

# **THE EFFECTS OF CREDIT RISK AND LIQUIDITY RISK ON THE FINANCIAL PERFORMANCE OF THE BANKS OF PAKISTAN**

**BY**

**YUMNA MAHMOOD  
64555**

A thesis submitted to the Business Studies Department, Bahria Business School, Bahria University Karachi Campus, in partial fulfillment of the requirements for MBA Degree



**Fall, 2020**

**BUSINESS STUDIES DEPARTMENT**

**BAHRIA BUSINESS SCHOOL**

**Bahria University Karachi Campus**



## MBA Thesis 2nd Half-Semester Progress Report & Thesis Approval Statement

### Supervisor – Student Meeting Record

S#	Date	Place of Meeting	Topic Discussed	Signature of Student
1	5-11-2020	Online	Corrections in framework	
2	12-11-2020	Online	Corrections in data collection	
3	09-12-2020	Online	Corrections in the interpretation of results	

### APPROVAL FOR EXAMINATION

Candidate's Name: Yumna Mahmood Registration No.: 64555

Thesis Title: THE EFFECTS OF CREDIT RISK AND LIQUIDITY RISK ON THE FINANCIAL PERFORMANCE OF THE BANKS OF PAKISTAN.

I hereby certify that the above candidate's thesis has been completed to my satisfaction and, to my belief, its standard is appropriate for submission for examination. I have also conducted a plagiarism test of this thesis using HEC prescribed software and found a similarity index at 18% that is within the permissible limit set by the HEC for the MBA thesis. I have also found the thesis in a format recognized by the Business Studies Department.

Supervisor's Signature:  Date: 4/3/2021

Supervisor's Name: DR. MUBASHIR ALI KHAN

HoD's Signature:  Date: \_\_\_\_\_

## Turnitin Similarity Report

### The Effects of Credit and Liquidity Risk Management on Profitability of Banks of Pakistan

#### ORIGINALITY REPORT

**18%**

SIMILARITY INDEX

**15%**

INTERNET SOURCES

**9%**

PUBLICATIONS

**9%**

STUDENT PAPERS

#### PRIMARY SOURCES

1

[businessperspectives.org](http://businessperspectives.org)  
Internet Source

1%

2

Submitted to essex  
Student Paper

1%

3

[pdfs.semanticscholar.org](http://pdfs.semanticscholar.org)  
Internet Source

1%

4

Submitted to University of Greenwich  
Student Paper

1%

5

Submitted to Higher Education Commission  
Pakistan  
Student Paper

1%

6

[eprints.utar.edu.my](http://eprints.utar.edu.my)  
Internet Source

<1%

7

Submitted to La Sagesse University  
Student Paper

<1%

8

[www.onlinejournal.in](http://www.onlinejournal.in)  
Internet Source

<1%



### **Acknowledgment**

I would like to express my greatest gratitude towards Bahria University, Karachi Campus for letting me study for Masters in Business Administration. I am entirely thankful to the Department of Business Studies Department for allowing me to conduct this thesis research. I would not have achieved success without the help of my supervisor, Dr. Mubashir Ali Khan – who not only assisted me but also encouraged me to improve. I would also like to acknowledge the dedication and coaching of the teachers I was lucky enough to be taught from throughout my MBA in Bahria University for manifesting the field of my study. My greatest acknowledgment towards Allah, without whom I would not have been successful.

## Abstract

### Purpose

*The purpose is to find if the credit risk and liquidity risk affect the financial performance of the banks of Pakistan.*

### Methodology & Design

*To conduct this research the data of twelve banks that are operating in Pakistan are used. The data was collected through the annual reports of the banks. E-view software is used to test the data.*

### Findings

*The researcher was able to find the effects of credit and liquidity risk on the financial performance (ROA) of the banks of Pakistan, statistically significant. Advance-to-deposit, loan loss coverage, the level of non-performing loans harm the profitability of the banks of Pakistan, where else, asset-to-advance, gross spread, capital adequacy positively affects the profitability of the banks operating in Pakistan. Further, it was found that the size of the bank does not affect the profitability of the banks.*

### Limitations and Recommendations

*The variables were found to have no relation with the return on equity (ROA) other than the gross spread ratio, it is suggested for future studies to select different indicators of credit risk and liquidity risk of the banks of Pakistan. The banks need more appropriate credit risk and liquidity risk management to reduce the level of non-performing loans to establish a lower loan coverage ratio, while they are earning well through interest and have strong capital adequacy. Where else, the banks seem to be relying on deposits to finance the advances which might cause liquidity issues when in need.*

**Keywords:** *Credit Risk, Liquidity Risk, Profitability, Financial Performance, Pakistan, Banks.*

## TABLE OF CONTENTS

INTRODUCTION .....	1
1.1 Introduction .....	1
1.2 Problem Statement .....	2
1.3 Research Objectives .....	4
1.4 Research Questions .....	4
1.5 Significance of the Study .....	5
1.6 Organization of the Thesis .....	6
LITERATURE REVIEW .....	8
2.1 Introduction .....	8
2.1.1 <i>Financial Risk</i> .....	8
2.2 Financial Risk Management .....	8
2.3 Credit Risk .....	9
2.3.1 <i>The Credit Risk in the Banking Sector</i> .....	9
2.3.2 <i>Loan Loss Coverage</i> .....	10
2.3.3 <i>Capital Adequacy</i> .....	11
2.3.4 <i>The Level of Non-performing Loans (NPLs)</i> .....	11
2.3.5 <i>Gross Spread Ratio</i> .....	12
2.4 Liquidity Risk .....	13
2.4.1 <i>Liquidity Risk for Banking Sector</i> .....	13
2.4.2 <i>Advance-to-Asset Ratio</i> .....	14
2.4.3 <i>Advance-to-deposit Ratio</i> .....	14
2.4.4 <i>Size of the Bank</i> .....	14
2.5 Bank Profitability .....	15
2.6 Summary of Literature Review .....	16
2.7 Research Hypotheses .....	16
2.8 Conceptual Framework .....	17
Research Methodology .....	18
3.1 Introduction .....	18
3.2 Research Approach and Type .....	18



3.3	Research Design .....	18
3.4	Research Population .....	18
3.5	Sample Size & Sampling Technique .....	19
3.6	Data Collection .....	19
3.7	Data Presentation .....	19
3.8	Data Analyses Method .....	19
3.8.1	<i>Analytical Model</i> .....	20
Results .....		23
4.1	Statistical Analysis and Interpretation .....	23
4.1.1	<i>Descriptive Analysis</i> .....	23
4.1.2	The Coefficient Analysis Test using Return on Equity (ROE) .....	24
4.1.3	The Coefficient Analysis Test using Return on Assets (ROA) .....	25
4.1.5	Summary of Hypotheses Testing .....	27
Discussion .....		29
5.1	Discussion .....	29
5.2	Finding of the Results .....	29
RECOMMENDATIONS AND Conclusion .....		33
6.1	Conclusion .....	33
6.2	Recommendations .....	35
6.3	Limitations and Future Research .....	36
References .....		37