



“The impact of political instability, macroeconomic and bank-specific factors on the profitability of Islamic banks: an empirical evidence”

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THE IMPACT OF POLITICAL INSTABILITY, MACROECONOMIC AND BANK-SPECIFIC FACTORS ON THE PROFITABILITY OF ISLAMIC BANKS: AN EMPIRICAL EVIDENCE

Abstract

This study investigates the impact of political instability, macroeconomic and bank-specific factors on the profitability of Islamic banks in the context of Yemen. The study used two common measures of profitability, namely, Return on Assets (ROA) and Return on Equity (ROE) as dependent variables. Seven key independent (internal and external) variables are also used. There are five fully-fledged Islamic banks (IBs) working in Yemen. The study selected only three out of five IBs due to the availability of data for the period ranging from 2010 to 2014. The descriptive and multiple regression analyses were done. The results of the study indicate that operating efficiency and financial risk have negative and significant relationships with ROA and ROE. The findings also show that capital adequacy has a negative and insignificant relationship with ROA and ROE. Furthermore, the study reveals that assets size (LogA), assets management, liquidity and deposits have a significant and positive impact on banks' profitability. GDP, Inflation rate (IR) and Political instability have positive and significant impact on Yemeni banks' profitability. Based on the best knowledge of the authors, this study is considered one of the first and pioneering studies that determine the factors affecting the profitability of Islamic banks of Yemen. Therefore, the study gives good insights for the policy makers, regulators and interested parties for enhancing the profitability of Islamic banks in Yemen.

Keywords

political instability, macroeconomic factors, bank-specific factors, ROA, ROE, Yemen, Islamic banks

JEL Classification A10, E60, G21

INTRODUCTION

Financial performance plays an essential role in the economic development of the countries (Sapuan & Aoly, 2013). The banking sector in Yemen is one of the main instruments of the country's economic growth. Its role in financing other sectors is, without doubt, critically important. The banking system of Yemen is considered as the backbone of the economy, and it also plays a magnificent role in different economic activities in the country. Finance is like blood to any economy. It is essential for socio-economic development of a society.

Today, Islamic banks exist all over the world, and are looked upon as available unconventional system which has several things to propose. One of the most important Islamic banks' aims is developed to fulfill the needs of Muslims and non-Muslims as well. In financial areas, Islamic banking is known as one of the fastest growing systems, and as a result of that growth it has gained universal recognition (Islam et al., 2014). Islamic banks proved their advantages for economic growth and financial stability around the globe, especially in the Middle East countries (Tabash & Dhankar, 2014).

Comparing the profitability of these two systems (conventional and Islamic) of banks creates a competitive space between them. Islamic banking has been operating in Yemen since 1995. There are 17 banks (Islamic and conventional) working in Yemen. Out of 17 banks, only 5 banks are operating on the principles of Islamic Shariah and other 12 banks are conventional (interest based) banks. The main objective of this study is to investigate the impact of political instability, macroeconomic and bank-specific variables on the Islamic banks' profitability in Yemen.

The study is structured as follows. Section one is an overview of Islamic banking in Yemen. Section two gives the literature review. Section three presents the methodology of the study. Hypotheses stated, findings and their discussion are shown in sections four and five. The last section concludes the article.

1. ISLAMIC BANKING IN YEMEN

Islamic banking in the republic of Yemen occurred in 1995; Islamic Bank of Yemen (IBY) for finance and investment was the first Islamic bank to work in Yemen. It was established in 1995, with a capital of unauthorized billion Riyals (currency of Yemen), under the decision of the Minister of Supply and Trade No. 137 of 1995 on 24-04-1995 and under the Central Bank of Yemen license No. 271 of 1995 on 09-08-1995.

Subsequently, the next year, Tadhamon International Islamic Bank (TIIB) was established with a capital of US \$ 93.00 million. Currently, TIIB is considered one of the largest banks in Yemen with 21 branches in different cities. In 1997, Saba Islamic Bank (SIB) was established and rapidly grew to reach more than 17 branches in both Yemen and Djibouti. Then, Shamil Bank of Yemen and Bahrain (SBYB) were founded in 2002.

In addition, there are five conventional banks that opened Islamic banking windows to provide Islamic banking services, i.e. Yemen Kuwait Bank (YKB), International Bank of Yemen (IBY), Yemen Gulf Bank (YGB), CAC Bank, and The Yemen Bank for Reconstruction and Development (Central Bank of Yemen, 2012). All these banks established Islamic windows since the last three years only. The Yemeni law of Islamic banking has defined Shariah audit as "the body which is responsible for the participation and approval of the Islamic bank products and ensures that all bank transactions are Shariah-compliant" (Yemen Islamic banking law, 2009) (Ayedh & Echchabi, 2015). The five Islamic banks of Yemen held nearly 40% of portfolio funding, while the thirteen com-

mercial banks are holding the remaining 60% share. Additionally, the Islamic banks account for 31% of the total assets held in the Yemeni banking sector (Abdou et al., 2014).

1.1. Problem statement

Islamic banking in Yemen achieved a good growth rates since the period of the establishment in 1996 till 2010. After this period, especially from 2011 onwards when the Arab spring uprising had started in some Arab countries (Yemen Republic was one of these countries), there is no political stability in these countries because of the continuing conflict. The problem of this study is the poor financial performance of Islamic banks during the period from 2011 till now; this poor performance is confirmed by the Islamic banks' financial statements during the period 2010–2014. The results of financial statements show that there are large instabilities in the Islamic banks' profitability in Yemen. The difference of profits among Islamic banks suggests that internal, external or both factors play an essential role in influencing the financial performance of Islamic banks in Yemen. These factors can help the policy makers to take some procedures that will enhance the profitability of Islamic banks in the long term.

1.2. Objectives of the study

The main aim of this study is to analyze the impact of both external and internal factors on the Islamic banks' profitability in Yemen and to achieve the following sub-objectives:

- To investigate the impact of the bank-specific variables on Islamic banks' profitability in Yemen.

- To examine the impact of the macroeconomic variables on Islamic banks' profitability in Yemen.
- To investigate the impact of the political factors (political stability) on Islamic banks' profitability in Yemen.
- To give recommendations and suggestions for policy makers to improve financial performance of Islamic banks of Yemen.

2. LITERATURE REVIEW

Many of the previous studies have been conducted to analyze the profitability of conventional bank determinants (Heffernan & Fu, 2008; Kosmidou et al., 2006; Goddard et al., 2004; Athanasoglou et al., 2006; Peters et al., 2004; and others). Only a few studies have examined the profitability of Islamic banking. Particularly in Yemen, profitability of Islamic banking has been gaining momentum in the financial performance evaluation of Islamic banks. Some of the previous studies have used external factors, while other studies have used only an internal factor or both.

Trad et al. (2017) have examined whether Islamic banks could be an alternative to the conventional banks and could achieve the stability in the period of crisis. They combined a number of internal (bank-specific) and external (country-specific) indicators to examine the reliability of Islamic banks' profitability measured by ROA and ROE. They found that capital adequacy and bank size are the main factors responsible for reducing the credit risk, increasing the profitability and achieving the stability of Islamic banks. They also found that macroeconomic indices, except for inflation, are capable to improve Islamic banks' stability. Further, Ibrahim (2015), Ramlan and Adnan (2016) compared and analyzed the financial performance of Islamic and conventional banks in UAE and Malaysia for five years, Ibrahim (2015) for the period 2002–2006, whereas Ramlan and Adnan (2016) for the period 2006–2011. Both studies found that Islamic banks are marked by more profitability, liquidity and capital structure than conventional banks. They also found that dependent variables of ROA and ROE have a significant

relationship with some of independent variables of total equity to total asset. A study by Shah and Jan (2014) dealt with financial performance of private banks in Pakistan. They found that the operational efficiency and bank size are negatively related with ROA and positively related with assets management, while the bank size has a positive relationship with the asset management and interest income. Interest income is negatively correlated with operational efficiency.

Ahangi et al. (2013) analyzed the effect of some internal and external factors on Islamic banks' profits in Malaysia. In addition, authors examined the results by using the financial crisis of 2008–2009 as a control variable. The study used regression analysis to examine the data for the period from 2008 to 2012. The results suggested that a high equity-to-asset ratio significantly increased the profitability of Islamic banking while negatively affecting the return on equities. An increase in the total expenses leads to high return on assets and return on equities. However, an increase in deposit-to-asset and loan-to-asset ratios does not significantly affect the Islamic banking profitability. Their results also indicate a positive and significant relationship between the concentration and the profitability. Moreover, an increase in the inflation rate negatively affected the profitability of Islamic banking. In another study of Malaysia, Wasiuzzaman and Nair Gunasegavan (2013) analyzed differences and similarities in bank characteristics of conventional and Islamic banks in Malaysia, especially when it comes to their bank specific indicators: profitability, capital adequacy, liquidity, asset quality and operational efficiency. They found that when it comes to return on assets, board size and bank size, conventional banks were higher compared to Islamic banks. The other indicators were higher for Islamic banks. Significant differences between the different types of the banks were found for all the variables, except for profitability and board independence. In the same year, Khalifa and Shafii (2013) evaluated the financial performance and identified affecting factors in the performance of non-oil manufacturing companies from 1999 to 2008. They found that the liquidity ratios were high, while the indicators of operational efficiency were insufficient. They also concluded that there are three variables that have negative significant relations with return on assets

(ROA), namely current ratio, quick ratio and account receivable. While other variables have positive significant relationships with return on assets (ROA), namely inventory turnover, net working capital, general administrative expenses, company age and company size.

Smaoui and Salah (2012) were the first who examined the impact of both internal and external factors on the Islamic banks' profitability. They found that the profit of Islamic banking is more than the one in conventional banking. Furthermore, the interest, inflation rate and size have significant and positive impact on the profitability of both types of banks. Masood et al. (2012) examined whether bank-specific and macro-economic determinants impact Islamic banks' profitability in some selected countries in different areas. They found that Islamic banks with efficient management and with higher assets size lead to greater return on assets. Their results showed that management efficiency regarding operating expenses significantly affects the banks' profitability.

In another study, Masruki et al. (2010) measured the performance of two Islamic Banks – Bank Muamalat and Bank Islam – in Malaysia for five years (2004–2008). They examined profitability and liquidity in both banks types and found that Islamic banks are more profit efficient and have better liquidity than conventional banks. With regard to profitability Islamic banks are less profitable than conventional banks.

A study by Samad (2004) compared the financial performance of two types of banks in Bahrain (conventional and Islamic banks) after the Gulf War in 1990. The study results indicated that there is no significant difference between Islamic banks and conventional banks in terms of liquidity and profitability. Moreover, conventional banks are exposed to higher credit risk than Islamic banks. In the same Year et al. (2004) and Haron (2004) evaluated the impacts of some external and internal factors on the Islamic banks' profitability. Haron and Azmi (2004) showed that assets structure, liquidity, inflation rate, deposit items and money supply have a significant impact on the profitability of Islamic banks. At the same time, Haron (2004) found that liquidity, funds deposited into current accounts, total capital and

reserves, and the percentage of profit sharing between bank and depositors positively influence the Islamic banks' profitability. He also found that there are significant and positive impact of interest, inflation rates and size on the profitability of Islamic banking.

A study by Hassan and Bashir (2003) enhanced the findings of Bashir (2000). They tested the profitability determinants of Islamic banks' during 1994–2001 for 21 countries, while Bashir (2000) evaluated the financial performance of Islamic banks between 1993 and 1998 in the Middle-Eastern countries. In another study, Hassan and Bashir (2003) found that conventional banks have less capital asset ratio compared to that of Islamic banks. They found a negative link between the profitability and bank size, which indicates that larger banks are less profitable than smaller banks. He also mentioned that the performance of banks during an economic growth seems to improve because the non-performing loans decrease. On the other hand, inflation does not have any impact on Islamic banks profitability. The results also showed that good macroeconomic factors positively impact profitability of Islamic banks.

3. STUDY METHODOLOGY

3.1. Study sample

The study sample consisted of three full-fledged Islamic banks during the period of 2010–2014. These banks are Islamic Bank of Yemen (IBY), Tadhamon International Islamic Bank (TIIB) and Saba Islamic Bank (SIB).

3.2. Data collection

The study is mainly based on secondary data. The data for this study are collected from the annual reports, financial statements (balance sheets and income statements), published by Islamic banks. Moreover, resources such as books and journals are used in this study. Macroeconomic data (GDP growth, inflation (IF) and political stability (PF)) are fetched from the Bank Scope/World Wide Bank database.

Table 1. Study variable ratios

| Variable | Measure | | Notation |
|---------------------|----------------------------------|---|----------|
| Dependent variables | Profitability (return on assets) | Net profit/total assets | ROA |
| | Profitability (return on equity) | Net profit/equity | ROE |
| Bank-specific | Asset size | Natural logarithm of total assets | LogA |
| | Liquidity | Liquid assets/total assets | LQ |
| | Capital adequacy | Equity/total assets | CA |
| | Deposits | Deposits/total assets | DT |
| | Assets management | Operating income/total assets | OPI |
| | Operating efficiency | Total operating expense/total assets | TOE |
| | Financial risk | Total liabilities/total assets | LA |
| | | | |
| Macro-economic | Economic activity | Annual real GDP growth | GDP |
| | | Inflation rate | IR |
| Moderator variables | Political factor | The rank of political stability (world competitiveness reports) | PF |

3.3. Data analysis method

The quantitative method is utilized in this study. All financial ratios, hypotheses test and statistical tests are done using E-views software version 7.0.

3.4. Model specification

In this study, a model is developed to identify the relationship between the profitability of Islamic banks in Yemen as dependent variables (ROA and ROE) and nine independent variables categorized into internal factors (bank size logarithm of total assets (LogA), liquidity (LQ), assets management (OPI), deposits (DT), operating efficiency (TOE), financial risk (LA)) and external factors ((GDP) and inflation rate (IR), political factors (PF)) as shown in Figure 1. The used model consists of $N = 1, \dots, n$, observed at each of T time periods, $T = 1, \dots, t$. In the dataset, the total observation is $n \cdot t$. The basic framework for the data is defined as per the following regression model (Brooks, 2008):

$$ROA_{nt} = \beta_0 + \beta_1 \cdot TOE + \beta_2 \cdot LogA + \beta_3 \cdot LQ + \beta_4 \cdot DT + \beta_5 \cdot OPI + \beta_6 \cdot LA + \beta_7 \cdot CA + \beta_8 \cdot GDP + \beta_9 \cdot IR + \beta_{10} \cdot PF + \varepsilon. \quad (1)$$

$$ROE_{nt} = \beta_0 + \beta_1 \cdot TOE + \beta_2 \cdot LogA + \beta_3 \cdot LQ + \beta_4 \cdot DT + \beta_5 \cdot OPI + \beta_6 \cdot LA + \beta_7 \cdot CA + \beta_8 \cdot GDP + \beta_9 \cdot IR + \beta_{10} \cdot PF + \varepsilon. \quad (2)$$

3.5. Variables

The ROA and ROE variables are used as dependent ones. The bank-specific (independent) variables are categorized as internal management and macro-economic (external) determinants of the profitability of Islamic banks (Table 1).

4. HYPOTHESES OF THE STUDY

To achieve the objectives of this study, the following hypotheses are stated:

H1: Operating efficiency has a positive impact on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H2: Assets management has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H3: Liquidity has a negative positive impact on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H4: Assets (banks size) has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H5: Financial risk has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

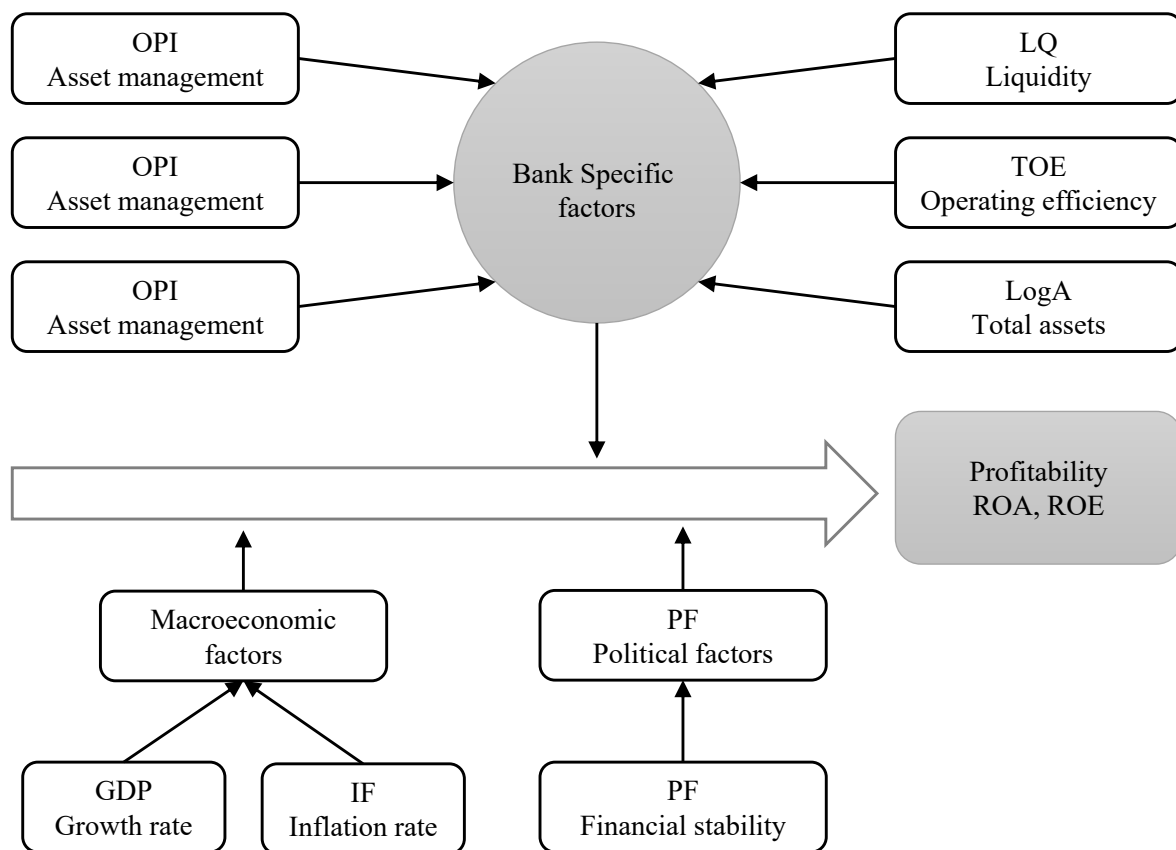


Figure 1. Study framework for all variables

H6: Deposits have a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H7: Capital adequacy has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H8: has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H9: Inflation rate (IR) has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

H10: Political instability has a positive effect on profitability (ROA & ROE) of Islamic banks in Yemen under the period 2010–2014.

5. DATA ANALYSIS AND RESULTS

5.1. Descriptive statistics analysis

Table 2 shows the descriptive analysis of the variables used in the study. The mean values of ROA and ROE are 0.000932 and 0.008697, respectively. It shows that the percentages of ROA and ROE are very small, while the standard deviations for both are also small – 0.004313 and 0.066997, respectively. We can conclude that there is no high variation. Assets size (LogA) measured as Natural logarithm of total assets registered a high mean of 8.180327, while standard deviation is not the highest – 0.435992.

The mean value of the macro-economic variables (GDP) is 0.04. It shows small value, while it has

Table 2. Descriptive summary of the study variables

| | ROA | ROE | TOE | OPI | LQ | LogA | LA | DT | CA | GDP | IR | PF |
|--------------|--------|--------|-------|--------|-------|-------|-------|-------|-------|---------|--------|-------|
| Mean | 0.003 | 0.024 | 0.023 | 0.024 | 0.385 | 8.180 | 0.413 | 0.040 | 0.113 | 0.040 | 15.368 | 1.612 |
| Median | 0.000 | 0.005 | 0.023 | 0.026 | 0.340 | 8.264 | 0.387 | 0.034 | 0.116 | 2.400 | 11.700 | 1.896 |
| Maximum | 0.033 | 0.189 | 0.046 | 0.046 | 0.613 | 8.720 | 0.605 | 0.093 | 0.203 | 7.700 | 24.700 | 1.896 |
| Minimum | -0.013 | -0.154 | 0.012 | -0.015 | 0.226 | 7.506 | 0.233 | 0.011 | 0.049 | -12.700 | 9.900 | 0.952 |
| Std. dev. | 0.010 | 0.090 | 0.009 | 0.013 | 0.123 | 0.436 | 0.134 | 0.028 | 0.050 | 7.368 | 5.981 | 0.391 |
| Observations | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 15 |

the largest standard deviation which is 7.368446. The mean of inflation rate (IR) is the highest mean which is 15.36800 and the standard deviation is 5.980763. The mean of political factor (PF) is 1.612277, while standard deviation is 0.390820. Moreover, the descriptive analysis shows negative values in profitability and GDP.

5.2. Multicollinearity test

The result of correlations indicates a weak positive correlation between dependent variables (ROA) and (ROE) and independent variables (TOE, OPI, LQ, LogA, LA, DT, CA, GDP, IR and PF).

It is also clear from correlation test that there are a very strong negative correlations between the independent variables of assets size (Log A) and financial risk (LA) and deposits/total assets (DT) which are -94% and -92%, respectively. While the relationship between independent variable (LA) and another independent variable (DT) is 88% percent.

5.3. Multiple regression analysis

Both Table 4 and Table 5 show the results of regression analysis between dependent and independent variables. The R-square is 73.9% and 70.6% for the first and second model, respectively. It is clear that independent variables explain 73.9% of variations in the dependent variable (ROA), while for ROE, the independent variables explain 70.6% of the variations of ROE and the remaining variations are explained by other factors not included in the study.

The results also show that the variables of operating efficiency (TOE) and financial risk (LA) are negatively related with return on assets (ROA) and return on equity (ROE). While the other variables are positively related with both dependent variables, ROA and ROE, except for capital adequacy (CA) which is negatively associated with return on assets (ROA) and positively with return on equity (ROE). The P-value of the bank-specific variables in both models are as follows: operating efficiency, assets management, liquidity, financial risk and capital adequacy are less than

Table 3. Multicollinearity results

| | ROA | ROE | TOE | OPI | LQ | Log A | LA | DT | CA | GDP | IR | PF |
|-------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|----|
| ROA | 1 | – | – | – | – | – | – | – | – | – | – | – |
| ROE | 0.909 | 1 | – | – | – | – | – | – | – | – | – | – |
| TOE | -0.051 | -0.027 | 1 | – | – | – | – | – | – | – | – | – |
| OPI | -0.096 | -0.224 | -0.638 | 1 | – | – | – | – | – | – | – | – |
| LQ | 0.308 | 0.220 | -0.571 | 0.146 | 1 | – | – | – | – | – | – | – |
| Log A | -0.16 | -0.051 | 0.719 | -0.385 | -0.841 | 1 | – | – | – | – | – | – |
| LA | 0.241 | 0.094 | -0.756 | 0.477 | 0.807 | -0.922 | 1 | – | – | – | – | – |
| DT | 0.264 | 0.139 | -0.663 | 0.405 | 0.761 | -0.942 | 0.887 | 1 | – | – | – | – |
| CA | 0.073 | -0.017 | 0.126 | -0.191 | 0.526 | -0.350 | 0.259 | 0.383 | 1 | – | – | – |
| GDP | 0.515 | 0.392 | 0.214 | -0.213 | -0.029 | 0.068 | 0.103 | -0.046 | -0.188 | 1 | – | – |
| IR | -0.451 | -0.439 | -0.022 | 0.151 | -0.225 | -0.002 | -0.064 | 0.014 | -0.004 | -0.651 | 1 | – |
| PF | 0.208 | 0.345 | 0.048 | -0.235 | 0.144 | -0.088 | -0.014 | 0.102 | 0.226 | 0.059 | -0.569 | 1 |

Note: significance at *, **, ***10 percent levels.

Table 4. Determinants of ROA

| Variable | Coefficient | Std. Error | T-statistic | Probability |
|--------------------|-------------|------------|-------------|-------------|
| TOE | -1.06926 | 0.385117 | -2.77646 | 0.0089 |
| OPI | 0.810785 | 0.176713 | 4.588154 | 0.0001 |
| LQ | 0.154974 | 0.040075 | 3.867133 | 0.0005 |
| LogA | 0.026688 | 0.011494 | 2.32185 | 0.0264 |
| LA | -0.148733 | 0.047522 | -3.12977 | 0.0036 |
| DT | -0.063803 | 0.13463 | -0.47391 | 0.6386 |
| CA | 0.143736 | 0.043868 | 3.276525 | 0.0024 |
| GDP | 0.001938 | 0.000628 | 3.082922 | 0.0041 |
| IR | 0.002653 | 0.000782 | 3.391755 | 0.0018 |
| PF | 0.025201 | 0.006624 | 3.804364 | 0.0006 |
| C | -0.302992 | 0.112788 | -2.6864 | 0.0111 |
| R-squared | 0.739 | — | — | — |
| F-statistic | 5.451553 | — | — | — |
| Prob (F-statistic) | 0.000086 | — | — | — |

Note: significance at *0, **5, ***10 percent levels.

1%, while bank (asset) size (LOGA) is 2.6% in the first model and less than 1% in the second model. The P-value of capital adequacy is less than 1% in the first model and 8.3% in the second model. The P-value of deposits is 64% in the first model and 25% in the second model that means no significant impact of deposits on the profitability of Islamic banks in Yemen and this is consistent with Ahangi (2013).

The previous results indicate that there is a strong significant relationship between profitability and bank-specific variables except for deposits. Thus,

we can accept first, second, third, fourth, fifth, and seven hypotheses, and reject the sixth hypothesis which indicates that there is no link between Deposits and profitability of Islamic banks of Yemen.

The results of this study are consistent with the some findings of prior studies like Smaoui and Salah (2013), and Haron (1996) who revealed that bank size has a significant and positive impact on the profitability of Islamic banks. This is also supported by other researchers like Ramlan and Sharrizat (2016), Trad et al. (2016) who found

Table 5. Determinants of ROE

| Variable | Coefficient | Std. Error | T-statistic | Probability |
|--------------------|-------------|------------|-------------|-------------|
| TOE | -11.69612 | 3.404458 | -3.43553 | 0.0016 |
| OPI | 6.392765 | 1.562153 | 4.092277 | 0.0002 |
| LQ | 1.806123 | 0.354263 | 5.098261 | 0.0000 |
| LOGA | 0.388986 | 0.101609 | 3.828251 | 0.0005 |
| LA | -1.524083 | 0.420097 | -3.62793 | 0.0009 |
| DT | 1.402944 | 1.190137 | 1.178809 | 0.2467 |
| CA | 0.692134 | 0.3878 | 1.784772 | 0.0832 |
| GDP | 0.022862 | 0.005556 | 4.115 | 0.0002 |
| IR | 0.029208 | 0.006916 | 4.223317 | 0.0002 |
| PF | 0.287019 | 0.058559 | 4.901388 | 0.0000 |
| C | -4.153515 | 0.997051 | -4.1658 | 0.0002 |
| R-square | 0.706 | — | — | — |
| F-statistic | 5.023053 | — | — | — |
| Prob (F-statistic) | 0.000177 | — | — | — |

Note: significance at *0, **5, ***10 percent levels.

that bank size and capital adequacy are the main factors that are responsible for increasing profitability of Islamic banks. They also found that macroeconomic variables, except for inflation, are able to improve Islamic banks' stability.

The P-values of the macroeconomic variables (GDP and IR) in both models are less than 1% which means that there exists a high significant relationship between profitability and macroeconomic

variables. Thus, we can accept eighth and ninth hypothesis.

Political factor (PF) in Yemen shows that p-value equals 0.0 which means that political stability has a significant impact on the profitability of Islamic banks in Yemen during the study period of 2010–2014 due to the political situation. Thus, we accepted our tenth hypothesis about profitability and political factor (political stability and absence of violence).

CONCLUSION

This study examines the impact of political stability, macro-economic and some of the bank-specific variables on the profitability of Yemeni Islamic banks. For the purpose of the study a sample of three banks was chosen from the population of five Islamic banks in Yemen. Return on asset (ROA) and returns on equity (ROE) were taken as dependent variables, while independent variables were divided into two categories: bank-specific variables (internal), namely bank size, asset management, operational efficiency, liquidity, deposits, financial risk and capital adequacy, and macro-economic variables (GDP and inflation rate) and political factors (PF) as external.

The analysis was performed in three stages. First, the descriptive statistics showed that the external factors (macroeconomic (GDP and IR) and political factors) have a higher mean, median, and standard deviation, while the internal factors (bank-specific variables) have a lower mean, median, and standard deviation. Second, correlation analysis was done to check multicollinearity. The third stage was a multiple regression analysis to evaluate the effect of the independent variables on bank profitability. The results of the study indicate that operating efficiency and financial risk have negative and significant relationships with ROA and ROE. The study also found that capital adequacy has a negative and statistically insignificant relationship with ROA and ROE. The study showed that the assets size (LogA), assets management, liquidity, and deposits have a significant and positive impact on bank's profitability. All the external factors (GDP, inflation rate (IR) and political instability) have positive and significant influence on bank's profitability.

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