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CREDIT RISK AND FINANCIAL PERFORMANCE IN COMMERCIAL BANKS: THE MEDIATING ROLE OF FINANCIAL SOUNDNESS

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ABSTRACT

The study examines both the direct impact of credit risk on financial performance and the indirect impact mediated by financial soundness in Egyptian banks over the period from 2013 to 2023. Methodology: This research examines the mediating role of financial soundness in the relationship between credit risk and banks' financial performance. The independent variable, credit risk, is measured by the ratio of loan loss provisions to total loans. The dependent variable, financial performance, is measured by Return on Assets (ROA), calculated as net profit after tax divided by total assets. The mediating variable is financial soundness, measured using the Z-Score index, alongside three control variables. The study population comprises all Egyptian banks. Data spanning the period from 2013 to 2023 were analyzed using multiple linear regression via SPSS (version 26). Findings: The results reveal that credit risk has a significant negative impact on financial performance due to deteriorating asset quality and liquidity, which adversely affects bank ratings and increases financing costs. Additionally, the study finds a significant impact of credit risk on the financial soundness of commercial banks; banks with high credit risk are more vulnerable to economic shocks, which undermines their stability. Furthermore, the results demonstrate a significant mediating effect of financial soundness on the relationship between credit risk and financial performance, suggesting that weak financial soundness exacerbates the negative impact of credit risk on overall performance. Originality: While numerous studies have explored the impact of credit risk on the financial performance of banks, this research distinguishes itself by examining the mediating role of financial soundness within this relationship in Egyptian banks listed on the stock exchange.

KEYWORDS: Credit Risk, Financial Soundness, Financial Performance, Egyptian Banks.

1. INTRODUCTION

Risks are an integral part of banking, especially in light of increasing technological developments and the growing volume of banking transactions (Attia, 2023). Bank credit is based on a set of main elements, the most important of which are: the bank's confidence in the customer, the availability of funds, the determination of the credit amount, the interest rate, the purpose of the credit, and credit guarantees (Al-Maliji et al., 2023).

Credit risk is defined as the inability or unwillingness of a client to fulfill their obligations to the bank on time or in full, leading to a breach of contract (Yanenkova et al., 2021). Among the main factors contributing to credit risk are mismanagement, ineffective loan policies, interest rate fluctuations, weak capital and liquidity ratios, inadequate credit assessment, improper lending practices, government intervention, and ineffective central bank regulation (Cheng et al., 2020).

Commercial banks strive to achieve a high level of profitability, which is considered one of the most important indicators of performance efficiency and a guarantee of success and survival. Therefore, they seek to attract more deposits and invest them in operations while avoiding loans and credit facilities characterized by high risk. Consequently, the study of credit risk holds significant importance due to its impact on financial performance. A client's inability to meet their obligations reflects a bank's inefficiency in utilizing resources and achieving returns. This, in turn, affects the net profit, the level of dividends distributed per share, and the return on equity, thereby negatively impacting the bank's overall financial performance (Muriithi et al., 2016).

The primary contribution of this research lies in analyzing the direct relationship between credit risk and financial performance, providing new evidence on its potential impacts. It also examines the mediating role of financial soundness to determine whether banks with high financial soundness can mitigate the negative effects of credit risk. Additionally, the study adds a practical dimension that assists bank decision-makers in improving risk management strategies and enhancing performance by strengthening financial soundness. This research contributes to the academic literature and provides applicable results for the banking sector, making it a valuable reference for researchers and financial practitioners.

The financial crises that have faced global economies highlight the necessity of reviewing banking safety strategies. Consequently, the

International Monetary Fund (IMF) has required its members to evaluate the financial soundness of their banking systems using models and bankruptcy prediction indicators (Ouma & Kirori, 2019). The soundness of the banking sector is a vital requirement for supporting any country's financial system, reflecting a bank's ability to manage operations during unfavorable economic conditions.

Therefore, the soundness of the banking system measures the health of the financial system, which leads to stability and supports economic development (Almahadin et al., 2020). Financial soundness is a key approach to risk management; the Financial Stability Board defines it as the activity that stabilizes the financial system to capture signals of danger or failure. To maintain the financial soundness of banks, two types of policies are utilized: first, preventive policies to avert financial crises, and second, remedial policies aimed at containing crises quickly and preventing contagion among banks (Bagha, 2021).

Evaluating the relationship between credit risk and banking soundness indicators has become a crucial tool for achieving financial and monetary stability. Given the risks and crises accompanying modern banking activities, this issue has garnered significant attention. Banks require financial indicators that provide a clear vision of their condition and indicate the likelihood of exposure to risks that directly affect the soundness of the banking system. A study by Jihad (2021) concluded that financial soundness indicators are essential for banks to identify financial crises and take appropriate preventive measures.

The importance of financial soundness indicators stems from their role in building efficient financial systems and understanding the reality of banks' financial positions and creditworthiness. These indicators are considered one of the means used in supervision and field control. They also reflect the true financial positions of banks based on regulatory decisions to maintain their stability, achieve sound banking sectors, protect the rights of customers and investors, and ensure the proper implementation of financial and monetary policies in both advanced and developing economies (Ersoy et al., 2022), which in turn reflects on the financial performance of banks.

This study examines the relationship between credit risk and financial performance, with financial soundness acting as a mediating variable. Credit risk reflects the likelihood of borrowers' default, which

directly affects banks' profitability through increased loan losses and reduced income stability. However, the impact of credit risk is not only direct; it also operates indirectly through financial soundness. Financial soundness represents the overall stability and resilience of a bank, including its capital adequacy, asset quality, and liquidity position. Higher levels of credit risk tend to weaken financial soundness by deteriorating asset quality and increasing financial vulnerability. In turn, reduced financial soundness negatively affects financial performance by limiting the bank's ability to generate sustainable returns. Therefore, financial soundness plays a crucial mediating role in transmitting and shaping the effect of credit risk on financial performance.

The research problem can be formulated in the following questions:

1. Do credit risks affect the financial soundness of Egyptian banks?
2. Do credit risks affect the financial performance of Egyptian banks?
3. Does financial soundness affect the financial performance of Egyptian banks?
4. Does the impact of credit risk on the financial performance of Egyptian banks transfer through financial soundness?

2. LITERATURE REVIEW

In this section, the researcher reviews the literature related to credit risk and financial performance.

This is followed by formulating the research hypotheses and developing the conceptual framework, as follows:

2.1. *The Relationship Between the Credit Risk and Financial Stability:*

Credit risks are considered one of the most significant sources of risk faced by banks due to their impact on growth and stability. Consequently, accounting literature has studied and analyzed the effect relationship between credit risk and financial soundness in banks.

Anh (2023) conducted a study to understand the impact of credit risk management on financial stability as a measure of financial soundness for 27 commercial banks from 2006 to 2020. Credit risk management is considered a key factor for financial stability, and thus it is the key to financial soundness, achieving financial stability, and better capital allocation. The results showed that non-performing loans and loan loss provisions have a direct impact on profitability and financial stability. Moreover,

there is an indirect relationship between credit risk management, profitability, and financial stability. Due to the negative impact of credit risk on the soundness and stability of banks, and because credit activity remains vital for its significant contribution to revenues, commercial banks must enhance requirements for improving credit risk management. Furthermore, credit growth must be accompanied by ensured credit quality.

A study by Kiemo et al. (2022) aimed to explore the role of capital in mitigating credit risks and enhancing financial stability by constructing a financial soundness index for 37 banks during the period 2001–2020. The study concluded that bank capital supports financial stability by mitigating and reducing credit risks. Therefore, the study recommends that authorities continue to adopt and implement appropriate capital policies to enhance financial stability and bank lending to increase profitability and achieve financial soundness.

Ismail and Ahmed (2023) studied the impact of systematic financial risks—including liquidity, credit, and operational risks—on the financial stability of banks. The study results indicated that liquidity risks may not directly affect financial stability, but they remain a critical factor requiring attention within risk management strategies. Additionally, credit risks have a negative impact on financial stability, highlighting the importance of effective risk management in maintaining a stable financial system. Operational risks do not have a direct impact on financial stability; however, irregular operational risks can significantly affect financial institutions and may indirectly impact overall stability. The study emphasizes the importance of comprehensive risk management strategies to mitigate the negative impact of irregular financial risks. Consequently, the study provided recommendations for risk management practices that could offer insights to policymakers and financial institutions aiming to improve a financial system characterized by soundness and stability.

In light of the above, credit risks are among the most important sources of risk faced by commercial banks, reflecting the likelihood of a client failing to meet their obligations. This affects a bank's growth, stability, and ability to withstand financial crises, as reflected in the financial soundness indicators. Therefore, it is expected that credit risks will have a significant impact on the financial soundness of Egyptian banks.

Thus, the first hypothesis of the research can be

formulated as follows:

"Credit risks have a significant impact on the financial soundness of Egyptian banks."

2.2. The Relationship Between the Credit Risk and the Financial Performance:

A study by Siddique et al. (2022) observed the impact of credit risk management and bank-specific factors on the financial performance of commercial banks in South Asia during the period from 2009 to 2018. Non-performing loans (NPLs) and the capital adequacy ratio (CAR) were used as risk measures, while the cost-to-income ratio, average lending rate, and liquidity ratio were used as bank-specific factors. Return on Equity (ROE) and Return on Assets (ROA) were measured as indicators of financial performance. The study's results indicated that NPLs, interest rates on loans, and the legal reserve ratio were negatively correlated with financial performance, while the CAR and legal reserve were positively correlated with the performance of Asian banks.

A study by Kepramareni et al. (2022) shed light on the impact of credit risk, capital adequacy, liquidity, and operational efficiency on financial performance in Perkreditan Rakyat banks from 2018 to 2020. The study concluded that operational efficiency has a negative impact on financial performance, while credit risk, capital adequacy, liquidity, and the ability to meet obligations do not affect it. This can be explained by the fact that credit risk is not a determining factor for financial performance in these banks. This means that an increase in the ratio of NPLs will not affect financial performance and vice versa. This is due to the banks' collaboration with insurance companies to provide protection against credit risks. A special price is imposed on credit risks that involve the possibility of default, which is then compensated by the insurance company. This indicates that the level of credit risk does not have a significant impact on profitability.

The main objective of Al Zaidanin's (2021) study was to measure the impact of the capital adequacy ratio, NPL ratio, cost-to-income ratio, liquidity ratio, and loan-to-deposit ratio on the financial performance of 16 banks in the UAE from 2013 to 2019. The study concluded that NPLs are the most important determinant of ROA in commercial banks compared to other credit risk measures. Therefore, banks that improve their lending policy and apply credit assessment to all applications can enhance their financial performance. Moreover, operating costs are a key driver of performance, as

banks can manage the cost of their operational activities. The study also indicated that capital adequacy, the availability of liquid assets, and the use of deposits for lending should be of concern to regulators and policymakers to enhance banking performance.

Given the impact of credit risk on the banking industry in Bangladesh, Yeasin's (2022) study aimed to analyze the effect of credit risk management on the financial performance of six commercial banks. ROA was used to measure performance, while NPLs, CAR, and the loan-to-deposit ratio were used as indicators of credit risk. The study's results showed that NPLs and the CAR had a significant negative impact on financial performance, while the loan-to-deposit ratio had a significant positive impact. Therefore, credit risk negatively affects the financial performance of commercial banks.

Kwashie et al. (2022) researched the impact of credit risk, focusing on NPLs, on the financial performance of 15 banks in Ghana during the period 2013–2018. ROA and Economic Value Added (EVA) were used as measures of performance. The results showed that NPLs have a negative impact on both measures, although it was not significant for the EVA measure. It was also found that bank size, age, and GDP have a significant positive impact on financial performance.

In a related context, a study by Abdelaziz and Helmi (2022) examined the relationship between credit risk, liquidity risk, and bank profitability in MENA countries from 2004 to 2015. The results indicated that the profitability of banks in the MENA region is significantly and negatively sensitive to increases in credit or liquidity risk. This negative impact was confirmed through either the separate or interactive effects of these two risks. Furthermore, the results indicated that bank profitability significantly reduces the levels of credit and liquidity risk. Moreover, as an institutional quality, law and order increases profitability and reduces risks in the MENA region (Abdelaziz & Helmi, 2022).

From the above, it can be said that credit risks lead to a lack of liquidity and the inability to effectively allocate a bank's resources among various activities to achieve the highest possible returns. Moreover, a client's inability to meet obligations will reflect on returns and cash distributions to shareholders. Along with poor asset quality, this leads to an increase in the ratio of non-performing loans to total loans, exposing the bank to financial crises, which in turn affects financial performance.

Therefore, it can be expected that there is a

significant impact of credit risks on the financial performance of Egyptian banks. Hence, the second research hypothesis can be formulated as follows: "Credit risks have a significant impact on the financial performance of Egyptian banks."

2.3. The Relationship Between the Financial Soundness and the Financial Performance:

The financial soundness of banks, which is the fundamental pillar of the financial system, is an important indicator that reflects the effectiveness of the system and affects the performance of banks. Therefore, accounting literature has dealt with the impact of banks' financial soundness on their financial performance.

Şit (2022) examined the impact of financial soundness on financial performance in the banking sector of 11 banks in Turkey from 2005 to 2019. The study's results showed a bidirectional relationship between financial soundness indicators and financial performance measured by market value, and a unidirectional causal relationship between financial performance measured by profitability ratios and financial soundness indicators. This means that bank profitability caused the bank soundness index rather than vice versa.

Thomas et al. (2020) theoretically studied the impact of financial performance on the level of bank soundness and its effect on earnings per share (EPS). Independent variables included non-performing loans (NPL), good corporate governance (GCG), return on assets (ROA), and the capital adequacy ratio (CAR). The results revealed a significant negative impact of NPLs on the level of bank soundness and EPS. However, the study found that the bank soundness variable did not mediate the relationship between financial performance and EPS.

A study by **Muhadzdzib and Leon (2022)** examined the role of financial soundness in influencing financial performance in 27 banks listed on the IDX from 2017 to 2021. The results concluded that the capital adequacy ratio, quality of assets, quality of earnings, and liquidity have a significant positive impact on financial performance, while management efficiency has a significant negative impact.

Kirimi et al. (2022) evaluated the regulating effect of bank size on the relationship between financial stability and financial performance of 39 banks in Kenya from 2009 to 2018. The results showed that the interaction between bank size and asset quality is positively related to both net interest margin and return on assets. However, the interaction of bank

size with management efficiency and liquidity is negatively associated with return on assets.

Nnubia et al. (2022) clarified the impact of financial soundness indicators on the financial performance of 8 Nigerian banks from 2009 to 2018. The researchers found that the liquidity ratio and the capital adequacy ratio positively affect bank performance (ROA and ROE), while non-performing loans harm performance. They concluded that financial soundness indicators affect and enhance bank performance.

From the above, it can be said that financial soundness indicators are among the most important determinants for analyzing and evaluating the performance of the banking sector, determining the solidity of banks' financial positions. They also enhance the banks' ability to cover obligations and optimally invest available funds, which reflects on financial performance.

Hence, the third research hypothesis can be formulated as follows:

"Financial soundness has a significant impact on the financial performance of Egyptian banks."

2.4. The Relationship Between Credit Risk, Financial Performance, And Financial Soundness:

In light of the previous presentation, it can be concluded that credit risks affect a bank's liquidity and its ability to efficiently allocate resources among various operational activities, and consequently its ability to cover obligations and withstand financial shocks. They also impact capital adequacy, asset quality, and profitability, which in turn reflects on the bank's financial growth, stability, and soundness. At the same time, a decline in financial soundness indicators leads to the weakening of banks' financial positions and performance. This raises the question of whether financial soundness mediates the relationship between credit risks and the financial performance of banks. In other words, can the impact of credit risks on the financial performance of Egyptian banks be transmitted through financial soundness? **Accordingly, the fourth research hypothesis can be formulated as follows:**

"Financial soundness mediates the relationship between credit risk and financial performance in Egyptian banks."

Based on the logical development of the research hypotheses, the proposed conceptual model illustrating the relationships among credit risk, financial soundness, and financial performance is presented in the following figure.

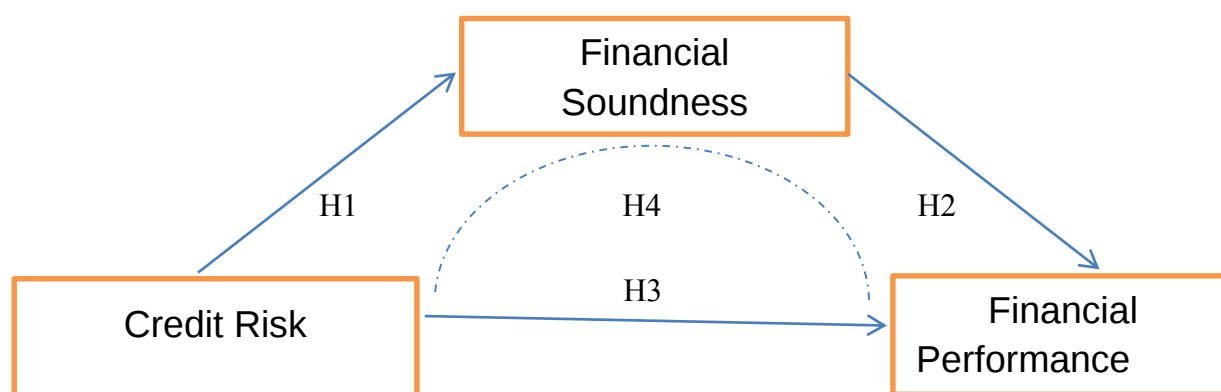


Figure 1: The Relationship Among the Study Variables.

3. METHODOLOGY OF THE STUDY

This part of the research discusses the following points:

3.1. Measuring Research Variables

The current research deals with the mediating role of financial soundness in the relationship between credit risk and the financial performance of banks. Accordingly, the research variables are represented as follows:

Credit Risk (Independent Variable): Credit risk refers to the inability of entities dealing with the bank to repay the principal or interest on a debt, which causes the bank to face doubtful or bad debts. This risk is measured by the ratio of **loan loss provisions to total loans**. This ratio is a primary concern for commercial banks in examining credit risk to protect depositors' funds

Financial Performance (Dependent Variable):

The financial performance of the banks was measured by the Return on Assets (ROA), calculated by dividing net profit after tax by total assets

Financial Soundness (Mediator Variable)

Financial soundness was measured using the Z-Score index, which was used in the study by Ullah et al. (2023).

$$Z = (\text{ROA} + \text{Equity} / \text{Asset}) / \text{Banks Sd. of ROA}$$

Where:

ROA = Return on Average Assets.

Equity = Return on Average Equity.

Banks Sd. of ROA Standard deviation of return on average assets.

Control Variables:

- Company size: measured by the natural logarithm of total assets.

- Leverage: Measured by total liabilities to total assets.

- COVID-19 crisis: A dummy variable that takes the value of one in the years before 2020 and the value of zero in the years after 2020.

3.2. Research Community:

The research community consists of all banks listed on the Egyptian Stock Exchange during the period from 2013 to 2023. These banks were selected to study the relationship between credit risk, financial soundness, and financial performance because they are the most affected by these variables. Additionally, banking data is readily available and analyzable, which facilitates reaching conclusions of significant economic and financial importance. The period from 2013 to 2023 was selected because it provides a sufficient timeframe to analyze long-term trends and encompasses significant economic and regulatory events that have impacted the credit risk, financial soundness, and financial performance of banks. Furthermore, the availability of data during this period ensures the accuracy of the analysis and the applicability of the findings to current and future banking policies.

3.3. Sources Of Research Data:

The data related to the research variables were obtained from the following sources:

- The financial statements of the banks under study, available on the Mubasher website and the Egyptian Stock Exchange.
- The banks' website.
- Board of Directors reports for banks.
- Governance reports for banks.

3.4. Data Analysis Methods and Testing Research Hypotheses:

For data analysis and hypothesis testing, the SPSS Ver (26) statistical analysis package and the Macro Process program were used to test the moderated mediation effect.

The following statistical methods were employed:

- 1- Descriptive Statistics.
- 2- Pearson Correlation Coefficient.
- 3- Multiple Linear Regression.

4. ANALYSIS, RESULTS, AND INTERPRETATION

4.1. Results Of the Descriptive Analysis of the Research Variables:

A descriptive analysis of the research variables was conducted to identify the values of the arithmetic means and standard deviations, as shown in the following table:

Table Number (I): Descriptive Analysis of Research Variables.

St. Deviation	Mean	Maximum	Minimum	variable
2130043573	745383654	18946738945	1137480	Loan provision
70365310466	31278110405	530118813705	16579761	Total deposits,
.157	.083	1.00	.0001	credit risk,
.0101	.0188	.048	.0016	return on assets
13.59	23.26	91.23	2.37	Financial soundness
1.38	9.183	11.79	7.29	Bank size
2.42	7.70	14.83	3.51	Leverage

Source: Prepared By the Researcher in Light of the Results of the Statistical Analysis.

The previous table reveals the following:

1. The values of the loan provisions range between 1,137,480 and 18,946,738,945, with an average of 745,383,654 and a standard deviation of 2,130,043,573, indicating a significant dispersion in loan provisions among banks.
2. The minimum total deposits reached 16,579,761, while the maximum total deposits reached 530,118,813,705 with an average of 31,278,110,405 and a standard deviation of 70,365,310,466, indicating a significant variation in deposit sizes between banks.
3. The minimum credit risk is 0.0001 and the maximum is 1.00, with a mean of 0.083 and a standard deviation of 0.157.
4. The return on assets in banks ranges between .0016 and .048, with a mean of .0188 and a standard deviation of .0101.
5. The Z-Score financial soundness index reached a minimum of 2.37, while the maximum financial soundness index reached 91.23 with an arithmetic mean of 23.26 and a standard deviation of 13.59.
6. The natural logarithm of the total assets of the banks ranged from a minimum of 7.29 to a maximum of 11.79, with an arithmetic mean of 9.183 and a standard deviation of 1.38.
7. The financial leverage of banks ranges between 3.51 and 14.83, with an average of 7.70 and a standard deviation of 2.42.

4.2. Pearson Correlation Matrix for the Correlation Between Research Variables:

To understand the nature and direction of the relationship between the research variables, correlations were tested using the Pearson correlation coefficient, as shown in the following table:

Table Number (II): Correlation Coefficient Matrix Between the Research Variables.

Variables	F_P	C_R	F_S
F_P Pearson Correlation Sig.	1		
C_R Pearson Correlation Sig.	-.0563 0.000	1	
C_G Pearson Correlation Sig.	0.522 0.001	-0.18 0.022	
F_S Pearson Correlation Sig.	0.883 0.004	-0.858 0.000	1

Source: Prepared By the Researcher in Light of the Results of the Statistical Analysis.

In light of the above, a negative correlation is observed between credit risk and both financial performance, financial soundness.

4.3. Research Hypothesis Test Results:

4.3.1. Results Of the First Research Hypothesis Test:

To test the validity of the first research hypothesis, Multiple Linear Regression Analysis was used to examine the relationship between the independent

variable (credit risk) and the mediating variable (financial soundness).

The test results are shown in the following table:

Table Number (III): The Impact of Credit Risk on Financial Stability.

Credit risks have a significant impact on the financial soundness of the Egyptian banks.					The first hypothesis
T		F	p-value	Determination coefficient	Variables
Level of significance	B				Constant
41.171	0.001				C_R
0.011	-2.443				Size
0.993	0.070				LEV
0.215	0.719				COV
0.544	-1.715	1.976	0.004	35%	

Source: Prepared By the Researcher in Light of the Statistical Analysis Results

The previous table makes the following clear:

- The coefficient of determination was (35%), meaning that the independent variable (credit risk) and the control variables contribute to explaining (35%) of the change that occurs in the mediating variable (financial soundness), and that 65% of the changes in the financial soundness of the banks are attributed to other factors.
- It is evident from the previous table that the regression model is significant, as the calculated (F) value for the model is 1.976, which is significant at the 1% significance level (P-value=0.004).
- Looking at the (T-Test), it is clear that there is a

significant negative impact of credit risk on the financial soundness of the banks, with a (P-value=0.011). Therefore, the first research hypothesis is accepted, which means that credit risk has a significant impact on the financial soundness of the Egyptian banks.

4.3.2. Results Of the Second Research Hypothesis Test:

To test the validity of the second research hypothesis, multiple linear regression analysis was used to examine the relationship between the independent variable (credit risk) and financial performance (the dependent variable).

The test results are shown in the following table:

Table Number (IV): The Impact of Credit Risk on Financial Performance.

The second hypothesis: "Credit risks have a significant impact on the financial performance of the Egyptian banks."					The second hypothesis:
T		F	p-value	Determination coefficient	Variables
Level of significance	B				Constant
0.017	0.015				C_R
0.037	-0.001				Size
0.005	0.366				LEV
0.001	0.002				COV
0.105	-0.003	11.213	0.001	27%	

Source: Prepared By the Researcher in Light of the Statistical Analysis Results.

In light of the above, the following can be concluded:

- The coefficient of determination reached (27%), which means that the independent variable (credit risk) contributes to explaining (27%) of the change that occurs in the dependent variable (financial performance), and that 73% of the changes that occur in the financial performance variable are attributed to other factors.
- It is clear from the previous table that the significance of the regression model, as the calculated (F) value for the model was 11.213, which is significant at the 1% significance level

(P-value= 0.001).

- Looking at the T-Test, it is clear that there is a significant negative impact of credit risks on the financial performance of banks, as the (P-value=0.037). Therefore, the second research hypothesis is accepted, which means that credit risks have a negative impact on the financial performance of the Egyptian banks.

4.3.3. Results Of the Third Research Hypothesis Test:

To test the validity of the third research hypothesis, multiple linear regression analysis was used to examine the relationship between the mediating

variable (financial safety) and financial performance (the dependent variable).

The test results are as shown in the following table:

Table Number (V): The Impact of Financial Stability on Financial Performance.

"Financial stability has a significant impact on the financial performance of the Egyptian banks."					Hypothesis Three:
T		F	p-value	Determination coefficient	Variables
Level of significance	B				
0.925	0.001	25.686	0.001	46%	Constant
0.001	0.003				F_S
0.337	-0.001				Size
0.001	0.002				LEV
0.212	-0.002				COV

Source: Prepared By the Researcher in Light of the Statistical Analysis Results.

In light of the above, the following can be concluded:

- The coefficient of determination was (46%), meaning that the mediating variable (financial soundness) and the controlling variables contribute to explaining (46%) of the change that occurs in the dependent variable (financial performance), and that 54% of the changes in the financial performance of banks are attributed to other factors.
- It is evident from the previous table that the regression model is significant, as the calculated (F) value for the model is 25.686, which is significant at the 1% significance level (P-value = 0.001).
- Looking at the (T-Test), it is clear that there is a significant positive impact of financial

soundness on the financial performance of banks, as the (P-value=0.001) indicates. Therefore, the third research hypothesis is accepted, meaning that financial soundness has a significant impact on the financial performance of Egyptian banks.

4.3.4. Results Of Testing the Fourth Research Hypothesis

To test the validity of the fourth research hypothesis, Multiple Linear Regression Analysis was used to examine the relationship between credit risk (independent variable) and financial performance (dependent variable) in the presence of financial soundness (mediating variable).

The test results are shown in the following table:

Table Number (VII): The Impact of Credit Risk on Financial Performance in the Presence of Financial Soundness.

"Financial soundness mediates the relationship between credit risk and financial performance in commercial banks."					Hypothesis Four:
T		F	p-value	Determination coefficient	Variables
Level of significance	B				
0.896	0.001	20.201	0.001	47%	Constant
0.289	-0.005				C_R
0.001	0.000				F_S
0.394	0.00				Size
0.001	0.002				LEV
0.127	-0.002				COV

Source: Prepared By the Researcher in Light of the Statistical Analysis Results.

In light of the above, the following can be concluded:

- The coefficient of determination reached (47%), meaning that the independent variable (credit risk) and the mediating variable (financial soundness) contribute to explaining (47%) of the change that occurs in the dependent variable (financial performance), and that 53% of the changes that occur in the financial performance variable are attributed to other factors.
- It is evident from the previous table that the regression model is significant, as the

calculated (F) value for the model is 20.201, which is significant at the 1% significance level (P-value=0.001).

- Referring to the T-Test, it is evident that there is a significant effect of financial soundness on financial performance in banks, where the P-value=0.001). Additionally, the relationship between credit risk and financial performance became insignificant with a (P-value=0.289). Therefore, the fourth research hypothesis is accepted, which means that financial soundness mediates the relationship between credit risk and financial performance in the

Egyptian banks, and the mediation of financial soundness is complete.

5. CONCLUSIONS

The research tested the mediating role of financial soundness in the relationship between credit risk and financial performance.

From the statistical tests of the research hypotheses, the following can be concluded:

- **Credit risks have a significant negative impact** on the financial soundness of commercial banks. Due to customer defaults, a bank's liquidity will decrease, thereby reducing its ability to withstand financial crises, especially under unfavorable conditions. This also reflects on capital inadequacy and, consequently, the bank's ability to meet its obligations. Additionally, asset quality will decline, leading to an increase in the ratio of non-performing loans and failure to achieve required profitability rates, which negatively affects the growth, stability, and financial soundness of banks.
- The research results revealed a **significant negative impact** of credit risk on the financial performance of commercial banks. Credit risk leads to a decrease in liquidity and reduces the bank's ability to efficiently allocate resources among various activities that yield the highest possible return. Additionally, the lack of liquidity reduces the bank's ability to meet obligations and decreases dividends distributed to shareholders.
- The research results observed a **significant positive relationship** between financial soundness indicators and financial performance in commercial banks. Financial soundness, in its various dimensions (capital adequacy, asset quality, profitability), is an important determinant used in evaluating the resilience of banks' financial positions. This improves their ability to grow and withstand crises through the efficient use of resources.
- The research results revealed a **significant impact of financial soundness** as a mediating variable in the relationship between credit risk and financial performance, due to the negative effect of credit risk on financial soundness, which negatively reflects on the performance of commercial banks.

6. RESEARCH RECOMMENDATIONS

In light of the research findings, the researcher recommends the following:

- Establishing a comprehensive and effective risk management framework in banks that covers all risks they are exposed to, along with organizing courses and training programs in banking risk management, and developing the skills of credit officers to ensure sound loan approvals and avoid problems arising from lending, while developing a culture and mechanisms for dealing with banking risks due to their negative impacts on the financial stability and soundness of the bank.
- The Credit Department should increase its focus on credit risk and credit quality by continuously evaluating granted loans and monitoring the financial positions of clients to assess their repayment ability and reduce the risk of default.
- Diversifying the bank's operational activities and avoiding the concentration of resources in specific investment areas to prevent banking crises, while balancing the capital structure to ensure financial stability and soundness.
- Strengthening Central Bank oversight, adhering to the implementation of Basel Committee Accords, and continuously updating regulatory controls and instructions to ensure proper risk management. Banks should be required to link credit risk indicators with financial soundness indicators in their financial reports and establish stricter instructions for credit risk management.
- Adopting statistical methods and tools to evaluate the financial soundness of banks and relying on them as early warning signals to predict and manage financial crises, while monitoring capital adequacy and liquidity ratios, as they are among the most important indicators reflecting the strength of a bank's financial position and its ability to withstand shocks.

7. SUGGESTIONS FOR FUTURE STUDIES

Considering the findings, the following research topics are proposed:

- The impact of financial soundness and flexibility on enhancing financial performance through financial stability under corporate governance.
- The joint impact of financial soundness and flexibility on risk management and financial performance in Egyptian banks.
- The role of financial soundness and flexibility

indicators in enhancing financial recovery in Egyptian banks.

- The joint impact of financial soundness and

flexibility indicators as risk management tools for achieving stability and enhancing performance in commercial banks.

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