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"A Comparative Study of the Risk–Return Trade-Off Islamic and Conventional Banks in Pakistan"

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Abstract

This study investigated risk-return trade-off between Islamic banks and conventional banks in Pakistan for ten banks (five Islamic and five conventional) for the period 2015-2024 with secondary panel data. The indicators of profitability were return on assets (ROA) and return on equity (ROE), while the risk-related indicators were the non-performing loans (NPLs), the capital adequacy ratio (CAR) and the earnings volatility (EV). The study used descriptive statistics, independent-samples t-tests, and fixed-effects regression models to compare the two banking systems and the impact of risk variables on banking performance. The results indicated that there was no significant difference between ROA and ROE of Islamic and conventional banks at 5% level of significance. Islamic banks, however, reported lower mean NPLs and higher CAR compared to conventional banks, indicating better asset quality and capital buffers. The regression results indicated that NPLs and volatility of Earnings negatively influenced the profitability whereas CAR positively influenced bank performance. Adequate capitalization, credit-risk control, operational efficiency, and earnings stability are shown to have more influence on the risk-return trade-off in Pakistan than the type of banking. The findings of this study are beneficial for bank managers, regulators, investors as well as for future researchers exploring Pakistan's dual banking system.

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