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CONCEPTUAL REVIEW OF MULTIDIMENSIONAL PERFORMANCE OF FINANCIAL INSTITUTIONS

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Abstract

The performance measurement system is crucial for any kind of business to assess their success. It is an indicator of the level of competitiveness and dynamism of the business. One important aspect of a performance measurement tool is that the performance measures of the measurement system have to be relevant, to provide timely information and to match the internal and external attributes of the organization for long-term survival. Literature and empirical tests have indicated that the performance measures have to link with organizational factors. The multidimensional performance measurement consists of financial and non-financial measures are necessary to overcome the traditional measures. The traditional measures are financial oriented is lack measuring the other dimension strategically important. This conceptual paper discusses the significant of financial institutions measuring the performance using the multidimensional measures. The discussion includes to the extent of use the multidimensional measures in the context of Malaysian Financial institutions and provides the research proposition for future research.

Introduction

The economic development of the country highly depends on upon the mobilization of resources, investment and the operational efficiency of the various segments of the economy. Banks contribute a high degree of support the mobilization of resources and investment. Therefore, the banks are one of the main stimuli for the economic development of every nation and it has been consciously used an engine of development. The Banking sector is reckoned as a hub and barometer of the financial system in a country. As a pillar of the economy, this sector plays a predominant role in the economic development of the country (RashmiSoni, 2012). A strong banking sector is, therefore, vital for growth, generation of wealth, developing agriculture, eradication of poverty, promotion of capital formation, trade and industry and Gross Domestic product (GDP) growth, all necessary factors for a country to emerge as a developed one.

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Malaysia's economy strengthened to a sturdy growth of 6.2 percent in the first quarter of 2014. On the contribution side, Services and Manufacturing sectors' strong performance drove the economy coupled with a bullish momentum in Construction, (Department of Statistics, 2014). According to Tanu Pandey's (2013) projection, Malaysia's service sector will contribute 70 percent to the country's gross domestic product (GDP) by 2015.The banking sector occupies a predominant role in the development of the nation's economy. The nation's banks are well capitalized and governance applies equally to all financial institutions (Axel Van, June 4, 2013). The success and strength of the domestic economy depend on the successful consolidation of the banking sector.

Financial Institutions in Malaysia

The Malaysian banking system is a systematic, organized and regulated one. It is not a new to the banking industry. The story of banking starts from the charted Mercantile Bank of India, London, and China was established in 1859. The origin of domestic banks in Malaysia goes back to the first decade of the twentieth century with the establishment of first domestic bank Kwong Yik Banking Corporation (now Malayan Banking Berhad) in 1913.Since then, the banking industry in Malaysia has continued its steady growth and expansion until.

Malaysian banking system comes across many revolutions, for example, the establishment of Bank Negara (BNM), the introduction of Banking and Financial Institutions Act 1989 (BAFIA), Mergers and Acquisitions (M&A) etc. Bank Negara Malaysia (BNM) (Central Bank) a statutory body which is wholly-owned by the Federal Government was established on 26 January 1959, under the Central Bank of Malaysia Ordinance 1958. The objectives of Bank Negara are to: promote monetary stability and a sound financial structure, act as a banker and financial adviser to the Government, issue currency and keep reserves safeguarding the value of the currency and influence the credit situation to the advantage of the country.

Initially, commercial banks in Malaysia were governed by the Banking Act 1973. This was subsequently replaced by the BAFIA in 1989. Banking & Financial Institutions Act 1989 came into force on 1 October 1989 for licensed institution, repealed the Banking Act 1973 and Finance Companies Act 1969. It provides for the licensing and regulation of institutions carrying on banking, finance company, merchant banking, discount house and money broking businesses.

The banking industry in Malaysia reformed and now it has 27 commercial banks. The Commercial banks are an important instrument of financial systems that contribute to the GDP growth. As stated by the ACARAVCI & Calim (2013) that the commercial banks are intermediating between the depositors (savers) and borrowers (investors). As financial intermediaries, banks play a crucial role in the operation of most economics.

According to Bank Negara (Central Bank of Malaysia), the licensed banking institutions in Malaysia are classified into five groups as shown in Table 1. The classifications are Commercial Banks, Islamic Banks, International Islamic Banks, Investment Banks and Other Financial Institutions.

Table 1: Banking Institutions in Malaysia

Classifications	Total	Malaysian Controlled Institutions	Foreign Controlled Institutions
Commercial Banks	27	8	19
Islamic Bank	16	10	6
International Islamic Banks	5	0	5
Investment Banks	13	13	0
Other Financial Institutions	2	2	0

Source: Official website: Bank Negara Malaysia.
http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_list

Among the banking institutions in Malaysia, the commercial banks play a vital role, and these institutions are specifically designed to further the capital formation process through the attraction of deposits and extension of credit. It is most significant fund providers in the banking system in Malaysia.

Malaysian Investment Development Authority (2014) mentioned that the banking system in Malaysia is the primary mobilizer of funds and the main source of financing which supports economic activities in Malaysia. The MIDA has categorized the commercial banks into Malaysian-controlled institutions and foreign-controlled institutions but Bank Negara classified the commercial banks into local owned commercial banks and foreign-owned commercial banks. The details of present banks in Malaysia on the basis of ownership are presented in table 2.

Table 2: List of Commercial banks in Malaysia on the basis of ownership

Local owned Commercial banks	Foreign-owned Commercial banks
1. Affin Bank Berhad 2. Alliance Bank Malaysia Berhad 3. AmBank (M) Berhad 4. CIMB Bank Berhad 5. Hong Leong Bank Berhad 6. Malayan Banking Berhad 7. Public Bank Berhad 8. RHB Bank Berhad	1. BNP Paribas Malaysia Berhad 2. Bangkok Bank Berhad 3. Bank of America Malaysia Berhad 4. Bank of China (Malaysia) Berhad 5. Bank of Tokyo-Mitsubishi UFJ (Malaysia) Berhad 6. Citibank Berhad 7. Deutsche Bank (Malaysia) Berhad 8. HSBC Bank Malaysia Berhad 9. India International Bank (Malaysia) Berhad 10. Industrial and Commercial Bank of China (Malaysia) Berhad 11. J.P. Morgan Chase Bank Berhad 12. Mizuho Bank (Malaysia) Berhad 13. National Bank of Abu Dhabi Malaysia Berhad 14. OCBC Bank (Malaysia) Berhad 15. Standard Chartered Bank Malaysia Berhad 16. Sumitomo Mitsui Banking Corporation Malaysia Berhad 17. The Bank of Nova Scotia Berhad 18. The Royal Bank of Scotland Berhad 19. United Overseas Bank (Malaysia) Bhd.

Source: Official website: Bank Negara Malaysia.
http://www.bnm.gov.my/index.php?ch=li&cat=banking&type=CB&sort=lf&order=desc

The performance measures of bank growth are an important yardstick to measure it share market. Empirical studies indicate that the performance measurement has an important role to play in the efficient and effective management of organizations (Kennerly & Neely, 2002). The performance measurement is necessary to provide the desired outcome. It addresses the issues related to the business process, that is expected to generate the sought after results by various stakeholders (Halachmi, 2005). Researchers from different fields (De Toni & Tonchia, 1996; Ghalayini & Noble, 1996; Kennerly & Neely, 2002) have identified the need for effective deployment of business resources down through the organization, and the subsequent measurement of performance in critical areas such as key elements of sustainable competitive strength. Thus, the performance measures are vital in identifying problematic areas and adding value to the organization by facilitating effective resource allocation to bring optimum results. The role of performance measurement on deployment resource allocation to address business objectives is described by Kanji (2002) as follows: -

> *"The immediate role for a performance measurement system is thus to check towards the established goals. Additionally, the use of performance indicators is not only for accountability purposes, but such indicators are also intended to drive future resource allocation decisions. It is important to build a measurement system where measures are used as a management and motivational tool. In order to fulfill this role, a performance measurement system must be deployed in a way that makes clear to each individual how he or she can contribute to the overall success of the firm."*

For long term survival, the bank has to develop and design an appropriate performance measure that brings benefits and added value to the organization. The benefits of a well-designed performance measurement system are to facilitate communication of the organization's objective, continuously emphasize the important aspects of the organization's success and identify the areas that need improvement (Kanji, 2002). Nanni (1992) stressed that performance measurement system encompasses the set of organizational policies, systems and practices that coordinate actions and transfers information in support of the entire business management cycle. Neely *et al.,* (1999) defines the system of measurement as the set of metrics used to quantify the efficiency and effectiveness of actions. According to Bititch *et al.,*(1997), performance measures enables a closed-loop deployment of organizational strategies, which provides a structured framework, to allow the relevant information to feedback to the appropriate points to facilitate the decision and control processes. The performance measure multidimensional provides the information to the management to gauge its growth.

Multidimensional Measures and Bank Performance

The Management Accounting Theory suggest that two different measures of branch performance should be computed; one to evaluate the economic performance of each branch and the other to evaluate the performance of branch managers (managerial performance) (Agyei-Mensah, 2012). As stated in the Management Accounting Theory both the economic and managerial performance are an important component of performance measurement tool. The performance measurement is mainly to ensure that objectives set by the organization are translated into action, and it measured using the financial and non-financial measures.

Through the outcome of the financial and non-financial measurement, the feedback is provided for further refined for future directions. Agyei-Mensah (2012, p79) stated that the feedback is important in the financial service industry, as in other types of business organizations, and a major part of this feedback in provided by performance evaluation. However, the feedback derived from performance evaluation is mainly concentrated using the outcomes from the financial or accounting based measures such as ratios. In the banking sectors, the financial measure is the main tool to evaluate the bank's profitability performance. The empirical research in the past has confirmed on this using various determinants at macro and micro level to assess the influence on bank's performance, especially on profitability. For instance, a study conducted by Guru et al. (1999) on 17 Malaysian trade banks over the period 1986-1995, stressed the importance of the bank deposits like determinant of the performance of these institutions. On another note, Okpara(2010) noted the macroeconomic variables such as interest rate, the inflation rate and the gross domestic product (GDP) as well as other banking variables namely liquidity, the size of the bank, the level of risk and the adequacy of capital have a significant influence on bank's profitability. All of these determinants of measuring the influence on banking performance are highly concentrated on financial measures (which include the variables of the economic measures) rather than the non-financial measures.

According to Westhuizen(2014), the use of financial measures as performance measures is faced by a number of obstacles. The limitation as highlighted by Westhuizen were summarized in Table 3.

Table 3: Limitation or obstacles of financial ratios

Obstacles	Reference
The financial ratios are only meaningful when compared to a benchmark, and finding a suitable benchmark may be difficult	Yeh, 1996
Each performance measures are partial in the sense that is calculated using only a subset of the data available to the firm. The problem with partial measures is that bank may perform well using one measure (e.g ratio of bad debts to assets) but badly using another (e.g total cost per employee).	Westhuizen, 2014
Financial ratios are not appropriate because they aggregate many aspects of performance such as financing, marketing, and operations. A bank may appear to be performance well, even if it is poorly managed on some of these dimensions, so long as it compensates by performing particularly well on other dimensions	Sherman and Gold, 1985

Source: Westhuizen (August 2014 p. 94)

The discussion in the literature provided sufficient evidence since 1970's the financial measures is insufficient to provide feedback that drives the long-term profitability. A research in the UK building societies found that the branch profitability measures were not used to evaluate the branch managers instead the managers are evaluated using the performance measures such as number of value of new mortgages, net savings receipts and etc, that critical to achieving the key critical success factors of branch performance (Agyei-Mensah, 2012, Coling Drury , 1994 cited in). The use of non-financial measures to supplement the financial measures in the performance evaluation is supported by prominent researchers in management accounting research. As highlighted in the CIMA research report by the Drury and El-Shishini(2005, p.15) that *"the need to distinguish between divisional managerial and economic performance leads to three different profit measures – divisional controllable profit, divisional contribution to corporate sustaining costs and profits and divisional net income."* The author further stated in the report that to overcome these difficulties is to use the performance measures that combines both the financial and non-financial measures. The use of both the financial and non-financial measures provides balanced performance evaluation and also it support long-term profitability effort. Some of the effort not able to measure using the financial measures likes ratios where it subject to manipulation which considers lagging indicators. The outcome of non-financial measures which consider in the literature leading indicators that drive the financial outcome and some of the effort not immediate measure by the financial measures will be reflected in the non-financial performance measures. Using the balanced performance measures has a positive impact on the organizational performance as evidenced in the empirical research (Franco, Bourne, & Neely, 2004). Research by Said, HassabElnaby, and Weir (2003) that survey on 144 US firms shows that non-financial measures have a positive relationship with the stock market return.

The concept of multidimensional performance consists of both financial and non-financial measures introduced by various researchers and one such tool widely used is the Balanced Scorecard introduced by Kaplan and Norton. A research was undertaken in the banking industry by Agyei-Mensah(2012) to empirically examine the usage of multidimensional performance measurement by the rural banks in the Ashanti Region of Ghana. The result of analysis found that despite the popularity of the balanced scorecard it is surprising to note that none of the respondents has ever used this as performance measures and the researcher concluded that the implication of this is that knowledge of this performance measure is very low among the respondent (Agyei-Mensah, 2012, p.101). Nevertheless, the research recommended the use of the Kaplan and Norton, multidimensional performance tool by the rural banks will achieve wide varieties benefits as indicated below (Agyei-Mensah, 2012, p102).

- The adoption of the balanced scorecard will facilitate learning within the banks. The measurement tools, depicted by the four perspectives will help assess how well the strategies of the banks are being implemented by the branches, i.e. where the branches are performing well and where they are underperforming.
- The adoption of the balanced scorecard will help align action to strategy. The

performance measures developed will help to clarify the organization's goals and strategic objectives and align action to strategy.

- The balanced scorecard will stimulate action in the most important areas of the rural banks. The measurement tools developed will help to focus attention and channel adequate resources quickly to the areas identified as critical to achieving the goals of the organization.
- The balanced scorecard will influence behavior within the rural banks. Identifying the appropriate performance measurement tools and indicators will influence the behavior of staff within the rural banks towards achieving the goals of the organization.

As concluded by the researcher Agyei-Mensah(2012) in his study that the traditional financial measures should be supplemented with non-financial performance measures such as customer satisfaction, social responsibility, investing in new state of the art technology, product development, and employee turnover. The non-financial measures are necessary for operational control purpose mainly to reduce the cost while offering the services that maximize the financial benefit in return.

Conclusion and Research Proposition

Despite the apparent objectives of the financial measures, many firms fail to understand that financial indicators are not drivers of the future success of the business; they simply measure the past performance rather than the future. The non-financial measures such as customer satisfaction, internal business processes, employee morale and capabilities are leading indicators that drive the future financial success. Researchers suggest that rather than analyzing the reasons from a historical perspective, it is very important to understand organizational excellence, which potentially leads to the success of a business in the future (Kanji, 2002). As a result of the Performance Measurement System that balances financial and non-financial measures provides more comprehensive strategies for future improvement.

According to Kaplan,R.S.,& Norton,D.P (2007) one of the major weakness of traditional performance measurement system is its' inability to link the company's long-term strategy with its short-term actions. The author further asserted that most companies' operational processes built around financial targets bear little relation to the progress in achieving long-term strategic objectives. As a result, the emphasis is on short-term financial measures and it leaves a gap between the development of a strategy and its implementation. Thus, performance measurement system designed using multidimensional consists of the financial and non – financial to close the gap between the strategy development and implementation.

In Malaysia, the concept of multidimensional study is extensively studied in manufacturing industry sectors (Krishnan & Ramasamy, 2013). Very limited studies have been undertaken in particular financial sectors whether the banks are adopting multidimensional performance measures instead of Financial Measures such as ratios. This empirical investigation further examines between the public and foreign private commercial bank sectors. The future research is necessary in this area empirically the following two propositions.

> Proposition 1: local commercial banks likely to use separate performance (non-financial) measures to evaluate the banks' performance
>
> Proposition 2: The foreign commercial banks likely to use separate performance (non-financial) measures to evaluate the banks' performance

This empirical study is necessary to identify whether the Commercial banks is using the separate performance measures that consist of non-financial performance measures to supplement financial measures will add value to existing literature in the performance measurement area.

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