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Decentralization, Performance Evaluation and Government Performance

Summary

G. Tjerk Budding

In Dutch local government, as well as in many other countries, a wave of reforms can be observed, starting from the 1980s. Internationally these reforms are coined New Public Management. Although many countries implemented NPM-like reforms, little is known about the successfulness (Lapsley, 1999; Pollitt and Bouckaert, 2004). In the Netherlands, NPM reforms attracted considerable attention, especially in local government.

This dissertation analyses the results of two specific NPM reforms, the decentralization of decision making authorities and the use of accounting performance measures (such as information about budgets, costs and level of services) for performance evaluation.

This study has been structured upon three empirical studies. The first study, which is described in Chapter 2, analyzes the influences of implementing NPM reforms on product costing and service pricing decisions in Dutch municipalities. This study uses survey data derived from 114 Dutch municipalities. It focuses on two reforms, the transition from functional budgeting to product budgeting and decentralization. We find that municipalities using a product budgeting system use a larger number of cost drivers to attribute indirect costs to their products and also apply time registration systems more frequently. Municipalities using a decentralized organizational model appear to monitor more strictly the degree to which revenues cover costs, include more indirect costs in product cost calculations and make more use of time registration systems in calculating product costs. Looking at pricing decisions, we find decentralization is associated with higher prices. However, we only have this finding for contracting marriages. For our other product, garbage collection, we do not find a statistically significant relation. A possible explanation for the higher tariffs for contracting marriages might be that decentralization introduces risk to middle managers: they now run the risk of providing bad services, of running out of budget and of incurring a budget deficit. An effective way to reduce these risks is to try to settle the highest attainable prices thereby increasing the available budgets. The possibilities to do so might depend, however, on the task variability and the cost analyzability of the services. Garbage collection activities are very similar in all municipalities.
and cost information as well as prices can easily be exchanged, compared and analyzed. Therefore, the possibilities for following cost and price policy on their own choice are more limited than for contracting marriages, that vary more in services (e.g., marriages in weekends, historic buildings, etc.) and for which limited cost information is available. These risk reduction strategies might be a contra-productive mechanism of the introduction of NPM to middle managers. Therefore, more insight into the behavioral effects of introducing these new techniques to managers seems to be required.

Chapter 3 attempts to enlarge these insights into the effects of NPM to middle managers by investigating the changes in performance evaluation styles of municipal managers. In this study, 23 managers were asked how they were evaluated, how they experienced this and how they felt about factors that might have an influence on their performance and their evaluation, such as the uncertainties with which they were confronted. The interviews revealed that the managers are evaluated on a rather broad set of criteria (cf. Ter Bogt, 2003). We found, however, that nonfinancial measures, such as dealing appropriately with subordinates and good cooperation with other colleagues within the municipality, are considered more important than the accounting measures. The municipal managers said they were confronted with uncertainties that were also indentified in private sector settings, such as the behavior of clients and suppliers (cf. Buchko, 1984; Milliken, 1997). However, we also found some uncertainties that seem to have a greater influence in the municipal setting: uncertainties derived from political aspects (especially from behavior of the central government) and uncertainties stemming from the behavior of operational superiors (political plays in the organizations). The managers said that all in all they did not experience the uncertainties as an impediment for being held accountable and that they were motivated by more results oriented performance evaluation. These findings seem to be contingent, however, on organizational conditions, such as how uncertainties that influence the operational management are dealt with by the manager and his superior. These more internal conditions were not included in our original study design, but our exploratory analyses revealed the importance of these conditions.

In order to extend the insights into the behavioral effects of implementing the management reforms that are central in this dissertation (decentralization and accounting based performance measurement), we aimed at extending the insights of the multiple field studies in Chapter 3 by conducting a survey research. This project is documented in Chapter 4. Almost all municipalities
in the Netherlands were contacted to participate in this research, and we got 214 usable observations for our study. Partially Least Squares (PLS) analysis was used as this enabled us to analyze all relationships we were interested in, in one model. First, the relationship between decentralization and performance evaluation systems was explored. We expected these to be interrelated: when managers are given more comprehensive decision making authority, they are expected to be held accountable for results and the accompanying costs as the focus will shift from process-oriented accountability to results-oriented accountability (Schwartz, 2002). Furthermore, previous literature has suggested that decentralization is associated with more elaborate use of accounting measures, as these express more aggregated and integrated information (Chenhall and Morris, 1986; Abernethy and Lillis, 2001; Abernethy et al., 2004). Our results indicate, however, that decentralization and the use of accounting measures for performance evaluation are not statistically significantly correlated. Our analysis revealed that decentralization was not associated with the use of specific groups of measures used for performance evaluation, indicating that managers are not held more accountable for results and the accompanying costs, when they have more decision making authorities. Secondly, we analyzed the behavioral effects of the performance evaluation system and which other factors might be contingent upon the relationship between performance evaluation and these effects. We found that the use of objective nonfinancial measures (such as care for quality and dealing properly with subordinates) was strongly positively associated with our output variables, confirming recent literature that emphasizes the benefits of using these indicators as they provide a broad view of a subordinate’s accomplishments (Ittner and Larcker, 1998; Said et al., 2003; Lau and Sholihin, 2005). We also found strong statistically significant relationships between our variable organic processes and the output variables goal clarity and agreement on evaluation criteria. This implies that internal conditions, such as having open communication and readiness for change, have positive behavioral effects on the managers.

The effect of using accounting measures for performance evaluation, however, was much more complicated. We found this effect to be moderated by the level of environmental uncertainty: at higher levels of environmental uncertainty, the use of accounting measures was considered positive for providing more clarity about the goals to be accomplished (cf. Marginson and Ogden, 2005). On the other hand, managers experienced a higher risk of being evaluated on aspects beyond their control. This calls for implementing mechanisms to assure middle managers that their evaluation will be fair, such as having open communication and trust in superiors.
(Ross, 1994; Emsley, 2001; Lau and Bauckland, 2001; Manzoni, 2002). Furthermore, our study showed that it is recommendable to pay more attention to the specific characteristics of uncertainties in research, as they all have their own, independent and specific effects (Hartmann, 2000).

Finally, we found positive and statistical significant relationships between our variables expressing the behavioral effects of performance evaluation (goal clarity and agreement on evaluation criteria) and our output variable, performance of the department. These findings underline the importance of choosing appropriate forms of evaluation, as this results (directly) in behavioral effects, but also (indirectly) in improved government performance.

Conclusions

We expected NPM reforms in Dutch municipalities to be helpful for them in improving the efficiency and effectiveness of operations. In this thesis, we analyzed two specific reforms: the decentralization of decision making authority and the use of accounting measures for performance evaluation.

We found that decentralization was associated with the design and use of more elaborate cost accounting systems. This finding is consistent with previous literature that has shown that these more formal systems indeed change as a result of management reforms (Geiger and Ittner, 1996). The more elaborate cost accounting systems enable managers to monitor costs more strictly and have more information about operations. However, we also found that decentralization was not associated with the performance evaluation system employed for assessing middle managers. Managers with more comprehensive decision making authority were not held more accountable for results and were not evaluated more on accounting measures, as we expected. This might indicate a lack in accountability systems, as they do not follow changes in responsibility structures. Several explanations might be applicable here: firstly, performance evaluation systems’ design and use might depend on institutional aspects (such as norms and common practices in municipalities, see Oliver, 1991) or personal considerations (leadership styles). Secondly, there could be a time lag between the implementation of decentralized decision making and the use of a different performance measurement system.
To our surprise, our analysis showed that nonfinancial performance measures have far more and a more positive influence than accounting performance measures. Using nonfinancial performance measures was associated with positive behavioral effects and these effects did not depend on internal or external conditions. Accounting performance measures, however, may be as useful for municipalities as they are problematic (Marginson and Ogden, 2005). Under higher levels of uncertainty, they might be useful in providing more clarity about the goals to be achieved, enhancing the ‘line of sight’. However, in these circumstances, managers express more concern with respect to their evaluation. This calls for implementing mechanisms to ensure middle managers that their evaluation will be fair, such as using nonfinancial performance measures, as well as having open communication and trust in superiors (Ross, 1994; Emsley, 2001; Lau and Buckland, 2001; Manzoni, 2002). Our analysis shows that a more open communication and a readiness for change, are also directly related to positive behavioral effects. These positive behavior effects resulted in improved performance of the department.

Furthermore, our study showed the relevance of distinguishing specific forms of uncertainty. We found that the three forms of uncertainty that are distinguished in this project (environmental uncertainty, task uncertainty and funding uncertainty) were not statistically significantly correlated and they all have their own and independent specific effects (Hartmann, 2000).

Our findings are not without implications for practitioners in local government. Firstly, the study calls to pay more attention to the relation between decentralization and performance evaluation. We found that these are hardly connected; the assignment of more comprehensive decision making authority to middle managers was not accompanied by holding managers more accountable for these authorities. Secondly, our study underlines the importance of using nonfinancial measures. It seems as if subordinate managers experience a rather broad view on their accomplishments by using nonfinancial measures and having open communication as important conditions for having more comprehensive authorities. This calls for securing the quality of this nonfinancial information (cf. Van Egten and Veldman, 2006) and carefully incorporating these measures in performance evaluation systems. Furthermore, management style and soft controls remain crucial conditions for organizational success.

Our findings are consistent with recent literature, showing that governmental management reforms have brought improvements in the public sector, but that the expectations of the
management reforms must not be overstated and considerable time is needed to adequately implement reforms in the organization (Ter Bogt, 2008; Groot and Budding, 2008a). It seems like NPM is ‘here to stay’ (Lapsley, 2008) and ‘there is no way back’ (OECD, 2005) in the management reforms. However, the challenge for both practitioners and academics is to continue following reforms critically and implement those elements that seem to fit the organization.