Risk Management Practices in the Conventional Banks Working in Peshawar

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Abstract   *The study is conducted to research the RMP and procedures pursued by conventional banks functioning in Peshawar region. In the study the risk management (RM) is elected as a dependent variable, whereas Risk assessment (RAs), risk identification (RI), risks monitoring (RMn), risk analysis (RA) and RMP (RMP) are taken independent variables. Data is collected through questionnaires on five Likert Scale. Total number of questionnaire distributed were 120, out of which 102 questionnaires were received with positive response from the banks. As per the regression, we found from the results that risk assessment and analysis, risk analysis and RMP have significant effects, and risk identification and risk monitoring have insignificant effects on RMP. The paper`s findings are limited to RMP`s of conventional bank operating in Peshawar region. This study will of value to those who are interested conventional banking industry.*

Key words   Conventional Bank, Risk management, Risk analysis, Risk assessment

1. Introduction

Risk has been delineated as all those things that may cause obstacles and barriers in the system to accomplish specific goals & objectives. The reason might be either internal or external environmental factors, depend on the many types of risk to occur within a specific situation. In fact Risk is considered as a natural phenomenon of business and community life that might be faced at any stage. Tracking and facing that risk can be sometimes critical more than expectations. Proactive precautions could be the best option to handle such circumstances to identify risk that can result in unpleased results. It is concluded, in straight forward terms, that it is better to react in advance to risk before the occurrence of unexpected events.

In today's modern age and rapidly growing business organizations, financial institutions particularly banks mostly face large number of risks. These include liquidity risk, credit risk, market risk, interest rate exchange risk, operational risk etc. In order, exposure to these different types of risks, effective and efficient practices of risk management are badly needed to minimize loss and maximize profit and also to eliminate weaknesses and extend strengths in such a competitive market. It's quite clear that risk and return have strong relation because both are linked to one another, it show that growing one shall definitely increase the other and vice versa. Once risk has been diagnosed and recognized basic techniques are to be used to manage it. Shafiq and Nasr (2010) discussed that risk must be managed prior to its occurrence, which is the best strategy to cope with it.

Risk Management is considered a regulation for each and every bank and encircles all the transactions which may disturb their risk résumé. It includes recognition, evaluation, monitoring and controlling these risks in timely manner (Guidelines for Commercial Banks & DFIs in Pakistan).The prospective of financial institution sector will apparently rely on risk management kinetics. All those banks only that possess decisive risk management set up will undoubtedly persist for long period in the market.

The basic mentality for adopting RMP is to minimize the possibility future collapse. But, in practical conditions, risk is not free of cost. Indeed, Risk is pricey in capital and in corporate interruption. However the price of postponing or neglecting risk may cause some unpleasant outcomes (Meyer, 2000), for example bankruptcy and also it has the possibility of system failure.

All banks including Conventional Banks are in the risk trade. In this mechanism to provide financial benefits, they encounter different sort of risks related to monetary terms. In last few years our competency and understanding regarding commercial banks has enhanced considerably. In this duration, much research has been conducted on the performance of commercial banks in the financial industry. These Banks are operating since 1947 and has been divided into four categories: 1) Private Banks 2) Foreign Banks, 3) Nationalized Commercial Banks and 4) Privatized Banks. (Kazmi, 2001)(Pakistan and Gulf Economist).

The core aspiration of current paper is to analyze the extent, to which the Commercial banks in Pakistan use effective and efficient RMP. It also classifies the mechanism and approaches used in handling different kinds of risks, including risk of liquidity, risk of credit, risk in the market and operational risk by Commercial bank in Pakistan. Current paper is in continuation of previous research work

2. Literature review

To begin with, generally plenty of researches presented their precious work to discuss risk management. But, practical studies on RMP are very limited on commercial banks. It is to be explained in the subsequent paragraphs to sum up the fundamental outcomes of few chosen researches on Risk Management.

Recently, Research has been conducted on the RMP followed by Islamic banks in Pakistan by Sania and Shehla (2012). These researchers use the similar methodology that was recommended by Al-Mazrooei and Al-Tamimi (2007) on RMP. Outcomes of that paper illustrates that Islamic banking practices are somehow apparently effective in managing risk. Whereas most effecting variables are risk and risk management, risk controlling and credit risk analysis in RMP.

In addition to that another comparative study is investigated between the practices of risk management in Commercial banks and Islamic banks. Another research has been investigated on comparison of RMP of Islamic and commercial banks in the Middle East, Hassan (2011). This study intended to determine the significant kinds of different risks that are faced by Conventional banks and Islamic banks in the Middle East region. There is a positive correlation among risk management tactics and competency to understand risk, risk management, risk identification, risk monitoring, risk assessment and risk analysis, , risk, and credit risk analysis, multi regression and ANOVA model tests were used to prove above results in Commercial banks and Islamic banks.

Hussain and Al-Ajmi (2012) organized a study on the comparison of RMP pursued by Commercial banks and Islamic banks operating Bahrain. Advanced artificial variable bank is exercised to compose the flawless comparativeness. The conclusion of the research was the better risk management and better understanding of risk, risk assessment and analysis, risk identification, risk monitoring and credit risk they have positive and significant relationship with risk management procedures in the conventional and Islamic banks working in Bahrain. Comparison of the research argues that there are significantly higher levels of risks encountered by Islamic banking system as compare to Commercial banking system. Furthermore, liquidity, and operational, country, settlement, and residual risks have been found that it is higher in Islamic banks than those in Commercial banks. All these outcomes are available to differences in the products of both types of banks that lead to unique risks to Islamic banks.

Nazir (2012) examined the present RMP followed by Islamic and Commercial banks operating in Pakistan. Data for the study was gathered through questionnaire to establish the outcome of relative analysis. The regression results reflects that banks in Pakistan are efficient in the analysis of credit risk, monitoring risk and understanding risk are the most important variables in the risk management and there result shows that they have a significant difference.

The conclusion of the research reveals that there is a better understanding regarding the risk management and their understanding in the Islamic Banks in Brunei, the conclusion of this research is that the Islamic banks are getting better in understanding risk management and moving towards growth. Foreign exchange risk, operational risk and credit are the major risks that are facing them these Islamic banks. The results of regression model are, RI, RAs and RA are the most affecting variables in the Islamic banks RM.

According to Hassan (2009) who conducted research on the RMP of Islamic banks in Brunei, to analyze the level of Islamic banks in Brunei to which they implemented the practices of risk management

and investigate them by applying different techniques on the different kinds of risks. According to the results, like the conventional banks, Islamic banks are also exposed to the variety of risk in the market because of different products they are offering to the public in addition to the products of conventional banks. The results reveals that the Brunei Islamic Banks have better understanding of risk and how to manage risk means that the staff working there are properly aware to these kinds of risks. The main risk that affects their performance is foreign exchange risk, operational risk and credit risk. As per the regression results, risk assessment, risk analysis and risk identification are the most significant variables that affects the performance of Islamic banks in Brunei.

3. Methodology of research

The ground of the study consists of 14 conventional banks. The data is assembled from their regional offices of these fourteen sampled banks located in Peshawar region. In data collecting process preference is given to those who are concerned with risk and appointed at managerial/officer rank. The study is positioned on random sampling technique and on primary data is collected through the use of standardized Five Likert scale questionnaire ranging from strongly agree, agree, neutral, disagree and strongly disagree. The conventional banking sector of Peshawar was considered as a target population of the study. Total 120 questionnaires were distributed to the risk management staff working in the sampled banks, out of which102 filled questionnaires was received back from the respondents. The risk management was taken as a dependent and Risk assessment, risk identification, risk monitoring, risk analysis and RMP were taken independent variables of the study.

4. Hypothesis

H_1: There is a positive relationship between understanding risk and risk management, and Risk assessment, risk identification, risk monitoring, risk analysis and RMP.

5. Results and discussions

Reliability statistics

S. No	Variables	Alpha
1	UR & RM	0.771
2	RA & RA	0.651
3	RI	0.689
4	RM	0.809
5	RA	0.765
6	RMP	0.887
	All Variables	0.762

The reliability statistics was measured to check the validity of variables for the data collection. The rule of thumb in the reliability statistics is 0.70, if the Cronbach alpha value is more than 0.70 it will be considered as valid for the data collection (Nunnally, 1978). The individual Cronbach's Alpha of UR & RM (0.771), RA & RA (0,651), RI (0.689), RM (0.809), RA (0.765) and RMP (0.887). The above value of all six variables shows reliable the overall reliability of all six variables 0.762.

Regression

Model	R	R^2	Adjusted R^2	F	Sig
	.781	.610	.366	2.500	.120

The above table shows the results of regression model. The model was used to check the effects of independent variables on the dependent variable. The value of R is .781, this shows the association of independent variables with dependent variable. The value shows that independent variables are 78 percent correlated to dependent variable. The value of R^2 is .610 which shows the effect of independent variables

on the dependent variable. The results show that 61 percent variation shows in the risk management by five dependent variables.

Variables	Beta	t-value	Sign
Constant		-.826	.433
RAs	.915	2.152	.050
RI	-.427	-1.212	.260
RM	-.399	-1.675	.132
RA	.834	2.895	.020
RMP	1.205	2.750	.025

The value of beta of risk assessment and analysis is .915, the value of beta shows the contribution in the variation in the dependent variable by each independent variable. The beta of risk assessment and analysis is .915 which shows a strongest contribution in the explanation of dependent variable by risk assessment and analysis. The value of t-ratio is 2.152 which is more than the standard value. The rule of thumb for t-ratio is 2, the value of t-ratio will always be interpreted as absolute (irrespective of its positive or negative sign). The p-value is .050 which is less than .05. Risk assessment and analysis has significant effects on risk management. The value of beta of risk identification is -.427, the value of beta shows the contribution in the variation in the dependent variable by each independent variable.

The beta of risk identification is -.427 which shows a strongest contribution (in opposite direction) in the explanation of dependent variable by risk identification. The value of t-ratio is -1.212 which less than the standard value is. The rule of thumb for t-ratio is 2; the value of t-ratio will always be interpreted as absolute (irrespective of its positive or negative sign). The p-value is .260 which is more than .005. Risk identification has insignificant effects on risk management.

The value of beta of risk monitoring is -.399, the value of beta shows the contribution in the variation in the dependent variable by each independent variable. The beta of risk monitoring is -.399 which shows a strongest contribution (in opposite direction) in the explanation of dependent variable by risk monitoring. The value of t-ratio is -1.675 which less than the standard value is. The rule of thumb for t-ratio is 2, the value of t-ratio will always be interpreted as absolute (irrespective of its positive or negative sign). The p-value is .132 which is more than .005. Risk monitoring has insignificant effects on risk management. The value of beta of risk analysis is .834, the value of beta shows the contribution in the variation in the dependent variable by each independent variable.

The beta of risk analysis is .834 which shows a strongest contribution (in same direction) in the explanation of dependent variable by risk monitoring. The value of t-ratio is 2.895 which is more than the standard value. The rule of thumb for t-ratio is 2, the value of t-ratio will always be interpreted as absolute (irrespective of its positive or negative sign). The p-value is .020 which is less than .005. Risk analysis has significant effects on risk management.

The value of beta of RMP is 1.205, the value of beta shows the contribution in the variation in the dependent variable by each independent variable. The beta of RMP is 1.205 which shows a strongest contribution (in same direction) in the explanation of dependent variable by risk monitoring. The value of t-ratio is 2.750 which is more than the standard value. The rule of thumb for t-ratio is 2, the value of t-ratio will always be interpreted as absolute (irrespective of its positive or negative sign). The p-value is .025 which is less than .005. RMP has significant effects on risk management.

Correlation

		URM	RAA	RI	RM	RA	RMP
URM	R	1					
	Sig						
RAA	R	.016	1				
	Sig	.957					
RI	R	-.023	.368	1			
	Sig	.937	.195				

		URM	RAA	RI	RM	RA	RMP
RM	R	-.194	-.082	-.251	1		
	Sig	.505	.782	.386			
RA	R	.334	-.050	-.492	.351	1	
	Sig	.244	.866	.074	.219		
RMP	R	.191	-.609*	.313	-.101	-.436	1
	Sig	.514	.021	.276	.732	.119	

*. Correlation is significant at the 0.05 level (2-tailed)

The above table shows the results of correlation test. The test was used to know the relationship between the variables. The value of URM and RAA is .016, which shows that URM and RAA are 1.6 percent correlated to each other. The relationship between URM and RAA are positively correlated to each other. The value of URM and RI is -.023, which shows that URM and RI are 2.3 percent correlated to each other. The relationship between URM and RI are negatively correlated to each other. The value of URM and RIM is -.194, which shows that URM and RM are 19.4 percent correlated to each other. The relationship between URM and RM are negatively correlated to each other. The value of URM and RA is .334, which shows that URM and RA are 33.4 percent correlated to each other. The relationship between URM and RA are positively correlated to each other. The value of URM and RMP is .191, which shows that URM and RMP are 19.1 percent correlated to each other. The relationship between URM and RMP are positively correlated to each other.

Reliability of the measure was evaluated by applying Cronbach`s Alpha. It permits to calculate the reliability of the different variables. In the estimation, a coefficient greater than or equal to 0.70 is considered acceptable and a perfect signal.

6. Conclusions

• As per correlation test, the relationship between URM and RAA is positive. URM and RI are negative. URM and RIM are negatively correlated to each other. URM and RA are positively correlated to each other. URM and RMP are positively associated to each other.

• As per the regression results, risk assessment and analysis, risk analysis and RMP have significant, and risk identification and risk monitoring have insignificant effects on RMP.

Based on the study results and personal observation it is recommended that the conventional banks are not avoiding the risk completely. The management of the banks should keep focus on the training of risk management.

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