

Asset Quality, Revenue Diversification and Profitability of Islamic Banks in Selected African Countries

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ABSTRACT

Profit-sharing and trade-based financings are the major means for revenue generation in Islamic banks. Making these financing contracts available in accordance with Shariah principles will not only increase the growth of banking market but also propel the profitability of existing Islamic banks. Profitability of the banks thus depends largely on effectiveness of the revenue models, asset (financing) quality as well as diversification methods employed. Despite the established theoretical link between asset quality, revenue diversification and profitability, empirical relationship between the variables remains underexplored. Therefore, this study examined the effect of asset quality and revenue diversification on Islamic bank profitability in Africa. A sample of five countries were purposively selected for the study from Islamic Financial Services Board (IFSB) member African countries. Country-level Quarterly data were extracted from IFSB database for 11 years from 2013 to 2023. The data were analysed via fixed effects regression technique. Findings revealed that revenue diversification had positive, significant effect (0.69, $p < 0.05$) on return on assets (ROA). Conversely, non-performing financing had negative, significant effect (-0.28, $p < 0.05$) on ROA. The study concluded that Islamic banks' profitability is significantly affected by revenue diversification and asset quality, in selected African countries. The study recommended diversification to more shariah-compliant products and effective monitoring of financing activities to reduce non-performing facilities that can deplete Islamic banks' profitability.

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INTRODUCTION

Islamic banking has gained significant traction across Africa in recent years, driven by the region's expanding Muslim population, increased financial inclusion efforts, and growing investor interest in shariah-compliant financial instruments (Muhammad Al Amine, 2016). Unlike conventional banks, Islamic banks operate in line with provision of Islamic laws that prohibits interest and speculative transactions (*gharar*), with emphasis on profit-sharing and asset-backed contracts (Hassan et al., 2022; Mirakhor & Zaidi, 2007; Osman, 2025). According to Siddique and Siddique (2025), Islamic law fundamentally prohibits *riba*-based transactions which can occur in two forms. The first type is charging of interest loan transactions (*riba al-nasī'ah*) and the other one results in surplus charged in exchange transactions (*riba al-fadl*). Islamic banking thus provides platform for interest-free banking which promotes equity, transparency, and financial inclusion by outlawing *riba* and encouraging profit- and risk-sharing strategies like *mudarabah* and *musharakah* (Anami, 2025).

Also, in the circle of these prohibitions there are *gharar*-based transactions. *Gharar* includes risk and uncertainty inherent in the objects of contracts, as well as some types of fraud and/or inadequate information. According to Shariah experts, modest *gharar* may be accepted as a necessary evil, but big or excessive *gharar* renders contracts void (Kuyateh, 2025). Another essential tenet of Islamic banking, investing, and finance is the ban on *maysir*, or gambling. Activities that rely solely on chance or conjecture without any solid or logical foundation are referred to as *maysir* (Damayanti, 2025). *Maysir*-based financial activities are viewed as ineffective and incompatible with Islamic principles since they unfairly expose one party to loss while benefiting another (Hikmat Nugraha & Setiawan, 2025). Financing of or investing in unethical transactions is also forbidden in Islamic banking. Islamic finance prohibits businesses engaged in alcohol, gambling, and pornography because it requires all investments to follow moral guidelines that respect Sharia (Ali, 2025). Screening procedures are normally conducted to ensure that economic activities are in line with social welfare and moral obligation (Ali, 2025). The basic aspect of Islamic banking's financial instruments is that they are Shariah-compliant. These principles guide the system's operation (Iqbal & Mirakhor, 2011). The banking system provides financial services, such as profit-and-loss sharing agreements, which foster long-term relationships with clients and increase market stability (Mirakhor & Zaidi, 2007). The banking model is growing fast in regions with large percentage of Muslim population including Africa.

Islamic banking in Africa has expanded over the past two decades, with countries such as Sudan, Egypt, Nigeria, Kenya, South Africa, and Morocco emerging as key players in the sector (Chouikh & Blagui, 2017). Increasing Muslim population, regulatory frameworks, and expansion of international banking institutions are the major factors that are responsible for the evolving Islamic banking market in the region. According to Mbawuni and Nimako (2018), increasing Muslim population in Africa, estimated at over 40% of the total population, has spurred demand for Islamic banking products. Even though over 40% of about 1.2 billion people in Africa are Muslims, the region's share of Islamic finance assets, though growing, is currently less than 10% of the total value of Islamic financial assets (Sonko & Sonko, 2025). Islamic banking market needs to be expanded across the region as inclusive growth solutions, to meet the financial demands of all groups and advance sustainable development goals (SGDs) agenda (Abubakar & Aysan, 2023).

On the expansion of Islamic banking market, Conteh et al. (2022) noted that Africa, especially the West Africa subregion, has enormous potential to lead the Islamic banking sector if it were not for a lack of a thorough regulatory framework and inadequate legal infrastructure, among other issues that impeded its growth. Islamic banking operations face the hurdles of regulatory differences, limited market liquidity, and insufficient financial product variety in the attempt to gain international penetration (Soomro, 2025). These challenges have the growth of Islamic banking market in Africa mostly to expansion of international banking institutions to Africa (Alharbi, 2017). Banks offer quality shariah compliant services to their customers, whether they operate locally or internationally, for them to remain in business and operate profitably. The banks efficiently and profitably mobilise financial resources from the surplus to the deficit segments by acting as financial intermediaries (Iqbal et al., 2025). So as financial intermediaries, they must provide quality services in line with Shariah.

Provision of quality services in accordance with Shariah principles will not only increase the growth of banking market but also propel the profitability of existing Islamic banks in the region. By improving welfare, lowering poverty, starting and growing businesses, and managing risks, increased financial inclusion may raise household income. This will ultimately result in several opportunities for the banking industry (Zachosova et al., 2018; Zhang & Posso, 2019). A rise in the number of people who are financially integrated into the formal financial system is projected to benefit the bank because it will boost demand for its financial services, resulting in higher profitability (Al-Eitan et al., 2022). Thus, profitability of the banks tends to be affected by the extent to which underserved population and small businesses, keyed into Islamic financial system. Such profitability moves up or down depending on the available growth opportunities (Hassan & Fatima, 2021), which may depend on customers' demand for shariah-compliant products from Islamic banks. Countries with strong financial inclusion initiatives, like Kenya, have seen greater success in Islamic banking (Banna et al., 2021).

Despite the growth and profitability potential, competition with well-established conventional banks, which may have better access to capital, more extensive branch networks, and diversified product offerings, becomes inevitable. For Islamic banks to compete favourably, their assets (financing) must be of high quality (low level of non-performing financing), and such financings must be well diversified to various shariah-compliant sources of revenue (Iskandar & Fasihah, 2024). Chouikh and Blagui (2017) identified asset quality, and revenue diversification, among others, factors determining Islamic bank profitability. This may be largely true, since the banks rely on profit-sharing and asset-backed financing, with exposure to different risks. Mudharabah and Musharakah are two examples of profit-loss sharing products that set Islamic banking apart from the traditional system (Azmat et al., 2020).

According to Kamal et al. (2025), the foundation of ethical finance that complies with Sharia law is profit-sharing arrangements, mainly through Mudharabah and Musharakah contracts. Mudharabah operates as a trust-based partnership in which capital providers (rabb al-mal) entrust funds to entrepreneurs (mudharib), with earnings distributed in accordance with predetermined ratios and capital providers incurring losses save in cases of negligence (Elfi Barus et al., 2024). On the other hand, musharakah refers to joint venture agreements in which all partners contribute capital and divide profits and losses equally (Saleem et al., 2025). Even though profit-sharing financing has a relatively small market share (Alhoul et al., 2023), it nonetheless plays a vital role in the development of the Islamic banking industry (Athief et al., 2024). However, because of their partnership structure, which is typically unsecured, profit-loss sharing contracts carry certain unique risks (Abdussalam et al., 2025). This lack of security can result in high non-performing financing which can erode profitability (Johari et al., 2022). Furthermore, Yusoff et al. (2023) stated that financial institutions are exposed to various risks especially credit risk from asset-backed financing contracts like Murabaha. However, effective credit risk management for profit-sharing and asset-backed contracts lowers non-performing financing, which eventually boosts Islamic profitability. (Widarjono et al., 2025). It is therefore necessary to manage the risk effectively to ensure high quality of the banks' assets.

Regarding diversification of revenue sources, it has been observed that profit-sharing contracts (Mudarabah), leasing (Ijarah), and trade-based financing (Murabaha) are the major sources of revenue for Islamic banks. Effectiveness at which these revenue models are utilized tends to affect profitability of the banks. Hence revenue diversification is also an important bank-specific factor that can influence Islamic banking profitability (Susanto et al., 2024).

Although Islamic banks are typically considered as having greater asset quality due to the shariah-compliant nature of their financing contracts (Bukanu & Mukama, 2025; Jaber, 2024), the extent to which excellent asset quality boosts profitability has not been consistently demonstrated in literature. While some studies indicate that enhanced asset management and lower non-performing finance enhance profitability (Gurung et al., 2024; Maulida, 2025; Saumanisa & Nurmalia, 2025; Wardana et al., 2025), others observed negative or insignificant benefits (Cheikh Tourad, 2024; Nugroho et al., 2020; Purnomo, 2024). Similarly, there are conflicting empirical results of revenue diversification. It cannot be concluded that diversification into more non-interest income contracts will boost profitability of the bank. Due to certain legal restrictions in Islamic banks, it has even been suggested that such diversification may result in a reduced return or perhaps have a negligible impact (Ammar & Boughrara, 2019; Molla et al., 2025). These opposing viewpoints brought up important issues regarding whether diversified revenue streams and good asset quality had a beneficial impact on Islamic banks' profitability. Thus, even though theoretical relationship has been established between the identified factors and profitability, empirical research is still underexplored and remains unclear on the relationship among the variables. Therefore, this study looked at how Islamic banks' profitability was affected by income diversification and asset quality in selected African countries.

Remainder of this paper is structured to include the literature review, methodology, result and discussion as well as conclusion. The literature section features the theoretical and empirical review of relevant literature. The methodology section provides in-depth coverage of the population, sample, sampling strategy, data gathering method, and data analysis method. The results and discussion section follows where the outcomes of the data analysis are presented and discussed. The final section discusses the conclusion reached based on the study's findings.

LITERATURE REVIEW

This section provides a thorough review of relevant literature on the resource-based view and the concept of efficient structure. The theories provide a theoretical framework for the study's variables. Previous empirical research related to this subject was also reviewed.

Efficient Structure Theory

The study was rooted in the theory of efficient structure, which provided a solid foundation for analysing the asset quality and revenue diversification influence profitability. Efficient structure theory which could be traced to Bourke (1989), argued that banks with superior management and operational efficiency achieve lower costs, better resource allocation, and enhanced profitability. The

theory suggests that efficient banks can reduce costs and increase earnings. Efficiency leads to market dominance, allowing banks to gain higher profits. The theory holds that well-managed banks naturally outperform inefficient ones, gaining competitive advantages in the process (Al-Jafari & Alchami, 2014).

The theory has been frequently applied to explain how several bank-specific factors, such as income diversification, efficiency, and liquidity, impact profitability. Relating operating efficiency to bank profitability, the theory emphasized that cost-efficient banks could offer competitive rates, attract more customers, and increase their profitability (Gržeta et al., 2023). Regarding revenue diversification, it was argued that diversifying revenue sources stabilizes profits of the banks (Gržeta et al., 2023; Stiroh, 2004). Relating the theory to this current study, efficient revenue diversification and good quality of assets, enhance profitability (Beck et al., 2013). Financial stability and returns are generally higher in banks with efficient management (Iqbal et al., 2024). Efficient banks are better positioned to develop fee-based services and Shariah-compliant investment products, thereby enhancing profitability via revenue diversification.

In line with efficient structure theory, banks that function more efficiently reduce operating expenses and hence increase profitability. Poor asset quality, on the other hand, imposes considerable operational costs that impair cost efficiency and divert resources away from productive operations, resulting in lower profitability. According to the theory, high non-performing loans lead to increased loan loss provision which reduces profitability and vice versa. In other words, poor asset quality tends to reduce profitability while better asset quality enhances profitability by reducing bad debt expenses (Menicucci & Paolucci, 2016).

Resource-Based View

The theoretical framework of the resource-based view can also be applied to explain the relationship between profitability and revenue diversification. The theory provides theoretical explanations for the concept of diversity (Onyango, 2018). The resource-based view which could be traced to Wernerfelt (1984), holds that a company has specific productive resources that can be used to take advantage of possibilities for productive growth. By increasing the effectiveness of their usage, these resources enable an organization to generate economies of scale and scope (Contractor et al., 2003). The Resource-Based View holds that a company can sustainably gain a competitive edge over its competitors by having such valuable, unique, and uncommon resources, skills, and capabilities (Akinyemi, 2025). This theory's proponents believed that businesses should search internally for resources that could provide them with a competitive edge over rivals. In conclusion, the resource-based perspective highlights the firm's assets as key factors influencing both profitability and competitive advantage (Ndirangu & Muturi, 2019). Having more resources with efficiency should lead to better performance (Brahmana et al., 2018)

In relation to banking business, diversification can have an impact on bank profitability. As economies of scale improve, having a diverse range of revenue sources should improve efficiency (Chiorazzo et

al., 2008; Klein & Saidenberg, 2010). Profitability is expected to rise because of increased level of efficiency. Profitability is one major indicator of financial performance, and it is essential to the success and survival of the banks (Hakizimana et al., 2023). Thus, profitability improves when bank diversified revenue sources are supported by high efficiency that allows for effective contract execution. Therefore, profitability of Islamic may be linked to diversification of resources to different revenue sources, especially when such resources are efficiently managed. Efficient structure in terms of resources ensures that diversified revenue sources contribute to increased earnings and overall profitability of the banks.

Empirical Review

Prior studies on determinants of Islamic banking profitability have provided inconclusive reports as mixed reports were given. Khan et al. (2014) assessed some factors affecting Islamic bank profitability for period 2007 to 2014. Various bank specific factors included explanatory variables. It was found that ROA, ROE and EPS were significantly affected by the selected bank-specific factors as well as CPI as a control variable. Similarly, Alharbi (2017) revealed that bank size, market concentration, operating income and capital adequacy had positive influence on profitability measures. Mennawi and Ahmed (2020) reported positive and significant effects of operational efficiency, bank capitalization, and short-term investment on financial performance. Capital adequacy ratio has equally been positively linked with return on asset of Islamic banks (Anugra et al., 2025). Furthermore, Eka (2025) revealed that Islamic bank profitability is positively connected with their size, asset structure, and age.

However, negative relationship was recorded between loan quality, size of deposit liability, and profitability (Mennawi & Ahmed, 2020). GDP growth and foreign ownership have also been found to have exhibited negative traits against bank performance (Alharbi, 2017). A more robust analysis of bank specific determinants of bank performance was conducted by Chowdhury and Rasid (2015) using Generalized method of moments (GMM) regression technique. Results of regression estimation showed mixed results on bank specific variables and profitability measures which include NIM, ROA and ROE. Similarly, Maulida (2025) discovered that ROA of Islamic banks in 12 IFSB member countries was negatively and significantly impacted by non-performing financing and cost to revenue ratio. Additionally, it has been discovered that bank expansion and the financing-to-deposit ratio had insignificant detrimental effects on profitability (Eka, 2025). Similarly, Shelda et al. (2025) reported negative impact of liquidity risk on ROA of Islamic banks in ASEAN region.

More so, empirical evidence has not been consistent regarding asset quality and performance. Non-performing loan and loan provision ratios were found to be inversely related to performance (Lucky & Nwosi, 2015). Kadioglu and Ocal (2017) recorded significant, negative impact of non-performing financing on both ROA and ROE of banks. The result supported the argument that low quality of bank asset (high non-performing facilities) leads to lower profitability. Salike and Ao (2017) measured asset quality impacts profitability negatively. Other studies have equally revealed that asset quality had significant negative on bank profitability (Aldizar & Agustina, 2022; Ashraf & Sulehri, 2023). Surprisingly, non-performing loan ratios were reported to have had positive influence on return on

investment (Lucky & Nwosi, 2015). Non-performing financing also had positive significant impact on return on ROA (Shelda et al., 2025). The report contradicted the theory probably due to the choice of ROI rather than ROA or ROE as measure of profitability. However, direct relationship could not be established between non-performing financing and performance.

The effect of non-performing financing could be felt on the association between financing ratio and performance (Nugroho et al., 2020). Similar report was given by Saleem and Ashfaq (2020) that asset quality could be said to be a predictor of Islamic banks in developing Islamic banking market. In another study of 12 Islamic commercial banks between 2019 and 2023, Anugra et al. (2025) revealed that non-performing financing exhibits negative influence on ROAs of the banks. The result demonstrated the adverse effect of credit risk on profitability. Using non-performing financing as a moderating variable, Muhammad and Fadlil (2025) examined the moderating effect of non-performing financing on the relationship between capital adequacy, operating expense ratio, net operating margin and ROA. Results showed that non-performing financing weakens the impact of capital adequacy ratio on ROA. However, non-performing financing could not significantly moderate the influence of operating expense ratio and operating net margin on ROA.

There is still disagreement among researchers about how revenue diversification affects performance (Asif & Akhter, 2019). Nisar et al. (2018) found positive impact of revenue diversification on bank profitability. Ammar and Boughrara (2019) used GMM system estimation technique to discover that diversification of revenue sources has the capability to enhance bank profitability. It has also been reported that financial performance improves with access to a wide variety of revenue sources (Mala et al., 2023). Also, Dinka and Asfaw (2026) found that income diversification significantly influences both ROA and NIM due to multiple revenue sources that reduce risk. Revenue diversification increases bank profitability significantly (Molla et al., 2025).

Some other researchers have also reported positive effect of revenue diversification on profitability (Ashyari & Rokhim, 2020; Molla et al., 2025; Susanto et al., 2024). However, Molyneux and Yip (2013) revealed that revenue diversification could propel income volatility with consequential negative effects on performance. Furthermore, Susanto et al. (2024) discovered that non-interest income sources had significant negative impact on profitability. Revenue diversification has also been reported with significantly negative impact on bank performance and stability (Febriana et al., 2025). Putri et al. (2025) revealed that credit risk and income diversification had no significant impact on profitability.

Although theoretical literature established asset quality and revenue diversification as important variables determining bank profitability, past studies have not been consistent regarding the impact of the variables especially for Islamic banks. While many of the previous studies focused on Asia probably due to the recorded success in terms of Islamic banking in the region, empirical research remains scanty for the continent of Africa. Also, past studies did not control for the level of development of Islamic banking market partly because most of them focused on single country analysis.

RESEARCH METHODOLOGY

Research Design, Population and Sample

Ex-post facto reserch design was employed and 15 Islamic Financial Service Board (IFSB) African member countries constitute the study population. 5 countries were selected. The selection was informed by availability of data as the sample consists of those countries whose data are available on IFSB database. Thus, Nigeria, Morocco, Libya, Sudan and Egypt were selected.

Data Collection and Analysis Methods

Data were obtained on Quarterly basis, from IFSB database for period between 2013 and 2023. Fixed Effects Model Regression technique was used to analyse the data. BP-LM test was initially conducted to decide between Pooled OLS and Effects models. Hausman test was used to eventually select the fixed effects model estimator. Fixed effects regression model estimation technique was selected because it controls unobserved heterogeneity in the model thereby removing any unwanted variations. By eliminating unwanted variation from the model, fixed effects technique reduces all concerns relating to omitted variables bias (Breuer & DeHaan, 2024). Ultimately, regression results become reliable.

Model Specification

The model was specified as follows:

Bank Profitability = f (Asset Quality, Revenue Diversification)

In establishing this relationship, the study adapted the model of Khan et al. (2014) and modified it as follows:

$$ROA_{it} = \beta_0 + \beta_1 NPF_{it} + \beta_2 RVD_{it} + \beta_3 DEP_{it} + \beta_4 LIQ_{it} + \beta_5 BSZ_{it} + \beta_6 TFN_{it} + \mu_{it}$$

Where:

ROA = Return on asset

RVD = Revenue Diversification

NPF = Non-performing financing

DEP = Deposit ratio

LIQ = Liquidity ratio

BSZ=Bank size

TFN = change in total financing

μ = error term

A priori expectation

$\beta_1 < 0, \beta_2 > 0, \beta_3 > 0, \beta_4 < 0, \beta_5 > 0, \beta_6 > 0$.

RESULT AND DISCUSSION

This section details the results of data analysis, interpretation and discussion of findings, for the purpose of making empirical inferences. Both descriptive and inferential analysis results are presented.

Descriptive Analysis

Table 1: Summary Statistics of Study Variables

Var.	Mean	SD	Min	Max	N
ROA	2.30	5.26	-31.00	24.53	220
NPF	8.07	5.78	3.14	36.31	220
DEP	12.62	10.83	2.38	74.63	220
LIQ	15.33	1.97	2.46	27.29	220
BSZ	25.00	3.45	7.91	31.25	220
RVD	17.00	1.26	2.22	67.15	220
TFN	23.70	0.03	11.19	48.83	220

Note. ROA = Return on Assets; NPF = Non-Performing Financing; DEP = Deposits; LIQ = Liquidity; BSZ = Board Size; RVD = Revenue Diversification; TFN = Total Financing. SD = standard deviation.

Table 1 presents the results of summary statistics of data collected for the study. From Table 1, average value of ROA from 2013Q1 to 2023Q4, was 2.30%. Capital adequacy ratio has an average score of 22.3%. Non-performing financing ratio (NPF) averaged 8.07% in the period under review. Similarly, the five sampled Islamic banks across the selected countries recorded mean values of 12.62% and 41.84% in growth of deposit liability (DEP) and Liquidity ratio (LIQ) respectively. Also, revenue diversification (RVD) has an average value of 17%. BSZ showed a mean value of 15.33% while growth rate of total financing had a mean value of 23.70% for the period under consideration.

The extent to which observations on respective variables move away from or get closer to their mean values is also reported using STD DEV while MIN and MAX values recorded in the period are as displayed in Table 1. STD DEV of ROA was 5.26%. This means that the actual ROA could only deviate from the expected ROA, by plus or minus 5.3% approximately.

NPF has a standard deviation of about 5.78% indicating a plus or minus 6% deviation from the average value. Also, in Table 1, the mean of DEP has standard deviation of 10.8%. The deviation from the

mean is quite large showing that DEP values move largely apart from their mean. Furthermore, LIQ showed STD DEV of 1.97% while STD DEV of RVD was found to be 1.26%. The two measures of Islamic banking development across the countries, bank size (BSZ) and growth rate of total financing (TFN) had standard deviation values of 3.45% and 0.03% respectively.

MIN and MAX observations were also reported in Table 1. OBS for each of the variables were 220 as shown in Table 1. This means that, for each variable, data were collected from 5 countries with aggregate Islamic banking data for a period of 11 years (2013Q1-2023Q4). The descriptive analysis displayed in Table 1 indicates that the variables are not static; they take varying values which make them capable of affecting determining the movement in profitability variable.

Table 2: Pairwise Correlations among the Variables

Var.	1	2	3	4	5	6
1. NPF	1.00					
2. DEP	0.06	1.00				
3. LIQ	0.29	0.39	1.00			
4. BSZ	0.23	0.01	0.17	1.00		
5. RVD	0.61	0.29	0.03	-0.53	1.00	
6. TFN	0.11	-0.12	0.09	-0.48	0.55	1.00

Note. NPF = Non-Performing Financing; DEP = Deposits; LIQ = Liquidity; BSZ = Board Size; RVD = Revenue Diversification; TFN = Total Financing. Correlation coefficients are Pearson's r .

Pair-wise correlation analysis results were displayed in Table 2. It could be observed from Table 2 that no strong correlation exists between each pair of variables, which implies that the model was not plagued with multicollinearity. Multicollinearity is a serious issue in OLS regression analysis and so it must be avoided. In a nutshell, there is no multicollinearity problem in the model, which renders OLS estimation technique suitable for data analysis.

Table 3: Variance Inflation Factor

Variable	VIF	TOLs
NPF	1.57	0.64
DEP	1.11	0.90
LIQ	1.47	0.68
BSZ	1.20	0.83
RVD	1.65	0.61
TFN	1.44	0.69
Average	1.41	

Researchers and econometricians have agreed, as a rule of thumb that variables are collinear if VIF score is higher than 10. According to Table 3, none of the VIF values is even close to the benchmark score of 10. This implies that the variables are not collinear. VIF results display in Table 3 also supported the tolerance levels (TOLs) with values higher 0.20 as their threshold. The implication is that OLS regression can be conducted without necessarily worrying about the reliability of result. This is because multicollinearity among independent variables invalidates results. T-statistics, F-statistics and R-squared will be erroneously estimated making OLS regression result unreliable. However, this is not the case in this study as can be observed from Table 2 and Table 3. Therefore, OLS regression could be reliably conducted. Based on the results of pair-wise correlation and variance inflation factor analyses, it could be safely concluded that no multicollinearity exists in the model. Absence of multicollinearity implies no stable coefficient estimates, small standard errors, valid statistical tests and reliable interpretations.

Table 4: Breusch–Pagan Lagrange Multiplier Test

Test	Stat.	df	<i>p</i>
Breusch–Pagan LM	20.21	185	.027

Note. df = degrees of freedom. *P* values are reported at conventional significance levels.

Table 4 shows BP-LM test results for selecting appropriate technique between Pooled OLS and Effect models. From Table 4, *p*-value of BP-LM statistics is 0.027 (<0.05), meaning zero variance hypothesis for random effects is rejected. It thus implies that effects model is more suitable for result interpretation

Table 5: Hausman Test Results

Test Summary	χ^2	df	<i>p</i>
Cross-section random effects	145.81	211	< .001

Note. χ^2 = chi-square statistic; df = degrees of freedom. *p* values less than .001 are reported as < .001 in accordance with APA guidelines.

The Hausman test result in Table 5 has a *p*-value of 0.000 (<0.05) indicating a significant result. This suggests a rejection of the hypothesis that the variance in the estimated parameters from random and fixed estimators is not systematic. This means that the fixed effect estimator was more suitable for data analysis and interpretation.

Regression Results

Table 6: Model Estimation Results for ROA

Variable	Pooled OLS	Fixed Effects	Random Effects
Constant	9.3327 (3.151)	5.4011 (2.0223)	-2.5057 (1.1419)
NPF	2.2000 (1.2130)	-0.2845** (0.1286)	-0.0974** (0.0287)
RVD	0.5527** (0.2011)	0.6850** (0.2005)	0.4570** (0.2120)
DEP	-0.7890** (0.3845)	0.3319** (0.1559)	1.7910** (0.7900)
LIQ	-0.1427** (0.0553)	2.2000 (1.2130)	5.5545 (2.8875)
BSZ	0.4050** (0.1531)	0.6850** (0.2005)	0.9594** (0.1120)
TFN	0.0842** (0.0211)	0.0579** (0.0195)	0.2137 (0.2968)
F-stat / Wald χ^2	9.061***	7.412***	19.263***
R ²	0.73	0.76	0.81

Note. Standard errors are shown in parentheses beneath coefficients. Significance: ** $p < .01$, * $p < .05$, $p < .10$.

From Table 6, revenue diversification (RVD) has positive correlation with ROA. 1% increase in RVD in terms of shariah-compliant opportunities, tends to increase banks' profitability (ROA) by 0.68%. This means that as more financing contracts are developed and adopted to meet market demand of various customers, profitability will increase. The result is significant as its p-value is less 0.05. Similarly, deposit liability had positive and significant effect on ROA. 1% percent increase in deposit liability (DEP) will bring about 0.33% in ROA. That is, more deposits make more funds available to the banks for profitable investments.

Conversely, non-performing financing ratio (NPF), and liquid ratio (LIQ) were negatively related with ROA. According to Fixed Effects model presented in Table 6, NPF is negatively correlated with ROA in such a way that 1% increase in NPF ratio will reduce ROA by 0.28%. Increased NPF represents lower quality of assets which tends to reduce bank profitability. The relationship is significant at 5% level of significance as indicated in Table 6. In the case of liquidity ratio, LIQ was also found to be

negatively correlated with ROA. This means that as bank liquidity increases, profitability decreases such that an increase of 1% in LIQ will cause ROA to drop by about 5.7%. High liquidity may imply that the banks were keeping too much liquidity assets than necessary. Such a situation will impact profitability as liquid assets yield little to the business.

The growth rate of total financing is positively associated with ROA, and the relationship was significant as p-value is less than 0.05 level of significance. According to Table 6, 1% increase in total financing (TFN) is likely to cause a rise of about 0.16% in ROA. The result shows that an improved level of Islamic banking facilitates attracts more demand and boost profitability. However, the relationship between BSZ and ROA was found to be insignificant. Finally, R-Squared of 0.76 means that 76% of variations or changes in ROA were accounted for by the explanatory variables of the model.

Discussing the findings of this study, revenue diversification was found to be significantly correlated with Islamic ROA. That is, banks become more profitable with higher deposit mobilization which enables them to finance profitable ventures. This is consistent with Ammar and Boughrara (2019), Nisar et al. (2018) and Susanto et al. (2024) which reported positive effect of deposit liability on profitability. The positive effect of revenue diversification was equally in line with observation of Mennawi and Ahmed (2020) and Beck et al. (2013).

However, the profitability measure, return on asset inversely related to NPF. The negative relationship that was found between NPF and ROA implies that low asset quality in terms of financing affects profitability. The higher cost of facilitating the repayment of financing facilities, the lower the profitability level and vice versa. The result of this study in relation to the relationship between non-performing financing and return on asset is similar to Aldizar and Agustina (2022), Ashraf and Sulehri (2023), and Kadioglu and Ocal (2017). Finding of this study on NPF is however inconsistent with Lucky and Nwosi (2015) that NPF had positive effect on performance.

CONCLUSION AND POLICY IMPLICATION

This study examined how revenue diversification and asset quality affected the profitability of Islamic banks in selected African countries. The relationship between the variables was investigated using an estimated fixed effects regression model. According to data analysis, the study found that non-performing financing and revenue diversification had substantial impact on profitability. Based on these findings, it was concluded that income diversification and asset quality enhance Islamic bank profitability.

Policy Implications

Based on the findings of the study and conclusion drawn therefrom, the study therefore recommends for policy implementation, that Islamic banks in Africa should ensure that financing activities are efficiently and effectively executed and monitored. This is to reduce the incidence of bad debt that might result from high non-performing facilities that are capable of depleting their profitability. Also,

management of Islamic banks in should prioritise robust credit risk management to reduce incidence of non-performing financing. Furthermore, regulatory authorities should enforce stricter prudential guidelines on financing quality and emphasis needs to be placed on Shariah-compliant risk assessment tools to aid in identifying credit risk exposures in Islamic banks' financing portfolios. In addition, Islamic banks in Africa should diversify to more shariah-compliant products to improve their profitability.

Limitation of the Study

This study seeks to examine the impact of asset quality and revenue diversification on profitability of Islamic banks in African. However, the scope was limited to the IFSB member countries in Africa. Although 15 countries were identified, the study was restricted to 5 countries whose Islamic banking data are available on the IFSB database. Furthermore, the study was based on country-level aggregate rather than firm level data on the variables under investigation. Future research should consider firm level analysis of a larger sample size. Notwithstanding the limitations, findings of this study remain reliable for drawing valid conclusion on the effects of asset quality and revenue diversification on profitability of Islamic banks in selected Africa countries.

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