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Analysing Impact of Efficiency, Profitability, and Risk Management on Sustainable Performance of the Pakistani Banks

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Abstract

This conceptual paper aims to create a comprehensive framework for the Pakistani banks by analysing the impact of banks' efficiency, profitability, and risk management capability on sustainable performance by incorporating most suitable determinants of banks specific internal and macroeconomic and external determinants. Internal determinants such as size of bank, capital ratio, loan intensity, credit risk, financial leverage, operating, return on asset (ROA), age of bank, Z-Score, bank ownership (foreign, domestic and government), and listing is studied and impact on efficiency, profitability, and risk management has been measured. Macroeconomic and external determinants such as Gross Domestic Product (GDP), inflation, interest rate, exchange rate, market capital, Global Financial Crisis, corruption control, and financial action task force (FATF) has been discussed and impact on efficiency, profitability, and risk management has been measured. During the process of research, the strands of reviewing literature show that renowned authors conducted independent studies on efficiency, profitability, and risk management and holistic studies analysing all these variables in one unison study are scarce. Whereas this paper has novelty that combines the impact of efficiency, profitability, and risk management capability on sustainable performance of banks and their corresponding banks' specific internal and macroeconomic external determinants are researched. This conceptual paper has limitations as it is not empirically tested yet and this paper is based on literature review and suggests empirical testing of this framework through another study. This conceptual paper will contribute in assisting management of banking sector to measure sustainable performance of banks and will be helpful to the investors for making investment decisions for different banks.

Keywords

Sustainable Performance, Efficiency, Profitability, Risk Management Capability, Banks' Internal Determinants, Macroeconomic External Determinants, Banking Sector, Pakistan.

Introduction

This paper aims to formulate a comprehensive framework to measure sustainable performance of banks through banks efficiency; banks profitability; and banks risk management capability by incorporating most suitable determinants of banks specific internal factors and macroeconomic external factors.

The distinguished authors and researchers are not inclined to conduct researches on banking, resulting into very less innovations, inventions, and introduction of new variables and theories in banking sector (Werner, 2016). Since last 300-500 years, scientists and scholars could not suggest new banking theory and even did not agree on the already written theories of banking (Werner, 2016). Banking studies are not looking at the complete picture as a wholesome subject and the researchers are either replicating previous researches or mostly focussing on one odd variable (Alharthi, 2016). Majoritie of studies focussed on developed countries and only some researchers are found replicating the research work of European and American work for the developing countries (Kamarudin et al., 2019; Majed Alharthi, 2016; Yu, 2017). Banks efficiency related researches has wide dispersion in selection of methods and variables (Abreu et al., 2019).

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Pakistan is recovering from the fallout of Soviet Union intervention in Afghanistan in 1979 and USA occupation of Afghanistan in 2001 in the wake of 9/11. In past two decades, besides precious loss of over 70,000 lives, there was a loss of over US \$ 150 billion to the economy of Pakistan (Choudhury, 2019).



Pakistan absorbed one of the world largest migration of over three million Afghan refugees and millions of internally displaced persons (IDPs) bringing a drastic change in the social and cultural pillars of society. Political instability, Global War on Terror (GWOT), and four wars with India due to disputed territory of Kashmir, brought long lasting effects on economy and banking sector performance. Pakistani success against war on terrorism, strategic location of Pakistan, China Pakistan Economic Corridor (CPEC), and prudent economic policies of current government of Pakistan are the positive indicators for economic growth and accelerated financial developments in the country. This will see enhance role of banks, however, in the absence of innovative studied in the banking sector of Pakistan, the targeted economic growth will be very difficult as banks are back bone of economy.

Banks performance related literature independently focused on mostly three topical areas of banks i.e banks efficiency; banks profitability or profitability; and banks capability to withstand risks, bankruptcy etc, whereas studies measuring sustainable performance of banks encompassing all important variables in one unison research integrating finance, accounting, and economic disciplines are scarce. Efficiency, profitability, and risk management capability have not been studied in one unison study in Pakistan as overall sustainable performance of Banks. Whereas the relationship between these three topics and the determinants like banks specific internal determinants and macroeconomic as external factors have not been analyzed in the banking sector literature of Pakistan. The impact of the internal determinants such as size of bank, capital ratio, loan intensity, credit risk, financial leverage, operating, return on asset (ROA), age of bank, Z-Score, bank ownership (foreign, domestic and government), and listing on efficiency, profitability, and risk management capability has not been researched in Pakistan as most of researchers missed very important determinants. Similarly impact of macroeconomic and external determinants like Gross Domestic Product (GDP), inflation, interest rate, exchange rate, market capital, GFC, corruption control, and financial action task force (FATF) on efficiency, profitability, and risk management capability has not been researched in Pakistan as most of researchers missed very important determinants.

Although Pakistani researchers has followed studies of the developed countries and focus of their studies remained on already identified variable and new contribution in the literary work in Pakistan is rare. This highlights that there is an urgent need to conduct further research studies in the context of the Pakistani banking sector in order to have some new theoretical contributions to the existing literature.