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Impact of the financial crisis on Islamic banks and conventional banks – evidence from existing empirical studies

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The literature provides considerable empirical evidence regarding the resilience and stability of the banking sector, the factors that enhance economic safety, and comparisons of the stability and robustness of Islamic versus conventional banks during the economic crisis. The first study to examine the solidity of Islamic versus conventional banks during the global financial crisis was that of Cihak & Hesse,[1] which found that Islamic banks showed greater solidity across 18 countries. In the same year, Hasan & Dridi revealed that Islamic banks had higher growth in loans and assets during financial crises compared to conventional banks.[2]

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Shafique observed that banks everywhere in the world were badly affected by the global financial crisis, including Islamic banks, but that the financial performance of Islamic banks was better,[3] with lower risk due to their interest-free nature. In 2009, Boumediene & Caby[4] found that Islamic banks were more resilient during the 2007 crisis, but were not well protected from the negative impacts after the crisis. Similarly, Hasan & Drisi found that Islamic banks had only limited exposure to the adverse impact of the financial crisis in 2008, but became progressively weaker in 2009 than conventional banks.[5]

Parashar & Venketesh[6] found mixed evidence, noting that during the crisis conventional banks suffered considerably more from poor liquidity and average returns on assets, whereas Islamic banks suffered more with poor average returns on equity, leverage and capital ratios, but they concluded that the Islamic banks performed better overall in 2006–2009. In contrast, Imam & Kpodar observed that Islamic banks are neither better nor worse but rather complementary to conventional banks, and argued that banks can remain stable during a financial crisis if their country has prudential regulations to ensure bank soundness during an uncertain financial environment.[7] In contrast, Turk-Ariss found Islamic banks less stable and more vulnerable in uncertain financial situations because they are less competitive than conventional banks.[8]

Hassan, Mohamed & Bader compared cost, revenue and profit efficiencies during the financial crisis and found no significant difference between Islamic and conventional banks using a sample of 40 banks in 11 OIC countries.[9] Hassan & Dridi, using both Islamic and conventional banks in different countries such as Turkey, UAE, Saudi Arabia, Malaysia, Qatar, Kuwait, Jordan and Bahrain, reported that Islamic banks were affected differently from conventional banks in 2008, showing stronger resilience during the crisis period of 2007–2009 due to their lower leverage, higher solvency, smaller investment portfolios and particularly their adherence to *shari'ah* principles.[10]

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According to Kassim & Majid, both types of bank were equally vulnerable to the financial crisis.[11] Similarly, Smolo & Mirakhor conclude that both conventional and Islamic banks were vulnerable during the financial crisis but the impact on Islamic banks was more limited.[12] In contrast, Abduh argues that Islamic banks were

more stable during the global crisis due to their profit-loss sharing.[13] Zarrouk points out that Islamic banks avoided the worst exposure to the financial crisis in 2008 but may still suffer in a future global crisis.[14]

Siraj & Pillai found that Islamic banks in the GCC region fared much better between 2005 and 2010 than did conventional banks. They found that the Islamic banks were more equity financed, and that their performance indicators, including capital adequacy, liquidity and profitability, were less affected by the global financial crisis from 2007.[15] Abdulle & Kassim analysed how the global financial crisis affected Malaysian banks from 2006 to 2010, assessing indicators such as credit risk, liquidity and profitability before, during and after the financial crisis. Islamic banks were shown to have greater liquidity than conventional banks and thus less liquidity risk exposure during the crisis.[16]

Rafiuddin & Alam studied banks in the United Arab Emirates from 2005–2009 and observed that Islamic banks had lower risk and higher liquidity than conventional banks.[17] However, unlike other studies, they found the conventional banks more profitable. They also noted a higher trend in registering Islamic than conventional banks after the 2008 meltdown.

Sehrish examined banks in Pakistan during 2007–2011, and found Islamic banks less efficient in expense management but also less risky in managing loans compared to conventional banks.[18] Hidayat & Abdhullah analysed the impact of the economic crisis on the financial performance of Islamic banks in Bahrain using a panel regression model, and noted no significant impact on these banks during the crisis period.[19]

Aktas analysed bank stability in Turkey during the global economic crisis using a trend analysis on a yearly basis for the 2006–2011 period, and noted that in terms of liquidity, capital adequacy and profitability, Islamic banks were more stable than conventional banks, even in 2008.[20]

Tabash & Dhankar investigated bank stability in the Kingdom of Saudi Arabia in 2005–2010, and revealed that Islamic banks were less exposed to liquidity risk because they held more liquid assets than conventional banks. They concluded that the limited scope for investment among Islamic banks could explain their higher liquidity ratio, which showed no significant difference before, during or after the financial crisis; they reliably held more short-term funds and high deposit percentages to meet sudden withdrawals.[21] The Islamic banks were also more equity financed and dependent on the profit-loss sharing relationship, whereas conventional banks were highly dependent on a debt-credit relationship. There was also no significant difference in the capital adequacy of Islamic banks before, during or after the financial crisis, because of their asset-backed financing and distinctive Islamic principles.[22]

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