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"The Role of Capital Structure, Operational Efficiency, and Corporate Governance in Enhancing the Financial Performance of Islamic Banks in Pakistan"

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Abstract

This research looks at how capital structure, operational efficiency, corporate governance, and Shariah governance affect Islamic banks in Pakistan. This research deals with an issue in Pakistan's dual-banking system. Currently, Islamic banking, in sharp contrast to profitability and efficiency, has grown substantially in terms of assets, deposits, and branches. This has made Islamic banking the preferred choice among customers. This research aims to look at the factors within the bank that can be improved and that are in the control of management and regulators. Therefore, the research is limited to bank-specific factors. This research uses a quantitative explanatory design with a sample of six full or converted Islamic banks (2020-2024), resulting in 30 bank-year cases. Financial performance is primarily defined in this research as return on assets and return on equity. Capital adequacy ratio is used to measure the capital structure. Cost-to-income ratio is used to measure operational efficiency. Board size and size of the Shariah Supervisory Board are used to capture governance, while size of the bank is captured using the logarithm of total assets. Descriptive statistics, trend analysis, correlation analysis, Hausman test, and random effect regression are used to establish the proposed relationships. Findings indicate that operational efficiency is the most reliable performance driver. Capital adequacy shows a positive relationship with return on assets and returns on equity, indicating the presence of capital buffers increases performance and does not merely serve the purpose of risk mitigation. Performance also shows a positive relationship with the size of the bank, indicating the benefits of increased operational scale. In the case of the governance variables, positive patterns are observed in the direct and correlational relationships, though the size of the boards, whether of the Board of Directors or the Shariah Board, is not significant in the final random-effects models. This is attributed to the limited variance of these variables across banks and time periods. For performance improvements, the thesis recommends the managed costs, optimally utilized capital, and the improved data driven monitoring systems and governance disclosures. Further, the thesis recommends the improved data driven governance disclosures and more uniform documentation, both at the level of banks and the Banking Regulatory Authority, to facilitate forthcoming studies with increased temporal scope and deeper investigation.

Keywords: Islamic banking; financial performance; capital adequacy; operational efficiency; Shariah governance.

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