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Do Non-Traditional Activities Matter for Income Diversification and Performance of Islamic Banks in Indonesia?

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Abstract

Non-traditional activities are started being concerned. It is questionable whether Islamic banks follow the trend of utilizing non-traditional activities to promote income. Therefore, it is important to examine the trend and the diversification among traditional (Profit Loss Sharing (PLS) and non-PLS) and non-traditional activities by Islamic banks. This study also examines the impact of these three activities on performance and how diversification affects performance. Eleven (11) Islamic banks are tested for a period of 2010-2018. This study finds that revenue is mostly earned from non-PLS activities, non-traditional activities and the lowest one is PLS activities as PLS activities contain high risks. This study also finds that PLS and non-PLS activities affect performance. Meanwhile, non-traditional activities cannot necessarily be a shift of traditional activities and does not play a major role in performance. It can be due to only fewer instruments of non-traditional activities that are available and suitable with Islamic banks. Besides, diversification does not affect performance which indicates that diversification is not optimal yet in supporting income. This results imply in providing information for Islamic bankers about how activities can diversify the income.

Keywords: traditional activities, non-traditional activities, Islamic Banks, diversification, performance

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1. Introduction

Profit loss sharing (PLS) contracts have a higher risk than margin-based (non-PLS) contracts. Besides, margin-based contracts can provide fix return that fluctuated return from PLS. These cause Islamic banks tend to use margin-based contracts more than PLS. Both PLS and non-PLS contracts are included in traditional activities of banks as intermediaries. Besides traditional activities, banks can perform non-traditional activities. As stated by Huang & Chen (2006), not only traditional activities, but non-traditional activities also become an important part of banks' operating revenue.

The main reason of why banks needs to perform non-traditional activities is to support income. Many literatures show that commercial banks in most countries increase non-traditional activities (Lup, 2015) such as revenue from securities, gain on sales of securities purchased, investments in other banks, service fee, brokerage, credit card activities, remittance, corporate advisory, underwriting, and other operating revenue (Edwards & Mishkin, 1995, Huang & Chen, 2006). It is due to the investor is more sensitive to interest rate. Depositors and borrowers have some alternative investments and funding that do not only through commercial banks (Edwards & Mishkin, 1995), but they can move their funds from deposits in banks to investments that provide a higher yield. Therefore, non-traditional activities can supply additional revenue if revenue from traditional activities is not sufficient.

Islamic banks are not known yet whether follow this trend or not. Islamic banks do not have as much flexibility as conventional banks due to sharia compliance and fewer instruments are available for Islamic banks (Lup, 2015). Islamic banks mostly perform non-traditional activities such as investments in money market for short-term investments or obtaining fund, service fee, or revenue from foreign exchange. If Islamic banks are willing to invest in money market, they also have to use Islamic contracts (Obaidullah, 2015).

Therefore, this study examines the income diversification of traditional and non-traditional activities to know whether non-traditional activities in Islamic banks have a high role in promoting income as conventional banks. This study then divides traditional activities into two types, PLS and non-PLS contracts to distinguish the impact of each contract to performance. This study also examines the trend of those activities performed and the diversification.

This study only focuses on fully Islamic banks in Indonesia. The paper fills the gap in the existing literature on PLS and non-PLS contract diversification in Islamic banks. It is expected to provide useful information for Islamic bankers related to how activities can diversify the instruments. This study also examines the role of non-traditional activities and income diversification in creating profit. Therefore, several questions of this paper are as follow:

Q1 : How is the proportion of revenue from traditional activities (PLS and non-PLS) and non-traditional activities (non-financing) of each Islamic bank?

Q2 : Does non-traditional activities affects performance positively?

Q3 : How is the trend of activities diversification in Islamic banks?

Q4 : Does diversification affect performance of Islamic banks positively?

2. Literature Review

2.1. Income (Net Operating Revenue) Diversification

Banks perform two kinds of activities, traditional and non-traditional activities. Traditional activities are related to the main function of banks as intermediaries which collect funds from depositors in the form of deposits, demand deposits, and saving. These funds are then distributed in the form of credits. Non-traditional activities consist of financial service fee out of interest revenue. In other words, these are other than financing (lending) activities.

Traditional activities need variable costs. Banks obtain interest or sharing from lending activities and also have to pay interest of sharing attributable to depositors. Meanwhile, mostly non-traditional activities incur fixed costs to perform the activities and less fluctuate (DeYoung & Roland, 2001). It causes revenue from non-traditional activities become more potential to be generated. Non-traditional activities are used to obtain additional profit if banks cannot disseminate funds optimally.

In Islamic banks contexts, Islamic banks collect funds from depositors in the form of wadiah or using PLS contracts such as musharaka. Depositors are capital providers, whereas banks are as entrepreneurs to invest the funds. These funds are then distributed in the form of selling with margin using murabaha, salam, or istishna'; credit using qardh; and PLS financing using mudharaba or musharaka.

Traditional activities of Islamic banks are in the form of PLS and non-PLS (consists of margin-based and fee-based contracts) which are distributed to third parties. Non-traditional activities can be divided into fee revenue, trading revenue, and other non-traditional revenue. Fee revenue is generated from service provided such as safe keeping the gold; money transfers, purchase and sale foreign currency, securities trading, payment and clearing checks; or issuing letters of credit (Bahari, 2009). Trading revenue is generated from trade stock and derivatives which are permissible in Islamic principles. Trading revenue can be limited due to fewer instruments available in according to sharia principles (Lup, 2015).

These two activities are like an offset. Proportion of non-traditional revenue will increase if traditional revenue decrease. Banks can benefit the diversification if these two activities are less co-varying each other (Lup, 2015).

3. Hypothesis Development

Hypothesis are developed to answer questions 2 and 4. There are two hypothesis developed as follow.

Due to revenue consists of traditional and non-traditional activities, those two activities are offset. If there is an increase of revenue from traditional activities, revenue from non-traditional activities will decline. Lup (2015) found that non-traditional revenue does not affect profitability. A relative smaller of non-traditional revenue exerts profit in more profitable banks.

Crouzille et al. (2013) found that non-traditional activities increase profit and risk-adjusted profit when banks involve more in government securities. Increase in revenue diversity and a shift from traditional to non-traditional revenue positively benefit profitability. Teimet et al. (2011) also found that diversification level has positive influence on performance in commercial banks. Based on this explanation, hypothesis is developed as follows:

H1: Revenue from non-traditional activities affects performance positively.

Diversification can potentially increase conflict with clients, thus it increases reputation risk as risk to maintaining reputation to clients (Lup, 2015). Besides that, lack of suffice human resources in monitoring different products can be a main factor why diversification cannot promote efficiency (Shaban et al., 2014). Lup (2015) found that diversification detriments profit when bank is less profitable, and no impact on average and more profitable banks. Wolfe et al. (2007) also found that diversification does not benefit the banks due to their lack of expertise and experience. Molyneux & Yip (2013) found that greater income diversification increases revenue volatility and then affects risk-adjusted performance negatively.

Meanwhile, wider range of products and services allows banks to obtain information, then it can open the opportunity to facilitate other products and perform more efficiently. Actually, diversification can affect the rate of costs depending on the risks. If diversification reduces the risk, banks can benefit from the lower costs and the increase of price/return. Gurbuz et al. (2013) found that income diversification increases risk-adjusted financial performance. Turkmen & Yigit (2012) and Ismail et al. (2015) also found that diversification explains ROA. Based on this explanation, the hypothesis is developed as follows:

H2: Diversification affects performance positively.

4. Methods

This study uses panel data. 11 Islamic banks are tested, which are 2 newest Islamic banks are excluded due to the operation period is not more than 3 years. This study only tests fully Islamic banks which are not bounded by main conventional operations like Islamic-window banks. Period tested is from 2010-2018 based on the consideration that the latest of 4 Islamic banks started operating since 2010.

Traditional revenue is measured in net value as referring to interest revenue minus interest expense in conventional banks explained by Gurbuz et al. (2013) and Wolfe et al. (2007). Therefore, this study also uses net value to calculate traditional revenue (financing revenue) referring to Molyneux & Yip (2013). The difference is this study distinguish financing revenue from PLS and non-PLS contracts. Revenue of PLS contracts involves revenue from *mudharaba* and *musharaka* minus sharing to third-parties of profit sharing contracts. Revenue of non-PLS contracts involves net revenue or margin of *murabaha, salam*, and *istishna*'; and net fee of *ijarah*.

Non-traditional revenue (or non-financing revenue) is measured as the sum of revenue from other securities than main contracts (PLS and non-PLS contracts) such as from investments in mutual funds; government monetary instruments like Sertifikat Bank Indonesia Syariah (SBIS) or *Surat Berharga Syariah Negara* (SBSN); net revenue from investments in other banks; revenue from other operation such as export notes, bonus from giro, bound investment, service fee, transaction in foreign currency, acceptance fee, sale of securities; and other operational revenue. Formula of traditional (formula 1 and 2) and non-traditional revenue (formula 3) are as follow:

$$\text{Net PLS}_{it} = \frac{\text{Net PLS Revenue}_{it}}{\text{Net Operating Revenue}_{it}} \tag{1}$$

$$\text{Net Non-PLS}_{it} = \frac{\text{Net Non-PLS Revenue}_{it}}{\text{Net Operating Revenue}_{it}} \tag{2}$$

$$\text{Non-Financing}_{it} = \frac{\text{Non-Financing Revenue}_{it}}{\text{Net Operating Revenue}_{it}} \tag{3}$$

Notes:

Net PLS Revenue$_{it}$: revenue generated from *mudharaba* and *musharaka* contracts minus sharing to third-parties in bank i at time t.

Net Non-PLS Revenue$_{it}$: net value of revenue generated from margin-based (*murabaha, salam,* and *istishna'*) and fee-based contracts (*ijarah*) in bank i at time t.

Non-Financing Revenue$_{it}$: non-financing revenue in bank i at time t.

Net Operating Revenue$_{it}$: total value of net PLS, net non-PLS, and non-financing revenue in bank i at time t.

This study uses Herfindahl-Hirshman index (HHI) to measure concentration (formula 4). Income diversification is measured by using one minus HHI (Lup, 2015; Turkmen & Yigit, 2012; Teimet et al., 2011) (formula 5), as follows:

$$\text{HHI}_{it} = (\text{Net PLS}_{it})^2 + (\text{Net Non-PLS}_{it})^2 + (\text{Non-Financing}_{it})^2 \tag{4}$$

$$\text{DIV}_{it} = 1 - \text{HHI}_{it} \tag{5}$$

Notes:

HHI$_{it}$: Herfindahl-Hirshman Index of bank i at time t.

DIV$_{it}$: degree of income diversification of bank i at time t.

Performance is measured by risk-adjusted performance i.e. RAROA (risk-adjusted return on assets) (Gurbuz et al., 2013; Wolfe et al., 2007). ROA is annual net revenue divided by total assets. RAROA is measured as formula 6 as follow:

$$\text{RAROA}_{it} = \frac{\text{ROA}_{it}}{\sigma\text{ROA}_{it}} \tag{6}$$

Notes:

RAROA$_{it}$: risk-adjusted of ROA for the bank i at time t.

σROA$_{it}$: standard deviation of ROA for the bank i at time t.

Question 1 and 3 will be answered using graphic and descriptive data. Question 2 and 4 will be examined using regression analysis. The tests of question 2 and 4 also involve banks' characteristics as control variables e.g. bank size, asset growth, and bank equity. Bigger size, growing, and well-capitalized banks will ease banks to diversify more and more profitable. Bank size is measured by the logarithm of total assets, asset growth is measured by the growth rate of total assets (t t1) divided by total assets t, and equity is measured by total equity divided by total assets (Lup, 2015; Gurbuz et al., 2013).

Question 2:

$$\text{RAROA}_{it} = \propto_0 + \beta_1\text{Net PLS}_{it} + \beta_2\text{Bank Size}_{it} + \beta_3\text{Assets Growth}_{it} + \beta_4\text{Total Equity}_{it} + \varepsilon_{it} \tag{7}$$

$$\begin{aligned}\text{RAROA}_{it} &= \propto_0 + \beta_1\text{Net Non-PLS}_{it} + \beta_2\text{Bank Size}_{it} + \beta_3\text{Assets Growth}_{it} \\ &\quad + \beta_4\text{Total Equity}_{it} + \varepsilon_{it}\end{aligned} \tag{8}$$

$$\text{RAROA}_{\text{it}} = \propto_0 + \beta_1 \text{Non Financing}_{\text{it}} + \beta_2 \text{Bank Size}_{\text{it}} + \beta_3 \text{Assets Growth}_{\text{it}} + \beta_4 \text{Total Equity}_{\text{it}} + \varepsilon_{\text{it}} \quad (9)$$

Question 4:

$$\text{RAROA}_{\text{it}} = \propto_0 + \beta_1 \text{DIV}_{\text{it}} + \beta_2 \text{Bank Size}_{\text{it}} + \beta_3 \text{Assets Growth}_{\text{it}} + \beta_4 \text{Total Equity}_{\text{it}} + \varepsilon_{\text{it}} \quad (10)$$

5. Result and Discussion

Q1: How is the proportion of revenue from traditional activities (PLS and non-PLS) and non-traditional activities (non-financing) of each Islamic bank?

Figure 1: Net Operating Revenue of Islamic Banks in Indonesia for the Year 2010-2018 (Source: Financial Statements (Processed))

Based on Figure 1 above, mostly revenue from net non-PLS activities such as margin-based and fee-based as shown in red line is the highest from 2010 to 2018. Meanwhile, revenue from net PLS activities as shown in blue line is the lowest one. After non-PLS activities, non-financing (non-traditional) activities as shown in green line is the second contributor to banks' income, and the lowest one is PLS activities, excepted for Maybank Syariah, Bank Panin Syariah, and Bank Victoria Syariah.

In 2010 as the early years of their operation, those three banks mostly generate revenue from non-traditional, continued with non-PLS, and the last one is PLS. Maybank Syariah, Bank Panin Syariah, and Bank Victoria Syariah started the operation since 2010, 2008, 2009, respectively. It shows that the banks use non-traditional activities more to gain income. It can be due to Islamic banks indeed have to compete with conventional banks in the context of raising and channeling funds. Besides that, new banks can face difficulty in employing the funds due to lacking skilled staff and experiences (Khan & Mirakhor, 1987). Because the use of contracts in channeling funds is limited, then banks boost the revenue from other operational sources, i.e. non-traditional.

As time goes by from 2010 to 2018, revenue for all banks from non-PLS activities mostly show a slight increase. In term of any condition, non-PLS activities seem to be dominant activities done by the banks. It can be due to non-PLS activities have a lower risk. Margin or fee has been determined at the beginning (Ferawati et al., 2015), therefore banks can minimize the uncertainty of return. Contrary to non-PLS, in 2010 revenue from PLS activities is the lowest one in mostly banks. It was not an easy to concern in PLS due to in around 2008-2010 most of Islamic banks just emerged in Indonesia, and Islamic banks and Islamic-banking products are newly in those years. From 2010 to 2018, revenue from PLS activities slightly decreases in ratio.

Revenue from non-traditional activities is mostly the second source of revenue after revenue from non-PLS activities. Although there was an increase, the increase is not that much compared with revenue from non-PLS activities.

However, mostly Islamic banks have similar trend of revenue from non-PLS, non-traditional, and PLS activities. An exception for Maybank Syariah, Bank Panin Syariah, and Bank Victoria Syariah that the trends of PLS and non-PLS fluctuate which increase and then decrease sharply. This fluctuated trend may indicate that the banks are still not stable in arranging the funds and returns.

Based on table 1, averages of PLS revenue are mostly in negative values. As mentioned earlier, PLS is measured as revenue generated from PLS activities minus profit shared to depositors, then divided by operating revenue. The negative values mean profit shared to depositor is higher than revenue from PLS generated. It does not mean Islamic banks loss from PLS contracts. Based on the assumption that banks always try to avoid loss, negative numbers show that although Islamic banks raise the funds

TABLE 1: Mean of Net Operating Revenue of Islamic Banks in Indonesia in 9 Years (2010-2018)

	$NetPLS_{it}$	$NetNon\text{-}PLS_{it}$	$Non\text{-}Financing_{it}$
Bank Muamalat Indonesia	-0.3096	1.0971	0.2125
BNI Syariah	-0.2731	0.9655	0.3076
BRI Syariah	-0.3398	1.0729	0.2668
Bank Syariah Bukopin	-0.7057	1.5400	0.1657
Bank Syariah Mandiri	-0.2415	1.0539	0.1876
Maybank Syariah	-0.0915	0.6732	0.4184
Bank Jabar Banten Syariah	-0.5542	1.2824	0.2718
Bank Mega Syariah	-0.5651	1.2367	0.3284
Bank Panin Syariah	0.1867	0.4863	0.3270
Bank Victoria Syariah	-0.7158	0.9518	0.7640
Bank Central Asia Syariah	-0.3116	0.8670	0.4446

Source: Financial Statements (Processed)

in PLS contract; banks distribute funds in not only PLS, but also in non-PLS contracts and can be in non-traditional activities, so that banks generate revenue from PLS, non-PLS contracts, and/or non-traditional. Then, the revenue generated from those three activities can be used to be shared to depositors of PLS contracts.

Averages of non-PLS revenue show positive values and the highest one among revenue from PLS, non-PLS, and non-traditional activities. It shows that margin-based contracts such as *murabaha, salam*, and *istishna*; or fee-based contracts such as *ijara* are the main sources of operational income.

Averages of non-traditional (non-financing) revenue show positive values in the range of 0.1 until 0.4, except for Victoria Syariah amounted to 0.764. The values of non-traditional revenue are also lower than non-PLS revenue in all banks. Victoria Syariah has the lowest value of PLS revenue amounted to -0.715.

TABLE 2: Descriptive Data

	N	Min.	Max.	Mean	Std. Deviation
NetPLS	99	-2.0547	0.5960	-0.3565	0.3852
NetNonPLS	99	0.0742	2.0491	1.0206	0.3701
NonFinancing	99	0.0675	1.9697	0.3359	0.2942
RAROA	99	-2.7993	7.2024	1.4455	2.2556
Diversification	99	-8.1397	0.6511	-0.6498	1.4013

Source: Statistic Results (Processed)

Based on table 2, the maximum value of PLS revenue amounted 0.596 is Panin Syariah in 2015. Mean value of -0.356 shows that profit shared to depositors is higher than revenue from PLS. It has the same explanation as before that banks channel funds not only in PLS contracts, but also in non-PLS or non-traditional activities. The revenue from non-PLS and non-traditional then are shared to depositors.

The maximum value of non-PLS revenue amounted to 2.049 is Bukopin Syariah in 2014. The mean value of 1.020 shows that revenue is mostly from non-PLS contracts. The maximum value of non-traditional revenue amounted to 1.969 is Victoria Syariah in 2011. The mean value of 0.335 shows that non-traditional is the second role in contributing income after non-PLS revenue.

The highest RAROA amounted to 7.202 is BNI Syariah in 2018, whereas the lowest one amounted to -2.799 is a loss of Panin Syariah in 2017. The highest value of diversification amounted to 0.651 is Panin Syariah in 2017, whereas the lowest amounted to -8.139 is Mega Syariah in 2018.

Q2: Does non-traditional activities affects performance positively?

Table 3: The Impact of Income from PLS, Non-PLS, and Non-Traditional Activities on Performance

	RAROA	RAROA	RAROA
Net-PLS	-0.260**		
Net Non-PLS		0.300***	
Non-Financing			0.020
Bank Size	0.594***	0.548***	0.471***
Assets Growth	0.245**	0.268***	0.213**
Total Equity	0.564***	0.635***	0.437***
F-statistics Adj. R^2	5.528 0.156	5.826 0.165	3.575 0.095

*, **, *** represent significance at the level of 10%, 5%, and 1%, respectively.

Source: Statistic Results (Processed)

Table 3 presents whether traditional (PLS and non-PLS) or non-traditional (non-financing) activities can increase performance. Net-PLS revenue has a negative effect on performance (RAROA). Contrary to PLS, net non-PLS revenue has a positive effect on performance. It shows that the revenue earned from non-PLS contracts increase banks' income. This can be explained and associated with table 2 whereas mostly Islamic banks used non-PLS contracts while channeling funds. And also based on Figure 1, when revenue from PLS and non-traditional did not show high increasing movement, the very high revenue from non-PLS appears to be steadily increasing until 2018.

Non-financing revenue does not affect performance. It means that non-traditional activities have no pattern in forming income. The ratio of non-financing revenue of Maybank Syariah, Panin Syariah, and Victoria Syariah goes up and down because of unstable PLS and non-PLS activities.

The result rejects hypothesis H1 which states positive impact of non-traditional activities on performance. This result support previous study of Asutay and Izhar (2007) whereas they found service activities have no contribution on profit of Bank Muamalat Indonesia for the period 1996 to 2001. It means until 2018, non-traditional activities still remain do not contribute too much to Islamic banks' profit. Islamic banks evidently do not follow the trend of conventional banks in optimizing non-traditional activities to boost income. Islamic banks do not take advantages of these activities too much. The main reason can be fewer instruments of non-traditional activities that fulfil sharia compliance than conventional products (Lup, 2015). Islamic banks have limited choice for investing in other securities.

Although non-traditional activities have no impact on performance and tend stable, Figure 1 obviously shows that non-traditional activities still have more contribution to income than PLS revenue. It indicates that management is almost certainly being pushed to support the income through non-traditional instruments although not in an optimal way.

Q3: How is the trend of activities diversification in Islamic banks?

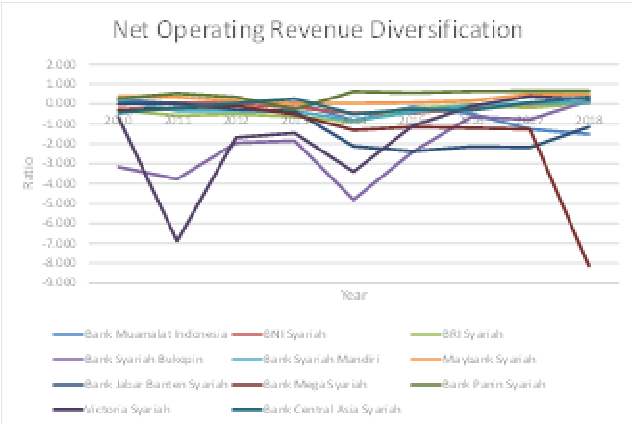

Figure 2: Income Diversification of Islamic Banks in Indonesia for the Year 2010-2018 (Source: Financial Statements (Processed)).

Based on Figure 2, the trend of diversification in 9 years tends to increase and decrease, but there was not too much movement. However, there are three banks with a big decline i.e. Victoria Syariah in 2011 and 2014, Syariah Bukopin in 2014, and Mega Syariah in 2018. It shows that banks collect a huge revenue from non-PLS or non-traditional and little from PLS activities.

Based on Table 4, the highest mean of diversification in Bank Panin Syariah amounted to 0.444 and the lowest is Syariah Bukopin amounted to -2.136. In accordance with Figure 2, mostly the diversification of Syariah Bukopin is in negative value that shows unbalance proportion revenue among PLS, non-PLS, and non-traditional activities.

Table 4: Mean of Diversification of Islamic Banks in Indonesia in 9 Years (2010-2018)

	Diversification
Bank Muamalat Indonesia	-0.4365
BNI Syariah	-0.1377
BRI Syariah	-0.3731
Bank Syariah Bukopin	-2.1369
Bank Syariah Mandiri	-0.2305
Maybank Syariah	0.2330
Bank Jabar Banten Syariah	-1.1793
Bank Mega Syariah	-1.5797
Bank Panin Syariah	0.4441
Bank Victoria Syariah	-1.6348
Bank Central Asia Syariah	-0.1159

Source: Financial Statements (Processed)

Q4: Does diversification affect performance of Islamic banks positively?

Table 5: The Impact of Diversification on Performance

	RAROA
Diversification	-0.159
Bank Size	0.542***
Assets Growth	0.229**
Total Equity	0.516***
F-statistics Adj. R^2	4.275 0.118

*, **, *** represent significance at the level of 10%, 5%, and 1%, respectively.

Source: Statistic Results (Processed)

Table 5 shows that diversification does not affect performance. It rejects hypothesis H2 which states positive impact of diversification on performance. Ideally, diversification can reduce risk and help to improve performance if diversification is managed well. It can also facilitate other products to contribute and encourage banks to perform efficiently. Therefore, non-traditional activities become important as a shift from traditional activities for commercial banks (Huang & Chen, 2006). Shahimi et al. (2006) stated that banks involved in non-traditional activities have more diverse and alternative sources funds, then can reduce risk, and can be safer.

However, no impact shows that diversification does not form a pattern in generating income. It can be due to diversification is not optimally performed, or the changes of the portion of each activity tend to be unstable. Islamic banks face lack of instruments available and it can restrict in optimizing the profit. It is supported by Lup (2015) that diversification levels of Islamic banks are lower than conventional banks. Molyneux &

Yip (2013) also stated that Islamic banks are more focused on deposit/loan financing and less diversified in non-traditional activities.

Besides, commonly, PLS contracts incur higher insolvency risks than margin or fee-based contracts. Revenue from non-PLS is found that does not have an impact on risk level. Therefore, Islamic banks prefer to invest in non-PLS contracts more (Grassa, 2012) that cause diversification lower. After all, the banks cannot benefit the result of diversification i.e. the lower costs and the increase of price/return.

6. Conclusion

In nine years, revenue of all banks mostly earned from non-PLS activities, then continued with non-financing (non-traditional) activities, and the lowest one is PLS activities. Averages of PLS revenue are mostly in negative values. It shows that although Islamic banks raise the funds in PLS contract; banks distribute funds in not only PLS, but also in non-PLS contracts and can be in non-traditional activities, so that banks generate revenue from PLS, non-PLS contracts, and/or non-traditional. Averages of non-PLS revenue show positive values that indicate that margin-based contracts are the main sources of operational income. Non-traditional revenue show positive values, but lower than non-PLS revenue in all banks.

PLS revenue has a negative effect on performance whereas non-PLS revenue has a positive effect on performance. It shows that mostly income of Islamic banks coming from non-PLS activities. Non-traditional revenue does not affect performance. It indicates that non-traditional activities do not draw any pattern in forming income and do not contribute a big role to Islamic banks' profit. Last, diversification does not form a pattern in generating income because the diversification does not optimally result income, or the changes of the portion of each activity tend to be unstable.

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