

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

Paresh Narayan
Alfred Deakin Professor of Finance
Deakin University
&
Dinh Phan
Monash University

19th MFA, UTAR 16-18 May, 2017





Outline

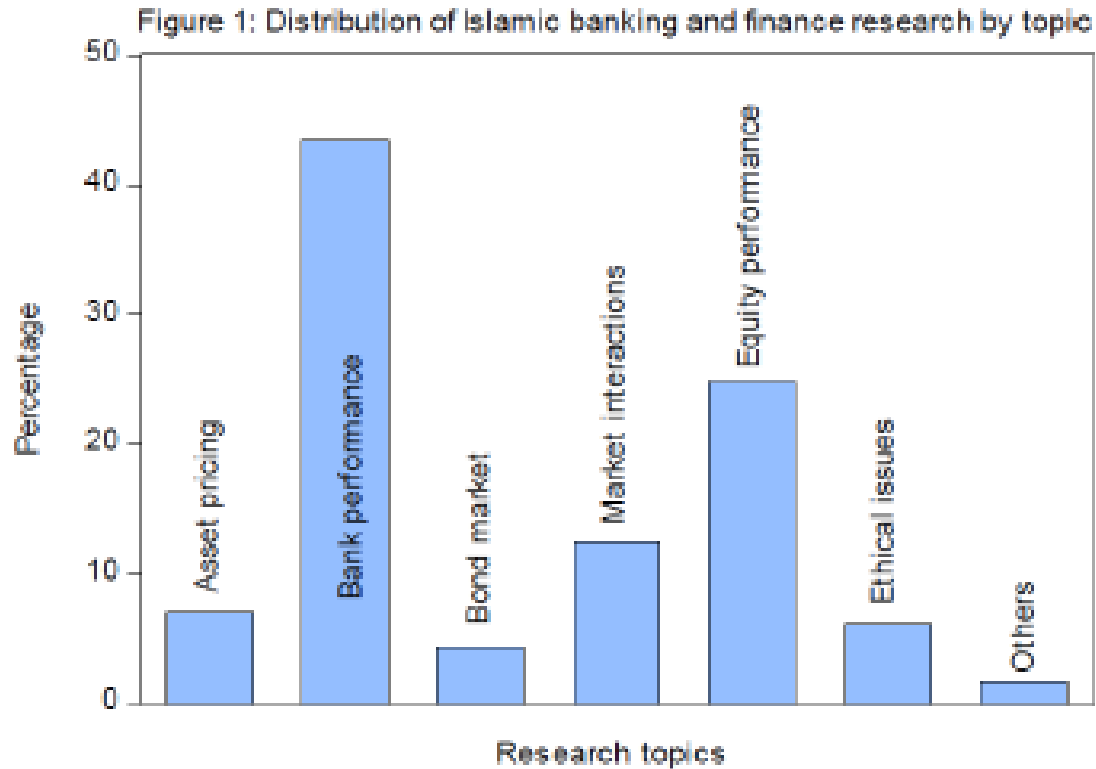
- Current status of literature
- What have we learned?
- Main features of the literature
- Key challenges
- Futures direction



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?



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.