EFFECTS OF FINANCIAL INNOVATION ON PROFITABILITY OF ISLAMIC BANKS

(A CASE OF GULF AFRICAN BANK)

BY

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ABSTRACT

The objective of this research study was to assess the effect of financial innovation on profitability of Shariah compliant financial products and services in Islamic banking in Kenya. This study targeted Gulf African Bank. It will be covered from April 2014 to September 2014. Specifically, the study sought to establish the relationship between Islamic financial innovations and banking profitability. The return on Assets (ROA) was used to measure profitability. The return on assets (ROA) was calculated by dividing the banks' net profit before taxation by the average of the total assets held by the bank over the study period. Based on the findings of the study, it can be concluded that bank innovations Effect financial profitability of Islamic banks in Kenya positively. The adoption of innovations by Islamic banks has a high potential of improving financial profitability and hence better returns to the shareholders. The versatility of innovations has made their adoption rate to be high among both the banks and their customers. This can be explained by the use of innovations which have enabled banks to start making income away from traditional sources like interest, trade and asset financing. Banks have been able to make more commission income from transactions done on innovation channels like; mobile phones, internet, credit cards and point of sale terminals. Innovations were found to have a high prediction power in terms of grouping banks using predictive discriminant analysis. It is therefore important for the Central bank of Kenya to consider grouping banks based on their market share of innovations and link the ranking to their profitability. This study did not include all bank innovations and a further study is recommended to include innovations like agency banking, securitization and credit guarantees and their Effect on the financial profitability of Islamic banks. A more detailed study can be conducted to establish whether the adoption of financial innovations contributed to financial deepening in Kenya