Divisional Performance Evaluation Tools Employed by Indigenous Ghanaian Banks

Kofi Opoku-Asante
School of Business and Management Studies, Accountancy Department, Accra Polytechnic, P.O. Box GP 561, Accra, Ghana.
* E-mail: kofiasanteus@yahoo.com

Abstract
Few studies have been undertaken on performance measures in service institutions, especially in developing countries like Ghana. There exists no empirical research on how local Ghanaian banks evaluate the performance of their branches and of the branch managers. The purpose of this study is to identify the performances measures used by local Ghanaian banks to measure the performance of their branches**.** Financial and non-financial statistics were collected from indigenous Ghanaian banks. Statistical tools such as mean, variances and standard deviations, tables and graphs are used to analyze responses obtained in arriving at the study's findings. Ranking techniques were also employed in accessing the relative importance of the various financial and non-financial performance measures. The research findings indicated that local Ghanaian banks are employing both financial and non-financial performance measures in accessing performance. However, most of them considered the financial performance measures as more important than non-financial performance measures when evaluating the performance of their branches.
Keywords: Division, performance measurement, Ghana, Banks.

1. Introduction

Performance measurement is at the centre of Management Accounting. It plays a central role in ascertaining whether an organisation is achieving its objectives. For investment centres and profit centres, residual income is the most appropriate measure of divisional performance. For those profit centres where divisional managers cannot influence the investment in working capital, conventional wisdom advocates return on investment (ROI) or target absolute profit (Drury, 2005). According to Kihn (2005) "*Accounting research and education on performance measurement splits, at the least, into four broad areas of inquiry. The first focuses on accounting as a performance measurement system that generates various reports for various purposes. The second is concerned with strategic measurement systems including both financial and non-financial measures designed, selected, implemented, used, and maintained by organizations. The third considers the role of performance measurement systems as part of management control systems in developing and implementing strategies, evaluating the achievement of objectives, providing feedback, and rewarding managers. The fourth analyses empirically why, how and when accounting systems and processes relate to performance… That is, do they improve performance?"* The focus of this paper would centre on the second point of enquiry in performance measurement research.

A lot of studies have been conducted on performance measurement, most of which have been undertaken on manufacturing firms. Very few have been undertaken on service institutions and little is known about performance measurement systems in service institutions operating in developing countries like Ghana. There exists no empirical knowledge on performance measurement systems employed by indigenous Ghanaian banking institutions.

The objectives of this research were to examine;

1. The different measures, financial and non-financial, used by Ghanaian banks to evaluate the financial performance of their branches and the performance of divisional managers.
2. If the same performance measures are used to access the performance of the divisional managers.

2. 0 Literature Review

2.1 The Ghanaian Banking Environment

The need to provide banking services to the British trading firms during the colonial era led to the establishment of the British bank for West Africa in the 1896 (Now Standard Chartered Bank) in the then Gold Coast, presently Ghana. The second bank to be established was the Barclays Bank DCO, now Barclays Bank Ghana Limited. These banks attracted the patronage of the indigenes resulting in the establishment of an indigenous bank called the bank of Gold Coast in 1953 to operate to provide banking services for the local people and mobilise resources from savers and make these resources available to borrowers. This bank was later split into two: the bank of Ghana and the Ghana Commercial Bank after the country gained independence in 1957.

The Ghanaian banking sector has experienced a number of banking reforms since 1998 aimed at liberalising the banks, enhancing their efficiency and soundness, strengthening banking supervision, improving regulatory framework, streamlining financially distressed banks, improving the mobilisation of deposits and credit, ensuring a healthy competition in the banking sector and diffusing new capital and improved management expertise into the system. These reforms started with various regulatory and legal reforms. The laws governing the Ghanaian banking sector has seen some many reforms and amendments since the initiation of the sector reforms. In 1989, the Banking Law, 1989, (PNDC Law 225) was enacted. This law replaced the old banking law that was in existence which was perceived by many as a colonial law. Then to give the Bank of Ghana more independence in performing its regulatory and supervisory role, the Bank of Ghana Act, 2002, Act (612) was enacted in 2002. Another banking law was passed in 2004, The Banking Act, 2004, (Act 673), which replaced the old banking law. The new law has however seen several amendments to allow for banks operating in Ghana to operate off-shore accounts. According to the monetary authorities, these banking reforms have resulted in appreciable success. The entry of more foreign banks into the Ghanaian banking system, increasing branch expansion, diversified range of financial services and integration of the Ghanaian financial system with the global economy are among some examples commonly cited as the success indicators of the reforms.

2.2 The Structure Of The Banking Sector In Ghana

In 1989, when the structural reform began, there were only seven (7) banks operating in Ghana. As at May, 2013, there were twenty- six (26) banks operating in Ghana. These banks constitute the main banking institutions in the country. However, the Ghanaian banking industry includes other institutions such as the Rural Banks, the Community Banks, the Savings and Loans Companies and Credit Unions. There are currently about 115 rural and community banks operating in Ghana with over 500 branch networks or agencies across the country. There Savings and Loans Companies also number about 19, with several branches operating in the country.

In term of regulations, the Rural and Community Banks are regulated by the Banking Act while the Savings and Loans Companies are regulated by the Non-Banking Financial Institution Law 1993(PNDCL 328). The regulatory framework for credit unions is now being prepared. The financial system in Ghana is dominated by the banking sector, majority of those are in the retail banking business dealing mostly in short-term monetary instruments. The main stream banks together had a total branch network of 822 as at May, 2013. The liberalisation of the sector has immensely contributed to the expansionary growth of the firms operating in the banking industry in terms of branches.

Studies on the performance of firms operating in the Ghanaian banking sector have mostly been conducted on the performance of the firms as a whole using various performance methods and not touching on how the banks have evaluated the performance of its constituent parts. Frimpong (2010) looked at the relative efficiency of Ghanaian banks in the year 2007. The work of Akoena et al (2009) investigated the technical efficiency and economies of scale of Ghanaian banks to obtain a sense of what might happen to efficiencies in the industry when banks get bigger. Yahaya (2009) studied whether some Ghanaian banks are using the Balances Score Card and how the Balance Score Card can be used more effectively to assess the performance a bank operating in Ghana.

The studies on the Ghanaian banking industry have not identified how the banks are measuring branch performance. Very little is known about how the banks are measuring the performance of the branches and the branch managers amid the face of increasing branch expansion. There is the need to know how they measure branch performance, the methods used, the principal factors affecting the choice of one method as against the other, the variables that are taken into consideration in measuring such performance and underlying reasons for the choice of those variables and whether these measures are inconformity with current practice.

2. 3 Financial performance measures

The traditional management accounting literature on performance measurement has been dominated by financial measures. Performance is mostly assessed with accounting information such as profitability, liquidity and the solvency ratios derived from financial statements. Most stakeholders equate performances effectiveness with financial viability. Two categories of financial performance measures are commonly used – those based on absolute values which are usually profitability criteria of one kind or the other and those based on relative values which are generally some form of return on investment or capital employed.

2.3.1 Return on Investment

For profit centres where divisional managers cannot influence the investment in working capital, conventional wisdom advocates return on investment (ROI) (Drury et al., 2005). The use of ROI has been argued to emphases the rational allocation of scares resources, normalises the size effect since it's a ratio and it's comparable to the cost of capital employed (Johnson and Kaplan 1987). Said et al. undertook a study using ROI to examine current and future accounting performances. Simons used the mean absolute three years return on investment to evaluate performance. According to Drury et al (2005), this measure may encourage divisional managers to maximise the ratio which can lead to suboptimal decisions.

2.3.2 Residual Income

In an attempt to overcome this problem associated with ROI, some authors have recommended the use of Residual Income (RI). Literature on Management accounting refers to residual income as net operations income or net after-tax earning plus interest (net of the tax effect) less the desired rate of return on investment multiplied by the amount of investment. Some writers such as Drury (2005): El-shishini (2000) advocate residual income as a major financial measure. For investment centres and profit centres, residual income is the most appropriate measure of divisional performance. Despite this recommendation, residual income does not appear to be widely used in practice (Skinner 1990). This is because RI does not facilitate comparism among division because it is an absolute figure.

2.3.3 Problems of Financial Performance Measures

Evidence, in recent times, from management accounting and operations management literature suggests increasing dissatisfaction with financial performance measures. It has been argued by prior researchers that financial measures fail to measure and monitor multiple dimensions of performance (Brignall et al, 1996). They have little regards to the perspectives of customers and competitors, as such, financial measures inhibit innovations in performance measures. According to Eccles and Pyburn (1992) financial measures are “lagging indicators” that shows the results of management actions rather than being the causes of it. They are cost focused, based on historical view, encourage short term perspective rather than the long-term and they are also internally focused (Johnson and Kaplan, 1987). Again they fail to bring out changes in the firms competitive environments and strategy.

2.4 Non-financial Performance Measures

In an effort to overcome the difficulties associated with financial performance measures, management accounting literature also advocates for the use of non-financial performance measures. A publication by the American Accounting Association (1975) referred to non-financial performance measures as information expressed in non-monetary units or ratio. Non-financial performance measures focus on areas such as competitiveness, product leadership, productivity, quality, delivery, innovation and flexibility in responding to changes in demand, market share, social responsibility and employee turnover (Drury et al, 2005). Non-financial performances measures are leading indicators and therefore provide managers with incentive to improve long-term financial performance (Moers, 2001).

2.4.1 Problems with Non-Financial Performance measures

According to Drury et al (2005) non-financial performance measures is mainly associated with two main problems. First there is difficulty in selecting which of the vast number of measures should be selected for inclusion in the performance report. Secondly, confusion arises when measures conflict with each other, resulting in it being possible to enhance one measure at the expense of another. In an attempt to incorporate non-financial performance measures, Kaplan and Norton (2001), provided that ad hoc non-financial performance measures are used rather than a comprehensive system of linked measures.

2.5 Integrating Financial and Non-financial Measures

As said by Solomon (1965), non-financial performances measures should be used alongside the traditional performance measures. Non-financial and financial performance measures are not substitutes but non-financial performance measures are used to complement financial measures (Kim et al., 1997 and Chenhall, 1997). They act as supplements to the financial measures. Neely (1990) makes the point that international quality awards such as European Foundation for Quality Management (EFQM) offer incentive for companies to integrate financial and non-financial performance measures in their performances measurement systems. Researchers such as Ittner et al., (2003) have supported the inclusion of non-financial performance measures in divisional performance reports as it provides a solution to some of the problems associated with the financial measures. Earlier researchers such as Kaplan (1983); McNair et al (1990) have called for improvement in performance measurement through the use of non-financial performance measures.

3. Methodology

A combination of qualitative and quantitative research methodologies were adopted for this research. A survey research method was adopted. Structured and unstructured interviews and questionnaires were designed to collect data on the performance measurement tools employed by the selected banking institutions. The population for the study was banking institutions operating in Ghana. For the result of the study to be representative of the population, a sample was selected. With the intent of knowing the performance measurement systems employed by indigenous Ghanaian banking institutions, only locally owned banking institutions operating in Ghana were included in the sample frame. Banks operating in Ghana but with a foreign controlled Head Office were excluded from the sample frame. For this reason, purposive sampling method was employed. Six different Ghanaian banking institutions were selected for the study. A questionnaire and both structured and unstructured interviews were the tools used in gathering primary data. Data was also gathered from Annual Banking Publications (2009, 2010, 2011, and 2012). Four respondents were interviewed from each banking institution for the study. A total of twenty-six respondents who are directly involved in measuring the performance of branches were interviewed.

4.0 Results and Findings

A target profit before charging interest on capital employed was ranked as the most important financial performance measure. Forty-two (42%) percent of the respondents ranked this measure as the most important financial performance measure. An absolute measure of performance may be favored because corporate head office managers are concerned about branches maximizing their returns rather that a ratio or percentage. A target cash flow figure was ranked as the second most important financial performance This could be explained by the fact that deposit mobilization by the branches of a bank is crucial to its financial performance in meeting its loan targets and hence profitability. For this reason, twenty-five percent (25%) of the respondents ranked this performance measure as the most important financial performance measure. The residual income method followed, being ranked as most important by thirteen percent (13%) of the respondents. Residual income refers to net operations income or net after-tax earning plus interest (net of the tax effect) less the desired rate of return on investment multiplied by the amount of investment. Return on Investment (ROI) which has been deemed by prior studies in the manufacturing sector as being extensively used, was ranked as the most important financial performance measure by eight (8%) of the respondent as the most important performance measure. This is however consistent with the studies of El-shishini (2000) in measuring the performance of divisions. Respondents were allowed the option to state an unlisted performance measure and to rank it. Only one respondent ranked an unlisted performance measure as the most important performance measure employed within the organization. This reflected four percent (4%) of indigenous Ghanaian banks. This unlisted performance measure is a combination of Loan Portfolio growth and Percentage of Portfolio at risk.

Table 1 Ranking of Three Most Important Financial measures.

	Highest Rank	
	Number	Percent
Achievement of a target rate of return on capital employed (ROI)	2	8
Residual income	3	13
A target profit before charging interest on capital employed	10	42
A target financial value added figure	2	8
A target cash flow figure	6	25
Other	1	4
TOTAL	24	100

Only 33% of the studied organizations used the same performance measures in accessing the performance of the branch and the branch managers. These organizations do not make any adjustment to the measure to differentiate branch performance from managerial performance. The remaining 67%, use either different performance measures or same measure but with different items in measuring the performance of the branch and branch manager. The financial performance of the bank at the end of the year is partly used to measure the performance of the branch in addition to the branch performance measures. Performance measures of branch managers included achievement of deposit and loan targets and attainment of a suitable loan portfolio at risk and some non-financial measures.

Table 2. Use of different performance measure for branch and branch managerial performance

	Number	**Percentage**
The same performance measures are used for assessing the performance of branch managers and the financial performance of the branches but different items are included within the performance measures	**10**	**42%**
Different performance measures are used for assessing the performance of branch managers and the financial performance of the branches	**6**	**25%**
Identical performance measures are used for assessing the performance of branch managers and the financial performance of branches	**8**	**33%**
Total	**24**	**100**

Twenty (20) out of the twenty four (24) respondents representing eighty-three percent (83%) of the respondent organizations are employing non-financial performance measures in evaluating branch and managerial performance. The number of loan applications and number of disbursement within the period were ranked as the most important non-financial performance measure. Eight (8) organizations, representing forty percent (40%) of the respondent organizations were employing this measure as the most important non-financial performance measure. This could be explained by the fact that such a measure is directly linked to the financial performance of the organization and the achievement of financial goals. Customer satisfaction index was ranked by four (4) respondents as the most important non-financial performance measure representing twenty (20%) of the respondents. The believe that the more customers are satisfied with the services of the organization, the greater the probability of them continuing business with the organization could be the reason why this was ranked the most important non-financial performance measure by twenty percent of the respondents. Three respondents each ranked the number of accounts opened and turnaround time of branch staff as the most important non-financial performance measure. This constituted fifteen (15%) of the respondents. The number of accounts opened influences the deposit mobilization of the branch and hence its ability to grant more loans and makes profit. A good turnaround time increases the speed with which services are offered to clients and hence the number of clients served within the period.

Table 3. Ranking of non-financial performance measure

	Highest Rank	
	NO	Percent
Customer satisfaction index	4	20
Number of accounts opened within the period	3	15
Number of loan applicants and disbursement within the period	8	40
Turnaround time of branch staff.	3	15
Employee satisfaction index	1	5
Other	1	5
TOTAL	20	100

With regards to the relative importance the banks attach to financial and non-financial performance measures, sixty percent (60%), considered financial performance measures as being more important than non-financial performance measure when evaluating branch and branch managerial performance. This bias towards financial performance measure could be the result that most of the respondents were in the finance department of the responding banks and would be more inclined towards financial performance measures. Also because financial performance measures can be easily and reliably obtained, more emphasis tend to be placed on them rather than non-financial performance measures which are more difficult to obtain. Non-financial performance measures were viewed as having the same level of importance to financial performance measures by twenty-five percent of banks whilst 15% ranked non-financial measures as of more importance than financial measures.

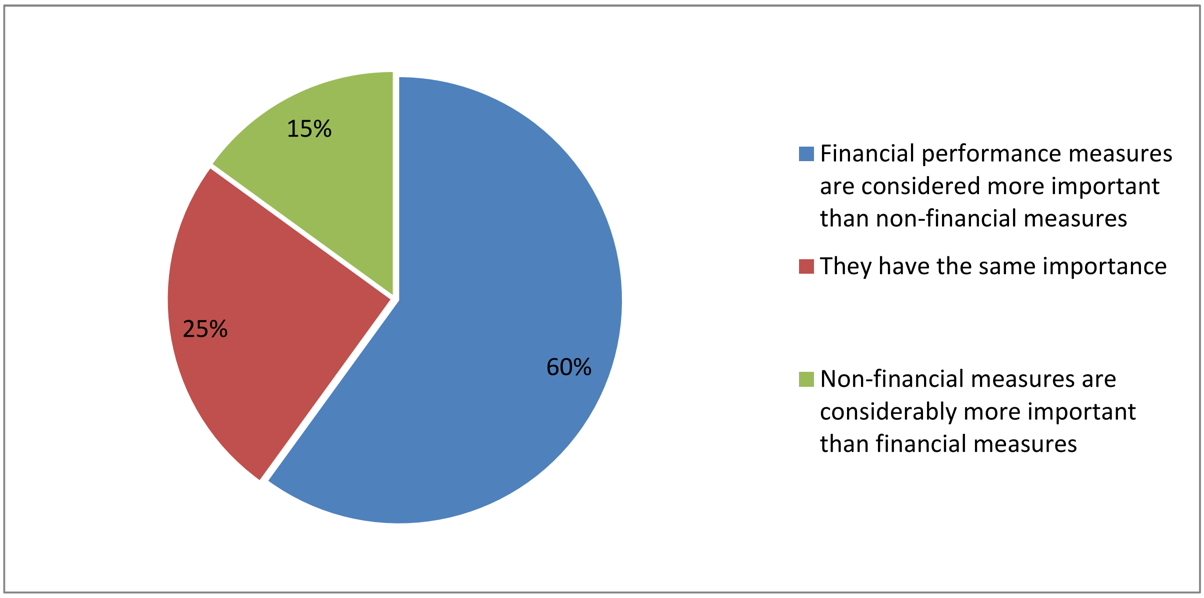

Figure 1. Relative Importance of Non-Financial and Financial Measure

5. Conclusion

The study has brought to light the financial and non-financial performance measurements methods and systems used in Ghanaian banks to measure the performance of their branches and that of the branch managers. The study show that most Ghanaian banks prefer using financial performance indicators in measuring the performance of the branches as well as their branch managers. Majority of banks used different measure in accessing the performance of the branch an regards that of the branch managers. Most banks prefer a target profit been achieved by their branches rather than a ratio or percentage of other value. The relative value attached to these performance measures have been identified.

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