

**Research  
Paper**



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## **Assessing Production Efficiency of Islamic Banks and Conventional Bank Islamic Windows in Malaysia**

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**Abstract:** This study presents new perspectives on performance evaluation of Islamic banking operations in Malaysia, by investigating for the first time, both cost and profit efficiency of full-fledged Islamic banks and Islamic window operations of domestic and foreign banks. The application of Data Envelopment Analysis (DEA) technique has provided several efficiency measures such as allocative, pure technical and scale efficiency that explain cost and profit efficiency differentials among banks. The findings of the study show that Islamic banking operators are relatively more efficient at controlling costs than at generating profits. The main contributor for cost efficiency of domestic and foreign banks comes from resource management and economies of scale respectively. These findings have implications on the reform process carried out in the aftermath of Asian financial crisis, particularly the Financial Sector Master Plan (FSMP).

**Keywords:** Data Envelopment Analysis, allocative efficiency, technical efficiency, foreign banks

### **INTRODUCTION**

Interest-free banking is growing in Malaysia very quickly and widely accepted by the public, standing at an average rate of 19 percent per annum in terms of assets since 2000. By the end of 2004, total assets of the Islamic banking sector increased to RM 94.6 billion which accounted for 10.5 percent of the total assets in the banking system. The market share of Islamic deposits and financing also increased to 11.2 percent and 11.3 percent of total banking sector deposits and financing respectively (Bank Negara Malaysia, 2004). This is contributed by 2

