

# **An Empirical Investigation of Lending Behaviour in Islamic Banks**



**SUBMITTED BY**

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## **Abstract**

Different studies have been conducted regarding comparison and differences between Islamic and commercial banks. The evidence regarding the comparison between these two types of banking system is limited and inconclusive. Therefore this study investigates whether the theory of Heuvel (2005) based on the lending behaviour of Commercial banks can be applied to Islamic banks. For this purpose the Islamic banks of Middle East have been selected for the period of 1997 to 2012. To examine that the determinants of lending of commercial banks have significant impact on Islamic banks or not. The determinants studied include Capital adequacy ratio, Square term of capital adequacy ratio, Interest rates, Bank size, Gross domestic product (GDP) and Herfindahl Index (HHI). The results indicated that capital adequacy ratio has a significant positive impact on new loans ratio whereas the square term of capital adequacy ratio has a significant negative impact on new loans ratio which recommends that Islamic banks are also forward looking as they minimize the risk by maintaining their capital up to the reserve requirement ratio in order to prevent themselves from getting penalized by the regulatory body. Interest rate is found to have insignificant negative impact on new lending which was in contrary to the theoretical expectation. Herfindahl Index known as the concentration ratio has a positive significant impact on new loans ratio while Gross domestic product (GDP) has negative insignificant effect on new loans ratio. Therefore this study concludes that Islamic and commercial banks are similar in terms of lending behaviour as all the variables that have significant impact on new loans of commercial banks also have significant effect on new loans ratio of Islamic banks except interest rates.

**Keywords:** Capital adequacy ratio, Lending Behaviour.

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