Cost Reduction Strategy and Firm Profitability during Recession Period: Nigerian Banking Industry Experience

Patrick Amaechi Egbunike[1], Segun Idowu Adeniyi[2]

Abstract: Nigeria banks faced financial crisis due to financial meltdown and government treasury single account policy. This has forced banks to employed strategic cost management techniques like downsizing of employee and reduction of staff salary to survive and sustain their competitiveness in banking industry. This study examines the influence of downsizing of staff and reduction of staff salary on bank profitability. The specific objective is to ascertain the influence of downsizing of employee and reduction of staff salary on return on asset. Survey design was used for the study. Purposive sampling technique was used to select the sample frame from first generation of banks that are licensed with international authorization in Nigeria This study obtained secondary data from the Nigerian Stock Exchange Fact-book and Annual Report and Accounts of the sample population for the period 2006 to 2016. A linear regression analysis was used in estimating the parameter of the model. The study finds out that there is negative relationship between downsizing of employee, reduction of staff salary and profitability. It was discovered that the period after banks downsize their employee, bank performance was at its low ebb. We strongly recommend that banks can reduce their employee salary instead of laying them off. Then, salary increment can be done when the financial performance is improving.

Keywords: cost reduction strategy; profitability; downsizing; salary reduction

JEL Classification: D24

1. Introduction

Strategic cost management improves competitive advantage that results in an efficient resources allocation, (Ellram & Stanley, 2008). One of the main strategic cost strategies is cost reduction. According to Groth and Kinnery (1994), cost reduction is an act of lowering current fixed costs and variable costs. It focuses on reducing total cost compared to income generated. This will directly or indirectly influence the financial performance of the organization.

[1] Department of Accountancy, Faculty of Management Sciences, Nnamdi Azikiwe University, Nigeria, Address: Along Enugu-Onitsha Expressway, 420110, Ifite Awka, Nigeria, Tel.: +234 708 161 0453, Corresponding author: amaechiegbunike@yahoo.com.

[2] Department of Accountancy, Faculty of Management Sciences, Nnamdi Azikiwe University, Nigeria, Address: Along Enugu-Onitsha Expressway, 420110, Ifite Awka, Nigeria, Tel.: +234 708 161 0453, E-mail: princeadeidowu@gmail.com.

Richardson (2002) view financial performance as a factor in assessing growth potential and overall financial strength of the firm. The financial strength of an organization are measured in monetary terms and the result are reflected in firm's return on investment, return on asset, liquidity, solvency among others. Therefore, the main goal of every business is to make profit and sustain competitive advantage within the business environment.

Banking business was a lucrative business in Nigeria before the advent of financial meltdown that struck the economy in 2008. Year 2008 was the period when financial networks and markets suddenly become unpredictable to the point where it mere collapse. Though, Eichengreen and Portes (1987) notes in their study that any change in asset prices that leads to distress within financial markets operator constitute financial crisis of financial meltdown. The banking industry was trying to navigate through the financial meltdown when Federal government decided to introduce treasury single account. This policy leads to withdrawal of government funds from deposit money banks in Nigeria.

According to Nigeria Deposit Insurance Corporation (2016), the financial sector appears to be having its own fair share of the effect of economic recession, as a number of banks are experiencing poor asset quality and increase in non-performing loans. Banks shifted their priorities from growth and leveraging up profits to survival strategy. Cost management therefore became a tool to look unto as a competitive tool for business survival in the recessionary times (Berliner, 1998). Innes, John, Mitchell and Sinclair (2000) said that cost management has to be an ongoing and continuous improvement activity within the company so as to enhance profitability and survival.

For the bank to survive in competitive environment, cost reduction strategy like; downsizing of staff and reduction in staff salary. This strategy was employed to maintain bank level of profitability. Despite the measures taken by banking industry to reduce costs and sustain their level of profitability, banks are still finding it difficult to survive in this economic situation. Hence, the study will examine the influence of cost reduction strategies employed by banks on their financial performance.

1.1. Objective of the Study

The main objective of the study is to examine the influence of strategic cost reduction techniques used by banks on their financial performance. The specific objective is; to ascertain the influence of downsizing of staff and reduction of staff salary on bank profitability.

The study will be guided by this hypothesis:

Ho: downsizing of staff and reduction of staff salary does not significantly leads to increase in return on asset.

1.2. Scope of the Study

The study will focus on selected money deposit banks that are licensed with international authorization in Nigeria. Some of the banks selected for the study are: First Bank Plc, United Bank of Africa Plc and Union Bank Plc. These banks are selected because they are old generation banks. The study will cover the period of 2006 to 2016.

2. Empirical Review

Siyanbola and Raji (2013) conducted study on impact of cost control on manufacturing industries profitability. The study focus on West African Portland Cement Plc (WAPCO) using budget as a tool for cost control. The study discovered that cost control has positive impact on business profitability. Kathleen (1999) study the effects of financial conditions and managerial ideologies on corporate downsizing in Electric Utilities Industry at United State of America. The study discovered that downsizing, as a strategic cost reduction tool, are no longer closely tied to the financial performance of the firm as they once were.

Huber and Glick, (1993) discovered that when downsizing is not well managed, it leads to reduction in firms performance. It was discovered by Bennett and Durkin (2000) in their study that downsizing has great influence on firm performance. Most downsizing strategy employed by firms leads to poor performance of the organization because the moral and job satisfaction of the surviving employee are greatly reduced Noer (1993). Hamed, Bowra, Aleem, and Hussain (2013) did an empirical investigation of downsizing within banking sector at Pakistan. The study discovered that reducing of the total number of employee does not lead to increase in banks profitability which is their main objective of cutting jobs. Guthrie and Datta (2008) opines that majority of the firms that reduced their employee have not been able to improve their level of profitability.

Edward et al., (2004) discovered that downsizing as a tool used to improve firm profitability by enhancing firm efficiency and reducing cost. While Sadri (1996) in his study agreed with the above finding. However, many studies proved that downsizing reduce the performance of firms Ozkanli and Bumin (2006); Cascio (1995); and Forsyth, (2002). Downsizing does not induce better corporate performance Mentzer (1996), and De Meuse et al. (2004). Oyewo (2013) studied Strategic cost management as a recession survival tool in the Nigerian Manufacturing sector. He discovered that cost management is good to maintain profits in the face of softening sales and shrinking margin.

Robert, Nixon, Michael, Hitt, Ho-Uk Lee and Eui Jeong (2004) examine the effect of downsizing strategy on market performance. The study discovered that management downsize their work force to reduce cost but it have negative impact on market reaction because of losses in valuable human capital that exceed the benefits derived from the strategy. Clint, Larry and Stephen (2004) discovered in their study that downsizing does not generally leads to improved organizational performance.

Many scholars research on influence of downsizing on employee performance, while some research was based on impact of downsizing, as a strategic cost reduction, on firm performance in manufacturing industry. Some literature that considered cost reduction strategy employed by banks to improve firm performance used one or two banks as a case study. However, the researcher is not aware of any study that examines the influence of downsizing of staff and reduction in staff salary, among old generation banks in Nigeria, on the level of banks profitability. Therefore, this study stands to fill the gap.

3. Design and Methodology

The population of the study consists of ten (10) money deposit banks that are licensed with international authorization in Nigeria. Purposive sampling technique was used to select the sample frame. The sample population is: First Bank Plc, Union Bank Plc and United Bank of Africa Plc. This bank was selected because they belong to first generation of banks in Nigeria.

Survey design was employed for the study. This study obtained secondary data from the Nigerian Stock Exchange Fact-book and Annual Report and Accounts of the sample population for the period 2006 to 2016.

A linear regression analysis was used in estimating the parameter of the model. In the regression model, profitability is the dependent variable while downsizing of staff and reduction of staff salary are the independent variables. Profitability is measured by return on asset while cost reduction. Return on asset was calculated by dividing net income by total asset, multiply by100%. We used downsizing of staff and reduction of staff salary as proxies for cost reduction strategy. Content analysis was used to derive data for downsizing of staff. Where it is reported in the annual report, we measure it with dummy score (1). When it is not reported in the annual report, we score it (0). Reduction in staff salary was measured by the difference in staff strength and salary paid to the staff. We compared the years for each sample population.

The linear regression models in its functional form were specified as follows:

(PrF = f (CoRSt)).

(PrF = f (DoZi, ReSal))…………eq. 1

(PrFij = β0 + β1 DoZi + β2 ReSalj + Uij) eq.2

Bi > 0; R2 > 0.

Where:

β0 = intercept;

β1-2 = Regression Coefficients;

Ut = Error term not represented in the model;

ij = Time period of the study;

PrF = Profitability (return on asset);

DoZi = Downsizing of staff;

ReSal = Reduction of staff salary.

4. Data Analysis, Results and Discussion

Ho: Downsizing of staff and reduction of staff salary does not significantly leads to increase in bank profit level.

Table 1.Descriptive Statistics for downsizing of staff and salary reduction of staff on profitability

	N	Minimum	Maximum	Mean		Std. Deviation	Skewness
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
Profitability	10	1.12	1.92	1.6200	.07701	.24354	.868
Downsizing	10	1.00	3.00	2.5000	.22361	.70711	1.179
Reduction in salary	10	2.00	3.00	2.9000	.10000	.31623	3.162
Valid N (listwise)	10						

Source: Authors own study 2017

From the above table, profitability (PrF) has a mean score value of (1.6200). The maximum value is (1.92), while the minimum value is (1.12) and standard deviation is (0.24354). The profitability was negatively skewed with a value of (.868). This suggests a low degree of variability of the data between profitability behaviour and independent variables. Reduction in staff salary had the highest mean with a value of (2.9000), maximum value of (3.00), and minimum value of (2.00) and standard deviation of (0.31623). Downsizing of staff had the mean value of (2.5000), maximum value of (3.00) and minimum value of (1.00). Therefore, reduction in salary has the highest skewness of (3.162).

Table 2. Regression coefficient for downsizing of staff and salary reduction of staff on profitability

Model Summary[b]						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig. F Change	Durbin-Watson
1	.769[a]	.591	.474	.17663	.044[b]	1.995
a. Predictors: (Constant), Reduction in salary, Downsizing						
b. Dependent Variable: Profitability						

Source: Authors own study 2017

Downsizing of staff and reduction in staff salary explains (47.4) per cent of variation experienced in profitability level of the selected banks. This result shows that there is no significant relationship between profitability and reduction in salary with downsizing of staff.

Table 3. ANOVA RESULT: downsizing of staff and salary reduction of staff on profitability

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.315	2	.158	5.055	.044[b]
	Residual	.218	7	.031		
	Total	.534	9			
a. Dependent Variable: Profitability						
b. Predictors: (Constant), Reduction in salary, Downsizing						

Source: Authors own study, 2017

Downsizing of staff and reduction in staff salary explains (47.4) per cent of variation experienced in profitability level of the selected banks. The *f*-ratio (5.055) shows that the independent variables (DoZi and ReSal) are not the major determinants in explaining profitability (return on asset).

The independent variables are statistically insignificant because its significance value is (0.044), that is (P>0.05). So the null hypothesis is rejected while alternative hypothesis is accepted. Therefore, there is no significant relationship between downsizing of employee population, reduction of staff salary and bank profitability.

Based on the analysis above, the alternate hypothesis (Hi) is rejected while the null hypothesis (Ho) is accepted; which state that downsizing of staff and reduction of staff salary does not significantly leads to increase in bank profit level.

5. Conclusion and Recommendation

Nigeria banks faced financial crisis due to financial meltdown and government treasury single account policy. This has forced banks to employed strategic cost management in order to survive and sustain their competitiveness in banking industry. Many banks employed downsizing of employee and reduction of staff salary as cost reduction technique. This study examines the influence of downsizing of staff and reduction of staff salary on bank profitability.

The study finds out that there is negative relationship between downsizing of employee, reduction of staff salary and profitability. The implication of the study is that, laying off of staff and reducing staff salary will help to cut banks cost but did not significantly boost the profit level of the bank. It shows that there are other factors that are responsible for low profit recorded by banks in Nigeria.

It was discovered that the period after banks downsize their employee, bank performance was at its low ebb. We strongly recommend that banks can reduce their employee salary instead of laying them off. Then, salary increment can be done when the financial performance is improving. However, it was discovered that most Nigerian banks depend on government funds. Treasury single account policy in Nigeria really affects their business and banks now decided to downsize their employee. We recommend that banks should intensify on how to mobilize fund from informal business sector into banking sector. This will help to boost their business and leads to increase in revenue than laying too much emphasis on cost reduction.

Government policies should make business environment conducive for banks to thrive well during this financial meltdown. Moreover, we recommend future researchers to examine other strategic cost management tools on bank profitability in Nigeria.

6. References

Bennett, H. & Durkin, M. (2000). The effects of organizational change on employee psychological attachment: An exploratory study. *Journal of Managerial Psychology*, 15(2), pp. 126-147.

Berliner, C (1998). Cost management for today's advanced manufacturing: The CAM-I conceptual design. Boston: *Harvard Business School Press.*

Casio, W.F. (2003). Responsible restructuring: seeing employees as assets, not costs. *Ivey Business Journal Online*, November.

Clint C.; Larry W.H. & Stephen L.W. (2004).Effects of downsizing practices on the performance of hospitals. *Strategic Management Journal*, vol. 25, no. 5. pp. 405-427.

De Meuse, K.P.; Bergmann, T.J.; Vanderheiden, P.A. & Roraff, C.E. (2004). New evidence regarding organizational downsizing and a firm's financial performance: along-term analysis. *Journal of Managerial Issues*, 16, pp. 155-177.

Edward, F.R.; Wicks, A.C. & Parmar, B. (2004). Stakeholder theory and the corporate objective revisited. *Organization Science journal*, pp. 364-369.

Ellram, L.M. & Stanley, L.L. (2008). *Integrating strategic cost management with a 3DCE environment: Strategies, practices, and benefits*. *Journal of purchasing and supply management.*

Groth, J. C. & Kinney, M.R. (1994). Cost management and value creation. *California Management Review.*

Guthrie, J.P. & Datta, D.K. (2008). Dumb and dumber: the impact of downsizing on firm performance as moderated by industry conditions. *Organization Science.* 19(1), pp. 108-123

Hamed, W.; Bowra, A.Z.; Aleem, M. & Hussain, A. (2013). An empirical investigation of downsizing: A study of banking sector of Pakistan. *African Journal of Business Management*, vol. 7(17), pp. 1640-1647.

Huber.G.P. & Glick, W. (Eds). (1993). *Organizational Change and Redesign*. New York: Oxford Press, pp. 3-15.

Kathleen, G.R. (1999). The effects of financial conditions and managerial ideologies on corporate downsizing: Some evidence from the U.S. investor-owned electric utilities industry, 1992-1995. *Journal of Management*, vol. 2, no. 3, pp. 89-126.

Mentzer, M.S. (1996). Corporate downsizing and profitability in Canada. *Canadian Journal of Administrative Sciences*, 13, pp. 237-250.

Noer, D. (1993). *Healing the Wounds: Overcoming the trauma of layoffs and revitalizing downsized organizations*, Jossey-Bass, San Francisco, CA.

Oyewo B.M. (2013). Strategic cost management: a recession survival tool in the Nigerian manufacturing and financial service industries. *Research Journal of Finance and Accounting*, 4(11).

Robert D.; Nixon, Hitt; Michael, A.; Ho-Uk Lee & Eui, Jeong (2004). Market reactions to announcements of corporate downsizing actions and implementation strategies. *Strategic Management Journal*, vol. 25, no. 11. pp. 1121-1129.

Sadri, G. (1996). Reflections: The impact of downsizing on survivors: some findings and recommendations. *Journal of Management Psychology*. 11(4), pp. 56- 59.

Siyanbola, T.T. & Raji, G.M.(2013). The impact of cost control on manufacturing industries profitability. *International Journal of Management and Social Sciences Research*, 2(4).