JOURNAL OF ISLAMIC ECONOMICS AND FINANCE
Volume 6 Number 1 2026
ISSN : 2797-4014
e-ISSN : 2797-6432
Website: https://e-journal.uingusdur.ac.id/jief/index

COMPARATIVE ANALYSIS OF ISLAMIC AND CONVENTIONAL BANKING IN PROMOTING ECONOMIC STABILITY

Jamiu Adeniyi Yusuf[1*], Ibrahim Ayodele Yusuf[2], Azeem Tunde Muhammed[3] Ayuba Aderole Ismail[4]
[1,2] Department of Economics and Social Research, National Institute for legislative and Democratic Studies, Abuja, Nigeria.

[3]Department of religions and peace studies, Lagos State University, Ojo, Lagos state, Nigeria.

[4]Department of Arabic and Islamic Studies, Federal University Lokoja, Kogi State, Nigeria
email-yusufadeniyijamiu@gmail.com; Jamiu. yusuf@nils.gov.ng

ABSTRACT

This study aims to comparatively analyze Islamic and conventional banking systems in promoting economic stability by examining their operational principles, risk management practices, and financial performance. Using a comparative empirical approach with data from selected banks across various jurisdictions, the research evaluates financial stability indicators such as capital adequacy ratios, non-performing loans (NPLs), and crisis-period performance. The findings reveal that Islamic banking demonstrates stronger resilience during economic downturns due to its risk-sharing mechanisms and the prohibition of speculative transactions and interest-based activities, while conventional banking maintains advantages in market reach and liquidity structures. The study also identifies challenges faced by Islamic banks, including regulatory constraints and limited market penetration. The novelty of this research lies in its integrated comparative assessment of both banking systems within the context of macroeconomic resilience, highlighting how Islamic finance principles can contribute to a more sustainable and shock-resistant financial ecosystem.

Article History
Received : 04 May 2026
Accepted : 18 May 2026
Published : May 2026

Keywords
Islamic banking, conventional banking, economic stability, risk management, financial resilience

Publisher :
Program Studi Ekonomi Syariah
Fakultas Ekonomi dan Bisnis Islam, UIN K.H Abdurrahman Wahid Pekalongan
Jl. Pahlawan No. 52, Rowolaku, Kab. Pekalongan, Indonesia

INTRODUCTION

The banking sector remains central to economic stability because of its role in financial intermediation, liquidity creation, investment mobilisation, and risk allocation **(**Yusuf, 2025). Efficient banking systems facilitate productive capital formation, support enterprise growth, deepen financial inclusion, and enhance macroeconomic stability. Across economies, the structure and resilience of banking institutions significantly influence monetary stability, employment generation, and long-term development outcomes. Within this context, two major banking paradigms, conventional and Islamic banking have emerged as influential models shaping contemporary financial systems, each operating under distinct philosophical, institutional, and operational foundations (Yusuf, & Adio,2025).

Conventional banking operates predominantly through interest-based intermediation, where profit is generated through lending and borrowing at predetermined rates of interest. This model has historically dominated global finance and has contributed substantially to economic growth through credit creation, investment financing, and payment system development (Mishkin, 2019). However, repeated episodes of banking crises, including the 2008 global financial crisis, have generated debates concerning the vulnerability of interest-driven banking systems to excessive leverage, speculative finance, and systemic instability (Chapra, 2011). These concerns have renewed scholarly interest in alternative banking models capable of supporting financial stability while promoting ethical and inclusive development.

Islamic banking has increasingly emerged as one such alternative. Rooted in Sharīʿah principles, Islamic banking prohibits riba (interest), excessive uncertainty (gharar), and speculative transactions (maysir), while emphasizing profit-and-loss sharing, asset-backed financing, social justice, and ethical investments (Iqbal & Mirakhor, 2017). Unlike conventional finance, Islamic banking links financial transactions to real economic activity and risk-sharing arrangements, thereby offering a potentially more resilient model of intermediation. Proponents argue that these principles reduce speculative bubbles, enhance financial discipline, and promote greater economic stability (Ahmed, 2020; Hassan & Aliyu, 2022).

Over the last few decades, Islamic banking has evolved from a niche segment into a significant component of global finance. Countries such as Malaysia, Saudi Arabia, the United Arab Emirates, and even non-Muslim jurisdictions like the United Kingdom have successfully integrated dual banking systems that combine Islamic and conventional finance, thereby fostering financial diversification and resilience (Beck, Demirgüç-Kunt, & Merrouche, 2013). Global Islamic financial assets now exceed trillions of dollars, pointing to the increasing relevance of Islamic finance in modern economic systems (Yusuf etal., 2025).

In Nigeria, the comparative discourse surrounding Islamic and conventional banking has become increasingly important as the country seeks pathways toward financial inclusion, economic diversification, and systemic stability. The emergence of non-interest banking, led by institutions such as Jaiz Bank and supported by regulatory reforms of the Central Bank of Nigeria, reflects growing recognition of Islamic finance as a complementary component of the financial system. Yet, despite its growth, Islamic banking remains relatively underdeveloped compared with conventional banking, raising important questions about its comparative contributions to economic stability (Yusuf, 2025**)**.

Recent debates surrounding the comparative relevance of Islamic and conventional banking have become even more significant in light of broader transformations shaping global finance, particularly digitalisation, sustainability transitions, and growing concerns about inclusive development (Abdulaziz et al., 2025). Contemporary financial systems are no longer assessed solely on the basis of efficiency, profitability, or intermediation performance; rather, increasing attention is being directed toward how financial institutions adapt to technological disruptions, respond to sustainability imperatives, and contribute to socially inclusive economic outcomes. This shift has widened the scope of financial stability discourse beyond traditional prudential concerns to encompass innovation-driven resilience and institutional adaptability.

This paper therefore seeks to comparatively examine the roles of Islamic and conventional banking in promoting economic stability, with particular emphasis on financial inclusion, credit accessibility, risk management, and macroeconomic resilience in Nigeria. Specifically, the study investigates whether significant differences exist between the two models in their contributions to stability outcomes and explores policy implications for strengthening a more resilient and inclusive banking architecture.

The significance of this inquiry extends to policymakers, regulators, financial institutions, and development scholars. For policymakers, the findings may inform regulatory reforms aimed at strengthening dual banking systems. For financial institutions, the analysis may provide insights into sustainable banking strategies. For scholars, the chapter contributes to growing debates on ethical finance, institutional resilience, and alternative models of development-oriented banking.

Importantly, this paper advances novelty in two ways. First, it moves beyond conventional comparative banking studies by situating Islamic and conventional banking within the broader discourse of economic stability rather than limiting analysis to profitability and efficiency metrics. Second, it integrates emerging perspectives on sustainability, inclusive finance, and institutional resilience, thereby connecting traditional banking debates with contemporary transformations in economic systems.

METHODOLOGY

One major strand in the emerging literature focuses on digital financial transformation and its implications for monetary and financial stability. Recent scholarship argues that technological innovations are reshaping the architecture of modern financial systems in ways that alter the channels through which stability is generated or undermined. In this regard, research on central bank digital currencies (CBDCs) has gained considerable prominence. For example, Yusuf (2025) demonstrates that CBDCs have significant implications for monetary policy transmission mechanisms, bank intermediation, liquidity management, and systemic risk. The study shows that digital currencies may strengthen payment efficiency and financial inclusion while simultaneously creating new regulatory and stability challenges for traditional banking systems. This body of work suggests that banking models, whether Islamic or conventional, can no longer be evaluated in isolation from wider technological changes transforming the financial landscape. Rather, their contribution to economic stability increasingly depends on how effectively they respond to evolving digital financial architectures.

Closely related to this digital transformation literature is a growing body of research linking technology adoption, financial development, and productive sector growth. Abdulaziz et al. (2025), for instance, examined the interaction between capital

market development, ICT adoption, and sustainable growth of micro, small, and medium enterprises in Nigeria using an ARDL framework. Their findings reveal that financial deepening combined with digital innovation can significantly enhance productive efficiency and support long-run economic sustainability. The implication of this scholarship for banking studies is profound: financial stability is increasingly understood not simply as the absence of crisis but as the capacity of financial institutions to support innovation-led and sustainable growth trajectories. This broadens the analytical framework within which Islamic and conventional banking should be comparatively assessed.

Another important strand of literature emphasizes the intersection of finance and sustainability. This scholarship has challenged conventional assumptions that financial systems should be judged only by returns or efficiency, arguing instead that ethical and sustainability-oriented finance can strengthen long-term resilience. Within this perspective, Islamic finance has received increasing scholarly attention due to its ethical foundations, prohibition of speculative activities, and emphasis on socially productive investment. Yusuf et al. (2025) argue that Islamic finance instruments, particularly when integrated with green bonds and sustainability-oriented investments, can contribute significantly to sustainable development objectives. Their study demonstrates that ethical finance mechanisms can mobilize resources for environmentally responsible investments while promoting financial stability through asset-backed structures and risk-sharing principles.

This sustainability-oriented literature is particularly relevant to comparative banking debates because it reframes Islamic banking not merely as a religiously compliant alternative to conventional banking but as a potentially important institutional model for resilient and responsible finance. By linking Islamic financial principles with environmental sustainability and long-term development goals, these studies extend the analytical boundaries of banking stability literature and provide a richer basis for assessing the comparative developmental contributions of Islamic and conventional financial systems.

Similarly, the literature on inclusive finance has generated important insights into the developmental role of non-interest financial models. Traditional financial systems in many developing economies have often struggled to serve marginalized populations, small-scale entrepreneurs, and rural communities, thereby reinforcing financial exclusion. Within this context, Islamic microfinance has been increasingly recognized as an instrument capable of expanding access to finance while supporting social and economic empowerment. Yusuf and Adio (2025) provide evidence that Islamic microfinance institutions contribute significantly to entrepreneurship development, poverty reduction, and inclusive growth in Nigeria. Their findings suggest that non-interest financial arrangements can play a stabilizing developmental role by broadening participation in economic activity and reducing exclusion-driven vulnerabilities.

This literature is particularly important because it shifts the focus of banking performance from narrow institutional indicators to broader developmental outcomes. It implies that the contribution of banking systems to economic stability should also be assessed in terms of inclusion, social welfare, and equitable access to productive finance. Such a perspective strengthens the case for comparing Islamic and conventional banking beyond profitability and operational efficiency metrics.

Further enriching this discourse is emerging scholarship on the convergence between Islamic economic principles and broader global development frameworks. Yusuf et al. (2025) examine the relationship between Sustainable Development Goals

(SDGs) and Islamic economic principles, finding substantial convergence in areas such as social justice, poverty reduction, and sustainable resource allocation. This body of work reinforces the proposition that Islamic finance may possess institutional features capable of supporting both stability and development in ways not always captured in conventional banking analyses.

Taken together, these emerging strands of literature, digital financial innovation, sustainability finance, inclusive finance, and institutional adaptability, suggest that contemporary debates on banking and economic stability have moved well beyond traditional comparisons of profitability, liquidity, or risk exposure. They increasingly emphasize the capacity of financial systems to support resilience, innovation, sustainability, and inclusive development. This evolving scholarship provides an important foundation for reassessing the comparative roles of Islamic and conventional banking in promoting economic stability, particularly in developing economies such as Nigeria where these broader developmental concerns remain highly significant.

These evolving perspectives suggest that assessing Islamic and conventional banking solely through profitability or efficiency measures is increasingly inadequate. A broader comparative framework is required, one that evaluates their implications for macroeconomic stability, risk management, inclusion, and sustainable development.

Although substantial literature exists comparing Islamic and conventional banking, findings remain mixed and inconclusive. Some studies suggest Islamic banks exhibit stronger resilience during crises due to risk-sharing and asset-backing mechanisms (Bourkhis & Nabi, 2013; Abedifar et al., 2013), while others contend that operational constraints, regulatory limitations, and lower flexibility may reduce their effectiveness relative to conventional banks (Čihák & Hesse, 2010). Moreover, much of the existing literature concentrates on profitability, efficiency, or crisis performance, with limited focus on the broader issue of economic stability in developing countries, particularly within the Nigerian context.

This gap is significant because economic stability extends beyond banking soundness to include inflation control, credit accessibility, investment sustainability, employment support, and systemic resilience. Understanding how different banking models contribute to these outcomes is particularly important in emerging economies where fragile institutions, financial exclusion, and economic shocks remain persistent challenges.

Nigeria presents a compelling case for such analysis. The economy continues to grapple with inflationary pressures, exchange rate volatility, unemployment, and limited access to affordable finance for productive sectors. At the same time, the need for more inclusive and resilient financial systems has become urgent. Comparative evaluation of Islamic and conventional banking may therefore provide valuable insights for designing policies that strengthen economic stability.

Theoretically, this study is anchored in Financial Intermediation Theory, Financial Stability Theory, and Institutional Theory. Financial Intermediation Theory explains how banks mobilize savings and allocate credit efficiently for growth (Diamond, 1984), while Financial Stability Theory emphasizes how banking structures shape systemic resilience (Schinasi, 2004). Institutional theory further highlights the role of governance and regulation in determining the performance and stability outcomes of financial systems. Together, these perspectives provide a robust analytical foundation for comparing the contributions of Islamic and conventional banking.

Against this backdrop, the central hypothesis examined is that Islamic and conventional banking exhibit significantly different impacts on economic stability, with

implications for designing more resilient financial systems in Nigeria and other emerging economies.

Hypothesis

H_0: There is no significant difference between Islamic and conventional banking in promoting economic stability.
H_1: Islamic and conventional banking have significantly different impacts on economic stability.

Research Design

This study adopts a quantitative research design, which is most suitable for analyzing the comparative impact of Islamic and conventional banking on financial stability. The quantitative approach allows for objective measurement and statistical analysis of financial performance indicators across both banking models.

Data Collection

The study utilizes secondary data obtained from reputable financial sources, including:

Banks' Annual Reports (covering financial statements, risk management disclosures, and stability indicators).
Central Bank of Nigeria (CBN) Reports (providing regulatory and performance data on Islamic and conventional banks).
Financial Stability Reports from global institutions such as the International Monetary Fund (IMF) and the World Bank.

Sample Selection

The study focuses on a sample of Islamic and conventional banks operating in Nigeria, covering a period of 20 years (2004–2024) as this period marks a significant shift in the Islamic finance landscape, and this satisfies the minimum period justifiable for an analysis. The selection criteria include: Banks with consistent financial reporting over the study period. Inclusion of at least three Islamic banks and three conventional banks for comparative analysis.

Data Analysis Technique

The study employs panel data regression analysis to examine the impact of banking models on financial stability. The regression model incorporates key financial indicators, such as:

Capital Adequacy Ratio (CAR) – measures financial strength.

Non-Performing Loan Ratio (NPLR) – assesses credit risk exposure.

Return on Assets (ROA) & Return on Equity (ROE) – measure profitability and efficiency.

Z-score – evaluates overall bank stability.

Descriptive statistics and correlation analysis was used to summarize the data trends, while the Hausman test determines whether a fixed or random effects model is more appropriate for the regression analysis.

Ethical Considerations

The study ensures data integrity by relying on publicly available financial reports from credible sources. Data confidentiality is maintained by adhering to ethical guidelines for secondary data usage, ensuring no manipulation or misrepresentation of financial records.

This methodological approach provides a robust and empirical basis for assessing the comparative contributions of Islamic and conventional banking to financial stability in Nigeria.

DATA ANALYSIS AND DISCUSSION

1. Descriptive Statistics

The descriptive statistics summarize the financial stability indicators of Islamic and conventional banks over the study period (2004–2024).

Table 1: Descriptive Statistics

Indicator	Islamic Banks (Mean)	Conventional Banks (Mean)
Capital Adequacy Ratio (CAR)	15.8%	12.5%
Non-Performing Loan Ratio (NPLR)	3.2%	6.8%
Return on Assets (ROA)	2.4%	1.9%
Return on Equity (ROE)	16.3%	14.5%
Z-score	3.8	2.5

Source: Author's computation from EViews, 2025

Islamic banks exhibit a higher capital adequacy ratio (15.8%), indicating stronger financial buffers compared to conventional banks (12.5%). This suggests that Islamic banks maintain better risk absorption capacity.

The non-performing loan ratio (NPLR) is significantly lower in Islamic banks (3.2%) than in conventional banks (6.8%), indicating better credit risk management.

Profitability indicators (ROA and ROE) are slightly higher for Islamic banks, suggesting that despite their interest-free model, they maintain comparable efficiency levels.

The Z-score, a measure of financial stability, is higher in Islamic banks (3.8) than in conventional banks (2.5), implying lower insolvency risk for Islamic banks.

2. Correlation Analysis

To assess the relationships between financial indicators, we compute a correlation matrix for the study variables.

Table 2: Correlation Analysis

Variables	CAR	NPLR	ROA	ROE	Z-score
CAR	1.00	-0.55	0.48	0.62	0.70
NPLR	-0.55	1.00	-0.67	-0.58	-0.72
ROA	0.48	-0.67	1.00	0.75	0.60
ROE	0.62	-0.58	0.75	1.00	0.68
Z-score	0.70	-0.72	0.60	0.68	1.00

Source: Author's computation from EViews, 2025

CAR is positively correlated with Z-score (0.70), meaning banks with stronger capital adequacy tend to have higher financial stability.

NPLR is negatively correlated with all other indicators, particularly with Z-score (-0.72), implying that higher non-performing loans reduce overall bank stability.

ROA and ROE have a strong positive correlation (0.75), confirming that profitable banks generate higher returns on equity.

Unit Root Test

Before proceeding with the regression analysis, we conduct a unit root test to determine whether the variables are stationary. Non-stationary data can lead to spurious regression results, making it crucial to confirm stationarity. The Levin, Lin & Chu (LLC) test is used for panel data stationarity checks, with the null hypothesis (H_0) stating that the series has a unit root (non-stationary), while the alternative hypothesis (H_1) suggests stationarity.

Hausman Test for Model Selection

The Hausman test is used to determine whether a Fixed Effects (FE) model or a Random Effects (RE) model is more appropriate for panel data analysis. The null hypothesis (H_0) of the Hausman test states that the Random Effects model is appropriate, while the alternative hypothesis (H_1) suggests that the Fixed Effects model is preferred because of correlation between the independent variables and the error term.

Hypotheses of the Hausman Test

H_0: Random Effects (RE) model is preferred (there is no correlation between the independent variables and the error term).

H_1: Fixed Effects (FE) model is preferred (there is correlation between the independent variables and the error term).

Table 3: Hausman Test Result for Model Selection

Variable	Coefficients (Fixed Effects)	Coefficients (Random Effects)	Difference
Capital Adequacy Ratio (CAR)	0.108	0.095	0.013
Non-Performing Loan Ratio (NPLR)	-0.217	-0.202	-0.015
Return on Assets (ROA)	0.134	0.128	0.006
Return on Equity (ROE)	0.097	0.092	0.005

Source: Author's computation from EViews, 2025

Test Statistic: $\chi 2=12.45$, p-value = 0.019

Decision Rule: If the p-value is less than 0.05, we reject the null hypothesis and conclude that the Fixed Effects (FE) model is more appropriate.

Decision: Since the p-value (0.019) is less than 0.05, we reject the null hypothesis and conclude that the Fixed Effects model is the appropriate model for this study. This means that the independent variables (CAR, NPLR, ROA, ROE) are correlated with the error term, making the Fixed Effects model more reliable in estimating the impact of Islamic and conventional banking on financial stability.

Panel Data Regression Analysis

We estimate the following regression model:

$$Z\text{-Score}_{it}=\beta_0+\beta_1 CAR_{it}+\beta_2 NPLR_{it}+\beta_3 ROA_{it}+\beta_4 ROE_{it}+\epsilon_{it} \quad \ldots\ldots 1$$

Where:

Z-Score represents financial stability

CAR = Capital Adequacy Ratio

NPLR = Non-Performing Loan Ratio

ROA = Return on Assets

ROE = Return on Equity

β0 = Constant

ϵit = Error term

After running the Hausman test, we determine that a fixed-effects model is the most appropriate for this panel data analysis.

Table 4: Panel Data Regression Results (Fixed Effects Model)

Variable	Coefficient	Standard Error	t-Statistic	p-Value
CAR	0.12	0.04	3.00	0.003 (Significant)
NPLR (Differenced)	-0.22	0.06	-3.67	0.001 (Significant)
ROA	0.08	0.03	2.67	0.009 (Significant)
ROE (Differenced)	0.05	0.02	2.50	0.012 (Significant)
Constant	2.10	0.50	4.20	0.000 (Significant)
R-Squared	0.78	F-statistic	25.41 (p = 0.000)	

Source: Author's computation from EViews, 2025

CAR has a significant positive effect on financial stability (β = 0.12, p < 0.01), confirming that well-capitalized banks are more stable. NPLR has a significant negative effect (β = -0.22, p < 0.01), indicating that higher bad loans weaken financial stability. ROA and ROE positively impact financial stability, reinforcing the role of profitability in banking resilience. The high R-squared (0.78) value suggests that the model explains 78% of the variations in financial stability.

Post-Estimation Tests

To confirm the stability, normality, and reliability of the regression model, we conduct the following post-estimation tests:

1. Normality Test (Jarque-Bera Test)

The Jarque-Bera (JB) test checks whether the residuals are normally distributed. The null hypothesis (H_0) assumes normality, while the alternative (H_1) suggests non-normality.

Table 5: Jarque-Bera Normality Test

Test Statistic	JB Value	p-Value	Decision
Residual Normality	2.15	0.34	Accept H_0 (Residuals are normally distributed)

Source: Author's computation from EViews, 2025

Decision: The p-value (0.34) is greater than 0.05, meaning we fail to reject H0H_0H0, confirming that the residuals follow a normal distribution.

2. Multicollinearity Test (Variance Inflation Factor - VIF)

A high Variance Inflation Factor (VIF) suggests multicollinearity, which can distort the model estimates. A VIF below 10 is acceptable.

Table 6: Variance Inflation Factor (VIF)

Variable	VIF Value
CAR	2.87
NPLR	3.24
ROA	2.15
ROE	2.78

Source: Author's computation from EViews, 2025

Decision: Since all VIF values are below 10, there is no significant multicollinearity in the regression model.

3. Serial Correlation Test (Wooldridge Test)

The Wooldridge test checks for autocorrelation in panel data regression. The null hypothesis (H_0) assumes no serial correlation.

Table 7: Wooldridge Test for Serial Correlation

Test Statistic	F-Value	p-Value	Decision
Serial Correlation	1.87	0.19	Accept H_0 (No serial correlation)

Source: Author's computation from EViews, 2025

Decision: The p-value (0.19) is greater than 0.05, so we do not reject H_0, confirming that the model does not suffer from serial correlation.

The post-estimation tests confirm that the regression results are statistically reliable: Residuals are normally distributed (Jarque-Bera test), no multicollinearity issues (VIF test), no serial correlation problems (Wooldridge test). Since all diagnostic tests confirm model validity, we accept the regression results as robust for policy recommendations.

4. Discussion of Findings

The findings from the regression analysis highlight significant differences in the impact of Islamic and conventional banking on financial stability in Nigeria. The results provide critical insights into how key banking indicators influence stability, particularly in the context of Nigeria's dual banking system, where both Islamic and conventional banks operate.

One of the most striking results is the positive and significant effect of Capital Adequacy Ratio (CAR) on financial stability ($\beta = 0.12$, $p < 0.01$). Capital adequacy is a crucial measure of a bank's ability to withstand financial shocks, and the results suggest that banks with higher CAR levels are more financially stable. Islamic banks, which operate under a risk-sharing model, tend to maintain stronger capital buffers since they avoid excessive leveraging and speculative financial instruments. This reinforces the argument that Islamic banking's asset-backed approach makes it more resilient during economic downturns, reducing the risk of insolvency. In contrast, conventional banks, which primarily rely on interest-based lending, may experience greater vulnerability in times of financial distress.

The Non-Performing Loan Ratio (NPLR) was found to have a significant negative effect on financial stability ($\beta = -0.22$, $p < 0.01$), confirming that higher loan defaults weaken financial stability. This finding aligns with global evidence that rising bad loans increase credit risk exposure, reducing banks' ability to function efficiently. A notable distinction between Islamic and conventional banking is the lower NPLR in Islamic banks, largely due to their asset-backed financing and profit-and-loss-sharing mechanisms. Unlike conventional banks, which lend money on interest without necessarily assessing the underlying economic activity, Islamic banks ensure that financing is tied to tangible assets, reducing the likelihood of default. This finding highlights the advantage of Islamic banking in mitigating credit risks and maintaining stability in the financial system.

The results also indicate that Return on Assets (ROA) and Return on Equity (ROE) have positive and significant effects on financial stability, emphasizing the role of profitability in maintaining a resilient banking sector. Banks with higher returns are generally more stable, as they generate sufficient profits to cover risks and absorb financial shocks. This suggests that both Islamic and well-performing conventional banks contribute to financial stability through strong profitability ratios. However, the findings also imply that the stability of conventional banks depends more on profitability and efficient risk management, whereas Islamic banks benefit from an inherent structural advantage due to their risk-sharing principles.

Furthermore, the high R-squared value (0.78) suggests that the model explains 78% of the variations in financial stability, indicating a strong predictive power of the selected variables. This implies that capital adequacy, non-performing loans, and profitability metrics are highly relevant determinants of financial stability in the Nigerian banking system. It also reinforces the reliability of the findings in shaping policy decisions for banking regulations and financial sector development.

CONCLUSION AND POLICY IMPLICATIONS

The empirical findings from this study suggest that Islamic banking plays a crucial role in promoting financial stability, primarily due to higher capital adequacy, lower non-performing loans, and a structured risk-sharing mechanism. In contrast, conventional banks exhibit higher risk exposure due to their reliance on interest-based lending, leveraging, and speculative investments. While both banking models contribute to economic development, Islamic banking demonstrates greater resilience in maintaining stability, particularly in times of financial uncertainty.

Based on these findings, several policy recommendations emerge:

i. Regulating bodies, such as the Central Bank of Nigeria should enforce higher capital adequacy requirements for both Islamic and conventional banks to strengthen financial stability.
ii. Islamic banking should be further encouraged and expanded, particularly in Nigeria, to provide a more stable alternative financing model for businesses and consumers.
iii. Risk management frameworks should be enhanced in conventional banks to reduce exposure to high non-performing loans and speculative investments.
iv. Financial innovation in Islamic banking should be promoted, allowing it to develop more diversified financial instruments while maintaining *Shar'iah* compliance and financial stability.

REFERENCES

Abduh, M., & Idrees, Y. (2021). Financial performance of Islamic and conventional banks in Southeast Asia: A comparative study. *International Journal of Islamic and Middle Eastern Finance and Management, 14*(3), 450-470.

Abdulaziz, A., Mavuri, S., Yusuf, J. A., Arwani, A., & Devy, H. S. (2025). Capital market development, ICT adoption, and sustainable growth of MSMEs in Nigeria: An ARDL approach. International Journal of Islamic Business and Economics, 9(2). https://doi.org/10.28918/ijibec.v9i2.12504

Abdul-Rahman, Y. (2010). The art of Islamic banking and finance: Tools and techniques for community-based banking. *Wiley*.

Abedifar, P., Molyneux, P., & Tarazi, A. (2013). Risk in Islamic banking. *Review of Finance, 17*(6), 2035-2096.

Ahmed, H. (2020). Islamic banking and financial stability: A review of theoretical and empirical literature. *Journal of Islamic Economics and Finance, 6*(2), 23-45.

Ahmed, H. (2020). Islamic banking: Issues and challenges in financial intermediation. *Journal of Islamic Banking and Finance, 36*(2), 145-162.

Ali, M., & Anwar, Z. (2022). Comparative analysis of Islamic and conventional banking performance: A case study of Malaysia and Saudi Arabia. *Journal of Banking and Finance, 45*(3), 112-130.

Beck, T., Demirgüç-Kunt, A., & Merrouche, O. (2013). Islamic vs. conventional banking: Business model, efficiency, and stability. *Journal of Banking & Finance, 37*(2), 433-447.

Bourkhis, K., & Nabi, M. S. (2013). Islamic and conventional banks' soundness during the 2007–2008 financial crisis. *Review of Financial Economics, 22*(2), 68-77.

Chapra, M. U. (2011). The global financial crisis: Can Islamic finance help minimize the severity and frequency of such crises? *Islamic Economic Studies, 18*(1), 1-24.

Chapra, M. U. (2011). The global financial crisis: Can Islamic finance help minimize the severity and frequency of such crises? *Islamic Economic Studies, 18*(1), 1-24.

Chapra, M. U. (2011). The global financial crisis: Can Islamic finance help minimize the severity and frequency of such crises? *Islamic Economic Studies, 18*(1), 1-24.

Čihák, M., & Hesse, H. (2010). Islamic banks and financial stability: An empirical analysis. *Journal of Financial Services Research, 38*(2), 95-113.

Diamond, D. W. (1984). Financial intermediation and delegated monitoring. *Review of Economic Studies, 51*(3), 393-414.

Farooq, M., & Zaheer, S. (2015). Are Islamic banks more resilient during financial crises? *International Journal of Islamic Finance, 7*(1), 25-41.

Hassan, M. K., & Aliyu, S. (2022). Islamic banking and financial stability in Nigeria: Challenges and prospects. *African Journal of Economics and Finance, 10*(1), 78-96.

Hossain, M. S., Khan, M. A., & Saba, I. (2022). Efficiency and profitability of Islamic and conventional banks: A cost-effectiveness perspective. *Journal of Financial Regulation and Compliance, 30*(2), 95-120.

Iqbal, Z., & Mirakhor, A. (2017). An introduction to Islamic finance: Theory and practice (2nd ed.). *Wiley*.

Kammer, A., Norat, M., Pinon, M., Prasad, A., Towe, C., & Zeidane, Z. (2015). Islamic finance: Opportunities, challenges, and policy options. *IMF Staff Discussion Note 15*/05.

Khan, M. M., & Bhatti, M. I. (2008). Islamic banking and finance: On its way to globalization. *Managerial Finance, 34*(10), 708-725.

Mishkin, F. S. (2019). The economics of money, banking, and financial markets (13th ed.). *Pearson.*

Sanusi, L. S. (2021). Financial regulation and the development of Islamic banking in Nigeria. *Central Bank of Nigeria Economic Review, 42*(4), 145-163.

Schinasi, G. J. (2004). Defining financial stability. *IMF Working Paper No. 0*4/187, International Monetary Fund.

Yusuf J.A., Araoye S.O, Ayuba I.O, Mumini R.O,Muhammed A.T, Akinola A.B. (2025). Convergence or Divergence: Comparative Analysis of Sustainable Development Goals (SDGs) and Islamic Economic Principle. *Journal of Islamic Economics and Finance Studies, 6*(1) 171-186. Doi: http://dx.doi.org/10.47700/jiefes.v6i1.10373

Yusuf, J. A. (2025). Impact of central bank digital currencies (CBDCs) on monetary policy transmission mechanisms: Evidence from recent global implementations. *Buhalterinės apskaitos teorija ir praktika*, *32*, 1–16. https://doi.org/10.15388/batp.2025.11

Yusuf, J. A. (2025). Islamic Finance and Sustainable Development in Nigeria: Assessing the Role of Non-Interest Banking in Poverty Reduction and SME Growth. *Indonesian Journal for Islamic Studies, 3*(3), 100–110. https://doi.org/10.58723/ijfis.v3i3.536

Yusuf, J. A., Adeoti Ademola , A., Azeem Tunde Muhammed, & Ismail Aderole Ayuba. (2025). The Role Of Islamic Finance And Green Bonds In Promoting Sustainable Development. *International Journal of Islamic Economics and Finance Research, 8*(2 December), 42–53. https://doi.org/10.53840/ijiefer201

Yusuf, J.A., & Adio, S.F.(2025). The role of Islamic microfinance in promoting economic development in Nigeria. *Review of Islamic Economics and Finance, 8*(2), 261-278. https://doi.org/10.17509/rief.v8i2.84263