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Does Islamic Banking Performance Vary Across Regions? A New Puzzle

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Does Islamic Banking Performance Vary Across Regions? A New Puzzle

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Abstract

This paper investigates the performance of Islamic Banks (IBs) across four different regions (Egypt, the Gulf, the UK and the US) in the aftermath of the subprime crisis. Using daily data and two performance ratio proxies (ROA and Tobin Q), we show that the performance of IBs varies significantly from one region to another, with the highest level for regions in the West. This result suggests a new puzzle as application of the same sharia board rules and sales of similar products should normally provide comparable performance outcomes for IBs.

Keywords: Islamic Banking, Performance, Statistical analysis.
JE: C22, G15.

1 Introduction

Islamic banks (IBs) first appeared in the 1970s. Their main mission was to develop financial activities consistent with the principles of the Sharia, also known as Islamic Law, which enables people to invest in the p-values of oil production in GCC countries. In line with Sharia principles, IBs refuse to fund unethical, speculative and immoral activities, and their operations do not involve interest rates (Riba), gambling (Maisir) or uncertainty (Gharar). Consequently, Islamic banking differs from conventional banking since the latter deals with Money, while Islamic banking tends to deal in Goods (Causse, 2012; Fakhfakh et al., 2016). For this reason, competition for leadership recently emerged between IBs and conventional banks (Jawadi et al., 2015 a). Islamic banking has grown rapidly, showing that it can provide a just, socially responsible and sustainable system. Further, in the aftermath of the recent global financial crisis, IBs appear to have the potential to provide an ethical, stable and secure alternative (Barnett and Jawadi, 2013). Consequently, Islamic banking not only developed rapidly in Muslim countries, but also reached other regions and non-Muslim countries (Causse, 2012). While several studies in the literature have compared the performance be- tween conventional and Islamic stock markets (see Arouri et al. 2013; Jawadi et al., 2014 and Fakhfakh et al., 2016 for recent literature), there is little consensus over the results, and conclusions are data and period dependent. Intuitively, it appears less complicated when only IBs handle banking and financial activities in a country, as the IB then applies the rules of the Sharia Board. In a financial system where both conventional and Islamic banks operate, however, the task of IBs is not so simple, and the latter have a tendency to compete with conventional banks. Consequently, when two IBs are doing the same business, selling the same products and following the same rules, but operating in two different countries or regions, their results and objectives may differ significantly at times. In the related literature, a few studies have statistically compared IB performance across regions. This issue is the focus of the present paper. We examine whether or not IB performance really differs across regions. The question is particularly interesting for investors that wish to identify regions where IBs might register high performance. It is also useful to identify the main factors that drive IB performance and to assess whether social, cultural, geographical and institutional factors play a role. Our main findings point to two interesting conclusions. On the one hand, IBs. Performance differs statistically and significantly from one region to another. On the other hand, IBs in the West seem to chalk up a better performance than IBs in the East, suggesting that IB products are more attractive in the West than those in the East. This appears to indicate a new puzzle, whereby IBs in different regions apply similar rules but generate different results and performance.

Our paper is structured as follows. The main empirical results are discussed briefly in the second section. Section 3 concludes.

2 Empirical Analysis

2.1 Data and preliminary results

We used daily data over the period July 2, 2007 to April 19, 2016, which covers both the global financial crisis and the aftermath of the crisis period. In particular, we focused on performance data using two proxies: ROA (Return on Asset) and Tobin Q. While ROA, defined as the ratio Net Income Total Assets ratio, measures profitability relative to a company's total assets, Tobin Q, defined as the ratio between a physical assets market value and its replacement value, allows us to evaluate the investment.

The data under consideration concern twelve Islamic Banks implanted in

four different regions: Egypt (National Bank of Kuwait, Faisal Islamic Bank of Egypt, Al Baraka Bank), the Gulf countries (Jordan Islamic Bank, Commercial Bank of Kuwait, Bank Muscat International Bahrain, Qatar International Islamic Bank Doha, Al Rajhi Bank Saudi Arabia, Abu Dhabi Islamic Bank and Dubai Islamic Bank), the UK (European Islamic Investment Bank) and the USA (Albaraka Partners USA). Accordingly, the sample includes 10 Islamic banks implanted in Eastern regions (generally Muslim regions), while the two others banks are located in so-called Western regions (generally non-Muslim regions). With such a sample, not only is it possible to evaluation Islamic banks. Performance through two different proxies, but also to compare performance regions.

First, we computed the main descriptive statistics for both ROA and Tobin Q and reported them in Tables 1 and 2. Accordingly, we note that Islamic banks (IBs) in the US and the UK show the highest performance in mean.

Further, performance also seems to be more volatile in these two regions. The performance distribution for all regions exhibits asymmetry, leptokurtic excess and non-normality.

Second, when we look at the unconditional correlation matrix between performance across regions, our analysis suggests further evidence of a new puzzle in Islamic banking. Indeed, while the correlation of IBs in the UK and the US reaches 76%, suggesting that both banking systems share similar principles and tendencies, British and US IBs are either weakly negative or independent from IBs in Egypt and the Gulf region. The IBs in the last two regions are negatively correlated. This finding suggests further evidence of significant differences, at least in term of performance, between IBs across regions and, more particularly, between IBs in the East and those in the West.

2.2 Examining a New Puzzle in Islamic Banking

These first results suggest that IBs .performance differs across regions, pointing to a certain kind of new puzzle, since normally IBs all use the same reference (Sharia Board rules) and propose similar products. We would therefore expect them to show a comparative level of return, risk and performance. However, this assumption does not seem to hold. In order to check whether IBs. Performance significantly varies across regions, we applied two tests: the equality of Means test, and the test of Equality of Variance. However, before moving on to these tests, we computed the variation coefficient (VC) that enables us to evaluate the relative dispersion.

The main results are reported in Table 5. We may note that the highest relative dispersion with regard to ROA is observed for American IBs (57.8%), while IBs in the UK show the highest relative dispersion in terms of Tobin Q (28.2%). However, for both performance proxies, IBs in Egypt are less volatile than the other IBs. This over-dispersion of IBs in the UK and the US raises another question: just how Islamic are IBs in these regions?

Next, we check the significance of these difference in Mean through two statistical tests and report the main results in Table 6. Both Anova and Welch tests significantly reject the null hypothesis of equality of Means, regardless of the performance proxy. Finally, we checked the hypothesis of variance equality using three tests: the Barlett test, the Levene test and the Brown-Forsythe test. We reported the main results in Table 7. Accordingly, the null hypothesis is significantly rejected at the 1% statistical level, regardless of the performance proxy. Overall, our findings show significant differences in IB performance across regions, which is somewhat perplexing since, with similar

regulation rules and legislation, we would expect IBs to share common factors, sell similar products and report similar results, regardless of their region.

3 Conclusion

This paper focuses on the performance of IBs across four main regions (Egypt, the Gulf region, the UK and the US) in the aftermath of the subprime crisis. Although in theory IBs are expected to propose an alternative banking framework (Barnett and Jawadi, 2012) and follow a comparative model, our results show that the performance of IBs is relatively region-dependent, and that IBs in the UK and the US report the best performance.

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