The effect of the COVID-19 pandemic on the performance of Turkish banks: a comparative panel data analysis

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Abstract: This study investigates the impact of the COVID-19 pandemic on the performance of conventional and participation banks in Turkey. Panel data with random effects was the main analysis methodology adopted by the study. The data of ten banks was analysed within the range of 2015–2021. The results of the combined analyses could not establish any impact of the pandemic on the profitability of both groups of banks. The same result is also observed when the analysis is conducted on both groups separately. In contrast, a negative impact on the operational efficiency of banks was observed when the analysis was conducted on the two sets of the banks combined. Interestingly, the results suggest that the pandemic had a negative impact on the operational efficiency of participation banks but not on conventional banks when the analysis was conducted on the two sets of the banks separately.

Keywords: COVID-19; profitability; operational efficiency; banks; Turkey; Islamic banks; panel data analysis.

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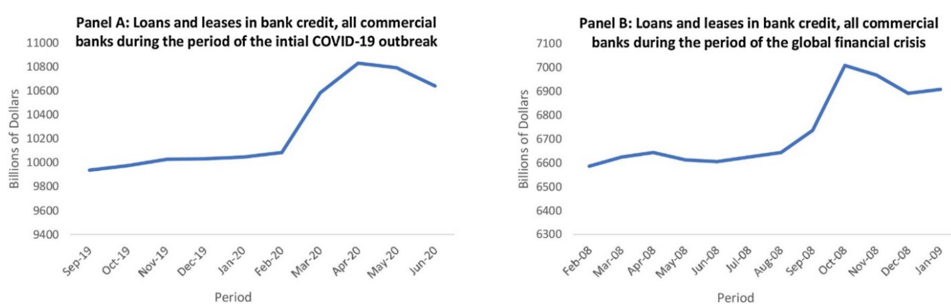
1 Introduction

On March 11, 2020, the World Health Organisation (WHO) declared COVID-19 a global pandemic (Mohammad et al., 2021). As a measure to counter the spread of the disease, many countries resorted to lockdowns, in which many economic activities were either minimised or totally closed. Economies became stagnant for a period exceeding six months, and hardly any formal business was functional at full capacity. According to Congressional Research Service, in 2020 global economic growth was reduced to an annualised rate of around –3.2%, global trade is estimated to have fallen by 5.3% in 2020 (Congressional Research Service, 2021). In the same year, unemployment in the US jumped to 4.9%, an unpresented level since 1930. In October 2021, there were around 4.2 million fewer jobs compared to February 2020 (Centre on Budget and Policy Priorities, 2022). Consequently, businesses encountered an unprecedented and unexpected decline in profits, in particular in sectors with no flexibility to work from home (Dunbar, 2022). Demand for liquidity pushed many firms to draw huge amounts of credit from pre-existing credit lines with their banks (Li et al., 2020). Mosser (2020) reported that the huge increase in the demand for liquidity resulted in non-financial customers of US banks to draw heavily on their existing lines of credit, as depicted in Figure 1, in a scenario very similar to the situation in the aftermath of the financial crises of 2008-09.

Figure 1 Loans and leases in bank credit during the COVID-19 and the global financial crisis (see online version for colours)



Source: Dunbar (2022)

What exacerbated the situation was the dramatic increase in the rate of default on most banks loans, including mortgages, automobiles loans, and personal loans (El-Chaarani et al., 2022). As a result, banks were under great financial strain for being unable to raise new capital to replace the leaving capital (Dunbar, 2022).

Banks' performance, operations, and profitability were all impacted indirectly as a result of their exposure to affected households and businesses with declining income and revenues (Le et al., 2022). The index STOXX Europe 600 Banks declined by 46% in the period between February 13 and April 21, 2020, a decline almost twice the decline of the MSCI Europe (ECB, 2020). Likely sources for these low valuations are the expectation of a pandemic-induced wave of non-performing loans, low-for-longer interest rates and lower anticipated bank profitability (Simoens and Vander, 2021).

Despite the existence of a reasonable volume of research on the adverse effects of the COVID-19 on the financial system (e.g., Elnahass et al., 2021; Ramelli and Wagner, 2020; International Monetary Fund, 2021; McKibbin and Fernando, 2020; Le et al., 2022; Agnese and Vento, 2020), studies on the COVID-19 impact on the banking system are still limited (Demirgüç-Kunt et al., 2021). This research gap applies to studies on both conventional as well as Islamic banking systems (Le et al., 2022).

This study aims at bridging this gap by capturing the effect of this pandemic on the Turkish banks (both conventional and participation). More specifically, it seeks to empirically assess the impact of the COVID-19 pandemic on the profitability and operational efficiency of conventional and participation banks in Turkey. By doing so, the study primarily endeavours to contribute to the existing literature in two ways: First, it investigates the impact of COVID-19 and the consequent lockdown on the banking system in Turkey. Second, it draws an analytical comparison between Islamic banks and conventional banks in terms of profitability and operational efficiency during the pandemic. It may be noted here that participation banking is synonymous with the term of Islamic banking or interest-free banking that operated according to the principles of Islamic law as it is specifically used in Turkey and Morocco (Kaplan, 2020).

The remainder of this study is structured as follows: Section 2 provides the conceptual and theoretical framework, while Section 3 contains a review of the literature. Section 4 highlights the research methodology Section 5 presents the results followed by the discussion in Section 6. Conclusion and research limitations are discussed in the final section.

2 The conceptual and theoretical framework

The conceptual framework of this paper is presented in Figure 2, which explains the relationship between the pandemic-driven economic crisis and banks' performance. Banks, as financial intermediaries, are positioned at the frontline of any economic downturn and are impacted directly by economic slowdowns or recessions. It is hard to overemphasise that there is a reciprocal relationship between economic growth and the financial and banking systems, in the sense that a strong economic performance should theoretically translate into a significant financial performance of firms and financial institutions including banks. Likewise, a robust financial system and banking system is essential to achieve economic growth. This latter notion has been articulated in the literature as early as 1873 and 1912 by Walter Bagehot and Joseph Schumpeter respectively.

The period of pandemic witnessed the impact of economic crises on the performance of financial institutions and banks. In the literature review section, the impact of the pandemic on Islamic and conventional banks is discussed in detail. However, a clear picture of the economic effects of the pandemic cannot be extracted without taking all