

## AN EXPLORATORY STUDY TO ANALYZE THE FACTORS AFFECTING THE PROFITABILITY OF PAKISTANI ISLAMIC BANKS DUE TO COVID-19 PANDEMIC BASED ON TOE THEORY

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### ABSTRACT

*The current study utilized the qualitative approach to explore the profitability of Islamic banks after the pandemic of Covid-19. Open-ended semi-structured interviews were conducted to collect data from Pakistani Islamic banks in Punjab district Sahiwal. Respondents were mainly the Islamic bank's operational managers and business managers. The study identified various factors which emerged due to the pandemic and directly affected Islamic banking profitability. Technological factors such as E-banking and digital banking developed faster in Pakistan and positively impacted Islamic banking profitability. Whereas environmental factors such as lockdowns and organizational factors, including policies and deregulations, impact the profitability of the Islamic banking sector. Thematic analysis was performed using NVivo12, tag cloud, word tree map, and the hierarchical chart were reported based on technological, organizational, and environmental (TOE) theory. The factors identified provide guidelines for managers and practitioners working in Islamic banks in Pakistan to improve profitability.*  
**Keywords:** technological, organizational, environmental, TOE theory, Islamic banks, profitability, Pakistan.

### INTRODUCTION

An efficient banking system plays a vital role in a country's economy (Mushafiq & Sehar, 2021). Banks provide a wide range of services like managing deposits and withdrawals, lending credits and advances, and agency services to corporations, firms, organizations, and businesses (Mushafiq & Sehar, 2021). Banking has evolved with time, and a new era of Islamic banking has emerged as compared to traditional banking (Majeed & Zainab, 2021).

The traditional banking system is described as "traditional" banking (Akram and Tahir, 2010). It is an institution that accepts deposits, offers services for checking accounts, offers various loans, and offers essential financial products to individuals and small-sized businesses like certificates of deposits (CDs) or savings accounts. The traditional banking system is a system of banking based on interest. It is based on relationships between creditors and depositors between the bank on one side and the borrowers along with the institution on the contrary (Barry and Njie, 2010). In Muslim majority nations, people are not inclined to engage in monetary transactions based on interest because Islam does not permit the usage of interest.

Islamic banking differs from conventional banking as it is based on interest-free transactions because Islam forbids interest. In Islamic Shari'ah, money is considered a medium of exchange, not a commodity. It includes products that do not include "riba" and are based on Shari'ah principles; hence, it is also known as interest-free banking (Salman & Nawaz, 2018). Shari'ah means "the way to the

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source of life” and refers to a legal system that follows the code of behavior narrated by the Holy Qur’an and preaching of Prophet Mohammad (PBUH) (Barry & Njie, 2020).

Islamic traditional and Islamic banks are different in a variety of ways. Still, the main difference is that conventional banking is built upon debt. In contrast, the structure of Islamic banks is built upon “riba,” no-cost transactions where the participants profit from their investments through agreements for loss and profit sharing. Every contracting party has to be able to share the benefits and risk of losing as per the contract between them (Arafat and co., 2021).

The Islamic banking system is evolving as the demand for interest-free products rises. Customers are tremendously interested in banking in an Islamic manner, and many commercial banks are launching Islamic banking solutions in addition to conventional ones (Salman & Nawaz, 2018). In Pakistan, several conventional banks have opened up their Islamic banks branches to serve the people who want to ensure that all of their monetary transactions are in accordance with Sharia laws (Ghouse et al., 2021). Meezan Bank laid the foundation of the first Islamic bank in Pakistan in 2002 (Akram & Tahir, 2020). Dubai Islamic Bank Pakistan, Bank Islami Pakistan Limited, Al-Baraka Bank (Pakistan) Limited, and MCB Islamic Bank Limited are also currently providing Islamic banking services in Pakistan.

The outbreak of COVID-19 in Wuhan, the capital of Hubei Province in central China, caused a lot of damage to the economy of every country (Yang et al., 2020). The banking sector is at the front line of battling the damage caused by the pandemic (Implications of COVID-19 for Banking and Capital Markets, 2020). The default rate of banks climbed significantly due to tight lockdowns (World Bank Group, 2020). Liquidity shortage was one of the biggest problems the conventional and Islamic banks faced. Those banks with liquidity shortages also severely dropped their stock prices (Demirgüç-Kunt et al., 2021). There was a sharp decline in the profitability of both traditional and Islamic banks as values of ROA and ROE were low due to the pandemic (Arafat et al., 2021). Due to all above mentioned problems the overall performance and efficiency of banks in Pakistan got affected severely due to COVID-19.

The major studies on the impacts of COVID-19 on the Islamic banking sector have been conducted in Malaysia and Indonesia (Ichsan et al., 2021; Salman & Nawaz, 2018). Very little work has been done in this regard in Pakistan. A study can be conducted to determine the impacts of COVID-19 on Islamic banking profitability in Pakistan. This research aims to explore the factors that impact the profitability of Islamic banks during COVID-19, as this area of study has not been done before in Pakistan.

## REVIEW OF LITERATURE

Amrah and Dina (2021) stated that the banking sector is an important financial institution of a country that has evolved with time. The traditional banking system is based on debtor and creditor relationships where interest is taken as an opportunity cost (Barry & Njie, 2020). Most Muslim communities do not like to be involved in interest-based transactions, so they choose the Islamic banking system over the conventional banking system.

Islamic banking differs from conventional banking in several ways. The Islamic banking sector follows the guidelines mentioned in Islamic “Sharia,” while traditional banking is entirely based on manmade principles (Mushafiq & Sehar, 2021). In conventional banking, interest is predetermined between two parties, whereas Islamic banking promotes profit and loss sharing. Islamic banks also act as Zakat collection centers. It is one of the services which conventional banks do not provide to their customers (Barry & Njie, 2020). These are some of the features which differentiate Islamic banks from conventional banks. Musharaka, Mudaraba, Murabaha, Musawama, Leasing, Salam, and Istisna are the essentials of the Islamic modes of financing. These essentials are approved by the commission, which the state bank set up for the transformation of the financial system of Pakistan (*State Bank of Pakistan*, n.d.).

The epidemic of COVID 19 has caused tremendous economic harm and has caused significant damage to many aspects of life, including financial markets (Baker et al., 2020). The extent and complexity of the catastrophe or damage caused by this pandemic is vastly different from any other crisis (Hassan et al., 2020). There is currently limited study on the impact of this epidemic, which has affected banks worldwide, including Pakistan (Arafat et al., 2021). COVID-19 is now causing problems in a variety of businesses. Considering some of the world’s diseases, the banking sector, including

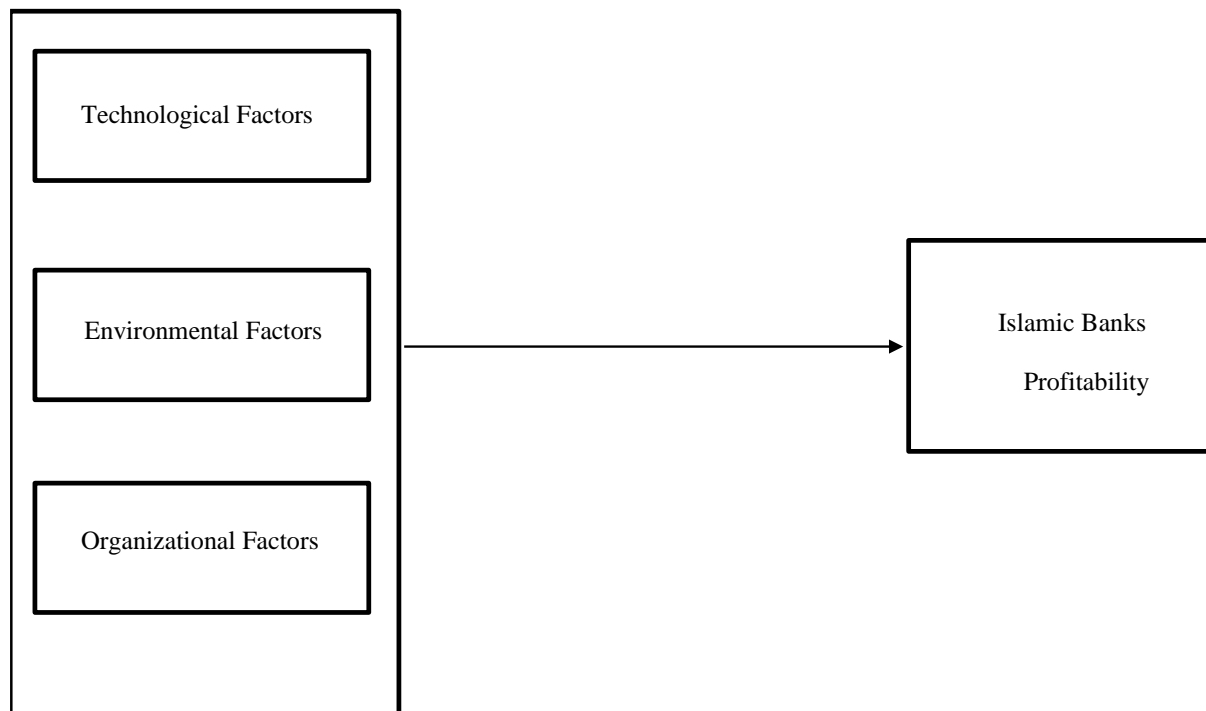
Islamic banking, has proposed many policies to ensure that Islamic banking continues to function throughout this pandemic (Arafat et al., 2021).

The Islamic financial sector has also received a severe backlash because of COVID-19 (Kayed & Hassan, 2011). The Islamic financial system is still in its development. As a consequence of this increase, a significant number of rivals are vying for a substantial market share. The Islamic Finance Development Report claims that the Islamic finance market increased by 3 percent in 2018 to roughly US\$ 2.4 trillion (Reuters, 2018). COVID-19 began in January 2020 and spread over the entire world within a short span of five months. This pandemic has quickly damaged the financial markets and banking sector because policymakers and regulators had little time to respond (Hassan et al., 2020).

In research by Kunt et al. (2021), the profitability and liquidity of the banking sector got negatively affected by the onset of COVID-19. Many Islamic and traditional banks faced a shortage of liquidity. ROA & ROE were used to measure banks' profitability during the pandemic. According to Arafat et al. (2021), banks' stock prices declined during COVID-19. Multiple reasons contributed to the overall decline of stock prices during the pandemic. One of the major reasons was the shortage of liquidity and lower banks' profits.

### **Conceptual Model**

The present study's conceptual model, shown in Figure 1, depicts the technological, organizational, and environmental factors based on TOE theory that affect the profitability of Pakistani Islamic banks due to the pandemic of COVID-19.



**Figure 1: Conceptual Model based on TOE theory**

## **METHODOLOGY**

### **Qualitative Approach**

The methods involved in carrying out the qualitative approach are provided, i.e., data sampling, inclusion/exclusion criteria, recruitment, interview protocol, data collection method, and data analysis technique to explore the different TOE factors affecting Islamic Banks' profitability.

### **Data collection**

The researcher contacted the participants working as managers in Islam banks in Punjab, Sahiwal district, and asked about their consent to participate in a semi-structured interview. The present study employed a semi-structured interview to capture participants' experiences and diverse views. The participants have also ensured the details which might reveal their identity will remain confidential. The

data collection process was stopped when the saturation point was reached as the answers became repetitive. Table 1 depicts the respondent's details of the present study.

**Table No. 1: Interviewee Details**

<b>Sr. No.</b>	<b>Age</b>	<b>Bank</b>	<b>Job Experience</b>
R1	35	Muslim Islamic commercial bank	3
R2	42	Bank Islami	5
R3	40	Dubai Islamic bank	6
R4	37	BOP Islamic branch	4
R5	39	Bank Alfalah Islamic	8
R6	38	ABL Islamic branch	2
R7	45	Bank Al Habib Islamic branch	6
R8	40	HBL Islamic bank	7
R9	46	Askari Islamic bank	9
R10	38	Bank Alfalah Islamic	3
R11	36	ABL Islamic branch	3
R12	35	Muslim Islamic commercial bank	3

### **Data Analysis Technique**

Braun and Clarke's (2006) thematic analysis step were performed using NVivo software. The transcribed data of interviews was imported into software, and codes and themes were generated from transcribed data of respondents. Table 2 depicts the analysis techniques deployed in the present study.

**Table No. 2: Analysis Techniques**

<b>Phase</b>	<b>Sampling</b>	<b>Interviewees</b>	<b>Consent</b>	<b>Technology used</b>
Semi-structured Interviews	Purposive	12 Islamic bank managers	Consent was obtained through consent forms	NVivo software

### **DATA ANALYSIS**

Thematic analysis was utilized to analyze the data transcribed in the present study. The thematic analysis offers detailed information to identify the key factors that fulfill the goals of this research. Braun and Clarke (2006) presented the six steps to analyze thematics. The phases aren't linear, and researchers can move between these phases throughout the qualitative analysis of data.

#### **Phase 1: Getting familiar with the data**

Clarke and Braun (2006) argued it is essential to conduct thematic research when data is collected since the researcher is already familiar with data and more interactions increase knowledge of patterns in data. When transcribing the next participant's information, the researcher could discover something similar to the previously transcribing data, which reinforces the idea and allows the researcher to become more acquainted with the information. Researchers must go through and read the data in this stage and get familiar with the information. In this study, the data were transcribed immediately following interviews (mainly on the same day). This way, the researcher was able to obtain complete data. After twelve interviews, researchers reached the saturation level without needing further interviews.

#### **Phase 2. Generating the initial codes**

Weston et al. (2001) said that coding isn't only the process of analyzing data and provides a significant connection between the growth of coding as well as the growth of understanding an event. In this study, the process involved the creation of codes from three different inquiries. The codes were then grouped following the research questions to ensure precision. Braun and Clarke (2006) stressed the importance of generating full codes using data to avoid all loss in the core of the research data.

#### **Phase 3 The search for themes**

The process moves to the next step, and codes are separated and grouped into possible topics (Braun & Clarke, 2006). In the present study, it was found that there are three different sets of codes. Code

repetitions or similar codes were compiled into the appropriate topic. This required a thorough study of codes because the same idea could be explained differently by the people who participated in the current study, and specific codes were not taken from the information. They had to be understood following a thorough description. If there was code that did not fit with any possible theme and so the term “miscellaneous topic” was created to place the codes under this theme to ensure that no data was lost and, in addition, the codes from the theme could be incorporated into a relevant theme after careful examination (Braun and Clarke,). A summary statistic is calculated using software to determine the importance of the theme in the course of how the codes changed.

**Phase 4: Revision of the main themes**

This is the crucial phase to finishing the themes, taking a close look at the codes gathered within each theme to determine if these codes are coherent and offer a clear structure (Braun and Clarke 2006). In this study, the researcher carried out a practical validation by verifying the research participants’ findings. They agreed on the various TOE factors that affect the profit of Islamic banks, as stated by them, and organized them into suitable themes.

**Phase 5: Define and Name themes**

Following phase 4, the following section continues to analyze the particulars of each theme to give an exact definition for each topic. The process of naming each theme was based on codes and information supplied by participants rather than relying on past literature. But, due to the nature of technology, the subjects were given names that were technical according to different researchers in their research that is also a sign of the credibility of the data.

**Phase 6: Writing the report**

After defining the clearly defined themes, the next step is to formalize the report. Braun and Clarke (2006) highlighted that providing sufficient evidence to back the main themes is essential. The participants’ quotes are used in the study to provide evidence of the formulated themes and a clear understanding of the three issues posed in the current study.

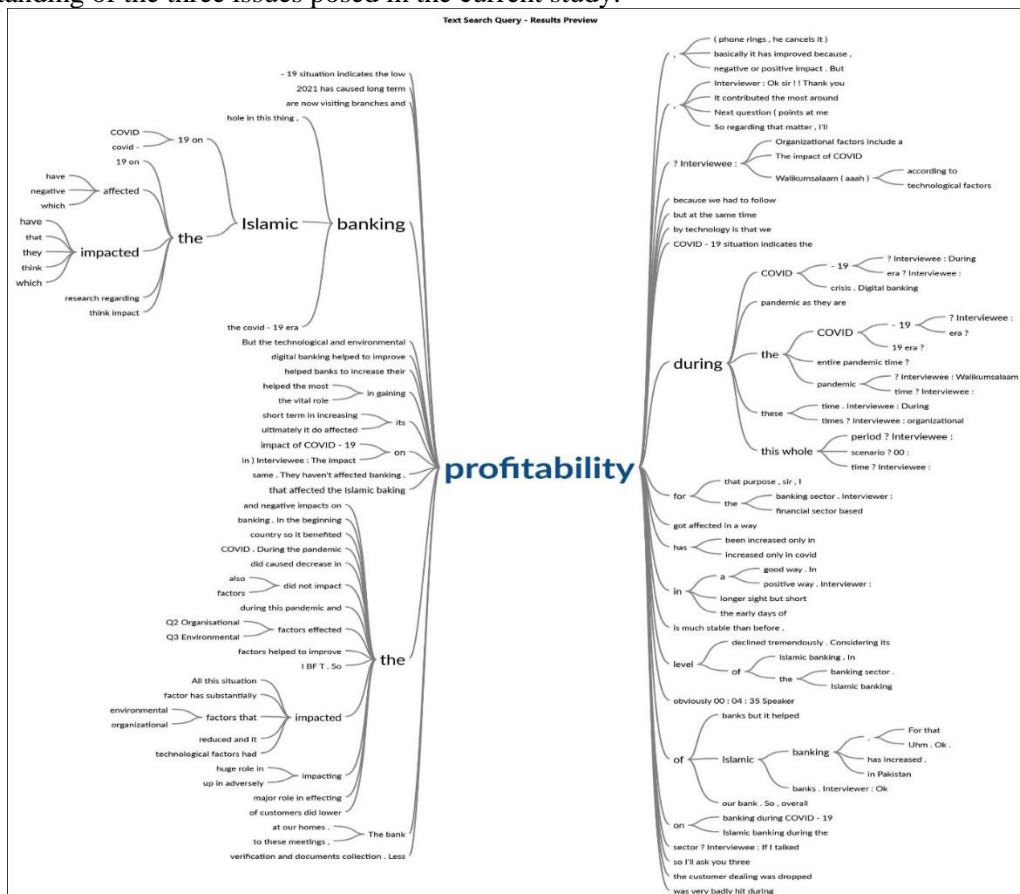
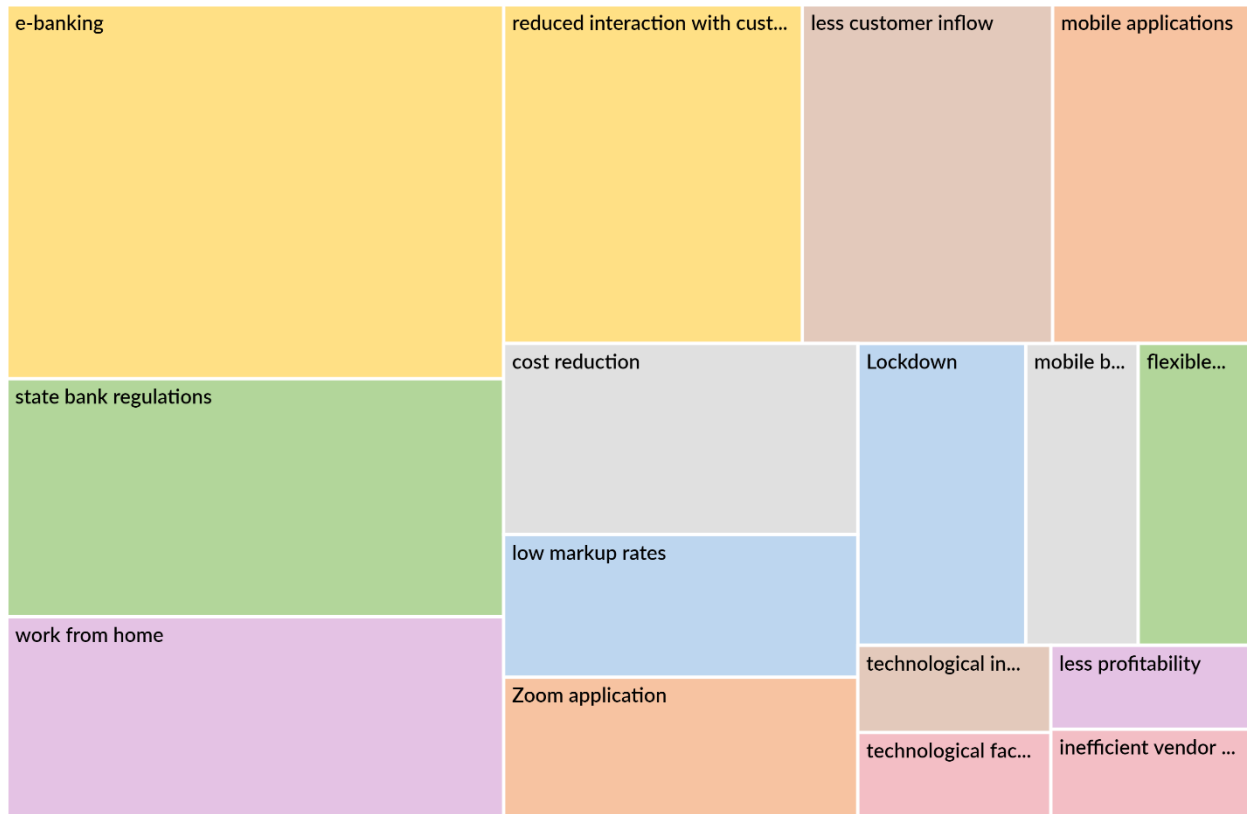


Figure 2: Word Tree Map

Figure 2 depicts a Word Tree Map, which displays the connections between a central word and other patterns of speech. In this inquiry, the key phrase is “Islamic banking profitability. Figure 3 depicts “e-banking,” “state bank regulations,” “work from home,” “reduced interaction with customers,” “low mark-up rates,” “cost reduction,” “less customer inflow,” and “mobile applications” as more critical results of COVID-19’s impact on Islamic banking profitability, as compared to the other results. On the other hand, flexible work hours, technological innovation, and inefficient vendor services have been recognized as less relevant COVID-19 effects on Islamic banking profitability.



**Figure 3: Hierarchy Chart**

The results of the impact of COVID-19 on the profitability of Islamic banks can be studied by considering three factors that had an impact on the profitability of Islamic banks. The three factors are technological, environmental, and organizational. The replies of various respondents in this study were used to investigate these links. E-banking, mobile banking, and mobile applications can be categorized as technological factors impacting Islamic banks’ profitability. State bank regulations and low mark-up rates are the major environmental factors that impact profitability. At the same time, flexible working hours, less direct interaction with customers, lockdown or social distancing, less customer inflow in branches, and work from home are the most prominent organizational factors. All of these factors, which arose as a result of the epidemic, significantly influenced Islamic banks’ profitability in Pakistan.

**DISCUSSION AND CONCLUSION**

This study identified the impact of COVID-19 on the profitability of Islamic banking in Pakistan. Data has been collected through video-recorded interviews with different bank managers of Islamic banks in Pakistan. NVivo 12 was used to do various qualitative data analyses. Multiple factors resulting from the pandemic are influencing the profitability of Islamic banks in Pakistan.

Based on the data, it may be inferred that technological, environmental and organizational factors which emerged during the pandemic have directly and indirectly affected the profitability of the Islamic banks. Technology has evolved at a faster pace due to the pandemic. The development of e-banking has been catalyzed because of the restrictions imposed on everyone due to the pandemic. The entire process got catalyzed. E-banking or digital banking developed at a faster rate in Pakistan and

helped to impact the profitability of Islamic banks positively. Due to digital or E-banking, banks were able to serve their customers in a better way during the COVID-19 era.

Whereas the environmental and organizational factors seem to have a negative impact on the profitability of the Islamic banks. The low markup rates set by the state bank and various other regulations imposed by the government and state bank of Pakistan negatively impacted the profitability of Islamic banks. Less direct interaction with customers and reduced staff also affected the performance and efficiency of the employees, indirectly affecting the banks' profitability.

### **Limitations & Future Predictions**

The present study has certain limitations. This kind of study has not been done in Pakistan before, so more work is needed to produce a better version of the study. The researcher should obtain a large sample in the future so that many other factors could be found which may describe the above study better. Also, the sample should be obtained from different provinces of Pakistan to get a clearer picture. In the future, the potential researchers could also obtain interviews from the customers so that a new dimension could be explored from the customers' point of view and what they feel about the impact of a pandemic on the banking sector.

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