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The Impact of Financial and Economic Indicators on the Financial Performance of Islamic Banks in Qatar

Israa Abdulridha Mousa Albusheekh Saleh[1], Abduljasem Abbas Alaallah[2]

[1]*Faculty of Administration and Economics, Department of Banking and Finance, Babylon University-Iraq; hsaaz20102010@gmail.com*
[2] *Faculty of Administration and Economics, Department of Banking and Finance, Babylon University-Iraq; bus.abd.aljasim@uobabylon.edu.iq*

[*] *Correspondence: hsaaz20102010@gmail.com*

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Abstract: Numerous economic and financial factors impact the financial performance of the banking industry, and this phenomenon warrants the attention of scholars. Therefore, this study investigates the effect of financial indicators such as capital adequacy requirement and liquidity, as well as economic factors such as interest rate, inflation, and economic growth, on the financial performance of Islamic banks in Qatar. From 1987 through 2020, secondary data were taken from the state bank database and world development indicators (WDI). The non-linear autoregressive distributed lag (NARDL) technique checks the relationship between variables. The results revealed a positive relationship between the capital adequacy requirement, liquidity, interest rate, inflation, and economic growth and the financial performance of Islamic banks in Qatar. Using financial and economic indicators, the study guides regulators in establishing regulations regarding the financial performance of Islamic banks.

Author Correspondence: hsaaz20102010@gmail.com
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1. Introduction

The performance of a nation's economy determines its economic prosperity. The economy combines many industries, such as manufacturing and services. The performance of the sectors also contributes to the improvement of the economy. The banking sector is one of the leading economic sectors. Nowadays, every area of the economy is intimately related to or dependent on the banking sector; hence, the banking sector is regarded as the economy's engine. Every nation has either a traditional or Islamic religion or a mixture. In recent decades, the significance of Islamic banking has increased at a rapid rate. Islamic finance, which was valued at $2.4 trillion in 2017 and is predicted to climb by 6% to $3.8 trillion by 2023, has been one of the industries with the highest growth rate over the past decade (Haddad et al., 2021; Ltaifa et al., 2021). All decision-makers, bankers, and financial professionals are attracted to the Islamic finance sector's continually high asset growth rate. Aside from the relationship between Islamic finance and economic growth, one of the key topics of discussion among financial experts and policymakers in recent years has been whether the financial performance of Islamic financing contributes to economic growth (Sekmen, 2021).

Since its founding in 1942, Qatar has relied on the petroleum and natural gas industries for its survival and economic growth. Qatar's banking sector benefited from its rapid economic growth (Jan et al., 2021). As a result, Islamic banks have delivered extraordinary outcomes in recent years. Between 1990 and 2018, the total assets of Qatar's fully-fledged Islamic banks increased from less than $1 billion in 1990 to more than $3 billion, a cumulative gain of up to 0.98 per cent (Ben Abdallah et al., 2021; El-Chaarani et al., 2022). Eleven local banks are registered with the central bank in Qatar, and one international bank has branches there. On the list of local banks are four Islamic banks fully adhering to Shariah principles, three conventional banks with Islamic windows, and one conventional bank with no Islamic banking activities (Elgammal et al., 2021). Despite having one of the GCC's smallest banking sectors in total assets, loans, and deposits, Qatar's economy has grown rapidly in recent years. Qatari banks enjoy the outstanding financial performance, adequate capitalization, and great asset quality (Ousama et al., 2020). In addition, the government supports banks by consistently working to regulate the financial services industry and enhance its efficacy. 1) Lack of innovation in financial products, 2) Lack of profit sharing, 3) Shariah-related issues, 4) Inadequate workforce with the required knowledge, and 5) Lack of awareness and competition are the greatest challenges facing Islamic banking in Qatar.

The past literature gaps that the present study will address are as follows: 1) the firms' performance has been studied extensively from different perspectives at different times and in different countries, but it has not yet reached its peak as there are still many of its aspects to be explored; 2) Irawati et al. (2019) have worked on the capital adequacy and the firms' performance; however, the present investigation will also work on both with the addition of other variables, i.e. the firms 3) The equation of financial performance, capital adequacy, liquidity, interest rate, inflation, and economic growth has not been tested in recent years, notably in Qatar. 4) Hongli et al. (2019) and Edem (2017) worked on the relationship between liquidity and the performance of firms; however, the current investigation will also work on both with the addition of economy-related variables, such as the interest rate, inflation, and economic growth, using a new data set. 5) Doan (2020) and Bui (2020) investigated the relationship between inflation and firm performance; however, the current investigation will also focus on both, in addition to the addition of other variables, such as capital adequacy, interest rate, and economic growth, using a new data set. The significance of the current study is that 1) it will highlight the importance of microeconomic factors for improved firm performance, 2) it will assist finance-related professionals in reviewing and upgrading the firms' finance-related policies to enhance the firm's performance, and 3) it will aid researchers in exploring additional aspects of firm performance.

The organization's structure is further divided into chapters. The first chapter provides a general introduction, including the significance and study gap. The literature on financial performance, capital adequacy, liquidity, interest rate, inflation, and economic growth is presented in the second chapter. The third chapter describes the methodology, i.e., data collection regarding financial performance, capital adequacy, liquidity, interest rate, inflation, and economic growth. The fourth chapter presents the study's findings, followed by the fifth chapter's conclusion, discussions, and implications.

2. Literature Review

Capital sufficiency is a major consideration for shareholders when picking an investment company. Capital adequacy refers to the minimal reserves a company must keep to prevent a lawsuit. Capital sufficiency has a significant impact on the firm's performance. Irawati et al. (2019) examined the relationship between adequate capital and company performance in this scenario. In Indonesia, the banking industry was the subject of the probe. The investigation sampled data from 30 banks over the years 2011 through 2015. Utilizing E-views, the collected data was analyzed. The analysis found that enough capital has a considerable and favourable effect on the firm's success.

Similarly, Dao (2020) explored whether adequate capital affects the performance of a company. The investigation took place in Vietnam. The analysis utilized information from 16 commercial banks from 2010 to 2017. With the aid of SPSS, the collected data was analyzed. The analysis suggested a significant relationship between capital adequacy ratio and bank performance and that loan growth and cost-to-income ratio significantly impact two dependent variables. In addition, Mohapatra et al. (2019) examined if intellectual capital, i.e. capital adequacy, influences the firm's performance. The probe was conducted in India's banking industry. The analysis utilized data from forty banks from 2011 to 2015. The collected data were analyzed using the DEA-BCC model. Only human capital efficiency, out of the three components of intellectual capital, was found to be significantly and favourably associated with operational efficiency.

In contrast, structural capital and financial capital were detrimental to the efficiency of banks. The banks should also invest in their human resources to get a competitive advantage. The conclusions remain unchanged when financial metrics are substituted for performance.

One of the variables that negatively affect businesses is liquidity. Any potential investor should avoid investing in a company based on its liquidity. Liquidity is the result of a company's poor performance. In this situation, In this context, Wuave et al. (2020) studied whether liquidity impacts firm performance. The investigation took place in Nigeria. As a sample, the study included data from eight years, from 2010 to 2018. The collected data was evaluated using Hausman and related tests. The investigation's findings demonstrated a strong correlation between liquidity and corporate performance. In addition, the study advised that Nigerian banks tighten their governance by implementing strict policies. In addition, Edem (2017) explored if liquidity management influences a company's performance. The inquiry was conducted in Nigeria's banking industry. As a sample, the

analysis utilized information from 24 banks from 1986 to 2011. The analysis indicated a significant positive correlation between the performance of Nigerian deposit money banks and their liquidity management. In addition, the ratios of liquidity and cash reserves have a positive impact on return on equity, whereas the ratio of loans to deposits has a negative impact.

Moreover, only banks with the highest liquidity could generate the greatest profits. Similarly, Hongli et al. (2019) examined the connection between liquidity and firm performance. The investigation was conducted in Ghana's industrial industry. 2007-2015 tenure information was utilized as an example. The collected sample was evaluated using the RE model. According to the investigation's findings, liquidity has a favourable and large effect on ROE. Moreover, financial leverage considerably positively affects business performance, as 65% of firm assets are funded by debt. Lastly, there is a strong correlation between liquidity and company performance.

Globally, businesses rely heavily on both internal and external financing. In both instances, the interest rate is decisive. Due to the funding involved, the interest rate substantially impacts the firm's performance. In this context, Pacini et al. (2017) examined whether microeconomic parameters, such as the interest rate, affect a company's performance. The investigation was conducted in the United Kingdom. The data from 100 companies from 2000 to 2014 was collected and used as a sample. SPSS was utilized to evaluate the collected sample. The analysis indicated that the company's success is considerably and positively impacted by the gross domestic product, inflation rate, and the ratio of interest payments on domestic debt to total income tax. However, the influence of the exchange rate, interest rate, and the ratio of short-term foreign debt to international reserves is in the opposite direction.

Similarly, Jayiddin et al. (2017) studied if the firm's capital structure, including interest rates, influences its performance. The inquiry was conducted on the public sector in Malaysia. A sample of tenure information from 2010 to 2014 was collected. The collected sample was evaluated using Tobin's Q. According to the study's findings, capital formation, i.e. interest rate, has a considerable impact on a company's performance. In addition, Sudiyatno et al. (2017) studied whether working capital influences the firm's performance, including the interest rate. The manufacturing sector in Indonesia was the focus of the inquiry. The collected sample was evaluated using Tobin's Q. The analysis found that interest has a large and favourable effect on the company's success. Leverage and the ratio of current liabilities to total assets have a negative and severe effect on a company's success. Additionally, the return on the asset has a negative and considerable impact on the value of the business.

Inflation is a crucial aspect of every financial system. It has an impact on every financial decision made in the country. Any change in inflation rates has a significant impact on all financial decisions made by a nation. In this connection, Doan (2020) explored whether inflation influences a company's success through its financing decisions. In Vietnam, the probe was conducted on nonfinancial businesses. The information from 102 companies was utilized as a sample. The collected material was examined using the GMM technique. The analysis indicated that a greater reliance on debt is detrimental to a company's performance. It is recommended that companies avoid using debt to finance operations, as it may harm their performance.

The studies also imply the major benefits of the inflation rate for financial development, for management and authorities to develop suitable policies to improve corporate performance and promote steady, sustainable growth. Any country's performance is a result of the firm's performance. If the enterprises are operating well, the economy as a whole is moving in the right direction, and the nation's performance is satisfactory. In this context, Bambe et al. (2022) examined whether inflation affects the nation's performance. The investigation was based on the information on 46 developments. Using the EB approach, data covering the period from 2006 to 2020 was collected and analyzed. The analysis indicated that inflation plays a crucial role in improving or deteriorating a country's performance; hence, there is a strong correlation between inflation and economic performance. In addition, Bui (2020) examined if inflation through financial leverage affects the firm's performance. The building industry in Vietnam was the focus of the inquiry. Data from thirty companies spanning the years 2015 to 2018 was collected as a sample. The collected sample was evaluated using the Pooled regression technique. The analysis indicated that inflation caused by financial leverage significantly impacts the firm's performance.

Any nation's economic growth is dependent on its business sector. Multiple enterprises comprise the country's business sector; hence, each firm's performance affects the nation's economic growth. Cao et al. (2022) studied whether there is a relationship between business performance and national economic growth in this environment. In China, the investigation was conducted. A sample of the data covering 2007 to 2015 was collected. The collected sample was analyzed with the assistance of Smart PLS. According to the inquiry, there is a considerable positive correlation between the firm's performance and economic growth. Governments, bankers, and other stakeholders have traditionally provided substantial support for large-scale businesses in emerging nations. However, small and medium-sized enterprises (SMEs) also play an essential role in economic growth. In this context, Feela (2020) also examined the correlation between the performance of enterprises and economic growth. The investigation was conducted in SADC nations. As a sample, data from 355 companies were obtained. The collected sample was evaluated using STATA. The analysis indicated that the company's success positively influences the country's economic growth.

Similarly, Yang (2018) examined whether there is a correlation between regional economic growth and the firm's success. In China, the investigation was conducted. Data from 285 companies spanning the years 1197 to 2016 was collected as a sample. SPSS was utilized to evaluate the collected sample. The investigation revealed a significant correlation between the company's performance and regional economic expansion.

3. Research Methods

This study investigates the influence of capital adequacy requirement, liquidity, interest rate, inflation, and economic growth on the financial performance of Islamic banks in Qatar. From 1987 to 2020, secondary data were extracted from the state bank database and WDI. The article developed the equation based on the following current study variables:

$$ROE_t = \alpha_0 + \beta_1 CA_t + \beta_2 LQ_t + \beta_3 IR_t + \beta_4 INF_t + \beta_6 EG_t + e_t \quad \textbf{(1)}$$

Where;

ROE	=	Return on Equity
t	=	Period
CA	=	Capital Adequacy
LQ	=	Liquidity
IR	=	Interest Rate
INF	=	Inflation
EG	=	Economic Growth

As a predictive variable, the study utilized banks' performance as measured by return on equity. In addition, the study employed two predictors, such as economic and financial indicators. The financial indicators consist of capital adequacy,

measured by the ratio of a bank's capital to its risk-weighted assets, and liquidity, measured by the ratio of current assets to current liabilities. In contrast, the economic factors consist of lending interest rates (%), inflation (annual%), and economic growth (annual%). Table 1 displays the measured variables.

Table 1. Variables with Measurements

S#	Variables	Measurement	Sources
01	Bank Performance	Return on Equity	State Bank Database
02	Capital Adequacy	The ratio of a bank's capital to its risk-weighted assets.	State Bank Database
03	Liquidity	The ratio of current assets and current liabilities	State Bank Database
04	Lending Interest Rate	Lending interest rate (%)	WDI
05	Inflation	Inflation, consumer prices (annual %)	WDI
06	Economic Growth	GDP growth (annual %)	WDI

The study checks the details of the constructs, and descriptive statistics are used. In addition, the article also examines the correlation among constructs using a correlation matrix. Moreover, the article also checks the unit root using the augmented Dickey-Fuller (ADF) test and Phillips-Perron (PP) test. The estimation equation of the test is given below:

$$d(Y_t) = \alpha_0 + \beta t + YY_{t-1} + d(Y_t(-1)) + \varepsilon_t \quad \textbf{(2)}$$

In addition, to apply the appropriate model, the study also runs the co-integration using the bound test. In addition, the study checks the asymmetric connection among capital adequacy, liquidity, and return on equity. Thus, the non-linear function is established as under:

$$ROE = f\,(IR, INF, EG, CA^{+}, CA^{-}, LQ^{+}, LQ^{-}) \quad \textbf{(3)}$$

Thus, based on the non-linear function mentioned above, the study developed the equation with the non-linear function given below:

$$ROE_t = \alpha_0 + \beta_1 IR_t + \beta_2 INF_t + \beta_3 EG_t + \beta_4 CA_t^{+} + \beta_5 CA_t^{-} + \beta_6 LQ_t^{+} + \beta_7 LQ_t^{-} + e_t \quad \textbf{(4)}$$

Finally, the study used the ARDL model to verify the connection among variables. It is suitable when co-integration exists. It is also a valuable technique when some constructs have no unit root at I(0), and others have no unit root at I(1) (Ali et al., 2021). It also provides long and short-run nexus among variables (Kong et al., 2021). The ARDL equation is mentioned below:

$$\Delta ROE_t = \alpha_0 + \sum\delta_1 \Delta ROE_{t-1} + \sum\delta_2 \Delta CA_{t-1} + \sum\delta_3 \Delta LQ_{t-1} + \sum\delta_4 \Delta IR_{t-1} + \sum\delta_5 \Delta INF_{t-1} + \sum\delta_6 \Delta EG_{t-1} + \varphi_1 ROE_{t-1} + \varphi_2 CA_{t-1} + \varphi_3 LQ_{t-1} + \varphi_4 IR_{t-1} + \varphi_5 INF_{t-1} + \varphi_6 EG_{t-1} + \varepsilon_t \quad \textbf{(5)}$$

Finally, the study used the NARDL approach to check the connection among constructs. So, the article has established the non-linear ARDL equation by adding positive and negative changes in capital adequacy and liquidity. This equation for the NARDL model is given below:

$$\Delta ROE_t = \alpha_0 + \sum\delta_1 \Delta ROE_{t-1} + \sum\delta_2 \Delta IR_{t-1} + \sum\delta_3 \Delta INF_{t-1} + \sum\delta_4 \Delta ED_{t-1} + \sum\delta_5 \Delta CA_{t-1}^{+} + \sum\delta_6 \Delta CA_{t-1}^{-} + \sum\delta_7 \Delta LQ_{t-1}^{+} + \sum\delta_8 \Delta LQ_{t-1}^{-} + \varphi_1 ROE_{t-1} + \varphi_2 IR_{t-1} + \varphi_3 INF_{t-1} + \varphi_4 EG_{t-1} + + \varphi_5 CA_{t-1}^{+} + \varphi_6 CA_{t-1}^{-} + \varphi_7 LQ_{t-1}^{+} + \varphi_8 LQ_{t-1}^{-} + \varepsilon_t \quad \textbf{(6)}$$

4. Research Findings

As a predictive predictor, the study utilized banks' performance evaluated by return on equity. In addition, the study employed two predictors, such as economic and financial data. The financial indicators consist of capital adequacy, assessed by the ratio of a bank's capital to its risk-weighted assets, and liquidity, measured by the ratio of current assets to current liabilities. In contrast, the economic elements consist of lending interest rates (%), inflation (annual%), and economic growth (annual%). Table 1 displays the measured variables.

Table 2. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROE	34	12.782	3.209	9.112	29.642
CA	34	11.732	2.648	7.747	18.094
LQ	34	2.903	0.746	1.947	4.998
IR	34	8.842	1.181	6.737	13.795
INF	34	13.846	1.903	7.735	17.093
EG	34	5.735	0.018	2.216	7.094

In addition, a correlation matrix is used to examine the correlation between constructs. The results demonstrated a favourable relationship between the capital adequacy requirement, liquidity, interest rate, inflation, and economic growth and the financial performance of Islamic banks in Qatar. Table 3 displays these numbers.

Table 3. Correlation Matrix

Variables	ROE	CA	LQ	IR	INF	EG
ROE	1.000					
CA	0.389	1.000				
LQ	0.732	0.483	1.000			
IR	0.483	0.455	0.473	1.000		
INF	0.640	-0.737	-0.372	0.721	1.000	
EG	0.331	0,372	0.338	-0.228	0.756	1.000

In addition, the unit root is examined using the PP unit root test and the augmented ADF test. ROE, IR, and INF have no unit root at the level, while CA, LQ, and EG have no unit root at the first difference. Table 4 displays these numbers.

Table 4. Unit Root Test

	ADF		PP	
Series	Level	First difference	Level	First difference
ROE	-2.784***	----	-2.102***	----
CA	----	-5.489***	----	-5.993***
LQ	----	-5.774***	----	-6.382***
IR	-3.826***	----	-2.392***	----
INF	-2.818***	----	-3.094***	----
EG	----	-4.823***	----	-5.348***

In addition, the bound test is applied to the co-integration to apply the proper model. The results demonstrated that the calculated f-statistics values exceed the critical values. These results demonstrated that co-integration exists. Table 5 displays these numbers.

Table 5. Bound Test of Nonlinear ARDL

	F-statistics	Lower Bound	Upper Bound	Decision
Linear ARDL	4.903	2.442	2.903	Co-integration
Asymmetric ARDL	4.938	2.671	2.987	Co-integration

Finally, the NARDL model was employed to validate the relationship between variables. The results demonstrated a favourable relationship between the capital adequacy requirement, liquidity, interest rate, inflation, and economic growth and the financial performance of Islamic banks in Qatar. This information is displayed in Table 6.

Table 6. Non-linear ARDL Results

Variables	Coefficients	Std. Err.	t-statistics
C	0.783	0.289	2.709
ROE (-1)	0.921	0.271	3.399
IR (-1)	1.289	0.431	2.991
INF (-1)	2.785	0.526	5.295
EG (-1)	2.901	0.453	6.404
CA-P (-1)	1.892	0.723	2.617
CA-N (-1)	1.282	0.356	3.601
LQ-P (-1)	2.337	0.201	11.627
LQ-N (-1)	2.172	0.633	3.431
Adj. R Square	0.712		
Prob.(F-statistics)	0.020		

5. Discussions

The results demonstrated a positive association between capital adequacy and the financial performance of banks. This research is consistent with Alfadli et al. (2020)'s assertion that a bank's adequate capital allows it to withstand risks that are contingent and have the potential to disrupt its normal operations, such as deposits and loans. Capital sufficiency permits the maintenance of a constant rate of profitability. These conclusions are further corroborated by Saerang et al. (2018). They argue that if banks have sufficient capital to absorb business-related losses, they can overcome the risks or manage the damages caused by risk exposures. Thus, banks' operations can be more sustainable, and profits can increase. The results demonstrated a positive association between liquidity and the financial performance of banks. According to Chen et al. (2021), if banks preserve their assets so that many of them may be readily converted into cash, a kind of ready-to-use asset, they can take more risks while conducting transactions and, consequently, earn greater profits. Therefore, more liquidity increases profits. These outcomes are also corroborated by Sahyouni et al. (2019), who note that increased liquidity enables banks to maintain smooth transactions and creates greater profitability.

The results demonstrated a positive association between interest rates and the financial performance of banks. These findings concur with Rathnayake et al. (2022)'s conclusion that banks deal in money and must adhere to a specified interest rate on deposits and loans. The increased interest rate could encourage more depositors to transact through banks. The larger deposits can be used to grow the firm and increase revenues. Wu et al. (2022)'s study also validates similar findings. This past study hypothesizes that banks will earn more regularly from loan distribution if there is a greater interest rate on loans. The results revealed a positive relationship between inflation and the financial performance of banks. These findings are consistent with Katırcıoglu et al. (2020)'s assertion that businesses tend to expand their activities and branches when inflation is present. These companies rely more on banks for financial management. Under these conditions, commercial banks have an excellent opportunity to raise their overall profits. These findings are also supported by Arsić et al. (2022), who assert that inflation stimulates economic activity. Therefore, financial growth encourages banking services and boosts bank profitability.

The results indicated a positive relationship between economic growth and the financial performance of banks. These findings are consistent with Khan et al. (2020)'s assertion that business transactions such as infrastructure bill payments, money transfers, and money collection, as well as the need for savings, increase with economic growth. Thus, banking activities expand, and banks generate greater profits. These findings are consistent with Cigu et al. (2018)'s assertion that the demand for credit and loans increases during economic expansion. The banks that grant more loans generate greater aggregate profits.

6. Implication

The present research piece is a significant literary contribution from which researchers can learn a great deal. The article

analyzes the effects of financial indicators such as capital adequacy and liquidity, together with economic variables such as interest rate, inflation, and economic growth, on the financial performance of commercial banks. This research is a preliminary attempt to evaluate the financial performance of Islamic banks in Qatar using a selection of financial and economic metrics.

The banks or financial institutions that deal in currency serve as the foundation of an economy. The research is pertinent to the financial performance of banks and applies to emerging economies such as Qatar. The study informs economists and institutional managers about strategies that can be utilized to improve the financial performance of businesses. It provides a guideline that the bank's management must acquire adequate capital to deal with difficult conditions and produce sustainable earnings. The report recommends that financial institutions boost their financial position by increasing the liquidity of their assets to generate greater revenues. The paper claims that interest rate adjustments are necessary to accelerate and maintain banks' profitability. The economists learn that inflation should be contrasted with deflation to increase bank profits under favourable economic conditions. Using financial and economic variables, the study aids authorities in creating policies on the financial performance of Islamic banks. It is recommended to the government and experts that the economic growth rate be accelerated to boost financial development.

7. Conclusion

This study aimed to examine the effects of financial and economic indicators, such as capital adequacy and liquidity, on the financial performance of commercial banks. Return on equity was positively correlated with capital sufficiency, liquidity, interest rate, inflation, and economic growth, according to evidence from Islamic banks in Qatar. The findings suggested that banking institutions with high capital adequacy could increase their profits by mitigating risk and loss and, as a result, creating business opportunities. The results demonstrated that increased liquidity improves banks' capacity to execute large and lengthy projects and boosts their overall financial performance. The study also concluded that if there is an increase in interest rates for deposits, credits, and loans, banks will have more deposits and a greater inclination to grant enormous credits and loans. Therefore, they can generate greater profits. In addition, the inflationary period, accompanied by a rise in economic financing needs, improves the financial performance of banks. Results also indicate that banks' financial performance improves as economic growth and business expansion increase.

8. Limitations

Additionally, the current study has limitations that must be addressed in future research. Here, the effects of certain financial and economic indicators on the financial performance of banks are examined. Significant roles are played by the bank's finances, human resources, marketing, and risk management. Future authors must also be aware of bank management to assess banks' financial performance. Moreover, the evidence from Islamic banks in Qatar diminishes the generalizability of the results. Therefore, it is suggested that future authors collect evidence from additional banking systems to obtain general results.

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