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Performance Management and Bank Profitability in Nigeria

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Abstract

Performance management ensures that the contributions of organizational members are directed toward growth and profitability. Although performance objectives are set at the beginning of the financial year, the achievement of such critical objectives rests on robust performance management. This embraces management action toward key FPIs such as gross earnings, ROA, ROE, NIM, among others that help in driving bank profitability. The exploratory research design was used for the study. Data were analyzed through descriptive and regression statistical methods and it was found that performance management has positive correlation with bank profitability. Based on the result of the study, it was recommended that banks should always check performance to ensure profitability.

Keywords: Balanced scorecard; Non-financial indicators; Financial year; Performance measurement; Performance milestones; Nonperforming loans.

1. Introduction

Bank profitability (BP) is the ultimate performance result showing the net effects of bank policies and activities in a financial year. According to van Greuning and Bratanovic (2003), bank BP is usually measured by certain financial performance indicators (FPIs) or ratios. Such FPIs often include return on asset (ROA), return on investment (ROI) and return on equity (ROE). The ROA expresses a relationship between the net profit and total assets of the enterprise. It is also a measure of total investment, or ROI, in the business. On the other hand, ROE relates to the networth and earnings per share (EPS). Specifically, the networth ratio measures the relationship between the funds contributed by lenders and owners relative to the funds contributed by owners (Nzotta, 2002). These traditional FPIs can be integrated into the balanced scorecard system to enhance monitoring and measurement of critical performance and profitability levels. It is strongly believed that a robust performance management (PM) framework brings proactive focus on value addition and profitability that translates to better actual performance of a bank. The implementation of such enterprise performance management (EPM) mechanism can record benefits in the range of 40 percent to 130 percent across key profitability metrics such as ROI, ROA, and ROE (www.pwc.com). Performance analysts and managers can easily track overall bank profitability across the FPIs, even in a complex hierarchical organizational environment. They can easily diagnose and dig deep into the root cause of problems and quickly conduct environmental analysis, where necessary to address the underlying challenges. PM enables bank management to hit profit target through comprehensive reporting and the effective alignment of enterprise plans with goals. PM is closely related to performance measurement. They are sometimes mistaken for each other, and therefore used interchangeably. However, in careful usage, PM is the larger domain and includes performance measurement as a component. Performance measurement is the process of assessing progress toward achieving predetermined goals. PM means building on that process, adding the relevant communication and action on the progress, and achievement against these predetermined goals. In definite terms, PM helps organizations to achieve their strategic goals of productivity, growth and profitability. In the light of the present global competition and low profit margins, the need for PM cannot be over-emphasized. PM is the activity of tracking the performance of an organization over a period of time against specific targets and exploring for opportunities to improve. PM in general is tightly tied up to setting pre-agreed targets, measurement of such targets and monitoring against performance. Performance measurement is an important component of PM because it allows for evaluation and reward of appropriate performance. Performance measurement is a primary tool for communicating and allocating scarce resources and for monitoring organizational performance in the quest for attaining the ultimate objective of organizational profitability. Profitability is the bottom line or ultimate performance result showing the net effects of organizational policies and activities in a financial year. Its stability and growth trends are the best summary indicators of an organization's performance in both the past and the future. PM as a strategic management approach to a high degree aims to ensure organizational profitability. Among the economic goals that guide the strategic direction of almost every business organization are survival through growth and profitability. Consequently, the goal of survival and the goals of growth and profitability are often regarded as principal criterion in strategic organizational decision-making process. Profitability is the mainstay goal of a business organization. Generally, no matter how profit is measured or defined, profit over the long-term is the clearest indication of a business organization's ability to satisfy the principal claims and desires of employees, shareholders and other stakeholders. To this extent, Pearce II and Robinson (2003), hypothesize that the strategic management process is oriented toward long-term organizational profitability because the growth of any business organization is tied inextricably to its survival and profitability. The main purpose of PM is therefore to link individual objectives and organizational objectives and bring about a situation where the individuals contribute to organizational profitability. Additionally, PM tries to develop skills of people to raise their capacity to satisfy their ambitiousness and also increase profitability for the enterprise (Bourne *et al.*, 2003). According to Golan (2008) PM provides a comprehensive view of goals versus actual results, and without PM, seeing real results typically becomes difficult. He posits that PM offers a powerful framework for connecting all parts of the organization to its goals and objectives. He emphasizes that when the entire organization embraces PM, it becomes a strategic part of the business. Arora and Jain (2013) Linking employee objectives with organizational objectives provides more accurate representation of the key perspectives and influences and strategic actions that have important implications for management behavior and organizational profitability (Ali, 2018).

1.1. Conceptual Perspective of the Study

Since the last half of the twentieth century bank management in Nigeria has made effort to institutionalize PM as a critical tool of driving profitability, because of the believe that BP is crucial to growth. Many studies suggest that ROA, ROE, ROI, among others, are the major independent variables influencing BP, Ongore and Kusa (2013), suggest that PM embraces these factors to significantly influence BP. Sound PM hinges on the motivation of the individual employees. It is one thing to manage performance; and it is another thing to motivate employees so as to achieve organizational goals. PM should put the information employees need to do their jobs better and right at their finger tips, if possible. This will have positive impact on their behavior and also allows them to take greater control of their own performance. Again, in order to motivate employees and to achieve realistic results, performance targets should be reasonable. If performance goals are seen to be realistic, it will receive acceptance which will lead to a work environment that promotes a culture for high performance and accountability in the organization. According to Golan (2008), once the PM initiative gains acceptance, it becomes a mechanism for optimizing people and processes, to ensure that good business results are delivered. For effective PM, organizations will have to identify the core values of the business and the key competencies required to move the business forward. This is important because each of these competencies has a potential role in managing individual performance. Torrington *et al.* (2005), suggests that organizational objectives are particularly important, as it is common for such objectives to be cascaded down the organization in order to ensure that individuals contribute to their achievement. This process is critical because PM includes activities to ensure that goals are consistently being met in an effective and efficient manner. Also PM can focus on performance of the organization, a department, processes to build a product or services, employees, among others. PM, measurement and monitoring are very critical success factors in achieving the organization’s objective, which if not achieved would likely result in a significant decrease in customers’ satisfaction, employees’ satisfaction and retention, effective financial management and organizational profitability (Ani *et al.*, 2012; Boshkoska, 2013; Hoffmann, 2011; Poposka and Trpkoski, 2013). Performance management is a cyclical process in which employees and managers work together to set expectations, give and receive coaching and feedback, review results, and provide rewards that are based on performance. A well-executed performance management system is a way for managers and employees to create an understanding of what the mission of the organization requires, how this should be accomplished, and to what degree it has been accomplished. Managers should empower their employees and provide strong support without removing responsibility. Employees at all levels should be included in the performance management system, and the system should focus employee efforts on the activities that are crucial to organizational success. Each employee should be held accountable for his or her own performance. In addition, employees should be rewarded for their performance achievements. Performance management in Nigerian organizations relies, to a large extent in a total emolument arrangement that seeks to encourage employees to contribute ideas and attain a high level of achievement. This involves four key components: basic pay, share ownership, benefits, and variable pay. Basic pay and benefits are not directly linked to performance management in Nigeria. However, variable pay and share ownership are often connected to performance management in Nigeria. Basic pay and benefits are fixed and to which an employee is entitled to either at the end of a week, or monthly. On the other hand, variable pay is based on the individual employee’s performance within a specified time target and is also known as pay-for-performance (PfP), pay-for-result (PfR), among others as pay-for-knowledge (PfK) for highly skilled professionals and return on investment (ROI) for the levels of share ownership (Acaravci and Calim, 2013; Amah and Ahiauzu, 2014; Kwenin *et al.*, 2013; Nelson and Quick, 2003),

1.2. Statement of the Problem

A major challenge to PM in Nigeria is the inability of management to match individual objectives with organizational objectives. A related problem is the inability to clearly define and understand organizational mission by both management and employees. To enhance PM, the mission of the organization must be understood, and what each member of the employee will contribute to the achievement of the mission must be clearly stated and well understood. In some cases in Nigeria, management simply rolls out performance targets without providing the managerial leadership necessary to achieve them. This shortsightedness often creates confusion and lack of motivation among the employees that leads to poor results. There is evidence that Diamond of Nigeria Plc lost its glamour of profitability partly due to weak PM resulting to huge nonperforming loans (NPLs) in excess of N18billion as at 2018 (Alagbe, 2018; Lata, 2014). To this extent, Torrington *et al.* (2005), opine that the critical point about a shared view of PM suggests that handing out a job description or list of objectives to the employee is not adequate. They suggest that performance expectations need to be understood, and, where possible to involve a contribution from the employee. Comprehending specific objectives allows for and benefit from a greater degree of input as employees will have a valid view of barriers to overcome, the effort involved and feasibility. Expressing objectives gives the employees the power to decide the appropriate approach in clearer terms and ensuring that they fully know what to do. This will likely generate a higher degree of employee ownership and commitment needed for superior result. Sound PM cannot be achieved in a vacuum, rather it hinges on the development of reasonable targets and critical competency to achieve the desired targets. Since individuals are often unable to always control their results, it becomes important for management to put in place behavior targets as well as output targets to support PM in the race for BP. These basic attributes of PM are at present not in common application in Nigeria, and not many researchers have directed their attention to such challenges. This work may not fill the gap, but it hopefully, will open the gate for more work in the areas of PM and BP in Nigeria based on a better understanding of what it really is (Daniels, 1987).

1.3. Objective of the Study

The study was designed to investigate the relationship between PM and BP in Nigeria.

1.4. Significance of the Study

The study will help students in the areas of management and social sciences to appreciate the importance of PM in BP in Nigeria. It will also be of benefit to top management in corporate planning activities. Researchers and academics may find the report as another framework for more work in the areas under investigation. It is also envisaged that the public and labour in particular, will find the work useful.

2. Literature Review

Torrington *et al.* (2005), posit that PM is the process by which objectives are agreed, reviewed, individuals are supported and developed through the year, and performance is reviewed at the end of the year. They state that there are four (4) principles which govern the structures, processes and systems and behaviours for PM that includes: aligned objectives; oint responsibility; constructive conversations; and reviewing and rewarding performance. As a PM process, alignment of objectives is necessary to ensure that every one is working towards the same overall organizational objectives in effective and efficient manner that would lead to profitability. PM also paves the way in which delivery of results against targets will be reviewed throughout a financial year (FY). It enhances the capacity of managers to encourage and support reasonable risk-taking, creativity, and innovation. Effective PM calls for the joint responsibility of individual employees and managers. This is imperative because managers create the supportive environment to enable all individuals to put in their best performance. In the circumstance, individuals will be able to achieve their own objectives, committed to the organizational objectives, and at the same time provide support for management in achieving outstanding performance, in terms of productivity and profitability. Employees and managers need to be engaged in regular meetings and conversations to review performance levels and the best ways to achieve objectives. In Nigeria, banks like the First Bank of Nigeria Plc (FBN) conducts Quarterly Performance Reviews (QPRs) as a PM process. This involves clear and open, discussions aimed at standards, and necessary actions to address any challenges promptly. Performance and rewards are closely tied and such must be properly communicated to enhance individual’s performance and his or her contribution to organizational performance or profitability (Astra, 2000; Uduji, 2009).

2.1. Monitoring and Measuring Performance

Performance objectives and action strategies are often prepared at the beginning of the FY as part of the yearly planning and budget exercise. According to McNaughton (1997) as the year starts, managers organize and allocate their resources for executing the action plans and achieving goals. As the year progresses, management continue to check progress with plans to ensure that they are in accordance with performance milestones. In the process, employees may need some clarifications, support and or ideas that would help in the achievement of goals. Throughout the performance monitoring and measurement process, the progress of different units towards the achievement of goals is examined critically. In this regard, Richard *et al.* (2009), describe PM or measuring organizational performance as one of the most important multidimensional management tool for enhancing organizational profitability. Each week, month or quarter management hosts meetings with managers to review performance progress. Such meetings provide the opportunity for managers to raise any concerns, obstacles or problems, that should be discussed and an opportunity for management to receive full feedback on the status of each unit or department and to help in further directing attention and action towards goal attainment. Where progress is satisfactory, the meetings become the opportunity to find more innovative ways to give and receive feedback, and where there are deviations actions are directed to correct deficiencies before it becomes too late. According to McNaughton (1997), many banks see monthly meetings as the heart of an effective relationship between management and employees that also opens the opportunity to think about equity and rewards. She opines that rewards are extremely important in the workplace. To this extent, many organizations have three basic objectives in implementing reward programmes which include: to attract the right quantity and caliber of employees, and to motivate all employees to meet work standards, motivate value addition, achieve critical result, make improvement and build resources for the future. To enhance performance monitoring and measurement and to enhance profitability the balanced scorecard methodology was introduced as part of quality management system in the last century at Harvard Business School. According to Pearce II and Robinson (2003), the balanced scorecard approach is intended to provide a clear prescription as to what companies should measure in order to balance the financial perspectives in the implementation and control of strategic plans. It provides feedback around both the internal business processes and external outcomes in order to continuously improve strategic performance and results. They opine that the balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age which is not often important for critical success. The balanced scorecard methodology incorporates feedback around internal business process outputs and also adds a feedback loop around outcomes of business strategies. They insist that the balanced scorecard methodology is a system that links shareholders interest and return on capital with a system of PM that is linked to ongoing, operational activities and processes within the organization. According to Kaplan and Norton (1993), operational control systems require systematic evaluation of performance against predetermined standards or targets. They suggest that the balanced scorecard is a control system that integrates strategic goals, operating outcomes, customer satisfaction and continuous improvement into an ongoing strategic management system. It is believed that the balanced scorecard approach in PM provides measurable mechanism through which the performance of units, departments and employees, are monitored, adjusted, and used to determine overall organizational performance (Khan *et al.*, 2011).

2.2. 360 Degree Feedback and Performance

The nature of 360-degree feedback refers to the use of a wide range of sources from which information or feedback can be collected about any team member or organization. Information is collected from any angle, analyzed and communicated in such a manner as to enhance PM and organizational performance. Atwater *et al.* (2002), emphasize that 360-degree feedback provides a better way to capture the complexities of performance. They suggest that feedback from multiple sources is more useful in the PM process. 360-degree feedback enables the organization to understand how employees, managers and other stakeholders are contributing towards the growth of the organization, and or how their weaknesses contrast with the objectives of the organization. The issue of 360-degree feedback cannot be over emphasized because sound PM relies to a high degree on behavioural competencies. A competency is an underlying characteristic of a person which results in superior work performance. Behavioural competencies are frequently seen as the means of expressing and understanding what is valued by an organization as well as the characteristics of what will result to superior performance. It also supports the concept of action management by being efficiency- oriented, and having the required disposition towards enhancing the mechanism for measuring performance in an organization. This ensures that plans are working as predetermined criteria. It helps to evaluate changes in performance and gives opportunities to reward superior performance. 360-degree feedback encourages the measurement of non-financial factors in the PM process, and organizations today see it as a tool towards good PM. A wonderful way of obtaining 360-degree feedback is through the workforce. Listening carefully to employees helps a great deal in obtaining 360-degree feedback. Managers need to give employees full attention at meetings, and also try to meet them on one-on-one basis. According to him employees like to hear about their career paths and how management wants to see them growing. They must get clear information of what to do so as to perform better. According to Enbysk (2008), employees must not learn about significant performance issues in an annual evaluation, rather, they should be confronted well before hand and in the most appropriate way, that there is something they need to improve upon. Giving and receiving feedback from employees as PM tool engender loyalty, commitment, thereby paving the way for profitability. Honest and open communications about management styles help to build good management-employee relationship necessary for enhanced performance and corresponding profitability of the enterprise. In addition to measuring financial performance, many organizations also measure performance in non-financial areas to improve overall performance and profitability. For example, in their own type of corporate environment, FBN PLC emphasizes that financial indicators remain the fundamental management tool and could be said to reflect the capital market's obsession with profitability as almost the sole indicator of corporate performance. Financial performance indicators are quantitative methods that organizations prefer above other indicators. According to FBN Plc (2004) in recent years, it has been proved by some organizations that effective management of other financial indicators would also lead to increased profitability. PM enhances competitive advantage-relative market share, customer base and sales growth. It embraces management action towards financial factors such as increase in gross earnings, ROA; balance sheet growth, ROI; among other factors. Wigwe (2017), FBN PLC, established in 1894 has a robust PM framework and has remained profitable till date. PM in FBN is necessitated by the bank's aggressive growth and modernization objectives and the need to reward employees and teams that contribute directly or indirectly to the agreed targets. It believes that the purpose of PM is to improve the performance of the organization, thus increase profitability. The aim of PM process in the bank is to optimize the enterprise activities and resources with regard to the short-term profit targets across functional and business lines. To this extent, the bank operates along Strategic Business Units (SBUs) and Functional Lines (FLs) to make for effective monitoring and to ensure value addition especially in the area of service delivery to customers. It recognizes that the performance of every member of an organization has direct or indirect impact on the organization's profitability. And to increase profitability therefore, everyone's performance must be monitored and measured for compliance with organizational targets, with the aim of sustainable profitability (London and Beatty, 1993; Syafri, 2012).

3. Methodology

3.1. Research Design

The quantitative technique of the exploratory research design was employed for the study. The objective of exploratory research is to define a problem more succinctly and develop course or courses of action that will lead to its solution. The nature of exploratory research requires the use of a flexible research process. It is evolutionary and historical in nature and it rarely involves the employment of large samples or use of structured questionnaire (Asika, 2004; Brannen, 2005).

3.2. Population and Sample

The population of study comprised all the 24 banks quoted on the Nigerian Stock Exchange (NSE). The sample of six banks was selected by the judgmental method, and the sample size was determined by the $1/10^{th}$ principle (Ezejelue *et al.*, 2008).

3.3. Source of Data

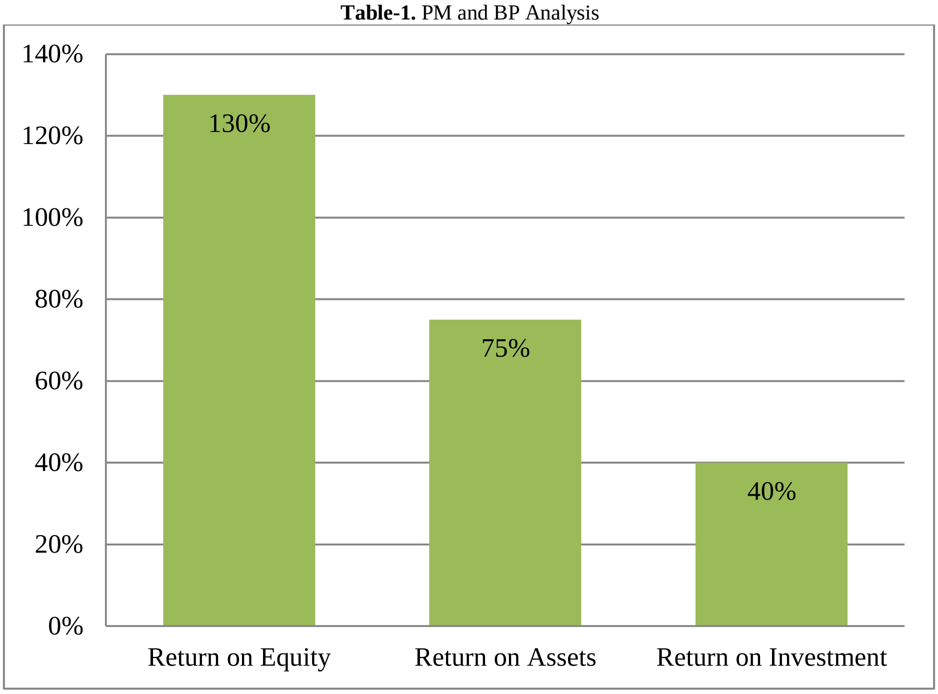
Data for the study were generated from primary and secondary sources. Secondary data are information that have been previously collected for some other purposes, other than the research project at hand, whereas primary data are information gathered and assembled specifically for the research objectives at hand (Aaker *et al.*, 2004).

3.4. Data Analysis

Data were analyzed through descriptive and regression statistical methods and result presented in tables (Nwankwo, 2011).

4. Presentation of Result

Table-1. PM and BP Analysis



Source: Author Fieldwork (2018) Adapted from www.pwc.com

As shown in Table 1, ROA, and ROI are the key performance indicators (KPIs) for the evaluation of BP. Other ratios such as Net Interest Margin (NIM), Cost Income Ratio (CIR) and Capital Adequacy Ratio (CAR) are also used to monitor BP. The KPIs contribute between 130 percent and 40 percent to BP (Okonkwo, 2017; PWC's, 2005-2010). This result supports the earlier finding of Arora and Jain (20130 that ROE, ROA, ROI, contribute to BP.

4.1. Model Specification

Model specification is the expression of a relationship into precise mathematical form. Economic theory sdoes not indicate the functional form of any relationship. This means that economic theory does not state whether a relationship will be expressed in linear form, quadratic form or in a cubic form. On the strength of the above, it was decided to specify the relationship between PM and BP thus:

$$BP = F\ (ROE,\ ROA,\ HIM)\ \ldots\ldots\qquad (1)$$

From the above functional relationship the econometric model is specified below:

$$BPt = b_0 + b_1ROE, + b_2ROA, b_3NIM, + u\ \ldots\ldots\ (2)$$

Where:

BP = Bank Profitability
ROE = Return on Equity
NIM = Net Interest Margin
b_o = Constant term
b_1, b_2, b_3 = Coefficient attached to explanatory variable
t = Time period
u = Stochastic error term

Table-2. OLS Regression Analysis

Variables	Coefficient	Std. Error	t-Statistic	Prob.
ROE	0.954924	0.211295	4.519389	0.0005
ROA	-1.529514	0.403113	-3.794252	0.0020
NIM	-1.599455	0.400559	-3.993057	0.0013
C	-4236.170	2592.99	-1.633745	0.1246
R-Squared	0.600935	Mean dependent var.		4997.539
Adjusted R-Squared	0.515421	S.D. dependent var.		9044.393
S.E of regression	6295.957	Akaike info criterion		20.52633
Sum squared resid.	5.55E+08	Schwarz criterion		20.72419
Log likelihood	-180.7370	F-Statistic		7.027333
Durbin-watson Stat	1.608119	Prob (F-Statistic)		0.004083

Computed through SPSS

From Table 2 of the model, coefficient of determination R^2 of 0.600 shows the highest percentage value that the independent variables explain 60 percentage change in the dependent variable. The goodness-of-fit test of the model is also good as the adjusted R^2 value is 0.52. The value of Durbin Watson is 1.608 that lie within the range between 1.5 and 2.5 so it can easily be stated that there is no autocorrelation among the independent variables. On the basis of this result it was found that PM has positive correlation with BP. This is the crux of the study.

4.2. Discussion

A robust performance management incorporating the balanced scorecard is important for a bank to enhance performance in critical areas and ultimately drive profitability. It ensures accurate management of the performance of individual employees who also monitor key performance indicators such as ROA, ROE, ROI, NIM, CAR, CIR, among other indices that effectively drive profitability. Banks in Nigeria that encourage performance management have continued to report steady financial growth and profitability. For example, First Bank of Nigeria Plc believes that its performance management imperative is necessitated by its aggressive growth and modernization objectives and the need to reward individuals and teams that contribute directly or indirectly to the agreed targets and for increasing profitability. PM as the activity of tracking the overall performance of an enterprise over a period of time and against predetermined targets is now a major function for banks in the face of recent global financial tsunami, growing competition and dwindling profitability often associated with board and management incompetence. In a recent report, Fidelity Bank Nigeria Plc that has a keen eye on quality PM reported strong profitability status. According to the Bank, its financial performance in the half year of 2017, grow to N85.8billion in gross earnings. The rise in gross earnings was driven primarily by a 27.8 percent increase in interest income and a 0.7 percent growth in net fee income to N11.2billion. Also profit rose by 66.7 percent from N6.1billion in 2016 to N102billion in 2017, and also achieved significant improvement in other key performance indices such as NIM, 7.4 percent, CIR, 67.3 percent and CAR, 18.4 percent. Such figures support Table 1, that KPIs, such as ROI, ROA, and ROE, can drive bank profitability within the range of 40 percent through 130 percent based on PM. Accordingly, the regression result in Table 2 showed that about 60 percent variation in BP is accounted for by good PM. This original result supports the earlier findings of PWC that high performance banks and banks dedicated to improving their performance care about profitability-oriented performance measurement and management.

4.3. Recommendations

i. Banks need to deploy good PM systems so to track performance with the ultimate aim of high profitability.
ii. A robust balanced scorecard mechanism should be an important PM element to help in monitoring the performance of individual employees and executives. This is necessary because lack of such monitoring can result in situations where excessive risk taking can jeopardize BM.
iii. PM and evaluation are critical to ensure equity in terms of the reward system, bring about motivation necessary for higher productivity and profitability.
iv. KPIs such as NIM, CIR, ROE, ROA, ROI, must be measured in conjunction with other non-financial indices to ensure optimum result and BP.
v. The performance of every member of an enterprise contributes either positively or negatively to profitability therefore, the performance of everyone needs to be evaluated for full compliance with set standards.

4.4. Scope for Further Study

Further study should evaluate the relationship between PM and bank failures. This will enable bank promoters, governments, and BODs, to plan against the factors that contributed to the last banking crisis in Nigeria.

5. Conclusion

Performance measurement and management help in sustaining bank profitability. Driving bank profitability requires integrating the balanced scorecard with both financial and non-financial components that are very important for enhancing bank profitability. Profitability is the mainstay of any organization, and tracking performance is essential to reward appropriate performance. Once good performance management mechanism is established it becomes the framework to focus organizational approach toward profitability. Performance management tries to develop skills of the people so as to achieve their capacity to satisfy their ambitiousness and also to increase the profitability of the enterprise. The exploratory research design was used for the study and the result showed that performance management has positive correlation with bank profitability. This result gives credence to the earlier report to PWC that a robust performance management framework brings proactive focus on value addition and bank profitability.

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