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RISK MANAGEMENT IN SAUDI ARABIA BANKING

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ABSTRACT

The financial meltdown in the banking sector in the last decade has affected the banking sector in Saudi Arabia. Investment, both locally and internationally, has decreased in the financial sector as a result of this crisis. Risk management has been the most prevalent risk in the banking sector, affecting all banks across Saudi Arabia. Thus, this work was done to analyze the approach to risk management in Saudi Arabia's banking sector. For this work, quantitative research method was used. In this study, the sample population consisted of banks in Saudi Arabia. The sample size of this study was 50 executives from the banks in Saudi Arabia who were chosen on the basis of a random sampling technique. Data collection was carried out using questionnaire. The key findings of this work have shown that majority of the banks have sector specific focus in dealing with risk. Furthermore, the results have shown that Saudi Arabia banking sector has both the traditional and modern approach of risk management. As a result, Saudi Arabia's banks are in a position to predict and manage risks affecting the industry accordingly.

CCS Concepts

• Information systems→Database management system engines • Computing methodologies →Massively parallel and high-performance simulations.

INTRODUCTION

In the last decade, the world has witnessed one of the most shocking financial meltdowns [1]. The impact of the crisis has been widespread and has affected almost every sector of global business; the most affected sector has been the financial services industry, particularly the banking sector [2]. There are numerous explanations for the causes of the financial crisis. The discourse on risk management is one factor that received significant attention during this crisis [3]. Risk management seems to have become an important tool for banks to seek legitimacy in the eyes of the public and regulators. This triggering effect has caused stakeholders in the banking sector not only to consider the returns made in the sector, but also to critically examine the frameworks used to manage risks in the sector and also to safeguard their interests [4]. This is because the failures faced by the industry were largely due to the weaknesses of the regulatory frameworks and the risk management practices of the financial institutions [5].

Risk management has evolved from a strictly banking activity, linked to the quality of loans, to a very complex set of procedures and instruments in the modern financial environment [5]. The fact that risk management underlines the survival of an organization, it depends heavily on its ability to anticipate and prepare for and respond to change. Risk management is described as the performance of activities designed to minimize the negative impact of uncertainty on potential losses [6]. Furthermore, risk management objectives include minimizing foreign exchange losses, reducing cash flow volatility, protecting fluctuations in earnings, increasing profitability and ensuring the bank's survival [7].

Maximizing expected profits is the main objective of bank management, taking into account its volatility [8]. Risk management is therefore an attempt to reduce the volatility of profit, which has the potential to lower the value of shareholder wealth. In the process of finding financial services, banks assume different types of risks, both financial and non-financial [8]. The type risk includes credit risk, market risks , operational risk and reputational risk [9]. Credit risk is the risk that the counterparty will not perform the obligation owed to its creditor [10]. Furthermore, credit risk is a major concern for banks, although this risk has been greatly increased with the growth of derivative markets. Market risk is the risk to earnings arising from changes in underlying economic factors such as interest rates or exchange rates, or from fluctuations in bonds, equity or commodity prices [10]. In addition, market risk is also influence by liquidity, foreign exchange rates and interest rates, Operational risk as a risk of direct or indirect loss resulting from inadequate or failed internal processes, personnel and systems, and external events [10]. Reputational risk is a risk that may have negative reputation capital if the company is valued at less than the value of its tangible assets [10]

Several studies have been conducted in relation to risk management in the banking sector. Elzamly et al. [11] presented the application of cloud computing for risk management in banking sector. The findings of their work have shown that clouding computing framework would highly improve risk management for the banking sector. Lundqvist and Vilhelmsson [12] examined the implementation of enterprise risk management (ERM) framework in the banking sector and found that the employment this framework has shown reduction in default risk of the banks. Hoffmann [13] analyzed at the role of scenario planning in risk management in banking, and found that early planning and forecasting of the expected outcome could contribute to and enhance the risk management process for banks. İncekara and Çetinkaya [14] compared the risk management between Islamic and conventional banking, and found that for liquidity risk management, there is significant relationship with gross domestic product and both conventional and Islamic banks should give importance to liquidity risk management.

With an increasing number of banks in Saudi Arabia, the risks to which the banks are exposed are also increasing [15]. Since banks need to make profits, there are different approaches to risk management that they need to adopt. The challenge remains whether modern approaches to risk management work for the benefit of financial institutions. Risk management is considered to be a criterion for determining the failure or success of a financial institution. However, no major tests have been carried out to determine the resilience of the Saudi Arabian banking industry to withstand major shocks. There is therefore a vacuum between the general belief in the risk position of the Saudi Arabian banking industry and the evidence to support that belief.

It is therefore necessary to assess the risk profiles of banks in Saudi Arabia and the adequacy of the risk management frameworks used by banks to manage the various risks they face. Therefore, This work has been done to analyze the approach to risk management in Saudi Arabia's banking sector.

METHODOLOGY

This work was carried out based on quantitative method. The sample population of this study is comprised of the banks in Saudi Arabia. The sampling technique used was random sampling. For this work, the sample size was 50 executives from the banks in Saudi Arabia. Data collection was done using questionnaire method. The questionnaires were distributed to the respondents by email. The data were analyzed in terms of basic statistics and were presented in graphical form.

Result And Discussion

Questionnaire Analysis

The respondents were asked to describe their position in their banking organization. Based on Figure 1,24.50 % of the respondents stated senior executive as their position, 36.70 % of the respondents stated manager position, 28.60 % of the respondents stated head of department and 10.20 % of the respondents stated risk officer.

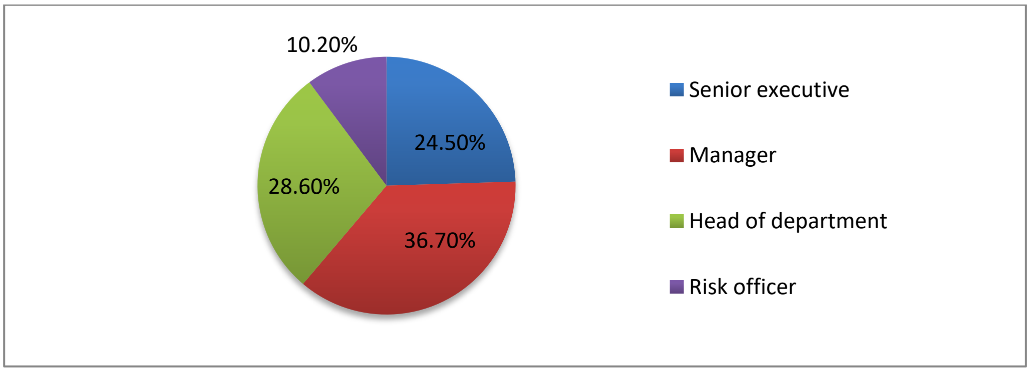

Figure 1. Position in the bank

The respondents were asked to indicate their number of years of experience in the risk management of their banks. Based on Figure 2, 6.10 % of the respondents stated below 1 year, 24.50 % of the respondents stated 1 to 5 years, 38.80 % of the respondents stated 6 to 10 years of experience and 30.60 % of the respondents stated above 10 years of experience.

The respondents were asked to indicate the type of bank they are working for. Based on Figure 3, 55.1 % of the respondents stated national bank and 44.9 % of the respondents stated foreign branch bank.

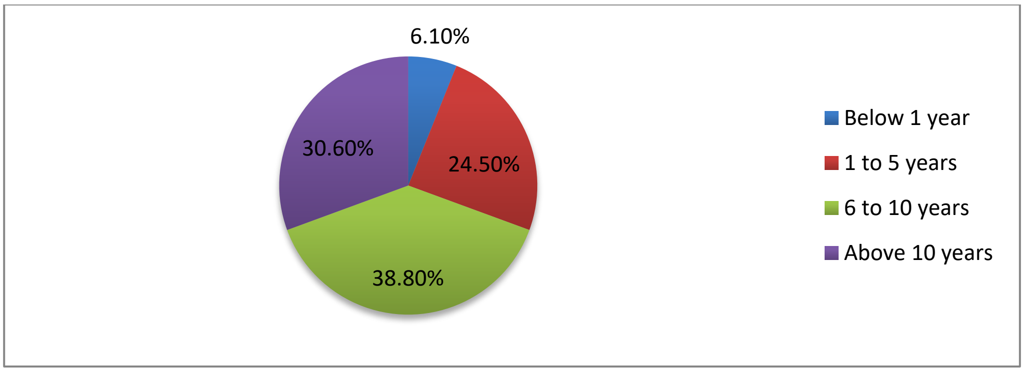

Figure 2. Experience in risk management

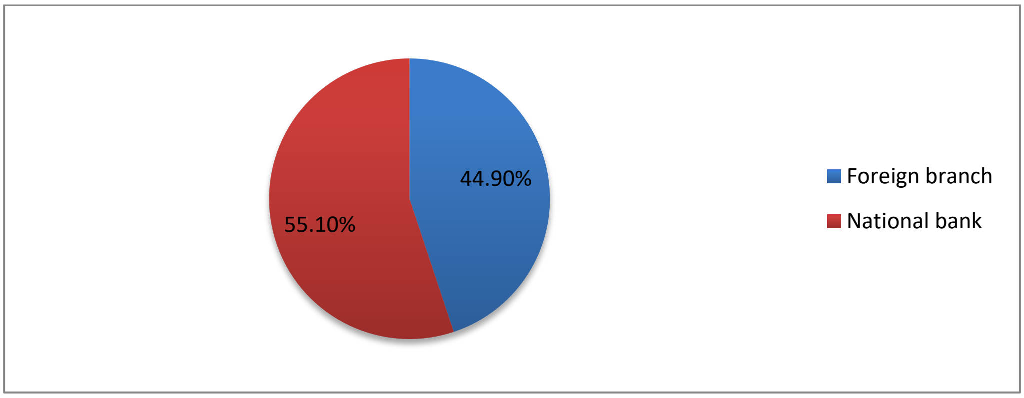

Figure 3. Type of bank

The respondents were asked whether their banking organization has a sector specific focus in dealing with risk. Based on Figure 4, 71.40 % of the respondents stated yes, 18.40 % of the respondents stated no and 10.20 % of the respondents stated maybe.

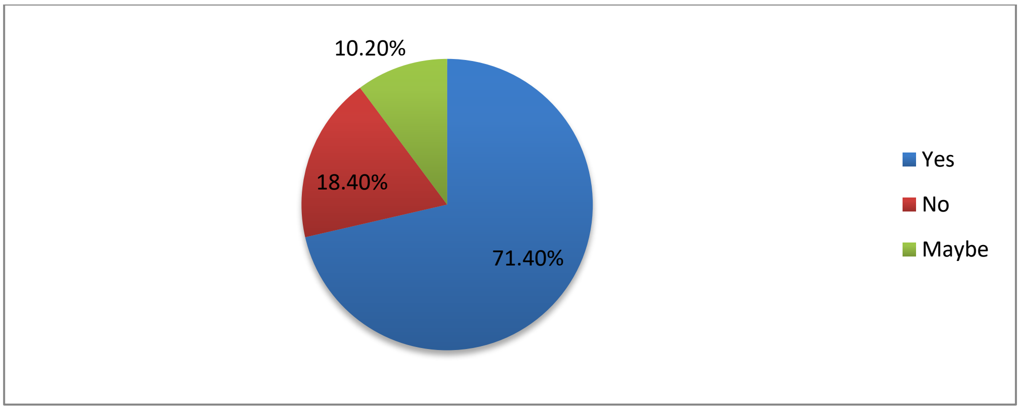

Figure 4. Dealing with risks

The respondents were asked what type of risk is their banking organization exposed to. Based on Figure 5, 22.40 % of the respondents stated operational risk, 30.60 % of the respondents stated credit risk, 28.60% of the respondents stated market risk, 8.20 % of the respondents stated reputational risk and 10.20 % of the respondents stated none.

The respondents were asked what type of risk their banking organization has suffered from. Based on Figure 6, 6.00 % of the respondents stated operational risk, 20.40 % of the respondents stated credit risk, 30.60 % of the respondents stated market risk, 6.00 % of the respondents stated reputational risk and 36.70 % of the respondents stated none.

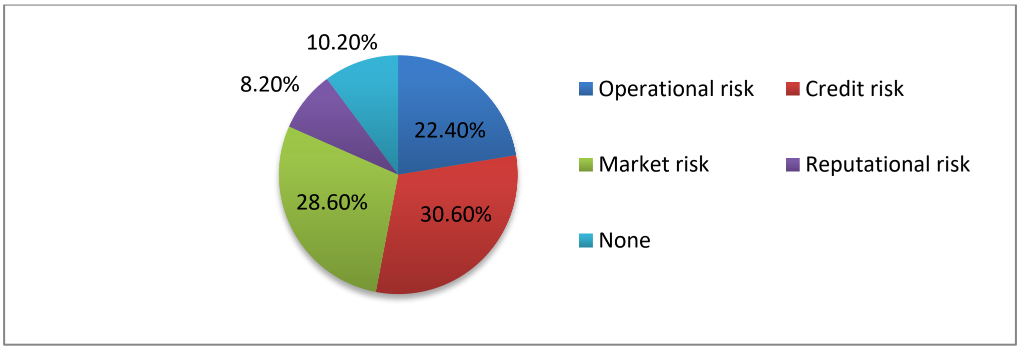

Figure 5. Type of risk

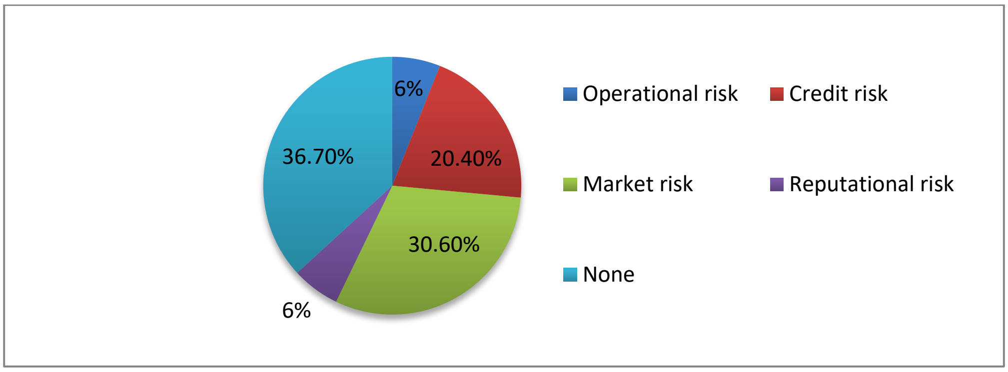

Figure 6. Type of risk bank has experienced

The respondents were asked what type of approach to risk management do they prefer in their banking organization. Based on Figure 7, 73.50 % of the respondents stated modern approach and 26.50 % of the respondents stated traditional approach.

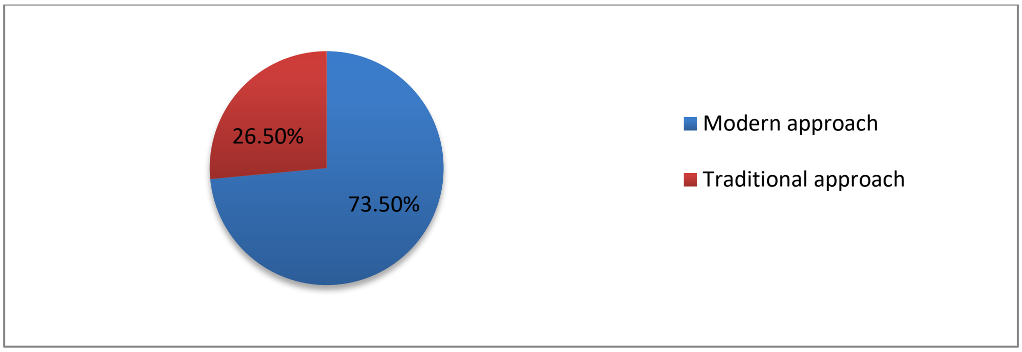

Figure 7. Approach to risk

The respondents were asked on how often does their banking organization refresh its assessment of the top risk. Based on Figure 8, 18.4 % of the respondents stated very often, 51.00 % of the respondents stated often, 20.40 % of the respondents stated rarely and 10.2 % of the respondents stated very rarely.

The respondents were asked whether their banking organization is prepared to respond to extreme risk events. Based on Figure 9, 68.80 % of the respondents stated yes, 16.70 % of the respondents stated no and 14.60 % of the respondents stated maybe.

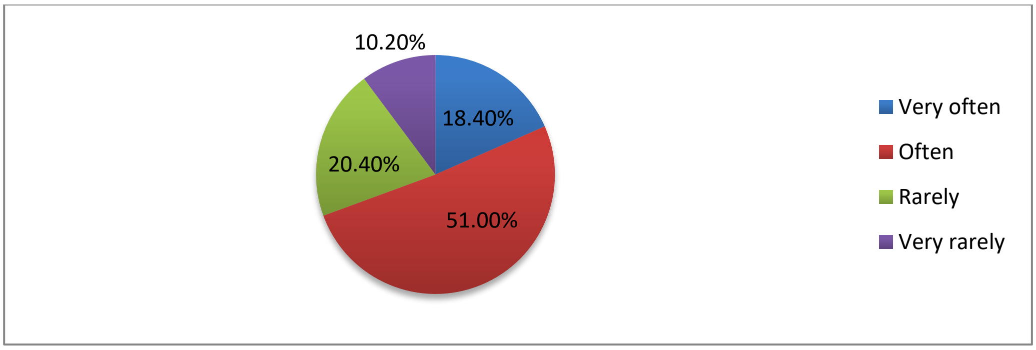

Figure 8 Assessment of risk

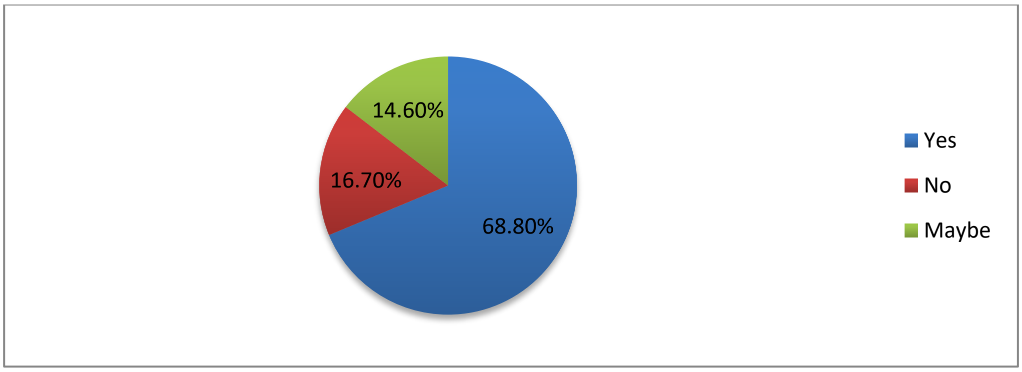

Figure 9. Prepared for extreme risk

The respondents were asked whether their banking organization board have the requisite skill sets to provide effective risk oversight. Based on Figure 10, 64.6 % of the respondents stated yes, 12.50 % of the respondents stated no and 22.90 % of the respondents stated maybe.

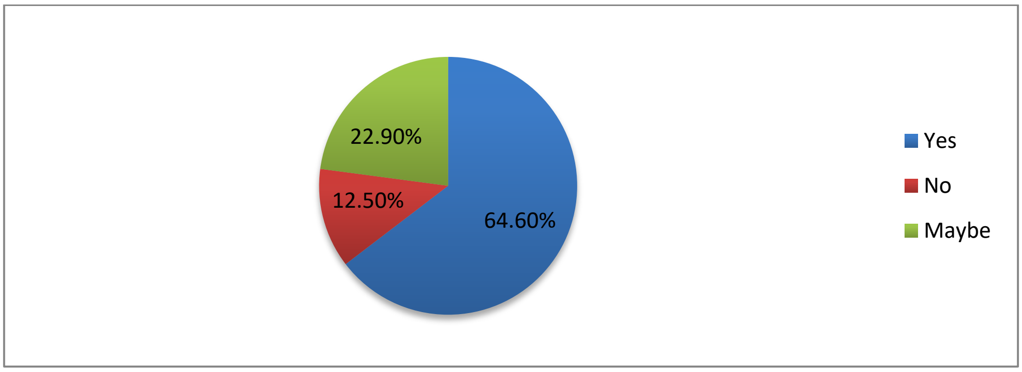

Figure 10. Risk Management skills

Overall Discussion

The findings of this work have shown that the number of people working in national banks is relatively close to the number of people working in foreign banks. Therefore, all data collected can be assumed to represent foreign and national banks equally in Saudi Arabia. Furthermore, the results have shown that majority of the banks have sector specific focus in dealing with risk. The industry can therefore be described as healthy because a high percentage of the industry focuses on dealing with risk. In addition, the findings of this work have shown that banks in Saudi Arabia are exposed to operational risk, credit risk, market risk and reputational risk. Moreover, majority of the respondents have stated the banks in Saudi Arabia have experienced market risk, followed by credit risk, operational risk and reputational risk. In addition, 36 .70 % of the respondents have stated that their bank has not experience any type of risk. Likewise, a comparison of traditional and modern approaches to risk management in Saudi Arabian banking in this survey shows that 73.5 % are using a modern approach to risk management, while 26.5 % are still using a traditional approach to risk management. On the other hand, majority of the respondents have stated that their banking organization often refresh its assessment of the top risk. Furthermore, the results have shown that majority of the banks in Saudi Arabia and its organization is prepared to respond to extreme risk events. Finally, the results of this work have also shown that the majority of high-ranking bank management members in Saudi Arabia have the skills needed to provide their banks with effective risk supervision. Thus, the overall findings of this work have deduced that majority of the banks in Saudi Arabia have implemented a framework for risk management and there is space for further improvement. This study shows that Saudi Arabia's banks are in a position to predict risks affecting their industry and, in turn, to manage risks. In addition, banks operating in Saudi Arabia are in a position to reorganize their staff in such a way that there will be enough people working in risk departments. In addition, since most people working in the banking sector have previous experience in risk management, banks can reassign their staff in terms of experience and improve the overall performance of their firm in risk management. This is inline with the work of Härle et al. [16] where it was stated that experienced banking staff would assist banking organization in enhancing the process of risk management and this will enable the bank to perform well.

CONCLUSION

This study analyzed the approach to risk management in Saudi Arabia's banking sector. This work, which encompassed both local and international banks based in Saudi Arabia, effectively outlined the types and level of risk faced by most of these institutions. The findings have shown that that majority of the banks in Saudi Arabia have implemented their own framework for risk management. In addition, Saudi Arabia banking sector has both the traditional and modern approach of risk management and further improvement in conducting risk management is necessary for long term stability.

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