

Islamic banking lends advantage to financial institutions

September 21 2016, by Tony Moran

Researchers at the Universities of Birmingham and Brighton studied a merger that took place in Bahrain, between an Islamic bank and a conventional bank in the wake of financial crises that rocked the world between 2007 and 2009.

Their study showed that the 2009 acquisition of Bahrain Saudi Bank by the Islamic institution Al Salam Bank Bahrain (ASBB) prompted a significant increase in the liquidity of ASBB after adopting an Islamic banking system.

Published in the *Journal of International Financial Markets, Institutions and Money*, the study looks at how the amalgamated bank operated after the merger, concluding that Islamic banking offered the institution significant advantages.

Professor Andros Gregoriou, Professor in Finance at Brighton Business School, said: "The 'credit crunch' resulted in customers losing confidence in the conventional banking system used throughout the world. As a result, some Western financial institutions changed their infrastructure into Islamic banks following the crises, as Islamic banks were better equipped to deal with the aftermath than Western banks."

Dr Jairaj Gupta, Lecturer in Finance at Birmingham Business School, said: "We have found overwhelming evidence that a change in banking philosophy from Western to Islamic provides financial institutions with distinct advantages. Our findings demonstrate a long-term improvement

in the liquidity of ASBB as a result of adopting an Islamic banking approach."

Islamic banking is consistent with the principles of sharia, or Islamic law, which prohibits acceptance of specific interest or fees for loans of money. Investment in businesses that provide goods or services considered contrary to Islamic principles, such as companies which sell pork or alcohol, is also prohibited.

The study directly tested the impact of a change from Western to Islamic banking on the same financial institution. It indicated that the permanent rise in liquidity of ASBB stocks could result in increase in the bank's value, as it could be less costly for them to borrow, issue capital or issue public equity after the increase in liquidity resulting from the introduction of Islamic banking.

Its findings revealed that better liquidity of ASBB stocks, following the introduction of Islamic banking, was maintained over a three-month trading interval. There were also permanent increases in the stock price and trading volume of ASBB stocks after the adoption of Islamic banking.

Provided by University of Birmingham

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