regulations of the Islamic banking industry. It currently has 26 Islamic commercial, investment and leasing banks as well as Islamic insurance (takaful) companies -- the largest concentration of Islamic financial institutions in the Middle East (The World Factbook, U.S. Department of State, 2012).

5. Profitability Determinants

In this study the profitability determinants are divided into bank-specific (internal determinants: capital, deposit, risk, efficiency, liquidity), macroeconomic and structural determinants (external variables: GPD, inflation and bank size):

5.1 Internal Determinants of Bank Profitability

The profitability variable is represented by two alternative measures: the ratio of profits to assets, i.e. the return on assets (ROA) and the profits to equity ratio, i.e. the return on equity (ROE). In principle, ROA reflects the ability of a bank's management to generate profits from the bank's assets, ROE indicates the return to shareholders on their equity and equals ROA times the t Bank-specific profitability determinants

Capital: the researcher uses the ratio of equity to assets (CAP) to proxy the capital variable. In this study this variable is expected to have a positive impact on banks' profitability for both Islamic as well as traditional banks. as well-capitalized banks face lower costs of going bankrupt which reduces their costs of funding.

Credit risk: To proxy this variable the researcher uses the loan-loss provisions to loans ratio (RIS). Increased exposure to credit risk is normally associated with decreased firm profitability and, hence, we expect a negative relationship between ROA (ROE) and PL. Banks would, therefore, improve profitability by improving screening and monitoring of credit risk.

Efficiency: the overheads-to-total assets ratio (EFF) is used to proxy the efficiency of banks which has been one of the most important concerns in the new monetary and financial

The accumulated intellectual and theoretical knowledge during the 1960s and early 1970s had laid the ground for the first private Islamic bank (Dubai Islamic Bank) as the world's first private interest-free bank and the Jeddah-based Islamic Development Bank in 1975(Ayub, 2007). Followed by the Kuwait finance house in 1977 and the Bahrain Islamic bank in 1978, all these banks where extensively involved in shari'ah compliant trade finance especially of imports from Europe using s structure known as *Murabahah.* Whereby, an Islamic bank would purchase an imported good on behalf of a client. And then resell the good to the importer for deferred payment covering the costs of the purchase plus a murk-up representing a bank's profit (Iqbal and Mirakhor, 2007).

Islamic banking spread dramatically during the final decades of the last century. Currently, there are about 270 Islamic financial institutions worldwide, including banks, mutual funds, mortgage companies, and Takaful or insurance firms (Ariss, 2010). Moreover, the growth of Islamic banking world-wide has been phenomenal with assets under management generally growing at annual rates of 12% to 15% per year (Olson and Zoubi, 2008). Aioanei (2007), mentioned that there are Islamic banks opening branches or subsidiaries in Europe or US, and they are "forcing" the authorities to find some ways to integrate these services into the global financial system. Much progress was made in UK for launching Islamic products from an UK authorized and established Islamic bank. This is expected to be followed by US and Canada. It is worth mentioning that a large number of traditional banks are providing Islamic products through their Islamic windows.

4.3 The Bahraini Economy and Banking System

Bahrain was an important center of trade by the 3rd millennium B.C. The islands were ruled by the Persians in the 4th century A.D., and then by Arabs until 1541, when the Portuguese invaded them. Persia again claimed Bahrain in 1602. In 1783 Ahmad ibn al-Khalifah took over, and the al-Khalifahs remain the ruling family today. Bahrain became a British protectorate in 1820. It did not gain full independence until Aug. 14, 1971.

The history of Bahrain started in 1932 when it was established and when Oil is first discovered, to be followed shortly thereafter by discoveries in Saudi Arabia and Kuwait. Bahrain is one of the members of the Gulf cooperation council and worked actively to build economic integration with the other members. Bahrain is one of the most diversified economies in the Persian Gulf. Highly developed communication and transport facilities make Bahrain home to numerous multinational firms with business in the Gulf.

Until the first quarter of the 20th century, Bahrain retained its importance as a distribution center helped by its strategic location and its harbor facilities. The growth of foreign trade encouraged expansion of the merchant sector, and by way of duties and tariffs on imports contributed the major part of the national budget. During the 1950s an 1960s, Bahrain's economic development progressed rapidly. The boom throughout the Gulf generated by increased oil revenues coupled with the diversification of Bahrain's economy, brought about a further revival of Bahrain's role as an important trading and finance centre (Molyneux and Iqbal, 2005)

H_4: Islamic banks' profitability is negatively influenced by liquidity.
H_5: Islamic banks' profitability is negatively influenced by credit risk.
H_6: Islamic banks' profitability is positively influenced by bank size.
H_7: Islamic banks' profitability is positively influenced by Inflation.
H_8: Islamic banks' profitability is positively influenced by GDP growth.

4. Theoretical Frame Work

In this section, the researchers discusses some issues that may help for understanding and providing insights; descriptions and some definitions for the study variables and the related issues including banks' profitability, the Islamic banks and the Bahraini economy and Financial System.

4.1 What is Islamic Banking?

Before defining what an Islamic bank is like, it is better to give a short description of conventional banking. Conventional banking does not follow one pattern. In Anglo-Saxon countries, commercial banking dominates, while in Germany, Switzerland, the Netherlands, and Japan, universal banking is the rule. Naturally, then, a comparison between banking patterns becomes inevitable Commercial banking is based on a pure financial intermediation model, whereby banks mainly borrow from savers and then lend to enterprises or individuals. They make their profit from the margin between the borrowing and lending rates of interest. They also provide banking services, like letters of credit and guarantees. A proportion of their profit comes from the low-cost funds that they obtain through demand deposits. Commercial banks are prohibited from trading and their shareholding is severely restricted to a small proportion of their net worth (Al-Jarhi and Iqbal, 2001).

Al-Jarhi and Iqbal (2001) identify An Islamic bank as a deposit-taking banking institution whose scope of activities includes all currently known banking activities, excluding borrowing and lending on the basis of interest. On the liabilities side, it mobilizes funds on the basis of a Mudarabah or Wakalah (agent) contract. It can also accept demand deposits which are treated as interest-free loans from the clients to the bank and which are guaranteed. On the assets side, it advances funds on a profit-and–loss sharing or a debt-creating basis, in accordance with the principles of the Shariah.

However, Silva (2006) states that Islamic banking can be considered banking with a conscience. Islamic banks each have a Shariah board made up of Shari'ah scholars as well as financial experts who are responsible for determining what activities are and are not Shari'ah-compliant.

4.2 A Brief Review of Developments in Islamic Banking

The first Islamic social bank was established in Pakistan in the 1950s to help poor farmers. At about the same time, Malaysian Muslims established funds that helped pilgrims gather their savings for the pilgrimage to Makkah (Mecca). Then the Mit Ghamer savings bank in Egypt was established in 1963 and closed down in 1967 after this the Nasser Social Bank was established in 1971 (Gait and Worthington, 2009).

finance is not limited to stakeholders with common religious backgrounds. Britain, as an example, has announced plans to turn London into the world centre of Islamic finance.

The original teachings of Judaism, Christianity, and Islam prohibit lending money and charging interest. The term "Usury" was used to indicate paying a rent for the use of money; the meaning was changed to mean, in today's language, lending at an excessive interest rate (this is different than Riba which is defined as any increase on loans regardless of the rate of interest charged).

It is also interesting to note that charging interest is prohibited in Buddhism, Hinduism, and many other faiths and philosophies (Wayne and McIntosh, 1998). Islamic Finance as terminology refer to finance system complying with Shari'ah laws that were introduced by prophet Mohamed (Peace Be Upon Him) in the sixth century with its main two sources Quran (the holy book of Islam) and Sunnah (also known as prophet's sayings or Hadith). After the prophet death, Islamic scholars and Jurists depended on other sources like Ijmaa (consensus), Qias (Analogy) and Ijthad (Diligence). The Islamic based financial transactions continued until the sixteen century (El-Salous, 1993). In the seventeenth century and because of the colonization, this Islamic banking system was replaced by the western banking system (i.e. Traditional) (Archer & Abd El Karim 2002).

The main purpose of this study is to investigate the main profitability determinants of Islamic banks in Bahrain for the period 2000-2014, by examining the relationship between these banks' profitability represented by the Return On Equity (ROE) and the Return On Assets (ROA), and a number of bank-specific internal characteristics (efficiency, deposits growth, capital, liquidity and risk) representing the microeconomic variables, and a number of external profitability determinants including macroeconomic factors (inflation and GDP growth) and structural factors (bank size) For this end the researcher seeks to answer the following two main questions: *"what are the main profitability determinants of Bahraini Islamic banks during the study period?*

2. Study Objectives

The following objectives are addressed and highlighted:

1. To identify the major financial features affecting the profitability of Islamic banks in Bahrain.
2. To determine the most significant influencer variable on Profitability of Bahraini Islamic banks;
3. This paper is intended to help Islamic banks to improve their performance to remain competitive.

3. Study Hypotheses

Based on the theoretical framework and previous studies, aiming for achieving the study objectives, the researcher tries to examine the following hypotheses:

H_1: Islamic banks' profitability is positively influenced by yearly growth of deposits.
H_2: Islamic banks' profitability is positively influenced by capital.
H_3: Islamic banks' profitability is negatively influenced by efficiency.

Profitability Determinants of Islamic Banks in Bahrain Using the Panel Data Analysis

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Abstract
The main purpose of this study is to investigate bank-specific (internal determinants: capital, deposit, risk, efficiency, liquidity), macroeconomic and structural determinants (external variables: GPD, inflation and bank size) of Bahraini Islamic banks bank profitability, using the panel regression analysis, during the period 2000-2014 ،The study sample contains 9 Islamic bank. The results reveal that all banks profitability determinants, with the exception of liquidity and risk, significantly affect the Islamic banks profitability using both measures (ROE and ROA) in the study period.
Key Words: profitability, Islamic banks, panel data, Bahrain.

ملخص
تهدف هذه الدراسة الى دراسة محددات ربحية البنوك (المحددات الداخلية : رأس المال والودائع والمخاطر والكفاءة والسيولة) والمحددات الاقتصادية الكلية والهيكلية (المتغيرات الخارجية: الناتج المحلي الاجمالي والتضخم و حجم البنك) باختيار عينة من البنوك الإسلامية البحرينية ، وذلك باستخدام تحليل الانحدار لبيانات البانل (Panel) ، خلال الفترة 2000-2014 ، وتتضمن عينة الدراسة 9 بنوك إسلامية . بينت النتائج أن جميع محددات ربحية البنوك ، باستثناء السيولة و المخاطر، تؤثر تأثيرا كبيرا ذو معنوية احصائيا على ربحية البنوك الإسلامية باستخدام مؤشرين للربحية (العائد على حقوق المساهمين و العائد على الأصول) خلال فترة الدراسة.
الكلمات الدالة: الربحية، البنوك الاسلامية، بيانات ال Panel، البحرين.

1. Introduction

The development of Islamic finance is growing very fast, especially in Asian countries such as Malaysia, Indonesia, Pakistan and Brunei, as well as in Middle East countries. Many Islamic financial institutions have been established by both foreign and local players and expanded their products and services to cover the growing Islamic finance market. Islamic finance has gained significant global exposure and has experienced phenomenal growth.

Total worldwide assets managed in accordance with the principles of Islamic finance are estimated at over US$ 800 billion, with growth of between 10% and 15% over the last ten years (Ilias, 2010). Global Islamic banking assets held by commercial banks are set to cross US$1.8 trillion in 2013, up from the US$1.3 trillion of assets held in 2011, and are forecasted to grow beyond $2 trillion by 2014. According to Ernst & Young's World Islamic Banking Competitiveness Report 2013, there are now about 270 Islamic financial institution worldwide, including banks, mutual funds, mortgage companies, and insurance firms. However, Islamic