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THE NEXUS BETWEEN COVID-19 PANDEMIC AND PERFORMANCE: EVIDENCE FROM PAKISTANI ISLAMIC BANKS

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Abstract
The COVID-19 pandemic is considered one of the most serious crises in recent history, as it has profoundly impacted the lives of millions of people and adversely affected the economies of many countries. The effect of this health crisis on the financial sector is an area that warrants thorough investigation. Therefore, this study analyzes the impact of the COVID-19 pandemic on the Islamic bank's financial performance. Data for this analysis were collected for the period from 2017 to 2022. The results reveal that the global health pandemic has no notable effect on the performance of Islamic banks; however, the findings are not statistically significant. As a result, no strong conclusion can be made. The results for the control variables are consistent with the existing literature.

INTRODUCTION

The most recent global catastrophic incident affecting all sectors of the economy is the covid-19 pandemic (Omar et al, 2020). This disaster posed too many challenges and problems to the business organizations all over the world via the lockdown and shutdown of multiple production factors due to the COVID-19 (Monica et al., 2021). Lockdowns, isolation, restrictions on movement, social distancing were some of the preventive strategies applied by the government to avoid the risk of injury to public health (Omar et al.,2020). Most of the economies in the globe imposed restrictions to their public to be in shelter, and also limited the movement of masses across the globe, and within the borders, although exceptions were made for the supply of vital resources/ commodities for instance drugs that save lives and food (Sharma et al., 2020).

Moreover, some Governments applied mitigation methods depending on social dislocation, national quarantines, and closing non-essential firms to slow down the transmission of the new COVID-19. The (recovery from) impact of the shutdown of the economy and the income loss led to a severe impact on the private sector, which meant firms were challenged to scramble for cash to fund their business activities (Kunt et al., 2020). Safety requirements included maintaining a minimum of one meter of distance from other people, as well as, not touching our face or other surfaces. Some recommended guidelines included avoiding crowded places, restricting large gatherings, wearing face masks, and provision of additional safeguards especially for the older one and those with poor health conditions (Ojukwu, C. O, 2021).

In the same manner, losses were incurred as a result of the closure of the businesses related to a decrease in demand, a fall off in cash flows, a drop in sales revenue, the labor supply, and marketing issues. Their ability to manage those challenges will dictate their future success, and even if they manage to overcome them, there financial future may still be at risk (Rababah et al., 2020). The Asian Development Bank has estimated the global economy loss of the pandemic to be between $5.8 - 8.8 trillion, which is equivalent to 6.4 - 9.7% of the world's GDP (Park et al., 2020).

Mansour et al. (2021) observed that the progression of the global economic recession tied to government enacted policies quickly impacted the financial markets. Financial institutions appear to be especially exposed to financial crisis considering nonperforming loans become more likely (Foglia et al. 2020). As the epidemic not only diminishes cumulative demand, output, trade and economic transactions to none or low levels however joblessness rises unencumbered by any government support, financial Institutions are ever mindful of the potential higher fallout threats in almost every country (IMF, 2020).

There were serious concerns regarding their consequences on the financial results of Banks and especially Islamic Banks. Islamic banks are evaluated for resilience to external shocks because of their non-involvement of garar transactions. However, with little known about the impact of Covid-19 pandemic on the financial performance of Islamic Banks thorough examination is warranted. This study however will reveal and contribute to the existing literature by looking at the consequences of recent pandemic on the Islamic bank's financial performance.

2. Literature Review

WHO declared COVID-19 to be a global health emergency pandemic. The COVID-19 pandemic is being classified as one of the worst health pandemics, as it has more impact than the Global Financial Crisis of 2008/2009. This is because this pandemic has also affected the nations that were not terribly affected by the global financial crises of 2008/2009 (Elliot, 2020). Along with many other industries being affected, the global banking industry (Ozili & Arun, 2020) is also been affected by the COVID-19.

The Islamic banking industry has seen tremendous growth over the past couple of decades. The Islamic banking system prohibits conventional banks from using conventional interest and too much uncertainty. Just like conventional banks, Islamic banks also define which activities are allowed. The activities determined to be contrary to Islamic law includes life insurance and gambling (Hassan & Aliyu, 2018). According to El-Chaarani et al. (2022), "Interest-free banks use and create financial products that are compatible with Islamic Shariah rules."

There are two fundamental concepts that drive Islamic banks: (1) Interest Free Economic business Transactions, and (2) share in gain and in loss. Rather than pay depositors a predetermined interest rate, Islamic banks typically act as investment partners – therefore cash amounts held at Islamic financial institutions are regarded as short-term interest free loans with Islamic Financial Institutions. According to Abdeldayem and Darwish, 2018, Islamic financial instruments using a agent charging a predetermined fee for dealing with the contra transactions "Wakalah", and a profit-sharing instrument "Mudarabah" are used in order to mobilize resource in an Interest Free banking context. There has been a considerable number of researchers who have studied and did the comparison of of both Interest Free Banking, and their interest-earning conventional banking peers, in various emerging countries. For example, Ika and Abdullah (2011)'s study found Islamic banks in Indonesia had a greater liquidity than conventional interest-earning banks. Similarly, Tho'in , (2019) concluded Indonesian Interest Free banks performed better than interest-based banking around this time of the establishment of the ACA.

Majeed and Zainab (2021) found that interest free banking banks in Pakistan, as opposed to commercial banks, are more flexible and capitalized, with lower risk. However, they are less profitable than commercial banks. Interest free banking and interest based banking in Jordan yielded different returns on capital between 2001 and 2011 according to Abdo (2020). According to Abdo (2020), Islamic financial institutions need to strengthen their money supply in order to improve their monetary efficiency.

During the 2010-15 Middle East Arab spring, traditional banks had greater success in asset management than Islamic banks, although Islamic banks focused on financial stability and insolvency risk (El-Chaarani and Ragab, 2018).

Conversely, other scholars, including Hassan et al. (2021); Kinateder et al. (2021); Adrian et al. (2019); Rephael et al. (2017), provided empirical evidence confirming the negative impact of COVID-19 on stock markets and investor confidence. Ben Abdallah and Bahloul's (2024) findings revealed that COVID-19 pandemic negatively and significantly affected the performance of Islamic banks operating in the North Africa, Middle East,and Southeast Asia (MENASA) region.

3. Research Methodology

To examine the impact of Covid-19 on financial consequences (ROA) of interest free banks operating in Pakistan, a multiple regression model have been used . All Islamic banks and banks having Islamic windows working in banking sector of Pakistan make up the study's population. Data was collected from the time period 2017 to 2022 . This time period is chosen to cover both the pre and post pandemic period. The final sample of the study thus includes those banks for which data was available throughout the sample period. Thus the total sample of the study include 18 Islamic banks operating in Pakistan.

To achieve the objectives of the study, the following regression model is used

$$ROA_{it} = \alpha + \beta_1 Size_{it} + \beta_2 Leverage_{it} + \beta_3 Tangible\ assets_{it} + \beta_4 COIVD\text{-}19_{it} + \mu_{it} \ldots\ldots\ldots (1)$$

ROA is Return on Asset, which is measured as ROA = Net Income after Tax / Total Asset (Kurniawan (2021);(Akbar et al., 2017) and Hery (2015)); Size is Company Size and measured as Log of Total Asset (Akbar et al., 2017; Akbar et al., 2013; Rehman et al., 2023; Rehman & Rehman, 2011, 2014); Tangible Assets (Fixed Assets) mostly include the non-current assets or tangible assets) being classified into property, plant and equipment. Debt equity ratio (DER) is a measure of leverage as follows DER = total debt / total assets

Covid-19 is a dummy variable with O for covid-19 (2019-2020) period and 0 for otherwise

4. Results and discussion

As the data is panel in nature, the study first checks whether the fixed effect or random effect is appropriate in this case. For this purpose, the Hausman Model specification test was run to determine which panel model is appropriate in our case. The result of Husman (1978) test is reported in table 1 below.

Table1: Hausman Model Test

	Coef.
Chi-square test value	10.845
P-value	.028

Table 1 suggests that $p < 0.05$ therefore, the result that Fixed effect model is appropriate in this study case. Therefore, the study run the panel fixed regression model and the results are reported in table 2 below

Table 2; Fixed Effect Regression Model

ROA	Coef.	St.Err.	t-value	p-value	Sig
Size	.664	.192	3.45	.001	***
Tassets	-.143	.112	-1.28	.204	
Leverage	.01	.012	0.81	.421	
COVID19	.247	.11	2.25	.027	**
Constant	-5.905	1.689	-3.50	.001	***

R-squared	0.233	Number of obs	114
F-test	6.917	Prob > F	0.000

Akaike crit. (AIC)	149.766	Bayesian crit. (BIC)	163.447
*** p<.01, ** p<.05, * p<.1			

Table 2 reveals that F-test is statistically significant at the level of 1% which suggests that overall model is statically significant. The size has positive coefficient and significant at the level of 1%. This implies that one unit increase in firm size enhances the firm performance (approximately 0.664). The positive coefficient implies that larger firms tend to have better performance.

The impact of tangible assets on firm performance is negative which shows that tangible assets have negative impact on performance. However, the result is statistically not significant. This implies that tangible asset have no impact or no clear relationship with ROA in our model. The coefficient of the leverage is positive but not statistically significant. As the result is not statistically significant therefore, it seems that leverage has no effect on ROA. This result appears consistent with the existing literature, as it report insignificant relationship between ROA and leverage Arora & Sharma (2016), Bansal & Sharma (2016), (Sheikh et al. (2013), , and Darko et al. (2016))

The coefficient of Covid-19 is positive and statistically significant at the level of 5%. This means that reuslts of the Islamic banks increased during global pandemic period. According to Islamic Sharia, the Islamic banks do not offer products and services on riba. Moreover, Islamic banks also must not involve Gharar transactions, which involve significant uncertainty. Therefore, Islamic banks seemed to be more resilient during the worldwide pandemic and has positively contributed towards the performance of Islamic banks.

We also addressed other econometric issues such as multicollinearity, heteroscedasticity and serial correlation. To address the multicollinearity issue we calculated simple correlation among variables. All the correlations are below 0.08, which suggest that there is no multicollinearity issue ((Gujarati & Porter, 2003). To address the problem of heteroscedasticity and serial correlation we used robust clustered standard errors which accounted for both heteroscedasticity and serial correlation at the panel level and run the regression model again by adjusting for heteroscedasticity and serial correlation. The result is reported in table 03 below. The results are qualitatively similar to the original regression result.

Table 03 Fixed Effect Regression Model with robust standard error

ROA	Coef.	St.Err.	t-value	p-value	Sig
Size	.664	.192	3.45	.001	***
Tassets	-.143	.112	-1.28	.204	
Leverage	.01	.012	0.81	.421	
COVID19	.247	.11	2.25	.027	**
Constant	-5.905	1.689	-3.50	.001	***
R-squared	0.233		Number of obs	114	
F-test	6.917		Prob > F	0.000	
Akaike crit. (AIC)	149.766		Bayesian crit. (BIC)	163.447	
*** p<.01, ** p<.05, * p<.1					

5. Conclusions

The study's findings reveal that size has positive and notable consequences on the performance of Islamic banks while tangible assets have negative and insignificant impact on ROA. Similarly, the leverage has positive and statistically insignificant impact on ROA. The Covid-19 has positive and statistically notable impact on results of Islamic banks. This shows that Islamic banks performance enhanced during global pandemic period. This study thus adds to the existing literature on the nexuses between crisis period and performance by providing evidence from the perspective of the Islamic banks. The study findings also have policy implications for both the

government and policy makers to encourage the Islamic modes of financing especially during the crisis period. The study recommends that further research on the topic is required especially the comparison of Islamic and conventional banks performance during the emergency period to better comprehend the issue.

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