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Islamic Banking in the Philippines: Financial Performance During the Covid-19 Pandemic

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Abstract

This study investigates the impact of the Covid-19 pandemic on the financial performance of the Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP), the country's first and only Islamic bank. The research focuses on several key financial indicators, including Capital Adequacy Ratio (CAR), Return on Assets (ROA), Return on Equity (ROE), and the performance of both Islamic and conventional deposits. Using quarterly data from the first quarter of 2019 to the fourth quarter of 2020, this study applies a significant difference test to compare the financial performance before and during the pandemic. The findings reveal that while the total assets and conventional deposits of the bank decreased during the pandemic, Islamic deposits saw a significant increase. Additionally, the Return on Deposits (ROD) and net income showed positive growth, while the CAR experienced a significant decline. These results suggest that, despite the global economic crisis, AAIIBP demonstrated resilience, particularly in its Islamic banking operations. The study provides insights into the unique stability of Islamic banks in a non-Muslim country during economic turmoil, offering valuable information for policymakers and financial institutions in strengthening Islamic banking practices.

Keywords: Financial Performance, Covid-19, Islamic Banking, Profitability.

Introduction

Islamic banking has emerged as a significant alternative within the global financial system, particularly in providing solutions that align with sharia principles. Unlike conventional banks, which operate based on interest (riba),

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Islamic banking is founded on principles of justice, partnership, and interest-free transactions (Narayan & Phan, 2019). Despite these differences, the financial performance of Islamic banks is often questioned, particularly during economic crises. Several studies indicate that Islamic banks are more stable compared to conventional banks during global economic crises, such as the one in 2008 (Zehri et al., 2012; Hidayat & Abduh, 2012). This stability is attributed to the unique characteristics of Islamic banking, which emphasize profit-sharing systems and prohibit speculative activities.

In the Philippines, the first and only Islamic bank, the Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP), occupies a unique position. The bank offers a dual banking system that includes both Islamic and conventional services, making it vulnerable to economic fluctuations while also demonstrating stability amidst various economic conditions (Huq in Mohamad et al., 2013). This situation becomes even more interesting when considering the performance of Islamic banking in a predominantly non-Muslim country like the Philippines, especially during the Covid-19 pandemic, which disrupted many financial institutions globally (Clifford & Wahba, 2020; Egan, 2020).

The global economic crisis caused by the Covid-19 pandemic presented a new challenge to the stability of both conventional and Islamic banking. Initial studies on the impact of the pandemic on Islamic banks, such as those conducted in Indonesia, indicate that the pandemic did not significantly affect the financial performance of Islamic banks in that country (Sutrisno et al., 2020). Another study using computer simulations found that while Islamic banks could withstand moderate scenarios, their financial performance declined under the worst-case scenarios (Nugroho et al., 2020). However, how did Islamic banking in the Philippines perform during this crisis?

This article aims to examine the impact of the Covid-19 pandemic on the financial performance of AAIIBP in the Philippines. The research focuses on specific banking variables such as the Capital Adequacy Ratio (CAR), Return on Assets (ROA), Return on Equity (ROE), as well as the performance of both Islamic and conventional deposits. By conducting a significant difference test on quarterly data before and during the pandemic, this study seeks to determine whether the pandemic had a significant impact on the performance of Islamic banks in the Philippines.

This research is expected to provide deeper insights into the resilience of Islamic banking during global economic crises, especially in the context of a non-Muslim country like the Philippines. The findings can serve as a reference for policymakers and financial institutions in developing more inclusive and resilient banking strategies in the future.

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).

Methods

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). 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.

Results and Discussion

Differences in the 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

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
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).

Discussion

The findings of this study reveal that the Covid-19 pandemic had a mixed impact on the financial performance of the Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP). On the one hand, the overall assets and conventional deposits of the bank experienced a decline during the pandemic. This reduction in conventional banking activities is consistent with global trends where economic uncertainty and reduced consumer confidence led to lower deposit volumes in traditional financial systems (Clifford & Wahba, 2020). The decrease in total assets also aligns with the challenges faced by financial institutions in maintaining liquidity and stability during crisis periods.

On the other hand, the study shows a significant increase in Islamic deposits during the pandemic, indicating a shift in consumer preference towards Islamic banking products. This finding suggests that in times of financial instability, depositors may view Islamic banks as safer alternatives due to their adherence to risk-sharing principles and avoidance of speculative transactions (Narayan & Phan, 2019). The growth in Islamic deposits also reflects a broader trend of increasing interest in ethical finance, which emphasizes transparency, fairness, and social responsibility.

The increase in Return on Deposits (ROD) and net income further supports the notion that AAIIBP was able to effectively manage its operations during the pandemic. The positive performance in these areas highlights the bank's ability to maintain profitability and meet its obligations to depositors, even in a challenging economic environment. However, the significant decline in the Capital Adequacy Ratio (CAR) points to ongoing difficulties in maintaining capital reserves. This issue may be attributed to the bank’s dual banking system, which requires balancing the needs of both conventional and Islamic banking operations, thus straining capital resources.

Moreover, the resilience demonstrated by AAIIBP during the pandemic underscores the unique characteristics of Islamic banking that differentiate it from conventional banking. Islamic banks’ reliance on asset-backed financing and the prohibition of riba (interest) provide a level of stability that conventional banks may not offer, particularly during times of economic turbulence. These findings echo previous studies that have found Islamic banks to be less affected by global financial crises compared to their conventional counterparts (Zehri et al., 2012; Hidayat & Abduh, 2012).

In conclusion, this study contributes to the growing body of literature on the impact of global crises on Islamic banking, particularly in non-Muslim-majority countries. The findings highlight the potential of Islamic banking as a stable and ethical alternative during economic downturns. For policymakers and financial institutions, these results suggest the importance of supporting and expanding Islamic banking services to enhance financial inclusion and stability, especially in diverse economic contexts.

Conclusion

Based on the analysis, this study shows that the Covid-19 pandemic had varied impacts on the financial performance of the Al-Amanah Islamic Investment Bank of the Philippines (AAIIBP). While total assets and conventional deposits declined during the pandemic, Islamic deposits significantly increased. Additionally, the Return on Deposits (ROD) and net income showed positive growth, indicating that this Islamic bank was able to maintain stable performance despite the global crisis. However, the decline in the Capital Adequacy Ratio (CAR) highlights challenges in maintaining sufficient capital during the crisis period.

This study reinforces the argument that Islamic banking possesses unique stability, particularly in facing global economic crises like the Covid-19 pandemic. This reflects the distinct economic system applied by Islamic banks, which do not fully depend on conventional economic variables. The study provides valuable insights for policymakers and financial institutions in strengthening Islamic banking practices, especially in non-Muslim-majority countries like the Philippines. The findings also underscore the need for more inclusive and resilient strategies to address future financial challenges.

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