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# Cost Management Practices and Strategic Decision Making in the Nigerian Banking Sector

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**Abstract**

*This study examines the relationship between cost management practices and strategic decision making in the banking sector. Survey design was used in the study and data were generated by means of questionnaire to sixty management staff of two selected banks in Lagos. Three hypotheses were formulated and tested using the chi- square method of analysis. The results of the study indicate that cost management practices are employed in strategic decision making; cost drivers are a major consideration in cost management systems; and that a relationship exists between cost management practices and strategic decision making. The implications of the study include the need for banks seeking leadership positions to realize the importance of taking out costs and investing the savings in strategic programs that will help them bring products to the market more quickly, interact with customers more effectively and gain competitive advantage. It is recommended that banks must continually revisit cost governance and instill a culture focused on cost management.*

**Keywords**: Cost management practices; Strategic decision making; Cost drivers; Cost management system; Nigeria.

## 1. Introduction

Business environments have been in recent times highly volatile and dynamic. The changes in the economics of the world have had direct impact on the operations, growth and profitability of small and big businesses. These, perhaps, are revealed in the closing down of some major businesses around the world. Developing countries, Nigeria inclusive, are understandably worse hit in experiencing the chain effects of the downturn in the global economies.

The banking sector is an integral part of a nation's economy. Hence, this sector plays a vital role in the well-being of the economy. A weak banking sector in the developing countries, including Nigeria, will not only jeopardize the socio-economic development of these nations, it can also trigger a financial crisis which can lead to economic crises (Vaithilingam, Nair and Samudram, 2006). Soludo (2009) asserts that the banking sector is the key driver of the Nigerian economy. As Soludo puts it, "Nigeria cannot afford a banking crisis: The non-deficit part of the Federal Government of Nigeria (FGN) budget in 2009 is less than banks' capital; hence the totality of FGN budget cannot recapitalize the banks if the system should collapse." Consequently, banks, in these crucial times are burdened with the responsibility of mapping out effective strategies for surviving the prevailing adverse conditions in their business environments.

Realizing that times are tough, effective cost management has become extremely important to drive improvement efforts (Marchesan and Formoso, 2010; Johnson and Kaplan, 1987) and good decision-making is more critical for banks and all organizations. The challenge will then be to determine how management will effectively position their respective companies in the face of competition in order to sail through difficult times. Therefore, the positioning, advantageously or otherwise, of a business organization is hinged on its strategies or strategic decisions. In recent times, businesses are finding it imperative to embark on strategies that would enable them reduce costs, as global credit crunch has reduced the availability of funds for their operations. In the same vein, businesses are awakening to the need to remain relevant in the face of global competition which has made business competition analogous to warfare (Alawattage 2007).

Hopwood (2000) argues that strategically efficient firms can go beyond the mere identification of costs and focus on ways to change cost structures to serve wider corporate objectives. This is the focus of cost management. As defined by Cooper and Kaplan (1999), cost management is one of the most important factors towards profit improvement. One of the most important areas, where substantial improvement can be made, is to understand the effectiveness of costs and cost techniques which can be usefully employed in the organization. In the present difficult economic environment, there is great urgency to reduce costs and improve efficiency, but cutting costs indiscriminately or too deeply might severely hamper the ability to grow revenues when the economic outlook improves. Thus, the need for effective and efficient cost management practices.

The importance of cost management practices in today's businesses is very vital. Changes in the business environment are, perhaps, making it more important for management to effectively manage costs and constantly refocus their business strategies to conform to the corporate vision, and to ensure continuity and efficiency of operations. In the face of globalization and competition, cost consciousness has probably become an agent for change in its own right. Competition and globalization have introduced a new momentum into cost management. Costs are now of strategic importance in a more intensive way and therefore must be managed effectively using the right techniques. Hence, strategic decision making is crucial. It is crucial because it involves those fundamental decisions, which shape the course of the firm (Eisenhardt and Zbaracki, 1992).

### 1.1 Purpose of the study

In view of the challenges that cost management practices pose for both theory and practice, it is imperative that we advance the understanding of its relationship with strategic decision-making. In this respect, the study specifically examines the following:

1. Whether cost management practices are employed in strategic decision-making.
2. Whether cost drivers are a major consideration in cost management systems.
3. Whether there is a relationship between cost management practices and strategic decision-making.

## 2. Literature review

In the contemporary business environment, cost management has become a critical survival skill for many organizations. It is not sufficient to simply reduce costs; instead, costs must be managed strategically (Cooper and Slagmulder 1998). Customers in highly competitive markets also expect that each generation of products presents improvements (Cooper and Slagmulder, 1998). These can be accomplished if cost is well managed. Thus, cost management is absolutely essential for the attainment of organizational objective.

Various authors have defined cost management in different ways. Horngren, Datar and Foster (2006) define cost management as the activities of managers in the short-run and long-run planning and control of costs. Cost management has a broad focus. It includes (but is not confined to) the continuous reduction of cost. Cost management is not practised in isolation; it is often carried out as a key part of general management strategies and their implementation. It is built around a philosophy, an attitude and a set of techniques to create more value at a lower cost. Indeed, an effective cost management system should aim at achieving the following purposes (Obaru and Ukpai, 2010):

1. To arrive at the cost of production of every unit, job, operation, process, department or service and develop cost standards.
2. To signify to the management any inefficiencies and the extent of various forms of waste, whether of materials, time, expense or in the use of machine equipment and tools. Analysis of the causes of unsatisfactory results may indicate remedial action.
3. To disclose sources of economies in production, having regards to methods, types of equipment, design, output and layout. Daily, weekly, monthly or quarterly information (reports) may be necessary to ensure prompt corrective action.
4. To provide actual figures of cost for comparison with estimates, and to serve as a guide for future estimates, or quotations, and to assist the management in their price-fixing policy.
5. To present comparative cost data for different periods and various volumes of production output, and to provide guidance in the development of the business.
6. To specify whether the cost of certain parts or components made in the factory is such that it would be more economical to buy from outside sources.

Hence, cost management is not limited to cost; it is inclusive of all resources used and deployed across the value chain of an organization (Cooper and Slagmulder 1998), as well as the consideration of cost drivers.

Cost drivers are factors which significantly influence the cost of delivering a service (Grimmer and Bowman, 1999; Maenee and Penchansky, 1994). According to Sheng (2009), a cost driver is the driving factor that triggers costs. It is a mediating factor between cost object, its directly related activities and its ultimately relevant resources. Sheng (2009) opines that a cost driver has the following central features:

*Concealment*. Cost driver is the driving factor that is concealed behind costs, which is usually difficult to identify directly. The characteristics of concealment call for deep and specific analysis of cost behaviours. In the implementation of activity-based costing, the most critical task is to identify the cost driver.

*Relevance*. Cost driver is highly relevant to the value activity which leads to the occurrence and changes of cost. The value activity is the direct reason for causing the consumption of resources, so it is only in analyzing their relevance via the activity chain that we can select the cost driver correctly.

*Applicability*. Cost driver is found in all types of operations, in a variety of resource flows and all kinds of costs. It applies to analyzing the causal relationship between various types of operations, resource flows and costs.

*Accountability*. With activity-based costing, all cost drivers can be measured, and, hence, can be used as criteria for allocating costs.

In essence, cost management should not confine its concerns and objectives only to cost, but should also consider revenue, productivity, customer value, and at the same time the strategic position of the company. Thus, the design, implementation and application of new forms of cost management techniques represent a great challenge for management accountants (Cooper and Kaplan 1999, Blocher, Chen and Lin 1999). All these require strategic decision making.

Strategic decisions are those important decisions that require a large amount of firm's resources and organizational environmental consideration (Pearce and Robinson, 1994; Richardson and Ndubisi, 2003). They are concerned with the long-run future of the entire firm and have three features (Wheelen and Hunger, 2004):

1. *Rare*: Strategic decisions are unusual and normally have no precedent to follow.
2. *Consequentially*: Strategic decisions commit substantial resources and demand a great deal of dedication from employees at all levels.
3. *Directive:* Strategic decisions set precedents for less significant decisions and future action.

Rational process of decision making involves three intertwined activities (Ebert and Mitchell, 1975; March and Simon, 1958; Simon, 1960; Wally and Baum, 1994) as follows:

1. *Intelligence activity* is the identification phase which deals with scanning that involves gathering and processing information. This information gathering provides signals for recognizing potential decision situations and formulating alternatives.
2. *Design activity* is the development phase: decision-makers analyze the formulated alternatives to determine probable outcomes and identify alternative outcomes that will satisfy the needs or goals associated with decisions.
3. *Choice activity* is the selection phase: decision-makers make judgements, choosing among the identified alternatives.

Several studies have provided evidence that strategic initiatives are associated with improved financial performance (Al-Khadash and Feridun, 2006; Hendricks and Singhal, 1999) and consequently, cost reduction. In looking at the interface between cost management practices and strategic decision making, Hilton, Maher and Selto (2006) describe the role of cost management teams as transforming cost accounting and other data into information for such decisions that support strategies for improving products and services and the use of resources that systematically reduce costs. This information is likely very vital for effective strategic decision-making in a rapidly changing, globally competitive industry. Thus, managing costs has probably been a strategic consideration in corporate and business affairs. Hence, the need to hypothesize the following:

$H_{01}$: Cost management practices are not employed in strategic decision-making.

$H_{02}$: Cost drivers are not major consideration in cost management systems.

$H_{03}$ There is no relationship between cost management practices and strategic decision-making.

## 3. Methodology

The survey research method was adopted for this study and primary data were collected via a constructed questionnaire. The use of the survey research method is justified because it follows a correlational research strategy and helps in predicting behaviour (Bordens and Abbott, 2002).

The population of study comprised top managers and employees who occupy strategic positions in two Banks (Oceanic Bank Nigeria PLC and UBA PLC) in Nigeria. The sample size was made up of sixty (60) respondents who were selected from various branches of the two banks in Lagos State, Nigeria. Lagos was considered a good representation of the Banking sector because it is regarded as the commercial nerve center of Nigeria.

Judgmental sampling technique was employed in selecting the sixty respondents. The justification for using judgmental sampling technique is that when one wishes to select a biased group for screening purposes, this sampling method is a good choice (Cooper and Schindler, 2001).

A five-point Likert scale ["Strongly Agree (SA); Agree (A); Undecided (U); Disagree (D); Strongly Disagree SD"] was applied to measure the variables of the study. The research hypotheses were tested, using the chi-square method of statistical analysis.

## 4. Hypotheses testing and results

Three hypotheses were formulated and tested, using Chi square ($\chi^2$). In order to test each of them, related questions were cross-tabulated. Frequency tables were derived from the combined questionnaire items. Thus:

$$\chi^2 = \sum^n \frac{(O-E)^2}{E}$$

Where:
O = observed frequency
E = Expected frequency
(r-1)(c-1) degrees of freedom
Where:
r = number of row
c = number of column

Table 1a: Variables Frequency

| | SA | A | U | D | SD | TOTAL |
|---|---|---|---|---|---|---|
| Strategic decision making (SDM) | 45 | 12 | 3 | 0 | 0 | 60 |
| Cost management practices (CMP) | 32 | 26 | 2 | 0 | 0 | 60 |
| Total | 77 | 38 | 5 | 0 | 0 | 120 |

Source: Analysis of Survey data (2009).

Table 1b: Expected Values

| | SA | A | U |
|---|---|---|---|
| E1 (SDM) | 38.5 | 19 | 2.5 |
| E2 (CMP) | 38.5 | 19 | 2.5 |

Source: Analysis of Survey data (2009).

Table 2c: Contingency table

| | | O | E | O−E | $(O-E)^2$ | $(O-E)^2/E$ |
|---|---|---|---|---|---|---|
| E1 | SA | 31 | 39 | 8 | 64 | 1.641 |
| | A | 25 | 19 | 6 | 36 | 1.895 |
| | U | 4 | 2 | 2 | 4 | 2 |
| E2 | SA | 47 | 39 | 8 | 64 | 1.641 |
| | A | 13 | 19 | 6 | 36 | 1.895 |
| | U | 0 | 2 | 2 | 4 | 2 |
| | | | | | | 11.072 |

Source: Analysis of Survey data (2009).

Hypothesis ($H_{02}$) was tested using Chi square ($\chi^2$). Tables 2a, 2b and 2c indicate the Variables Frequency, Expected Values and the Contingency Table respectively. The decision rule adopted for this study is: *reject Null Hypothesis if Chi square calculated ($\chi^2_{cal}$) is greater than the table value of chi square ($\chi^2_{tab}$) at four degrees of freedom and 95% confidence level, otherwise, accept.*

The result of the Chi square analysis in Table 2c shows that ($\chi^2c$) is 11.072. However, the table value of Chi square ($\chi^2_{tab}$) at four degrees of freedom and 95% confidence level is 9.49. Since $\chi^2_{cal} > \chi^2_{tab}$, the null hypothesis that cost drivers are not a major consideration in cost management systems is rejected. Thus, cost drivers are a major consideration in cost management systems in Nigeria.

Table 3a: Table of Frequencies

| | SA | A | U | D | SD | TOTAL |
|---|---|---|---|---|---|---|
| Cost management practices | 30 | 28 | 2 | 0 | 0 | 60 |
| Strategic decision making | 45 | 12 | 3 | 0 | 0 | 60 |
| Total | 75 | 40 | 5 | 0 | 0 | 120 |

Source: Analysis of Survey data (2009).

Table 3b: Expected Values

| | SA | A | U |
|---|---|---|---|
| E1 | 37.5 | 20 | 2.5 |
| E2 | 37.5 | 20 | 2.5 |

Source: Analysis of Survey data (2009).

Table 3c: Contingency table

| | | O | E | O-E | $(O-E)^2$ | $(O-E)^2/E$ |
|---|---|---|---|---|---|---|
| E1 | SA | 30 | 37.5 | -7.5 | 56.25 | 1.5 |
| | A | 28 | 20 | 8 | 64 | 3.2 |
| | U | 2 | 2.5 | -0.5 | 0.25 | 0.1 |
| E2 | SA | 45 | 37.5 | 7.5 | 56.25 | 1.5 |
| | A | 12 | 20 | -8 | 64 | 3.2 |
| | U | 3 | 2.5 | 0.5 | 0.25 | 0.1 |
| | | | | | | **9.60** |

Source: Analysis of Survey data (2009).

Hypothesis ($H_{03}$) was tested, using Chi square ($\chi^2$). Tables 3a, 3b and 3c indicate the Variables Frequency, Expected Values and the Contingency table respectively. The decision rule adopted for this study is: *reject Null Hypothesis if Chi square calculated ($\chi^2_{cal}$) is greater than the table value of chi square ($\chi^2_{tab}$) at four degrees of freedom and 95% confidence level, otherwise, accept.*

The result of the Chi square analysis in table 3c shows that ($\chi^2$c) is. 9.60. However, the table value of Chi square ($\chi^2_{tab}$) at four degrees of freedom and 95% confidence level is 9.49. Since $\chi^2_{cal} > \chi^2_{tab}$, the null hypothesis that there is no relationship between cost management practices and strategic decision making is rejected. Hence, there is a relationship between cost management practices and strategic decision-making in Nigeria.

**Summary, conclusion and recommendations**

The summary of the foregoing is that in the current business environment, the development and use of cost management information are critical success factors in the effective management of an organization. As the business environment is changing, the role of cost management information has expanded to serve the management's strategic decision-making function.

Based on the data analyzed, we find that cost plays a significant role in all operations and decisions. By answering the research questions and from the outcome of the test of hypotheses, the following were established: Costs directly or indirectly attributable to any activity or operation in the banking sector respond to any change in the level of activity or amount of resources used as input. Also, increase in bank's operations leads to increase in the cost of performing the basic activities. We find that cost information for top-level management decision-making inculcates, not only cost information, but also financial information. It was also observed that cost techniques are employed in the banking industry and that a relationship exists between cost management practices and strategic decisions made by management.

In the light of the findings, summarized above, a number of deductions can be made. Firstly, cost management is basically the function of top-level management who are the policy makers. However, they make decisions, based on the information on costs they receive from middle-level and low-level management.

Secondly, cost management is pervasive in nature. It does not begin and end with top- management, but spreads to the controlling of the excesses in performing basic activities in order to add more value. The effect of this is that cutting costs is felt, not only organization-wide, but also in the processes of the organization, and may go as far as requiring major structural adjustments. That is how sensitive the organization is to cost.

Thirdly, cost management, though more pronounced in the manufacturing industry, is also essential in the service industry, like the banking industry. Using specified cost techniques, vital information on costs can be obtained, for example, as to the flexibility, or otherwise, of the cost and the related activities incurring such costs in order to determine efficiency in performance and cost position in relation to other comparable companies in the same industry.

Lastly, cost management has been seen to have a strategic leading role in the sense that efficient cost management could improve the bank's competitive advantage in cost leadership and translate into higher revenues and increased returns to shareholders.

This study would be of immense benefit to organizations, both private and public, because it highlights the need for conscious cost management, strategic decision-making, and a better understanding of their relationship.
The study would also be of immense importance to organizational leaders, managers, executives, officers and staff generally for various reasons: it would enable them to gain more insights into and deepen understanding, on the creative use of costs to position themselves to face the changing global economy.

Based on the findings of this study, it is recommended that banks must continually revisit cost governance and instill a culture focused on cost management. It is also proposed that costs be managed by constantly benchmarking the bank's processes with competitors, industry comparable and industry leaders. Management should ensure that financial control is established in every area of operation where costs are incurred, even with the diversification/sharing of the responsibility for cost and cost analysis.
In conclusion, all these should be critical issues of consideration for strategic decision- making, if firms must compete effectively and efficiently in the present hypercompetitive dynamic business environment.

Future research should cover other sectors of the economy, such as the manufacturing sector, agriculture and communications, to mention a few, which were outside the scope of this study. Further studies could also look at cost management practices and strategic decision-making in small and medium scale industries. In addition, the sample size should be increased to include all the banks in the country.

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