DOI: 10.36347/sjebm.2017.v04i02.005

Scholars Journal of Economics, Business and Management e-ISSN 2348-5302
Sch J Econ Bus Manag, 2017; 4(2):85-88 p-ISSN 2348-8875

(An International Publisher for Academic and Scientific Resources)

Risk Management: An Approach to Manage Risk (Comparative study between Pakistan & Chinese Banks)

Muhammad Zubair Saeed[1], Muhammad Uzair Saeed[2], Liu Jun Qi[3], Anum Zulfiqar[4]
[1]PhD Scholar, College of Economics, Liaoning University, China
[2]Bachelor in Commerce Student, United College, Sargoda University, Pakistan
[3]Professor, College of Economics, Liaoning University, China
[4]Visiting Lecturer, Bahauddin Zakariya University, Pakistan

*Corresponding Author
Muhammad Zubair Saeed
Email: zubairdgkhan@gmail.com

Abstract: The objective of this study is to compare the risk management system of Pakistan and Chinese financial institutions system. For this study we explored some primary data by interviewing in Banks in Pakistan and analyzed by some perspective approaches and comparisons. The secondary data was retrieved from both countries financial institutions term reports and financial statements and analyzed by comparison by banks performance and their methods of risk management. The results showed that the Chinese banks have efficient tools to averse the risk and its tool may be use as follower instruments towards success for developing financial system. In analysis we will emphasis on that risk averse tools which we learnt according to our various experiences.
Keywords: Risk Management, financial institutions, banks

INTRODUCTION

Risk can be defined as the probability of loss or an adverse outcome associated with an action. We can say that in future we do not know that what is going to happen. If the uncertainty is at large level so it means that risk is also large and high. Banking sectors and financial institutions involve in optimizing expected outcomes subject to the level of risk involved and tolerance they beard in risk.

Financial institutions make decisions in a risky environment almost every day while they go for any debt transaction. The results of their decisions taken are generally unknown. Furthermore, the results may be better or worse than they have expected. There are many different situations concern with the decisions by financial institutions. The situations may cause the high level probability of negative consequences and it may also go for favourable side.

Even we are assuring in this point that risk factor is involved in every economy, without the risk the economic growth is not possible. In our research we will emphasis on two different countries financial system between Chinese and Pakistani banks. We will also analyze the system of evaluation risk adopt by these two different countries and at end we will give our result that which one is effective as like we above stated that it's the comparative study between two various environment in different countries. To more details these two systems are bearing the two kinds of risks, financial risks and non-financial risks. Financial risk is further divided into credit risk, liquidity risk and market risk where as non-financial risks are divided into legal risk, operational risk and regulatory risk [1]. In our daily routines in banks to make the effective risk management is the important part of banking transactions they have to deal either willingly or unwillingly. Risk management is an essential component of strategic management of an organization. It is an ongoing process of risk assessment through different tools and methods which identify all possible risks, determine which risks are critical to solve as soon as possible and then execute strategies to deal with these risks [3]. Current risk management system based on the Basel II aims to promote financial stability [2]. The Basel Accord has consequently appeared as an attempt to protect banking system all around the world from the affects of financial crises and structures it by using a set of rules which allow for systematic risk management [4].

An efficient and effective risk management is the need of each and every organization and is one of the key responsibilities of bank. However effective risk management boosts the performance of an organization. The past financial crises uncovered shortcomings in the performance and risk management practices with many banks taking on excessive risk with too little regard for long run performance[5]. Banks can grab opportunities with greater confidence only with an integrated approach of managing risk and performance. They may use the various types to quantify risk according and by following international standards.

AIMS & OBJECTIVES OF THE STUDY

As we know in any case we go for the risk management to identify the potential future issues before occurring. Because of this we arrange some measures to defend these kinds of happenings. Any organizations it's financial or non-financial, they go for take some steps to averse from risk happening and some objectives maybe as follows:

1. As like we studied in various academic course works of Risk management, by adopting various hedging techniques, we will learn the method to cover potential loss
2. We will cover the gaps that where we have a space which financial organizations are missing
3. We will develop the various institutional risk managing policies and procedures to ensure the financial institutions risk is mitigated.
4. By adopting these measures we will make the policies that how we can cover the related disputes regarding recovery and claims.
5. By adopting the following techniques, we will learn about the coverage of operational risk like Information Technology for reporting.
6. The importance will be determined that how the Chinese Banking policies are more effective than Pakistani Banks

LITERATURE REVIEW

In our research paper we have collected majority the secondary data already published in different journals. Regarding analyzing the various articles we came to state some information published by different scholars and researchers. Sitwat Habib *et al.* [6] conducted research on Operational Risk Management in Corporate and Banking Sector of Pakistan. This research aims to find the reasons for the implementation or lack of adoption of integrated operational risk management approach. The paper revealed that risk management can improve organizational performance but in Pakistan, companies and various financial institutions do not have appropriate infrastructure and proper knowledge of risk management. Research showed that in banking sector of Pakistan the concept of operational risk management can be seen up to some extent.

Barati *et al.* [7] have carried out an empirical study of Risk Management in Iranian Banks. The intention of this research was to study the factors which extensively influence the risk management practices and to study relationship between some banking ratios like cash to asset ratio, capital adequacy, size of bank and debt to equity with liquidity, credit and operational risks. This study concluded that all risks have positive relationship with capital adequacy and debt. On one hand, capital adequacy had a positive relationship with liquidity risk where as the sizes of banks, cash to asset and debt to equity ratios had an inverse relationship with liquidity risk. In case of credit risk, capital adequacy had an inverse relationship with it where as debt to equity ratio and credit risk are positively related and there weren't any relation between credit risk and other variables. On the other hand, the cash to asset ratio, sizes of banks and capital adequacy had an inverse relationship with operational risk. Finally the results of this study also showed that there weren't any relation between the debts to equity ratio and operational risk.

Now we move to the financial system working in the environment of country China. All over the china the conventional banking system is working and they are using the most modern tools to averse from risk associated with financial system. The financial industry in China is an emerging market that is experiencing rapid expansion and growth in financial products, such as the recent launch of CDS [1] instruments and RMB options. Financial institutions are expanding across multiple financial verticals and entering overseas businesses. Chinese regulators are also gradually adopting or referencing international regulations for the financial industry. As shown by this Celent study, these changes are all fast influencing the risk management arena. Compared to regulation being a key factor in the past, competition from within the industry and a more complex financial environment are now the key considerations in risk management at large financial institutions in China. (By Andre Map) Keeping up with regulatory change can be one of treasurer's biggest frustrations. According to survey results in a recent white paper, Treasury Technology – Six-step Guide to Gaining Sophistication through Simplification, "the second biggest group of participants, 20 percent, identified regulation as their biggest challenge in the coming year." Processes and reporting that were previously highly automated suddenly have exceptions and workarounds, while treasury policy may be pulled towards "easier" compliance rather than the needs of the business. However, often this is because treasury technology is not being maintained in line with new and updated functionality that is available. A quick run through the list of current or forthcoming financial regulations reveals more than 50 regional or global changes that treasurers will need to contend with, in addition to local regulations in the countries in which they do business.

The average ratio of nonperforming assets (NPA)—loans that are unlikely to be paid back—to total bank loans outstanding is around 2 percent. But this is widely seen, even by the government itself, as an

[1] CDS: Credit Default Swap

understatement of the true extent of the problem. Adding in the category of “special mention” loans, those which are not yet in default but have a high probability of becoming so, even the official data put the NPA ratio at about 5 percent. Banks have kept NPAs off their books by “ever greening” their loans, i.e., giving even weak and unprofitable companies new loans to pay off their old loans.

Private analyst estimates of the actual ratio of NPAs range from 6–7 percent to as much as 20 percent, with even higher ratios of around 25 percent for some of the smaller banks. Still, Chinese banks do not face the potentially catastrophic problems that many Western banks faced during the financial crisis. Most of their funding comes from bank deposits, which tend to be stable, rather than from debt. Moreover, banks have about 17 percent of required reserves at the PBC. Even if a banking crisis can be avoided, however, it will still be necessary to cover losses from loans made to companies that become insolvent or go bankrupt. This could involve a combination of two types of measures—sweeping nonperforming assets into asset management companies and infusing new capital into the banks. This will ultimately result in a fiscal cost. This cost would be reduced by partial loan recoveries, asset sales, and the use of loan loss provisions that banks maintain. Still, the fiscal cost will be substantial.

RESEARCH METHODS & DESIGN

In our research work we conducted some quantitative as well as the qualitative work because both kind of research is required for the development of risk management. Personally during my MBA Major Finance during 2010 I have conducted some direct interviews specifically in Pakistan Habib Bank and others. The other way, we also collected a lot of secondary data from various journals and published platform and we came to know that mixed method can give us the excellent level of understanding.

ANALYSIS & INTERPRETATION

Now a day’s risk management system has been revolutionized with the advanced findings and innovations. The improvement of risk management has found the new ways for the betterment of financial institutions to minimize its risk.

As we have learnt from our course work that different type of models have been derived and by adopting these models we may minimize the risk level. These models may include VAR Model, Credit Risk Model. By using these models we can get the better results for the specific achievements like to quantify market and credit risk. Now according to some researches model of operational risk is also evolved, but many arguments and issues are still lying in this operational risk model. These new model-based approaches not only strengthen the financial institution’s ability of risk measurement and management, but also contribute to more efficient resource allocation through better evaluation of risk. In result, the financial institutions can more thoroughly understand their risk exposure and hedge unwanted risk.

As learned from our course work, large value loans are assessed individually to identify any impairment early so that the risk of high loss is prevented or contained. The limit for treating a loan as a 'large value loan' will vary, depending on the nature and size of a bank's business. A loan of USD 100,000 might be considered a large value loan for the purpose of assessing provisions to a bank with assets of less than USD 10 million; the same loan may not be a large value loan to a bank with assets in excess of USD 1 billion. Loans that are adversely classified are also generally assessed individually. These include those in the doubtful and loss classification categories as per the supervisory credit classification system, or in the adversely classified or defaulted grades as per the bank’s internal rating system. Here I want to share one model, which I designed for hedging risk.

RISK MODEL TO AVERSE THE RISK

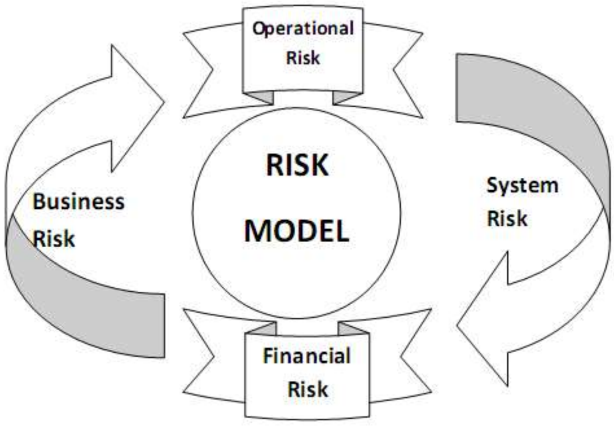

Fig-1: Risk Model To Averse The Risk

According to this model, we have learnt this in our course work also that this is the basic model to averse the risk in financial institutions.

Chinese Current Regulatory Structure

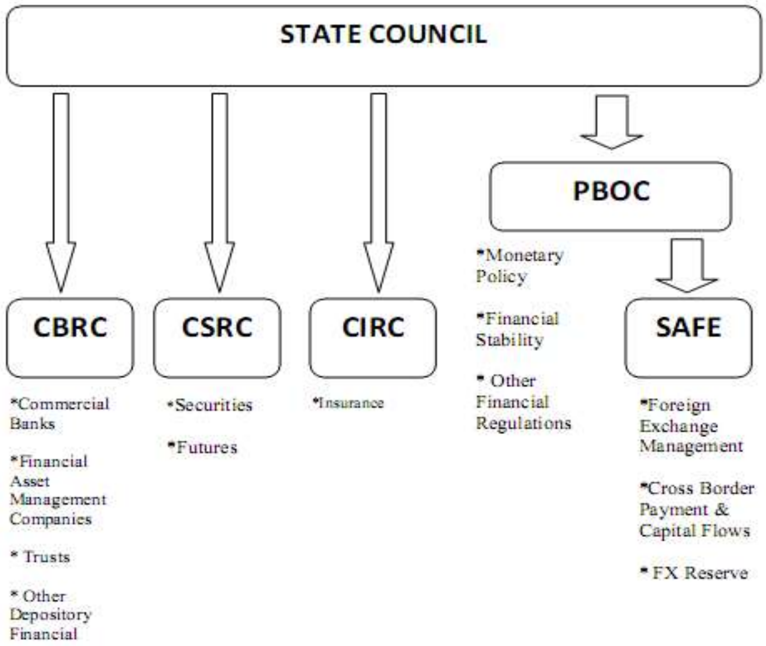

Fig-2: Chinese Current Regulatory Structure
CBRC: Chinese Banking Regulatory Commission
CSRC: China Securities Regulatory Commission
CIRC: China Insurance Regulatory Commission
PBOC: The People's Bank of China
SAFE: State Administration of Foreign Exchange

As we discussed in out interpretation that the Chinese Banks are using latest and innovated risk management tool and their financial industry is booming day by day. In our above both kind of analysis statements we showed that in China there are different kind of regulation commissions, these commissions have high level authority so the other institutions and governments cannot influence the economic condition of the country. So that is why Chinese banking system is far better than banking system working in Pakistan. As we showed the Chinese Current Regulatory Structure is managing the system with excellent and innovative techniques while in Pakistan the banks are being regulated by The State Bank of Pakistan. In Pakistan some private institutions are there like IBP (Institute of Bankers of Pakistan) this institute is only Pakistan's registered institute which is involved in to enhance the quality of financial institutions in Pakistan but as like in China various commissions are performing excellent job and playing a vital role to reduce the risk in banking and financial industry.

REFERENCES

1. Gleason JT. Risk: The new management imperative in finance. Bloomberg Press, Princeton, USA, 2000.
2. BCBS. International Convergence of Capital Measurement and Capital Standards: a Revised Framework, Comprehensive Version, BIS, 2006.
3. Khan T, Ahmed H. Risk management: an analysis of issues in Islamic financial industry. Occasional Paper No. 5, IslamicDevelopment Bank, Jeddah, Saudi Arabia. 2001;28-39.
4. Makwirmiti AM. The implementation of the New Capital Accord (Basel II): A comparative study of South Africa, Switzerland, Brazil, and The United States, 2008. Unpublished Master of Commerce Thesis, Department of Economics and Economic History, Rhodes University, Grahamstown South Africa. http://eprints.ru.ac.za/view/creators/Makwiramiti=3AA=2E_M=2E_=3A=3A.html [Accessed on April 21st 2011].
5. Kaliti G. The effect of risk Management practices on Performance of Firms in the Hospitality Industry in Nairobi County, Kenya (Doctoral dissertation, University of Nairobi). 2015.
6. Habib S, Masood H, Hassan T, Mubin M, Baig U. Operational risk management in corporate and banking sector of Pakistan. 2014.
7. Barati M, Navid BJ, Ghanbari M, Kheirollahi F. A Review of Financial Strategies Impact on the Financial Performance In Iranian Banks. International Journal of Humanities and Cultural Studies (IJHCS) 2016 Jul 6;1(1):1789-806.