

Risk Management Practices of Islamic Financial Institutions in Malaysia and Pakistan



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LAPORAN AKHIR PENYELIDIKAN “RISK MANAGEMENT PRACTICES OF ISLAMIC FINANCIAL INSTITUTIONS IN MALAYSIA AND PAKISTAN”

Merujuk kepada perkara di atas, bersama-sama ini disertakan 2 (dua) naskah Laporan Akhir Penyelidikan yang bertajuk seperti tertera di atas untuk simpanan pihak YBhg. Prof.

Sekian, terima kasih.

Yang Benar,

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4. Report

4.1 Executive Summary

The focus of this study is to examine the effectiveness of the risk management process (understanding risk management, risk identification, risk assessment and analysis, and risk monitoring) on risk management practices among Islamic banks in Malaysia and Pakistan. The study also compares the risk management process and practices between the banks in both countries. The study found that Islamic banks in Malaysia and Pakistan are somewhat efficient in managing risk and that there is a significant difference between the banks in Malaysia and Pakistan in the practice of understanding risk management and risk identification. The results also indicate that risk identification and risk assessment and analysis are the most influencing factors in risk management practices in both countries.

4.2 Introduction

Risk management has been at the forefront of news headlines worldwide due to the incompetent practices, which led to today's banking crisis. The inability to fully appreciate the extent of risk exposure and the implications to business strategies has placed many banking institutions in disarray. Arising from the experiences during the 1997 Asian and Latin American financial crisis and the more recent US sub-prime loan crisis, greater emphasis has been placed on enhancing the risk skills and creating a more robust risk culture. In fact, banks in many emerging market countries are also increasing their focus on risk management in an effort to build more robust and sound financial systems, to remedy the weaknesses that were exposed by the recent regional problems and to position themselves to participate more fully in the global economy. Thus, effective risk management is critical to sustain the business growth and continued profitability of the banks. Given today's challenging financial and economic environment, adopting a balanced risk-return profile is important in striving for the continued enhancement of shareholders' value. With the growing globalization of the financial markets, the risks associated with Islamic banks and financial institutions in any one country are likely to affect the markets in other countries.

Thus, the main focus of this paper is to assess the level of risk management practices among Islamic banks in Malaysia and Pakistan. The secondary objective is to compare risk management practices among Islamic banks in both countries. Due to the lack of research in this field (Hassan, 2009), this study will be among the few to examine the level of risk management practices in Islamic Banks and the first to focus solely on Malaysia and Pakistan. Furthermore, although these two countries have Islamic banking systems, no comparative study between Pakistan and Malaysia has been done before.

Since the establishment of Bank Islam Malaysia Berhad and Takaful Malaysia in 1983 and 1984, respectively, Malaysia has embraced the practice of Islamic banking and finance and has been growing strongly over the last 28 years. In Pakistan, private sector banks dominated the market during the 1950s and 1960s.