Differences in the risk management practices of Islamic versus conventional financial institutions in Pakistan: An empirical study

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Abstract

Purpose
The purpose of this paper is to provide an insight into the differences in the risk management practices of Islamic financial institutions (IFI) and conventional financial institutions (CFI) in Pakistan.

Design/methodology/approach
The study makes use of primary data collection method using a questionnaire survey.

Findings
Literature review discovered that the types of risks faced by both types of financial institutions can be classified under six categories. The research concludes that credit risk, equity investment risk, market risk, liquidity risk, rate of return risk and operational risk management practices in IFI are not different from the practices in CFI. Whereas the overall risk management practices of IFI and CFI are alike in Pakistan.

Research limitations/implications
Further research with a larger sample size is recommended.

Practical implications
The paper opens our eyes to the fact that much is unknown about the risk management practices in Pakistani financial system, creating a need for empirical studies for further discoveries to formulate better frameworks and to prevent an impending financial crisis that might be unravelling at the time this paper is being read.

Originality/value
This is the first empirical study of its kind that addresses the unmarked topic of RMP in IFI and CFI in Pakistan. The research was conducted because few studies have been executed to understand differences in the risk management practices in Pakistan, exclusively among Islamic financial institutions. This study is expected to expand the existing literature by providing novel empirical evidence.

Keywords
Islam, Financial institutions, Risk management, Risk management practices, Islamic financial institutions, Pakistan, Conventional financial institutions, Empirical, Credit risk, Operational risk, Rate of return risk

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In Pakistan Islamic banking is at infant stage although last 10 years growth is marvelous. Islamic banking has grown at an average annual rate of 63% in the last ten years (01/04-09/13) in Pakistan. Evidences suggest Islamic banking is very much practiced like modern conventional banking with certain restrictions imposed by Shari'a and addresses the large number of business requirements successfully hence perceiving Islamic banking as totally foreign to business world is not correct. It is further found in the study that Islamic banking is not a mere copy of conventional practices rather major differences exist in the operations of Islamic Financial Institutions (IFIs) in comparison with conventional banking. Islamic banks and other financial institutions must comply with a variety of principles besides avoiding interest. Islamic finance is based on four core principles: Prohibiting usury. That difference is just one of many ways that the fundamentals of Islamic banking differ from those of conventional commercial banking. The basic purpose for establishing an Islamic bank is to promote and encourage Islamic principles. Conventional banks are profit-making organizations that generally aren't based on religious principles. Risk management practices of conventional and Islamic banks in Bahrain. The Journal of Risk Finance, 13(3), 215-239. Iqbal, M., & Molyneux, P. (2005). Differences in the risk management practices of Islamic versus conventional financial institutions in Pakistan An empirical study. Journal of Risk Finance, 14(2), 179-196. Tafri, F. H., Rahman, R. A., & Omar, N. (2011). Empirical Evidence on the Risk Management Tools Practised in Islamic and Conventional Banks. Qualitative Research in Financial Markets, Emerald, 3(2).

Related Articles. The risk management practices in the manufacturing SMEs in Cape Town. Now in Pakistan 5 Islamic, 5 public sectors, 4 specialized, 18 conventional and 6 foreign banks are operating their functions. Islamic banks also face same risk in liquidity as conventional banks. He suggested that through adopting risk management practices, which include risk assessment and the other one is risk identification. Haron and Wan Azmi (2008) studied. Hassan et al. 1697. Islamic financial institutions are more concerned with the acceptability of shariah. So they have to follow the shariah principles. Due to the fast growth of Islamic financial industry and the desire of shariah compatible instruments by the investors the Islamic securitization is necessary. Replicate conventional risk management products and risk profiles. As for the first type, there is a global trend towards the unification or de facto standardisation of risk management products, which can be currently observed in the market. Moreover, variants of Islamic standard contracts may become more popular in the future, such as diversified deferred price products, value-based Salam, credit-based Mudarabah, Mudarabah (or Musharakh) with deferred sale, as well as methods like appointing debt collectors, creating quasi-debt discount facilities, using cooperative hedging mechanisms or bilateral mutual adjustments. In fact, conventional financial instruments have been developed to solve