

講演

Performance Management and Human Resource Development

The Experience of OECD Countries and Its Implication for Asia and the Pacific

Bunzo HIRAI

(Asia University)

Abstract

Performance management has been emphasized in Organisation for Economic Cooperation and Development (OECD) countries since 1980's, following the New Public Management (NPM) movement. Performance management focuses on managers' i.e. career civil servants' i) clear objectives of management, ii) managerial autonomy on resources, and iii) ex-post appraisal on performance, putting strong focus on outputs and outcomes.

In this paper the author would like to discuss on i) the use of performance appraisal for managers, ii) the use of performance related pay as an incentive to improve performance, and iii) the impact of performance management on human resource development.

The paper begins with the review of several theories on performance management and performance-related pay. The first and most influential one is the management by objectives and self-control advocated by Drucker. Others are theory of expectancy advocated by psychologist such as Lawler and Vroom, principal-agent theory in economics and goal setting theory advocated by Locke.

Then the paper turns its focus to the OECD countries' experience, based on the outputs of OECD Public Governance Committee's Network on Public Employment and Management, the author participated in, and shows some implication for Asia and the Pacific.

NPM Movement and Performance Appraisal

NPM movement initially emerged in the beginning of 1980's, mainly in Commonwealth nations (especially, United Kingdom (UK), Australia, New Zealand (NZ) and Canada) and some state and local governments in the United States (US). Two key features of NPM are largely composed of i) introduction of new management ideas into the public sector, and ii) introduction of market entity or other actors into production and distribution of goods and services produced by the public sector in order to improve efficiency through (market) competition (Aucoin 1991, Hood 1991, Osborne and Gaebler 1992).

One of the major initiatives included in the former category mentioned above is the delegation of managerial decision-making authority or autonomy from the minister, vice-minister or the center of the government to the managers of line ministries, who are in charge of provision of specific goods and services the government provides to the general public. Major managerial autonomy delegated here is usually related to financial disposition and human resource management (sometimes one of these two components influences the other, though). In turn, those line managers are forced to show their achievement or performance in the light of economy, efficiency and effectiveness. Usually they have to promise what to do (achieve) *ex ante*, then after the time-period determined in advance, they are forced to measure performance *ex post* with indicators. From time to time program evaluation shall be conducted in order to verify the validity of performance indicators, including the causal relationship of the performance measured through indicators to the impact to the society and economy in general. Agencification trend in the OECD countries is related to these ideas. In an executive agency, specific functions with single or minimal number missions are split out organizationally, the head (or executive board) has high level of financial and human resource management autonomy, and the agency has to set *ex ante* performance indicators and targets and has to have the achievement of the targets measured, which results in the reward or negative sanction.

The initiatives included in the latter category is, for example, contracting-

out (the extreme case of this is market-testing or compulsory competitive tendering), voucher, public-private partnership (in UK and nations influenced by it the term “private finance initiative” is used), user charges, transferable permits, and privatization of government enterprises as a whole. Also, utilizing non-profit organizations (civil society organizations in OECD terminology) and non-governmental organizations (this term used usually in international context), or empowering local communities and committing themselves to the provision of the goods and services which previously the public sector had provided can be sorted to this category because this might break the government monopoly of the provision of public goods and services (OECD 2005b: 129-155).

This paper mainly focuses on the former, i.e. the improvement and reform of the efficiency and effectiveness of core government establishments, which has not been and cannot be substituted by the private or non-profit sectors.

Before proceeding to the main topic of this paper “human resource development”, the relationship shall be examined between organizational performance and that of individual career officials. The original aim of NPM movement is organizational; after the 2 consecutive oil crises and stagflation caused by them (and some countries faced currency crisis or loss of commonwealth tariff privilege), most OECD countries had to struggle for “doing more with less”. They have less tax revenue and expanding public deficit and public debt under the stagnant economy and soaring inflation. They needed to stimulate economy but they did not have enough financial resource for them. Thus they tried to enhance efficiency and economy through new management ideas. Some of them are Ibbs “Next Steps” report in UK or “Government Management” report in NZ.

However, organizations are the tools with which a number of people’s efforts are consolidated and coordinated to one or few directions in order to obtain more results than the sum of the efforts of individuals without organization. Therefore in order to improve organizational performance we have to look at two constructs; one is the mechanism or framework with which an organization works effectively, in other words “coordination mechanism”.

The other is the way an individual member of an organization can maximize his/her efforts according to the organization's direction (mission).

Human resource development side of NPM plays the indispensable role in the latter side; enhancing individual members' capability in the organization. In the following sections, this paper turns the focus on human resource development side in NPM reform for organizations under core executive (ministries or departments).

Major Theories Supporting Performance Appraisal

(a) Management Science: Drucker's "Management by Objectives and Self Control"

The first management scientist who advocates the importance of goal (objectives) setting and ex post measurement might be Drucker in his early book *The Practice of Management* (Drucker 1954: 121-136). He insisted that any business enterprise must weld individual efforts into a common goal, their efforts must direct to the same direction, and their contribution must fit together to produce a whole without gaps, friction, unnecessary duplication of effort. Thus each job, especially each manager's job, must be focused on the success of the enterprise. Thus the manager must know the business goals demanded to him and his superior must know the contribution of the manager and judge him.

Drucker mentioned three patterns of misdirection; managers in charge of specialized workers do not care about whole goal of the enterprise; superiors make misdirection in the hierarchical structure of management; and various levels of management, which is insulated each other, has different vision and work.

In order to break such obstacles he advocated the introduction of "management by objectives and self-control" into management of an enterprise or company. In his proposal of "management by objectives and self-control", he mentioned five tips:

1) The objectives of every manager should spell out his contribution to the

attainment of company goals in all areas of the business.

- 2) Proper management requires balanced stress on objectives, especially by top management, thus it shall rule out “management by crisis” or “management by drives (campaigns)”.
- 3) A manager is responsible for the contribution that his component makes to larger unit above him and eventually to the enterprise. This requires each manager to develop and set the objectives his unit himself, and this is his primary responsibility, even though higher management must reserve the power to approve (or disapprove) these objectives. Further, every manager should have responsibility to participate in the development of the objectives of the higher unit he belongs to because he must know the ultimate business goals, expectation to him, and why, what his works be measured against how. This also produces mutual understanding between the superiors and the subordinate managers, which can never be produced by hierarchical “communications down”.
- 4) “Self-control” and “control from above” shall be distinguished. To be able to control his own performance a manager needs to know more than what his goals are. He must be able to measure his performance and results against the goals. It should indeed be an invariable practice to supply managers with clear and common measurements in all key areas of business. These measurements need not be rigidly quantitative; nor need they be exact. But they have to be clear, simple and rational. They have to be relevant and direct attention and efforts where they should go. They have to be reliable, at least to the point where their margin of error is acknowledged and understood. They have to be self-announcing, understandable without complicated interpretation or philosophical discussion. Each manager should have the information he needs to measure his own performance and should receive it soon enough to make any changes necessary for the desired results. This information should go to the manager himself, not to superior (not a tool of control from above). Within the limits of unethical, unprofessional or unsound behavior the company limits, every manager must be free to decide what he has to do, and only if he has all the information

regarding his operations he can fully be held accountable for results.

5) Reports and procedures should focus only on the performance needed to achieve results in key areas. They should be the tools of the man who fills them out. A man must never be judged by the quality of the production of forms he fills out; he must always be judged by his production of performance.

(b) Economics: Agency Theory

(1) Principal Agent Theory in General

In the most simple form, principal-agent theory (or agency theory) discusses two people, i.e. one principal and one agent, the latter of whom makes decisions on behalf of the former. These two do not necessarily have the same incentives. The principal can be assumed to prefer to maximize his utility. On the other hand, the agent might have his own incentives apart from his principal's one, such as to expand the agent's original wealth. Further there might be asymmetry of information between two of them. Assume the principal is the owner(s) of a company and the agent is the chief executive officer of the company. The agent has information on the management of the company, but the principal does not. In order to align incentives of them, i) the principal needs remedial measures for asymmetry of information and/or ii) the principal needs to construct the agent's reward structure through which the agent's incentive can be aligned to the principal's one (Dauma and Schreuder 1991, Kikuchi 2006).

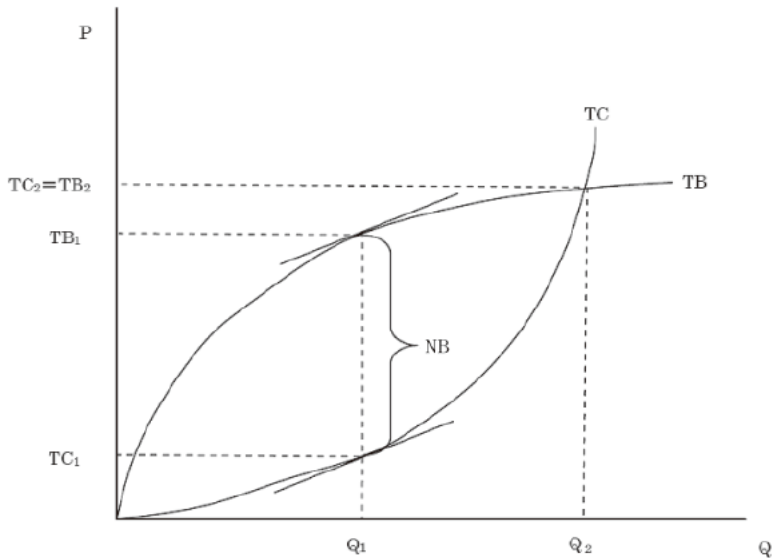
(2) Niskanen's "Budget Maximizing Bureaucracy" as an Application of Principal-Agent Theory

Niskanen's approach is an application of principal-agent theory to the Government as well as an application of public choice theory, which intends to analyze political decision-making through economic approach, i.e. methodological individualism developed by such as Buchanan and Tullock (Niskanen 1971).

In Niskanen's theory it is assumed that the Congress (which represents the general public) and the career bureaucrats with life-long tenure are in the game relationship competing for the desired level of the public service the

bureaucrats provide. Also assumed that compared to the amount (quantity) of the public service, the cost of the public service is increasing and the benefit of the public service is diminishing. The reward of the bureaucrats (not only monetary rewards but also fame, perks and privileges accompanying to the position) is positive linear function of the cost. Figure 1 is the graphical presentation of his model.

Figure 1 Niskanen's Model



P: Price of the Public Service

Q: Quantity of the Public Service

TB: Total Benefit

TC: Total Cost

NB: Net Benefit of the General Public (=TB-TC)

In his model the most efficient amount of the public service is Q_1 , where the benefit of the general public is maximized. However, because of the

asymmetry of information, i.e. the bureaucrats monopolize the information on cost and benefit of the public service, the Congress cannot but accept the level of the public service proposed by the bureaucrats unless the cost exceeds the benefit, thus the resulting level of the provision goes up to inefficient Q2. Niskanen's analysis might be one of the bases for personnel appraisal for the remedy to information asymmetry, especially for high-ranking senior career civil servants.

(c) Psychology

(1) Expectancy Theory

Expectancy theory advocated by Vroom is composed of 2 propositions. In proposition 1, "the valence of an outcome to a person is a monotonically increasing function of the algebraic sum of the products of the valences of all other outcomes and his conceptions of its instrumentality for attainment of these other outcomes." In proposition 2, "the force on a person to perform an act is a monotonically increasing function of the algebraic sum of the products of valences of all outcomes and the strength of his expectancies that the act will be followed by the attainment of these outcomes". Expectancy is a probability that an act produces the attainment of an outcome. Although the concept of valences and instrumentality are similar to the concept of utility as both are subjective, this formularization gives us some suggestion of "instrumental" role of performance appraisal and performance-related pay (Vroom 1964: 14-19).

However, Vroom mentioned in the same book that job satisfaction is negatively related to turnover and absences, but it is much less clear why job satisfaction should result in greater productivity (Vroom 1964: 175-187). Frederic Herzberg, in the book published in the end of 1950's, through empirical survey, proposed "motivation-hygiene theory" (Herzberg 1959: 113-119). Achievement, recognition, advancement, responsibility and work itself are significantly frequent events which increase job satisfaction (motivation factors), but on the other hand, company policy and administration, supervision, salary, interpersonal relations and working conditions are

significantly frequent events which decrease job satisfaction (hygiene factors). Deci, in 1970's, expanded the research on intrinsic motivation and the effect of externally mediated rewards (Deci 1975). Here we have to be careful that salary itself might not necessarily secure improvement of motivation.

Lawler narrowly focuses on the relationship between pay and performance. He positively admits the effect of pay to performance, but reserve that there is conditions in which pay does not work effectively for performance (Lawler 1971).

(2) Goal Setting Theory

Since 1970's Locke and Latham has advocated the positive relationship between goal setting and job performance (Locke and Latham 1984, Locke and Latham 2002). They have emphasized the importance of difficulty and specificity of the goals. As for monetary incentive, they are positive with some reservation. First, more commitment requires more money. Second, when the goal is very difficult, paying people only if they reach goal can hurt performance.

Trend in OECD Countries

In 2003 13 OECD countries (Canada, Denmark, Finland, France, Germany, Hungary, Italy, Korea, NZ, Spain, Sweden, Switzerland and the UK) and one observer country (at that time) (Chili) participated in case study research on performance-related pay scheme (OECD 2005a).

The main findings were as follows;

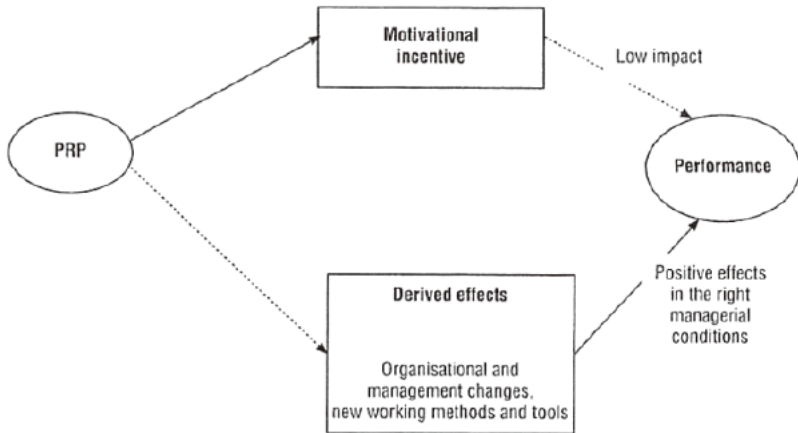
- The decentralization of the scheme was not widespread,
- There were some shift from the individual performance-related pay to collective one,
- The use of job objective as a criteria is increasing,
- Rating quota became flexible and appraisal used as dialogue rather than control, and,
- The size of performance-related pay is relatively small to total pay.

In the conclusions of OECD report the impact of the financial incentive of performance-related pay appears to be limited and other incentives are more

influential for motivating employees, such as satisfactory job content and career development, which agrees most of theories mentioned above.

The process accompanying performance-related pay has produced positive results as an impetus to improved goal setting, organizational culture change, management innovation and, thereby, to improved performance. Objective setting has to be the centerpiece of the system, as Locke and Latham mentions (See Figure 2).

Figure 2 The overall impact of performance-related pay on performance



Source: OECD 2005a: 82, Figure 3.2

Situation in Japan

In 2009 the Government of Japan started its performance appraisal system formally based on the Diet legislation in 2007 in order to enhance merit and performance in civil service system. The system is composed of performance appraisal (management by objective and self-control system) biannually, and competency appraisal (behavioral and attitudinal appraisal) annually.

The individual amount of bonus and annual pay raise has been determined based on the appraisal results since 2011. The promotion of positions and pay grades has been determined based on the results since 2012. It is too early

to evaluate the impact of performance appraisal and performance-related pay system in Japan.

Conclusion and Implication to nations in Asia and the Pacific

Most of the theories and OECD experience might suggest the effect of performance appraisal or goal setting for the improvement of individual jobs and organizational management as a whole. We should not too much emphasize the motivational effect caused by monetary incentives.

Before introducing performance appraisal or performance management system, especially under the NPM environment with delegated authority and autonomy, there might have to have some organizational infrastructure as prerequisite;

- transparency and trust of government, almost free from corruption and nepotism,
- budgetary provision adequate for constructing system and pay for performance,
- appraisal training for managers,
- monitoring of system operation (adequate implementation of appraisals), and,
- trust between the superiors and the subordinates because performance appraisal (and consecutive performance-related pay) works effectively as a communication tool between two rather than as a “carrot and horse” type monetary incentive.

Note: This article is based on the author's paper originally presented at the simultaneous workshop session (B1-2: Governability (Management)) of the Eastern Regional Organization for Public Administration (EROPA) 2013 Conference at Local Autonomy College in Tachikawa-city, Tokyo, Japan, in October, 17, 2013.

References

Aucoin, Peter 1990. “Administrative Reform in Public Management: Paradigms, Principles, Paradoxes and Pendulums”, *Governance*, vol. 3 (2), pp. 115-137.

- Dauma, Sytse and Schreuder, Hein 1991. *Economic Approaches to Organizations*, Harlow, England: Prentice Hall International, translated by Kazuhide, Okada et.al. 1994, *Soshiki no Keizaigaku Nyumon*, Tokyo: Bunshindo.
- Deci, Edward L 1975. *Intrinsic Motivation*, New York, New York: Plenum Press, translated by Nobuo, Ando et.al. 1980, *Naihatsuteki Dokizuke*, Tokyo: Seishin Shobo.
- Drucker, Peter 1954. *The Practice of management*, New York, New York: Harper & Row.
- Lawler, Edward E, III 1971. *Pay and Organizational Effectiveness: A Psychological View*, New York, New York: McGraw-Hill.
- Herzberg, Frederic 1962. *Work and the Nature of Man*, New York, New York: Thomas Y. Crowell.
- Herzberg, Frederic, Mausner, Bernard and Snyderman, Barbara B 1959. *The Motivation to Work*, New York, New York: John Willey and Sons, reprinted in 1993 by New Brunswick, New Jersey: Transaction Publishers.
- Hood, Christopher. 1991. "A Public Management for All Seasons?", *Public Administration*, vol. 69 (Spring), pp. 3-19.
- Kikuchi, Kenso 2006. *Soshiki no Keizaigaku Nyumon* [Introduction to Organizational Economics], Tokyo: Yuhikaku.
- Locke, Edwin A and Latham, Gary P 1984. *Goal Setting*, Englewood Cliffs, New Jersey: Prentice-Hall.
- Locke, Edwin A and Latham, Gary P 2002. "Building a Practically Useful Theory of Goal Setting and Task Motivation: A 35-Years Odyssey", *American Psychologist*, vol. 57 No. 9 (September), pp.705-717.
- Niskanen, William 1971. *Representative Government and Bureaucracy*, Chicago, Illinois: Aldine.
- Nobuo, Takahashi 2004. *Kyomo no Seika Shugi* [Fiction of the Performance Orientation], Tokyo: Nikkei BP.
- OECD 2005a. *Performance-related Pay Policies for Government Employees*, Paris: OECD Publishing.
- OECD 2005b. *Modernising Government: the Way Forward*, Paris: OECD Publishing.
- Osborne, David and Gaebler, Ted 1992. *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*, Reading, Massachusetts: Addison-Wesley.
- Vroom, Victor H 1964. *Work and Motivation*, New York, New York: John Willey & Sons.