

Performance Measurement in the United Kingdom (UK) retail banking industry

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Abstract

The assets size of the UK commercial banking industry accounts for a significant proportion of the European commercial banking total assets. Given the developed nature of the UK country and its attendant economic transitioning; the significant growth in the financial service industry; the divergence of banks' ownership structures; recurring incidence of business combinations; proliferation of financial institutions; strategic cost management; and lax regulation in the UK banking industry, it is considered important to examine the Performance Measurement Systems (PMS) adopted by UK retail banks to cope with these vagaries. Besides, studying the PMS utilised by banks operating in leading economies like the UK, could provide useful insights, guidance, and practice-adoption for other developed and emerging nations. The research was undertaken to address these concerns. Data was collected through a survey of 15 UK retail banks. **Statistics such as charts, percentage analysis, Wilcoxon signed rank test, Pearson Chi – square, Kruskal Wallis test, and Mann- Whitney U test were utilised for data analyses.** There is empirical evidence from the study that within the UK retail banking industry, the three most common PMS utilised are; the Balanced Scorecard, Performance dashboards, and financial performance measures. Notwithstanding that the PMS in the UK banking industry is symmetrical across banks, and relatively balances a mix of financial and non-financial measures, it is the recommendation of this research that the UK banking industry can be improved by making PMS more flexible in order to embed and account for changes in banks' strategies.

Keywords: Performance measurement, risk, strategy, strategic cost management, UK Banks

1.0 INTRODUCTION

The UK commercial banking industry, with total assets of \$5,513.2 billion, accounts for 26.4% of the European commercial banking total assets (Datamonitor, 2009), which is an indication of a profitable, highly developed and growing industry. The industry consists of different ownership structures within privately owned stock banks (POBs), government owned banks (GOBs) and mutual banks. However the banks are indistinguishable in terms of services provided (Iannotta and Nocera, 2007). There have been several mergers and acquisitions in the UK banking industry since 1820; a very notable one was the consolidation in 1913, which has given rise to intense competition for the past 50 years (Consoli, 2005).

Since the mid-1990s, with the reduction in operational cost through the evolution of internet banking, the UK financial industry has consisted of a diverse number of financial intermediaries; commercial banks, saving banks, building societies and retail banks. The highly fragmented banking industry is mainly induced by the liberalisation of domestic competition, increased information systems technology, and the unconstrained regulatory structure (Consoli, 2005). The bank of England was the main regulatory body until 1998 when this function was transferred to Financial Services Authority (FSA). It is one of the least regulated banking industries in the world; there is minimal regulation for foreign banks. The existence of slack regulations has made the industry highly competitive with the presence of many foreign banks constituting about 55% of the UK banking industry (Kosmidou and Pasiouras, 2006).

Given the developed nature of the UK country and its attendant economic transitioning; the significant growth in the financial service industry; the divergence of ownership structure; recurring counts of business combinations; proliferation of financial institutions; strategic cost management; and lax regulation in the UK banking industry, it is considered important to examine the Performance Measurement Systems (PMS) adopted by UK retail banks to cope with these vagaries. Besides, studying the PMS utilised by banks operating in leading economies, like the UK, could provide useful insights, guidance, and practice-adoption for other developed and emerging nations

in the world, because there have been recent calls for the assessment of performance measurement systems across emerging economies (Khan et al, 2011). The research was undertaken to address these concerns.

The paper assesses the type of PMS utilised in the UK banking industry with respect to firm characteristics such as bank's base (local or foreign), age and market position; evaluates the appropriateness and effectiveness of the PMS; and examines the interrelationship between the PMS and UK banks' strategies.

2.0 REVIEW OF LITERATURE

Performance measurement comprises of a systematic method for setting financial and non-financial targets which are accompanied by regular feedback meetings for monitoring progress against the targets (Simons, 2000). Performance measures are facilitators for the understanding, administration and enhancement of business activities. They should aid the monitoring of business strategy success through a comparison between set objectives and actual results.

A PMS should comprise of the purpose, properties and processes while integrating the benefits and challenges within the organisational context (Micheli and Manzoni, 2010). Enablers to the use of PMS include the size of the organisation, political structure, technological innovations, and regulatory policies while barriers include insufficient management time, organisational culture, unavailability of data and increased staff turnover. The ability to use PMS to support the implementation of strategy could be a distinguishing feature of PMS (Micheli and Manzoni, 2010).

It is argued that banks play a less significant role in developed countries compared to the capital market but it is still correlated to the economic development of countries especially emerging economies (Makler 2001), through its financial intermediary role. In monetary terms, the global banking industry posted total assets of \$90,880.4 billion in 2008 (Datamonitor, 2009). The banking industry has not been static over the years, it has dynamically evolved to a highly competitive and revenue mobilization industry. It has evolved from a single undifferentiated unit to differentiated and specialized units. Activities like liberalisation, consolidations, mergers and acquisitions, deregulations and the recent banking crisis have continuously sharpened the banking industry (KPMG, 2010; Munir et al, 2011). The banking industry has become one of the most regulated industries worldwide (Santomero, 2002). Regulations in the banking industry can be in various forms: restrictions on domestic and foreign bank entry, promotion of information disclosure, private sector supervision of banks, regulations on capital requirement, restrictions on banking activities with commerce, loan diversification rules, government ownership and deposit insurance system attributes (Barth, 2004).

According to Makler (2001), regulatory systems vary from country to country, however most countries embrace the Core Principles for Effective Bank Supervision (BCPs) (Demirgüç-Kunt, 2008). The BCPs are directed by each country's supervisory body. For example, in the United Kingdom, the Bank of England is the regulatory body and it communicates with the industry in various forms; Minutes of Monetary Policy Committee (MPC) meetings; the Inflation Report; speeches by MPC members (Reeves and Sawicki, 2007).

The importance of regulatory body in the banking industry is justified by several works; a recent study conducted by Naceur and Omran (2011) discloses that regulatory and institutional variables have an impact on bank performance. Their work suggests that corruption increases the cost efficiency and net interest margins in Middle East and North African (MENA) banks. Similarly, in the United Kingdom, Kohn and Sack (2003) assert that communication—in the form of written policy statements by Chairman of the regulatory body—significantly affects interest rate expectations. In the United Kingdom, Reeves and Sawicki (2007) acknowledge that financial markets react to the communication of Bank of England. Furthermore, a study across countries by Barth (2004) affirms that restricting bank activities is negatively associated with bank development and stability and rigidity of capital regulations is positively correlated with bank development. Demirgüç-Kunt (2008) noted that overall compliance with the BCPs is positively correlated with bank soundness.

Invariably, it is generally agreed that the regulatory bodies in various economies have an effect on the internal and external activities of the banking industry. This may be linked to the performance measurement system which is primarily an internal activity of the bank. A study in China, showed that government policies were a major determinant in the choice and adoption of PMS within an organisation (Li and Tang, 2009). Specifically, regulations that affect the competitive nature of the industry affect the performance measurement structure (Tan and Rae, 2009). In 2001, the Basel committee encouraged the measurement of operational risk within the

banking industry (Basel committee, 2001). Also, the effect of regulators on the performance measurement in an organisation is dependent on the size of the organisation (Tan and Rae 2009). Therefore it is possible for the regulatory body to make directives that directly or indirectly influence the choice and usage of a PMS within the banking industry.

In the banking industry, there is a wide range of performance measures used within the PMS, including: financial measures/ratios; the Economic value added (EVA); performance dashboards; the European Foundation for Quality Management (EFQM); and the balanced score card (BSC) developed by Kaplan and Norton (2001). The dynamism in the banking industry has caused performance measures to evolve from the traditional financial variables to the inclusion of customer based measures. In the measurement of customer satisfaction, the following variables are used: customer retention rate, customer complaints rate and customer acquisition rate. Customer satisfaction is driven by the reputation of the bank and interpersonal relationships with banking officers, waiting time, variety of services, appearances and service processes (Mihelis, 2001). There is a strong link between customer satisfaction and referrals by word of mouth, and the willingness to pay first-rate prices (Arbore and Busacca, 2009). Customer based measures are related to the financial measures, for example customer satisfaction has an effect on the account retention rates, the average deposits and future earnings of the bank (Nagar and Rajan, 2005).

Risk measurement is increasingly becoming important in performance measures especially with the aftermath of the financial crisis. In 2001, the Basel committee encouraged the measurement of operational risk in the banking industry. Operational risk accounts for loss from internal and external events (Basel Committee, 2001). Other specific risks measured are capital risk, liquidity risk, credit risk, and market risk. However, it may be ambiguous to define and measure risk in the banking sector as a result of the enormous number of transactions within the system. (Wahlström, 2006).

Contemporary works have called for the identification of connections between PMS and Strategy, as well as the linkage of strategy to performance measures (Pun and White, 2005). Neely et al (2002) maintained that there is a relationship between the appropriateness of the PMS and its relationship with the bank's strategy in a developed economy.

The importance of developing employees in the field of management has grown over the years. Banks now recognize the importance of training and investing in staff who invariably offer the services to the customers. (Jackson and Sirianni, 2009). Employee development in the field of performance management has become vital in improving overall performance. (Gruman and Saks, 2011). Within the bank, performance measures relating to employee like employee satisfaction, employee turnover rate and employee capabilities are being assessed and monitored.

It is important to note that these measures are not independent of each other but rather there is dependence amongst them. According to the third era of PMS, there is a synchronisation between the performance measures (Kunc, 2009). Similarly, Kaplan and Norton (2000) advocate the interrelationships between performance measures. In the banking industry, there are multiple relationships between the measures; an increase in customer service could lead to financial returns. The optimization of business processes increase customer satisfaction as well.

3.0 RESEARCH METHOD

The study adopted a survey research using questionnaire as research instrument, which featured both open-ended and closed ended questions. Closed-ended questions enable the explanatory analysis using quantitative tools while the open-ended questions enable the exploratory and descriptive analysis. Furthermore, majority of the closed-ended questions are in the Likert format; this also enables the efficient coding and appropriate classification of the data collected (Klooster, 2008).

An exploratory survey research was relevant to understand the use of PMS in the banking industry and explanatory research was adopted to verify relationships among study variables. Some of the hypothesized relationships were between; the type of the PMS and each of the following; the effectiveness of the PMS, market position of the bank, and age of the bank. The multiple stage sampling method was employed, so as to include different **categories of banks**. The sample size for the survey was 15 banks from the population size of 21 UK retail banks.

Copies of the research instrument were administered to banking officers that understand the current performance management systems of their individual banks within specific units including: Strategy, Human Resources and Performance management. The choice of these personnel in the bank was based on their direct involvement in the development and usage of PMS. The chosen method of the questionnaire distribution was web-based, which enables the survey to be sent directly to the targeted respondents and can be filled at the respondent's convenience. Furthermore, the loss of questionnaire in transit is minimized.

Statistics such as charts, percentage analysis, Wilcoxon signed rank test, Pearson Chi – square, Kruskal Wallis test, and Mann- Whitney U test were utilised for various descriptive and inferential analyses.

4.0 DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Characteristics of the PMS in the UK Banking Industry

Anderson and McAdam (2004) classified PMS into two broad categories— Traditional and Innovative.

Traditional PMS show properties of cost efficiency, profit measurement, short term measures and individual measures. Innovative PMS is based on non-financial measures, customer-based measures, long term measures, and team-work measures.

The analysis of PMS characteristics was done using this categorization. The result is graphed in figure 1.

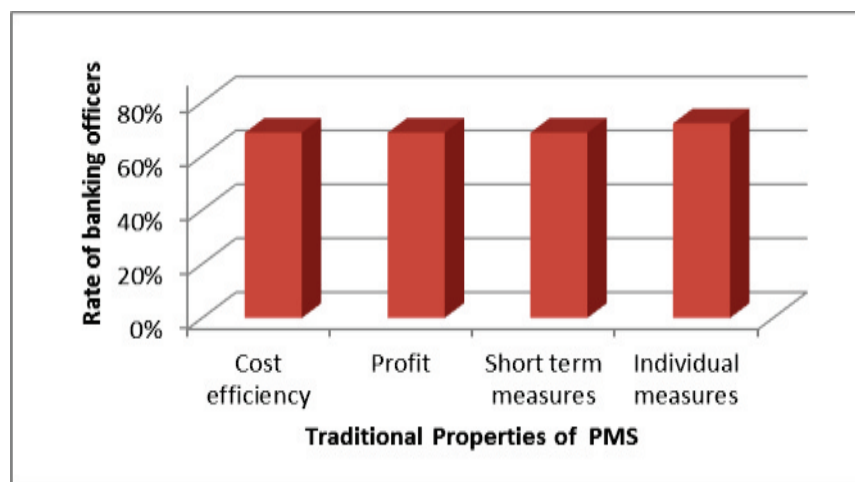


Figure 1: Classification of UK Banks' PMS as traditional

The evaluation of the PMS in the United Kingdom banking industry reveals some content of traditional properties. On the other hand, an evaluation of the innovative properties in the PMS reveals a high focuses on non-financial measures particularly customer based measures; the use of team measures is average and not as high as the other innovative properties of the PMS (Figure 2).

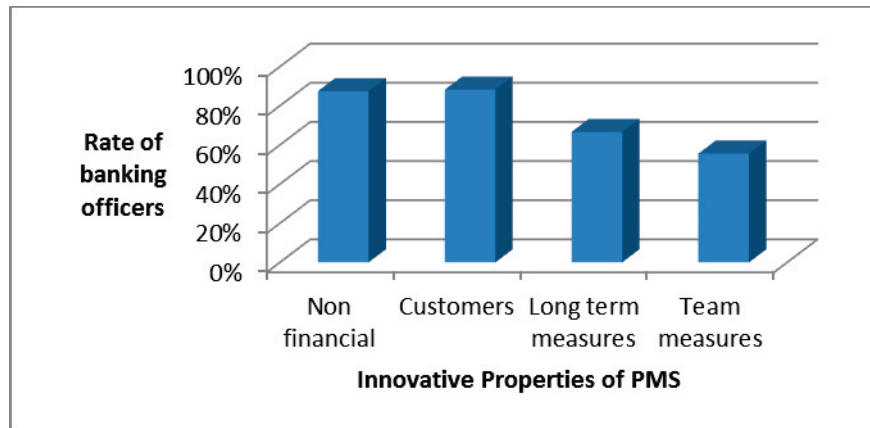


Figure 2. Classification of UK Banks' PMS as Innovative

A comparison between the levels of traditional and innovative properties in the banking industry reveals that the respondents recognise the non-financial measures as more utilised in their PMS compared to the financial measures. Similarly, the PMS is focused more on customers than profit measures. The utilisation of long and short term measures is about the same level but there is more evidence of individual measures compared to team measures. The analysis of traditional and innovative characteristics is contained in Table 1.

Table 1: Rate of using Traditional and Innovative PMS by UK Banks

PMS characteristics	Cost efficiency/ Non-financial measure	Profit/Customer	Short / long term measures	Individual/ Team measures
Traditional	69%	69%	69%	72%
Innovative	88%	88%	67%	56%

The use of an inferential test examined if there is a significant difference in the composition of traditional and innovative measures by comparing the median of the responses. Wilcoxon test at 1% significance level indicates that there is no significant difference ($p = 0.915$) between the composition of traditional and innovative properties in the UK retail banking industry.

Table 2: Hypothesis Test summary for difference between Traditional and Innovative PMS of UK banks

Null Hypothesis	Test	Sig.	Decision (at 1% significance level)
The median of differences between Traditional and innovative equals 0	Related-samples Wilcoxon Signed Rank Test	.915	Retain the null hypothesis

Overall, PMS in the UK retail banking industry have a combination of both traditional and innovative properties. The innovative properties seem stronger in composition except in the inclusion of team based measures; however, the difference in the composition of traditional and innovative properties is not significant. This implies that the PMS in the UK banking industry is not fully innovative and some innovative properties need to be improved upon for a more efficient PMS.

4.2 Types of PMS utilised according to bank classification

Assessing the relationship between the PMS used in the UK banks and the bank's characteristics should also provide further insights into the PMS adopted by retail banks in the UK. The characteristics to be assessed are the ownership of banks and age. With the UK banking industry consisting of 55% foreign banks, it is important to assess whether there is a difference in the PMS utilised between the domestic and foreign banks. An evaluation shows that domestic banks utilise more traditional PMS compared to the foreign banks (Table 3). This may be attributed to the need for the foreign banks to compete favourable in the market; they recognise the need for a more advanced PMS.

Table 3. Rate of PMS utilization across UK Banks' Base and Age

PMS characteristics	Bank's base		Bank's Age	
	Domestic	Foreign	Below 100yrs	Above 100yrs
Traditional	43%	17%	13%	36%
Innovative	57%	83%	88%	64%

Inferential statistics—the chi square test— shows there is no significant association between the PMS employed and the classification of banks according to foreign and domestic banks ($p > 0.05$ at 0.211). This result may be related to the fact that a number of foreign banks are from developed countries and therefore are exposed a similar use of innovative PMS.

In the assessment according to banks' ages, the sampled banks can be classified into two according to their ages: below 100 and above 100 years. From the descriptive analysis, the banks below 100 years utilise more innovative PMS compared to the banks above 100 years.

Using chi square test, with a p value > 0.05 at 0.243, this does not show a significant association between the ages and the type of PMS employed. This result may be attributed to the fact that a large number of the banks below 100 years are older than 50 and the banks in the UK are highly developed despite their varying ages.

Table 4: Evaluation of Banks' characteristics that influences the type of PMS adopted

Banks' Characteristics	Statistical result	Interpretation at 5% significance level
Bank base	0.211	Insignificant
Age of bank	0.243	Insignificant

Overall, the utilisation of PMS is not influenced by the ownership of the banks or the ages of the banks. These results may be attributed to the developed UK banking industry which consists of highly established banks within its market. These banks may have incorporated standardized and international best practices during their developmental processes which have initiated the use of more innovative PMS.

4.3 Specific type of PMS utilised in the UK Banking industry

An evaluation of the PMS utilised in the UK retail banking industry shows that the three most popular PMS are the financial measures, the balanced scorecard and the performance dashboards. Specifically, 67% of the bank officers describe their PMS as financial measures and Economic Value Added, 61% as the balanced scorecard and 49% as the performance dashboards (Table 5).

Table 5: Type of PMS adopted in the UK Banking industry

S/N	PMS	Rate of utilisation
1.	Financial measures	67%
2	EFQM model	43%
3	Performance dashboards	49%
4	Strategic measurement Analysis and Reporting technique	31%
5	Performance Measurement Questionnaire	12%
6	Results and Determinant Matrix	12%
7	Balanced Scorecard	61%
8	Comparative business score	6%
9	Performance prism	18%
10	Cambridge Performance Measurement Process	0%

The result of the most common PMS in the UK banking industry shows a mix of traditional and innovative properties. The balanced scorecard (BSC) and performance dashboards provide a mix of traditional and innovative properties, while the use of strict financial measures provides the traditional properties. The result of the BSC being a common PMS in this industry is in corroboration of the work of Letza (1996) who stated that the BSC has been utilised in some UK banks.

An evaluation on the performance measures in the UK banking industry reveals a “balanced” combination. The findings show a spread of financial, customers-based measures, employee growth, internal business measures and others. Interestingly, financial measures account for less than 50% of the identified performance measures; some of the specified financial measures are sales, profit, and return on investment. The customer based measures account for 22% of the identified measures; customer satisfaction, number of customers, relationship with client. Similarly, the employee related measures account for 22% of the identified measures; they include employee engagement, staff turnover, career progression, job rotation, amongst others. Internal business measures account for 10% of the identified measures; these include minimal waste, incident/ error rate and service time. The inclusion of other measures which cannot be assigned to any of the four perspectives accounts for 13% of the identified measures; innovation, continuous improvement, risk, fraud and security. Figure 3 shows the analysis.

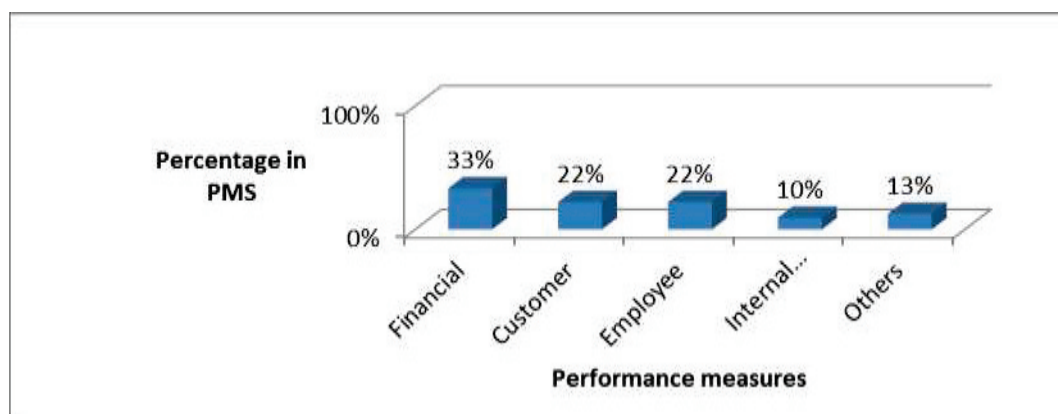


Figure 3. Distribution of PMS using the balanced score card perspectives

The result of evaluation shows that the system is balanced to a large extent, as no performance measure accounts for over 50% of the PMS measures. This outcome corroborates the innovative nature of the PMS used in UK banking industries; the spread may be linked to the developed and established banking system of the country.

4.4 Appropriateness and effectiveness of the PMS in UK Banking industry

According to literature review findings, the appropriateness and effectiveness of a PMS can be assessed based on the following factors— account for the externalities within the industry, consideration of internal resources and stakeholders, and account for difference time frames (Richard, 2009). The assessment of the appropriateness and effectiveness of the PMS shows varying degrees across the factors. Results are summarised in table 6.

Table 6: Assessment of the appropriateness and effectiveness of PMS in the UK banking industry

Factor	Account for externalities	Internal resources	Stakeholders	Past, present and future
Rate	43%	86%	19%	80%

The relatively low account for externalities and stakeholders may be as a result of the loose regulatory system in the UK banking industry. Consoli (2005) describes the regulatory system as one of the least regulated in the world. A further reduction in the account for stakeholders may cause a reduction in the attractiveness of investment in the UK banking industry.

The characteristics of the bank may influence the appropriateness and effectiveness of the PMS. Using Kruskal-Wallis test to determine the effect of base/ location of head offices (local or foreign) on the appropriateness and effectiveness of the PMS adopted indicates that there is no significant effect between the classification and the appropriateness of the PMS adopted. With a $p > 0.05$ at 0.364, there is no significant difference in the appropriateness of PMS between the bank classifications. The insignificant difference in the classification may be attributed to the similarities in the bank classifications. Foreign banks in the UK are as highly developed as the domestic banks in the UK with over 75% of the foreign banks are from the EU countries (Kosmidou and Pasiouras, 2006).

In the assessment of the impact of age on the appropriateness of PMS; the banks in UK were classified according to their ages. The Kruskal Wallis test indicates that there is no significant effect of age on the appropriateness of the PMS with $p > 0.05$ at 0.787. The result may be attributed to the maturity of many of the retail banks in UK; hence a bank's age does not give it certain advantage(s) over another.

Furthermore, market competitiveness may have led to the utilisation of more appropriate PMS by highly positioned banks. Using Kruskal Wallis test, result shows there is no significant difference in the appropriateness of the PMS across banks' market positions at 5% level of significance (p value of 0.074). The result could be attributed to the effort of the top banks to retain their market share and hence the utilisation of more appropriate PMS in comparison with other banks within the same industry. This could promote the continuous consolidation of top banks with weaker banks.

Table 7: Evaluation characteristics that influence the utilisation of appropriate and effective PMS

Bank's Characteristics	Statistical result	Interpretation at 5% significance level
Bank base	0.364	Insignificant
Age of bank	0.787	Insignificant
Market Position	0.074	Insignificant

An assessment of the relationship between the PMS type and its appropriateness and effectiveness as in table 8 shows that there is no significant relationship between the PMS employed and the appropriateness of the PMS within the banking industry ($p > 0.01$ at 0.381). This result may be related to the large percentage of innovative PMS used within the banks which minimizes the effect of the use of some traditional PMS.

Table 8: Hypothesis Test summary for relationship between PMS type, appropriateness and effectiveness

Null Hypothesis	Test	Sig.	Decision (at significance level)	1%
There is no significant relationship between the PMS employed and the appropriateness	Related-samples Wilcoxon Signed Rank Test	.381	Retain the null hypothesis	

4.5 Interrelationship between PMS and strategy in the UK Banking Industry

Gimbert (2010) posited that the presence of PMS does not automatically lead to a SPMS (Strategic Performance Measurement systems). It is a deliberate act for PMS to be linked to the strategy of the firm. In order to test for the linkage between strategy and PMS, the following factors were used as assessment basis; the effect of a change in strategy on performance measures, linkage between the goals and the performance measures, the rate at which PMS translates the goal of the organisation, the utilization of performance measures in strategy reformulation, and the utilization of PMS in making strategic decisions. Table 9 shows result obtained from response analysis.

Table 9: Evaluation of the link between strategy and PMS in the UK Banking industry

Factors	Effect of change in strategy on change in PMS	Linkage of goals with PMS	Transition of goals to PMS	Strategy formulation using PMS	Strategic decision using PMS
Rate	41%	79%	68%	63%	60%

The result showed no significant variation across the bank characteristics; age, market position, and base (local or foreign).

Furthermore, it is important to test if the use of specific PMS influences the interrelationship between the PMS and the strategy of the bank. Using Kruskal Wallis test, there is no significant relationship between the type of PMS and the alignment with strategy ($p > 0.05$ at 0.288). This is in accordance with Gimbert (2010) that the PMS need to be deliberately linked to the strategy of the organisation.

Table 10: Hypotheses Test summary for relationships between PMS type, strategy, and appropriateness

Null Hypothesis	Test	Sig.	Decision
The distribution of PMS strategy is the same across the PMS types	Independent-samples Kruskal-Wallis Test	.288	Retain the null hypothesis (at 5% significance level)
The distribution of PMS appropriateness is the same across categories of PMS strategy	Independent-samples Kruskal-Wallis Test	0.067	Reject the null hypothesis (at 10% significance level)

A key element to the appropriateness of PMS is the interrelationship between the PMS and the strategy of the organisation (Kennerly and Neely, 2002). This is the reason for the assessment of the appropriateness of the PMS at different levels of interrelationship with strategy. Using the Kruskal Wallis test, at 10% level of significance, there is a variation in the appropriateness level (table 10) and this is in line with the work of Kennerly and Neely (2002). Stated in other words, the appropriateness of the PMS in the UK banking industry will increase as the PMS are further linked to banks' strategies.

5.0 CONCLUSION

There is empirical evidence from this study that within the UK retail banking industry, the three most common PMS utilised are; the Balanced Scorecard, Performance dashboards, and use of financial measures. The industry is characterised by the use of both traditional and innovative PMS. There is also a mix of financial and non-financial measures such as; customer-based measures, employee-based measures, internal business processes, and risk measures. In assessing the interrelationship between the PMS and the strategy of UK banks as advocated by Kaplan and Norton (1996), it was observed that there are strong indications as to a relationship between the PMS and the bank's strategy, except change(s) in PMS as the strategy changes. However, no specific bank characteristics; age, base/ownership structure, and market position shows a significant association with the PMS adopted in the banking industry.

The PMS in the UK banking industry is symmetrical across banks and has a relatively balanced mix of financial and non-financial measures; this notwithstanding, the PMS in the UK banking industry can be improved by increasing its flexibility to account for changes in the bank's strategy. Considering that there is an interrelationship between strategy and performance measures, it is recommended that organisational strategies should be linked with the performance measures in order to develop an efficient PMS. This will increase its direct relationship with strategy, thereby improving its appropriateness within the industry. Also there is a need for the UK banking PMS to account for more externalities and all stakeholders. Further researches could be carried out by expansion of the work to assessment of PMS utilisation in different sectors of an economy. Transnational comparative analysis of different industries could also be carried out to advance knowledge.

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