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DO ISLAMIC WINDOWS OUTPERFORM FULL-FLEDGED ISLAMIC BANKS? EMPIRICAL INSIGHTS FROM A FIVE-COUNTRY PANEL

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Abstract

Islamic finance has moved from the periphery to a recognisable component of the international financial system over the past two decades. Recent industry data (ICD-LSEG, 2023) point to 336 fully licensed Islamic banks and 274 Islamic windows operating within conventional institutions worldwide, with the latter category expanding roughly twice as fast as the former during the preceding ten-year period. For Uzbekistan, where Law LRU-1126 took effect on 17 June 2026 and established the legal foundation for Islamic banking activity, the natural policy question is whether the window model - Shariah-compliant divisions embedded within conventional banks - delivers stronger financial performance than fully separate Islamic banks. This article addresses that question empirically. A balanced quarterly panel comprising 394 observations across ten cross-sectional units was constructed from the IFSB Prudential and Structural Islamic Financial Indicators database. The sample covers Indonesia, Malaysia, Oman, Pakistan and Saudi Arabia over 2014Q1–2023Q4, jurisdictions selected for the coexistence of both organisational forms and consistent reporting throughout the period. Four dimensions of bank performance were examined: operational efficiency (cost-to-income ratio, CIR), profitability (net profit margin, NPM),

asset productivity (return on assets, ROA) and asset quality (non-performing financing, NPF). Estimation was carried out in EViews Student Version using pooled ordinary least squares with country fixed effects (Indonesia serving as the baseline) and Huber-White heteroskedasticity-consistent standard errors. Cross-section fixed effects could not be applied because the window indicator is time-invariant within each cross-sectional unit and would be absorbed by perfect collinearity.

Table 1 summarises the empirical findings, combining group means, Welch tests of mean equality and the estimated coefficients on the window indicator from the fully specified regression models.

Table 1. Comparative performance of Islamic windows and Islamic banks

Indicator	**Mean (BANK)**	**Mean (WINDOW)**	**Welch t**	**OLS β (WINDOW)**	**R^2**
CIR (%)	65.77	46.07	7.13***	−30.467***	0.517
NPM (%)	26.18	46.38	7.14***	+28.266***	0.450
ROA (%)	1.26	1.78	4.64***	+0.740***	0.469
NPF (%)	2.44	1.67	5.32***	−0.763***	0.593
N	197	197	394	394	—

Notes. Welch t refers to Satterthwaite-Welch statistics for the null hypothesis of equal means across the WINDOW dummy. OLS coefficients are from pooled regressions with country fixed effects and HC1 heteroskedasticity-consistent standard errors, controlling for bank size (log total assets) and — where applicable — non-performing financing. *** significant at 1%. Source: author's calculations based on IFSB PSIFIs (2024).

Three points warrant emphasis. First, all four performance indicators favour Islamic windows, and every differential is statistically significant at the 1% level. The cost-to-income advantage of roughly 30 percentage points is particularly striking: even after controlling for bank size and country-level heterogeneity, windows operate at approximately two-thirds the cost intensity of standalone Islamic banks. Second, the regression estimates on the window indicator generally exceed their unconditional counterparts in absolute magnitude, indicating that the raw differences understate the true window premium once controls are introduced. Third, and importantly for policy concerns commonly raised in dual-banking regulatory debates, Islamic windows exhibit lower - not higher - non-performing financing ratios, weighing against the argument that hybrid Shariah-compliant structures might attract weaker borrowers or dilute credit discipline. The empirical patterns align with entry-cost theory (Duvall and Ford, 1985), which attributes the efficiency premium to shared use of the parent bank's branch network and compliance infrastructure, and with the dynamic capabilities framework (Teece, Pisano and Shuen, 1997), which explains the asset-quality advantage through the transfer of established risk-management routines from the parent institution.

For Uzbekistan, these findings deliver a fairly clear policy message. Prioritising the window model as the initial vehicle for Shariah-compliant banking is likely to yield efficiency gains that would not be available were regulators to insist on fully separate Islamic banks from the outset, while the observed asset-quality advantage should alleviate supervisory concerns about credit-discipline risks. Recent Uzbek-language scholarship (Dadabayev, 2025) reaches broadly compatible conclusions, characterising the window model as a pragmatic transitional architecture particularly suited to jurisdictions building Islamic finance capacity from scratch. The main limitations of the present analysis - the

five-country sample and the country-level rather than bank-level granularity - indicate natural directions for extension once bank-level microdata become available.

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