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The internal determinants of bank profitability and stability: An insight from banking sector of Pakistan

Muhammad Ali, Chin Hong Puah,

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The internal determinants of bank profitability and stability

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An insight from banking sector of Pakistan

Muhammad Ali

*Department of Business Administration, Iqra University, Karachi, Pakistan and
Department of Economics, Universiti Malaysia Sarawak Faculty of Economics and
Business, Kota Samarahan, Malaysia, and*

Chin Hong Puah

*Department of Economics,
Universiti Malaysia Sarawak Faculty of Economics and Business,
Kota Samarahan, Malaysia*

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Abstract

Purpose – The purpose of this study is to examine the internal determinants of bank profitability and stability in Pakistan banking sector. Because of specific research objectives, this study excludes the external factors of profitability and stability to find the role of bank internal determinants in achieving high performance.

Design/methodology/approach – A panel regression analysis is built on a balanced panel data using 24 commercial banks over the sample period of 2007-2015. The authors performed a separate analysis of bank profitability and stability. Both models used a comprehensive set of bank internal determinants.

Findings – The results that were obtained from profitability model indicated that bank size, credit risk, funding risk and stability have statistically significant impacts on profitability, while liquidity risk showed the statistically insignificant impact on profitability. Regression findings from stability model reveal that bank size, liquidity risk, funding risk and profitability have statistically significant impacts on stability, while credit risk had an insignificant effect on stability. However, the effect of the financial crisis is uniform and showed statistically insignificant impact in both models.

Practical implications – Overall, the authors' findings bring some new but useful insights to the banking literature. Some recommendations may be functional for the sustainable performance of banks.

Originality/value – In view of study results, the authors provide interesting insights into the practices and characteristics of banks in Pakistan. This study also highlights significant bank internal determinants to improve understanding in the existing literature.

Keywords Finance, Corporate finance, Credit risk, Bank profitability, Financial institutions, Bank stability, Funding risk

Paper type Research paper

1. Introduction

It is argued that bank profitability and stability in financial institutions is a growing concern for regulators and bank supervisors. This issue has gained significant attention among the researchers after 2007/2008 financial crisis. The debate on global financial crisis accounts large banks for the crisis, which influenced significantly to the many economies (Adusei, 2015). Since the global economies have emerged from the crisis period, Viñals *et al.* (2013) indicate that the discussion on organizational complexity, optimal bank size and financial institutions' activities has heightened. According to Vickers Report (2011),

