

## **Are the Determinants of Credit Facilities of Islamic Banks different from Conventional Commercial Banks? An Omani Perspective**

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**ABSTRACT.** This study aims to explore and understand whether the determinants of credit facilities are different in Islamic commercial banks as compared with conventional banks. Seven groups of determinants of granting credit facilities are tested in both types of Omani banks. The sample of the study comprises the credit managers of six conventional banks and six Islamic banks (including four Islamic windows) in Oman. The findings of this study have indicated that no significant differences exist between Islamic and conventional banks regarding client-related, political, economic, guarantees and warranties, financial position, and banking credits system related determinants. However, a significant difference exists regarding bank-related determinants. The result of the factor analysis has indicated that the clients' guarantees and warranties, bank-related determinants, economic conditions of the country, and the banking credits system have a higher priority as determinants of credit facilities in Omani banks.

**KEYWORDS:** Islamic banks, Commercial banks, Credit facilities, Oman.

**JEL CLASSIFICATION:** G21, F65

**KAUJIE CLASSIFICATION:** F51, I41

## 1. Introduction and Theoretical Background

Banks play an important role in the economy. Banks constitute the most important element in the financial system that constitutes the hub to provide, meet, and match the surplus money units with deficit money units within the economy. Individuals, firms, and governments completely rely on banks for their financial needs and investments. Any failure of this system may result in the failure of the economic system. One of the crucial functions of the banking system is the creation of credit. Although sensitive and risky, banking credit is one of the most important activities performed by a bank's management, given that it is considered as an important investment for commercial banks, which may lead to bankruptcy or access to high profits (al-Muharrami, 2015, p. 341). Bank credit facilities provide financing for their clients' investors to build and develop their investment goals and projects for the banking industry worldwide.

Credit facilities in the banking sector are of two types: direct and indirect credit facilities. Direct banking facilities entail paying the investors in cash or crediting to their account with a bank (al-Rawashdeh, al-Omari, Saleh, & al-Nawayseh, 2013, p. 131). These facilities are deemed risky credit, given that the probabilities of loss are usually high. The decision to grant direct credit facilities to the investors is imperative and crucial from the perspective of banks, given that it could lead to considerable non-performing assets (NPAs) and bankruptcy due to wrong selection of clients for these facilities. The indirect credit facilities offered by banks may constitute an indirect involvement through instruments such as letters of guarantees, letter of credits, and bill collections, which have an impact on the bank's profitability and solvency in the future.

The decision involved in credit (finance) facilities is one of the most important decisions for Omani banks, either commercial or Islamic. The Omani banking sector is composed of foreign, local commercial, and Islamic banks. Local commercial banks are seven in total: Bank Muscat, National Bank of Oman, Bank Dhofar, Ahli Bank, Bank Sohar, Oman Arab Bank, and HSBC Bank Oman. Islamic banks include Bank Nizwa and Bank Al-Izz, which were both established and listed in 2012. In addition, Bank Muscat, National Bank of Oman, Bank Dhofar, Ahli

Bank, and Bank Sohar have started offering Islamic banking through their Islamic windows. Bank Muscat has '*Methaq*' window, Bank Dhofar has '*Maisarah*' window, National Bank of Oman has '*Muzn*' window, Sohar Bank has '*Sohar*' Islamic window, and Ahli Bank has '*AlHilal*' Islamic window. The total gross banking credit of the six listed conventional banks as of the end of June 2014 was RO 15.2 billion, against the deposits of RO 15.8 billion (al-Maha Financial Services, 2014, p. 4). The total Islamic banking and financing receivables and deposits of the two Islamic banks and Islamic banking windows are RO 696 million and RO 314 million, respectively (al-Maha Financial Services, 2014, p. 7).

The Omani banking sector is the main source of credit, whereas the Islamic and commercial banks in Oman are the main source of finance for various economic enterprises. The most important role played by Islamic and commercial banks is to finance investors or customers in general. In commercial banks, credit facilities should be covered by warranties and guarantees to ensure that the bank can recover its capital with profit through interest and commission. Islamic banks cannot provide a loan with interest, given that they cannot charge interest. However, Islamic banks can charge a profit on investments. Islamic banks cannot issue loans except interest-free loans (*qard hasan*) for any requirement. However, these banks can conduct business by providing the required asset to clients. Actually, Islamic banking introduced new concepts and practices and it does not merely imply an interest-free banking system (Lodhi & Kalim, 2005, p. 1003).

In Oman, the monetary policy is used as a key macroeconomic policy tool in the management of overall macroeconomic conditions. The central bank of Oman uses this policy to find some balance between the demand for and supply of money, often achieved by altering the price of money and the interest rate. In the Islamic banking frame, the central bank of Oman also regulates all issues related to the credit facilities such as the conditions, disclosure, and granting of credit. This means that the central bank of Oman has full supervision on the credit facilities in Islamic banks and commercial banks, and the credit facilities decisions are affected by the monetary policy and regulations of the central bank of Oman.

Banks consider numerous determinants that can influence their decision for either accepting or rejecting the credit request of investors and customers. These determinants can be categorized as those related to banks, the investors and customers, economic and political determinants, and determinants related to the banking credits system. In Oman, existing studies have attempted to examine the banking sector, the performance of banks, and challenges and benefits of commercial and Islamic banks. However, only few studies have examined the determinants influencing the decision of granting the credit facilities.

Universally, there are various studies that have discussed the differences between Islamic banks and commercial banks with respect to credit facilities. For example, Hassan, Mohamad, and Bader (2009) have examined the differences between Islamic and conventional banks in the Middle East in terms of cost, revenue, and profit. Jenkins and Hussain, (2014) have examined the effect of macroeconomic conditions on the financing of SMEs by the banks in Turkey. Rabab'ah (2015, p. 177) has indicated that bank size and economic growth have a positive and significant impact on the ratio of credit facilities in Jordan. Olu-muyiwa, Oluwatosin, and Chukwuemeka (2012, p. 71) have shown a negative relationship between credit facilities decisions and interest rate.

In Oman, there is no known study that studies the differences between Islamic banks and commercial banks with respect to the determinants of credit facilities. This study tries to fill this gap through investigating those determinants which the management of commercial and Islamic banks in Oman considers in their credit facilities decision. Though the results are drawn from an Omani perspective, the findings have significant implications for regulators, bankers, and stockholders or investors within the country, outside the region, and around the world.

In this study, we analyze the determinants of credit facilities in both types of banks: commercial and Islamic. In particular, we explore the question on how the determinants of credit facilities are different between commercial and Islamic banks. The rationale of this study is based on four premises. First, the banking sector in Oman is a relatively new and evolving sector that needs more studies to examine the factors influencing the Omani banking system

(al-Muharrami, 2017, p. 48). Second, only few studies have examined and discussed the determinants influencing the credit facilities decision in Oman. Third, the Omani government has issued various ordinances to regulate the banking system in the last 10 years and it is subject to critical analysis. Fourth, the credit facilities provided by banks in Oman are increasing steadily and the gap between deposits and credits is narrow. According to the central bank of Oman, in 2018, both credit and deposits maintained a reasonable growth of 6.4 percent and 7.8 percent, respectively. This means that there was a lower growth in deposits as compared to credit growth. These data indicate the importance of these credits to the banks and the economy (CBO, 2018, p. 7).

This study is organized into five sections. The first section presents the introduction and details on the theoretical background, present scenario, problems, and gaps. The second section provides a discussion on existing literature with regard to the issue. The third section introduces the hypotheses, methodology, sample selection, and questionnaire used in the study. The fourth section discusses the results of the analysis. The fifth section presents the summary and conclusion.

## **2. Literature Review, Determinants, and Hypotheses Development**

There are many researches which have discussed the difference between Islamic banks and commercial banks. The research about credit facilities and their determinants are one of the most notable researches in this area. Al-Ghfais (2017, p. 15) examined six differences between Islamic and conventional banks in Saudi Arabia. The study shows a noticeable difference between conventional and Islamic banks in Saudi Arabia in terms of profitability, credit risk, capitalization, efficiency, liquidity, and contribution to economic growth. Effendi and Disman (2017, p. 308) analyzed the influence of micro-economy or bank-specific to the liquidity risk in Islamic and conventional banks in seven countries, namely Albania, Saudi Arabia, Bahrain, Malaysia, Dubai, Qatar, and Indonesia from 2009 to 2015. The study found some differences between conventional and Islamic banks in terms of liquidity. Miah and Uddin (2017, p. 172) examined the differences between Islamic and conventional banks in terms of business orientation, stability,

and efficiency in the Gulf Cooperative Council (GCC) countries over the period 2005 to 2014. In general, the study found some differences between Islamic and conventional banks as the conventional banks are more efficient in managing cost while the Islamic banks are more solid in terms of short-term solvency. Hassan, Khan, Amin, and Khokhar (2018, p. 112) examined the efficiency of the Islamic banking industry in Saudi Arabia. The findings of the study showed that the efficiency of the sample of Islamic banks is different and the large banks ranked the highest in the scale of efficiency.

A considerable amount of research has examined the determinants which may influence the credit facilities decisions of banks. The steady increase in the last decade of the influence and presence of Islamic banks has generated far-reaching ramifications for the economic system of different countries. Therefore, an important question arises that whether differences exist between Islamic and commercial banks' credit facilities determinants. Many studies have explored the differences pertaining to the determinants of credit facilities between commercial and Islamic banks and concluded that differences and similarities exist between them.

Researchers have investigated the determinants of credit facilities decisions in banks, which are crucial in their lending process and are followed meticulously to reduce NPAs. These studies have basically focused on the determinants related to the banks and their relationship with customers, such as the volume of deposits, investment portfolio, interest (lending) rate, stipulated cash reserve requirements ratio, liquidity ratio, the size of banks, and the economic growth, financial position, and business results of banks. Most of the studies have showed that there are multiple determinants for the credit facilities and lending decisions of the banks. Studies have concluded various relationships between determinants of credit facilities and credit facilities decisions.

Cole, Goldberg, and White (2004, p. 227) have found that the banks use financial statements for loan decision-making purposes. Lin (2009, p. 6) examined the information about credit score of clients as an important factor of loan success. Olokoyo (2011, p. 61) has examined some determinants of commercial

banks' lending behavior in Nigeria such as deposits, liquidity, and interest rate and he found that deposits have the greatest effect on lending behavior. Chen and Han (2012, p. 8) have discussed the role of demographic characteristics in the credit facilities decision. Olumuyiwa et al. (2012, p. 71) have shown a negative relationship between credit facilities decisions and interest rate (lending rate). Al-Rawashdeh et al., (2013, p. 132) checked some bank-related determinants such as customer borrowers, credit policies, central administration of the loans, and the environmental conditions of the local economy. Rabab'ah (2015, p. 177) has indicated that bank size and economic growth have a positive and significant impact on the ratio of credit facilities. Al-Khazaleh (2017, p. 36) examined the impact of some internal and external factors on bank lending in Jordan. The results indicated that some factors such as profitability, size, and inflation have a positive effect on bank lending.

Credit analysis is a crucial feature of the process of lending for most of the banks, including commercial and Islamic banks. Any weakness in this process will lead to NPAs for banks, which will reflect on the performance of banks (Ghuslan, Muhammed, & Abidin, 2010, p. 39; Adzido, Ahiave, Kamasah, Akoto, & Dorkpah, 2016, p. 52). Studies have pointed out that the financial statement analysis for the purposes of credit facilities decision is crucial for the bank lending process. Maitah, Zedan, and Shibani (2012, p. 106) have attempted to determine the level of use of financial analysis in Libyan banks and found that the usage of financial analysis is weak in the decision making process for credit facilities.

Given that the financial results of banks are an important determinant, Hassan et al. (2009, p. 46) have examined the differences between Islamic and conventional banks in the Middle East in terms of cost, revenue, and profit. They have concluded that no significant differences exist between the overall efficiency of conventional and Islamic banks.

These studies support our argument that the credit facilities decision needs to be discussed in order to find out how this decision is affected by various determinants. These studies provide a framework to develop our hypotheses and compare our results with their results.

In summary, only a few studies have examined the determinants of credit facilities in the GCC region, and whether a difference exists between commercial and Islamic banks in terms of their respective determinants of credit facilities. Therefore, we analyze the determinants that may affect Omani banks' decision on credit facilities and explore the differences (if any) between commercial and Islamic banks with regard to these determinants.

The process by which credit facilities are granted can be complex and influenced by a number of determinants. These determinants are collected from existing literature such as Ghuslan et al. (2010, pp. 42-45), Olokoyo (2011, p. 65), al-Rawashdeh et al. (2013, pp. 132-133), Rabab'ah (2015, pp. 170-174), and al-Khazaleh (2017, p. 35). Based on the current available literature on determinants that have significant influence on banks' credit decisions, we have attempted to group these determinants to form the hypotheses. These determinants are as follows:

a) *Determinants related to the investors, clients, or customers*: Determinants directly related to customer/clients include clients' personality, credit score, and repayment ability. For example, customers' personality has an influence on different variables related to banks and services provided to customers (Dimitriu, 2012, p. 134). Lin (2009) has found that clients' credit score has a positive relationship with the possibility of loan success. Therefore, the null hypothesis is formulated as follows:

H1: No differences exist between commercial and Islamic banks with regard to determinants related to the investors, clients, or customers.

b) *Determinants related to the financial position and business performance of banks*: Cole et al. (2004, p. 230) have found evidence that the credit facilities such as lending decisions of large banks are likely to be a function of financial variables, such as the profitability of banks, liquidity, and capital adequacy related to the financial position and business results of banks. Kim and Elias (2008, p. 69), provided evidence that financial statements are perceived as important information used in the lending decision. Nouaili, Abaoub, and Ochi (2015, p. 410) pointed out that the performance of banks is influenced by some internal and external determinants. Also, liquidity

risk was examined by Effendi and Disman (2017, p. 316) who found that some bank-specific variables such as, profit and size of banks have an impact on liquidity risk. Therefore, the null hypothesis is formulated as follows:

H2: No differences exist between commercial and Islamic banks with regard to determinants related to the financial position and business performance of banks.

c) *Determinants related to the customers' guarantees and warranties*: Bank guarantee is a contract between a bank and its customer, concluded at the request of the bank's customer. Lukic (2014, p. 6) has pointed out that guarantees and warranties are the most important demand by banks, which may represent a substitute for cash to provide their customers with a rapid monetary reform against the principal counterparty to the underlying contract. Therefore, the null hypothesis is formulated as follows:

H3: No differences exist between commercial and Islamic banks with regard to determinants related to the customers' guarantees and warranties.

d) *Determinants related to the economic condition of a country*: Jenkins and Hussain (2014, p. 1) have found that the "high GDP growth rate and increasing competition in the Turkish banking sector have contributed to the growing banking sector credit". Also, al-Ghfais (2017, p. 15) has found that Islamic and commercial banks positively contribute to the economic growth in Saudi Arabia. Therefore, the null hypothesis is formulated as follows:

H4: No differences exist between commercial and Islamic banks with regard to determinants related to the economic condition of a country.

e) *Determinants related to the political condition of a country*: Harrigan Wang, and el-Said (2006, pp. 247-248) have indicated that the political interests and conditions of a country are one of the most important determinants that the International Money Fund (IMF) and the World Bank (WB) consider in lending decisions. Ananda (2017, p. 30) has found that due to political and economic conditions, the net profit, total assets, and total deposits of banks have increased over the last five years in Oman. Therefore, the null hypothesis is formulated as follows:

H5: No differences exist between commercial and Islamic banks with regard to determinants related to the political condition of a country.

f) *Determinants related to the banks*: Olumuyiwa et al. (2012, p. 74) have pointed out that determinants such as bank strategy are abundant in credit making decisions, wherein the general objectives of the bank, market value of banks, cash reserves, and assets and human resources in the banks have several effects on the provided credit facilities. Also, Hassan et al., (2018, p. 112) found the large size of banks as one of the bank determinants for efficiency. Therefore, the null hypothesis is formulated as follows:

H6: No differences exist between commercial and Islamic banks with regard to determinants related to the banks.

g) *Determinants related to the banking credit system*: According to Roszbach (2004, p. 948), the decision of whether to provide a loan or not should be assessed by banks to develop the procedures and policies involved in credit facilities. Numerous determinants, such as the purpose of the credit facility granted to customers, time taken by banks to provide the credit facility, the method and source of repayment, and the type of required facility, are involved in such an assessment. Therefore, the null hypothesis is formulated as follows:

H7: No differences exist between commercial and Islamic banks with regard to determinants related to the banking credit system.

### 3. Methodology

#### 3.1 Research Design

This study analyzes the determinants of credit facilities in commercial and Islamic banks. Specifically, the focus of our study is to explore whether differences exist amongst the determinants of credit facilities of commercial and Islamic banks. A descriptive design is adopted to elicit information with regard to respondents' characteristics in terms of gender, age, experience, and educational level.

#### 3.2 Population and Sample

The population of our study is the banking sector in Oman, which comprises commercial and Islamic banks. According to the data from the Central Bank of Oman, in 2016, 18 commercial banks are operating in Oman, which include seven local commercial banks, two Islamic banks, and nine licensed foreign banks. In addition, four local commercial banks are also operating Islamic-windows, which operate similar to full-fledged banks with separate building, staff, and all other facilities. Out of the nine commercial banks, eight were listed in the Muscat Securities Market (MSM) until 2017: six local commercial banks and two Islamic banks. Four commercial banks have Islamic windows as separate departments using full Islamic banking system. This study has attempted to survey a total population size of 90 credit managers (relationship manager) of the six listed commercial banks and six Islamic banks (including four Islamic-windows) in Oman. These four Islamic-windows are not listed on MSM, but we have included them in the study sample to maintain the balance between Islamic and commercial banks. A total of 61 questionnaires are successfully received from administering 90 to credit managers. Table 1 shows the population and sampling scheme.

**Table (1) Population and Sampling**

Items	Sample: Banks	Sample: Credit Managers
Population	18	90
Sample	12	61
Percentage	67%	67%
No. of sample subject to analysis		61
Percentage		100%

**Source:** Output of MSM Companies Guide (2018).

### 3.3 Research Tool

A questionnaire was developed to explore the determinants influencing credit facilities decision. This questionnaire was composed of two parts: part 1 comprised the demographic characteristics of the respondents, such as gender, age, years of experience, and educational level, while part 2 contained seven determinants of credit facilities decision. The respondents' answers were based on a five-point Likert

scale, ranging from decrease (1), increase (5), or no impact (3), on the likelihood of credit facilities. The Cronbach's alpha coefficient value was used to estimate the reliability of the determinants of the sample. In this study, the Cronbach's alpha coefficient was 0.88, indicating the overall reliability of the questionnaire that was also pretested. Table 2 shows the demographic characteristics of the sample.

**Table (2) Demographic Statistics of Respondents**

Characteristics		Number	Percentage
<i>Gender</i>	Male	45	73.8%
	Female	16	26.25%
<i>Age</i>	40 and less	37	60.7%
	More than 40-45	17	27.9%
	More than 45-50	4	6.5%
	More than 50	3	4.9%
<i>Years of Experience</i>	1-5	0	
	More than 5-10	17	27.9%
	More than 10-15	18	29.5%
	More than 15	26	42.6%
<i>Education</i>	Bachelors	37	60.7%
	Masters	17	27.9%
	Professional qualification	7	11.5%

**Source:** Prepared by authors.

Table 2 shows that amongst the respondents, males are predominant. Out of 61 respondents, 57% have an average of 10 years of work experience serving on their sector, 88% of them have a bachelor and post graduate certificate, and 12% have a professional qualification. In sum, we believe that the respondents are fit to answer the questionnaire.

## 4. Results and Discussion

### 4.1 Test of Normality

To test the normality of the data, the Kolmogorov-Smirnov and Shapiro-Wilk tests were conducted. Table 3 shows the results of this test.

**Table (3) Tests of Normality**

Determinants	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Client-related determinants	0.249	61	0.038	0.825	61	0.066
Financial position and business results of banks	0.206	61	0.168	0.854	61	0.061
Clients' guarantees and warranties	0.206	61	0.171	0.867	61	0.060
Economic conditions of a country	0.217	61	0.125	0.889	61	0.115
Political conditions of a country	0.248	61	0.051	0.268	61	0.071
Bank-related determinants	0.170	61	0.200	0.921	61	0.291
Banking credit system determinants	0.282	61	0.119	0.912	61	0.227

**Source:** Estimated by authors.

Table 3 presents the results of tests of normality using the Kolmogorov-Smirnov and the Shapiro-Wilk tests. All seven variables were normally distributed, given that the significance values of the Shapiro-Wilk and Kolmogorov-Smirnov tests are greater than 0.05. Thus, the data in this study is normal. Actually, there is a difference in the result of normality for client-related determinants between the Shapiro-Wilk and Kolmogorov-Smirnov tests, however, we will consider the result of Shapiro-Wilk as it provides better

power than the Kolmogorov-Smirnov (Ghasemi & Zahediasl, 2012, p. 487).

#### 4.2 Descriptive Statistics

To identify the determinants influencing the decision of credit facilities in commercial and Islamic banks, the Likert scale scores (1-5) were used to obtain descriptive statistics. Table 4 presents the results of mean (M) and standard deviation (SD).

**Table (4) Results of Mean (M) and Standard Deviation (Sd) for Islamic and Commercial Banks**

Determinants	Islamic Banks			Commercial Banks		
	M	SD	Rank	M	SD	Rank
Client-related determinants	3.91	0.32317	5	3.86	0.39873	5
Financial position and business results of banks	4.12	0.18427	2	4.11	0.19352	2
Clients' guarantees and warranties	4.18	0.28115	1	4.20	0.36085	1
Economic conditions of a country	3.79	0.63609	6	3.60	0.74483	6
Political conditions of a country	3.78	0.78004	7	3.52	0.85657	7
Bank-related determinants	3.95	0.15765	4	3.91	0.20181	4
Banking credit system determinants	4.07	0.29931	3	4.07	0.27635	3

**Source:** Estimated by authors.

Table 4 shows that the determinants related to clients' guarantees and warranties have a higher rank in both types of banks. However, the determinants related to political conditions of a country have a lower rank in both types of banks. The standard deviation of all determinants in both types of banks is low, which means that the answers are not spread out over a wider range of mean but are closer to the mean. According to the results indicated in table 4, the ranks of determinants of credit facilities are similar between commercial and Islamic banks. This finding suggests that the importance of determinants is equal for both types of banks, which also rely on the same determinants in credit facilities decision.

#### 4.3 Testing the Hypotheses

To test the hypotheses, *t*-test for one sample and two independent samples is conducted. Descriptive statistic is used to examine the differences between Islamic and commercial banks with regard to the determinants of credit facilities. Also, Levene's test is conducted to test the homogeneity of variances between the commercial banks and Islamic banks. The results are shown in table 5 which indicate that there is no difference between the two types of banks as the values of the Levene statistic are 2.368 and 1.236, and the significance values are 0.104 and 0.315, for commercial banks and Islamic banks respectively.

**Table (5) Summary of the Test for Homogeneity of Variances**

Bank	Levene Statistic	Sig.
CB	2.368	0.104
IB	1.236	0.315

**Source:** Estimated by authors.



4.3.1 One sample under t-test

According to table 6, the mean of client-related determinants, economic conditions of a country, and banking credit system determinants (3.57, 3.43, and 3.62, respectively) are below the estimated mean of the population (equal to 4). This finding indicates that the mean of the sample and the mean of the population are statistically significantly different. The means

of the other determinants (financial position and business results of a bank, clients' guarantees and warranties, political conditions of a country, and bank-related determinants) are more than 4, which indicate that the sample is statistically significantly different from the population. Table 6 shows the results of the t-test for the commercial banks sample.

**Table (6) One-Sample Test (Commercial Banks)**

Determinants	T	df	Sig. (2-tailed)	Mean	Std. D	Mean Difference	95% Confidence Interval of the Difference	
							Lower	Upper
							Test Value = 4	
Client-related determinants	-2.805	60	0.019	3.5764	0.50096	-0.42364	-0.7602	-0.0871
Financial position and business results of banks	1.270	60	0.233	4.1118	0.29209	0.11182	-0.0844	0.3080
Clients' guarantees and warranties	0.527	60	0.609	4.0755	0.47454	0.07545	-0.2433	0.3943
Economic conditions of a country	-4.288	60	0.002	3.4318	0.43947	-0.56818	-0.8634	-0.2729
Political conditions of a country	0.890	60	0.394	10.5491	24.39639	6.54909	-9.8406	22.9388
Bank-related determinants	-0.546	60	0.597	3.9465	0.32481	-0.05347	-0.2717	0.1647
Banking credit system	-2.326	60	0.042	3.6203	0.54128	-0.37967	-0.7433	-0.0160

Source: Estimated by authors.

As shown in table 6, client-related determinants, economic conditions of a country, and banking credit system determinants are statistically significantly different where  $p < 0.05$  ( $p = .019$ ,  $p = 0.002$ , and  $p = 0.042$ , respectively). Therefore, a statistically significant difference exists between the observed mean of the sample and the estimated mean for the population. These results indicate that the commercial banks need to provide more attention to these determinants of credit facilities in their decision-making process. Due to the challenges and increased competition in the banking system in Oman, varying aspects of this system are developed. For example, one of the most important challenges in this environment is the global competition and business expansion within a growing

economy. To face this challenge, the central bank of Oman has raised the minimum capital requirement for new local and foreign banks entering the Omani financial system as this minimum increased from RO 50 million to RO 100 million for new local banks and from RO 10 million to RO 20 million for foreign banks (CBO, 2009, p. 652 & p. 805).

For the other determinants,  $p > 0.05$ , in which the difference between the sample-estimated population mean and the comparison population mean was insignificantly different.

Table 7 shows the results of the t-test analysis for Islamic banks.

**Table (7) One-Sample Test (Islamic Banks)**

Determinants	Test Value = 4						95% Confidence Interval of the Difference	
	T	df	Sig. (2-tailed)	Mean	Std. D	Mean Dif-ference	Lower	Upper
	Client-related determinants	-3.230	60	0.008	3.5283	0.50580	-0.47167	-0.7930
Financial position and business results of banks	1.510	60	0.159	4.1225	0.28094	0.12250	-0.0560	0.3010
Clients' guarantees and warranties	1.722	60	0.113	4.1525	0.30681	0.15250	-0.0424	0.3474
Economic conditions of a country	-4.787	60	0.001	3.3958	0.43717	-0.60417	-0.8819	-0.3264
Political conditions of a country	0.986	60	0.346	10.5867	23.15172	6.58667	-8.1232	21.2966
Bank-related determinants	-0.548	60	0.595	3.9510	0.31008	-0.04902	-0.2460	0.1480
Banking credit system	-0.236	60	0.818	3.9853	0.21594	-0.01470	-0.1519	0.1225

Source: Estimated by authors.

According to table 7, only client-related determinants and economic condition determinants have statistically significant differences, given that the observed mean of the sample is below the hypothesized mean of the population (equal to 4) and the significant value for both determinants is less than 0.05 ( $p < 0.05$ ). The results indicate that Islamic banks need to focus on providing the best services to their clients to increase the level of clients' satisfaction. In addition, Islamic banks in Oman need to focus more on the determinants of economic condition to measure their

progress. Economic conditions are the main topic of prior studies (e.g., Johnson, 2013, p. 2; el-Galfy & Khiyar, 2012, p. 943), which have concluded that the economic conditions, and the contribution of Islamic banks to the GDP are the most important challenges against the progress of Islamic banks.

#### 4.3.2 Two independent samples under *t*-test

In this section, the *t*-test for two independent samples is conducted. Table 8 shows the results of this test.

**Table (8) Results of *t*-Test (Two Independent Samples)**

Determinants	Type of bank	Sample Size	M	SD	T-value	Sig.	Result of Hypotheses
Client-related determinants	CB	44	3.85	0.39695	0.565	0.455	Supports H1
	IB	17	3.91	0.32756			
Financial position and business results of banks	CB	44	4.10	0.19450	0.169	0.683	Supports H2
	IB	17	4.12	0.18427			
Clients' guarantees and warranties	CB	44	4.19	0.36205	2.318	0.133	Supports H3
	IB	17	4.18	0.28115			
Economic conditions of a country	CB	44	3.58	0.73708	1.238	0.270	Supports H4
	IB	17	3.79	0.63609			
Political conditions of a country	CB	44	3.50	0.84648	1.124	0.293	Supports H5
	IB	17	3.77	0.78004			
Bank-related determinants	CB	44	3.91	0.20223	3.086	0.048	Rejects H6
	IB	17	3.94	0.15765			
Banking credit system determinants	CB	44	4.06	0.27635	0.091	0.764	Supports H7
	IB	17	4.08	0.28598			

CB = Commercial Bank; IB = Islamic Bank; Sig = 0.05

Source: Estimated by authors.

Based on the results shown in table 8, for client-related determinants, determinants related to financial position and business results of banks, clients' guarantees and warranties, economic conditions of a country, political conditions of a country, and determinants related to banking credit system, the *t*-test failed to reveal a statistical reliable difference between the mean number of commercial and Islamic banks. The significant value for these determinants is greater than 0.05, which means that H1, H2, H3, H4, H5, and H7 are accepted and no differences exist between commercial and Islamic banks. The significance value for determinants related to banks is less than 0.05, which means that H6 is rejected (i.e., the alternative hypothesis is accepted) and that differences exist between commercial and Islamic banks in this regard. The result of determinants related to Islamic banks has shown a mean of 3.94, which is greater than the mean (3.91) of commercial banks. This finding suggests that both types of banks are careful with regard to the decision of credit facilities, given that this decision has important effects on the financial position of banks. Islamic banks are more careful with regard to determinants related to banks. This may be because these banks are new in the Omani banking industry. Thus, Islamic banks' market share is less than that of commercial banks and their objectives are still in progress.

#### 4.4 Factor Analysis

Given that this study explores numerous variables (seven variables), we have used a factor analysis to reduce the number of these variables. The aim of the factor analysis is to produce a small number of factors from a large number of variables which are capable of explaining the observed variance in the larger number of variables. We have conducted the factor analysis for each of the two samples together, given that no major differences exist between them according to the results of *t*-tests.

By running a factor analysis for this sample, the following results are produced (we have ignored some outputs to make the analysis more oriented).

The first output is the correlation matrix, which is focused on whether or not the correlation phenomenon exists. To determine the correlation between the variables, this study determines the value of the determinant of the correlation matrix, which should be more than 0.001. In our case, the value of the determinant of the correlation matrix is equal to 0.123, which means that the correlation phenomenon is non-existent. Then, we determine the value of KMO and Bartlett's test to measure the strength of the relationship amongst variables and decide the adequacy of the sample. Table 9 shows the value of these tests.

**Table (9) KMO and Bartlett's Test**

Kaiser–Meyer–Olkin Measure of Sampling Adequacy.		0.512
Bartlett's Test of Sphericity	Approx. Chi-Square	72.533
	Df	21
	Sig.	0.000

**Source:** Estimated by authors.

According to the results shown in table 9, the KMO is 0.512, which is higher than the minimum limit (0.50). According to Hair, Black, Babin, and Anderson (2010, p. 130), the acceptable limit of KMO is 0.5 and if the significant value of Bartlett's test is less than 0.05, the factorability of the correlation matrix is assumed to conduct a factor analysis. Furthermore, table 9 shows, the significance level is small enough

( $p < 0.05$ ). Therefore, the null hypothesis which suggests that the correlation matrix is not an identity matrix, is rejected.

The next item from the output is shown in table 10. Table 10 presents the communalities, which may show how much of the variance in the variables has been accounted for by the extracted factors.

**Table (10) Communalities**

	<b>Initial</b>	<b>Extraction</b>
Client-related determinants	1.000	0.688
Financial position and business results of banks	1.000	0.352
Clients' guarantees and warranties	1.000	0.828
Economic conditions of a country	1.000	0.675
Political conditions of a country	1.000	0.760
Bank-related determinants	1.000	0.678
Banking credit system	1.000	0.704

*Extraction method: Principal Component Analysis.*

**Source:** Estimated by authors.

The maximum value of the variable is 82.8% for clients' guarantees and warranties, and the minimum value is 35.2% for the financial position and business results of banks.

Table 11 shows all the factors extractable from the analysis together with their eigenvalues, the percentage of variance attributable to each factor, and

the cumulative variance of the factor and previous factors. The first factor accounts for 25.764% of the variance, while the second factor accounts for 22.556%, and the third accounts for 18.593%. All the remaining factors are insignificant. Table 11 presents the results.

**Table (11) Total Variance Explained**

<i>Component</i>	<b>Initial Eigenvalues</b>			<b>Extraction Sums of Squared Loadings</b>			<b>Rotation Sums of Squared Loadings</b>		
	<i>Total</i>	<i>% of Vari- ance</i>	<i>Cumulative %</i>	<i>Total</i>	<i>% of Variance</i>	<i>Cumulative %</i>	<i>Total</i>	<i>% of Variance</i>	<i>Cumulative %</i>
1	1.884	26.913	26.913	1.884	26.913	26.913	1.804	25.764	25.764
2	1.571	22.438	49.351	1.571	22.438	49.351	1.579	22.556	48.321
3	1.229	17.563	66.913	1.229	17.563	66.913	1.302	18.593	66.913
4	0.860	12.288	79.202						
5	0.706	10.085	89.287						
6	0.494	7.062	96.349						
7	0.256	3.651	100.000						

*Extraction method: Principal Component Analysis.*

**Source:** Estimated by authors.

Table 12 shows the loadings of the seven variables on the three factors extracted. The loadings are used to determine the strength of the relationships between the factor and variable in the component matrix.

Factors can be identified by the largest loadings ignoring the sign (Yong & Pearce, 2013, p. 84). In this study, we have selected all loadings of more than 0.5.

**Table (12) Component Matrix<sup>(a)</sup>**

	Component		
	1	2	3
Client-related determinants	-0.797		0.221
Bank-related determinants	0.749	0.342	
Financial position and business results of banks	-0.485	0.309	0.146
Clients' guarantees and warranties	0.217	0.735	-0.490
Political conditions of a country	0.490	-0.713	0.107
Banking credit system	0.406		0.728
Economic conditions of a country		0.546	0.614

<sup>(a)</sup> Three components extracted.

*Extraction method: Principal Component Analysis.*

**Source:** Estimated by authors.

Given the results shown in table 13, two variables, which are bank-related determinants, and client-related determinants, are present in Component 1. Three variables in Component 2, which are clients' guarantees and warranties, economic conditions of a country, and political conditions of a country. In Component 3, two variables are present, namely, economic conditions of a country, and banking credit system.

After the rotation, the rotated component matrix has shown three components. Three variables, namely, client-related determinants, clients' guarantees and warranties, and bank-related determinants are present in Component 1. In Component 2, two variables are present, namely, clients' guarantees and warranties, and political conditions of a country. In Component 3, two variables are present, namely, economic conditions of a country, and banking credit system. Table 13 presents the rotated component matrix.

**Table (13) Rotated Component Matrix<sup>(a)</sup>**

	Component		
	1	2	3
Client-related determinants	-0.815	0.151	
Bank-related determinants	0.770		0.285
Financial position and business results of banks	-0.416	0.399	0.141
Political conditions of a country	0.244	-0.835	
Clients' guarantees and warranties	0.530	0.727	-0.139
Banking credit system	0.172	-0.254	0.781
Economic conditions of a country		0.322	0.754

<sup>(a)</sup> Rotation converged in 10 iterations.

*Rotation method: Varimax with Kaiser Normalisation; Extraction method: Principal Component Analysis.*

**Source:** Estimated by authors.

#### 4.5 Discussion of Results

Commercial banks remain dominant in the banking system in terms of their shares of total credit facilities in Oman. Commercial banks' total credits to the private sector are still increasing in spite of major constraints. Evidence also shows that Islamic banks in Oman will achieve great success, given that customers have a positive attitude towards the dealings with them. Mubeen, Kulkarni, and al-Hussaini (2014, p.

208) have concluded that Islamic banks in Oman will contribute in increasing the GDP and to the stability of the Omani financial and monetary system. However, commercial and Islamic banks should know that the determinants in which they operate are important factors in their performance, financial position, and credit facilities decision.

The results of the mean, standard deviation, and rank of determinants have shown that the determinants related to clients' guarantees and warranties have a higher rank in both types of banks. However, the determinants related to political conditions of a country have a lower rank in both types of banks. The ranks and importance of the determinants of credit facilities are similar between commercial and Islamic banks. Some of the reasons which can be attributed to the results are: First, the lack of high-level competition between Islamic and commercial banks in Oman. Second, as most of the products in both types of banks are business-oriented, investors may not be willing to invest when the determinants have negative effects. Hence, the determinants ranks are also similar. Third, Omani customers perceive Islamic and commercial banks as almost the same (Begum, 2014, p. 8).

Based on the hypothesis results, no differences exist between both types of banks with regard to the determinants of clients' guarantees and warranties, client-related determinants, economic conditions, political conditions, financial positions and results, and banking credit system.

For clients' guarantees and warranties, the result is consistent with Lukic (2014, p. 9), in which the guarantee is one of the most frequently used in businesses in Oman and is crucial for credit facilities decision given that banks want to protect their money. Economic and political determinants have an important role in credit facilities decision. Commercial bank lending is largely determined by the economic growth of a country. Economic growth is a positive change in the national income or the level of production of goods and services in a country over a certain period of time.

Our result on determinants related to clients supports the results found by Lin (2009, p. 6), and Chen and Han (2012, p. 2), in which the credit score and demographic characteristics are important in the credit facilities decision. Unlike the credit assessment in the US and other leading economies, no third external agency exists in Oman that can validate a borrower's credit score. Therefore, Omani banks have to evaluate a borrower's credit worthiness via other means that are available to them, such as the score provided by risk committees in each bank and through using a standardized approach.

In terms of financial positions and business results, both types of banks consider the financial performance indicators in deciding the credit facilities and no differences exist between them regarding this issue. This result is in line with Kim and Elias (2008, p. 69), who provided evidence that financial statements are perceived as important information used in the lending decision.

Varying implications are observed to indicate the importance of financial performance in this decision. First, this study reflects the importance of accounting information in decision-making processes of banks. This finding is supported by Cole et al., (2004, p. 227) who found that the banks use financial statements for loan decision-making purposes. Second, in commercial banks, banks' transactions are motivated by profit, and thus the measurements of profit and loss are crucial for banks. This finding is not only for commercial banks, but also for Islamic banks, in which the measurements of *murābahah* and *muḍārabah* require a bulk of accounting information. This result is supported by al-Khazaleh (2017, p. 37) who found that profit has a positive effect on bank lending decision.

The risk measurement as financial indicator is needed in commercial and Islamic banks with regard to investment and financing decisions. In Islamic banks, starting with a high investment is not enough. The result of risk is supported by Effendi and Disman (2017, p. 309) who stated that risk is an important factor in the banks and there are many types of risk faced by Islamic banks and commercial banks.

The results showed that there is no difference between Islamic banks and commercial banks with respect to the banking credit system. The main objective of banking credit system is to minimize default rates or the number of loans that are incorrectly classified as defaulted or non-defaulted. The central bank of Oman has defined lending policies clearly set forth in a manner as to provide effective supervision of all commercial banks, e.g., the interest rate decisions are taken by the central bank of Oman. Moreover, the Omani central bank has full control and responsibility of Islamic banks in all aspects and operations as both Islamic banks and commercial banks contribute to the economic growth in Oman. This result is inconsistent with the result of al-Ghfais (2017, p.13), who

find that the contribution to the economic growth of Islamic banks in Saudi Arabia is more than commercial banks.

In this study, we find further evidence with regard to Islamic banks in Oman. The Islamic banking system in Oman is undergoing a transition from a commercial model of banking to the Islamic banking, based on the principles of Islamic finance. The new system should not only eliminate interest-based transactions, but also introduce the practices of Islamic banking, such as *murābahah*, *salam*, and *mushārahah*. Therefore, Islamic banks in Oman are more careful about their strategy, market share, and performance. This evidence is consistent with Lodhi and Kalim (2005, p. 1003) in Pakistan, in which Islamic banks have new practices and concepts rather than an interest free banking system. If we consider the credit facilities decision in Oman, we will find the same result as in this study. The results of this study are consistent with al-Rawashdeh et al. (2013, p. 140), who concluded that all determinants of credit facilities are important and should be examined for credit facilities decision purposes.

In a factor analysis, the most important decision to be made is about the number of factors. Results derived from the factor analysis in analyzing the credit facilities determinants have shown that six important variables exist, which are priority in credit facilities decision, client-related determinants, clients' guarantees and warranties, bank-related determinants, political conditions of a country, economic conditions of a country, and banking credit system. Logically, banks are gaining customers' satisfaction, given that they are the main source of bank transactions and have developed their services to fulfill the needs of customers. Dimitriu, (2012, p. 134) have found that customers' personality such as satisfaction and loyalty have an influence on the services provided by the banks.

Our results are supported by Nouaili et al. (2015, pp. 415-416) who found a positive relationship between bank-related determinants and bank performance. This result suggests the ability of banks to reduce the cost of its services and own a high level of capital. For example, the average of the equity-to-assets ratios for the last five years (2013-2017) in the largest three banks in Oman is 12.58% (Bank Dhofar), 13.66% (Bank Muscat), and 14.08% (National Bank

of Oman). In Islamic banks, the ratios are 51.8% (Al Izz Islamic Bank), and 54.4% (Nazwa Bank).

Our result regarding the guarantees and warranties is consistent with Lukic (2014, p. 9), who found that guarantees and warranties are one of the most important instruments of security payments in international trading operations.

Political and economic conditions are priorities in Oman. Oman is one of the more stable countries in the region in terms of political and economic condition. This stability has a positive effect on the banking system. For example, Ananda (2017, p. 30) has found that due to these conditions, the net profit, total assets, and total deposits of banks have increased over the last five years.

Finally, according to the factor analysis, the banking-related determinant is prioritized as an important determinant of credit facilities in Oman with factor loading equal to 0.749. This finding is supported by data of the central bank of Oman in 2018 as the total credit of banks had increased by 6.4%. This will provide a positive outlook of the future of banks in Oman, which will in turn, facilitate the investment and development of the infrastructure in this country.

## 5. Summary and Conclusion

This study aims to examine the determinants of credit facilities between Islamic and commercial banks in Oman. Seven groups of determinants of credit facilities are tested in both types of banks. The sample of this study comprises credit managers of six commercial banks and six Islamic banks (including four Islamic-windows) in Oman.

The importance of this study may be viewed from its contribution to fill an important gap in literature. The findings of this study can add to the existing literature, in which it can serve as a starting point on which future studies can be conducted in Oman.

No differences are observed between commercial and Islamic banks regarding the determinants of credit facilities decision. Bank managers, credit managers, policy-makers, and investors should take these determinants in consideration with regard to this decision.

The results show that all seven groups of determinants are important in terms of mean and rank. The results also show that the determinants related to

clients' guarantees and warranties have a higher rank in both types of banks. However, the determinants related to the political conditions of a country have a lower rank in both types of banks.

The results of the hypotheses of all seven groups of determinants have shown that no differences exist between commercial and Islamic banks with regard to determinants related to investors, clients or customers; determinants related to financial position and business results of banks; determinants related to customers' guarantees and warranties; determinants related to the economic condition of a country; determinants related to the political condition of a country; and the determinants related to the banking credit system. By contrast, differences are observed between two types of banks regarding the determinants related to bank.

This study uses factor analysis to reduce variables into a smaller set to save time and facilitate easier interpretations. The results of the factor analysis have shown that six factor components exist, namely, client-related determinants, clients' guarantees and warranties, bank-related determinants, economic conditions, political conditions, and banking credit system. The three extracted factors explain only 67% of the variance which means that there are other factors which might affect the credit facilities decision such as interest rate, profit sharing rate, cost of fund, nature of portfolio structure, clients' awareness, and regulations and laws of credit facilities.

The findings of this study are subject to a number of limitations. First, the questionnaire is only distributed to a number of banks in Oman and the respondents have taken a long time to answer the questionnaire. Thus, an opportunity has presented itself to extend the scope of this study and include all banks working in this country and other GCC countries. Doing this could validate the results of this study and explore whether these outcomes are generalizable.

Second, the sample of the study is rather small, which may not provide significant and generalizable

results. Third, in this study, we did not discuss the difference between Islamic banks and commercial banks regarding interest rate, profit sharing rate, and cost of fund. This is beyond the scope of this paper. However, there are many studies which have discussed this issue and most of them agree that this is a most important difference between the two types of the banks.

Fourth, this study did not discuss any issue related to the nature of portfolio structures in Islamic banks and commercial banks. As known, Islamic banks deal with trade and asset-based finance whereas the commercial banks deal with debt-like financing. Therefore, the portfolio structure is also one of the most important differences between Islamic banks and commercial banks. Fifth, this study examined only seven determinants and excluded some of the other determinants, such as clients' awareness, and regulations and laws of credit facilities. In future studies, there is a good chance to examine the role of such determinants on credit facilities decision. This will give a comprehensive picture about credit facilities decision in Islamic and commercial banks.

Last, the Kaiser-Meyer-Olkin measure of sampling adequacy value for the study is low at 0.512, which is lower than 0.60. Although the value of KMO is above the acceptable limit which is 0.5, however, it is better to improve this value in future studies.

On the practical dimension, this study may help decision-makers to focus on the major credit facilities decision that may increase the bank ranking and financial performance positions compared with other financial institutions. Such a study should help the management of commercial and Islamic banks in creating appropriate financial strategies to attain the required financial performance. Studying the relationship between the credit facilities decision and financial and market performance between the two types of banks in Oman and all GCC countries is recommended as a comparison study.



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## هل تختلف محددات التسهيلات الائتمانية في المصارف الإسلامية عنها في المصارف التقليديّة؟ وجهة نظر من عُمان

معاوية كريم العاني

قسم المحاسبة، جامعة ظفار، صلالة، سلطنة عمان

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قسم الإدارة، جامعة ظفار، صلالة، سلطنة عمان

المستخلص. هدفت هذه الدراسة إلى استكشاف وفهم ما إذا كانت مُحددات التسهيلات الائتمانية في المصارف التجارية الإسلامية تختلف عنها في نظيرتها التقليديّة. تم اختبار سبع مجموعات من هذه المحددات في كلا النوعين من المصارف في سلطنة عُمان. تكونت عينة الدراسة من مدرّاء الائتمان في ستة مصارف تجارية تقليديّة وستة مصارف تجارية إسلامية بها (أربع نوافذ إسلامية). أشارت نتائج الدراسة إلى عدم وجود فروق جوهرية بين المصارف الإسلامية والمصارف التقليديّة فيما يتعلق بالمحددات المرتبطة بالعميل والمحددات السياسية، والمحددات الاقتصادية، والمحددات المتعلقة بالضمانات والوعود، والمحددات المتعلقة بالمركز المالي، والمحددات المتعلقة بنظام الائتمان المصرفي. وقد أظهرت النتائج وجود فروق جوهرية بين كلا النوعين من المصارف فيما يتعلق بالمحددات المرتبطة بالمصرف. أما نتائج التحليل العاملي فقد أظهرت أن محدّدات الضمانات والوعود، والمحددات المتعلقة بالمصرف، والمحددات الاقتصادية للبلد، وكذلك المحددات المتعلقة بالنظام المصرفي لها أولوية كبيرة في منح التسهيلات الائتمانية في المصارف العُمانية.

الكلمات الدالّة: المصارف الإسلامية، المصارف التجارية، التسهيلات الائتمانية، عُمان.

تصنيف JEL: G21, F65

تصنيف KAUJIE: F51, I41