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The mediating role of management control system in the relationship between corporate governance and the performance of bailed-out banks in Nigeria

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Abstract

This paper proposes the mediating influence of management control systems using performance measurement as a proxy in the relationship between corporate governance and performance of banks in an era of post banking crisis that called for a bailout reform. Since the performance measurement information is used to influence the behaviour of organizational resources to implement organizational strategies, this study will test its ability to strengthen and facilitates boards' functional effectiveness in ensuring sound banks' performance after the bail-out reform using Otley 2009 performance measurement model.

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Keywords: Corporate governance; management control system; performance measurement system; banks performance

1. Introduction

Performance measurement of business organizations has long been of central interest to both managers, board of directors, shareholders, management accounting researchers and the government of every country (Otley, 2003). Performance is reflected through financial and non-financial measures which are indicators usually used in

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monitoring strategy implementation throughout the organization and whether strategic goals are being achieved or not (Bremser & Chung, 2005; de Waal, 2002). Also according to Grafton, Lillis and Widener (2010), the provision of broad-based, strategically-aligned performance indicators is expected to improve organizational outcomes by enhancing the decision-relevant information available to managers thereby facilitating strategy- consistent decision making. Therefore, we argue that modern broad-based performance measurement systems (PMS) can lead to a wide range of better organizational performance (Ferreira & Otley, 2009; Grafton et al., 2010). This because it is used as a tool of Management Control System (MCS) of a firm to evaluate the performance of different organizational resources like human, physical, financial and also the organization as a whole, influence their behaviour to achieve the organizational strategies (Otley, 1994, Anthony, 2007). Several cases of performance inefficiencies, deterioration in performance or total liquidation of various organizations around the world, have been levied against managerial leadership and corporate governance (CG). Specifically for the financial sector (banking in particular), poor managerial performance and poor CG had been identified as the major culprits in virtually all known cases of a financial institution's distress in the Nigeria, which even led to consolidation reform in 2004, and yet re-emerged afterwards, and led to another reform in late 2009 that necessitated the bail-out of ten (10) banks which nearly collapsed due to high non-performing loans, poor CG, bad liquidity and risk management (Sanusi, 2010; CBN, 2010). This bail-out reform generated a lot of panic and doubt concerning the status of the investments of these banks' depositors, shareholders and other Nigerians consequently, led to a sparked interest in examining the potential outcome of this reform through researches.

This paper aims to propose a framework that could examine the potential relevance of PMS as a proxy and element of MCS in strengthening the relationship between CG and the performance of these bail-out banks. This study is hence is proposing a framework that selects the most appropriate board variables that best address the banks' CG problems peculiar to Nigeria, and introducing a mediating variable (MCS) that will strengthen the inconsistent weak relationship between CG and banks performance as suggested by (Zahra & Pearce, 1989). This framework, unique as it is, aims at covering only the bailed-out banks with a total of 2,811 branches in Nigeria using a primary source of data (questionnaire). There is paucity of studies that use MCS as mediating variable that captures board control or monitoring role like PMS which addresses the Nigerian bail-out banks, hence the need to be introduced into these inconclusive weak relations. Also, studies on CG are either conducted before the banks' bail-out reform, or not in the area of bail-out reform. Only few studies were found on bail-out such as "Kuye, Ogundele and Otike-Obaro, (2013); Nworji, (2011); Oghojafor, Olayemi, Okonjia and Okolie, (2010)", which all have certain kind of shortcomings, small sample, addressing policy issue not the banks' performance etc. Furthermore, most researches conducted globally and Nigeria in particular, are having some other kind of shortcomings which results in usual conflicting findings like: inconsistent operationalization of board variables, limited scope, and convenience samples, and usual focus mainly on the direct relationships between board variables and firm's performance, thus ignoring the indirect path through roles and strategic initiatives (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Studies on CG covering both financial and non-financial performance are very rare in Nigeria except Ogbechie et al. (2009). The outcome of this paper shall be of immense importance to academics, regulators, shareholders, and other Nigerians as it will reveal the contribution of PMS in strengthening board of directors' functions in ensuring good banks' performance. Therefore, we selected Ferreira and Otley (2009) PMS model among others due to its strength and holistic composition of many other models within it.

Also, this paper adopts the agency and resource dependence theory as in de Villiers, Naiker and Van Staden, (2011) and Hillman and Dalziel (2003) which argued that firms are often characterized by a conflict of interest between management and shareholders, where managers often utilizes their control over firm operations to increase their short-term wealth at the expense of shareholders' long-term interests (de Villiers et al., 2011; Zahra & Pearce, 1989; Fama & Jensen, 1983; Jensen & Meckling, 1976). Therefore, the presence of vigilant directors can surely reduce such agency costs by close monitoring of firm management (CEOs) (Daily et al., 2003; Hillman & Dalziel, 2003; Westphal, 1999). Under agency theory, management initiates and implements business plans, strategies, and systems whereas directors monitor it (Deutsch, Kei, & Laamanen, 2007). Under this view, independent directors and directors who own shares will be more likely to monitor rigorously the effectiveness of the management control system (de Villiers et al., 2011; Hillman & Dalziel, 2003). This paper therefore, divide its four board variables and hypotheses into two groups that reflect directors' monitoring role (driven by agency theory) and directors' resource provision (driven by resource dependency theory), respectively. Additionally, these CG variables were actually selected based on their prominent importance in solving the practical problem of corporate governance in Nigerian banks as mentioned in (Sanusi, 2010; CBN, 2010). The paper is subdivided into five sections from introduction, literature review, CG/PMS (mediator), framework, conclusion then to reference.

2. Literature review

2.1 Bail-out in the Nigerian banking sector

The most recent bank distress in the Nigerian economy can be traced to the global financial crisis which began in the United States of America and the United Kingdom and then spilled over several nations in which Nigeria fell among. Consequently, another set of banking sector rescue program "Bail-out" was inevitably being introduced to ensure stability and prevent distress. The Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC) in July 2009, conducted a joint special examination of all 24 deposit banks in Nigeria, with the purpose of evaluating their health, with especial focus on Liquidity, Capital adequacy, Risk management and Corporate Governance practices (CG). The outcome was announced by Mal. Sanusi Lamido Sanusi the governor of CBN, who declared ten (10) banks of the Nigerian banking sector as being distressed or nearly collapsed due to "excessively high level of non-performing loans in the banks which was attributable to poor corporate governance practices, bad liquidity position and risk management. Consequently, a bail-out of about N620 billion was injected to rescue them, and then the Managing Directors (MD/CEOs) and the board of directors of 8 banks were immediately removed and then replaced with new ones. Some of these CEOs were then detained, prosecuted by the Economic and Financial Crimes Commission (EFCC) and also tried before the high court for outright stealing, corruption and mismanagement of their banks (CBN, 2010; NDIC, 2011; Sanusi, 2010).

2.2 Management Control Systems (MCS)

A management control systems (MCS) is a formal or informal system which gathers and uses information to evaluate the performance of different organizational resources like human, physical, financial and also the organization as a whole considering the organizational strategies (adapted from Otley, 1994). MCS influences the behaviour of organizational resources to implement organizational strategies (Anthony, 2007). However, Management control systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities (Simons, 1995b, p.5) While Horngren et al. (2005), sees MCS is an integrated technique for collecting and using information to motivate employee behaviour and to evaluate performance. MCS are not only used as control devices that monitor activities to ensure that organisational goals are achieved, but plays a role in maintaining or altering patterns of organisational activity (Langfield-Smith, 1997).

2.2.1Performance measurement system (Mediator)

PMS will be used as a proxy for MCS being a major key element of MCS (Henri, 2006)which naturally fall to the category of diagnostic control systems but still work together with other control subsystems (Otley, 1994). PMS are collections of financial and/or non-financial performance indicators which managers use to evaluate their own performance, or their subordinates performance or their unit's performance. Therefore, these financial and non-financial measures are indicators usually used to monitor strategy implementation throughout the organization and whether strategic goals are being achieved or not, for better decision making (Bremser & Chung, 2005; de Waal, 2002; Mohamed & Jamil, 2013). Bremser and Chung, (2005) opined that the renewed interest in performance measurement has resulted in the creation of numerous performance measurement frameworks or models by authors (see Kaplan & Norton, 1996; Otley, 1999; Ferreira & Otley, 2009;Henri, 2006;Jamil & Mohamed, 2011; Neely et al, 2002; Otley & Fakiolas2000; Simon, 1995; Speklé & Verbeeten, 2013). Mohamed and Jamil (2013)also suggested that PMS should emanates from or be tailored to the firm's strategy. However, the Balance scorecard, levers of control, Otley (1999) framework, Ferreira and Otley (2009) are all derived from strategy and these measures helps in tracking whether all the resources i.e. management/employees (human), capital/investments (financial) and properties/processes (physical) are moving the firm in the right direction based on the firms' strategy (Bremser & Chung, 2005). Simons (1995) proposed the levers of control (LOC) framework as a tool for the implementation and control of business strategies. Beliefs systems and interactive control systems are used to encourage new ideas, strategies, opportunities, innovation, while boundary systems and diagnostic control systems are applied to ensure that people behave according to pre-established rules and plans through monitoring, rewards (Ferreira & Otley, 2009; Jamil & Mohamed, 2013; Simons, 1995a,b). However, Otley (1999) came up with his 5 items measurement framework to address 5 aspects of MCS. Therefore, this study will implement the extended measurement framework of (Ferreira & Otley, 2009) which comprises both Simon's 1995 LOC and Otley1999 measurement framework. Ferreira and Otley (2009) believe that their PMSs framework provides a tool which researchers can employ to describe the structure and use of the 'package' of controls deployed by management and designed to ensure that an organization's strategies and plans are effectively implemented. To ensure effective implementation of plans, strategies, performance of all the organisational resources must be measured hence, the need for PMS. The previous models mentioned were restricted to measuring some aspects of MCS but this (Ferreira & Otley, 2009 extended model) gives more overall holistic view of firm's PMS data.

3. Corporate governance and performance measurement system

CG is related to PMS through the interference of the board in the review of the strategy formulation, and implementation by using information from performance measurement. Zahra and Pearce (1989) asserts that the Chief Executive Officer (CEO) and senior executives develop and implement strategic initiatives that are reviewed by directors. This review aims to ensure the alignment of management's strategic initiatives with the interests of the owners. Prior studies like (Judge & Zeithaml, 1992; Langfield-Smith, 1997; McNulty & Pettigrew, 1999; Ruigrok, Peck, & Keller, 2006)among others had established the involvement of boards in strategy formulation, implementation and decision making. While PMS is used in all these stages to monitor the progress. Similarly, Ogbechie, Koufopoulos and Argyropoulou (2009)opined that boards of public companies in Nigeria are involved in their company's strategy process but found that board characteristics have no/little influence on strategic decision making. However, Otley (1994) and Anthony (2007) opined that MCS uses performance measurement information to influence the behaviour of organizational resources in order to implement organizational strategies. Therefore, we see the relevance of boards' function (monitoring/resource provision) in ensuring effective performance measurement of all the organisational resources (management, subordinate managers, and others) using Otley, 2009 framework which the information may call for board's review and corrective actions that can results to a better firm performance. Also, boards' accessibility to timely and reliable performance control data enables them to monitor progress in achieving firm objectives (Zahra & Pearce, 1989). Additionally, the mediator became necessary in this weak relationship and inconclusive findings between CG and performance (Baron & Kenny, 1986).

3.1 Board independence

This is percentage of outside independent directors in the boardroom, and the concentration of independent directors appointed before the present CEO (de Villiers et al., 2011). Previous researches measure this as the higher the concentration of independent directors on the board, the higher will be the level of effective monitoring by the board (Albring, Robinson, & Robinson, 2013). In Nigeria, many banks' boards lacked independence, the bank Chairman/CEO often had an overbearing influence on the board, resulting to directors failing to make sound contributions in safeguarding the growth and development of their banks (CBN, 2010). Board independence is still one of the provisions of the CBN code that, CBN on-site verification reports of some institutions revealed non-compliance with (CBN, 2008). However, prior evidence of agency theory based researches such as Fama and

Jensen, (1983); Jensen and Meckling, (1976); Lefort and Urzúa, (2008) and Zahra and Pearce, (1989) revealed that board members are more vigilant in exercising their monitoring functions when they are independent of the firm management (Byun, Lee, & Park, 2013; de Villiers et al., 2011; Hillman & Dalziel, 2003). Also, board's accessibility to timely and reliable performance/control data makes it possible for them to monitor progress in achieving company goals. We therefore argue that performance measurement is essential to strengthening the relationship between CG and banks performance because information on the frequent measurement of CEO, subordinate managers, and banks performance which is reviewed by the board or its committee will result in feedback for appropriate corrective actions (Zahra & Pearce, 1989). Thus the following preposition is formed:

P1. Independence of board members is positively related to Banks performance after the bailout.

P2. Performance measurement mediates the relationship between Independent board members monitoring functions and banks' performance after the bail-out.

3.2 Audit committee quality

This is a very sensitive board attribute that provides monitoring control roles of boards. Albring et al. (2013) reported that the best measure of audit committee quality is accounting financial expertise, because of the perceived lack of accounting and financial expertise in boards and audit committees triggered a widespread regulatory and public attention (Hilzenrath, 2002). A competent and effective audit committee could improve the credibility and reliability of the financial statements provided to users (Abernathy, Herrmann, Kang, & Krishnan, 2013). However, previous research suggests that audit committees with financial experts as members are more effective at monitoring the process and quality of financial reporting especially in; the effects of materiality justification and accounting precision (DeZoort, Hermanson, & Houston, 2003); detecting material misstatements (Abbott, Parker, & Peters, 2004).Since frequent measurement of CEO, other managers and firm performance by the board or its standing committee will result in feedback for appropriate corrective actions (Zahra & Pearce, 1989) we argue that audit committee with financial experts may surely verify the quality of the measured information, as well as financial reporting. Thus the following proposition is formed:

P3. Audit committee quality is positively related to Banks performance after the bail-out.

P4. Performance measurement mediates the relationship between qualitative audit committee monitoring functions and banks' performance after the bail-out.

3.3 Board size

This is a board attribute that rely on the resource dependence theory. Under this theory, researchers examine the relationship between the board as a provider of vital resources (e.g., legitimacy, advice and counsel, connections/contacts to other outside organizations, etc.) and firm performance (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Regarding the size of a board, several conflicting outcomes were given since the past decades. On one hand, (Eisenberg, Lipton & Lorsch, 1992; Hermalin & Weisbach 2001; Jensen, 1993; Uwuigbe & Fakile, 2012; Yermack, 1996) argues that a smaller board size contributes more to the firm performance as larger boards are less effective due to co-ordination problems. However, majority of other past researches (Chen & Al-Najjar, 2012; de Villiers et al., 2011; Sanda et al., 2005; Uadiale, 2010) among others asserted that larger board size relates positively to firm performance. This is because, larger boards were assumed to have many directors with diverse expertise, educational and industrial experience, skills, external connections, reputations and with other qualities that improved the quality of actions taken by the firm. Consistent with prior studies, we argue that, in a larger board, it is more likely that one or more directors have been exposed to the effects banking crisis and have the experience on how to measure performance of all firm resources to ensure better firm performance especially after a bail-out. As such, directors with such exposure are likely to guide the rest of the board regarding the related strength/weakness of the management, challenges/opportunities facing any bank branch/unit that must be managed to achieve higher performance. Thus we form this proposition:

P5. Board Size is positively related to Banks performance after the bail-out.

P6. Performance measurement mediates the relationship between board size resource provision functions and banks' performance after the bail-out.

3.4. Female presence in the boardroom

To strengthen the resources provision abilities, more recent researches on CG has begun to refocus on proposing gender diversity (female board membership) in top management positions and corporate boardrooms (Farrell & Hersch, 2005; Daily et al., 1999; Carter et al., 2003). Several researches have reported conflicting findings about the effect of presence of female board members on firm's performance. The study of Vo and Phan (2013), reported that female board members represent a diversification of board's membership and this diversified nature will contribute positively to firm's performance. Carter et al. (2003), Adams and Ferreira (2003) and Agrawal and Knoeber (2001) also found a positive relationship between the no of women on the board of directors and firm value. This study therefore argue and predict that female director's accessibility to timely and reliable performance/control information may enables her to monitor progress in achieving higher banks' performance because the frequent measurement of CEO, other managers and firm performance by the board will result in feedback for appropriate corrective actions(Zahra & Pearce, 1989). Thus we proposed that this:

P7. Female board membership is positively related to Banks performance after the bail-out.

P8. Performance measurement system moderates the relationship between female board membership resource provision functions and banks' performance after the bail-out

4. Organisational performance

Organisational performance is an important concept that relates to the way and manner in which financial, material and human resources available to an organization are judiciously used to achieve the overall corporate objective of an organisation. Various measurement models were previously developed to take care of either managerial or organisational or both performances. However, among them all this study adopts the Balance scorecard (BSC) performance model which was developed by Kaplan and Norton, 1996. Balance scorecard model provides an excellent system for performance measurement in the commercial banking industry (Bremser & Chung, 2005). The BSC is the major element of a strategic management system that enables firms to translate strategic objectives into measures of performance. The measures consist both financial and non-financial measures which serves as indicators used in monitoring strategy implementation throughout the organization and whether strategic goals are being achieved or not (Bremser & Chung, 2005). The framework comprises of four (1 financial, and 3 non-financial aspects (customer perspective, internal process, learning & growth).

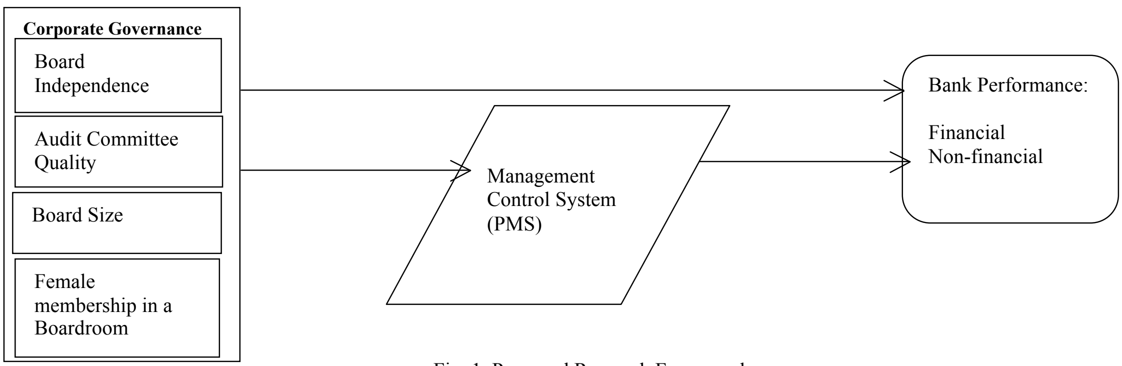

Fig. 1. Proposed Research Framework.

5. Conclusion

This paper is a proposes a framework based on an on going projects, to examine the influence of performance measurement in providing an adequate information to support the Board of directors of banks who has the function of monitoring and advising the managements' overall strategic system of control which will results in a better banks performance after the reform. If this proposed framework is validated and the study completed, the finding will provide significant contribution to the literature, managers and regulators.

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