



# The use of performance measurement systems in the public sector: Effects on performance



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## ABSTRACT

We study the use of performance measurement systems in the public sector. We hypothesize that the way in which these systems are being used affects organizational performance, and that these performance effects depend on contractibility. Contractibility encompasses clarity of goals, the ability to select undistorted performance metrics, and the degree to which managers know and control the transformation process. We expect that public sector organizations that use their performance measurement systems in ways that match the characteristics of their activities outperform those that fail to achieve such fit. We test our hypotheses using survey data from 101 public sector organizations. Our findings indicate that contractibility moderates the relationship between the incentive-oriented use of the performance measurement system and performance. Using the performance measurement system for incentive purposes negatively influences organizational performance, but this effect is less severe when contractibility is high. We also find that an exploratory use of the performance measurement system tends to enhance performance; this positive effect is independent of the level of contractibility. The effectiveness of the introduction of performance measurement systems in public sector organizations thus depends both on contractibility and on how the system is being used by managers. These findings have important implications, both for practice and for public policy.

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## 1. Introduction

Over the past two decades, the introduction of performance measurement has been one of the most widespread international trends in public management (Pollitt, 2006). Reforms in the spirit of the New Public Management (NPM) movement have led to major changes in the management of public sector organizations, based on the notion of competitive markets and the adoption of private sector management techniques (Groot and Budding, 2008; Hood, 1995; Pollitt, 2002; Walker et al., 2011). Although specific manifestations of NPM reforms vary over time and across

countries (Kelman and Friedman, 2009; Pollitt, 2006), they share a number of common themes (Hood, 1995; Pollitt, 2002; Ter Bogt, 2008). Two common characteristics of NPM thinking are the introduction of economic rationality and efficiency as overarching principles, and its belief in the beneficial effects of business-like management practices and instruments (Ter Bogt et al., 2010), including performance measurement practices (Brignall and Modell, 2000; Broadbent and Laughlin, 1998; Groot and Budding, 2008; Hood, 1995; Pollitt, 2002, 2006).

To promote an effective, efficient, and accountable public sector, NPM advocates a rather mechanistic notion of performance contracting in which explicit and measurable pre-set performance targets should guide civil servants' efforts towards the achievement of their organizations' objectives (Bevan and Hood, 2006; Newberry and Pallot, 2004). In this cybernetic view of contracting, performance

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measurement systems are supposed to create incentives that help to align individual goals with the objectives of the organization, provide valuable feedback information on the progress towards these objectives, and form the basis for internal and external accountability (Cavalluzzo and Ittner, 2004; Heinrich, 2002).

NPM's emphasis on the role of performance measurement systems in target setting, performance evaluation, and incentive provision is, however, problematic for two main reasons. The first of these is that NPM's exclusive focus on the role of performance measurement systems in accountability and incentive provision is too narrow. In the academic literature, it is widely acknowledged that performance measurement systems can serve various different purposes, and that they can be applied in a variety of different ways (e.g. Franco-Santos et al., 2007; Hansen and Van der Stede, 2004; Henri, 2006; Simons, 1990). By ignoring these other roles, NPM disregards the performance consequences of alternative ways of using the performance measurement system.

The second problem with NPM's focus on incentive-oriented performance contracting is that the assumed benefits meet uneasily with a large body of theoretical work in the academic literature. In this literature, the consensus is that incentive-oriented performance contracting of the NPM type can only work in conditions of high contractibility, i.e. when: (1) the goals of the organization are clear and unambiguous; (2) performance can be measured in ways that are consistent with organizational goal achievement; and (3) organizational actors know and control the transformation processes and are able to predict the likely outcomes of various alternative courses of action (e.g. Baker, 2002; Feltham and Xie, 1994; Gibbons, 1998; Hofstede, 1981; Otley and Berry, 1980). If these three cumulative conditions cannot be met, performance measures will only provide a partial representation of the organization's ultimate objectives, in which case a strong emphasis on result targets is likely to have dysfunctional consequences because the incentives induce organizational actors to focus on target achievement rather than on organizational goals. In a public sector context, this risk is particularly real (cf. Kelman and Friedman, 2009) because the goals of many public sector organizations are notoriously ambiguous (Burgess and Ratto, 2003; Dixit, 1997, 2002; Tirole, 1994), and the selection of appropriate performance measures is known to be difficult in this sector (Hyndman and Eden, 2000).

This problem is not just hypothetical. While analytical (Dewatripont et al., 1999) and practitioner (Wilson, 1989) literature emphasizes the benefits of the NPM-approach, several small-sample studies provide qualitative evidence of dysfunctional effects of performance contracting in the public sector (e.g. Bevan and Hood, 2006; De Bruijn, 2002; Newberry and Pallot, 2004). But larger scale empirical evidence on the organizational conditions that are appropriate for applying performance contracting in the public sector is still remarkably scarce (Goddard, 2010; Hood, 2007; Taylor, 2011; Van Helden, 2005), and at present, the question as to the effect of NPM-type incentive-oriented contracting on organizational performance cannot be answered conclusively.

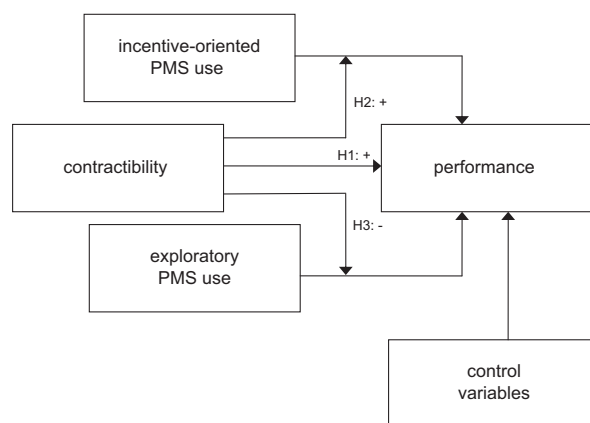


Fig. 1. Theoretical Model.

Our study aims to contribute to this debate by providing larger sample quantitative evidence on the organizational factors that moderate the effectiveness of the use of performance measurement systems in public sector organizations. We focus on two roles of the performance measurement system (incentive-oriented use and exploratory use), and on one key organizational characteristic (contractibility of performance). Building on economic and behavioural theories, we develop and test the model that is reflected in Fig. 1.

We will argue in subsequent sections of this paper that the cybernetic, incentive-oriented use of performance measures as advocated by NPM enhances performance only when contractibility is high. Relying on an incentive-oriented use when contractibility is low is likely to result in an unbalanced attention to quantifiable results, 'managing measures rather than results', and data manipulation (Marsden and Belfield, 2006; Newberry and Pallot, 2004). When contractibility is low, performance may benefit from an exploratory use of performance measures as this provides opportunities for double loop learning, mutual consultation, and adaptation to emerging insights (cf. Burchell et al., 1980). Our central claim is that public sector organizations that use their performance measurement systems in ways that are consistent with the characteristics of their activities outperform organizations that fail to achieve such fit.

We empirically test the model using survey data from 101 public sector organizations. The results partially confirm our theoretical expectations. Specifically, we find that contractibility moderates the relationship between an incentive-oriented use of the performance measurement system and performance: while using the performance measurement system for incentive purposes negatively influences organizational performance, this effect is less severe when contractibility is high. This finding suggests that NPM should allow for a more situation-dependent approach to performance measurement. We also find that an exploratory use of the performance measurement system tends to enhance performance in public sector organizations. Contrary to our expectations, this positive effect appears to exist independent of the level of contractibility. These results suggest that public sector managers need not

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