OBAFEMI AWOLOWO UNIVERSITY

OUTSOURCING AND PERFORMANCE OF BANKS IN NIGERIA

By

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CERTIFICATION

This is to certify that SANUSI BOLANLE MISTURA carried out this research work under my supervision in the Department of Management and Accounting, Faculty of Administration, Obafemi Awolowo University, Ile-Ife.

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"Oh Allah! I seek your protection

Against knowledge which does not benefit

Against the mind which is not lifted to God

And against the supplication which is not acceptable by Him (Hadith)."

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

Abstract

This study examined the services outsourced in the Nigerian banking industry and analysed the factors influencing outsourcing decisions in the industry. It also assessed the perceived benefits and risks of outsourcing activities of banks; and examined the effects of outsourcing activities on banks' performance in Nigeria. Furthermore, it investigated the challenges facing outsourcing in the industry. These were with a view to providing information on the extent to which banks engage in outsourcing; and on how outsourcing would contribute to banks' efficiency and performance in Nigeria

Primary and secondary data were used for the study. The primary data were sourced through administration of structured questionnaire to selected employees of 20 out of 22 post-consolidated banks in Nigeria. The banks selected were those having their headquarters based in Lagos. Questionnaire was administered on four categories of people in the selected banks, namely: the management; non-management and outsourced staff; as well as vendors of the outsourced activities. Eight respondents were purposively selected from each of management, non-management and outsourced staff while six respondents were selected from the vendors of the outsourced activities. On the whole, 30 respondents were purposively selected from each of the 20 post-consolidated banks. In-depth interview was conducted on one management staff each from the banks. In all, 620 respondents were used for the study; 600 for the questionnaire administration and 20 for the conduct of in-depth interviews. Secondary data on variables such as size, cost, profitability were also collected from the Nigeria Stock Exchange (NSE) Fact book. Data collected were analyzed using content analysis, descriptive and inferential statistics.

The result showed that the services outsourced in the Nigerian banking industry included security (87%); cleaning (75.4%); recruitment and training (71%); Automated Teller Machine

(ATM); Information Technology (IT) units (50.6%); and marketing and promotion (20.9%). The results also showed that the factors influencing outsourcing decisions in the industry included bank size ($t = 6.32$, $p < 0.05$); cost ($t = 2.67$, $p < 0.05$); and profitability ($t = -0.28$, $p > 0.05$) The results further revealed that core competencies (95.8%); reduction in staff headcount/size (94.8%); curtailing and preventing industrial disputes (90%); cost reduction (89.8%); and reduction in managers' burden and meeting targets (78.3%) were the perceived benefits. In addition, inadequate expertise to oversee the service providers (42.6%); poor supplier leading to additional cost (26.6%); and suppliers' failure that might damage the reputation of the banks (22.2%) were the perceived risks associated with outsourcing in the banking industry. Furthermore, the results showed that outsourcing activities had positive significant effect ($t = 9.02$; $p < 0.05$) on banks' performance in Nigeria. Finally, the results revealed that the challenges facing outsourcing in the Nigerian banking included failure to adhere to quality requirements and specification (34.2%); increase in the cost of outsourcing administration and provision (28%); dilution of control (26.2%); poor structure to manage the outsourcing functions well (15.6%); and poor planning (14.8%).

The study concluded that Nigerian banks' engagement in outsourcing activities had contributed significantly to their overall performance in Nigeria.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The roles of banks in a nation's economy have been accentuated all over the world as to their contributions to total productivity and job opportunities. In developing countries, banks play significant roles as sources of employment generation and funding for real sectors of the economy. Hence, emphasis is being placed on the healthiness and stability of banking sectors by policy makers across the globe. However, the state of the Nigerian banking industry and the diagnostic survey of the banks as stated by the Central Bank Governor (2004) in the consolidation programme showed that the Nigerian banking industry was plagued with persistent liquidity problems, poor asset management and weak corporate governance. Also, there was a weak capital base, over dependency on public sector deposit, late publication of annual account and neglect of small and medium scale enterprises. Thus the federal government directed all sectors to undergo reform which set the context for outsourcing in banks.

The current reforms which began in 2004 with the consolidation programme were necessitated by the need to strengthen the banks. The policy thrust at inception was to grow the banks and position them to play pivotal roles in driving development across the sectors of the economy. As a result, banks were consolidated through merger and acquisition raising the capital base from ₦2b to ₦25b which reduced the number of banks from 89 to 24. Therefore consolidations became imperative to change the structure of the Nigerian banking system.

Outsourcing, the practice of charging external service providers with the task of performing in–house activities, has attracted growing interest in recent years as managers consider whether it is in their best interest to perform activities in – house or contract out to external body or bodies (Maltz and Ellram, 2000, Lewis and Talalayevsky, 2000).

There are three major categories of motivations for outsourcing: cost, strategy and politics. The first two are commonly driven outsourcing by private industries. Political agenda often drive outsourcing by public organizations (Kakabadse and Kakabadse, 2000a). While there may be three categories, outsourcing activities are likely to be initiated for more than one reason and in fact may be driven by elements from all the three categories.

Outsourcing is increasingly being used as a means of both reducing cost and achieving strategic goals (Basel, 2004). Previous authors have highlighted the advantages of outsourcing which include realizing the same or better service at lower costs, increased flexibility and/or quality, access to latest technology and best talents and the ability to refocus scarce resources onto core functions. By outsourcing functions or tasks, banks would be able to focus on the value-creating functions that drive competitive benefits (Gilley and Rasheed, 2000), improve managerial efficiency and performance and hence play its critical role in the development process of the economy. Hence, outsourcing of services enables a firm's capabilities to be improved by better performance. Earl 1996 identified 11 risks which were due to lack of proper monitoring and inappropriate management. However, despite the optimism about the benefits associated with outsourcing, evidence abound that the process might incur some significant risks (McFarlan and Nolan, 1995; Lacity and Hirschheim, 1993).

Outsourcing is a fast growing aspect of the world economy with a worldwide spending of about US$ 3-7 trillion in 2001 (Clott, 2004). Although there are good reasons for outsourcing a number of potential obstacles associated with outsourcing are recognized. The banking industry is currently facing stiff competitions from new banks and financial institutions in terms of performance and service delivery to the intended customers in the society.

More specifically, despite the significant rise in outsourcing activities in the banking sector in Nigeria, there is sparingly little attention paid to the issue of outsourcing activities in terms of trends, types and implication of outsourcing on bank performance in the literature on Nigerian economy. Most of these studies concentrated on issues relating to corporate governance, risk management, merger and acquisition. Evidence from other countries like Kenya, Ghana and South Africa which adopted similar policy in the past have shown that consolidation exercise induced several other activities like outsourcing that have direct implications on the efficacy and performance of the banking industry. Also, issues relating to factors influencing banks' decision to outsource and the type of activities to be outsourced are yet to be explored. Given the fact that the federal government gave a directive for all parastatals to undergo reforms, guidelines were issued in March 2006. Further directives came to all parastatals to restructure by the end of July 2006. These directives set the context for outsourcing in banks.

1.2 Statement of the Problem

Banks today operate in an environment marked by growing consolidation, rising customer expectations, increasing regulatory requirements, technological innovation and mounting competitions. Additionally, pressures to deliver improved transparency, and risk management, reduce costs and successfully navigate an ever-changing and consolidated financial ecosystem is adding to the complexity. As resources in the financial services industry continue to become even more strapped, institutions are turning to outsourcing as a way to reduce cost.