Financial Stability of Islamic Banks: A Review of the Literature

AKEEM KOLAWOLE ODEDUNTAN[1] AND ABIDEEN ADEYEMI ADEWALE[2]

[1] Oaksprings Educational Services, Nigeria, ak.odeduntan@oakspring.com.ng
[2] International Islamic University Malaysia, abidewale@iium.edu.my

Abstract— **The recent global financial crisis that began in the US and spread sporadically to other parts of the world has been a sort of awakening that financial stability of financial institutions should be on check from time to time. This scenario has called for a concerted effort that may possibly be geared towards introducing a framework or policy that tends to promote and sustain economic growth and stability. The present paper therefore reviews financial stability of banks by surveying the extant literature on the subject. It employs library method to gather information and further analyze it by way of comparative, inductive and deductive methods. The paper establishes that while some Islamic banks are relatively stable in terms of their financial activities, some banks are not.**

Keywords-component; Global financial meltdown; Islamic finance; Financial stability

I. INTRODUCTION

Islamic finance industry has shown a tremendous growth in the last three decades. Its cross-border activities have also maintained a steady growth. The events of the recent global financial crisis that reached its apex in 2008 will still be fresh in our memories. It is interesting to note that despite the long lasting impacts of the crises on many conventional banks across the globe, Islamic banks were largely found to be insulated from it. This feat is connected with the fact that Islamic finance operates in an environment that is highly regulated under the principles of Shariah which prohibit investments in any type of instruments except those ones that are found to be compliant with the Islamic principles of transaction. Consequently, this impressive growth rate of Islamic finance and its stability during financial crisis and beyond have continued to attract the attention of many policy makers and financial experts worldwide. While applauding the success and growth of Islamic finance, researches have shown that participating banks (like Islamic banks) were either not or less affected by the global financial crisis than their conventional peers. The reason for this the study claimed is attributable to its nature which emphasizes participating banking wherein all financial transactions are trade-based and asset-linked.

Meanwhile, financial stability remains an essential tool for economic growth because most transactions in the real economy are made through the financial system. Realizing the role of the banking sector (as a main financial service sector) in the overall economic development, the stability and growth of any economy depend to a large extent on the stability of its banking sector. It among others serves as an intermediary that links surplus and deficit units and facilitates funds for productive purposes. This explains why the term ‘financial stability’ has continually drawn attention in both academic and professional realms since we all have got to draw lessons from the global financial meltdown. Reviewing the extant literatures on the financial stability of Islamic banks, we found that only few researches have been carried out and their findings are accessible for all inquisitive minds. In the literature as well, some writers and authors such as Cihak and Hessel (2008) have tried to examine the financial stability of Islamic banks within a large geographical territories; others have tried to contrast financial stability of Islamic banks with their conventional counterparts. Studies by Umar Islam Muhammad and Kozokov Shakhboz (2009) as well as Sitti Rohaya Mat Rahim, Norsilawati Mohd Hassan and Roza Hazli Zakaria (2012) belong to this category.

Nevertheless, some other researchers like Said Ali (2012) have concentrated their studies on the risk management and performance or efficiency of Islamic banks. Meanwhile, overviews of most of these previous studies were actually concentrated on comparison between Islamic and conventional banks. Hence, only little attention or effort has been paid or dissipated as the case may be to examining financial stability of Islamic banks as a whole or as an entity. This is the gap this paper therefore attempts to bridge.

II. ISLAMIC BANKING SYSTEM

In a periodical publication of the Institute of Islamic Banking and Insurance (IIBI) based in London in 2013 titled “Discover new perspective”, Islamic banking is defined as:

> ‘*a system of banking or a banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics’*

Ismail (2010: 3) in one of his academic treatise defined Islamic finance as:

> ‘*Islamic financial institutions that collect and invest money in a way that is in harmony with the rulings of Islamic Shari`ah; where money is exposed to profit and loss. They depend on their transactions in the Islamic finance system which meets all the needs of economic sectors in return for a fixed share of unknown profit rate, thereby making them free of the prohibited usury’*.

Meanwhile, Monzer Kahf (2007) gave the guiding precepts of Islamic financing which according to him is basically very simple. Islamic finance as practised could be said to rely on a combination of three principles comprising sharing, leasing and sale; as a result funds are channeled to entrepreneurs through sale, sharing and lease contracts. Kahf maintained that this process of Islamic finance is in line with growth and development of any economy that indulges in it. First of all, Islamic finance is directly linked to real economy through the profit participation, the sale and purchase of commodities together with the acquisition and leasing of assets. Besides, ethical and moral values are so much integrated with the financing to such an extent that gambling and other illicit activities which are often as a result of self aggrandizement and greed do not get funded, while devoting resources to charity and welfare needs. Last but not least is the fact that in Islamic finance participatory financing has substituted lending; this therefore facilitates a kind of relationship that is rooted on profit-generating activities between the financier and entrepreneur.

III. DEFINITIONS OF FINANCIAL STABILITY

It is important to note that there is no broadly acceptable definition of financial stability. Different authors and writers perceive it from different angles; this is connected with their divergent backgrounds and orientations. However, a basic reason for this divergence of opinion, according to Schinasi (2004) is that the term ‘financial stability analysis’ is still relatively new in terms of development and practice unlike monetary and macroeconomic stability analysis that have fully been developed. Against the backdrop, Alawode and Al Sadek (2008) identified two schools of thought in the literature with respect to the definition of financial stability. There is a school of writers that prefers to define financial *instability* while there is another school that attempts to define financial *stability*. A few of these definitions from different perspectives and schools that are considered for the purpose of this paper are briefly described as follows:

Citing the European Central Bank’s publication entitled ‘Financial Stability Review’ (2012), financial stability was described as:

> “*A circumstance where the financial system (i.e. financial intermediaries, markets and market infrastructures) is able to withstand shocks, thereby reducing the possibility of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities*”

Further, the Bank Negara Malaysia (Central Bank of Malaysia) defines financial stability as:

> “*The condition where the financial intermediation process function smoothly and there is confidence in the operation of key financial institutions and markets within the economy*”

In the same vein, the financial stability report (2008) of the Central Bank of Bahrain defines financial stability as

> “*a situation where the financial system can function prudently, efficiently and uninterrupted, even in the face of shocks*”

Foot (2003) opined that certain factors exist that contribute to enhance finance stability. These factors according to him must take place before financial stability can be ensured. They are: monetary stability; employment levels being close to the economy’s natural rate; confidence in the operation of the generality of key financial institutions and markets in the economy; and the price movement being relatively real or financial assets within the economy that undermines monetary stability and the level between employment and economy’s natural rate.

A review of the foregoing definitions actually portrays financial stability as a broad concept that comprises different aspects of a financial system in terms of infrastructure, institutions and markets. These definitions on a general note reveal that the ability of a financial system to survive any economic pressure or stress is termed financial stability.

However, in the study of Davis (2001) systemic risk and financial instability is defined as

> “*a heightened risk of a financial crisis*”.

Equally, the author described a financial crisis as:

> “*a major collapse of the financial system, entailing inability to provide payments*

> *services or to allocate credit to productive investment opportunities*".

Ferguson (2003) in his study described financial instability as:

> "*A situation characterized by three basic criteria. These are: the seemingly sharp divergence of some important set of financial asset prices from fundamentals; significant distortion of market functioning and credit availability, domestically and perhaps internationally; and finally, the significant deviation of aggregate spending either above or below, from the economy's ability to produce*"

Chant (2003) defined financial instability as:

> …conditions in financial markets that harm or threaten to harm an economy's performance through their impact on the working of the financial system

Allen and Wood (2006) referred to financial instability as:

> episodes in which a large number of parties, whether they are households, companies or (individual) governments, experience financial crises which are not warranted by their previous behavior and where these crises collectively have seriously adverse macro-economic effects

All the above definitions of financial instability paint a picture of a financial system in all its ramifications that fails or is incapable of withstanding any given economic shock or impending economic crisis.

From the above definitions, it may be deduced that the divergence of opinions of the scholars are primarily in terminologies. The use of terms by different schools of thought was basically to express their minds in the best possible form. This is because both schools acknowledge the importance of a financial system and its effectiveness or otherwise. An effective financial system ensures financial stability of an economy while an ineffective one contributes in no small means to the economy's financial stress and meltdown.

IV. MAINTAINING FINANCIAL STABILITY

Khwan and Muljawan (2008) argued that financial stability depends on several factors. Some of them according to the authors are the extent to which the owned funds are put in place by the owners of financial institutions, the level of transparency and disclosures, effectiveness of banking supervision and presence of efficient financial infrastructures as well as legal frameworks. In the view of Chapra (2008) who posited that one of the measures of enhancing financial stability is to strengthen market discipline. This, he believed, could be achieved through promoting risk sharing by greater reliance on equity. Another means of achieving market discipline according to the author is to tie the availability of credit to the real economy. Moreover, Chapra (2008) held that financial stability can be enhanced by curbing speculation as well as establishing the required support institution for the industry.

The need to ensure financial stability in Islamic banks has propelled the world bank and International Monetary Fund (IMF) quoted by Cihak and Hesse (2008) to propose some basic observations that must be taken into cognizance when assessing stability in a given financial system particularly in the context of Islamic banking. These observations are as follows:

1. The Profit and Loss Sharing financing exposes Islamic banks to risks that ordinarily should be borne by equity investors rather than holders of debt;
2. Profit and Loss Sharing should not be made dependent on collateral or guarantees to reduce credit risk;
3. Profit and Loss Sharing modes expose Islamic banks to more operational risk;
4. Product standardization becomes more difficult as a result of the multiplicity of potential financing methods, increasing operational risk and legal uncertainty in interpreting contracts;
5. Islamic banks should use fewer risk-hedging instruments and techniques than conventional banks;
6. Non- Profit and Loss Sharing modes of financing are less risky and more closely resemble conventional financing facilities, but are also associated with risks (such as elevated operational risk in some cases) that need to be recognized;
7. A specific risk inherent in Islamic banks stems from the special nature of investment deposits, whose capital value and rate of return are not guaranteed.

V. FINANCIAL STABILITY OF ISLAMIC BANKS

In reviewing financial stability of Islamic banks, the study of Mat Rahim, Mohd Hassan and Zakaria (2012) is one of the few in the line of the subject of this paper. Mat Rahim, Mohd Hassan and Zakaria (2012) employed z-score model to find out whether Islamic banks were less or more stable than conventional banks. The study collected data from 17 Islamic banks and 21 conventional banks from their annual reports (consolidated and unconsolidated) in Malaysia. The time-frame covered in this study was 2002-2010. The result of the z-score model specification and NPL analyses indicated that there was significant difference between Islamic banks and conventional. Nonetheless, the difference found was that Islamic banks had significant result towards risk with respect to cost-income ratios, Herfindahl Index, GDP and of course inflation. In other words, the findings revealed that Islamic banks were more stable than their conventional counterparts.

Said (2012) in his study measured efficiency in Islamic banking during the global financial meltdown. Owing to the fact that Islamic bank promotes equity based model adopted the Data Envelopment Analysis (DEA) model. His data were collected from the financial statement of 47 Islamic banks having critically analysed the end of the year balance sheet and income statement. For efficient analysis, the author classified Islamic banks covered in the study based on size and region; thus, giving mention of small and large sized banks on one hand and middle-eastern and non-middle eastern banks on the other hand. The study concluded that large Islamic banks had a boost in efficiency during 2006 to 2008 crises but declined in 2009. In contrast, however, small to medium banks witnessed lower level of efficiency at least at the initial stage. More so, Said (2012) concluded that the efficiency of Islamic banks improved appreciably during the economic crises at both regions: middle-eastern and non-middle eastern countries.

Furthermore, Cihak and Hesse (2008) studied the financial stability of Islamic and Conventional banks. All relevant were collected data from bank-scope database; due to availability to information, the data collected was on unconsolidated bank statement. Anyway, the study encompassed 77 Islamic banks and 397 conventional banks over a period of 1993 to 2004. The study which adopted Z-score model to analyze its data found that Islamic banks were more likely to be sound and stable than conventional banks. The result of the analyses also showed that large Islamic banks were less stable than both small Islamic banks and large conventional banks; while small Islamic banks were quite as stable as small conventional banks. In other words, the findings of the study revealed that small Islamic banks have a propensity to be financially stronger than conventional banks; when large conventional banks are possibly stronger than large Islamic banks.

The study of Cihak and Hesse (2008) also found that small Islamic banks were financially stronger than large Islamic banks. Thus, the research concluded that Islamic banks could be said to be more stable when on a small scale but were less stable when operating on a large scale. The reason advanced for the less stability of large scale Islamic banks is that they find it more complex to regulate their credit risk monitoring system as they expand. In the same vein, Cihak and Hesse (2008) asserted that the consequential effect of inappropriate credit risk management is that various profit and loss arrangements will become very much more complicated as the banking operation experiences growth; thereby resulting in the prevalent of adverse selection and moral hazard. However, the findings showed that small banks do not share this with big ones. Small banks are more stable as they concentrate on low-risk investment and fee income while large banks do more of profit and loss business.

Albeit, transactions in Islamic banks (and other related financial institutions) are totally free from interest, movements in the interest rate have significant effects on the performance of Islamic banks. This was the outcome of a study conducted by Zairy and Salina (2012) that centered around a review of the literature on the rate of return and risk in Islamic banks. The authors maintained that development of Islamic banking alongside with the conventional banking system poses several problems while the persistent reliance on conventional market interest rate as benchmark due to absence of an Islamic index rate of return at the moment increases the sensitivity of Islamic banks to the changes in the interest rate. This, ultimately, contributes to the stability or otherwise of the Islamic financial system. As a way out of this impediment, Islamic banks should therefore create their own instrument that can be adopted in setting their rate of return.

Wahida and Robin (2010) in their study compared efficiency of Islamic banks and Conventional banks in Turkey, Germany and United Kingdom. The study which covered the period from 2005 to 2008 adopted a non-parametric method as a measure of efficiency. The authors found that Islamic banks were more efficient than conventional. This meant that there was lower cost efficiency for Islamic banks as against their conventional counterparts in Europe.

According to the authors, even though, the values of asset of Islamic banks were not as much as that of the conventional banks, Islamic banks were still efficient especially in terms of cost. The implication of this is that based on the outcome of the study Islamic banks have cost control mechanism as compared to conventional banks. It is therefore proven empirically that Islamic banks were more efficient in the three European countries than conventional banks.

The problem facing Islamic banks according to the study is the choice of input price mix. This is because the sources of inefficiency do not arise from managerial issues. Meanwhile the reason for efficiency of Islamic banks as noted above is that they seized the opportunity of the existing competitive atmosphere in the European integrated banking market. They also exploited favorable economic environment and banking innovations in 2007. This, thus, supports the hypothesis of market power and efficiency, the quiet life hypothesis in which more integrated market Islamic banks improve management effort to maximize operating efficiency. So, the more the competition in the European market, the higher the pressures of cost control in Islamic banks.

Furthermore, Beck, Demirgul-Kunt and Meriouche (2010) in their paper titled Islamic vs. Conventional Banking found that Islamic banks are more cost-effective in a large samples of countries. However, in countries where both Islamic and conventional banks exist side by side, conventional banks are proven to be more cost-effective than Islamic banks. The study observed some variation of efficiency and stability of conventional banks across countries with different market shares of Islamic banks. This suggests that in countries where the market share of Islamic banks is higher, conventional banks tend to be more cost-effective but less stable.

Beck, Demirgul-Kunt and Meriouche (2010) also found that during the recent global financial meltdown, little differences existed between the performance of Islamic and conventional banks. The only differences lie in the fact that Islamic banks were able to increase their liquidity holding and capitalization in the run-up and even during the crisis. This scenario gives a picture of why the stocks of Islamic banks perform better during the meltdown than their conventional counterparts.

The authors revealed that even though Islamic banks are significantly more profitable and better capitalized than conventional banks, their returns tend to be much more volatile. In other words, they are closer to insolvency than conventional banks. Besides, the study found that larger banks whether Islamic or conventional were more efficient due to scale economies. This may make them engage in fee-based business and have easier access to wholesale market. The authors concluded that Islamic banks are more efficient than conventional banks and have higher capitalization ratio. However, they are constraint in the sense that they are not stable as compared to the conventional system.

In comparing the efficiency of Islamic and conventional banks, Hussein (2004) collected his data from Bahrain banks and had his samples varied across banks. Also, he selected eight Islamic banks consisting one commercial and seven investment banks as well as eight conventional banks comprising five commercial and three investment banks. The study revealed that in general sense the performance of commercial banks is more stable than investment banks. The reason for this according to the author is as a result of the fact that investment banks are more vulnerable to external shocks. Also, he argued that the difference between profit efficiency in Islamic and conventional banks is not unconnected with the performance of commercial rather than investment banks.

Based on the outcome of his findings Hussein (2004) concluded that generally speaking Islamic banks performed better than their conventional counterparts. The author further argued that the difference between profit efficiency in Islamic and conventional banks is not unconnected with the performance of commercial rather than investment banks.

Similarly, Farook, Hassan and Qinch (2012) assessed the overall differences in the financial stability of Islamic banks in comparison with conventional banks. The data collected comprised 50 Islamic banks and 150 conventional banks covering the period 1991 to 2005. All necessary data were sourced from Bank-scope's database. Z-score was utilized as a measure of financial stability and the outcome of their findings showed that Islamic banks are not as stable financially as their conventional peers. The study specifically purported that while small Islamic banks are more financially stable than conventional banks, large Islamic banks were found to be less stable.

In the same token, Shahid and Abbas (2012) in their work adopted Z-score and econometric model to study the financial stability of Islamic banking in Pakistan. The authors used the annual financial data for 2006 to 2009 covering all the 6 Islamic banks that are operational in Pakistan and top 10 conventional banks (i.e. based on the ranking of Credit Rating Agency). Their outcomes showed that small Islamic banks seem to be stronger than small conventional banks as well as large Islamic banks. Large Islamic banks on the other hand were found to be stronger than large conventional banks. However, conventional banks proved to be more efficient than other banks.

Similarly, Rajhi (2012) considers the channels through which the global financial meltdown would affect Islamic banks. The author empirically assessed the relative financial strength of Islamic and conventional banks based on evidence covering individual banks in 16 banking systems. Using z-score and a robust quantile estimation model, the study explored causes of insolvency risk in the Middle East and North Africa (MENA) and Southeast Asian countries, by controlling for various factors, bank-by-bank data, macroeconomic and other system-wide indicators. The sample covers 467 conventional banks and 90 Islamic banks for the period 2000-2008. The main research result shows that different methods have confirmed the risk of insolvency in MENA and Southeast Asian countries. This, according to the author, is in contrast to the findings of several authors who did not detect a risk of insolvency in these countries.

In a study by Hussein (2010), financial stability in the banking sector was measured using three indicators which includes ROAV, Tobin Q and bank liquidity. The data was obtained from bank-scope and the sample drawn cut across six countries for the period from 2000 to 2007. The countries in their study are Bahrain, Kuwait, Qatar, Saudi Arabia, Oman and United Arab Emirate (UAE). The sample comprised 194 banks out of which 50 are Islamic banks and I44 are conventional banks. Their findings with particular interest on liquidity showed that even though Islamic banks are more capitalised than their conventional counterparts, liquidity in the banks within the Gulf Coperation Council (GCC) countries are not determined by bank-specific factors. Rather, external factors to the banks such as macro economic and market behaviour do have a significant relationship with liquidity of banks.

Ali (2012) examined the impact of the Islamic banks market structure on the overall bank risk using Z-index. The research adopted bank-level data from 39 full-fledged Islamic banks in 17 selected countries. The outcome of the reserach revealed high overall Islamic bank stability. The result of the Z-index showed that Islamic banks enjoyed higher franchise value and greater stability. The author, however, concluded that the Z-index result suggested that the investigated Islamic banks might have used their market power to increase their financing rates which led to inrease in the credit risk. This, however, protects their charter value in the form of risk sharing rule and high capitalisation level. Hence, the researcher concluded based on the outcome of his study that Islamic banks are financially stable. The result of their concentration structure coupled with in-built prudential regulations from Shariah butressed this fact. Little wonder Islamic banks are more conservative inlending and selecting their investment portfolio.

Mat Rahim and Zakaria (2013) examined relative stability between Islam and conventional banks in malaysia. The relevant data was sourced from the banks‘ annual reports as well as consolidated and unconsolidated bank statement for various financial institutions in Malaysia. This was gathered online and also from published copies. The time-frame for analysis is from 2005-2010, a total of six years. Data was collected from all the existing Islamic banks and conventional banks in Malaysia. The result of the finding shows that Islamic banks are relatively more stable than conventional banks even though factors affecting the duo's stability are similar, except for the degree of diversification in income.

Najjar (2013) utilized secondary data sources which represent annual report of commercial banks in Bahrain for the period of 2005 to 2009 to analyze the financial performance of major banks in Bahrain. The population included all the 109 banks in Bahrain which comprised 82 conventional banks (retail and wholesale) and 27 Islamic banks. The study used a set of ratios including credit risk ratio. With particular concern on the loan to deposit ratio, the finding revealed virtually all the banks in the study showed a decline trend. The reason for this was said to be the impact of financial crisis that had depressed the market making those banks to adjust their lending policies.

Onakoya and Onakoya (2013) investigated the performance efficiency of conventional banks and Islamic banks in the United Kingdom from 2007 to 2011. Four top Islamic banks and five conventional banks were involved and compared on given financial ratios as performance indicators. The data were collected from the financial statements of these banks. This was further transformed into percentages and ratios for easy comparison. The findings showed that Islamic banks are less exposed to liquidity risk and seem to be more cost-effective.

Tabash and Dhankar (2014) supported the standpoint that Islamic finance remains a stable and safe way of financing. The authors attempted in their study to examine the impact of global financial crisis on the key performance ratios of all full-fledged-Islamic banks in the Kingdom of Saudi Arabia (KSA). Time series data from 2005 to 2010 were employed to document the relationship between the performance of Islamic banks and financial stability for all fledged-Islamic banks within the nooks and crannies of the KSA. The study adopted the trend analysis method to compute via Microsoft Excel the yearly financial ratios of Islamic banking sector. This helped to determine liquidity ratios and capital adequacy ratios for the analysis. Equally, One Way Analysis of Variance (ANOVA) was used to test hypotheses using SPSS. The outcome of the empirical results showed that Islamic banking sector was more stable sector in terms of, capital adequacy and liquidity at least in the period under study.

Umar Islam and Kozokov (2009) conducted a study on financial stability of banks. The authors specifically compared financial stability of Islamic banks and conventional banks; the study which adopted z-score model found that the difference is insignificant. We may attribute the little or no difference to the fact that Islamic banks at least as practised in Malaysia are basically debt based which principally deviate from the original principles of profit and loss sharing on which Islamic finance is built. This makes them not too different from conventional banks. Also, the study revealed that conventional banks demonstrated high variability and volatility as weighed against Islamic banks. The reason is simply because Islamic banks are based on basic Islamic banking philosophy that actually prohibits them from investing in highly speculative or leveraged businesses or transactions.

Umar Islam and Kosokov (2009) further compared Islamic and conventional banks using NPL/asset ratio and the results indicated that Islamic banks were stronger than their conventional counterparts in terms of operation. The study also unfolded that Islamic banks had better liquidity situation than conventional. Meanwhile, this result is however contradictory to the findings of Cihak and Hesse (2008) who posited that the loan/asset ratio of Islamic and conventional banks were somewhat similar.

However, the findings of Abdi (2011) do not support the argument that Islamic banks are more stable than conventional ones. Abdi (2011) examines whether there is an empirical evidence to substantiate the assertion that Islamic banks are more stable than conventional banks in general and more specifically during the global financial crisis. Using regression and descriptive statistical tools to analyze his data, the outcome of the study showed that Islamic banking is less stable than conventional banking in countries where both types are systematically important for the banking system such as the Middle East and South East Asia. The author, however, concluded that there are signs that point to the fact that Islamic banking is improving its performance in this regard.

VI. SUMMARY

Invariably, the paper avails us the opportunity of appreciating Islamic finance especially in this contemporary age. Principally, Islamic banking and finance is an industry that follows the dictates of the divine guidance. Although it is a nascent industry in relation to conventional method, it has the potentials of not only bringing banking to the door steps of the individuals irrespective of their religious indoctrination but also making financial instability a thing of the past. Therefore, a holistic analysis of the extant literatures reviewed in this paper reveals that Islamic banks on a general term are financially stable either during or after the global financial crisis and are able to withstand any financial shocks.

VII. CONCLUSION

This paper attempts to provide a comprehensive review of the financial stability of Islamic banks particularly during and after the recent global financial crisis which still has a severe loss on the world economy. In a nutshell, many authors have continued to prove either through empirical studies or theoretical analysis that Islamic banks are financially stable even during the unprecedented financial crisis that rocked the entire world. It must however be emphasized based on the outcome of our study that the excessive dominance of debt financing model that is prevalent in most of these Islamic financial institutions can hamper the development that trail Islamic finance in this contemporary age. Furthermore, having understood the fact that the success of this nascent industry lies on innovation and designing products that meet the needs of the customers; the attitude of some practitioners who are fond of introducing policies and products that are dressed up conventional practices and loan structure in Islamic finance need to be wary of the consequences of their action. Rather, the basic objective of Islamic finance should be the driving force. This paper therefore concluded that even though Islamic banks are found to be financially stable, except in few instances; caution must be exercised by all stakeholders who are driven only by profit or dividends while underplaying the very essence of Islamic Finance, the *Maqasid Shariah* (the goal of Shariah). In other words, the stakeholders should appreciate the overall goal of Islamic finance in their conducts so that all and sundry will benefit from the opportunities Islamic finance offers.

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