ISLAMIC BANKING AND PERFORMANCE IN THE ASEAN BANKING INDUSTRY: A TOPSIS APPROACH WITH PROBABILISTIC WEIGHTS

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ABSTRACT

This paper uses an integrated two-stage approach to assess the performance of 88 ASEAN (Association of Southeast Asian Nations) banks from 2010-2013. The relative importance of different financial ratios that emulate the CAMELS rating is collected using the expert opinions of 88 ASEAN bank managers with the help of a structured questionnaire. The computation of empirical joint probabilities is used first to derive weights for a number of criteria related to Capital adequacy, Asset quality, Management quality, Earnings, Liquidity, and Sensitivity to market risk. In the second stage, these weights are used as TOPSIS (Technique for Order of Preference by Similarity to Ideal Solution) inputs to assess the relative efficiency of ASEAN banks. The results reveal the prominent role of Islamic principles in banking efficiency. More specifically, these beneficial results are found when banks are private. We then use our results to develop policy recommendations.

Keywords: Islamic Banking; Probabilistic Weights; TOPSIS; CAMELS; Performance Evaluation.

1. INTRODUCTION

Accurately predicting financial performance and providing proper guidelines builds investors’ confidence. Measuring the performance of the banking sector has remained significantly important for decades due to its unparalleled contribution in economic development and sustainability (Liu, Lu, Lu, & Lin, 2013a, 2013b). Thus, policy implications often rely on the proper measurement of bank performance. Thus far, bank performance measurement techniques are normally categorized into two main groups: parametric and non-parametric (Berger & Humphrey, 1997; Lampe & Hilgers, 2015; Sengupta, 1993). The Stochastic Frontier Approach (SFA) is the most popular parametric test (Sengupta, 1993). Among the non-parametric tests, Data Envelopment Analysis (DEA) is the most popular (Liu et al., 2013b; Paradi & Zhu, 2013). Due to some major advantages in ease of use and interpretation of benchmarking, non-parametric methods

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