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THE INFLUENCE OF BANK CAPITAL, LIQUIDITY RISK, AND CREDIT RISK ON THE FINANCIAL INSTITUTIONS PROFITABILITY: FINDINGS FROM NEWLY GROWING MARKET ON ISLAMIC V/S CONVENTIONAL BANKS

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KEYWORDS	ABSTRACT
Liquidity risk, credit risk, bank capital, profitability, Islamic banks, conventional banks, interest rate, return on asset, return on equity, loan.	The main focus of this study is to check the influence of bank capital, liquidity risk, and credit risk on profitability of financial institutions of both Islamic and conventional banking profitability. Purposive sampling technique has been applied for this study to collected data with 138 respondents who are working in finance department of both Islamic and conventional banking. In this study using explanatory research approach with using quantitative research of 138 respondents in Karachi, Pakistan. Afterwards, to check the relationship between different constructs PLS-SEM software has been used for statistical technique to analyze the current model. Finding of this study show the influence of bank capital, liquidity risk, and credit risk on profitability of financial institutions both banks. Credit risk is negatively effect on the bank profitability and the bank capital and Liquidity risk is positively impact on the profitability of both banking. The Study has been finding into four main areas such bank capital, liquidity risk and credit risk.
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Introduction

Background of the study

Financial institutions are played very important role for the development of economic stability of any country also considered as backbone of economic stability of country mostly the banking institutions are involved for the development of economic stability (Batten & Vo, 2019). As we have seen that a country is totally depend on banking sector to boost up their economic level. The investors tend to use future tasks and growth in customer self-assurance in result economic

condition of country growing up day-by-day (Luo et al., 2016). Banks basically accept the deposit and give that deposit as loan to the other financial sector or personal loan with additional interest rate which may lead the profitability of bank. If the bank don't charges interest rate from the borrowers which may loss for the bank overall profitability. That's why the loss of banking industry faced problem and moreover the risk factors mostly in the bank worldwide with credit risk (Chou, 2016).

Nowadays banking industry is fast growing day by day and it is important for the banking industry that run the business by providing credit to its customers and recovering those principle and additional interest amount. Bank basically accept deposit from its customer and this is the asset of the bank and bank use these asset by providing loan to the other financial sector with different mode of financing in the context of conventional bank in Pakistan. In the context of Islamic banking it's not focusing on interest but followed by sharia compliant of Islamic structure. Credit risk is one of the main risk where banks face loss due to borrower not paying principle and interest amount to the bank therefore the profitability of bank decreases. Banks capital is basically the difference between asset and its liabilities also the net value of the bank. Liquidity is also important in the business where the companies measure its liquidity ratio through current ratio and quick ratio. Where the liquidity risk in the business the bank face struggle to convert asset in to cash to cover its liabilities and lending to potential financial stress.

The conventional and Islamic banks both have their own structures providing loan to its customers with different set of Islamic Sharia compliant followed by Islamic structure of Islamic banking i.e. Car Ijarah, Home Musharakah, Mudaraba and conventional bank providing its own conventional structure to increase their bank profitability which included credit money, Car financing, Personal financing etc.

Mostly in the financial institution their aims to increase profitability maximization (Kargi, 2011). the profit maximization in the bank is only when bank receive deposit at lower interest rate and giving to investors and customers with huge interest rate (Khieu et al., 2012). In the opinion of (Kargi, 2011) the only method bank can increase their profitability giving a large amount of credit to its customers. When the bank take risk highly the profit also highly these are proportional (Haneef et al., 2012).

Islamic banking play important role in the Islamic countries which is also called IBs. The bank operated in Islamic countries for the Muslims populated regions, which is the widely spread around the worldwide. In the recent times that the Islamic banks are working in different countries and the Islamic banking increases day by day and most of the conventional banks in Pakistan fully converted into Islamic banking such as Bank Islami, Meezan, & Faysal ,which is widely operated its branches throughout the country and as their customers increase gradually. According to IFSB reported the Islamic banking growth rate is increased up to 22% in the 2023 with the total net asset value of 5,239 billion. Islamic Banking is totally different as compared to conventional bank regarding to their products nature and its structure. In Islamic Banking, where transactions are not allowed on the basis of interest (riba), uncertainty (gharar). Islamic and

Conventional banking difference are only in loss and profit on dividing mode of finance show in the mostly in liabilities side (Obaidullah., 2005). In the other side conventional banks also play important role in the banking sector which is totally based on interest and these banks operated throughout the globe and most focused to earn more profit. When compare Islamic banking with conventional banking the most net asset value of conventional banking is greater than Islamic banking and its operational volume are more than Islamic banking. As both are involved in credit, liquidity and bank capital risk and the interference of these risk bank face to decrease in its profitability.

Problem Statement

Previous studies that explain liquidity risk and credit risk in Islamic banks compared to conventional banks It emphasizes the difficulties faced by IBs in managing liquidity, credit risks, and overall stability and manage risk position is better than over conventional, despite their different Sharia-compliant banking operations risk management and their stability. While conventional banks are not properly managing risk but need to more work on their banking operations to reduce the credit and liquidity risk in their business to earn more profit. Paltrinieri and Hassan in 2018, when they compared both banking it's confirmed that the Islamic banking is better than conventional banking while managing risk positions. Previous studies that the conventional banking are not managing risk properly as compared to Islamic banking the research gap is to find out these risk mostly effected conventional banking system while comparing with Islamic banking.

Previous research indicate that the bank face a lot of difficulties in credit risk and liquidity risk in the banking system therefore banking profitability decrease day by day and banks not maintain high level of profitability and this is the main issue in this research. Moreover, exposure to credit and liquidity risk could have a significant impact on the financial sustainability and profitability of conventional banks compared to Islamic banks, which persistently face credit and liquidity risk. While both banking models exist in different institutional and regulatory environments, if the risks are not managed properly, they can make it difficult for banks to maintain adequate liquidity, manage asset quality and remain profitable. Therefore, a comparative study is recommended to find out if conventional banks are still more exposed to credit risk and liquidity risk than Islamic Bank, and to see how the credit and liquidity risk dimensions affect the profitability of conventional banks. This evaluation could help to clarify the divergent risk-management approaches of the two banking systems.

Research Gap

Previous literature has focused on the credit risk-liquidity risk relationship, the bank capital-liquidity risk relationship and the relationship between credit risk and profitability, while very little research has investigated the relationship between liquidity risk, bank capital and profitability. How these factors are different in Islamic banking and conventional banking institutions especially in the Pakistan banking scenario. To date, the literature has recognized that

Islamic banks could perform better in terms of risk management than conventional banks, but it has been less well established how particular aspects of risk impact banking profitability. Another gap is the lack of an integrated approach to credit risk and liquidity risk. Previous research usually focuses on these risks in isolation or in a specific banking system, thus providing limited knowledge about the overall impact of these risks on profitability between Islamic and conventional banking systems. This is especially significant in the context that both banking models are based on different financial structures: conventional banks are primarily based on interest-based lending systems while Islamic banks are based on financing practices that are compliant with the Sharia. The current study also suggests that credit risk, liquidity risk may negatively affect the profitability of banks, and the bank capital can have varying impacts on financial performance. However, further research is still needed that examines these relationships more closely, comparing between Islamic and conventional banks. This unanswered question is identified in the thesis by emphasizing the necessity to find out which risks have a more detrimental effect on conventional banking as compared to Islamic banking.

Hence, the gap in existing literature is less comparative evidence regarding the impact of credit risk, liquidity risk and bank capital on the profitability of Islamic Bank versus conventional bank in the context of Pakistan. This gap can be filled to understand if the different operational and financing framework of the two banking systems is associated with meaningful differences in risk exposure and profitability. This investigation is particularly relevant as there are longstanding challenges in managing credit.

Band risks and liquidity risks can jeopardize banks' profitability and financial stability. This research, therefore, aims to fill the void in the literature by comparing the credit risk, liquidity risk, bank capital and profitability of Islamic versus conventional banks in Pakistan. The results can be useful for the banking literature as a comparative example to help researchers, banking practitioners and financial decision makers better understand the risk–profitability relationship in two structurally different banking systems.

Research Objective

The main objective of this study is to comparatively examine credit risk and liquidity risk in Islamic Banks and conventional banks and determine their implications for banking profitability.

The specific objectives are:

To examine the level of credit risk in Islamic Banks and conventional banks.

To assess and compare liquidity risk between Islamic Banks and conventional banks.

To investigate the effect of credit risk on the profitability of Islamic Banks and conventional banks.

To determine the influence of liquidity risk on the profitability of Islamic Banks and conventional banks.

Research Question

Answer of the following questions in Pakistan on the banking profitability.

What is the level of credit risk in Islamic Banks compared with conventional banks?

How does liquidity risk differ between Islamic Banks and conventional banks?

What is the effect of credit risk on the profitability of Islamic Banks and conventional banks?

What is the influence of liquidity risk on the profitability of Islamic Banks and conventional banks?

Significant of Study

In this research the importance for the investor, owners, and managers how to deals with the risk associated with the bank and how to reduce those risk which is very harmful in the banking business so this helpful for the both banks managers and financial analysis how to manage their risk position in order obtain more profit in the business to control over liquidity and credit risk associated with the bank profitability for the banking industry and how to deal with this risks. The mere objective of the study is to narrow the gap between risk management and profitability analysis in banking sector in Pakistan. It is not only an interest in which banking model yields better profits but it's a fascination with the process of creating profits from banks, the risks involved and how well they can be managed.

The results can therefore help banking managers, investors, shareholders, financial analysts and regulators and researchers to better understand banking performance. The study's analysis of the three broad categories of bank risks, namely, bank capital, liquidity risk and credit risk, contributes to a deeper understanding of the financial strength and profitability of Islamic and conventional banks in Pakistan.

Theoretical Background

This research is done to check the influence of bank capital, liquidity risk and credit risk on the Islamic and conventional banking profitability. Theories that can be applied in this research are theories in financial intermediary, which is very close to financial institutions and helps to link credit risk with liquidity risk in financial intermediary that relates to the profitability of the financial institution concerned, namely the bank.

The theory is developed in 1997 by Anthony Santomero and Franklin Allen. Financial inter mediation theory – Financial institution like credit unions. Facilitates to the customer that offer different types of loans, mortgage and investment vehicle; banks, investment firms and

intermediaries. Which help the manage risk and promote country economic growth by the need of borrowers over the savers. In financial institution, Intermediaries also play an important role in giving financial advice to the savers, in transferring the financial liquidity and risk management service to the borrowers.

In this theoretical view, banks are seen as key intermediaries in the funneling of excess funds to the financial needs of individuals and businesses. Their inter mediation role is not just in the transfer of money but also in the valuation, pricing and taking of financial risk involved in lending and investment operations. Bank capital, in this sense, acts as a cushion against unforeseen losses while liquidity allows banks to meet their short-term obligations without selling distressed assets. Credit risk, on the other hand, occurs when the borrower does not fulfill the terms of the contract, which reduces profits and lowers the financial standing of the financial institution. Liquidity risk and credit risk thus can have a significant effect on profitability in conjunction with capital adequacy, especially when Islamic and conventional banking systems are contrasted, as they are based on different principles, contracts, and risk-sharing frameworks.

Literature Review

As the previous century, there is a huge number of studies about the consideration of the importance of financial institution especially in the banking sector. Earlier the literature review on the Islamic banks as we have analyzed that the Islamic banks primarily investigate their overall risk management, efficiency, performance individually as compared to conventional banks (Bitar et al., 2017). Mostly researcher highly recommended that the Islamic banking is better in managing over risk than conventional banks and Islamic banks maintain liquidity risk properly while conventional not maintain its liquidity risks properly. Bitar et al. (2017) found that Islamic banks were, on average, more capitalized, more liquid, and more profitable than conventional banks, although their earnings were more volatile. The past studies that the Islamic banking structure is very different as compared to conventional banking but in their function both are similar to each other. Both are working parallel around the world to fulfil the need of its stakeholder but in Islamic banks concept that the contractual structure is different according to (Hennie & Iqbal., 2008). Credit risk is negatively impact on the both Islamic and conventional banks profitability (Islam and Abu., 2020) and liquidity risk is also not converting cash quickly which is negatively impact on the bank profitability. Hassan, Khan, and Paltrinieri (2019) provide comparative evidence that Islamic and conventional banks share important risk-management concerns while differing in their treatment and management of liquidity and credit risk. Their analysis of 26 Islamic and 26 conventional banks found a negative relationship between credit risk and liquidity risk and concluded that Islamic banks were better at managing these risks in the examined sample. (Negri et al., 2023) The researcher worked on the title of credit risk impact on Islamic and conventional banking system. The research method was mixed method and worked on secondary data. The data was collected between 1975 to 2023 gather international and national journals. They worked on the following variable credit risk and profitability. The result showed that the Islamic banking is more secure than convention banking in managing credit risk. Comparative research on Islamic and conventional banking provides further evidence that

risk-management performance can differ between the two banking systems, particularly in relation to credit and liquidity risk.

(Ramlan and Adnan, 2015) This study is conducted to find out Islamic and conventional banks profitability in Malaysia. The data collected with the sample size of 65 each bank and they worked on the variable total equity to total asset, total loan to total asset, deposit to total asset as independent variable and the dependent variable such as Return on asset and return to equity. The result showed that the Islamic bank profitability directly positivity with loans and equity and also the result confirmed that there is no any difference in profitability and liquidity both as compared to Islamic and conventional banks. Comparative banking studies have similarly examined bank-specific variables such as capitalization, liquidity, asset composition, and profitability when distinguishing Islamic and conventional banking performance. Bitar et al. (2017), for example, used a large international sample to assess differences in capitalization, liquidity, profitability, and earnings volatility.

According to (Mokni & Rachdi, 2014) conducted a research to find out comparing between both Islamic and conventional bank's profitability in Middle Eastern and north South Africa. The research methodology is used in this research was a quantitative techniques. The data collected with the sample size of 15 conventional and 15 Islamic banks. They worked on the following independent variable such as credit risk, liquidity risk, interest rate risk, bank age and bank profitability is a dependent variable. The result clarify that there is a quit profitability in both banks because of high government intervention. Mokni and Rachdi (2014) examined 15 conventional and 15 Islamic banks in the MENA region over 2002–2009 using system-GMM and reported that the determinants of profitability differed between the two banking systems. They also identified persistent profitability and the possible influence of government intervention and barriers to competition.

(Chiabi and Omri, 2020) worked on the topic assessing liquidity risk on the both Islamic and conventional banks in Tunisia, north Africa. The data collected with the sample size of 49 conventional banks and 27 Islamic banks. They used in their research dependent variable such as liquidity risk and independent variable such as credit risk, bank size, inflation, liquidity gap, financial crisis, profitability ratio. The research methodology is used in this research was quantitative techniques. the results shows that the variable that influence the liquidity risk on the Islamic and conventional banks whole systems, macroeconomic factors of conventional banks as compere to Islamic banks is not affected by macroeconomic determinants in liquidity risk so conventional banks is affected by macroeconomics determinants. Ghenimi, Chaibi, and Lajmi's comparative study of Islamic and conventional banks found reciprocal relationships among credit risk, liquidity risk, and profitability and reported that both credit and liquidity risks were detrimental to profitability.

(Bamahriz and Suseno, 2017) the researcher worked on the topic of the effect of bank risks on the Islamic banks overall profitability in Malaysia. The data collected with the sample size of 75 Islamic banks across the 24 countries. They worked on the following independent variable such as

insolvency risk, credit risk, operational risk, liquidity risk. And dependent variable is bank profitability. The research methodology is used in this research was quantitative techniques. The result reflected to the all four independent variable effect the bank's profitability. Each independent variable affect the whole profitability of the banks which bank face difficulties to increase their profitability. The broader literature also indicates that bank profitability is shaped by a combination of risk exposure, capitalization, asset quality, liquidity, and cost efficiency rather than by a single risk measure.

(Alghzwai et al., 2014) the researcher worked on the topic of risks factors that influence the bank profitability in Jordan. The researcher used quantitative research method and the data collected with the sample size of 16 banks which of 13 is conventional and 3 are Islamic banks. They worked on the following variables such as profitability of the bank is dependent variable and credit risk, liquidity risk, bank size as independent variable. The result shows that the higher risk which may decrease the profitability of the banks so thus independent variables negative impact on the profitability of the bank. Evidence from comparative studies likewise indicates that credit and liquidity risk can have adverse implications for bank profitability, while bank size and capitalization may also contribute to differences in performance.

A study represented by (Isam and Affix, 2020) that there is a complex connection between credit risk, liquidity risk, and bank capital and bank profitability, further examined that, how these independent variables effect dependent variable. In their study, they have taken sample size of 13 banks and analysis their data based on advanced econometric panel with generalized method of moments techniques to gather empirical evidence for the nine years period from 2010 to 2018. In their findings, they highlighted that how the bank profitability is effect from these independent variables and indicated the importance of Basel regulation in this regard. Risk managing and regulatory compliance playing vital role in increasing of from 2003 to 2006 in Bangladesh. Liquidity risk and banking industry outcomes have a positive relationship with each other's, so there for bank required on increase capacity of liquidity. Research on Basel compliance and Islamic banking further emphasizes the relationship between regulatory requirements, capitalization, risk, and financial stability.

(Islam and Nishivama, 2016) worked on the effect of credit risk and liproductivity and enhancing financial stability, further it provides comprehensive insights into the complex dynamics of emerging banking industry. The comparative banking literature continues to emphasize credit risk, financial stability, liquidity, and profitability as interconnected dimensions of banking-sector performance.

(Rim et al., 2014) the study was worked on the topic of identify the conventional and Islamic bank comparative profitability in the MENA region. They have chosen 15 banks from each category of Conventional and Islamic respectively from the year 2002 to 2009, to assess the influence of variety of factors on bank profitability through using of Generalized Method of Moments. The results indicated that both banking sector have been different factors that affect their profitability. Further study showed that there is stable trend of profitability, which could be

explained by substantial government involvement making possible obstacles to competition in the region of MENA. A thing that differentiate their research is the creation of a thorough model that takes into account factors specific to banks, the industry, and the economy. This model allowed for a complete assessment of performance of Conventional and Islamic Banks in MENA region. The Model provided a board picture of effects of particular components on bank profitability. Non-performing loans were included as negative causes for Islamic banking, but liquidity have positive effect on Islamic banks. In other context, where conventional banks obtained profit from off-balance sheet operations, meanwhile Islamic banking negatively affected. This study proven that how bank capital is essential for conventional banking profitability. A shocking result was that there is inversed relationship between profitability and expense management of Islamic banks. Moreover, ownership status was considered a good sign for Islamic banking, suggesting that Islamic banks can make higher profit. This study provides a better understanding and clear information regarding bank profitability to the professionals of industry and policy makers. Researchers suggest that larger samples sizes should be used in upcoming research for clear picture. They also advise looking into profitability of a bank, whiles measuring of bank performance, must be consider the role of insurance companies and rating agencies. Mokni and Rachdi (2014) provide direct empirical support for this comparative MENA framework, using 15 Islamic and 15 conventional banks over 2002–2009 and a system-GMM approach to account for bank-specific, industry-specific, macroeconomic, and crisis-related determinants of profitability.

A study conducted by (Hamidah et al., 2015) to analyzing profitability of Islamic and Conventional Banking for the year of 2006 to 2011 in Malaysia. They have selected three banks from each segment and collected data from Malaysian banking website and Busra Malaysia. T-Test Model, Regression and Correlation methods use to assess the data by researchers for this study. Finding of this research indicated that Islamic banks have more total loans to total assets as compared to conventional banks, that's why Islamic bank were more profitable. By regression analysis, ROE was considered significant element in profitability of conventional banking, while ROA and ROE were considered significant element for Islamic Banking. The Correlation test results directed that the conventional bank profitability had impact by ROE, and in other hand, ROA and ROE were significant relationship in term of Islamic Banks. The theoretical model results highlighted that how conventional banks are different in terms of profitability from Islamic banks. Alternatively, the independent variables included the ratio of total assets to total loans, total deposits, and total equity. Based on available data, researcher used T-Test, Regression and Correlation methods and analyzed that the conventional banks performed worse than Islamic banks in term of total loans to total assets. This study improved our knowledge of the factors which effecting the profitability Islamic and Conventional banking sector in Malaysia and focusing that how the total equity to total asset plays role in profitability generation of banks. However, more studies required to understand the components of bank profitability, while considering specific factors and how they can affect Islamic and conventional banks. Existing comparative evidence confirms that profitability studies frequently use ROA, ROE, capitalization, liquidity, asset quality, and loan-related ratios to evaluate differences between Islamic and conventional banks.

A research is conducted by (Muhammad, khizer and Shama., 2011) on the topic of factor that effect the Islamic profitability. They worked on the following variable ROA and ROE as independent variable and bank size, asset management, capital adequacy as explanatory variable. The research was conducted in Pakistan between 2006 to 2009. The research methodology was quantitative method. The result find out that all dependent variable improve the profit of banking business. Research on Islamic bank profitability generally identifies capitalization, asset quality, cost efficiency, and bank-specific characteristics as important explanatory dimensions of profitability

A study executed by (Hassan et al., 2018), stated that Islamic banks were better in risk management as compared to conventional banks. They have used dataset of 26 Islamic and 26 Conventional banks form OIC member countries for the year 2007 to 2015. They investigated the connection between liquidity and credit risk. Finding from their showed that there was a negative connection between credit risk and liquidity risk for both Islamic and Conventional banks. Hassan, Khan, and Paltrinieri (2019) examined 26 Islamic and 26 conventional banks from selected OIC countries over 2007–2015 and found a negative relationship between credit and liquidity risk, while also reporting stronger risk management by Islamic banks in the examined sample.

Acquiring and financing of funds referred to be a credit, whereas commercial banks provide loaning a facility to their customers as new financing opportunity in support of capital raising operations (Gande, 2008). There are many causes and sources of risk sources its include credit risk, liquidity threats, political uncertainty and market hazard, but in financial system, credit risk is considered a greatest risk (Chen & Pan, 2012). While analyzing Indonesian conventional banking sector from 2007 to 2011, the researcher argument that bank profitability effected varyingly from credit risk (Ruziga , 2013) purposed a study and justified how financial results of a bank influenced from credit risk and suggest that ROE and ROA decrease by credit risk. (Ozili, 2017) approved that the worst quality loaning causes rise rate of loan losses and increases in non-performing loans, which effect financial performance of financial institution. Comparative credit-risk research in Pakistan similarly demonstrates the importance of loan quality and credit-risk management for Islamic and conventional banks. Akram and Rahman (2018), using annual-report data from 2004–2016, specifically examined credit-risk management across five conventional and four Islamic banks.

According to (Arif & Anees., 2012) the financial institution gives more preference to the liquidity risk. There is more liquidity risk in financial sector because their customers withdraw unnecessary funds, which may causes more chance of liquidity risk. Whereas it effect adversely on banking performance by stopping potential buyers and customers from banks, and banks loses their utilization in market places. (Ejoh et al., 2014). Put more simply, the liquidity risk invent due to lack of protection from banks short-term liabilities and unforeseen financial loses, which are considered as liquidity risk sources (Diamond & Rajan., 2005). Liquidity risk remains a central issue in banking because institutions must balance immediately available or readily convertible assets against liabilities that may become due or withdrawable at short notice. Hassan et al. (2019)

similarly operationalized liquidity risk through the relationship between liabilities subject to short-notice withdrawal and assets that can be converted into cash quickly and at low cost.

In financial institution, the liquidity risk would be rises or falls due to surplus and shortfalls in cash. Therefore, there is a conflict between long-term assets and short-term liabilities in liquidity risk. So financial institutions rises cash reserves by issuing long-term debts and reduced their liquidity (Matz & Neu, 2007). Bourke (1989) argues that in his study, the financial institution have more liquidity assets, they earned more profit. As per (Kosmidou, 2008), more profitable organization having more liquidities. Rahman et al. (2015) carried at study on of sample size of 25 banks quidity risk on the banking profitability. The data collected with the sample size of 230 banks in Southeast Asian nations. They worked on the following variables credit risk, liquidity risk, bank size and bank growth as independent variable and bank profitability was independent variable. The research method is quantitative method and find out the result that credit risk and liquidity risk negatively impact on the banking profitability which bank face problems and decrease in profitability. More recent comparative evidence reinforces the argument that liquidity risk and credit risk can adversely affect profitability. Ghenimi, Chaibi, and Lajmi found that credit risk, liquidity risk, and profitability interact reciprocally in both Islamic and conventional banking systems and that both forms of risk are detrimental to profitability.

Hypothesis Development

Credit Risk Relationship with Bank Profitability

Credit generally refers to the technique of acquiring and financing funds. Commercial lenders provide their clients with fresh financing options in order to support capital-raising operations (Gande, 2008). Within the banking industry, credit is one of the main ways that financial institutions lend money to borrowers, make interest income and carry on their lending. This means that the granting of credit entails some risk of that credit being defaulted on, especially when the borrower is unable or unwilling to make their contractual obligations.

A huge credit risk negative impact on the bank profitability because of huge credit given to the customers and not recover those amount and interest rate which was fixed at the time of obligation thus bank face loss in their profit which is very negative impact on the overall profit (Chen & Pan, 2012). If a significant number of loans go bad, banks can experience a drop in interest revenue, an increase in provisioning and extra recovery costs. Under these conditions, the institution's income can slowly be depleted and its financial strength can be compromised.

Liquidity Risk Relationship with Bank Profitability

Bank face liquidity risk due to various factors such as market condition, depositor behavior, and maturity mismatch. Depositor behavior explain when a bank customers withdraw unexpected money from the bank thus bank face liquidity risk due to shortage of money to convert in to cash to meet their obligation. Quick ratio also measure how bank generate quickly convert into cash by using its asset. We asses at the end that the liquidity risk most likely positive impact on the

banking overall profitability their relation is positive in our research. Most likely a huge liquidity is not good for banking business. So sometimes economic condition also effect bank up and down the rate of asset value in the market and the interest rate also affect the bank profitability because of this bank face liquidity risk. The financial institution places a high value on liquidity risk (Arif & Anees, 2012).

Liquidity risk has a special significance because banks need to keep adequate liquid assets on hand to meet demand for cash withdrawals and their short-term financial obligations. Liquidity problems can arise even if a financial institution's balance sheet is well-positioned, as the short-term needs can exceed the available liquidity. The opportunity cost, on the other hand, of a high level of liquidity might also result from keeping assets in a highly liquid and not very profitable manner. Thus banks are faced with the challenge of finding the right balance between liquidity and profitability.

Bank Capital Relationship with Bank Profitability

Bank capital play important role in the financial industry to boost up their net asset and equity value. A bank can increase their profitability by using its bank capital a huge capital provide bank for a huge benefit for the business thus bank should reserve a high value of asset to increase their overall profitability. According to (Abdullahi's, 2013) improving banking capital is positive reflection for the banking growth and it is very important for the bank to maximize their overall banking capital to enhance the profitability. The connection among banking capital and banking profit is positively effect for the improvement of the bank profitability as we asses that the more capital of the banking surely maximization their overall profitability so their relationship is positively impact on each other's. Capital improves all financial institutions and allows a capital injection by raising the minimum paid-up capital. This improvement will facilitate better and better operations, thus promoting business expansion and productivity.

Bank capital also acts as a financial buffer for unforeseen losses and operational challenges. A well-capitalized institution typically has greater flexibility when facing a change in credit quality, liquidity and overall economic conditions. Proper capital can build stakeholders' trust as it shows the bank has a better ability to withstand financial shocks without putting the viability of its future business at risk. Capital, in this regard, is not just a balance-sheet item but a crucial pillar of financial stability, strategic growth, and overall performance in banking.

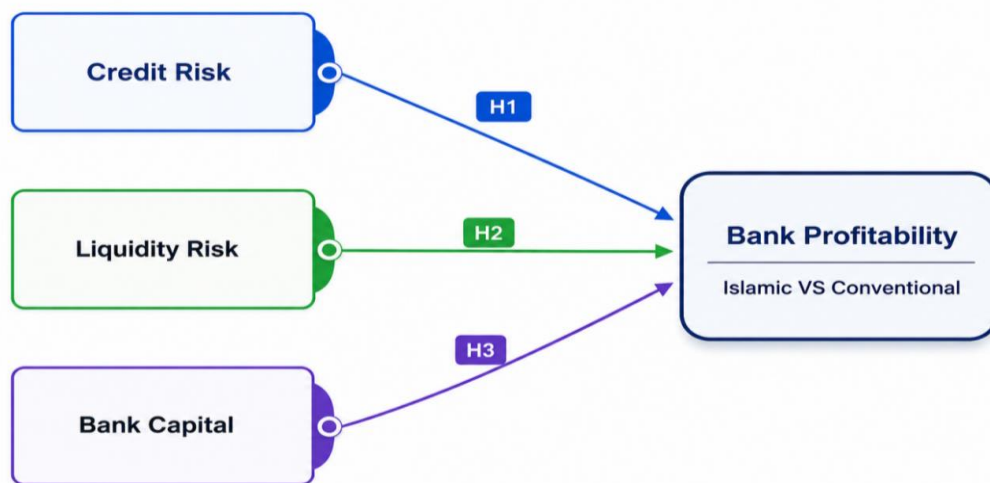
Model Hypothesis

H1: The relation among credit risk and bank profitability represent positive.

H2: The relation among liquidity risk and bank profitability represent positive.

H3: The relation between bank capital and bank profitability represent positive

Model



Methodology

Research Methodology

In this study, a research methodology provides helps to examining the issues connected with the study. It was a technique regarding collecting, generating and analyzing important source of information related to this study for evaluating a contracts reliability and validity testing (Zabkar et al., 2018). In the context of this study, the methodology is particularly concerned with examining the relationship among bank capital, credit risk, liquidity risk, and bank profitability. The methodological framework is thus designed to form a coherent way to assess these variables and determine if the evidence gathered is adequate to support the proposed relationships.

Research Approach

The quantitative approach in this study is used to investigate the influence of bank capital, credit risk and liquidity risk on bank profitability, where quantitative approach can convert the variables that are related to this study into numerical measurable indicators and then analyze the influence of the variables by following statistical procedures. This methodology is suitable as the study aims to establish the dimension and direction of the relationship between the banking variables selected instead of descriptive observation only. The research can, through the systematic analysis of numerical data, give empirical evidence for whether variations in bank capital, credit risk and liquidity risk have corresponding variations in bank profitability. Through the systematic analysis of numerical data, the research can provide empirical evidence concerning whether variations in bank capital, credit risk, and liquidity risk are associated with corresponding changes in bank profitability.

Research Design

Examine a relationship between two different variables, correlation and causal design would be used for this study. These research designs is necessary for judging related to a criterion validity, because it tells a relationship of variables could be exist or not (Aila ., 2016). The correlation design provides a means of determining the degree and direction of association among the variables under investigation, while the causal design assists in examining whether changes in one variable may be systematically associated with changes in another. In this study, these designs provide an appropriate analytical structure for assessing the relationships among bank capital, credit risk, liquidity risk, and bank profitability.

Target Population

In this study data was gather from those people who are working both Islamic and conventional banking in finance department who lives in Karachi, Pakistan.

Sample Size

To find out how much sample size would be required for this study, Therefore, a data has been collecting from those who are working both Islamic and conventional banking. So we recommended minimum 138 sample size in our research which is good enough for this study which help us finding the result.

Sampling Technique

Sampling technique have two types one is purposive and other is convenience: both are the major part of non-probability sampling techniques. In our research, purposive technique is used to collecting data through purposive sampling techniques which provide us quality of information for this study from different banker's information which is very valuable for this study. Selecting this technique is very important to selecting from different groups of peoples related to specific and relevant information to this study (Sekaran, 2016).

Statistical Technique

The two major factors has been using for statistical technique. First (PLS-SEM) software has been used in a professional version for our research. A purpose of using this software because that was more advance and relevant software for checking variance relationship (accept and rejection) of the variable constructs and it is also can be used for the predictions or advance implication of multi regression analysis (Becker et al., 2012). Many researchers recommend using (PLS-SEM) software than the (CB-SEM) because of some statistic problematic modeling issues. Afterward, through (PLS-SEM) a researcher also can be using the estimation of path models comparison and their relationships.

Survey Questionnaire

This study is being conducted for thesis purpose at Karachi University. I would like to gather the information regarding “The influence of bank capital, liquidity risk, and credit risk on the financial institutions profitability: Findings from newly growing market on Islamic banks vs conventional banks”

The respondent responses & especially their information must be kept confidential. The opinions shared by you will be used only for academic purpose.

Result and Data Analysis

Descriptive Statistics

The descriptive statistics provide an overview of respondents’ perceptions regarding bank credit, bank profitability, credit risk, and liquidity risk. The analysis considers the mean, median, and standard deviation of the individual measurement items. The perception on bank capital level is generally positive with the responses. The mean scores for BC1, BC2, and BC3 are 3.46, 3.69, and 3.36, respectively. Of these indicators, BC2 has the highest mean indicating that respondents agreed the most with this aspect of bank capital. All three medians are 4, meaning that the typical response falls towards an agreement with each statement. The range of the standard deviation is between 1.24 and 1.36, indicating that answers from respondents were somewhat variable. So that is to say that the overall responses are positive, but there is some variation in how people feel about each response.

Table 1: Descriptive Statistics

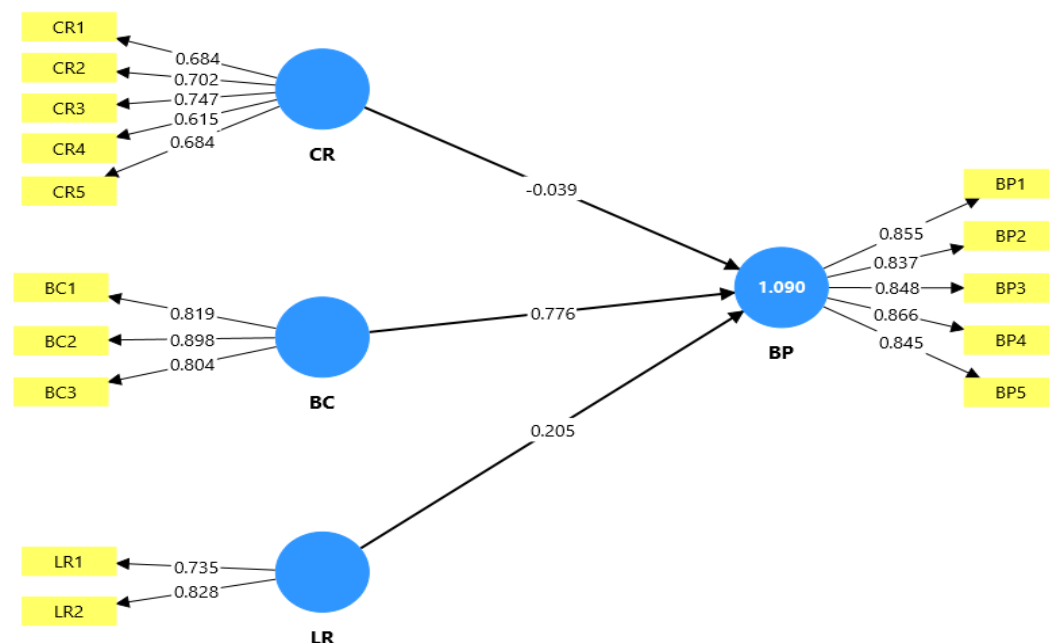
	Mean	Median	Standard deviation
BC1	3.457	4.000	1.363
BC2	3.688	4.000	1.238
BC3	3.355	4.000	1.345
BP1	3.384	4.000	1.342
BP2	3.674	4.000	1.275
BP3	3.362	4.000	1.335
BP4	3.703	4.000	1.253
BP5	3.674	4.000	1.269
CR1	1.862	2.000	0.800
CR2	2.928	3.000	1.344
CR3	3.014	3.000	1.234
CR4	2.768	3.000	1.315
CR5	1.862	2.000	0.800
LR1	3.420	4.000	1.334

LR2	3.725	4.000	1.250
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Diagram of Variables

Figure 1:

As the diagram represent the individual relationship between each variable and showed the values of each variable items.



Outer Loading

Once the data screening process then further the factor loading was done by using the Smart PLS software 4 version. According to the (Hair Jr et al., 2010) the outer loading for every single item should be greater than 0.70. The outer loading results indicate substantial variation among the observed indicators. The indicators of Bank Capital (BC) demonstrate relatively low outer loading, with BC1, BC2, and BC3 recording values of 0.362, 0.397, and 0.355, respectively. Similarly, the indicators of Bank Performance (BP) exhibit loading ranging from 0.223 to 0.231, while the loading for Credit Risk (CR) range from 0.235 to 0.286. In contrast, the two indicators of Liquidity Risk (LR) show comparatively stronger loading of 0.524 and 0.590.

Table 2: Outer Loadings

	Bank Capital	Bank Profitability	Credit Risk	Liquidity Risk
BC1	0.819			
BC2	0.898			
BC3	0.804			
BP1		0.855		
BP2		0.837		
BP3		0.848		
BP4		0.866		
BP5		0.845		
CR1			0.684	
CR2			0.702	
CR3			0.747	
CR4			0.615	
CR5			0.684	
LR1				0.735
LR2				0.828

Reliability and Validity

Cronbach's alpha measures not inward consistency but rather the degree to which a group of things are connected to one another. It is used as a scale steadfastness marker. The estimation couldn't be one-layered notwithstanding the way that expecting alpha has a "high" regard. Additional tests should be possible if you wish to demonstrate that the requested action may be unit-directional in terms of interior consistency. Cronbach alpha calculate the reliability.

Composite Reliability

As referred to in advance that reliability and authenticity test should be evaluated for this survey. The 0.5 stacking factor is acceptable for merged legitimacy. Accepting that the stacking factor regard >0.5 then, the simultaneous authenticity is fulfilled, expecting the stacking factor regard <0.5 then the form ought to be banished from the examination. The unfaltering nature of an improvement ought to be attempted in a survey. Constancy test are the assessment of how solid the respondents noticing the requests in the study.

Table 3: Composite Reliability

Construct reliability and validity				
	Cronbach's alpha	Composite reliability (rho _a)	Composite reliability (rho _c)	Average variance extracted (AVE)
BC	0.883	0.882	0.879	0.708
BP	0.929	0.929	0.929	0.723

CR	0.818	0.820	0.817	0.581
LR	0.756	0.764	0.759	0.613

The construct reliability results present a considerably more favorable picture. For Bank Capital (BC), Cronbach's alpha is 0.883, composite reliability (ρ_a) is 0.882, composite reliability (ρ_c) is 0.879, and AVE is 0.708. The internal consistency and convergent validity of these values are acceptable on the basis of widely-used criteria. In the case of Bank Performance (BP), Cronbach's alpha is 0.929 and ρ_a and ρ_c are around 0.929. The AVE is 0.723. The figures show good internal consistency as the AVE is greater than the recommended minimum value of 0.50, implying that a large percentage of the variance for the construct is covered by the indicators. The Cronbach's alpha of the Credit Risk (CR) construct is 0.818, while the ρ_a and ρ_c are 0.820 and 0.817, respectively. It has an AVE of 0.581, higher than the traditional value. So, the internal consistency and the convergent validity of CR are acceptable. For Liquidity Risk (LR), Cronbach's alpha is 0.756, ρ_a is 0.764, and ρ_c is 0.759, while the AVE is 0.613. These results indicate acceptable reliability and convergent validity. Although LR exhibits the lowest reliability coefficients among the four constructs, its values remain above the commonly accepted benchmark of 0.70, while its AVE is comfortably above 0.50.

Discriminated Validity

Calculating discriminant validity with the help of Smart PLS software in the professional version. Discriminant validity conducting into three different criteria Fornell & Larcker, cross-loading and Hetero Trait Mono Trait Ratio (HTMT). A purpose discriminant validity is to identify empirically differences between one and another construct (Hair Jr. et al., 2014).

Table 4: HTMT

Heterotrait-Monotrait Ratio (HTMT)	
BP <-> BC	1.046
CR <-> BC	0.812
CR <-> BP	0.867
LR <-> BC	1.201
LR <-> BP	1.170
LR <-> CR	0.926

The HTMT value between Bank Performance (BP) and Bank Capital (BC) is 1.046, which exceeds both the recommended 0.85 and the more lenient 0.90 threshold. This indicates that BP and BC may not be sufficiently distinct empirically. The relationship between Credit Risk (CR) and Bank Capital (BC) records an HTMT value of 0.812. Since this value is below 0.85, the result provides evidence of satisfactory discriminant validity between these two constructs. For Credit Risk (CR) and Bank Performance (BP), the HTMT value is 0.867. Although this exceeds the stricter 0.85 criterion, it remains below 0.90. Therefore, discriminant validity can be regarded as acceptable when the 0.90 threshold is adopted, although the result warrants some caution.

The maximum value of HTMT is found between Liquidity Risk (LR) and Bank Capital (BC) at 1.201. This is well above the accepted limit and suggests a high degree of empirical overlap between the two. In the same way, there is no discriminant validity between Liquidity Risk (LR) and Bank Performance (BP) because the HTMT value is 1.170. Finally, the HTMT value between Liquidity Risk (LR) and Credit Risk (CR) is 0.926. This exceeds both the stricter 0.85 threshold and the commonly used 0.90 threshold, suggesting that discriminant validity between these constructs is not adequately demonstrated.

Path Coefficient

Using software of Smart PLS (professional version) for conducting the path analysis with the help of bootstrapping inside the software. It was used for measuring the approximation of the constructs from conducting sample data with 138 respondents (Hair et al., 2014). Path analysis was used for estimating the significant connection between two different hypothesized constructs; they would be accepted or rejected with a degree level of 5%. This analysis studying every individual constructs relationship with other constructs should be less than 0.05 percent to supporting hypothesis.

Table 5: Path Coefficient

	BC	BP	CR	LR
BC		0.776		
BP				
CR		-0.039		
LR		0.205		

The path coefficient, which is 0.776, demonstrates the connection between bank profitability and capital. While the relationship of Acknowledge risk for bank benefit is -0.039 and then again, the relationship among Liquidity risk with bank productivity is 0.205

The coefficient of 0.776 indicates a positive association between Bank Capital and Bank profitability. Substantively this means that an improved capital position corresponds to an increase in profitability. A sound bank has a wider financial buffer to buffer shocks in losses and maintain normal banking activities and lending. Thus, the positive coefficient indicates that there is a positive relationship between capital adequacy and the financial performance of banks, allowing one to conclude that the capital structure of banks has a positive relationship with their financial performance.

R-Square

Table 6: R-Square

	R-square	R-square adjusted
BP	0.971	0.971

From the R-square results, it is seen that the Bank Performance (BP) has R^2 value of 0.971 and the adjusted R^2 value is 0.971 as well. The coefficient of determination R^2 is equal to 0.971, which means that the total variation of Bank Performance (BP) is explained by the predictor variables in the structural model by 97.1%. This means that the changes or variations in BP that are not explained by the explanatory constructs included in the model, but can be attributed to something other than the model and to random error, make up about 2.9% of the overall variance in BP. The adjusted R^2 of 0.971 is the same as the R^2 value, meaning that there is very little loss in the explanatory power of the model when the number of predictors is adjusted. This indicates that the model's predictors are a very significant element of the knowledge of Bank Performance.

Path Coefficients

Table 7: Path Coefficients

Path	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values	Findings
BC → BP	-0.254	-0.256	0.093	2.741	0.006	Accepted
CR → BP	-0.061	-0.061	0.024	2.493	0.013	Accepted
LR → BP	1.188	1.190	0.095	12.527	0.000	Accepted

The path coefficient results illustrate the magnitude, direction, and statistical significance of the relationships between BC, CR, LR, and BP. The findings indicate that all three proposed relationships are statistically significant, although their direction and intensity differ considerably. The relationship between BC and BP records a path coefficient (β) of -0.254 , accompanied by a t-statistic of 2.741 and a p-value of 0.006. Since the p-value is below the conventional 0.05 threshold, the relationship is statistically significant. The negative coefficient suggests that an increase in BC is associated with a corresponding decline in BP, indicating an inverse relationship between the two constructs. Similarly, $CR \rightarrow BP$ demonstrates a negative path coefficient of -0.061 . The corresponding t-statistic of 2.493 and p-value of 0.013 confirm that this relationship is statistically significant at the 5% level. Although the association is statistically meaningful, its comparatively small coefficient indicates that the effect of CR on BP is relatively modest. In contrast, the relationship between LR and BP exhibits a markedly stronger positive association. The path coefficient is 1.188, with a substantial t-statistic of 12.527 and a p-value below 0.001. This provides compelling statistical evidence that LR has a significant positive effect on BP. Moreover, its coefficient is considerably larger than those observed for BC and CR, suggesting that LR represents the most pronounced predictor of BP among the relationships examined.

Result, Discussion, Conclusion

Results

The main purpose of this research is to check the influence of bank capital, liquidity risk and credit risk on the financial institutions profitability by comparing Islamic and conventional banking profitability. After data analysis in IBM- SPSS and PLS –SEM software, we find out the relationship between variables and their impact on the profitability that the first H1 hypothesis represents the connection between credit risk and bank profitability represent negative and H2 represent the connection between liquidity risk and bank profitability represent positive. In addition, the last H3 the connection between bank capital and bank profitability represent positive each other.

The results clearly represent that the role of credit risk, opposite of the Islamic and conventional banking profitability represent decrease in profitability. However, Islamic banking manage liquidity and credit risk better than conventional banking therefore conventional banking face difficulties to face loss and decrease their profitability compared to Islamic banking.

Bank capital is positive impact on both Islamic and conventional banking profitability so high levels of bank capital increase the profitability of the bank. It is important for the banking industry to increase their bank capital to earn more profit and growth in banking business. Increased bank capital offers banks a larger financial buffer against losses, as well as greater ability to engage in positive banking operations. A well capitalized bank will have more latitude for dealing with economic uncertainty, maintaining business continuity, and taking advantage of profitable opportunities without having to depend too heavily on outside funding. The results, therefore, highlight the need to have a sufficient and robust capital position in the banking sector. Raising bank capital can lead to better profitability as well as sustainable growth, financial stability and increased trust in the banking business. Thus, both Islamic and conventional banks should put emphasis on building up their capital position and at the same time implement effective credit and liquidity risk management mechanisms.

Discussion

According to the results the variables, significantly, impact on the bank profitability and their connection shows negatively affect in conventional banking but Islamic banks are good in managing risk position. In our research we asses that the conventional banking face losses because of higher credit risk while Islamic banking manage risk is better than conventional banking. Bank capital and liquidity risk impact positively on both banks. Its recommendations for the both banking to decreases their credit risk in order to increase their profitability of the bank also should increase their bank capital to invest in different sector to earn more profit in the business. Furthermore, it is important for the banking industry to check it out on banking credit and liquidity risk impact on their profitability and to find out any solution to reduce these risks, which is better for the banking industry. Also banking capital is very important for the banking

profitability, which create positive impact on the profitability. The findings further indicate that the relationship between banking risk factors and profitability deserves particular attention because the financial performance of a bank is closely associated with the manner in which it identifies, evaluates, and controls its financial exposure. In cases where the credit risk is high, conventional banks could face more difficulties to maintain the quality of their assets, especially when the borrowers fail to meet their financial obligations. These situations can lead to further impact on the banks' bottom line and can potentially reduce overall profitability. Islamic banks, on the other hand, seem to have a relatively better ability to manage risk, which could be linked to their unique financing principles and risk-sharing mechanisms. This does not mean that Islamic banks have no financial risk; however, the results indicate that Islamic banks' risk management may offer a relatively beneficial environment for managing some banking risks.

The banking sector needs to increase its capital in order to make more profits, and allocate those profits to other financial industries for overall higher profit. Mostly both banking and banking system followed these process to gain more profitability in their business. Islamic and conventional banking system can easily manage their risk position by taking proper decision in the banking operations and overall banking management. If investments generate extra capital, it gives banks a larger financial base from which to build up their assets and look for potentially lucrative investment opportunities. But expanding and utilizing capital should be done carefully as it is not enough to increase capital to increase profitability. Whether added investment will lead to better financial results depends on the quality of investment decisions, the efficiency of using assets, and the effectiveness of risk management. It is, therefore, the duty of the banks to make sure that their resources are concentrated on areas and operations with a reasonable return with an acceptable risk. This can benefit both banks' systems to better their overall financial health and maintain profitability in the future.

The past data analysis which has been mostly done in Islamic countries, shows that the Islamic banking system is one of the fastest growing banking systems and is well developing its banking capital by effectively managing credit and liquidity risk and improving its banking operations, so that the number of customers' engagement towards the Islamic banking system is increased. The expansion of Islamic banking in Islamic countries also points to the growing importance of sound risk management and capitalization in Islamic banking. The effective handling of credit and liquidity risk becomes even more crucial as Islamic banking institutions grow in size and expand their activities to ensure a stable financial position and profitability. Islamic banks can operate their financing activities more efficiently with better risk management practices and in a manner that minimizes the potential for significant financial losses. Meanwhile, the enhancement of banking capital will help improve the capacity of Islamic banks to grow their assets, growth of financial services as well as to increase customer base.

The growing penetration of Islamic banking into the market may also be expected to lead to better customer engagement, as customers are increasingly looking at financial strength, reliability and efficiency of banking institutions when choosing banking services. Islamic banks that manage their credit and liquidity positions well, have a healthy capital base, and enhance

their banking practices can become more able to attract and retain customers. This may further consolidate their market position and help in the further development of the Islamic banking market. Improved banking operations can also facilitate more efficient service delivery, better financial management, and stronger institutional performance.

Conclusion

The main purpose of this study is to finding out how these independent variable credit risk, bank capital and liquidity risk influencing the dependent variable bank profit each other. This scenario refer to the emerging Islamic and conventional banking sector of Pakistan for years 2010 to 2023. Financial performance gauges ROE and ROA are used in this study to analysis to provide broad picture and how these factors influence and plays their role in the financial results of banks that functioning in Pakistan under the Islamic and Conventional banking systems. This investigative study is includes a detailed analysis of ten popular banks of Pakistan and data is collected from both Islamic and Conventional sector comparatively. The samples size included five conventional banks i.e. Bank Alfalah, HBL (Habib Bank Limited), Al Habib Bank, MCB, UBL and five pure Islamic bank Dubai Islamic Bank, Bankislami, Albaraka Bank, Faysal Bank, and Meezan Bank to investigate financial years from 2010 to 2023. Purpose of this study is to provide a broad picture of financial performance through analysis the available data. The Focus in this research is to find out the connection of these factors such as bank capital, credit risk, and liquidity risk influence the Islamic and conventional banking profitability. The result clearly show that there is negative connection between credit risk with conventional banking profitability, However there is positive connection between liquidity risk and bank profitability in conventional banking system, While Islamic bank also face problem related to these risk but in some way Islamic banking is better than conventional bank managing these risk also bank capital is positive impact on the both banking profitability. In future its indicates that the Islamic banking is fast growing and beat the conventional banking system and rule in the banking industry and their operations side is very secure for the customer viewpoint Islamic basis. The banks also not involving any riba which is prohibited in Islam this is the main thing that customer attract toward Islamic bank. The results of this research gives a comprehensive insight of the correlation both independent and dependent variables. Results of this research represent that the credit risk connected with the banking profitability is harmful for increasing the business profit. Which bank will influence negatively from these risk. Bank capital and liquidity are the most important variable that improve the banking profit. High banking capital increase the more chances to earn more profit in the banking business therefore bank capital is positive.

Research results recommend that both banking sector should improve their credit related polices in order to reduce the credit risk that effects the profitability of banks. In other words, profitability will positively influenced from appropriate credit policies. Moreover, this research suggests that both banking sector should maintained and raised the liquidity and capital to safeguard profitability against unpredicted loses and unfavorable situations in future days. At the end based on this study's results, Islamic banking sector in Pakistan is stronger than the conventional banking sector, as Islamic banks have maintained large reserves of bank capital and liquidity as

compared to conventional banks. Thus, the bank capital and liquidity risk will positively affect profitability of Islamic banking. This investigation helpful for the banking owners, chief executive officer, financial analyst and managers to tend the future outcome of the bank profitability in order to monitoring of these risks.

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