A Survey of Islamic Banking & Finance Literature: Issues, Challenges & Future Directions

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Outline

- Current status of literature
- What have we learned?
- Main features of the literature
- Key challenges
- Futures direction
Current Status

- 2014-2016: 112 papers published in GOOD journals.
- Variety of topics
  - Asset pricing
  - Profitability/performance of equities
  - Bank performance
  - Islamic bonds
  - Co-movement of markets
  - Ethical issues
Popularity of Topics?

Figure 1: Distribution of Islamic banking and finance research by topic

- Asset pricing
- Bank performance
- Bond market
- Market interactions
- Equity performance
- Ethical issues
- Others

Percentage vs. Research topics
What have we learned?—Banking literature

- Mixed evidence on efficiency
- Smaller I-banks more stable & mitigate risks better
- I-banks with better asset quality = less risk of failure
- I-banks more included toward funding SMEs
What have we learned?—Asset Pricing literature

• Predictability of Islamic stock returns
  – A range of variables predict returns
  – Predictability models can guide investment

• Islamic stocks are characterised by calendar anomalies
  – Ramadan effect
  – Usefulness?
What have we learned?—Islamic bond literature

- Credit rating of Islamic bonds dependent on religious orientation and institutional changes
- Existence of Islamic bond market depends in large part on Shariah conscious ethical investors
- Islamic bond market is more sensitive to global conventional markets than to the Islamic market
What have we learned?—Market interactions literature

• Islamic & conventional markets are integrated
  – Offers opportunities for diversification
  – Islamic stocks more resilient to global crises

• Islamic markets are well connected to commodity markets
  – Offers opportunities for portfolio risk diversification
What have we learned?—Equity MKT performance literature

- Studies using momentum strategies find conclusive evidence that Islamic markets are profitable & beat conventional markets
- Relevance of ‘Islamic Label’
  - Matters to predicting bankruptcy but not to the quality of governance
What have we learned? — Ethical issues literature

• Evidence that ethical issues and CSR objectives are not met by many financial institutions
• Mixed evidence on the relation between ethical issues and bank/institutional performance
Main features of literature: Data

- Time-series
  - Daily or monthly
  - As far back as 1980
- Panel data
  - Short time periods
  - Mostly yearly data
Main features of literature: Methods used

• Combination of econometrics and financial models used
  – Econometrics: cointegration, predictability, copula, GARCH, stochastic dominance, DEA, Tobit/probit, EGLS, LSTAR, GMM, SVAR, event study, wavelet, meta-frontier analysis, & price discovery models
  – Financial models: momentum, portfolio diversification, mean-variance investment models, & VaR
Main features of literature: New things?

- Given the applied nature of research, one new outcome has been improved/new datasets
  - Time series data
  - Survey data
Main features of literature: Robustness test?

- 50% have no robustness tests!
- From the 50% of studies with robustness tests, many are not well thought-out robustness tests
- It is OK, because this is an emerging area of research
- This is one area which needs to be improved
Key challenges

• Independent research?
  – Islamic vs non-Islamic

• Improve on quality of data
  – More in-depth, firm/stock level analysis
  – Market level analysis offers little value
Key challenges

• Too much focus on statistics and not the economics of the research question
  – Implications: with economic meaning
  – So what type questions?

• Uniqueness of the research question relative to the broader literature
  – Some topics less researched: asset pricing & corporate finance issues
  – More theoretical work
Future Directions

• Innovation in research question and therefore data
  – Thinking outside the conventional topics
  – Limited work on:
    • Mutual funds
    • Islamic bonds
    • Role of institutions in performance of Islamic financial markets
    • Corporate finance issues
Future Directions

• Innovation in research question and therefore data
  – Thinking outside the conventional topics
  – Limited work on:
    • Corporate investment---what determines Islamic corporate investment? Are there unique features in Islamic corporate finance that can potentially have implications for conventional finance?
Future Directions

• Making practical sense of statistical/econometric analysis
  – For e.g.: what do the statistics imply for practical purposes?
  – Can the statistical story be converted into an economic story?
  – Can there be direct policy implications?
Future Directions

• Undertaking robustness tests
  – Since the bulk of the research is empirical/applied, making use of data, there is a need for establishing the robustness of the results
  • Needs greater thinking in light of data constraints
Concluding Remarks

- Islamic banking and finance a relatively new area of research in as far as good journal publications are concerned: 112 pubs over 2014-2016
- 6 main topics of research, led by Islamic banking (44%), and equity performance (24%).
- Features of the literature: heavily focussed on statistical analysis (not economics), and limited robustness tests
Concluding Remarks

• Scope for innovative research in areas of limited studies
• Innovative research questions will lead to development of new (interesting) dataset
• Focus of new research should be on economic meaning of results and their broader implications to the profession as opposed to the statistics only.