UNIVERSITI TEKNOLOGI MARA

THE EFFECTS OF SUKUK MARKET DEVELOPMENT ON ISLAMIC BANKING PERFORMANCE IN THE TOP SUKUK ISSUER COUNTRIES: COMPETITION AND BANK SIZE AS MODERATING VARIABLES

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ABSTRACT

Bank performance, which has a direct effect on the sustainability of the banking industry, is an ongoing concern for central banks. In terms of Islamic banks (IBs), a prerequisite for resilience is yielding sufficient profitability. Nonetheless, some IB profitability indicators remain stagnant, with no improvements made. Despite the slight moderation achieved by the net profit margin (NPM), which declined at times, the stability of the bank remains unchanged. Meanwhile, the inherent issues underlying liquidity management in IBs have limited access to both asset and funding. Some scholars have highlighted the significance of the sukuk instrument in addressing this issue. Despite the rapid development of the sukuk market, such advancement did not significantly assist IBs in addressing the issue. Previous studies have documented that the rapid growth of the sukuk market adversely affects IBs, suggesting the presence of competition. Thus, this study aims to determine the specific competition level at which the sukuk market's effect can enhance or deprive the bank's performance by precisely capturing the level of competition. As bank size is also a key concern for policymakers, the specific value of bank size must be identified to improve bank performance in the context of the sukuk market. As the current data consists of small N and large T, a macro panel is employed in this study. The effect on both short and long-run perspectives must be determined, as this study is related to bank performance. Hence, Cross-Sectional ARDL estimators are utilised to identify the significant relationship in both the periods and address the potential cross-sectional dependence problem, slope heterogeneity, and endogeneity issues inherent in panel data. To address concerns about estimator sensitivity, all model specifications are subjected to rigorous Common Correlated Effects Mean Group (CCEMG) and Augmented Mean Group (AMG) robustness checks. The findings revealed that sukuk market development (SMD) positively affected NPM in the long and short-run, thus demonstrating their complementarity. Nonetheless, a positive, insignificant effect was exerted on bank stability. Both bank size and market power positively and significantly influenced IBs' bank profitability and stability. Conversely, there was an insignificant moderating effect of competition, indicating that competitive strength does not inherently alter how an Islamic bank responds to sukuk market growth. Meanwhile, a positive and strong interaction was identified between SMD and bank size in the long run within the context of NPM. Large Islamic banks were ideally positioned during the development of the sukuk market, thus providing opportunities to increase liquidity and profitability. While the sukuk market offers moderate stabilisation for small banks in the short run, the level of stability decreases as banks grow larger. The elicited outcomes can guide policymakers to implement both short and long-run approaches to increase bank performance and complement SMD.

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CHAPTER 1
INTRODUCTION

1.1 Introduction

This study aimed to examine the effect of sukuk market development (SMD) on Islamic banking performance in top sukuk issuer countries. The total of sukuk issuances or sukuk market capitalisation as a percentage of gross domestic product (GDP) is known as SMD, which indicates the size of the sukuk market (Al-raeai et al., 2018; Mimouni et al., 2019). As such, the present study mainly focused on the macro level of sukuk, which is limited to countries with an active sukuk market. These countries record a high number of total sukuk issuances on a regular basis. According to the 2024 IIFM Sukuk Report, sukuk is currently established as a viable source of financing for the various requirements of corporations and financial institutions: project financing, general needs, capital adequacy, the budgetary and fiscal needs of a sovereign (government) and liquidity management. The sukuk market potentially affects the bank's lending activities due to their similar function as money funders, thus crowding out and impacting its profitability and stability, respectively (Smaoui et al., 2020).

Meanwhile, a nation's economic growth is driven by SMD and the Islamic banking sector (Lebdaoui & Wild, 2016; Yıldırım et al., 2020; Zeqiraj et al., 2020). Relevant scholars have conducted market and bank-based studies, where financial market development influences economic growth, depending on the environments they are implemented in and whether the country is more market or bank-oriented (Demirguc-Kunt & Levine, 1999; Levine, 2002; Khoutem, 2014; Smaoui et al., 2017, and Bats & Houben, 2020). Although Levine (2002) reported that overall financial developments catalyse economic growth, no evidence demonstrated whether the development is more inclined toward market or bank-based views. Smaoui et al. (2017) claimed that a robust banking sector (bank-oriented) is detrimental to SMD, whereas well-developed bond and stock markets (market-oriented) promote sukuk expansion. Bats and Houben (2020) disclosed that less-dominant banking sectors (as an intermediary) would render it easier for the capital market to become a substitute unit.

Studies examining the relationship between SMD and Islamic banking relationship (Bibi & Mazhar,2019; Mimouni et al., 2019; Smaoui & Ghouma, 2020;