

Risk Management Practices of Specialized Banks in Pakistan**Muhammad Ishtiaq****Muhammad Shahid Tufail****Muhammad Mateen***Government College University, Faisalabad, Pakistan***Saqib Muneer***University of Hail, Hail, Saudi Arabia***Abstract**

The issue of risk management in banks got an important place after the financial crises. Several efforts have been made to improve the risk management and performance of banks including introducing the Basel Accords as well as risk management guidelines by central banks. Consequently, the State Bank of Pakistan has issued risk management guidelines to strengthen the risk management system and to avoid unwanted happening. Specialized banks also play an important role in different sector of economy. As being the part of financial system need is to analyze the degree of Risk Management Practice in these banks also. So this study will be efforts to critically evaluate the specialized banks regarding risk management practices in their operations.

Keywords: Risk Management Practices, Specialized banks

Growth of different sectors in Pakistan steadily increasing over the last few years. Contribution to the GDP of agriculture sector is about 20.9%, industrial sector 20%, and SME about 30%. Progress of these different sectors is also positively influenced by financial institution about 9% as being observed in the overall economy. Financial system of Pakistan includes banks, insurance organization, stock market and development institution of finance. Aurangzeb (2012) suggested that Pakistani banks majorly contributing in financial services up till 95% in domestic market and evident to be the important part of the economy.

Studies on Risk Management Practice with respect to specialized banks least conducted, as specialized banks drive with especial focus to regulate the financing needs of different sectors of the economy. For desired output in different sectors of economy SBP provide the directions to specialized banks to advance the loan to the concerned sector. As only one specialized bank increases their advances by 110 billion and growth of Agriculture Sector increase with 20.9% in total GDP. For optimal use of resources and successful accomplishment of the task, success of these specialized banks is much necessary. For controlled operation of working risk management is necessary.

Like other forms of banks, specialized banks also face different risk i.e. credit risk, foreign exchange risk, market risk and interest rate risk and these banks are listed in scheduled banks. Ahmed and Ahsan (2011) proposed that effective risk management practice absolutely required for banks like other banks for optimum utilization of the resource. SBP declared the autonomous body and is authorized to regulate and supervise the credit policy and monetary policy, As SBP influence all the scheduled bank of Pakistan so the specialized banks also in the jurisdiction of central bank, therefore controlled and monitor by SBP. To interact with competitive market SBP has launched guidelines.

This frame work of guideline includes the detail of important risk that can be intercepting the banks during their routine operations. It is regardless of their size, complexity and their scope of work so specialized banks also contain the same importance as that of commercial or Islamic banks in the country. Therefore, it is necessary for even specialized banks that should avoid unnecessary risk for the flawless movement of banking operation. With this respect numbers of studies have been conducted to analyze the risk management approaches in banks (Bilal, Talib and Khan, 2013; Selma, Abdelghani and Rajhi, 2013).

However, with respect to Pakistan very limited concerned study is available (Shafique, Hussain and Hassan, 2013; Ishtiaq, 2015). These researches consist of some aspects like risk identification, understanding, assessment and analysis, managing risk credit, market, liquidity and operation. All these studies particularly focus on commercial as well as Islamic banks but least attempt made on specialized banks of the Pakistan. More or less the guideline by SBP is for all scheduled banks but no attempt particularly made to assess the degree of risk elements in specialized banks of Pakistan.

Aim and Objectives of the Study

Study aimed at the analysis to examine the level of degree to which the specialized banks of Pakistan adopt various risk management practices in their business operation. With the view of above-mentioned aim of the study following objective of the study has formulated;

- To identify the risk awareness among the staff of Specialized Pakistani banks and draws the relationship with risk management practices employed by these banks.
- To analyze the degree of the extent of risk understanding among staff of Specialized Pakistani bank.
- To realize risk assessment and analysis within the specialized Pakistani banks,
- To analyze the potency of the risk monitoring and control as the, specialized banks of Pakistan are being exercised.
- To evaluate the management of different risk factors like risk of credit, market and operation during the core work in specialized Pakistani banks.

Significance of the Study

After the global financial crisis number of studies conducted to learn from the history. Previously number of studies have been conducted (Al-Tamimi and Al-Mazrooei, 2007; Shafiq and Nasr, 2010; Khalid and Amjad, 2012; Ishtiaq, 2015). All the studies focus on commercial as well as Islamic banks but least efforts conducted for specialized banks not only in Pakistan but in whole world.

Especially focus of this study is on the specialized banks of Pakistan as how much they are employing the practices of risk management in their operations. So this study will be the triggering factor in the literature about the risk management practice in specialized banks for new entrants, practitioners and for the academic perspective. This study will be the source for the central bank to design the policies in a more efficient way for specialized banks of Pakistan to gain the national objectives.

This study analyzes the risk understanding and management degree in specialized banks of Pakistan, within this perspective the data obtain from the staff of the Specialized banks only including managers of different division regardless of the fact that they are solely responsible for risk management or not. As everyone working for organization is responsible for that (KPMG, 2009) whereas in other efforts conducted and data collected only from risk division. Besides all this study evaluate the different risk management aspect only of Specialized banks in Pakistan particularly for the first time and assess the level of degree to which extent the specialized bank is employing risk management practices and its relations with various risk elements like identification and understanding level among the staff, risk assessment and analysis, managing risk of operation, credit, market as well as of monitoring and controlling. It is clear that good knowledge about risk and its management leads to enhance the capacity of the banks to handle its risk (Al Tamimi and Al Mazrooei, 2007).

This study adopts the pattern which cover some additional view of RM liked managing risk of market, credit and operational risk as suggested by (Ishtiaq, 2015). All banking industry is directed to formulate such framework of risk management which covers all aspects of credit, market, operation and liquidity (KPMG, 2009). This study makes a contribution with respect to specialized Pakistani banks to the new entrants of literature, for banks management and authorities responsible for risk formulation strategies for specialized Pakistani banks.

Literature Review

Khalid and Amjad (2012) explored the RM practices in Islamic banks of Pakistan and obtain the primary data by using the questionnaire survey from risk managers of the banks. Descriptive statistics were applied to obtain the results. They found that there were common understanding among the staff of these banks and banks were better in dealing with various elements like risk identification, assessment, analysis, monitoring and its control. They also used the regression analysis to find the significance of the risk element on risk management practice.

They suggested that risk understanding and monitoring were the critical elements of risk management practice.

Nazir, Daniel and Nawaz (2012) evaluated the study of RM practice of various Pakistani banks; and employed the questionnaire method to obtain the information from the credit risk staff of risk division. They disclosed that banking staff had general understanding of risk and management in banks. They also appreciated that banks were efficient in handling identification of risk, assessment and analysis of risk and monitoring of risk. They applied the regression model and through OLS method declared that understanding of risk and monitoring were the essential elements of RM practices of banks operating in Pakistan.

Another attempt made to explore the RM practices of bank in the upcoming economies and analyzed risk aversion techniques and importance of Basel III outline for coping with the challenges of international financial critics in the banks situated in sub-continent and gulf (Bilal, Talib and Khan, 2013). They applied dual mode of data obtaining method including questionnaire and the interviews. They showed that banks were much eager to handle the potential risk. In addition to this they revealed that banks were stepping ahead to develop the framework in accordance with the new accords of Basel III. Regression analysis also employed to analyze the influence of the risk elements on risk management practices and disclosed that significant positive association between the understanding of risk, its identification, assessment and analysis, monitoring, managing credit risk and the risk management practices of the banks.

Ishtiaq (2015) explored the risk management practices in Pakistani banks. He employed the dual mode of method to collect data from 20 banks operating in Pakistan including public, private and foreign banks. He used survey questionnaire and interview from the staff of the selected banks based at Pakistan. He used the descriptive and inferential statistics to elaborate the results of various risk elements prevailing in selected banks. He revealed that risk aspects like risk identification, risk understanding, risk assessment and analysis, risk monitoring and controlling were effectively being adhered by these banks. He also declared that managing credit risk, operational risk, liquidity risk, and market risk were also effectively managed by these banks. He used the multiple regression and employed ordinary least square to judge the association of risk aspects with RM practices. He revealed that there is also positive significant relationship between the risk management practices and the risk identification, risk understanding, risk assessment and analysis, risk monitoring and controlling. He also suggested the significance relationship between RM practices and performance of these banks. Least efforts conducted for specialized banks regarding risk management practices adoption. However some efforts regarding some focused investments in particular sectors like agriculture, industrial and small and medium term loans to project certain localities being addressed.

We can observe the number of studies conducted on Islamic or commercial bank but purely specialized segment is least discussed so the need is to address this segment in Pakistan is also there. In the above analysis it is obvious that there is sever requirement to study the risk management practices even in specialized Pakistani banks also with additive perspective of various risk element to materialize the benefit of risk management practices. It is established in various studies that commercial as well as Islamic banks are adopting the RM practices in Pakistan as well as in foreign banks. As the Specialized banks in Pakistan also being controlled and monitored by State Bank of Pakistan and as per Institutional theory (DiMaggio and Powell, 1983) like other banks RM practice have to adopt by these banks to meet the regulatory requirement. Studying the result of previous study of RM practices for other banks including commercial as well as for Islamic banks (Ishtiaq, 2015; Al-Tamimi and Al-Mazrooei, 2007). It is also expected the significant relation between RM practices and other RM element for Specialized Pakistani banks also.

Research Methodology

The Population of current study contains all the specialized banks of Pakistan. The current study utilized the stratified random sampling technique for the sample selection that should be systematically arranged and represent the particular proportion of the all the specialized banks. The current study used the survey questionnaire method to obtain the targeted data form 300 managers of different division of specialized bank of Pakistan. Prior to initiating the survey questionnaire, the database of these specialized bank developed and required information obtained through website and telephonically in the different cities of Province Punjab.

As this study applied the self-delivery and collection questionnaire technique, 269 questionnaires received back out of which 22 found incomplete or inappropriate can not to be utilized. At the end 247 questionnaires were that decided to use with the response rate of 82%. For

the analysis of survey questionnaire data various differential statistics methods applied. SPSS 20 has been used to execute the different tools like descriptive statistics, multicollinearity, reliability, and correlation and regression analysis.

Results and Discussion

Respondent detail regarding their gender, age, work experience is assessed in the Table 1.

Table 1: Demographical Aspects of Respondents

Gender	Respondent	Percentages	Cumulative %
Male	194	78.5	78.5
Female	53	21.5	100
Age (Years)			
20-29	69	27.9	27.9
30-39	102	41.3	69.2
40-49	54	21.9	91.1
50 and Above	22	8.9	100
Work Experience (Years)			
Up to 5	64	25.9	25.9
6-10	72	29.1	55.1
11-15	45	18.2	73.3
16-20	30	12.1	85.4
21-25	14	5.7	91.1
26 or More	22	8.9	100

Demographic detail as mentioned in above table shows the demographical elements like gender, age and their work experience. Male are the major contributor in this study. The age range lies between 20 to 58 years. Majority of the staff members are between 30 to 39 years age wise and this groups contribute up to 41.3 percent in whole. The work experience of respondents ranges from 1 year to 36 years. Majority the respondents contain the work exposure between 11 and 15 years, and group touches the figure of 29.1 percentages in total data.

Correlation Analysis, Examining the Association between Variables

Pearson Correlation Coefficient (r) is conducted to analyze the association among different variable, Correlation matrix representing the value as given below in the Table 2. Result of Correlation Coefficient (r) between RM Practices and other variables RI, RU, RAA, RMC, MCR, MOR, MLR, and MMR show the positive relation. As mentioned in the above Table the Correlation values falls among independent variables are less than 0.55 and suggesting that data is free from multicollinearity (Gujrati and Porter, 2009).

Table 2. Correlations Matrix

Variables	1	2	3	4	5	6	7	8
1-Risk_Ident	1							
2-Risk_AA	.14*	1						
3-Risk_MC	-.03	.26**	1					
4-Risk_CrRisk	.06	.42**	.29**	1				
5-Risk_MktRisk	.01	.41**	.27**	.70**	1			

6-Risk_OptRisk	.00	.38**	.30**	.56**	.56**	1	
7-Risk_MgtPrcs	.02	.27**	.30**	.52**	.47**	.53**	1
8- Risk_Undstd	.04	.34**	.18**	.41**	.44**	.28**	.36** 1

**Significant at $p \leq .001$, *Significant at $p \leq .05$,

Regression analysis is employed to test the hypothesis keeping in consideration that in number of previous studies it was being used (Al-Tamimi and Al Mazrooei, 2007; Ishtiaq M, 2015). Selection of hypothesis is based on the regression analysis and following model is being used as also used by in other previous study (Ishtiaq M, 2015):

$$RMP = f(RI, RU, RAA, RMC, MCR, MOR, MLR, MMR)$$

Table 3. Regression Analysis

Independent Variables	Coefficient (β)	Std. Error (e)	T	Significance (p)
Risk_Undstd	.141	.046	2.430	.016**
Risk_Ident	.003	.037	.054	.957
Risk_MC	.114	.044	2.107	.036**
Risk_OptRisk	.311	.046	4.799	.000***
Risk_AA	.053	.067	.887	.376
Risk_CrRisk	.236	.064	3.113	.002**
Risk_MktRisk	.060	.061	.791	.430

$R^2 = .386$, F Value = 21.494 ($p = .000$)

N = 247

Level of Acceptance: ***Significant at $p \leq .001$, **Significant at $p \leq .05$, *Significant at $p \leq .01$, No differentiation in Significance

R^2 indicates seven independent variables express 38% change in dependent variables. As per Collinearity review of value of tolerance ranges from .441 to .971, as well as the value of variance inflation factor is not greater than 2.269 indicating the absence of multicollinearity in information (Garson, 2012) In the Durbin Watson 1.961, close to the 2 and highlighted it is free from serial correlation (Gujrati and Porter, 2009).

Initial step to test hypothesis of relationship between RI and RM practice. Multiple regression analysis employed to test this relation. As per the result positive significant influence of RI ($\beta=.141$, $p=.016$) has observed on RM practice in Specialized banks located in Pakistan. In addition to this there is also the indication of positive association between RU and RM practice. Here conclusion can be withdrawn that RM practices is significantly influenced by risk understanding in specialized banking sector. Risk Understanding is an important factor in specialized banks with respect to RM practice.

In second hypothesis relationship of Risk_Ident and Risk_MgtPrc examined through regression technique. As per the result insignificant influence of Risk_Ident ($\beta=.003$, $p=.957$) has been found on RM practices. Unlike other studies conducted and found significant relation of Risk_Ident and Risk_MgtPrc here find no relation in Specialized Pakistani banks. It might be with the fact of that focused market with some contained objective. Therefore for effective RM practices the interception of risk understanding has relatively no influence so management could think to design the policy with this consideration to endorse how much the risk identification level among their staff of specialized banks. Result regarding Risk_Ident is also similar with those of previous study conducted for Islamic as well for conventional banking system (Nazir, Daniel and Nawaz, 2012).

In third hypothesis the relationship of RAA examined on RM practice and run the regression analysis. As per result the insignificant influence of Risk_AA ($\beta=.053$ $p=.376$) has

observed on RM practice. The result regarding the Risk assessment and analysis for specialized Pakistani banks showing the same result as find in previous study conducted for Islamic bank. (Nazir, Daniel and Nawaz, 2012). We can conclude here that for RM practice the role of risk assessment and analysis is negligible. Management of Specialized banks can review their strategy to which extent staff should be authorized to assess and analyze the risk to encounter the RM practice in specialized bank.

Fourth hypothesis about the relationship of Risk_MC and Risk_MgtPrc of specialized Pakistani banks tested through Regression analysis. It has been found a significant positive association between RMC and RM practices in specialized Pakistani banks. Furthermore it is also supported by Correlation of Pearson in which there is also the positive relation observed.

The results also support the presumptions of institutional theory (DiMaggio and Powell, 1983) that requires the uniformity in the development of institutional rules and procedure with respect to follow the directions of regulatory authorities (Hudin and Hamid, 2014). As per central bank of Pakistan it is principle applicable for all financial institution that a compact and strict method of RMC in Pakistan. With respect to the positive significant relationship the need is to enhance more focus on risk monitoring and controlling to accelerate the better impact of RM practices in specialized banks based in Pakistan

The fifth hypothesis is concerning with the relationship of managing Credit risk and RM practices in specialized banks of Pakistan. Multiple Regression analysis run and found a significant positive impact of MCR ($\beta=.236$ $p=.002$) on RM practices in specialized banks of Pakistan. Results are also endorsed by the Correlation technique and exert a positive relationship between MCR and RM practice.

The result also assists the assumption of homogeneous of theory of Institution (DiMaggio and Powell, 1983) as per that regulatory pressure exert on bank (Collier and Woods, 2011). In Pakistan SBP has already launched the strict guideline regarding Credit RM for banking operational activities including supervising of board and top management, infra-structure, RMC. Results of study emphasis that MCR is essential to accelerate the RM practices in specialized Pakistani banks like rest banking industry of the country.

The sixth hypothesis regarding the relationship of managing market risk and RM practices in specialized Pakistani banks. Multiple regression analysis employed and it is found that insignificant impact of MMR ($\beta=.60$ $p=.430$) found on RM practices in specialized Pakistani banks regardless of the positive association shows in Pearson Correlation analysis. Unlike the studies conducted for other banks in Pakistan managing market risk has no significant impact on RM practices in specialized banks. The specialized focused market has different influence for specialized banks unlike other form of banks. Managing market risk guideline by SBP is considerably available for all banks including specialized banks in Pakistan but management could review this aspect with the concern of RM practices for specialized Pakistani banks.

Seventh hypothesis is regarding the relationship of Mag_OptRisk and Risk_MgtrPrc in specialized Pakistani banks. Multiple regression analysis runs to test the hypothesis. Results revealed that there is direct significant impact of Mag_OptRisk with ($\beta=.311$, $p=.000$) on Risk_Mgtprc. The result also endorsed by the Correlation shows the positive relationship among variables. Thus it can be inferred that MOR is considered to be of prime importance for RM practices for specialized banks like other local as well as foreign banks. The result of this hypothesis is strongly endorsed the recommendations of previous studies conducted for other form of local as well as foreign banks. (Ishtiaq M, 2015; Shafique, Hussain and Hassan, 2013).

Furthermore, this study also supports the assumption of Institutional theory (DiMaggio and Powel, 1983) that describe about the uniformity view of the firm's policies and procedures developed to meet the condition subjected the political and regulatory pressure (Collier and Woods, 2011 and Hudin and Hamid, 2014). With Pakistani perspective as SBP has directed all the banks including specialized bank to develop compact plans for managing operational risk with the view of providing definite frame work of RM. We can observe the result depicting the direct significant relationship between MOR and RM practices in specialized banks of Pakistan like other banks.

This study of research contributes in the existing literature in multiple ways. The study aims to generate the understanding of RM in specialized bank of Pakistan and support the existing literature and incorporate the efforts towards the theoretical explanation even for specialized banks of Pakistan. This study contributes in the research to evaluate the more elements of risk with RM practices in specialized banks of Pakistan. This study like in the latest study for commercial banks (Ishtiaq, 2015) attempted to discuss the assumption of homogeneity of theory for Institution

(DiMaggio and Powell, 1983) through considering the RM practices in specialized bank of Pakistan for the first time. Thus it contributes massively in the existing literature.

This research covers the core area of operation of banking business important for organization and critical for regulatory authorities (Maghyereh and Awartani, 2014) and also particularly for specialized banks which are subjected to promote the country's specific sector on need base. The current research is fully devoted for specialized Pakistani banks first ever in the literature to cover the different aspects of risk. This research purely designed and conducted for the specialized Pakistan banks, but can also be employed globally where to address the banks with the nature of specialized action required. As most specialized banks are state owned that's why this research would definitely pave the way of Government and regulatory authorities to develop the policies accordingly to anticipate the risk aspect prevailing with certain specialized banks.

Conclusion

This research work focused on RM practices and its relationship with various risk elements like RI, RU, RAA, RMC, MCR, MOR, and MMR. The study finds out the positive significant relationship between RM practice and the various elements mentioned above except RI, RU, RAA, and RMC. Research further reveal the level of extent to which specialized Pakistani banks realize these risk elements in their practice of RM, it revealed that specialized Pakistani banks are advanced in realizing the RI, RU, RAA, RMC in their practices. This study is also evident that specialized banks adopting the RM practice not only to fulfill the regulatory requirement of SBP but also to improve their function.

The research based on the primary data collected from the staff of the specialized banks, the single mode of technique is adopted to collect the data and analysis to that with descriptive as well as inferential frame work to test this data. The research depicts only the result based on the quantitative system so it's the limitation of this research. The research has focused on limited segments of risk and find out the relationship between RM practice of specialized banks with risk RI, RU, RAA, RMC, MCR, MOR, MMR. However, number of other aspect can also be included in this study like quality of management, board composition, board size, loan difference, geographical constraints might have been evaluated.

As already mentioned in the limitation that study considers the specialized banks only but it could add the microfinance as well as the specialized division of other banks also. This will ultimately provide the overall framework regarding the RM practices and procedure for all these banks for specialized sectors would be available. Further in this study data collected from three specialized banks of Pakistan in future this base can enhance and add more banks like microfinance banks as well as specialized division of other banks to enhance the scope of this study as well. Since this research evaluated the relationship among specific elements with RM practice, there are more other aspect could also be considering like board size, quality and composition did not discuss.

References

- Ahmed, A., & Ahsan, H. (2011). Contribution of services sector in the economy of Pakistan. *Working Papers & Research Reports*, 2011.
- Al-Tamimi, H. and Al-Mazrooei, F.M., 2007. Banks' risk management: a comparison study of UAE national and foreign banks. *The Journal of Risk Finance*, 8(4), pp. 394-409.
- Aurangzeb, C. (2012). Contributions of banking sector in economic growth: A case of Pakistan. *Economics and Finance Review*, 2(6), 45-54.
- Collier, P. M., and Woods, M. (2011). A comparison of the local authority adoption of risk management in England and Australia. *Australian Accounting Review*, 21(2), 111-123.
- DiMaggio, P.J. and Powell, W.W., (1983). The iron cage revisited: institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, 48(2), pp.147-160.
- Garson, G. D. (2012). Testing statistical assumptions. *Asheboro, NC: Statistical Associates Publishing*.
- Gujarati, D.N., and Porter, D.C., (2009). *Basic econometrics*. 5th Ed. New York
- Hudin, N.S. and Hamid, A.B.A., (2014). Drivers to the implementation of risk management practices: a conceptual framework. *Journal of Advanced Management Science*, 2(3), pp.163-169.

- Maghyereh, A., &Awartani, B. (2014). The effect of market structure, regulation, and risk on banks efficiency: Evidence from the Gulf cooperation council countries. *Journal of Economic Studies*, 41(3), 405-430.
- Ishtiaq. M. (2015), Risk Management in banks: Determination of Practices and relationship with performance: *PhD Thesis, University of Bedfordshire*.
- Khalid, S. and Amjad, S., (2012). Risk management practices in Islamic banks of Pakistan. *The Journal of Risk Finance*, 13(2), pp.148-159.
- KPMG International, (2009). Never again? Risk management in banking beyond the credit crisis. Berne: KPMG International.
- Nazir, M.A., Daniel, A. and Nawaz, M.M., (2012). Risk management practices: a comparison of conventional and Islamic banks in Pakistan. *American Journal of Scientific Research*, (68), pp.114-122.
- Raza Bilal, A., Bt. Abu Talib, N., & Noor Azli Ali Khan, M. (2013). Remodeling of risk management in banking: evidence from the sub-continent and gulf. *The Journal of Risk Finance*, 14(5), 468-489.
- Selma, M.R.B., Abdelghani, E. and Rajhi M.T., (2013). Risk management tools practiced in Tunisian commercial banks. *Studies in Business and Economics*, 8(1), pp.55-78.
- Shafiq, A. and Nasr, M., (2010). Risk management practices followed by the commercial banks in Pakistan. *International Review of Business Research Papers*, 6(2), pp.308-325.
- Shafique, O., Hussain, N. and Hassan, M.T., (2013). Differences in the risk management practices of Islamic versus conventional financial institutions in Pakistan. *The Journal of Risk Finance*, 14(2), pp.179-196.