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Impact of Risk Management Practices on Bank Performance: A case of Banking Sector in Pakistan

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Abstract: This paper aims to investigate the impact of risk management practices on the banking sector of Pakistan. Papulation of this study was the employee in the banking sector in the risk management department. The researcher used random sampling to collect data to test the hypothesis of this study. The researcher used SEM to analyze this study. The result reveals that the independent variables, i.e., risk management, level of risk control & monitoring, risk identification, and level of risk control & monitoring, was positive and significant on the dependent variable, i.e., bank performance. The researcher recommended that a comparative analysis of both Islamic and conventional banking be conducted in the future.

Keywords: Risk management, Risk, Islamic banking, Risk analysis, bank performance

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INTRODUCTION

Risk management has been necessary for all aspects of the economy in recent years, so companies can preserve their interests when attaining their targets. Through risk management, companies will ensure that the desired outcomes are achieved, that the effect of threats is minimized to reasonable levels, and that opportunities are improved to seize opportunities (Hopkin, 2017).

It is not sufficient to handle risk only at the practical level; the current business climate demands a more integrated approach to risk management. Internationally reflections of all threats faced and it's being taken by all organizations all over the world. Integrated risk assessment is an ongoing mechanism in which possible risks are analyzed at all corporate levels, and all findings are obtained at the group level to facilitate decision-making (Vovchenko et al., 2017). An integrated risk assessment must be part of the company's policy to have a major effect on the organization's risk management. This technique lets companies at the next level optimize their advantages. The integrated strategy focuses only on defining and evaluating risks and mitigating impacts to mitigate appropriate risks. Take risks reasonably and support organizations in hermitages to accelerate innovation (Kaplan & Mikes, 2016).

Financial institutions (banks) face many risks, such as credit, markup, liquidity, market, foreign exchange, and solvency (Kabir et al., 2015). Credit risk management is considered the most prominent because of its matchless banking services, especially in the Islamic banking sector. Also, they assume additional risks in drawing their financial contracts based on their infrastructure of liquidation, legal requirements, and SOPs about Sharia which they practice in daily operations (Abdullah et al., 2012).

In the Islamic finance fabric, Islamic banking is considered an important factor. The Islamic bank and conventional banking differ from each other due to the principles followed. In Islamic banking, the sharia rule is applied, whereas the interest-bearing rule is applied in conventional banking (Rashi & Jabeen, 2016).

One of the major differences between Islamic and conventional bank practices is the following: Conventional banks work as mediators between lenders and borrowers, but Islamic banks, in most transactions and services,

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become a part of the transaction and share profit and losses with their customers. - Conventional banks have no constraints on the type of transaction and industry they are willing to serve. However, Islamic banks must only engage in Halal transactions or industry (permissible sharia). - Conventional banks obtain their profit from the interest they charge upon their customers. However, Islamic banks work based on interest-free transactions as sharia prohibited (Nyabicha, 2017). But the credit management practices implemented by both traditional and Islamic banks have not yet been studied in Pakistan, and information on how credit risk management practices impact the performance of both conventional and Islamic banks has not been studied. Furthermore, the presence or otherwise relevant discrepancies between the two categories of organizations have not been reported concerning credit risk management. Islamic banking has been active in engaging in Pakistan's highly rooted traditional banking system. Pakistan's Islamic banks have seen strong growth over the last few years. Islamic banks have reported a lot of substantial growth in the past. In view of the fact that the Islamic banking sector has various idiosyncratic features, owing to the principle of profit-sharing strategy in Islamic banks, the temperament and level of risk facing such organizations can be considerably different. The value of studying the risks posed by Pakistan's Islamic banks may be best justified by the fact that Islamic banks in Pakistan play a major role in complementing services in combination with traditional banks. This paper will examine the influence of risk management practices and organizational performance in Pakistan.

LITERATURE REVIEW

In this part, relevant study of this topic was evaluated and mentioned. Literature indicates that risk management has gain attention was the Basel Committee on banking supervision (2006). It was observed that failure of bank characterized by increasing level of non-performing loans which linked with macroeconomic instability of country (Robert and Gary, 1994). Whereas Hosnaj, Manzura and Juanjauan (2009) stated that risk management affect the bank performance.

Muthusi (2017)concluded that various controls have to be established at diverse levels since the control by the management board alone is not enough to ensure the effective functioning of the risk monitoring system due to management board members do not have proper time to control over the organization. Hence, the management board should appoint an independent unit which is responsible for internal supervision (Turedi & Celayir, 2018; Waheed, Kaur, & Kumar, 2016).

A separate unit responsible for internal control can then be named by the management board (Scholtens, 2003). Credit risk recognition is the initial stage in the method of credit risk management, according to (Temile et al., 2019). However, for proper functioning of credit risk management it is necessary to explore the study of risk and its influence on the firms.

The internal audit is usually responsible for this role, although it is often assumed that the supervisory board will control the process of credit risk management, as it is assisted by internal auditors. The Supervisory Board and the Executive Board must be aware of any violations found by the internal auditors. In order to determine the efficacy of the credit risk management feature, the owners of the company may also exercise their right to insist on receiving relevant information. The director's report should also be adequately detailed to encourage shareholders to fully analyze and evaluate the corporation's position with regard to the credit risk management function (Bilal et al., 2013; Waheed, Kaur, & Qazi, 2016).

Owolabi et al., (2017) study titled: "The Impact of Risk Management on The Profitability of Insurance Companies in Nigeria". For the assessment of risk management influence on the profitability of the insurance companies; survey conducted to examine the insurance companies' adopted risk management policies. "To investigate the impact of risk management on the profitability of insurance companies". Descriptive plan of research was adopted in this study. Random sampling technique was having 60 respondents in total involved in all of its survey moreover linear regression used to find the compact coefficients from Pearson in statistical analysis system (SAS 9.2). Insurance companies' profitability can be affected by financial risk management also findings show that operational risk management practices leave direct impact on profitability. It is also funded that there is a link between strategic risk management practices and profitability in insurance companies. There are 36 study investigations suggested that insurance manager can easily over the risk by identify and construct smart methods for risk declining and ensure also that financial performance will not be affected. Thabet & Alaeddin (2017) study "Management Accounting System Credit Risk Management Practices and Organizational

Performance at Commercial Banking Sector in Palestine". Expected to report the aftereffects of an examination on the linkages between credit risk management practices and management bookkeeping framework. (MAS) towards authoritative execution through testing the match and join impacts of MAS and CRM on hierarchical execution. Some of the techniques included regulating and 11 survey of commercial banks founded in Palestinian Monetary Authority site and all the responded from the risk management office of the banks like; CEOs, chief risk officers, CMR, head supervisors, risk administrators and bank employees were divided for identification for risk management in Palestinian commercial banks. In light of IFAC's 1998 the structure and the Bank of International Settlement report 2013, it's founded that mainly the Palestinian commercial banks has total of execution for the ERM system. There are some management book keeping rehearses practices remain assistant credit risks in two primary measurements costing framework and planning in view of connections between CRM practices and MAS. Moreover communication among CRM and costing framework MAS towards authoritative execution were affirm. The motive behind is to acknowledge the enterprises of the findings of the connections among credit risk management practices and MAS (Management Accounting System) and organizational performance through combined effects of compliance testing and MAS.

It was observed that bank has to face a number of challenges if it avoid to implement risk management practices in dynamic business environment today. Banks have to follow different risk strategies such diversification in products and services to reduce risk and enhance the financial performance. Diversification in financial product and financial services, bank required to deal with credit risk Kou et. Al (2016). Furthermore, bank management has to implement an monitoring policies as well to make sure that employs are careful about the operational risk management by elaborating the financial product in detail. Another threat highlighted by Chao et. Al (2019) is money laundering that is trade based which is using the signboard of international trade. As a result of money laundering, the collapse of financial market by capital movement occur and difficult to prevent since it has trade characterization.

To encourage a critical number of partners, Islamic banks execute various capacities. This fuses the pool of assets through the acknowledgment of stores. These assets are hence sent to business people or firms for dynamic and productive dares to raise benefits. What's more, Islamic banks offer revenue let loose items to dish the assorted economy sections in consistence with Shariah standards. Also, the Islamic bank is to embrace and energize exchange conduct as a powerful collaboration of the economy.

In literature, most of researcher conducted research in insurance companies and in advance financial market. Furthermore, risk management objective continuously changed over time due to change in business dynamic environment. Learning from the experience of the risk-taking company and displaying senior management leadership tends to discourage automatic shame by the organization. The ultimate purpose of risk management is to develop an environment that facilitates the cooperation of the company, implements the decision-making process for all employees, and provides an appropriate coordination channel for risk-addressing. Learning from the company's risk-taking experience and showing senior management leadership helps to discourage the organization's automatic embarrassment.

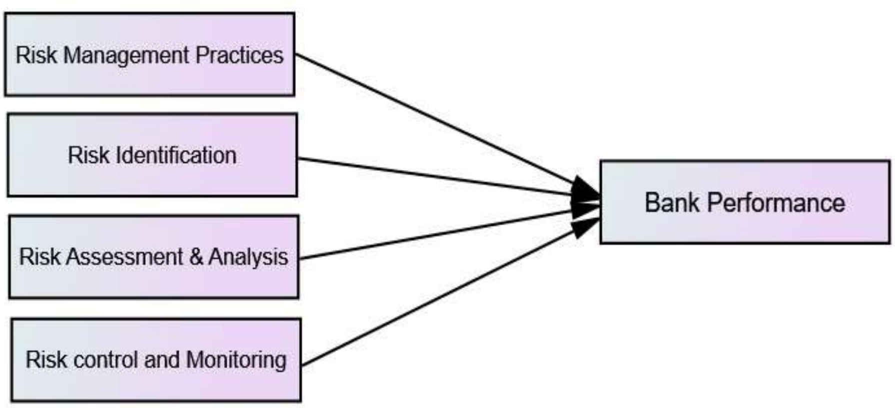

Figure 1: Theoretical Framework

Hypothesis

H1: Risk management practices positively and significantly affect the bank performance.

H2: Risk identification positively and significantly affect the bank performance. bank performance.

H3: Risk assessment & analysis positively and significantly affect the bank performance. bank performance.

H4: Risk control & monitoring positively and significantly affect the bank performance. bank performance.

RESEARCH METHODOLOGY

In this study, quantitative approach adopted. According to this approach, researcher has to develop, adopt and adept questionnaire on the base of literature. All employees in banking sector were the population of this study. A random sampling technique used to collect data from the respondent. More than 500 questionnaires were distributed. Only 235 duly filled questionnaires were received. Detail regarding the data collection tool used for this study presented in Table 1.

All variables adapted from the literature review are mentioned below in Table 1. Each construct were measured on five point Likert.

Table 1: Source of Questionnaire

Sr. No.	Variables	Items	Sources of Questionnaire
1.	Risk Management Practices	14	(Ishtiaq, 2015)
2.	Risk Identification	9	(Sleimi, 2020)
3.	Risk Assesment & Analysis	8	(Sleimi, 2020)
4.	Level of Risk Control & Monitoring	6	(Sleimi, 2020)
5.	Bank Performance	11	(Dabari & Saidin, 2015)

RESULTS & DISCUSSION

Demographic Profile of Respondent

Majority of respondent of this study were male (67%),while female were (33%). In study age were group in four category. There are total 235 respondents out of which 23.5% are belong to age group of 30-35 years about 48 respondents. 29.9% (61) of the respondent were 36-40 years and 33.8% belongs to all ther age groups among all of this 26 years of respondents were having 45year old or above.

Factor Analysis

Before testing hypothesis, researcher applied validity and reliability test. As factor load of each item of each construct is above 0.4, therefore the research tool considered as practically significant. Risk management practices construct comprised of eighteen items. Four items were removed due to factor load below the cut off score i.e., 40. Hence fourteen items were utilized for further analysis. Risk Identification constructs comprised of 11 items. Two items factor load were below the cut score i.e., 40 that were deleted. Nine items were included for final study. Risk assessment & analysis, level of control and monitoring, and bank performance constructs comprised of eight, six and eleven items respectively. Factor load of all items of aforementioned constructs were above the threshold value i.e., 40 (see Table 2). Therefore, all items were utilized for further analysis. The result also indicates that all construct of this study reliable and valid. This means that questionnaire were fit to collect data.

Table 2: Component Matrix

Dimension	Items	Load	Reliability	AVE
Risk management practices	RMP-1	0.71	0.93	0.50
	RMP-2	0.62		
	RMP-3	0.76		
	RMP-4	0.60		
	RMP-5	0.77		
	RMP-6	0.75		
	RMP-7	0.79		
	RMP-8	0.73		
	RMP-9	0.74		
	RMP-10	0.76		
	RMP-11	0.66		
	RMP-12	0.77		
	RMP-13	0.76		
	RMP-14	0.78		
Risk Identification	RI-1	0.73	0.94	0.50
	RI-2	0.65		
	RI-3	0.64		
	RI-4	0.77		
	RI-5	0.69		
	RI-6	0.77		
	RI-7	0.75		
	RI-8	0.64		
	RI-9	0.79		
Risk assesment & analysis	RAA-1	0.67	0.83	0.52
	RAA-2	0.67		
	RAA-3	0.65		
	RAA-4	0.61		
	RAA-5	0.77		
	RAA-6	0.62		
	RAA-7	0.79		
	RAA-8	0.75		
Level of risk control & monitoring	RCM-1	0.75	0.94	0.50
	RCM-2	0.70		
	RCM-3	0.68		
	RCM-4	0.77		
	RCM-5	0.69		
	RCM-6	0.72		
Bank Performance	BP-1	0.66	0.92	0.53
	BP-2	0.68		
	BP-3	0.64		
	BP-4	0.61		
	BP-5	0.86		
	BP-6	0.74		
	BP-7	0.68		
	BP-8	0.77		
	BP-9	0.71		
	BP-10	0.72		
	BP-11	0.75		

Measurement of Model

To check the validity of model, the researcher follow the parameter indicated by Hair et. al. (2010) mentioned in Table 3. For the examining of the adaptability of this model structural model was performed in AMOS. All values are above the mentioned criteria as all model fitness indicators, for the best choice for our model at suggested levels consult Table 3.

Table 3: Model Fits

Model Fit Criteria	Measurement Model	Acceptable Range
χ^2	1.45	
Df	1	
χ^2/Df	1.45	1-3
GFI	0.94	> 0.90
AGFI	0.95	> 0.80
CFI	0.93	> 0.95
TLI	0.96	> 0.90
NFI	0.92	> 0.90
RMR	0.04	< 0.09
RMSEA	0.06	< 0.08
PCLOSE	0.45	> 0.05

Notes: *There is no universal criterion for model fitness. This study relied on Hu and Bentler (1999) and Hair et al. (2010) criteria of model fitness because of mostly used in prior studies

Hypothesis Testing

After checking the model validity, structural equation modeling used to test the research hypothesis. Researcher adopt the procedure described by the Hayes and preacher (2014) to test the relationship among dependent and independent variables.

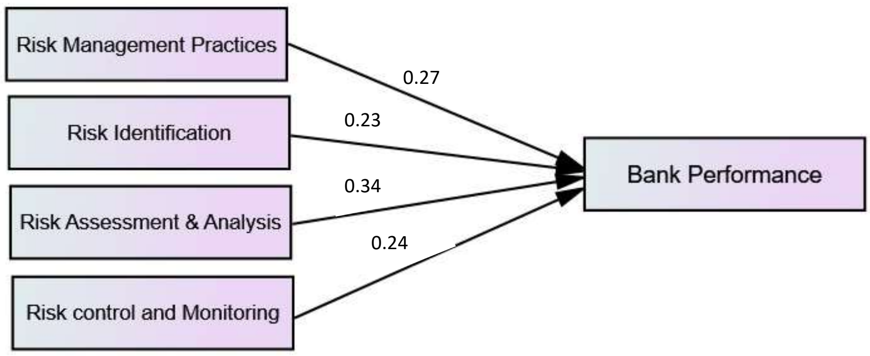

Figure 2: Structural Equation Model

From the Figure 2 elucidates the SEM, described the influence of risk management practices, risk identification, risk assessment & analysis, level of risk control & monitoring, bank performance. SEM analysis illuminates that dependent variable significantly affects by the independent variables. The result shows that one-unit variation in Risk Management Practices (RMP) brings 0.27 units' variation in bank performance. Likewise, one-unit variation in risk management identification cause 0.21 units' variation in bank performance. Furthermore, one-unit variation in risk assessment & analysis and level of Risk control & monitoring brings 0.34 and 0.24 units' variation in bank performance, respectively. The p-value (see Table 4) for all relationship is less than 0.05, which means that all independent variable has significant and positive relationship with independent variable. Hence, the result in Table 4 support the H1, H2, H3 and H4 hypothesis showing the risk management practices, risk identification, risk assessment and analysis and and level of risk control & monitoring has significant influence for the determination of the organizations' performance. Furthermore it founds that firm's multiple risk management methods simultaneously can assess the financing, investing and operating operations.

Table 4: Structural Equation Modeling Result

Variables	Estimates	*p*-Value	Hypothesis Support
Bank Performance ← Risk Management Practice	0.27	0.001	H1 Accepted
Bank Performance ← Risk Identification	0.23	0.02	H2 Accepted
Bank Performance ← Risk Assessment & Analysis	0.34	***	H3 Accepted
Bank Performance ← Level of Risk Control & Monitoring	0.24	0.008	H4 Accepted

DISCUSSION

This study is conducted to investigate the role of Risk Management which improve the bank's performance in the country (Pakistan). In the light of above literature and analysis findings are mentioned below:

The first hypothesis of the study i.e., risk management practices has significant impact on organization is supported by earlier studies such as (Shahzad & Khan, 2020). The possible reason behind this may be the business manager try to increase understanding the possible risk, its implication on organization performance and incorporate possible measures to counter the possible hazard (Kolay & Sahu, 1992). The second hypothesis of the study i.e., risk identification has significant impact on organization performance. The third hypothesis of the study i.e., risk assessment & analysis has significant impact on organization performance, is accepted. The fourth hypothesis of the study i.e., level of risk control and monitoring has significant impact on organization performance, is accepted. The investigation reveals that significant relationship between organization performance & internal controls. The findings of study supported by the studies such as (Sleimi, 2020).

CONCLUSION

The study aims to investigate the risk management practice, risk assessment & analysis, risk identification and level of risk control & monitoring on bank performance. To conduct data analysis structural equation modeling was adopted to check influence of independent variable on dependent variables. The results shows that all the four paths in the research model were found to be significant. A new dynamism has emerged after liberalization of the economy and that has been observed more or less in every sector. The result of this study would motivate the strategic decision makers within organization to formulate effective, integrated risk management model that cope with dynamic situation for better performance. One of the major limitations of this research was response of the target population as mentioned above the actual response rate was almost 50%, the other limitation includes limitations generalization of the results and limitations of resources.

In future researchers can apply similar research on different industrial sectors and compare their results or could also conduct cross regional research using same or similar variables. Furthermore, researcher should add further variables in order to further validate their findings.

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