



## A Critical Review of Literature on Performance Contracting

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### Abstract

Public sector reforms aimed at making the public sector efficient in provision of goods and services has been around since the world financial crises of the 1980s that resulted from the unprecedented surge in oil prices and the collapse of centrally planned economic systems of the eastern bloc. These reforms have been characterized by adoption of prudent management of resources through introduction of financial and non-financial controls. One of the key pillars of public sector reforms is the introduction of performance contracting. This paper critically looks at studies conducted on the subject identifying consensus among scholars and controversies as well as gaps that exist in the literature on the subject. Though performance contracting has received positive reception, it is evident that its implementation has not been without challenges.

**Key words:** Public sector, Civil service, State corporations, performance contracting, public sector reforms

### 1. Background

The quest for productivity improvement goes back to the beginning of civilization. The invention of stone tools, fire and iron are some of the oldest indicators of human endeavors to produce more (International Society for Performance Improvement (ISPI), 2006). Economists in the 17<sup>th</sup> and 18<sup>th</sup> century developed theories to explain performance. The initial theories held that hungry workers would be most productive. This was however challenged by philosophers such as Adam Smith who argued that productivity would increase if workers were paid according to performance (ISPI, 2006). Measuring performance enhances performance both to the individual and the organization and encourages a culture of continuous improvement (Letsoalo, 2007). Performance measurement in public service help in gaining public confidence that tax revenues are being used effectively (Chartered Institute of Management Accountants (CIMA), 2010). Nzube and Njeru (2013) argues that an effective performance management system define expectations and align individual performance goals with those of an organization.

Early performance management systems were fairly simple and mainly focused on employee in ranking and comparing individuals with others (Cardy & Dobbin, 1986). In the 1970s, most countries in Europe and Americas adopted the Japanese systems of Total Quality Management with emphasis on teams rather than individuals as the focus of productivity improvement. In the 1980s and early 1990s, the 360 degree appraisal systems were introduced. More recently, the balanced score card performance management system that link individual targets with organizational strategy have been adopted by many organizations. Performance management may be seen as a control mechanism employed by the top management to guide, control and monitor the actions of juniors to ensure that they contribute to the strategy of the organization (Mackie, 2008). An effective performance management should go beyond control and focus on performance improvement by encouraging learning (Werner & Desimone, 2009)

Performance contracting as a management tool was originally developed for private enterprises but has been adopted by the public sector (Lin & Lee, 2011). The private enterprise adopted performance contracting as they have limited resources and have to innovate to achieve higher performance. In addition, it is easy to measure performance in the private sector as their main measure is profitability while public sector has many and sometimes conflicting goals. Introduction of performance measurement in most organizations is influence by the presence of tangible outputs that are easy measure and organizational environment which include support by stakeholders and political class in the case of public entities (Dooren, 2006). Mackie (2008) is of the opinion that the aim of performance management system is to introduce systematic controls and regulating activities of an organization to attain agreed objectives.

#### 1.1 Evolution of performance contracting

Performance contracting in the public service emerged with adoption of what scholars have come to refer to as New Public Management (NPM) theory which originated from the Public – Choice theory (Gruening, 2001). Three sets of pressures precipitated the emergence of NPM. The first was the global economic crises of the 1970s and 1980s that resulted from the unprecedented surge in oil prices. This eroded the ability of state to provide goods and services which had been extended to citizenry during times of abundance (Mutahaba, 2011).

The second set of pressure arose due to the collapse of the centrally planned economic systems of what was then referred as the eastern bloc. This led to most government reassessing the role of state in provision of public goods and services. There was broad consensus on the need to reduce the role of the state and allowing the private sector to take over the role of provision of services to the public (Mutahaba, 2011).

Ayee (2008) argues that the emergence of neo-liberals in the United States and the West in general advocating for ‘rolling back of state’ had a big influence in the reforms that were initiated in public service from the 1980s to date. The ultimate goal of these reforms was raising the quality of service to citizens and promotion of social-economic growth (ECA, 2010).

## 1.2 Performance Contract on the global scene

The first practitioners of NPM emerged in United Kingdom (UK), New Zealand and Australia, the United States of America (USA) and eventually to the rest of the world (Gruening, 2001).

According to Gruening (2001) and Mutahaba (2011), NPM was identified as having the following characteristics; outsourcing of non-core functions, budget cuts, user charges, separation of politics and administration, improved financial management, accountability, performance auditing, privatization, use of information technology and improved accounting.

France in the late 1960s was the first country to introduce PC as a performance improvement tool in the public service before it was adopted in Pakistan, Korea and later India. By 1990s, PC model had been adopted in management of public service in many countries (Kobia & Mohammed, 2006).

In Africa, the end of colonialism brought with it tremendously expansion of public service. Employment in to the public service was used by leaders to reward cronies for loyalty and as a way of ensuring that crucial services were not left in the hands of foreigners (Mutahaba, 2011). This situation led to ballooning of wage bill relative to Gross domestic product leading governments to borrow from multi-lateral lenders to meet operational costs (Lienert & Modi, 1997). The inability of governments to meet operational costs leading to borrowing from multilateral donors was the trigger to public service reforms as the lenders specifically the World Bank and the International Monetary Fund forced most government to reform their public service under structural adjustment programme (Mutahaba, 2011). Larbi (2010) argues that the World Bank has been responsible for introduction of performance contracting in several developing countries. The focus of most reforms initiated by World Bank in public sector management was targeted at cost containment.

Swaziland enacted The Public Enterprise Act of 1989 to focus on control of semi-autonomous state agencies sector following public outcry that they were a drain to the economy while Gambia placed strategic state corporations and departments under PC (Mutahaba, 2011 and Kobia & Mohammed, 2006). Ghana introduced Civil Service Performance Improvement Programme in 1996 in which staff were to engage their clients and agree on performance improvement programme which would then form the basis on performance agreement.

### 1.2.1 Evolution of Performance contract in Kenya

The government of Kenya launched the first phase of public sector reforms in 1993 focused on cost containment with staff right sizing and rationalization of government functions and structures. This phase was mainly driven by donors and creditors especially by World Bank under the Structural Adjustment Programme (Lienert & Modi, 1997 and Kobia & Mohammed, 2006). In this phase, the following activities were undertaken; employment in public service was frozen, removal of 'ghost workers' through cleaning of payrolls, voluntary retirement, early retirement and retrenchment and removal of government guaranteed employment to new graduates were the main focus. The next phase focused on rationalization of government functions and structures to determine optimal structure and size in the civil service which was linked to budgetary limits (Lienert & Modi, 1997, Kobia & Mohammed, 2006 and Mutahaba, 2011).

In 2003, the Government of Kenya (GoK) formulated the Economic Recovery Strategy for Wealth and Employment Creation (ERWEC) covering the period 2003-2007. This policy document recognized PC as a strategy in improving performance in the public service (Kobia & Mohammed, 2006). In 2001, the GoK launched a strategy for performance improvement in the public service whose aim was to increase productivity and improvement in service delivery underpinned by results based management orientation (Gatere, Keraro & Gakure, 2013).

The first attempt at PC in the public service in Kenya was made in 1984 with Kenya Railways signing a PC while National Cereals and Produce Board signed in 1990. The initiative however floundered as there was no political will to see it through. A strategy paper recommending re-introduction of PC in state corporations was presented to the cabinet in 1991 but this too did not take off (Kobia & Mohammed, 2006 and Mbua & Sarisar, 2013).

Based on lessons learnt after the failure of the first phase of implementation of public service reforms, the focus shifted from cost containment to productivity improvement and in addition, the processes was fully controlled by the public service itself unlike the first phase that was donor driven (Kobia & Mohammed, 2006). During the second phase, initiatives aimed at reducing corruption and reduce wastage were introduced. The GoK enacted the Ethics and Economic Crimes Act, 2003 that addressed issues of ethics and corruption in the service. This was closely followed by the enactment of the Public Procurement and Disposal Act, 2005 (Kogei, Magugui, Yano, Chepkemei & Chebet, 2013). The GoK then shifted its attention to measuring performance in the public service.

The third and the current phase of reforms focused on improvement of service delivery rather than the processes. This led to the birth of performance contracting in the public service in Kenya (Kobia & Mohammed, 2006 and Mutahaba, 2011). The first batch of organizations to be put under PC on a pilot basis was sixteen (16). By 2011, a total of 468 government agencies were actively involved in PC (Office of the Prime Minister, 2012). Today all organizations in the executive arm of government that are under the national government are under PC.

The PC is seen as an effective way to provide quality goods and services within budget constraints (Kariuki, 2011). PC has been hugely celebrated and is associated with improvements in service delivery in the public sector (Muthaura, 2010). As Dooren (2006) noted, an effective performance management tool should not forever be an administrative tool; it need to become a political as well as a societal tool as well.

## 2. Review of Literature

The concept of performance contracting has attracted considerable attention from scholars due to its potential to transform service delivery. Most of the available literature has focused on employee awareness and participation, the linkage between PC and individual targets, linkage between PC and reward systems, effects of PC on performance, training and the theories that underpin the concept.

### 2.1 Theoretical framework

There is little agreement among scholar on which theory performance contracting should be anchored on though

there is consensus that it is closely associated with New Public Management (NPM) theory or movement, (Obong'o, 2009, Mutahaba, 2011, Larbi, 2014). Hood (as cited in Mackie, 2008) refer to NPM as 'a series of themes relating to reforming the organisation and procedures of the public sector in order to make it more competitive and efficient in resource use and service delivery'. NPM is associated with the various reforms initiated in the public sector with the aim of improving accountability and maximize the use of scarce resources in provision of public goods and services. There is agreement among scholars who have studied performance contracting that PC is one of the reforms that have been initiated under NPM whose main focus is making government more efficient by using less to produce more.

Ayee (2008) and Petri (2002) argue that PC is based on the Principal agent theory. There are different principal agent relationships in implementation of PC. The theory is based on the premise that both the principal and the agent want to maximize benefits. However, the principal is disadvantaged because of lack of information such as the actual ability of the agent. The agent will try and set targets that minimize risk of not attaining. The principal has to design a contract that is attractive to the agent while maximizing benefits for the principal (Ssengooba, 2010). The key question in the theory is how the principal (shareholder) can control the actions of the agent (bureaucrats) to ensure they act in his best interest. When applied to public sector, PC is a tool that is used by citizens to hold public officials accountable and in turn elected officials use it to hold the bureaucrats accountable (Larbi, 2010).

In the context of public service, in the first instance, the citizens act as the principal while the political class act as the agent. To maximize their chance of re-election, the politicians have a contract with the citizens to fulfill the campaign promises. However, the political class does not provide services to the citizenry directly. This is done through institutions that are headed by appointees of the political class who then assumes the role of principal while the bureaucrats become the agents. The politicians have an interest in re-election and hence have to meet their part of the bargain to secure it while the bureaucrats are motivated by the prestige and benefits accruing from continued occupation of office (Petrie, 2002).

To successfully implement a new performance management system, Change management theory would offer theoretical support. This theory is based on a participative bottom-up approach where systems develop within an organization supported by top management and general membership of the organization feel they own them (Mackie, 2008)

Though other theories have been used in explaining performance management, the researcher in this paper is convinced that the above theories adequately cover the concepts in performance contracting.

## **2.2 Conceptualization of key concepts**

Performance contracting is a complex concept with many variables that interact. The researcher has identified the following key variable that will be analyzed further in this section; commitment, performance management, performance measurement, stakeholder and employee involvement and performance targets

### **2.2.1 Performance management**

Performance management is concerned with encouraging behavior that leads to attainment of the organizational objectives. It creates shared understanding on how to improve performance by agreeing what need to be done and how achievement will be measured (Armstrong, 2006). Buytendijk (2009) argues that a good performance management system should focus on outcomes and not outputs. In public organizations, performance management is seen as a form of political communication (Lin & Lee, 2011). In a nutshell, performance management is a management tool that aims at aligning goals of the principal and the agent in a manner that creates a shared vision.

### **2.2.2 Performance measurement**

According to Armstrong (2006), performance measurement is the process of establishing achievements and gaps in order to provide feedback. Dooren (2006) argues that performance measurement in public sector should lead to data that feeds in to public policy. She further states that a quality performance measure should be able to measure what it is supposed to measure. Performance contracts are based on employing performance indicators that are meant to measure performance. In coming up with indicators, care should be taken to ensure that they are effective. Letsalo (2007) argue that performance measurement enhance performance both for the individual and the organization. Mackie (2008) avers that performance measurement will only succeed if there is ownership at all a level. Performance measurement does not always leads to positive consequences (Kariuki, 2011).

### **2.2.3 Commitment**

In performance contracting context, commitment is at two levels; top management and the level of employees. Top management commitment may be viewed from willingness to give energy and loyalty to implementation process (Gakure, Eliud & Karanja, n.d). Expectancy theory by Victor Vroom tells us that employee commitment to organizational goals depends on the strength of expectation that doing so will be followed by favorable outcome and the value that the individual attach to the reward (Robbins, 1991). Muthaura (2010) in a presentation on the role of Kenya's public service in a changing environment argued that people will oppose change if they do not see clear and reliable gains. This means that employees commitment is dependent on their perceived gains from implementing the system of PC. Buytendijk (2009) argues that unless performance management system gain acceptance through encouraging people to collaborate because they want to not because they have to, performance management system may actually lead to suboptimal performance by making figures look good only on paper.

### **2.2.4 Targets**

A good target should be clear and precise on what is being measured and how this is calculated without any ambiguity (Gakure, Eliud & Karanja, n.d). Dooren (2006) argues that involvement of citizens in setting targets for public sector organizations would ensure that what is measured matters to the citizens and that data is not corrupted by

managers who in any case have a stake. Mackie (2008) argues that target setting in public institution gives the government ammunition to prove to the public that public resources are being spent prudently. Setting targets ensure that there is focus in an organization and at the broader public service level; target setting may help in aligning different organizations which would ordinarily be reluctant to cooperate (Mackie, 2008)

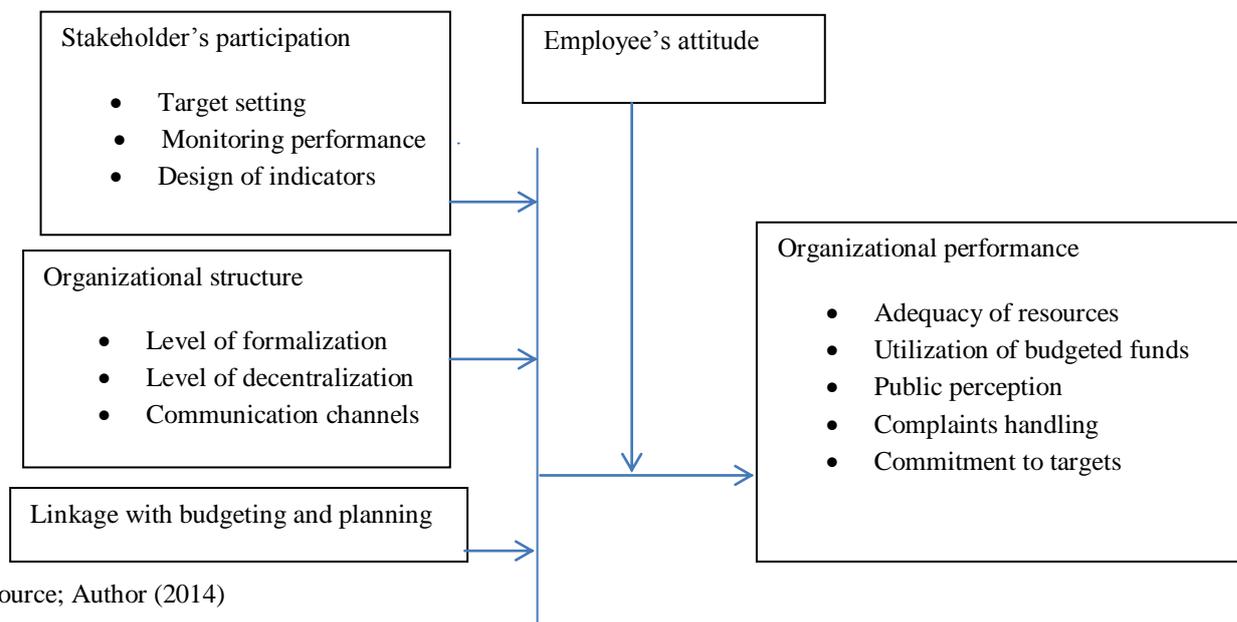
### 2.3 Empirical literature

Uusikyla and Virtanen (1999) in a study on performance contracting in Finland found that some of the benefits that were associated with its introduction were better coordination between state agencies themselves and between them and the parent ministry as well as better linkage with planning and budgeting process. In Mauritius, Chittoo (2009) found that there is very complex communication in the public service with each ministry jealously guarding its sphere of influence. This suggests that performance contracts in Africa may not have had meaningful impact on internal communication between institutions.

Research carried out by Kobia and Mohammed (2006) revealed that most employees in public service had not signed individual performance contract. Later studies have had different outcome; Letangule and Letting (2012) in a study on PC implementation at the Ministry of Education in Kenya found integration of PC and departmental work plans, Gakure, Eliud & Karanja (n.d) established that at Kenya Civil Aviation Authority, 56% of employees had signed a performance contract. In another study at Maua Municipal Council in Kenya by Kariuki (2011), the level of employee participation in PC was found to be 59% which was similar to a later study at Teachers Service Commission in Kenya by Gatere, Keraro and Gakure (2013) where employees were found to have individual contracts that were interlinked with departmental work-plans and institutional PC targets. These findings show that PC has to a great extent been cascaded to the lower levels. However, research comparing PC integration in different sectors or between line ministries and state corporations ought to be undertaken to validate the findings since most are based on single entities

Kinanga and Partoip (2013) in a study on linkage between employee productivity and participation in target setting found that most employees associated improved performance with performance target setting. These findings were similar to earlier findings by Kobia and Mohammed (2006). Kogei *et al.*, 2013 concluded that involving stakeholders in setting of targets would be crucial in ensuring greater transparency and accountability. Nzuve and Njeru (2013) in a study on PC in Nairobi County in Kenya found that 82% of employees believed that stakeholders have not been involved in performance contracting. All these studies have demonstrated the central role of ensuring that employees and stakeholder are involved in target setting in order to create ownership and by extension, commitment. However a comprehensive investigation on stakeholder involvement in PC is lacking.

### 2.4 Conceptual framework



### 3. Methodology

This was a desktop review and the researcher reviewed literature to identify the evolution, key concepts and the empirical literature available on the concept of performance contracting while identifying gaps in research. Based on the identified gaps, the researcher proposes to carry out research on performance contracting in Kenya's public service to investigate relationship between variable in the conceptual framework. Sample will be selected using stratified random sampling. This will ensure that the sample is representative of different types of organizations and that the results from the research could be generalized to the whole. Data will be collected from employees and the general public who consume services offered by the organizations that will be included in the study. Questionnaires and face to face interviews will be used to collect data. Regression analysis will be employed to analyze the data collected.

### 4. Findings

The researcher established that several empirical studies on performance contracting have been conducted especially in the last few years. However, most of the studies carried out on PC were based on individual organizations and as such cannot be used to make generalization. There is general agreement among scholars that PC has had a positive

impact on service delivery in the public service. There is also agreement on the need for greater participation by employees and the stakeholders in setting of targets and monitoring of performance.

Researchers don't seem to agree on the most appropriate theories to anchor studies on performance contracts. Several theories have been used the most common being; Agency theory, public choice theory, transaction cost theory, complexity theory, motivation theories, happiness and success theory and change management theory. Researchers are however agreed that in public sector, performance contract is closely associated with the NPM theory.

## 5. Conclusions and Recommendations

The purpose of the study was to identify research gaps in available literature on performance contracting and use the information gathered to form a research agenda for the researcher. It is evident from the reviewed literature that there is a lot that has been done and yet a lot more still need to be covered. The researcher recommends that research be carried out in the following identified areas which have not been adequately covered;

The extent to which stakeholders and employees are involved in setting of PC targets and whether their involvement has any impact on implementation of the targets

An investigation should be carried out to establish the extent to which PC targets are cascaded to all levels of the organizations and their linkage with individual performance targets. Available research is not conclusive as it is based on small samples that cannot be used for meaningful conclusions

Research should also be carried out on the effect of organizational structure on performance contracting with the aim of establishing whether the type of structure has affected employee participation, stakeholder's participation and the actual implementation of the targets

Finally, the researcher recommends that investigation be carried out to establish whether the introduction of performance contracts have improved coordination between various public agencies and whether this has also improved linkage with planning and budgeting system

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