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The impact of efficiency on discretionary loans/finance loss provision: A comparative study of Islamic and conventional banks (Article)

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Abstract

The paper investigates whether there is a significance difference between the practices of **discretionary** loan/finance loss provisions between Islamic and conventional banks. Same time, the paper tests whether the **efficiency** may influence the behaviour of **discretionary** loans/finance loss provisions, taken into consideration other micro and macro variables. The study utilizes panel data runs over 1996-2011 with unbalanced observations for 16 banks, of which 4 Islamic banks. In order to achieve research objectives, the two-stage approach is adopted to examine the factors that may influence the behaviour of **discretionary** loan/finance loss provisions with specific emphasize on the **efficiency**. Furthermore, **efficiency** scores are estimated using Data Envelopment Windows Analysis. The findings of the research show that Islamic banks employ the **discretionary** loans/finance loss provisions to manage their earnings. However, the magnitude of discretion of accruals is significantly lower than conventional banks with exception for foreign banks which have reported lower **discretionary** loans/finance loss provisions than Islamic banks. Moreover, the analysis showed that **efficiency** affects the overall **discretionary** loans/finance loss provision positively, although this **impact** is shaped differently for Islamic and conventional banks. © 2015 The Authors.

Author keywords

Conventional banks; **Efficiency**; Islamic banks; Loan loss provisions; Yemen

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