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The Controllability Principle as Applied by Indigenous Ghanaian Banks in Branch Managerial Performance Measurement

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Abstract
The increasing expansion and decentralization of most organizations around the world has brought to the fore issues with regards to measuring the economic performance of the branch and the managerial performance. Following this pattern, Ghanaian banks have seen a dramatic increase in branch expansion. The literature on performance measurement requires that branch economic performance is distinguished from branch managerial performance. As such branch managerial performance should include only factors that are within the control of the branch managers. The study used the survey method in examining if Ghanaian banks are employing the controllability principle in evaluating the performance of the branch heads. Statistical tools such as mean, variances and standard deviations, ranks, tables and graphs are used to analyze responses obtained in arriving at the study's findings. The study findings suggest the wide spread disregard for the controllability principle when evaluating the performance of the branch heads. Some banks though minority allocate to branches corporate head office overhead cost for the purpose of evaluating the performance of the branch manager. Branch heads have very little influence on the performance targets imposed on them.
Keywords: Division, controllability principle, performance measurement, Ghanaian Banks.

1.0 Introduction

Most firms around the world have experienced considerable changes in their organisational design which have been attributed mostly to globalization and liberalization of the world economies (Chow and Van der Stede, 2006). This has made organisations to reconsider the suitability of their control systems, including performance measurement so that they can be more effective in the business environment. Banks have also been affected by these changes (Cobb, Heller and Innes, 1995). They have been subjected to various levels of deregulations, strict capital requirements and massive growth in information technology. As a result, banks' organisational structures have developed gradually into semi-autonomous lines of business (Humphery, 1985; Karr, 1997; Kimball, 1988). This decentralisation has brought in its wake issues with regard to divisional performance measurement, allocation of resources and cost and the need for new improved methods and approaches for measuring the economic performance of the branches and the managerial performance of the branch head. In response, several banks developed and adopted a number of innovative solutions for divisional performance measurement, new databases and analytical ways of prudently assessing cost, benefits and risk (Karr, 1997). Jensen and Meckling (1992) defined banks organisational design as consisting of allocation of decision rights, the performance measurement systems and the reward system and banks that allocate more decision right to branch managers are also more likely to measure the performance of branch managers and reward them based on these performance measures.

Previous studies on performance measurement by Ghanaian banks have identified both the financial and non-financial measures used by the banks in evaluating the performance of the bank branches (Opoku-Asante, 2013). Very little is known about the ability of branch managers to influence the targets given them and whether cost outside the control of the branch but incurred for the benefit of the branch are considered in evaluating the performance of the branches. And there exist no empirical study on whether the banks apply the controllability principle when evaluation the economic performance of the branch heads.

The objectives of this research were to examine;

1. If branch managers can influence the operational targets expected of them.
2. The application of the controllability principle in evaluating branch managerial performance.
3. If administrative overhead cost of corporate head office are allocated to branches for branch economic and managerial performance

2. 0 Literature Review

2.1 The Ghanaian Banking Environment

The first banks to be established in West Africa was the British bank for West Africa in the 1896 (Now Standard Chartered Bank) in the then Gold Coast, presently Ghana. Thereafter, the Barclays Bank DCO was also established. These banks were established to serve the colonial merchants. Due to the high patronage by the indigenes, an indigenous bank was established in 1953 called the Bank of the Gold Coast which was later slit into the Bank of Ghana (The Central Bank of Ghana) and Ghana Commercial Bank in 1957. There has been the establishment of more banks in Ghana after independence. The sector has seen a number of reforms among which are the enactment of various Laws and deregulation of the sector. 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. These banks are required to have a minimum capital base of not less than sixty million dollars ($60 million). 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 115 rural and community banks operating in Ghana with over 500 branch networks or agencies across the country. The Savings and Loans Companies also number 19, with several branches operating in the country. Another tread that has arisen in the banking industry in recent times is the establishments of Micro Finance Companies, providing savings and credit services to indigenes who are uncomfortable dealing with the main banking firms.

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 and the micro finance companies 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.

2.3 The Controllability Principle

Distinguishing between the performance of the branch manager and the performance of the branch requires the application of the controllability principle. According to Drury et al., (2005), the controllability principle provides that managers should be held accountable only for the results that they can significantly influence. This means that managers should not be held accountable for factors and costs that they cannot control. The literature on controllability suggests a continuum of two extremes: on one extreme is the non-application of the controllability principle where managers are held accountable for all the cost and on the other extreme is the full application of the controllability principle where managers are answerable only for the factors and costs under their control. Along this continuum a manager may be held accountable for some uncontrollable factors. Prior studies have not been able to identify exactly where a company falls along this continuum. Most cost items are partially controllable and do not neatly fit into controllable and non-controllable making the controllability principle difficult in practice. Empirical evidence suggest the wide spread allocation of uncontrollable cost for evaluating divisional performance and that the controllability principle seems not to be widely applied in practice (Drury et al., 2004: Drury et al., 2005: El-Shishini, 2000: Martins et al., 2006). For example, a study by Skinner (1990) in New Zealand, by Ramadan (1985) and Drury and El-shishini (2005) in United Kingdom reported the allocation of uncontrollable common cost. The agency theory has been used theoretically by advocates of the allocation of uncontrollable cost to justify their position.

Prior researchers like Choudhury (1986) identified two main sources of uncontrollable: Internal and External. To them, internal uncontrollable is generated inside the firms and external uncontrollable originates mainly from environmental factors. Building on this, Merchant (1998) identified three types of uncontrollability: Economic and competitive factors, to which managers have to react; Acts of nature, which is beyond management control and Divisional interdependencies whereby the actions of divisions impact on each other. The time period under consideration has been identified as a factor that affect the level of controllable and non-controllable cost. The longer the time period, the more cost items become controllable.

Drury and El-shishini (2004) in putting forward some reasons for the allocation of uncontrollable cost suggested that the allocation of uncontrollable cost is to inform managers of the existence of such cost and must be catered for by divisional profit and to place full business risk onto divisional managers as if they were managers of non-divisionalised companies. Allocation of non-controllable cost encourages divisional managers to take a greater interest in the cost of shared resources and to put pressure on divisional managers to control such costs.

Reasons given for the non-allocation of common resource cost include the fact that the amounts involved are often too small to warrant allocation and the cost of making the allocation would exceed their benefits. Again divisional managers most often object to charges they cannot influence. Allocations are arbitrary and tend to distort divisional profits which can create unnecessary internal tension. The inclusion of less controllable items in budgets and other forms of contracts used to monitor the performance of managers and organizational sub-units has typically been considered to induce a risk of various dysfunctional effects such as reduced motivation,

staff turnover and various forms of gaming (Merchant, 1989).
In an effort to distinguish between controllable and uncontrollable, Drury et al., (2005) provides that one should look at the ability of the branch or divisional manger to control either the quantity of the item of cost and or the price of the item of cost. According to them, if a manager can control the quantity and price paid for a service then the manager is responsible for all the expenditure incurred for the services and the expenditure is fully controllable. If the manager can control the quantity of the service but not the price paid for the service then the costs are partially controllable and only that amount of difference between actual and budgeted expenditure that is due to usage should be identified with the manager. And if the manager cannot control either the quantity or the price paid for the services then the expenditure is uncontrollable and should not be identified with the manager. Merchant (1989) found that divisional managers with considerable decision-making discretion in dealing with environmental uncertainties were in many cases held responsible for environmental factors over which they had incomplete control but to which their superiors wished to direct their attention.
Previous empirical studies have suggested that branch performance targets are imposed on the branch by corporate managers and that branch managers have no or little influence on these targets (Scapens et al., 1982; Tomkins, 1973).

3.0 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 application of the controllability principle 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-four respondents who are directly involved in measuring the performance of branches were interviewed.

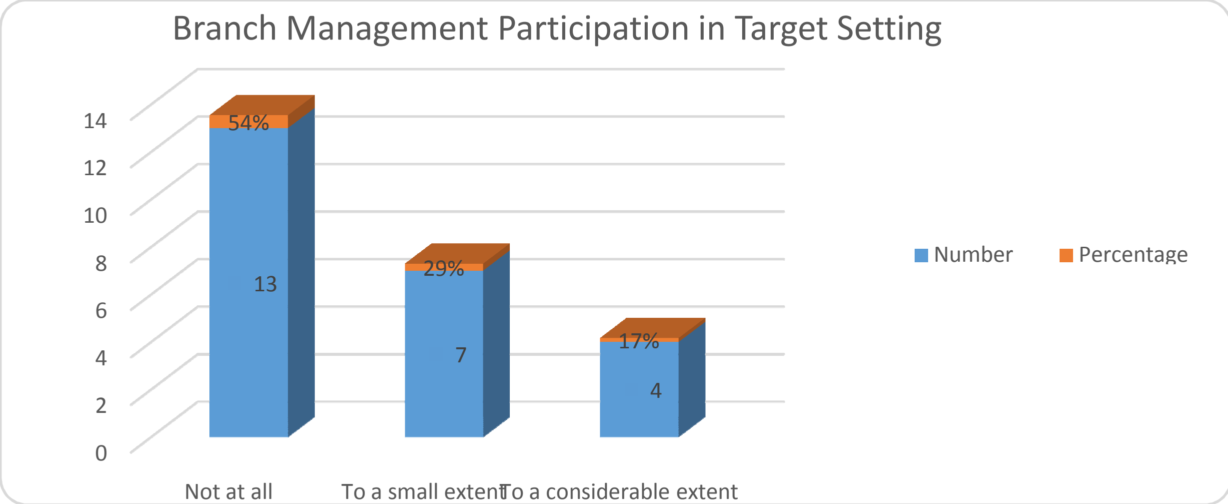
4.0 Results and Findings
Only 33% of the studied organizations used the same performance measures in accessing the performance of the branch and the branch managers. These organizations do not make any adjustment to the measure to differentiate branch performance from managerial performance. This goes to indicate that these banks are not applying the controllability principle in assessing the performance of the branch managers. 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.

Table (1) 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**

This results of the study suggested that fifty-four percent of Ghanaian banks imposed branch performance targets on their branches without consulting the branch managers. Only seventeen percent of branch managers have a considerable influence on the target expected of them. The rest have marginal influence on the performance targets expected of them in that they are consulted before arriving at the target. However, their views and comments does not influence the performance targets substantially. On a scale point of 1 to 3 where 1 is where branch managers have no influence on target set for them, 2 being a marginal influence on branch and 3 being considerable influence on branch target returned a mean score of 1.652 and a standard deviation of 1.556 which suggest that branch managers have no or little influence on the targets imposed on them by corporate management.

Figure (1) Branch Management Participation in Target Setting

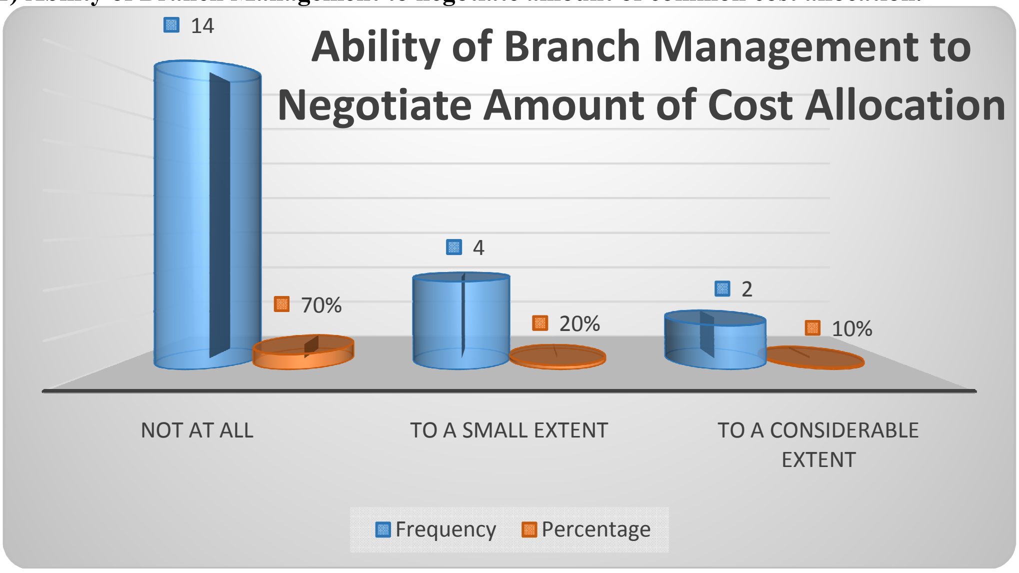


Most of the banks in Ghana have centralized data processing through networking of branches. It was therefore expected that there would be some form of central cost incurred by corporate head office for the benefit of the branches. To test this expectation, respondents were asked whether branches used a common resource. Common resource was explained as being service or resource provided by head office of the bank for the benefit of branches of the bank. All respondents replied in the affirmative. This means that branches of the banks benefits from some service performed by the corporate head office such as legal services, group lending, training programs, marketing services and most commonly, data processing. It was therefore necessary to ascertain if the controllability principle is being followed with regard to the cost of such centralised service performed by corporate head office. The controllability principle requires that managers should be held responsible only for cost items within their control. Non-controllable cost should therefore not be allocated to branches for the purpose of measuring branch and branch managerial performance. The responses suggest that majority of these banks do not adhere to the controllability principle as eighty-three (83%) of such banks allocate the proportionate share of common resource cost to their branches for the purpose of measuring branch managers performance. Seventeen percent (17%) of respondents, answered that their bank did not allocate common resource cost to branches before accessing the performance of the branch and of its management.

Empirical studies on controllability principle provides that controllability principle falls along a continuum of two extremes, the allocation of all cost to branch managers on one hand and non-allocation of cost to branch managers on the other hand. Along this continuum, there exist different levels of the application of the controllability principle. The study suggest that thirty-eight percent (38%) of the respondent banks lies on one extreme end of the controllability continuum where all cost of common resources are allocated to the branch managers in determining their performance. That is, such banks allocate all cost of common resources to the branch managers prior to evaluating the performance of the branch managers. Seventeen percent (17%) of respondent banks answered that their banks do not allocate the cost of common resource cost to the branch managers for performance measurement purposes and as such can be said to lie on the other extreme end of the controllability continuum. In between these two extremes ends, there existed various levels of the application of the controllability principle. Of the other respondent banks, thirteen percent (13%) allocated only a minor proportion of the cost of common resources. Seventeen percent (17%) of the respondents allocated a small but significant proportion of common resource cost to branch managers for performances measurement purposes. The remaining fifteen percent (15%) of respondents allocated most but not all of the cost of common resources to branch managers for performance evaluation purposes.

Previous studies have suggested that branch managers have little or no control on the amount of common resource cost allocated to their branch for the purpose of measuring managerial performance and the performance of the branch. Respondents were therefore asked to indicate if branch managers can negotiate the amount that is allocated to the branch and the extent to which they can negotiate the amount of common resource cost allocated to the branch for performance measurement purpose. Per the responses obtained, most organisations do not allow branch managers to negotiate the amount of common resource cost allocated to them for performance measurement purposes. Seventy percent (70%) of the respondent banks did not allow branch managers to negotiate the amount of common resource cost allocated to their branch. This suggests that costs of common resources are imposed when evaluating the performance of the branch managers. The other thirty percent (30%) allowed branch managers to negotiate the amount and level of common resource cost allocated. However, the extent to which branch managers can negotiate differed. Twenty percent (20%) of indigenous Ghanaian allowed branch managers to negotiate such cost only to a small extent. Only ten percent (10%) of respondent banks allowed branch managers to negotiate, without major impediments, the amount of common resource cost that are allocated to them.

Figure (2) Ability of Branch Management to negotiate amount of common cost allocation.



Some organisations allocate, in addition to allocating cost of common resource to branch and branch managers for the purpose of evaluating performance, also the cost of corporate head office expenses to the branches when measuring performance. Corporate head office expenses refer to the General and Administrative expenses and are incurred for the bank as a whole but not for a single branch. This indicates that branch managers have no control over such cost. Corporate general and administrative expenses have been described as 'Business-sustaining expenses and are distinguished from common resource cost. Prior studies such as Drury et al., (2000, 2005) and El-shishini (2000) have suggested various reason for this practice. For performance measurement purposes, fifty-eight percent (58%) of the responding indigenous Ghanaian banks, were not allocating essential business-sustaining general and administrative cost to branches prior to performance measurement. This could be attributed to the fact that no single branch benefit directly from this cost. Thirty-three percent (33%) of responding banks allocated to the branches only a minor proportion of corporate general and administrative expenses. Eight percent (8%) allocated a significant proportion of corporate head office cost to branches prior to measuring the performance of the branch and of its management. No indigenous bank was allocating most or all corporate head office cost to the branches before measuring the performance of the branches. The results is as summarized below;

Table (2) Allocation of General and Administrative cost

Cost Allocation	Frequency	Percentage
None of the costs are allocated	14	58%
Only a minor proportion of the costs are allocated	8	33%
A small but significant proportion of the costs are allocated	2	8%
Most, but not all of the costs, are allocated	0	0%
All of the costs are allocated	0	0%
Total	24	100%

Conclusion

The study builds on the work of Opoku-Asante (2013) which identified the performance measures used in evaluating economic performance of Ghanaian banks. The findings of this survey are largely in line with the prior studies on the subject conducted in other countries - Drury et al., (2000, 2005), Merchant (1998), EL-Shishini, (2000). The findings of this survey indicate that majority of Ghanaian banks are not applying the controllability when evaluating the performance of branch managers. The controllability principle exist basically in literature but not in practice. Branch managers have little influence with regards to the amount of common cost allocated to them for the purpose of measuring their performance. However, most of the Ghanaian banks do not allocate corporate head office general and administrative expenses to branches when evaluating the performance of the branch and the performance of the branch managers.

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