

# **RISK MANAGEMENT AND ITS IMPACT ON BANK PROFITABILITY EVIDENCE FROM THE PAKISTAN BANKING SECTOR**

**BY**

**IBRAHIM ZAFAR**

**68069**

**ABDUL WAHAB**

**67556**

**ZAIN ABBAS**

**67563**

A Project submitted to Department of Management Studies, Bahria Business School, Bahria University – Karachi Campus, in partial fulfillment of the requirement for BS A&F Degree



**BS (ACCOUNTING & FINANCE)  
FALL-2023**

**Bahria University Karachi Campus**

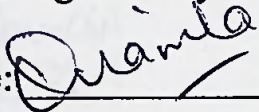
## APPROVAL FOR EXAMINATION

Candidate's Name: M. Ibrahim Zafar  
Candidate's Name: Abdul Wahab Essani  
Candidate's Name: Syed Zain Abbas

Registration No.: 67539  
Registration No.: 57752  
Registration No.: 57758

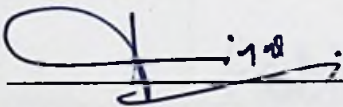
Project Title: Risk Management and Its Impact on Bank Profitability Evidence from Pakistan Banking Sector

I hereby certify that the above candidate's thesis has been completed to my satisfaction and, to my belief, its standard is appropriate for submission for examination. I have also conducted plagiarism test of this thesis using HEC prescribed software and found similarity index at \_\_\_ that is within the permissible limit set by the HEC for the MBA/BS (A&F)/BS Economics thesis. I have also found the thesis in a format recognized by the Department of Management Sciences.

Supervisor's Signature: 

Date: 14-12-2023

Supervisor's Name: Ms. Quanita Shamoona

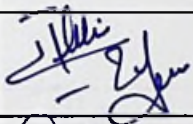
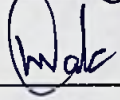

HOD's Signature: 

Date: 28-2-27

### 1<sup>st</sup> Half Semester Progress Report

Name of Student(s)	Ibrahim Zafar, Abdul Wahab Essani, Syed Zain Abbas Zaidi
Enrollment No.	02-112201-017, 02-112201-034, 02-112201-043
Thesis/Project Title	Risk Management and its impact on Banks Profitability Evidence from Pakistan Banking Sector

#### Supervisor Student Meeting Record

No.	Date	Place of Meeting	Topic Discussed	Signature of Student
1	17-09-23	Faculty Room 04 Liberal #01	Planning of FYP, LR	
2	11-10-23		Introduction	
3	21-10-23		Problem Statement	
4	28-10-23		Theoretical Background	

Progress Satisfactory       Progress Unsatisfactory

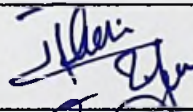


Remarks: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Signature of Supervisor: Quanita      Date: 14-12-23  
 Name of Supervisor: Quanita Shamoon

## 2<sup>nd</sup> Half Semester Progress Report & Thesis Approval Statement

Name of Student(s)	Ibrahim Zafar, Abdul Wahab Essani, Syed Zain Abbas Zaidi
Enrollment No.	02-112201-017, 02-112201-034, 02-112201-43
Thesis/Project Title	Risk Management and its impact on Bank Profitability Evidence from Pakistan Banking Sector.

### Supervisor Student Meeting Record

No.	Date	Place of Meeting	Topic Discussed	Signature of Student
1	21-11-23	Faculty Room Nodh Celsical #01	Data Collection, Methodology	
2	29-11-23		Measurement, Reference, Discussion	
3	5-12-23		Conclusion	

## DECLARATION OF AUTHENTICATION

I, hereby, declare that no portion of the work referred to in this project has been submitted in support of any application for another degree or qualification of this university or any other institution of learning.

Student's Signature:

1. Wah

2. Zain

3. Ibrahim

## Table of Contents

<b>S. No</b>	<b>Description</b>	<b>Page #</b>
<b>1</b>	<b>1. INTRODUCTION</b>	<b>1</b>
	1.1. Background of the Study	1
	1.2. Problem Statement	2
	1.3. Research Questions	3
	1.4. Research Objectives	3
	1.5. Significance of the Study	3
<b>2</b>	<b>2. LITERATURE REVIEW</b>	<b>5</b>
	2.1. Theoretical Background	8
	2.1.1. Underpinning Theory	9
	2.1.1.1. Agency Theory	9
	2.2. Theoretical Framework	11
	2.3. Hypothesis Development	11
	2.3.1. Capital Adequacy Ratio	11
	2.3.2. Liquidity Risk	12
	2.3.3. Non-Performing Loans	13
<b>3</b>	<b>3. RESEARCH METHODOLOGY</b>	<b>15</b>
	3.1. Sample and Data Collection	15
	3.2. Research Design	15
	3.3. Econometrics Equation	17
	3.4. Measures of Variables	17
<b>4</b>	<b>4. RESULTS &amp; DISCUSSION</b>	<b>19</b>
	4.1. Descriptive Analysis	19
	4.2. Pairwise Correlations	19
	4.3. Linear Regression	23
	4.4. Discussion	24
<b>5</b>	<b>5. CONCLUSION &amp; RECOMMENDATIONS</b>	<b>26</b>
	5.1. Conclusion	26

	5.2. Recommendations	27
	5.3. Limitations	28
	5.4. Theoretical Implications	28
	5.5. Practical Implications	29
6	6. REFERENCES	30

#### List of Tables

S No.	Description	Page No.
1	Table 1: Descriptive Analysis	19
2	Table 2: Pairwise Correlation	19
3	Table 3: Ramsey Resey Test for Omitted Variables	17
	Table 4: Shapiro Wilk Test	22
4	Table 4: Linear Regression (ROA)	23
5	Table 5: Linear Regression (ROE)	24

#### List of Figures

S No.	Description	Page No.
1	Figure 1: Theoretical Framework	11
2	Figure 2: Research Design	16

## **ABSTRACT:**

Risk management issues in the banking sector not only have a greater impact on bank profitability but also on national economic growth and general business development. The bank's motivation for risk management comes from those risks which can lead to underperformance. This study seeks to assess the impact of risk management on banks' profitability in Pakistan. To achieve this, the study covered 10 years ranging from 2012-2021. Also, ten commercial banks were chosen as samples from the whole of Pakistan. Audited annual financial statements of the selected banks for the years were used in obtaining data for this research. The independent variable which is Risk Management is proxied as Non-Performing Loan Ratio (NPL), Capital Adequacy Ratio (CAR), and Liquidity Risk (LR) while the dependent variable which is profitability was measured as return on assets (ROA) and return on equity (ROE). Using panel random effects regression, the results revealed that non-performing loans and, Liquidity risk ratio have a significant effect on banks' profitability, while capital adequacy ratio is also significant. The study concluded that risk management in terms of non-performing loan ratio and liquidity risk has a significant effect on banks' profitability. The study therefore recommended that the bank's management should do more in the area of controlling the rate at which subprime loans are given out, to mitigate the risk of future loss on non-performing loans. Also, banks should further implement more policies that support increased lending to customers, especially the more credit-worthy ones, to increase returns and performance.

**Keywords:** Nonperforming loans, Capital Adequacy Ratio, Liquidity Risk, Return on Assets & Return on Equity