

INTRICACIES OF COMPETITION, STABILITY, AND DIVERSIFICATION: EVIDENCE FROM DUAL BANKING ECONOMIES

Source: Azmi, W., Ali, M., Arshad, S., & Rizvi, S. A. R. (2019). Intricacies of competition, stability, and diversification: evidence from dual banking economies. *Economic Modelling*, 83, 111-126. <https://doi.org/10.1016/j.econmod.2019.02.002>

PUBLISHED IN ECONOMIC MODELLING

<https://doi.org/10.1016/j.econmod.2019.02.002>

Keywords

Dual Banking Economies

Diversification

Stability

Bank Competition



Introduction

In the aftermath of the global financial crisis in 2008, the fragility of conventional banking system became evident, urging policymakers, regulators and researchers to shift their focus on Islamic banking which was contended to be more stable due to its inherent resilience (Mirakhor, 2008).



Countries where Islamic banking has seen growth have been termed as dual banking economies.



The growth of Islamic banking sector and increased competition in the dual banking economies raises questions regarding the stability of banks in dual banking economies.

Data

Dataset

Consists of **354** banks:

86 are Islamic banks and **268** are conventional banks.

Data is obtained from the **Fitch Connect database**.

Time-period of data: **2005-2016**.

14 countries: Bangladesh, Brunei, Indonesia, Jordan, Kuwait, Lebanon, Malaysia, Pakistan, Qatar, Saudi Arabia, Tunisia, Turkey, the UAE, and Yemen.

Methodology

The methodology used in this study delves into two aspects:

- i) The estimation of the measurements of the competition, stability and profitability
- ii) The econometric modelling

| Measurement of competition | Measurement of stability | Econometric method |
|--|---|---|
| Using: <ul style="list-style-type: none"> • Boone index (2008) • Herfindahl-Hirschman Index (HH Index) • Lerner index | <ul style="list-style-type: none"> • Using Z-score proposed by Yeyati and Micco (2007) • For robustness purposes, use Z-score proposed by Cihak and Hesse (2007) and the loan loss provisions to equity ratio | <ul style="list-style-type: none"> • Employ GMM methodology to test hypothesis |

Conclusion

- In dual banking economies, the diversification opportunities may exacerbate the effect of competition on stability.
- The results indicate that concentration is beneficial for the banking stability of both the banks.
- With regards to stability, both types of banks are found to be similar, which is contrary to the theoretical expectation.
- Main implication: the presence of Islamic banks may not necessarily destabilize the system as their respond to different situation is similar to their conventional counterparts.
- Further research would benefit from market-based indicators as they present a future-looking estimation of bank stability.