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**ANALYSIS OF FINANCIAL PERFORMANCE OF THE
COMMERCIAL BANKS IN THE GULF COOPERATION
COUNCIL (GCC) COUNTRIES**

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UUM

Universiti Utara Malaysia

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By

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UUM
Universiti Utara Malaysia

**Thesis Submitted to
School of Economics, Finance and Banking,
Universiti Utara Malaysia,
In Fulfillment of the Requirement for the Degree of Doctor of Philosophy**

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ABSTRACT

Research on performance of banks in the Gulf Cooperation Council (GCC) countries is very limited despite being one of the key global banking markets, main suppliers of oil around the globe, and economies that attract significant foreign direct investment (FDI). Hence, this study provides new insight on bank performance using bank-specific, macroeconomic, and financial structure indicators. Using the generalized method of moments dynamic model estimation, this study analyses the performance of banks in GCC countries over the period from 2000-2015. This study finds that the performance of foreign banks is better than that of domestic banks and the performance of listed banks is better than that of unlisted banks. The results show that there is a significant direct impact of oil price shocks, FDI inflows, and financial crisis on bank performance. It also finds that the bank-specific factors, macroeconomic factors and financial structure indicators are significant determinants of bank performance. In terms of theories, the study finds evidence to support the moral hazard theory, competition-stability theory, defensive expansion theory and traditional intermediation theory (except Bahraini banks). The results are also robust when controlling for the Arab Spring transition period as well as when using alternative risk and bank competition measures. The results show that Arab Spring increases bank risk. The findings of this study have major policy implications. Gulf authorities need to enhance bank protection against risk by improving the application of Basel III especially during the crisis period like the Arab Spring. Gulf Banks also need to track the changes in oil prices as this also have impact on bank performance. There is a need for some ease of restrictions on the entry of foreign banks in the domestic market in the Gulf countries (except for Bahrain) as it can enhance bank performance.

Keywords: bank performance, macroeconomic and financial structure indicators, financial crisis, Arab Spring, GCC countries.

ABSTRAK

Kajian untuk menilai prestasi bank di negara anggota Majlis Kerjasama Negara Teluk (GCC) amat terhad walaupun negara-negara ini merupakan antara pasaran perbankan utama dunia, pembekal utama minyak di seluruh dunia, dan memiliki ekonomi yang dapat menarik pelaburan langsung asing (FDI) yang signifikan. Oleh itu, kajian ini memberikan wawasan baharu mengenai prestasi bank menggunakan penunjuk spesifik untuk bank, makroekonomi dan struktur kewangan. Dengan menggunakan model anggaran dinamik “*generalized methods of moments*”, kajian ini menganalisis prestasi bank di negara GCC sepanjang tempoh 2000-2015. Kajian mendapati bahawa prestasi bank asing lebih baik berbanding bank domestik dan prestasi bank tersenarai adalah lebih baik berbanding bank yang tidak tersenarai. Dapatan kajian menunjukkan bahawa terdapat kesan langsung yang signifikan dari perubahan harga minyak, aliran masuk FDI, dan krisis kewangan terhadap prestasi bank. Kajian juga mendapati bahawa faktor spesifik bank, faktor makroekonomi dan penunjuk struktur kewangan adalah penentu yang signifikan bagi prestasi bank. Dari segi teori, kajian ini menemui bukti untuk menyokong teori bahaya moral, teori persaingan-kestabilan, teori pengembangan pertahanan dan teori pengantaraan tradisional (kecuali bank-bank di Bahrain). Dapatan kajian juga tidak berubah apabila tempoh peralihan *Arab Spring* (Kebangkitan Arab) dikawal serta apabila menggunakan ukuran-ukuran alternatif untuk risiko dan persaingan bank. Dapatan kajian menunjukkan bahawa *Arab Spring* meningkatkan risiko bank. Penemuan kajian ini mempunyai implikasi dasar utama. Pihak berkuasa negara Teluk perlu meningkatkan perlindungan bank terhadap risiko dengan meningkatkan penerapan *Basel III* terutamanya dalam tempoh krisis seperti *Arab Spring*. Bank-bank negara Teluk perlu juga mengesan perubahan harga minyak kerana hal ini turut memberikan kesan terhadap prestasi bank. Selain itu, terdapat keperluan untuk meringankan sekatan kemasukan bank asing ke dalam pasaran domestik negara-negara Teluk (kecuali Bahrain) kerana kemasukan ini dapat meningkatkan prestasi bank.

Kata kunci: prestasi bank, penunjuk struktur ekonomi makro dan kewangan, krisis kewangan, *Arab Spring*, negara GCC

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TABLE OF CONTENTS

TITEL PAGE	i
CERTIFICATION OF THESIS WORK.....	ii
PERMISSION TO USE.....	iv
ABSTRACT.....	v
ABSTRAK.....	vi
ACKNOWLEDGEMENTS	vii
TABLE OF CONTENTS	viii
LIST OF TABLES	xv
LIST OF FIGURES.....	xviii
LIST OF ABBREVIATIONS	xix
CHAPTER ONE INTRODUCTION	1
1.1 Background of Study.....	1
1.2 GCC Economy Overview.....	7
1.3 Banking Industry in GCC Countries	8
1.4 Problem Statement	11
1.5 Research Questions	29
1.6 Research Objectives	30
1.7 Significance of the Study	31
1.8 Scope of the Study.....	37
1.9 Organization of the Thesis Chapters	38
CHAPTER TWO ANALYSIS OF THE GCC ECONOMIES AND BANKING SECTOR	40
2.1 Introduction	40
2.2 An Analysis of GCC Economies.....	40
2.2.1 Trends of Economic Growth.....	42
2.2.1.1 Trends of Economic Growth in GCC Countries	42
2.2.1.2 Trends of Economic Growth in GCC Countries Vis-à-Vis other Economies	45
2.2.2 Trends of Inflation Rate.....	46
2.2.2.1 Trends of Inflation Rate in GCC Countries	46
2.2.2.2 Trends of Inflation Rate in GCC Countries Vis-à-Vis Other Economies	50

2.2.3	Trends of FDI in GCC Countries.....	51
2.3	GCC Financial Systems Before and After the Financial Crisis	57
2.4	The GCC Banking Sector.....	60
2.4.1	Structure of the GCC Banking Sector.....	62
2.4.2	Trends in Credit Growth of the GCC Banking Sector.....	65
2.4.3	Balance Sheets of GCC Banking Sector: Stylized Facts	70
2.4.4	Financial Soundness Indicators of GCC Countries	75
2.4.4.1	Capitalization	75
2.4.4.2	Asset Quality	77
2.4.4.3	Profitability.....	79
2.4.4.4	Liquidity.....	83
2.4.5	Some of the Key Weaknesses of the Banking Sector in the GCC Countries	86
2.5	Chapter Summary.....	91
CHAPTER THREE LITERATURE REVIEW.....		92
3.1	Introduction.....	92
3.2	Underpinning Theories.....	92
3.2.1	Agency Theory in Financial Intermediation.....	92
3.2.2	Financial Intermediation Theory.....	94
3.2.3	Diversification Theory	96
3.2.4	Internalisation Theory	96
3.2.5	The Structure–Conduct–Performance Theory	98
3.3	Related Empirical Studies	99
3.3.1	Empirical Studies on the Determinants of Bank Performance	99
3.3.1.1	Bank-specific characteristics.....	101
3.3.1.1.1	Cost to Income Ratio.....	101
3.3.1.1.2	Non-Interest Revenues	107
3.3.1.1.3	Opportunity Cost.....	112
3.3.1.1.4	Liquidity Risk.....	114
3.3.1.1.5	Demand Deposits	118
3.3.1.1.6	Market Risk	121
3.3.1.1.7	Non-Performing Loans.....	124

3.3.1.1.8 Loan Loss Provisions	127
3.3.1.1.9 Capital Adequacy Ratio	133
3.3.1.1.10 Loans to Total Assets	142
3.3.1.1.11 Loan Growth	146
3.3.1.1.12 Bank Size.....	149
3.3.1.1.13 Off-Balance Sheet Activities.....	155
3.3.1.2 Macroeconomic Indicators	162
3.3.1.2.1 GDP Growth Rate	162
3.3.1.2.2 Inflation Rate.....	168
3.3.1.2.3 Real Interest Rate	173
3.3.1.2.4 Foreign Direct Investment.....	177
3.3.1.2.5 Oil Price Shocks	182
3.3.1.3 Financial Structure Indicators	187
3.3.1.3.1 Herfindahl–Hirschman Index.....	187
3.3.1.3.2 Stock Market Capitalization.....	196
3.3.1.3.3 Credit to Private Sector	199
3.3.1.4 Listed Dummy	201
3.3.1.5 Global Financial Crisis	205
3.3.2 Foreign Verues Domestic Banks	210
3.3.2.1 Empirical Studies on Foreign Versus Domestic Banks	210
3.3.2.2 The Role of Foreign Banks: Related Literature	218
3.4 Gap in Literature	221
3.5 Chapter Summary.....	228
CHAPTER FOUR RESEARCH METHODOLOGY	229
4.1 Introduction	229
4.2 Research Framework.....	229
4.3 Hypotheses Development.....	231
4.3.1 Foreign Versus Domestic Banks	231
4.3.2 Bank specific Characteristics	232
4.3.2.1 Cost to Income Ratio.....	232
4.3.2.2 Non-Interest Revenues	233

4.3.2.3	Opportunity Cost.....	234
4.3.2.4	Liquidity Risk.....	234
4.3.2.5	Demand Deposits	235
4.3.2.6	Market Risk	236
4.3.2.7	Non-Performing Loans.....	236
4.3.2.8	Loan Loss Provisions	237
4.3.2.9	Capital Adequacy Ratio	238
4.3.2.10	Loans to Total Assets.....	239
4.3.2.11	Loan Growth	240
4.3.2.12	Bank Size	240
4.3.2.13	Off-Balance Sheet Activities	241
4.3.3	Macroeconomic Indicators.....	242
4.3.3.1	GDP Growth Rate	242
4.3.3.2	Inflation Rate.....	243
4.3.3.3	Real Interest Rate	244
4.3.3.4	FDI Inflow.....	245
4.3.3.5	Oil Price Shocks	245
4.3.4	Financial Structure Indicators.....	246
4.3.4.1	Herfindahl-Hirschman Index.....	246
4.3.4.2	Stock Market Capitalization.....	247
4.3.4.3	Credit to Private Sector	248
4.3.5	Listed Bank	249
4.3.6	Global Financial Crisis	250
4.4	Research Design.....	250
4.5	Operational Variables Definition and Their Measurements	251
4.5.1	Dependent Variables.....	251
4.5.1.1	Bank Profitability.....	252
4.5.1.2	Market-Based Performance (Tobin's Q).....	254
4.5.1.3	Bank Risk.....	255
4.5.2	Independent Variables	257
4.5.2.1	Bank Specific Characteristics	257

4.5.2.1.1 Lagged of dependent variable	257
4.5.2.1.2 Cost-Income-Ratio	257
4.5.2.1.1 Non-Interest Revenues	258
4.5.2.1.4 Opportunity Cost	259
4.5.2.1.5 Liquidity Risk.....	259
4.5.2.1.6 Demand Deposits	260
4.5.2.1.7 Market Risk	261
4.5.2.1.8 Non-Performing Loans.....	262
4.5.2.1.9 Loan Loss Provision.....	262
4.5.2.1.10 Capital Adequacy Ratio	263
4.5.2.1.11 Loan to Total Assets.....	264
4.5.2.1.12 Loan Growth	265
4.5.2.1.13 Bank Size.....	265
4.5.2.1.14 Off-Balance Sheet Activities.....	266
4.5.2.2 Macroeconomic Indicators.....	267
4.5.2.2.1 GDP Growth Rate	267
4.5.2.2.2 Inflation Rate.....	268
4.5.2.2.3 Real Interest Rate	268
4.5.2.2.4 FDI Inflow.....	269
4.5.2.2.5 Oil Price Shocks	270
4.5.2.3 Financial Structure Indicators	271
4.5.2.3.1 Herfindahl-Hirschman Index.....	271
4.5.2.3.2 Stock Market Capitalization.....	272
4.5.2.3.3 Credit to Private Sector	273
4.5.2.4 Listed Banks.....	273
4.5.2.5 Foreign Banks	274
4.5.2.6 Global Financial Crisis	274
4.5.2.7 Country Dummies.....	275
4.6 Population and Data Collection	282
4.7 Regression Models	283
4.8 Preliminary Tests of Data analysis.....	287

4.8.1	Normality Test	287
4.8.2	Linearity.....	287
4.8.3	Multicollinearity Test.....	288
4.8.4	Heteroscedasticity Test	288
4.9	Technique of Data Analysis	288
4.10	Chapter Summary.....	293
CHAPTER FIVE ANALYSIS OF RESULTS AND DISCUSSIONS		294
5.1	Introduction	294
5.2	Descriptive Statistics	294
5.3	Normality Test.....	299
5.3	Multicollinearity Analysis.....	301
5.4	Homoscedasticity Analysis	305
5.5	Auto-Correlation Analysis	305
5.6	Regression Analysis	305
5.6.1.	Empirical Results for Profitability Measures	306
5.6.1.1.	Empirical Results for the ROA	306
5.6.1.2.	Empirical Results for the ROE	321
5.6.1.3.	Empirical Results for the NIM.....	328
5.6.2.	Empirical Results for the Market-Based performance (Tobin's Q).....	334
5.6.3.	Empirical Results for the Bank Risk-Taking Behavior	341
5.6.3.1.	Empirical Results for the SDROA.....	341
5.6.3.2.	Empirical Results for the SDROE	352
5.6.4	Robustness Check	362
5.6.4.1.	Regress Bank-Specific Factors with FDI Inflow and Oil Price Shocks	362
5.6.4.2.	Exclusion of Bank Size Variable	364
5.6.4.3	Regress using the ROAA, ROAE, SDROAA and SDROAE.....	364
5.6.4.4	Exclusion of Bahrain and UAE Banks Sample.....	367
5.6.4.5	Replace HHI by Concentration ratio, Lerner Index and Boone indicator	372
5.6.4.5.1	Concentration Ratio	372
5.6.4.5.2	Lerner Index	372
5.6.4.5.3	Boone indicator	373

5.6.4.6	Exclude the Financial Crisis Period 2007-2009	379
5.6.4.7	Using Alternative Measures of Bank Risk-Adjusted Performance.....	379
5.6.4.8	Controlling for the Individual and Time Fixed Effects	383
5.6.4.9	Controlling for the Arab Spring.....	385
5.6.4.10	Winsorize Test.....	390
5.7	Summary of Chapter	392
CHAPTER SIX CONCLUSION AND RECOMMENDATIONS.....		394
6.1	Introduction	394
6.2	Summary of the Study.....	394
6.2.1	Objective Two: Difference between GCC Domestic and Foreign Banks	395
6.2.2	Objective Three: Bank Specific Characteristics	395
6.2.3	Objective Four: Macroeconomic Indicators	397
6.2.4	Objective Five: Financial Structure Indicators	397
6.2.5	Objective Six: Differences between Listed and Unlisted Banks	398
6.2.6	Objective Seven: Global Financial Crisis 2008	398
6.3	Contributions of the Study	399
6.3.1	New Approach of Analysis and Insight.....	399
6.3.2	New Focus Area.....	400
6.3.3	New Variables Tested	401
6.3.4	Theoretical Contribution.....	403
6.4	Policy Implications.....	404
6.5	Practical Implications.....	407
6.6	Limitations of the Study	408
6.7	Suggestions for Future Research.....	408
REFERENCES.....		410

LIST OF TABLES

Table	Page
Table 2.1: GDP Growth Rate of GCC Countries and other Regions 2000-2019 (USD. Billion).	44
Table 2.2: Inflation Rates, Average Consumer Prices of GCC Countries and other Regions 2000-2019 (USD. Billion).	49
Table 2.3: FDI in GCC Economies and other Regions during the Period OF 2000-2014.	55
Table 2.4: Rankings of some Developed and Developing Countries by the Inward FDI Performance Index, 2012.	57
Table 2.5: Total Banking Sector Assets 2000-2014 as % of GDP.	63
Table 2.6: Structure of the Domestic and Foreign Banking Sector in GCC Countries in the end of 2014.	65
Table 2.7: Trends the Domestic Credit to Private Sector (% of GDP) during the Period 2000-2014.	69
Table 2.8: Financial Soundness Indicators (Capitalization) of GCC Countries 2000-2014.	76
Table 2.9: Financial Soundness Indicators (Asset Quality) of GCC Countries 2000-2014.	78
Table 2.10: Financial Soundness Indicators (Profitability) of GCC Countries 2000-2014.	82
Table 2.11: Financial Soundness Indicators (Liquidity) of GCC Countries 2000-2014.	85
Table 3.1: Summary of Cost-to-Income Ratio and its Impact on Bank Performance.	105
Table 3.2: Summary of Non-Interest Income Ratio and its Impact on Bank Performance.	110
Table 3.3: Summary of Opportunity Costs Ratio and its Impact on Bank Performance.	113
Table 3. 4: Summary of Liquidity Risk (loans to total Deposits Ratio) and its Impact on Bank Performance.	116
Table 3. 5: Summary of Demand Deposits to Total Deposits and its Impact on Bank Performance.	120
Table 3.6: Summary of Market Risk and its Impact on Bank Performance.	123
Table 3.7: Summary of Credit Risk (NPLs Ratio to Total Loans) and its Impact on Bank Performance.	126
Table 3.8: Summary of Ratio of Loan Loss Provisions to Total Loans and its Impact on Bank Performance.	131
Table 3.9: Summary of Capital Adequacy Ratio and its Impact on Bank Performance.	138
Table 3.10: Summary of Loan to Assets Ratio and its Impact on Bank Performance.	144
Table 3.11: Summary of Loan Growth and its Impact on Bank Performance.	148
Table 3.12: Summary of Bank Size and its Impact on Bank Performance.	152
Table 3.13: Summary of Off-Balance-Sheet Activities and its Impact on Bank Performance.	160

Table 3.14:	Summary of GDP growth and its Impact on Bank Performance.	165
Table 3.15:	Summary of Inflation Rate and its Impact on Bank Performance.	171
Table 3.16:	Summary of Real Interest Rate and its Impact on Bank Performance.	175
Table 3.17:	Summary of Defensive Expansion or FDIs and its Impact on MNBs Performance.	181
Table 3.18:	Summary of Oil Price Shocks and its Impact on Bank Performance.	186
Table 3.19:	Summary of HHI of Market Concentration and its Impact on Banks Performance.	192
Table 3.20:	Summary of Stock Market Capitalization as % of GDP and its Impact on Banks Performance.	198
Table 3.21:	Summary of Credit to Private Sector as % of GD and its Impact on Bank Performance.	200
Table 3.22:	Summary of Listed Banks Vs. Unlisted Bank Performance.	204
Table 3.23:	Summary of Financial Crisis and its Impact on Bank Performance	208
Table 3.24:	Empirical Studies on Foreign Versus Domestic Banks Performance.	215
Table 3.25:	Summary of the Independent Variables (IVs) That Examined in Previous Studies with the Dependent Variables (DVs) of this Study and Gap in Literature.	224
Table 3.26:	Summary of the Independent Variables (IVs) that Examined in Previous Studies of GCC Countries with the Dependent Variables (DVs) of this Study and Gap in Literature.	226
Table 4.1:	Summary of Variables, Measurements and Expected Sign.	276
Table 4.2:	Types and Numbers of GCC Banks Included in this Study.	282
Table 5.1	Descriptive Statistics of Variables.	296
Table 5.2	Test of Normality.	299
Table 5.3	Skewness and Kurtosis Test.	300
Table 5.4	Multicollinearity Diagnostic Test.	302
Table 5.5	Correlation Matrix.	303
Table 5.6	Regression Results for ROA as Dependent Variable.	310
Table 5.7	Summary of Empirical Results for ROA.	320
Table 5.8	Regression Results for ROE as Dependent Variable.	322
Table 5.9	Summary of Empirical Results for ROE.	327
Table 5.10	Regression Results for NIM as a Dependent Variable.	329
Table 5.11	Summary of Empirical Results for NIM.	333
Table 5.12	Regression Results for Tobin's Q as Dependent Variable.	335
Table 5.13	Summary of Empirical Results for Tobins'Q.	340

Table 5.14	Regression Results for SDROA as Dependent Variable.	342
Table 5.15	Summary of Empirical Results for SDROA.	351
Table 5.16	Regression Results for SDROE as Dependent Variable.	353
Table 5.17	Summary of Empirical Results for SDROE.	357
Table 5.18	Summary of Regression Results of Independent Variables on Bank Performance.	358
Table 5.19	Summary of Hypotheses Testing Results of Independent Variables on Bank Performance.	359
Table 5.20	Regression Results for Bank-Specific Factors with Oil Price and FDI Inflow on Bank Performance Measures (Robustness Check 1).	363
Table 5.21	Regression Results when the Study Excludes the Variable of Bank Size (Robustness Check 2).	365
Table 5.22	Regression Results of the when the study Replaces ROA, ROE, SDROA, and SDROE by ROAA, ROAE, SDROAA and SDROAE (Robustness Check 3).	366
Table 5.23	Regression Results when the Study Excludes the Bahrain and UAE Banks Sample (Robustness Check 4).	369
Table 5.24	Regression Results when the Study Replaces HHI by CR, Lerner Index and Boone Indicator (Robustness Check 5).	377
Table 5.25	Regression Results when the Study Excludes the Financial Crisis Period 2007-2009 (Robustness Check 6).	381
Table 5.26	Regression Results when the Study uses Alternative Measures of Bank Risk-Adjusted Performance (Robustness Check 7).	382
Table 5.27	Regression Results when the Study Incorporates the Individual and Time Fixed Effects (Robustness Check 8).	384
Table 5.28	Arab Spring for GCC Countries.	386
Table 5.29	Regression Results when the Study Incorporates the Impact of the Arab Spring (Robustness Check 9).	388
Table 5.30	Regression Results when the Study uses Winsorize Test (Robustness Check 10)	391

LIST OF FIGURES

Figure	Page
Figure 2.1: GCC Capital Spending and Oil Price 1990-2013.	41
Figure 2.2: GCC Public Wages and Oil Price 1990-2013.	41
Figure 2.3: GDP Growth in GCC Countries 2000-2019.	43
Figure 2.4: GCC GDP Growth Compared to others Regions 2000-2019.	46
Figure 2.5: Inflation Rates in GCC Countries 2000-2019.	48
Figure 2.6: GCC Inflation Rates Compared to others Regions 2000-2019.	51
Figure 2.7: Performance of GCC Stock Markets 2010-2014.	60
Figure 2.8: Domestic Credit to Private Sector as % of GDP in GCC countries 2000-2014.	66
Figure 2.9: Domestic Credit to Private Sector as % of GDP in Different Region 2000-2014.	67
Figure 2.10: Oil Prices and Domestic Credit to Private Sector in GCC countries 2000-2014.	67
Figure 2.11: Banking Sector Deposits as % of GDP in GCC countries 2000-2014.	67
Figure 2.12: Assets Structure of Banking Sector in GCC Countries 2014.	71
Figure 2.13: Liabilities and Equity Structure of Banking Sector in GCC countries 2014.	73
Figure 2.14: Foreign Liabilities to Total Liabilities for the Banking Sector in GCC countries 2000-2014.	74
Figure 2.15: External financing of GCC Banks during the period of 2000-2014.	84
Figure 2.16: Key indicators of performance in GCC Economies.	88
Figure 2.17: Average of NPLs Ratio to Total Loans for Selected Countries during the Period 2005-2014.	91
Figure 4.1: Research Framework.	230

LIST OF ABBREVIATIONS

GCC	The Gulf Cooperation Council
UAE	United Arab Emirates
MNCs	Multinational Corporations
MNBs	Multinational Banks
MNEs	Multinational Enterprises
SMEs	Small and Medium Enterprises
IMF	International Monetary Fund
WDI	World Development Indicators
WTO	World Trade Organization
OPEC	Organization Of Petroleum Exporting Countries
MENA	Middle East and North Africa
MSCI	Morgan Stanley Capital International
IPOs	Initial Public Offering
NBFIs	Nonbank financial institutions
SAMA	Saudi Arabia Monetary Agency
KIA	Kuwait Investment Authority
CEE	Central and Eastern European Countries
SFA	Stochastic Frontier Approach
FSAs	Firm-Specific Advantages
HRSAs	Home Region-Specific Benefits
SCP	The Structure–Conduct–Performance Theory
RMP	Relative Market Power Hypothesis
ESX	X-Efficiency Hypothesis
NEIO	New Empirical Industrial Organization
M&As	mergers and acquisitions
P&As	Purchases and Assumptions
GPI	Gross Personal Income
CPI	consumer price index
UNCTAD	United Nations Conference on Trade and Development
WTI	West Texas Intermediate
ROA	Return on Assets
ROE	Return on Equity
NIM	Net Interest Margin
Tobin's Q	Measure of The market-Based Shareholders Value
SDROA	Standard Deviation of ROA
SDROE	Standard Deviation of ROE
COST	Cost-Income-Ratio
NIR	Non-Interest Revenues

OPC	Opportunity Cost
LR	Liquidity Risk
DMDEP	Demand Deposits Ratio
MR	Market Risk
NPLs	Non-performing Loans
LLPs	Loan Loss Provision
CAR	Capital Adequacy Ratio
LOAN	Loan to Total Assets
LNGRTH	Loan Growth
SIZE	Bank Size
OBSs	Off-Balance Sheet Activities
GDP	Real GDP Growth
INF	Inflation Rate
RIR	Real Interest Rate
FDI	Foreign Direct investment Inflows
OIL	Oil Price shocks
HHI	The Herfindahl-Hirschman Index of Market Concentration
MARKE_CAP	Stock Market Capitalization to GDP
DCPS	Domestic Credit to Private Sector to GDP
LISTED	Listed Banks as dummy variable
FOREIGN	Foreign bank's ownership as dummy
CRISIS	Global Financial Crisis as dummy variable
COUNTRY	Country Dummies
ROAA	Average Return on Assets
ROAE	Average Return on Equity
SDROAA	Standard Deviation of Average ROA
SDROAE	Standard Deviation of Average ROE
CR5	Five Largest Bank Concentration Ratio
Lerner	Lerner Index of Market Power Measure
Boone	Boone Indicator of Bank Competition Measure
ZROE	Z-score measures based on ROE a measure of default risk
ZROA	Z-score measures based on ROA a measure of default risk
ZROA1	Z-score measures based on ROA a measure of bank portfolio
ZROA2	Z-score measures based on ROA a measure of leverage risk
ArabSpring1	Arab Spring Revolution Period
LLRs	Loan Loss Reserves
VROA	Variance of ROA
VROE	Variance of ROE
GMM	Generalized Method of Moments

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

The financial services commercial banking sector is one of the most important service sectors in a nation's economy (Huang, Chiang, & Tsai, 2015; Saci, Giorgioni, & Holden, 2009). Banks provide a safe linkage between the savers and the borrowers. Therefore, government and the central bank of any country are always concerned to ensure continuing strength and stability of the country's banking and financial system for capital formation, innovation, the creation of job opportunities (Huang *et al.*, 2015). There are five key elements in the financial climate of any economy viz., money; financial institutions; financial tools; and system and rules (Karim & Alam, 2013; Saif-Alyousfi, Saha, & Md-Rus, 2017a).

Banks are the main component of the financial system of any country and are also active players in financial markets of any a nation (Dhanabhakym & Kavitha, 2012). Efficiency in the financial performance of banks is, therefore, the key to ensuring economic growth and development. Analysis and evaluation of bank performance can identify the inherent strengths and also weaknesses in the financial position of banks. According to, Rachdi (2014) evaluation of bank performance is important for all parties: bank managers, borrowers, depositors, and regulators. Soundness in the financial health of banks also attracts shareholders interest to strengthen their capital base to bring it in line with the regulatory and prudential requirements.

Globalization and internationalization initiatives of the government of many countries have opened up the domestic banking sector by allowing foreign banks to enter domestic markets and

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