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The Impact of Covid-19 on the Financial Performance of Banking Sector Operating in GCC Countries

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Abstract

The Covid-19 pandemic has had a significant impact on the industries around the world, since the banking sector is one of the most important contributors to an economy, it has been selected for this research. The literature has limited studies associated with the performance of banks in the GCC countries during the pandemic using secondary quantitative data. The Gulf region which includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates has been specified in the research to identify how the pandemic has affected the banking sector. The research was conducted on secondary quantitative data of 20 banks which has been analyzed using descriptive statistics and graphical analysis to look at the changes in profitability of the banks. The results indicate that the overall performance of banks has been affected as evidenced by lower ratios in terms of profitability, credibility, and financial leverage. Although, the ratios became steadily decreased just after the pandemic started. The topic has been covered for western countries or Islamic banks only using different methodologies, however, for GCC countries and secondary quantitative data of both Islamic and conventional banks, the studies are limited.

Keywords: Financial performance; Banking sector; Covid-19.

1. Introduction

The financial performance of the banking sector in any state holds great value for the financial stability and economic growth of nations. According to Demirgüç-Kunt *et al.* (2021) big banks are the major source of lending; though the vulnerable and unstable financial performance of big banks resulted in the economic recession that also causes the slow down the growth and economic development of a country. Consequently, the year 2020 was not favorable for the global banking sector including Gulf countries due to the enormous outbreak of the COVID-19 pandemic (Akkas and Al Samman, 2021). The report shows that the outbreak of this enormous virus named corona was spread from China in December 2019 and later on spread all over the globe due to the movement of people from one region to another (Salman and Ali, 2021). Consequently, The United Nations declared this virus a global pandemic and forced the government to impose restrictions on travel (Alber and Dabour, 2020). Concerning this, Arfah *et al.* (2020) elaborated that the banned on traveling as well as international trade adversely affects the commercial and banking sectors of all the developed and developing countries.

The banking sector of the entire world has been affected by the global pandemic and restrictions on trade and travel. According to the reports of S&P and Dow Jones, S&P reported a major loss of 6 trillion dollars in February 2020 as the indices fell by the ratio of 28%. The financial analysis reports indicate that the global pandemic of COVID-19 has negatively affected the financial performance of the banking sectors. Additionally, Mateev *et al.* (2021) described that the banking sector faced a liquidity crunch that was resulted in raise of 250 bases points of non-performing bank loans. As the research further explains due to the global restrictions on trade and travel, all the loans that became non-performing which was issued to the aviation industry, retail industry, tourism, and hospitality industry. Besides, these industries were also in the phase of unproductivity and were not able to repay the loans. Ultimately, this resulted in negative impacts on the financial performance of banking sectors. Most of the studies have either focused western banking sector or Islamic banks, this study would add value by including both Islamic and conventional banks in the GCC countries during the pandemic.

The main focus of this study is to analyze the impact of the global COVID-19 pandemic on the financial performance of banking sectors in the GCC countries i.e. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Although, Hassan *et al.* (2021) articulated that the differences in the concept of conventional banks (CB) and Islamic banks (IBs) are the center of attention in the GCC region. Concerning this, Mateev *et al.* (2021) explain that Islamic banks follow the fundamentals of interest-free banking whereas the entire banking system of conventional banks is based on debts where participants are more likely to earn a profit on fixed ratios. On the other hand, participants earn profit or loss on their investment based on shared ratios of profit and loss. Consequently, investors must share the profit as well as loss; however, this is not the case in conventional banks. Hence, this study will lookout the impacts of COVID-19 on the financial performance of both conventional and Islamic banks in the Gulf region since this topic has been researched to a limited extent while more focus was on either western countries or Islamic banks only.

2. Significance and Rationale of the Study

The global banking sectors including Gulf countries are more exposed to financial constraints and crises, and during the pandemic, banks all around the globe have faced a significant decline in financial performance (Asli *et al.*, 2020).

The research conducted by Salman and Ali (2021) revealed that the banking sectors of the CGG region are trying their best to sustain the business continuity and manage their finances, as they might be pushed to the edge of disclosure during a pandemic.

Covid-19 has significantly impacted the banks due to the limited scale of business and resources, which highlights the need for guidance for finance and accounting experts. It has been observed that among the available literature, the financial performance of banks in the western countries has been explored during the pandemic, however, the research on non-western countries such as GCC is left unexplored (Alber and Dabour, 2020; Hassan *et al.*, 2021). This highlights the gap which will be filled with the help of the following research and since the banks in the Gulf region have been taken into account, hence, this research will enable the banks to analyze their financial performance during Covid-19 and take guidance from it to manage the continuity of the business in the post-covid19 situation. These aspects highlight the significance of the research and rationale for choosing the GCC countries and the inclusion of both Islamic and conventional banks.

3. Objectives of the Study

The main aim of the study is to evaluate the impact of Covid-19 on the financial performance of the banking sectors in the Gulf region and to achieve this aim, the following research objectives have been achieved.

To determine the financial factors of the banking sectors that have been most impacted by Covid-19.

To analyze the impact of Covid-19 on the financial performance of banking sectors in the Gulf region.

To recommend ways through which the financial performance of banking sectors can be managed during covid-19.

4. Literature Review

4.1. Covid-19 and Banking Sector

COVID-19 has left a significant impact on all aspects of life. The professional sector was equally impacted due to the instability and increased volatility in the international capital market. Demirgüç-Kunt *et al.* (2021), explained that the impact that the pandemic has on the business sector, is yet to be fully determined but it has left its impact on both, the supply and demand side of the economy which has eventually resulted in a decline in capital flow globally. In the banking sector, the factors that have been impacted the most are valuation and profitability. This study further elaborates on the financial models through financial ratios, stability, and the model of business of banks. In wake of COVID-19, the banking sector did not only face regulatory challenges but operational challenges as well. The lockdown during the pandemic crisis had impacted the majority of the countries in the GCC region causing the banks to face challenges such as decreased demand for oil due to the constant lockdowns, however, the supply was increased. Moreover, the banks also had to face challenges such as credit loss provisions, along with regulatory and operational challenges. The financial challenge majorly prevailed due to the relaxation provided by the GCC and central banks by providing economic support i.e. payment holidays for borrowers and liquidity support provided for banks.

4.2. Causes of Crisis in Banking Sector

There have been several causes of the crisis in the banking sector due to COVID-19 such as regulation failures, corporate governance failed mechanisms and greed. As highlighted by Cerović *et al.* (2017), Islamic and conventional banks, both were impacted due to the pandemic but the conventional sector was comparatively more impacted as compared to Islamic banking as Islamic banking does not allow the depositors to borrow which eventually decreases the risk of financial loss as well as reduces the risk of loss. As highlighted by Alshammari (2017), conventional and Islamic banks were greatly impacted due to the pandemic but the countries that were least impacted were K.S.A, U.A.E, and Kuwait.

The main function of conventional banking is similar to depository institutions which is also their main function. However, it has been explained by Salman and Nawaz (2018) that conventional banks are riskier as the depositors have to pay their money on demand as its guaranteed. Whereas, the function of Islamic banks acts as investment institutions where the investment is collected based on the system based on shared profit and loss. Moreover, the factor of risk for commercial banks is much higher than that of Islamic banks. As per Khaskhelly (2015), the equity financing in Islamic Banking in GCC countries was less impacted than conventional banking as the financing in conventional banking is based on debt which causes the risk factor the conventional banking to increase due to its high capitalization.

4.3. Covid-19 and Performance of Banking Sector in GCC Countries

According to the research conducted by Alqahtani and Mayes (2018), during the COVID crisis, as per the comparison between 76 Islamic and conventional banks of the Gulf Cooperation Council (GCC) region highlighted that the smaller Islamic Banks were comparatively more stable than the other banks. This study highlighted that there is a major difference in the performance of Islamic Banking and Conventional Banking with regards to performance and stability. The performance is measured and compared in terms of profitability, liquidity ratios, leverage ratios, etc. However, Asli *et al.* (2020) highlighted that shortly, it has been assumed that there will be a domino effect due to COVID-19, and the banking sector, is said to further evolve only if they are flexible and willing to adapt to new ways of working i.e. by transforming the business model to be able to be successful and secure their growth financially and bring in more stability.

There are various measures the banks have come up with to be able to cope with the changing trends, for instance, to overcome and minimize the credit risks, banks have re-strategize and adjusted their portfolio in a way that is focused more on the sectors that are less affected along with being mindful of the fact that these circumstances may occur again, the rating models are rectified along with better management of regulatory deadlines followed by enhanced risk management which helps in reducing the probability of loss. Furthermore, Rehman *et al.* (2021) elaborated that to minimize the liquidity risk the banks have begun to analyze reports of key metrics of liquidity followed by the proper documentation of decisions taken by the stakeholders. Further, to ensure the stakeholders regarding the progress and survival, the banks are being transparent at the time of providing information such as LCR, etc. Also, there are certain campaigns carried out to retain customers and attract new customers. According to Mateev *et al.* (2021), the essence of the matter is that length of the emergency and the profundity of its seriousness is as yet unclear both locally and around the world. Eventually, measures taken by regulators are intended to be transitory facilitative measures. While regulators would not stop the actions for the time being or without due notice, banks should prepare for a re-visitation of ordinariness. They ought to likewise be planning for any change by another typical - we expect that respondents will be considering what worked, and what didn't, during this emergency. Banks can expect a specific measure of change following the emergency as regulators tweak their strategy and requirements about financial stability.

4.4. Empirical Review About GCC Countries

The global pandemic of COVID-19 has imposed severe impacts on the global banking sectors which has also surpassed the financial crisis of 2007 and 2008 (Elsiefy, 2012). The significant downfall of the financial sectors of banks has been witnessed to the economic recession due to the global pandemic. Additionally, Akkas and Al Samman (2021) articulated that the number of investors has stopped investing due to the probability of high risk and this resulted in a major loss approximate of $3 trillion since the pandemic just started. In addition, Alber and Dabour (2020) discussed that the banking sector of the GCC region is being dealt with the lowest downfall in oil price in the last decades which is a terrible phase for Gulf countries which are majorly known as oil-dependent countries. Consequently, the GCC region reported a loss of USSD554 million per day due to the downfall of oil prices. Similarly, to the global banks, GCC banks have also reported a downward trend on the ratio of 20% YTD since the execution of the first lockdown in the UAE (Salman and Ali, 2021). The author further declared that in Dubai, Abu Dhabi, Saudi Arabia, Kuwait, and Qatar investors reported losses regularly of $6 billion, $8.3 billion, $41 billion, $ 2.8 billion, and $11.9 billion respectively in March 2020.

A study conducted by Elsiefy (2012) analyse the financial performance of the Qatar banking sector while considering the following elements which are credit risk, foreign exchange risk, and interest rate risk. The findings of the study revealed that the probability of risk for the conventional bank has been reduced in stressful circumstances whereas the risk for Islamic banks had been raised in stressful circumstances. Furthermore, Ozil and Arun (2020) state that Islamic banks as compared to conventional banks are more likely to be exposed to severe financial crises as Hassan *et al.* (2021) articulated that the probability of credit risk is high for Islamic banks as compared to conventional banks. Concerning this, a study conducted by Mateev *et al.* (2021) revealed that Islamic banks reported a higher probability of credit risk at the time of the 2008 economic crisis.

5. Methodology

The study is associated with the banks' performance which would require a review of the profitability of the banking sector. The variables used for the profitability of banks are profit margin, earnings per share, liquidity, return on assets, and return on equity. Data will be extracted from banks' websites or other relevant websites where available. The methodology used is a secondary quantitative design where data has been collected from annual reports of banks. The sample would be the data of 20 banks in GCC for the years 2018-2020. The data will be analyzed using descriptive and graphical analysis to assess the impact of COVID-19 on banks' financial performance, the movement in graphs will identify how COVID has affected the banks' performance in GCC countries.

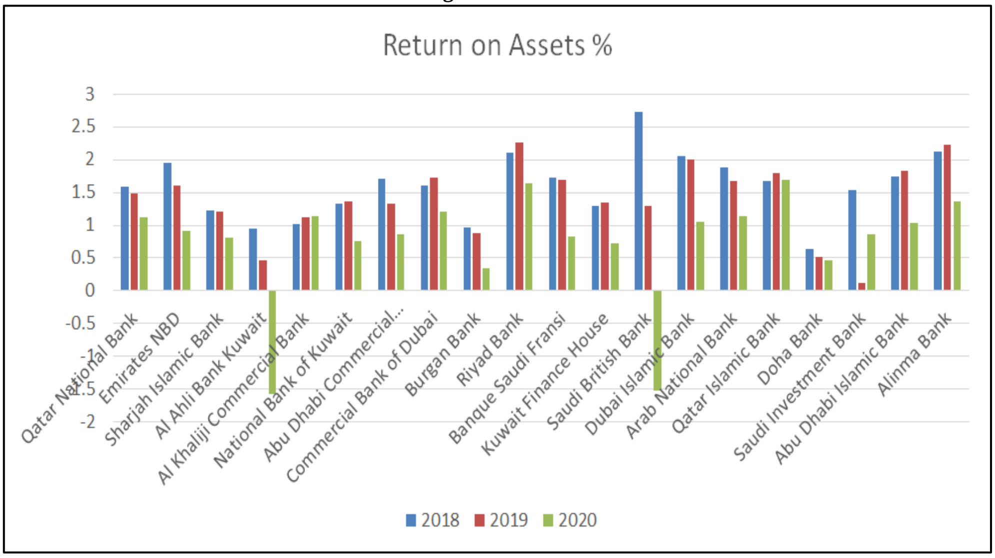
6. Results

This section presents the findings and results of the GCC banking sector in which a total of 20 different gulf banks are selected to evaluate the impact of Covid-19 on the financial performance of the banking sectors. Following are the fundamental financial key ratios considered to examine the financial performance of banks from the gulf region. The presented data consist of three years from 2018 to 2020, in which the year 2018 shows the banks' performance before COVID-19. On the other hand, 2019 and 2020 considered to examine the during and post COVID-19 impacts.

7. Return on Assets

Figure 1, shows the flow of return on assets ratio of the Gulf banking sector. The graph presents an increased return on assets in 2018 which is the period before COVID-19 as it is visible in the figure below that Saudi British bank reported the highest ratios in 2018; however, the same bank reported negative ROA% in 2020. Correspondingly, Al Ahli Bank of Kuwait reported a negative ROA% ratio in 2020. Similarly, the remaining banks also reported a decreased ROA% ratio in the year 2020. Though, it is very clear that there is a significant negative impact of COVID-19 on Gulf banking sectors as several banks cannot utilize their assets effectively in order to generate more income to enhance their financial performance.

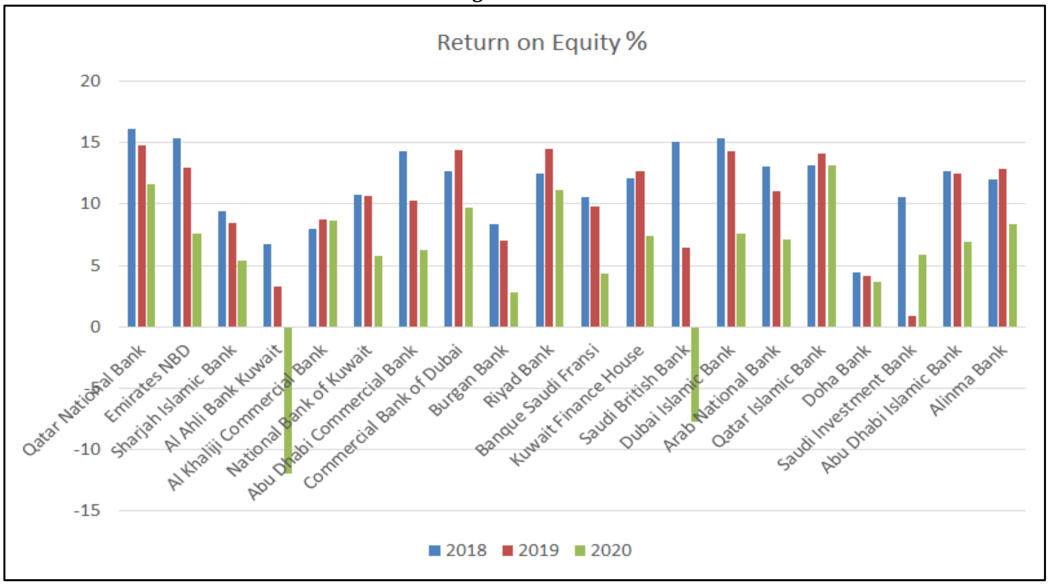
Figure-1. RoA%



8. Return on Equity

Figure 2 shows the flow of ROE% of Gulf banking sectors from the year range of 2018 to 2020. A number of banks from the Gulf region reported a slightly increased ROE% ratio in the fiscal year of 2019 as compared to 2018. For example, the ROE% ratio of Riyadh bank has increased by 1.98%, significant raise. However, the same bank reported decreased ROE% in the fiscal year of 2020 which shows that Riyadh bank is in financial distress during the global pandemic of COVID-19. On the other hand, it has been found that Qatar Islamic bank has effectively comprised its financial performance as the bank reported a 13.17 ROE% ratio in 2020 which is very close to the ratio of 2018. Nevertheless, the overall results do not show favourable outcomes during and post COVID-19. Hence, it would not be wrong to state that the banking sector of the Gulf region earned slightly low as compared to shareholder's equity.

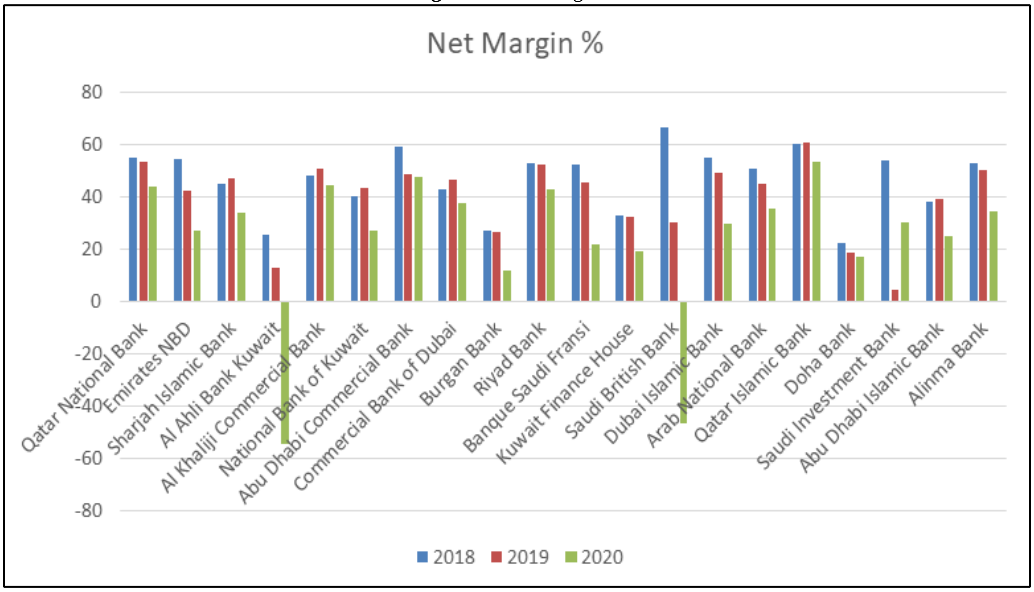
Figure-2. RoE%



9. Net Margin

Figure 3 shows earned profit ratio of Gulf banking sectors from the year range of 2018 to 2020. As it has been found that the net profit margin ratio of Gulf banking sectors is low in the fiscal year of 2020 as compared to the fiscal year of 2018. Moreover, few of them reported negative net profit margin ratios; for example, Al Ahli Bank of Kuwait and the British bank of Saudi Arabia. Reports show that Saudi British Bank reported a 66.75% of net profit ratio in 2018 which seemed like the highest ratio in the figure below. Although, the same bank reported a negative net profit margin ratio of -46.56 in the annual year of 2020. Likewise, Al Ahli Bank of Kuwait reported a 25.42% of net profit ratio is 2018 whereas he same bank reported a negative net profit margin ratio of -54.78% in the annual year of 2020. Though, it is obvious that COVID-19 has negatively influenced the Gulf banking sectors as a number of banks report high production cost than their total annual revenue due to the restrictions on international trade because of the global pandemic.

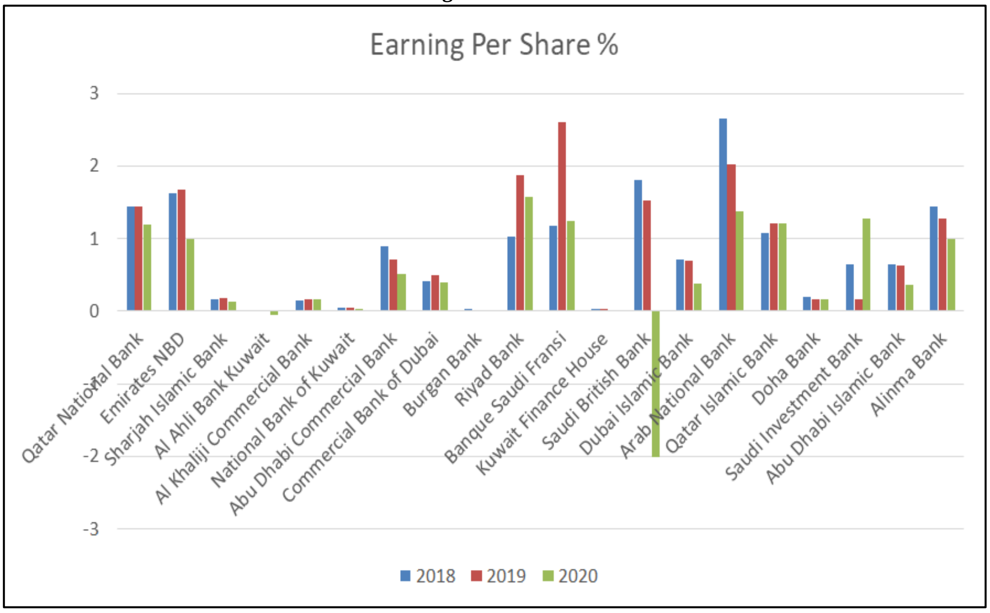
Figure-3. Net Margin %



10. Earnings Per Share

Figure 4 shows earning per share ratio of the banking sectors of Gulf region. As it has been found that the earning per ratio of most Gulf banks are slightly decreased in 2020 as compared to 2018. For example, the Earnings per share ratios of Burgan bank are 0.03, 0.02 and 0.01 in 2018, 2019 and 2020 respectively. On the contrary, Saudi Investment bank reported a significant rise in the earnings per share ratio in the fiscal year of 2020 (during the period of COVID-19). On the other hand, a few banks reported negative earnings per share ratio such as Saudi British bank and Al Ahli Bank of Kuwait. Inclusively, it has been analysed that COVID-19 has some effects on banks' profit allocation on its outstanding share stock; although, the figures do not show a significant difference.

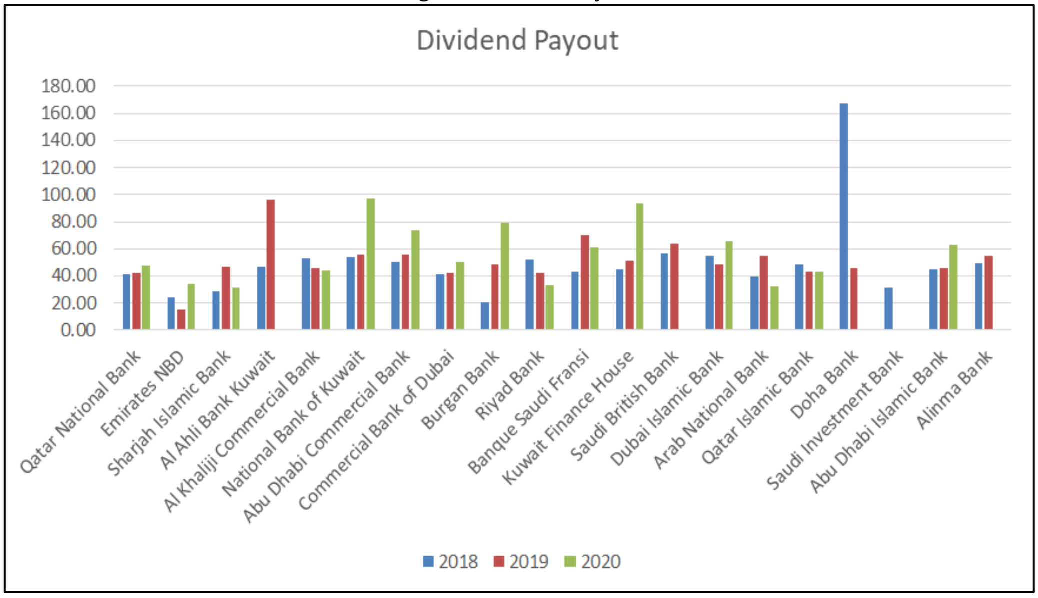
Figure-4. EPS%



11. Dividend Pay-Out Ratio

Figure 5 shows the flow of dividend pay-out ratio of the Gulf banking sector from the year range of 2018 to 2020. The overall findings show positive results as a number of banks reported sustainable dividend pay-out ratio such as Qatar National Bank, Emirates NBD, Abu Dhabi Islamic Bank, Dubai Islamic Bank and Riyadh Bank. Although, few of them reported excessive dividend pay-out ratios such as the National Bank of Kuwait reported a 96.80% of dividend pay-out ratio which is a sign of an unsustainable financial position. Likewise, Kuwait Finance House reported a 93.90% dividend pay-out ratio as it indicates an unsustainable financial position as the bank is expected to pay more than its earnings per share. On the contrary, few banks reported a decreased dividend pay-out ratio such as Sharjah Islamic bank, Al Khalij Commercial bank, Riyadh Bank and Arab National bank. although, Qatar Islamic bank reported a minor decrease in dividend pay-out ratio as the figures are 42.8% in 2019 and 43.4% in 2020. Though, the difference is just 0.6%. hence, it would be wrong to say that the COVID-19 poses a negative on banks' dividend pay-out ratio because the figures show a slight difference. Consequently, the banking sector of the Gulf region has been earning acceptable after paying all the taxes.

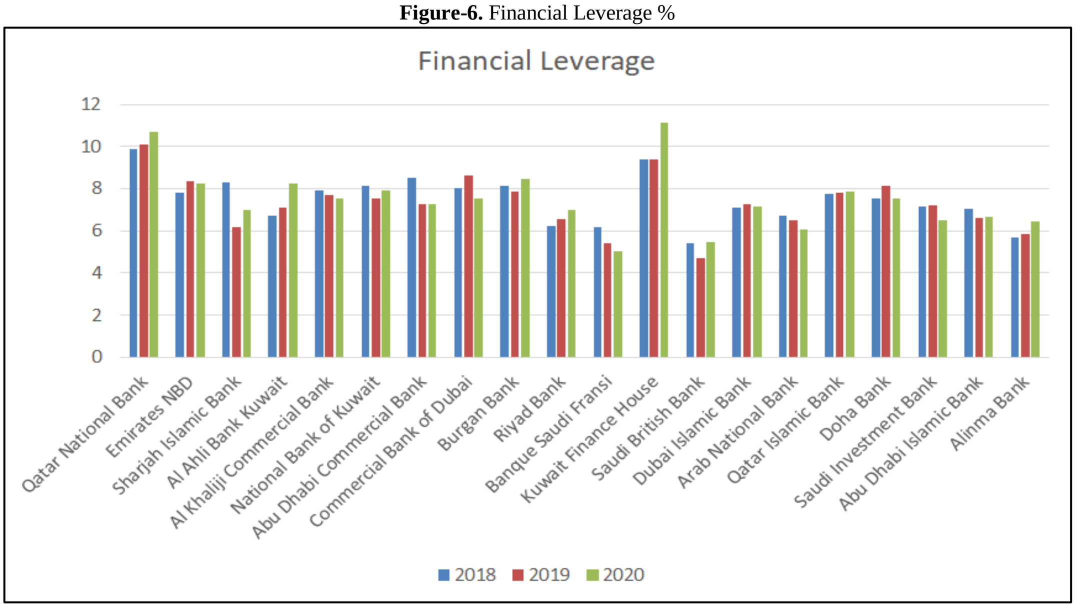
Figure-5. Dividend Pay-out



12. Financial Leverages

Figure 6 shows the flow of financial leverage of the Gulf banking sector from the year range of 2018 to 2020. It is acknowledged to mention that the banking sector of Gulf region reports a higher leverage ratio which indicate higher financial risk. For instance, Kuwait financial house reported highest financial leverage ratio 11.11 as compare to other banks. On the contrary, Banque Saudi Fransi report 5.02 leverage ratio in the fiscal year of 2020 (post period of COVID-19) whereas the leverage ratio is 6.17 in 2018. Though, it indicates favourable financial performance of Banque Saudi Fransi during and post period of COVID-19 where all other Gulf banks face severe financial crisis. Eventually, it can be said that the banking sector of Gulf region face financial crisis and unable to access finance to paying off debt.

Figure-6. Financial Leverage %



13. Discussion

Due to the ongoing global pandemic, the global banking sector has been facing adverse financial crises including the banking sector of the Gulf region. Additionally, Demirgüç-Kunt *et al.* (2021) elaborated that the banking sector is also facing operational challenges due to the restrictions on international trade. Correspondingly, the findings of the current study show unfavourable results for the GCC banking sectors as Asli *et al.* (2020) narrates that the global oil demand is being decreased which is the major cause of concern for the Gulf region. Moreover, the current findings indicate a higher probability of financial risk for the Gulf banking sector as the number of banks reported a higher financial leverage ratio. Similarly, Akkas and Al Samman (2021) articulated that the number of investors has stopped investing due to the probability of high risk and this resulted in a major loss approximate of $3 trillion since the pandemic just started.

Additionally, Hassan *et al.* (2021) claim that Islamic banks are more likely to report severe financial crises. Correspondingly, the current findings support Hassan *et al.* (2021) claim as the banking sector of the Gulf region reported a low net profit margin ratio as compared to European conventional banks (Ozil and Arun, 2020). Additionally, a financial analysis of the Gulf region conducted by Salman and Ali (2021) revealed that investors reported losses regularly by $6 billion, $8.3 billion, $41 billion, $ 2.8 billion and $11.9 billion respectively in March 2020. Moreover, reflected ratios such as return on assets and return on equity shows stable financial position of the Gulf banking sector; although, the ratios became decreased just after the pandemic started. The steady deterioration of ROA and ROE have a significant influence on the net profit margin ratio (Ozil and Arun, 2020). The lower ratio of net profit margin indicates a major interruption in banking operations as the banks face unavailability of cash. However, banks can still maximise the overall profitability if they will become successful to increase the sales volume.

Furthermore, stable financial performance of banks depends on liquidity and profitability therefore, a significant rise in financial leverage ratio indicates more dependency of the bank on its shareholders' equity due to global pandemic and restrictions on international trade. Hence, the banking sector of the Gulf region has been facing increased financial risk due to increase in credit risk as investors stop investing due to uncertain market conditions (Alber and Dabour, 2020). Additionally, number of Gulf banks has reported an increased dividend pay-out ratio which indicates that the banking sector the of Gulf have been earning acceptable after paying all the taxes. Correspondingly, Mateev *et al.* (2021) elaborated that the higher dividend pay-out ratio shows a balancing position of firm's finance as the companies with 30% to 50% of dividend pay-out ratio experienced a stable financial positon. Similarly, the dividend pay-out ratios of the Gulf banking sector are like 47.20 (Qatar National Bank), 44.10 (Al Khaliji Commercial Bank), 50.50 (Commercial Bank of Dubai), 33.20 (Riyad Bank) and 43.30 (Qatar Islamic Bank) during and post period of COVID-19. On the contrary, Asli *et al.* (2020) described that the companies with more than 50% of dividend pay-out ratios indicate unsustainable financial stability which cannot be considered as prolonged period. Respectively, National Bank of Kuwait reported the highest dividend pay-out ratio of 96.80 which also indicates unsustainable financial position as the bank is expected to pay more than its earning per share.

Hence, the current study's findings are meaningful as the data has been collected of three years in order to thoroughly review the key ratios of before, during and post period of COVID-19. Inclusively, the overall financial risk is in-lined with challenging economic condition such as the global pandemic and restrictions on international trade. Though, the financial stability of the banking sector is being under pressure during and post period of COVID-19 as evidenced by low net profit margin ratio. Though, it has been analysed that the global pandemic of COVID-19 has negatively influenced the overall financial performance of the banking sectors in the Gulf region.

14. Conclusion

The current study aimed to analyse the impact of Covid-19 on the financial performance of the banking sectors in the Gulf region and in order to achieve the research aim, a financial ratio analysis has been conducted. The key financial ratios such as return on assets, return on equity, net profit margin, earnings per share, dividend pay-out and financial leverage ratio are being considered to evaluate the financial performance of the Gulf banking sector Though the data has been collected from the banks' annual report and other official financial websites from the year range of 2018 to 2020. Further, the current study's findings revealed that the overall financial performance of the Gulf banking sector has been negatively affected by the global pandemic of COVID-19.

Inclusively, the results indicate that the overall performance of banks has been affected as evidenced by lower ratios in terms of profitability, credibility and financial leverage. Although, the financial position of banks was stable before the pandemic, although, the ratios became steadily decreased just after the pandemic started. In the support of literary evidence, the steady decrease in the global demand for oil has been found as the major cause of concern for the unstable financial position of the Gulf banking sector. During and post period of COVID-19 reflects a downward trend in increasing dependency of banks on shareholders' equity. Conclusively, the overall financial performance of banks has been deteriorated due to the global pandemic which slow down the economic condition.

15. Policy Implications

The current findings have revealed that the liquidity level of the Gulf banking sector has reached an extreme level of liquidity. This has been bank extracted as mostly all the Gulf banks reported high financial leverage ratios which indicate higher financial risk. Despite such financial crises, the banking sector of the Gulf region has managed profit allocation on its outstanding share stock as evident by the maintained earnings per share ratio. Low leverage and limited exposure to foreign conventional banks enable them to maintain their capitalisation. From the current findings and along with the support of literary evidence, it has been observed that the global economic crisis due to the COVID pandemic and restrictions on international trade, negatively affect the profitability level of global banking sectors. However, the difference in the financial ratios of the Gulf banking sector is significant because the number of considered banks are Islamic.

Moreover, it has been recommended to the Gulf banking sector that banks should aggressively increase their loans portfolios and develop sound credit risk management policies to overcome the financial crisis. As the restrictions on international trade were found as a major cause of the financial crisis during the period of COVID-19. Subsequently, the banking sector of the Gulf region should measure financial crisis and risk on a consistent approach while following a sensible way of exit along with sustainable long-term strategies. Additionally, the banking sector should also go for online sales during the period of the global pandemic, via updating their social networking sites.

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