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The Impact of Covid-19 Pandemic on the Financial Performance of Islamic Banks in the Philippines

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ABSTRACT

This paper investigated the impact of the Covid-19 Pandemic on the performance of Islamic banks in the Philippines. It used the quarterly data before and during the pandemic. To empirically measure its impact on the Islamic bank in the country, this study used significant different tests to ascertain differences in the financial performance of the bank starting from the 1st quarter to the 4th quarter of 2019 used as a proxy for pre-pandemic variable and the 1st to 4th quarter of 2020 which was during the heights of the pandemic as data that represents the duration of the crisis. The result shows that the overall bank size during the pandemic was reduced by 2.08% while changes in return on deposits and return on equity before and during the pandemic were not statistically significant. However, there was enough evidence to show that Islamic deposits, return on assets, and net income, were significantly positively affected by the Covid-19 Pandemic. Test for significant difference further ascertained that the decrease in capital adequacy ratio during the pandemic was found statistically significant. It suggested that Islamic banking in the Philippines fared differently compared to its conventional counterparts in the country.

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I. Introduction

The Islamic banking system is a financial institution that has an independent economic system of its own compared to the conventional banks that follow Western economic trajectory (Narayan & Phan, 2019). To test this supposed polarity, several studies have been conducted that affirmed such dichotomy using the conventional economic indicators like the overall effect of macroeconomic variables on the performance of Islamic banks (Abduh et al., 2011; AL-Oqool et al., 2014; Hidayat & Abduh, 2012; Khater Arabi, 2014; Rosman et al., 2014; Sassi & Goaied, 2011; Zehri et al., 2012). However, despite the distinctive feature of Islamic banks which prohibits *riba* that its conventional counterparts do not, many scholars found that the rise and fall of the economy has an impact on the financial performance of the Islamic banks (Ali et al., 2018; Elhachemi & Othman, 2016; Hasan & Dridi, 2010; Yousfi, 2016; Zahid & Basit, 2018). Given the two sides of research findings, today scholars are still debating whether or not Islamic banks are impacted by *riba* driven economy.

In the Philippines, the first and only Islamic bank in the country, the al-Amanah Islamic Investment Bank of the Philippines, presents a unique position in the study of its stability relative to its host economy due to the fact that it is offering a dual window for having not only Islamic but also conventional banking system in its business operations (Huq (2007) in Mohamad et al., 2013). This makes the bank, one hand, vulnerable to the volatility of the economy while on the other hand, stable irrelevant to the economic conditions of the time. On top of that, it is also interesting to see how Islamic banks performed in a non-Muslim country like the Philippines and more specifically, this study investigated the effect of the world financial crisis due to the Covid-19 Pandemic which toppled many financial institutions (Clifford & Wahba Phil, 2020; Egan, 2020).

II. Review of Related Literature

Zehri, Abdelbaki, and Bouabdellah (2012) studied the impact of the world financial crisis on the performance of Islamic banks and their conventional counterparts in 2008. Using at least 26 financial ratios on 110 bank-year observations the authors found that compared to conventional banks, the Islamic banks were more stable during the 2008 World Economic Crisis. They explained that is due to the fact that Islamic banks have their characteristics and operate under the separate principles of sharia (Zehri et al., 2012).

The findings of Zehri et al (2012) were verified by Hidayat and Abduh (2012) in the case of Islamic banks in Bahrain. Using panel regression analysis on bank-specific variables total assets, return on asset and return on equity during and after the 2008 World Economic Crisis, they found that was no significant impact of the economic crisis on Islamic banks in the country during and even after the economic crisis (Hidayat & Abduh, 2012). These findings were consistent with the case of Islamic banks in Malaysia (Abduh et al., 2011), Middle Eastern and African counties (Sassi & Goaied, 2011), and the Middle Eastern and Asian countries (Rosman et al., 2014). This suggested the stability of Islamic banks despite turbulence in the world economy.

The paper of Hasan and Dridi in 2010 presented a rather different finding. Investigating the effect of the 2008 world economic crisis on Islamic as well as conventional banks in Bahrain (including offshore), Jordan, Kuwait, Malaysia, Qatar, Saudi Arabia, Turkey, and the UAE. It found that during the crisis Islamic banks performed better in terms of credit and asset growth while its business model helped limit the adverse impact of the crisis on its profitability (Hasan & Dridi, 2010). Similar findings were reported in the case of Islamic banks in Iran, (Elhachemi & Othman, 2016).

In 2020 another world financial crisis emerged that dropped down many financial institutions around the world brought about by the Covid-19 Pandemic. One of the pioneering studies that investigated the impact of the pandemic on the performance of Islamic banks using bank-specific variables was the study of Sutrisno, Bagus, and Fikri Irfan published in 2020. Through the data from 12 Islamic banks in Indonesia before and during the pandemic, it found that the capital adequacy ratio, the non-performing financing, return on assets, and operating expenses to operating income ratio were not significantly different from the data before the pandemic thus concluded that the pandemic did not affect the financial performance of the Islamic banks in Indonesia (Sutrisno et al., 2020).

A similar case was also studied earlier by Nugroho et al in 2020 but instead of a difference in the financial performance of the Islamic banks, it utilized external factors like economic growth and foreign exchange rate to ascertain their impact on Islamic banks during the Covid-19 pandemic. Using computer simulations via stress tests, it found that Islamic banks were able to withstand the effect of Covid-19 during the determined-mild and moderate scenarios but decline financial performance of the bank was noted during the identified worst scenarios (Nugroho, L., Buana, U. M., Utami, W., Buana, U. M., Doktoralina, C. M., Harnovinsah, H., & Buana, 2020).

III. Methodology

This study investigated several banking profitability measures of the al-Amanah Islamic Investment Bank of the Philippines that shows its financial condition which includes the Capital Adequacy Ratio (CAR), the bank's size, the Return on Assets (ROA), Return on Equity (ROE), Deposits both Islamic and conventional, the net income, the total deposit by the total asset (TD/TA). The data were taken from the bank which were uploaded publictly in their official website. To measure the impact of the Covid-19 Pandemic on Islamic banking in the Philippines, the above-mentioned variables were tested using the significant different test on the quarterly data before and during the pandemic which was composed of 1st quarter of 2019 up until the 4th quarter of 2019 and on the other hand, four quarters from 2020 starting from the 1st quarter until the last quarter of the said fiscal year. This study assumes that changes in the financial performance of Islamic banking in 2020 were due to the effect of the pandemic. Hence, it tested if there is a significant difference between the 2020 and 2019 data thus, the impact of the pandemic before and during the crisis on Islamic banks in the Philippines.

IV. Results And Discussion

A. Differences in mean

To track the impact of Covid-19 on Islamic banks in the Philippines, the mean performance of the bank expressed in terms of the total assets, conventional deposits, Islamic deposits return on deposits (ROD) return on equity (ROE), the total deposits on total assets (TD/TA), the capital adequacy ratio (CAR) return on assets (ROA) as well as the net income from the 1st quarter to the 4th quarter before and during the pandemic is explored in Table 1 as an initial preview on the changes of their values before and during the crisis.

Table 1. Descriptive Statistics

Pairs	Variables	Mean	N	Std. Deviation	Std. Error Mean
Assets	Before Covid-19	758,428,756.42	4	75342566.98	37671283.49
	During Covid-19	742,935,267.67	4	40323318.76	20161659.38
Conv'l Deposits	Before Covid-19	598,282,967.09	4	54454660.15	27227330.07
	During Covid-19	535,118,325.63	4	252056860.42	126028430.21

Islamic Deposits	Before Covid-19	106,702,613.13	4	7997292.83	3998646.41
	During Covid-19	167,347,037.35	4	13866061.09	6933030.54
ROD	Before Covid-19	.45	4	.04041	.02021
	During Covid-19	2.06	4	.03367	.01683
ROE	Before Covid-19	2.45	4	.47	.23
	During Covid-19	53.96	4	45.85	22.92
TD/TA	Before Covid-19	.79	4	.01	.00
	During Covid-19	.72	4	.33	.16
CAR	Before Covid-19	.210	4	.284261211	.142130606
	During Covid-19	-.093	4	.176213601	.088106800
ROA	Before Covid-19	.38	4	.035	.01
	During Covid-19	1.94	4	.029	.01
Net Income	Before Covid-19	288,100,091.77	4	10359338.95	5179669.47
	During Covid-19	1,445,011,235.17	4	58231666.08	29115833.04

Table 1 shows the comparison between the bank's performance before and during the Covid-19 pandemic. It revealed that before the pandemic, the average mean of the AAIIBP assets was 758,428,756.42 it decreased to 742,935,267.67 suggesting a decrease of 2.04% during the Covid-19 Pandemic this indicated that the pandemic negatively impacted the AAIIBP's total asset value. While the conventional deposits, on one hand, decreased by 10.55% from 598,282,967.09 to only 535,118,325.63 during the pandemic. However, Islamic deposits were found positively impacted by the pandemic as they grew from 106,702,613.13 to 167,347,037.35 recording a 56.87% increase during the crisis. The Return on Equity (ROE) increased from 2.45% to 53.96%. Apart from that, the Total Deposit divided by Total Assets also noted a decrease in value from .79 to only .72. The data also shows that the Capital Adequacy Ratio (CAR) dropped from -1.61% to -2.12% during the crisis while the Return on Assets (ROA) increased from .38% to 1.99%. Alternately the net income of the AAIIBP increased from 288,100,091.77 to 1,445,011,235.17.

This suggested that there have been ups and downs in the financial performance of the al-Amanah Islamic Investment Bank of the Philippines (AAIIBP) during the pandemic. However, such fluctuation can only indicate

B. Test for Significant Difference

The changes in the recorded performance of financial institutions like a bank are common occurrence elsewhere in any country but this study investigated whether such changes before and during the pandemic were statistically significant. Table 2 shows the result of the difference test. The impact of the Covid-19 Pandemic is ascertained with a *p*-value of 0.05 and below.

Table 2. T-test for Significant Difference Result

Variables	**Duration**	**95% Conf. Interval of the Difference**		***t***	**df**	***p*-value**
		Lower	**Upper**			
Assets	Before Covid-19 During Covid-19	-61551266.43	92538243.93	.64	3	.568
Convent'l Deposits	Before Covid-19 During Covid-19	-301023814.23	427353097.16	.55	3	.619

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Islamic Deposits	Before Covid-19 During Covid-19	-88810928.47	-32477919.94	-6.85	3	.006
ROD	Before Covid-19 During Covid-19	-1.70	-1.50	-49.72	3	.000
ROE	Before Covid-19 During Covid-19	-123.75	20.74	-2.26	3	.108
TD/TA	Before Covid-19 During Covid-19	-.45	.60	.45	3	.681
CAR	Before Covid-19 During Covid-19	.10	.50	4.80	3	.017
ROA	Before Covid-19 During Covid-19	-1.60	-1.52	-118.82	3	.000
Net Income	Before Covid-19 During Covid-19	-1237221982.33	-1076600304.44	-45.84	3	.000

Table no. 2 shows that among the several bank-specific variables tested, it revealed that the impact of the Covid-19 Pandemic on Islamic deposits, *p*-value 0.006, was statistically significant compared to the conventional deposits which were found not significant at a *p*-value of 0.61. This result indicated the Covid-19 Pandemic impacted the Islamic deposits in the AAIIBP and the impact was positive as suggested by the comparison of the mean score before and during the Pandemic in table 1. This result suggested that the economic crisis surrounding the Islamic banks in the country was not detrimental and in fact, advantageous to the Islamic deposit side of the bank. This could be justified by the fact that during the financial crisis, people shifted their deposits to Islamic banks due to the relative stability of the bank during the crisis.

The result also showed that the increase in the Return on Deposits (ROD) indicated in table no. 1 was found statistically significant with *t* (-49.72) = 3 and a *p*-value of 0.00. This indicated that the AAIIBP was able to, not only withstood the effect of the financial crisis brought about by the Covid-19 Pandemic but also gain enough ROD to pay its liabilities to the depositors of the bank. It suggested that Islamic banks in the country continued to fare amidst the pandemic further suggesting its independence on the macroeconomy sounding its banking operations.

This study also found that the reduction in Capital Adequacy Ratio (CAR) as indicated earlier in table no. 1 was found statistically significant as reflected in table no. 2 with *t* (4.80) = 3, *p*-value = 0.017. This suggested that despite the relative surge in Islamic deposits as well as an increase in the Return on Deposits (ROD) it was not enough to increase the Capital Adequacy Ratio (CAR) of the Islamic banks in the country during the heights of the pandemic.

In terms of the Return on Assets, ROA, this study found that with *t* (-118.82) = 3 and a *p*-value of 0.00, the increase from .38 before the Covid-19 Pandemic to 1.94 during the pandemic was statistically significant. This finding contradicts with the paper of Sutrisno, Panuntun and Adristi in 2020 on the impact of the Covid-19 Pandemic on Islamic banks in Indonesia (Nugroho, L., Buana, U. M., Utami, W., Buana, U. M., Doktoralina, C. M., Harnovinsah, H., & Buana, 2020)

Lastly, this study also found that the 19.92% increase in net income of the AAIIBP from 288,100,091.77 pesos in 2019 to 1,445,011,235.17 pesos during the Covid-19 pandemic in 2020 was statistically significant with *t* (-45.84) = 3 and a *p*-value of 0.00. This suggested that Islamic banks in the Philippines fared differently compared to other financial institutions in the country. The negligible impact of financial crisis on Islamic banks is in consistent with the findings of Nugroho et al, 2020 in the case of (Nugroho, L., Buana, U. M., Utami, W., Buana, U. M., Doktoralina, C. M., Harnovinsah, H., & Buana, 2020)

V. Conclusion

The impact of the Covid-19 pandemic on financial institutions around the world was a test of economic stability that in most cases, took down many business establishments. This study focused on the impact of the Covid-19 pandemic on the financial performance of Islamic banks in the Philippines. The result showed that the pandemic significantly affected the overall net income of the bank in a positive way. It suggested that despite the seemingly harmful effect of the financial crisis brought about by the pandemic, the Islamic bank in the Philippines was not harmed but instead, it proved to be stable during the crisis. It further suggested that Islamic banks do not follow the conventional economic trend but instead have an economic system of their own. This could be explained by the fact that while many business establishments capitalized on *riba* Islamic banks prohibit the same. Hence, changes if the former may not necessarily cause a change in the latter.

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