

**THE EXTENT TO WHICH KENYA REVENUE  
AUTHORITY (KRA) SATISFIED CONDITIONS  
NECESSARY FOR INTRODUCING AND IMPLEMENTING  
PERFORMANCE CONTRACT**

**BY:**

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UNIVERSITY OF NAIROBI  
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**A MANAGEMENT RESEARCH PROJECT SUBMITTED IN  
PARTIAL FULFILMENT OF THE REQUIREMENTS FOR  
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## DECLARATION

This research is my original work and has never been presented in any other University or College for the award of degree or diploma or certificate.

Signature: \_\_\_\_\_



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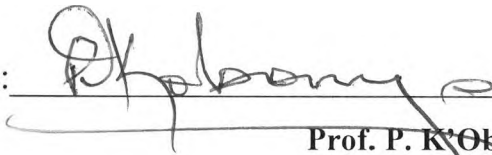
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## **DEDICATION**

This project is dedicated first and foremost to my God whose providence, grace and care I cherish.

I also dedicate the project to my late father Mr. Michael Pius Odundo and my mother Margaret Sunga Odundo.

I further dedicate the work to my brothers and sisters and the entire Odundo family.

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I am truly grateful to the Lord Almighty for having seen me through the entire Master of Business Administration (MBA) Programme and giving me the strength, courage and wisdom to continue with the course even when times were rough.

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I am grateful to the KRA staff who played a key role in the development and implementation of performance contracts at the organisation and who agreed to share their experiences and opinions; and patiently answered all questions. Their time and effort are acknowledged with gratitude. I wish them God's blessings.

Most importantly I would like to thank my brothers, Maurice Odundo, Edward Odundo and Geoffrey Odundo, who have been truly inspirational and supportive throughout the period when I was undertaking the MBA programme. I also would like to thank my other siblings, friends and colleagues who were supportive of me through out the MBA programme, not forgetting those who assisted me in one way or another throughout the period. May God bless them abundantly

Last but not least, I would especially like to thank my parents for having instilled in me the importance of education and thank them for their hard work and commitment to

ensure that I and my siblings acquire the education that we earnestly needed. May God's grace be with them.

Whereas I acknowledge input from all these persons in the research project, I take responsibility of any deficiencies and flaws therein.

## **ABSTRACT**

This study sought to determine the extent to which the necessary conditions for developing and implementing performance contracts were satisfied by Kenya Revenue Authority (KRA). It was limited to KRA staff based at the head office; mainly the Managers who played a key role in the development and implementation of performance contracts at KRA were interviewed.

This was a case study which involved an in-depth investigation of the extent to which KRA considered the conditions or factors necessary in developing and implementing performance contracts. Both primary and secondary data was collected .The secondary data was collected from KRA's Third Corporate Plan, while the primary data collection was done through personal interviews, which was pre-tested and later on administered through a survey.

From the research findings we have established that KRA satisfied the necessary conditions for developing and implementing the performance contract, except for one condition, that is sensitization of the staff, which was not keenly addressed during the development and implementation of performance contract.

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background

Since the seminal work of Berle and Means (1932), the conflict between the owner and the manager of the firm has been in the spotlight. If ownership is dispersed, there will be a free rider Problem leading to higher agency costs of capital and lower firm performance. In the last decade new attention is given to this issue of Corporate Governance, defined as the manner in which state Corporations are managed. Agency problems that arise in publicly held corporations have been a focus of academic research for some time. Jensen and Meckling (1976), highlight the importance of agency problems. The agency literature has also elaborated on the mechanisms that are available to mitigate these agency problems. The goal of these mechanisms is to align the interest of managers or Board members with the interest of shareholders.

With the separation of management and ownership in large publicly traded corporations, (Means and Berle, 1932; Fama and Jensen, 1983), shareholders have ceded power to the Board of Directors and management. The increasing power of management and management-dominated boards has led to accountability problems ( Morck et al, 1988). Increase in agency conflict has led to development of various conflict resolution mechanisms. Measures such as board structure (in terms of Board size, percentage of Executive to Non- Executive Directors), use of Board committees( e.g. Audit committees), corporate takeovers and performance based contracting have been used for decades to mitigate against agency costs arising from separation of ownership and management.

Some countries have established National codes of best practice to address their own special requirements with regard to corporate governance. Bowes (2000) several years ago estimated that there were in excess of 60 codes of Corporate Governance in use

through out the world. This unfortunately leads to confusion for Directors and those countries endeavoring to develop their own code of conduct. To address these concerns, the Commonwealth Approach to Corporate Governance (CACG ) was founded in 1998 to prepare a set of guidelines that could appropriately represent the Commonwealth Approach to Corporate Governance. According to the CACG, the commonwealth countries had to have certain common characteristics. These included a similar structure and system of government, Public Administration and Law, a similar structure and system of commerce and common working language. They also had to have an organizational structure that would enable governments and professional associations to regularly debate and develop common policies to promote a positive policy environment. Nevertheless, the countries of commonwealth are diverse and consequently the guidelines developed by the CACG are neither mandatory nor prescriptive. They are therefore intended to facilitate best business practice and behavior whether of private sector or state owned enterprises. In addition, the World Bank and the Organization for Economic Co-operation and Development (OECD) established the global corporate governance forum in 1999 to try and co-ordinate corporate governance activities throughout the world.

In Kenya, the main concern particularly in the late 1980's and early 1990's, was the governance of public sector. The underlying reason for these concerns was the realization that poor corporate governance had led to wastage and misuse of public resources and there was also increasing demands by donor agencies and World Bank that there should be good corporate governance as a condition for Aid. The World Bank indicated that good corporate governance was a critical ingredient in the development process. During this period the government sought to reduce its traditional role of playing a pervasive role in the social and economic development. In accordance with Session paper No 1 of 1986 on Economic management for renewed growth, the government was expected to play a facilitating role whereas the private sector was to become the engine of growth. Consequently, concern shifted to corporate governance and in particular how to ensure that private and public sector corporations used resources effectively and efficiently.

Several seminars and workshops were organized by various organizations among them the Government, Capital Markets Authority (CMA), The Central Bank of Kenya (CBK) and professional bodies such as the Institute of Certified Public Accountants of Kenya (ICPAK). One of these was a performance contracts sensitization workshop organized by the Government of Kenya which was held on 17<sup>th</sup> and 18<sup>th</sup> June 2004 at Safari Park Hotel as a follow up to various initiatives by the performance contracts steering Committee which was intended to move the performance based contracts process forward.

### **1.1.1 Performance Contract**

According to Blasi (2002), a performance contract is an agreement between two parties that clearly specifies their mutual performance obligations, intentions and responsibilities. It is a freely negotiated performance agreement between the government, acting as the owner of a government agency, and the agency itself up to and including other levels of management of the organization. Most commonly, performance contracts include bonuses for a job well done, and, less often, salary decreases for poor performance. The increased interest in performance contracts coincides with demands for greater accountability.

Nellis (1989) observes that performance contracts are negotiated agreements as owners of a public enterprise, and the enterprise itself in which the intentions, obligations and responsibilities of the two parties are clearly set out. Shirley (1998) advocates the view that performance contracts seem to be a logical solution since similar contracts have been successful in the private sector in shifting ex anti control to ex post evaluation, thus giving managers the autonomy and incentives to improve efficiency and thereafter holding the managers accountable for results. Shirley and Xu (2000) observe that performance contracts are now widely used in developing countries where successful contracts have featured sensible targets, stronger incentives, longer terms, and managerial bonds but confined within competitive industries.

The classical models of performance measurement and management have been found to be ineffective with the drastic changes in the external environment. Traditional performance measures in the public sector have been able to drive performance necessitating the development of measures that take care of the intricate mix of stakeholders that are served by the public organizations. In the private sector, the principal measure of successful performance is profit, but in the public sector organizations, performance is judged against goals of their programs and whether the desired results and outcomes have been achieved.

A Performance Contract is aimed at addressing economic, social or other tasks that an agency has to discharge for economic performance or for other desired results. It organizes and defines tasks so that management can perform them systematically, purposefully, and with reasonable probability of accomplishment. It also assists in developing points of view, concepts and approaches for determining what should be done and how to go about it. Performance contracts comprise determination of mutually agreed performance targets and review and evaluation of periodic and terminal performance (England, 2000)

According to Directorate of Personnel Management Training Manual (2005), performance contracts should focus on two levels: For the State Corporations, the first level is between the Government and the Board of Directors. Generally, Boards of Directors and management of public enterprises bind themselves to the achievement of mutually agreed targets, in return for operating autonomy and specified rewards. The second level is between the Board of Directors and the Chief Executive: Since the Board is not in charge of routine management of the Corporation, it assigns its responsibility assumed in the contract with Government through signing of a performance contract with the Chief Executive.

Performance Contracts (PCs) have their origins in the general perception that the performance of the public sector in general and government agencies in particular has consistently fallen below the expectations of the public. The problems that have inhibited

the performance of government agencies are largely common and have been identified as excessive controls, multiplicity of principals, frequent political interference, poor management and outright mismanagement (Larbi, 2001)

Different approaches to public sector management have been employed to address these challenges. These approaches include first, new institutional structures and arrangements for managing and delivering programs and services (privatization, commercialization, contracting out and decentralization to local government). Second, systematic reforms (market type mechanisms, new budgeting and planning systems, administrative modernization, decentralization of management authorities); and lastly new methods of service delivery (case management and one-stop shops) (Larbi, 2001).

While these new methods are seen as addressing weaknesses in the more traditional centralized and compliance based public management systems, they bring their own set of problems. Most notably, management systems that are disaggregated, decentralized and devolved need a new framework to guide behavior. These changes do not rely on uniform rules for the management relationship nor for ensuring accountability in the use of public resources and delivery of public services. In view of the shortcomings evident in the systems, countries have adopted the system of performance contracting as a management tool.

Mann (1995) observes that performance contracting is among the multiple ways of improving efficiency of public enterprises. Malathy (1997) argues for the adoption of performance contracts as an alternative public enterprise reform strategy where privatization may be less feasible due to political or technical reasons, particularly those requiring sophisticated legal and regulatory structures or those that cannot be easily privatized for political reasons.

The fundamental principle of performance contracting is the devolved management style where emphasis is management by outcome rather than management by processes. It therefore provides a framework for changing behaviors in the context of devolved

management structures. Governments view performance contracting as a useful vehicle for articulating clearer definitions of objectives and supporting new management monitoring and control methods, while at the same time leaving day-to-day management to the managers themselves. Performance Contracts include a range of management instruments used within the public sector to define responsibilities and expectations between parties to achieve mutually agreed results (England, 2000; Blasi, 2002).

### **1.1.2 The Kenyan Public Sector**

When Kenya attained her independence in 1963, like many other emerging independent nations in the 1950s and 1960s, the Government took upon itself the task of providing basic needs and services in response to the needs and aspirations of its citizens. Consequently, apart from its traditional role of maintenance of law and order, the public service was given the following other responsibilities: coordination of national development; promotion of economic growth and development especially among the Africans; and managing industrial and commercial concerns where government had an interest.

Since independence, the Kenya government has encouraged the growth of a "mixed" economy where private and public corporations co-exist. Nearly all post-independence public corporations in Kenya were established in realization of commitments made in the ruling party's (Kenya African National Union) manifesto and reiterated thereafter in the Government of Kenya Sessional Paper No. 10 of 1965. These commitments included the elimination of hunger, disease, ignorance and poverty, the desalinization of the economy, the promotion of development and regional balance and increase in citizen participation in the economy and greater control of the economy.

Public corporations in Kenya were established with the expectation that: they would earn a surplus and also accomplish other societal objectives not necessarily financial in nature; they would establish businesses to provide goods and services deemed necessary for development; they may engage in projects with large capital outlay, which while necessary for development are unattractive to the private sector; they may provide much needed direction, support to commercial enterprises and act as the consumer's watchdog (Nyamongo, 1993 in Njoroge, 2003).



The public sector in Kenya has been faced with the challenge of poor and declining performance, which in turn inhibited realization of sustainable economic growth. The problem of poor performance in the Public Service is largely attributable to excessive regulations and controls, frequent political interference, multiplicity of principals, poor management, outright mismanagement and bloated staff establishment. In addition to regressing economic growth, declining performance in the Public Service resulted in poor service delivery, degeneration of infrastructure and a brain drain. Mann (1995) notes that inefficiencies within commercially oriented enterprises (e.g. electricity, water, telephones) have clear national, financial and fiscal implications as their activities impact directly on overall public and private sector expenditures and resources.

Although commendable initiatives have been implemented in the past, such as civil service reform, ministerial rationalization etc, they however, lack the following important ingredients of performance improvement systems. The initiatives lacked a focus on outcome-oriented measures — measures that are concerned with results achieved instead of what work was done for those results. The initiatives also had too many measures. With the absence of outcome-oriented performance measures, the emphasis has been placed entirely on the work that is done — the processes. Agencies often develop a litany of activity-oriented performance measures that focused on the work being done by front-line employees and not the mission-aligned results generated by the program. Those measures are often then used in decisions on funding, resource allocation and goal attainment in the absence of true outcome measures (Armstrong and Baron, 1998 in Njau, 2005).

Traditionally, the State Corporation management culture emphasized inputs and conformity to laws, regulations, and procedures rather than on outputs, efficiency and cost effectiveness. The government has committed itself to create a management culture in the State Corporations that is focused on results. Emphasis on results requires a performance-oriented management culture that is guided by the right values and behaviors. The introduction of performance contracts is therefore, intended to introduce into the State Corporations a performance-oriented culture that will facilitate the

attainment of desired results. The contracts are expected to instill accountability for results at the highest levels in the government enterprises. In turn, the top-level officials will hold those below them accountable for results. Eventually, it is expected that the culture of accountability will trickle down to all levels of government machinery (Njau, 2005).

State corporations play a critical role in the socio-economic development of the country. Formed soon after independence, State Corporations were created with various mandates (as outlined in the sessional paper No. 10 of 1965 on African socialism) including; Accelerating Development; through investments in various departments such as the utility sector, manufacturing, processing etc, that was to add value to the general development of the country's economy. Secondly it was aimed at addressing regional imbalances by ensuring equitable distribution of resources by investing in marginalized areas. Thirdly, it aimed at increasing indigenous entrepreneurship participation through share ownership in such firms as well as provisions of utility services enabling the private sector invest effectively.( the sessional paper No. 10 of 1965).

Statistics from the Central Bureau of Statistics (Dec 2004), show that the parastatal sector was the third largest employer accounting for 15% of formal sector employment after Central Government and Teachers Service Commission with 30% and 36% respectively. Although the initial performance of state corporations was very encouraging, the multiplicities of objectives over time distorted the core functions of these enterprises. Furthermore, these objectives emerged to be largely social in nature and sometimes were in conflict with each other and not geared towards profit maximization. The entrenched loss-making trend in most of them had left them with limited resources, weak financial bases and largely undercapitalized. As a result, they became unable to service their loans and maintain plant and equipment, leading to inefficient and high cost of production and poor service delivery. Furthermore, inadequate policies have led to low contribution by the sector to the National Economy (Performance Contract Steering Committee training Manual, Feb 2005 pg 4)

Consequently, most of the parastatals had become a drain to the Exchequer for financial support in form of grants and loans, which became a major impediment to economic growth and obstacle to the recovery of the economy. The cost of reinstating some of the parastatals to effective operational levels was enormous making it necessary to review their future operational status within the context of limited public resources. In changing environment some of the mandates became redundant while others are overlapping. In addition, donors/financiers perception has changed redirecting resources to utilities operated by the private sector. These and many other factors constitute realities, which required to be addressed for the sector to contribute significantly to Economic development. (Performance Contracts steering Committee in its Training manual of February 2005).

The Government has majority shareholding directly in each of the State Corporations. Their performance, however, has been less than satisfactory for several reasons as spelled out by the Performance Contracts steering Committee in its Training manual of February 2005 (pages 7-8). These reasons include over staffing, political patronage, poor management, obsolete and poor state of machinery and equipment, bureaucratic procedures, poor corporate Governance, lack of proper and consistent performance evaluation and poor remuneration of the members of staff (Performance Contract Steering Committee training Manual.) .

The performance of 70 major state corporations for the year ended 30<sup>th</sup> June 2005 as highlighted by the Training manual on Performance contract in the public service, Feb 2005 shows Total Revenue generated by the corporations was Kshs 92.4 Billion against Total Expenditure of Kshs 99 Billion; total profits were Kshs 8.5 Billion while total Losses were 15 Billion, total grants were 9.5 Billion while dividends received amounted to Kshs 72.7 million. The major challenge cited are the non performing loans which have had an adverse effect on the performance of these firms (Performance Contract Steering Committee training Manual, Feb 2005).

To address this problem, the Government, through the Economic Recovery Strategy for Wealth and employment Creation (2003-2007), identified State Corporations as one of those sectors that required urgent reforms in view of their significant role in the economy. The strategy paper noted that the problems attributed to State Corporations arose from, among others, lack of clear performance contracts that would facilitate the monitoring and evaluation of performance of Chief Executive Officers (CEO) and other senior officers to manage the corporations. In order to improve performance and corporate governance, Government undertook, among other actions, to establish performance contracts for CEOs/Boards as instruments to improve the performance of State Corporations and Statutory Boards' (...Pg 23) . "In the design and implementation of performance contracts for the CEOs of Public Enterprises in the country, the Government was to benchmark best practices in countries that have successfully implemented performance contracts and managed to turn around poorly performing corporations"

The strategy paper recommended introduction and implementation of Performance contracts for CEOs, Executives and Boards as Measures to improve the performance of state corporations and statutory Boards. This move was further to be extended to cover Permanent secretaries and other senior Government officers in the subsequent financial year 2005/2006. To give effect to this strategy, the permanent secretary / secretary to the cabinet and Head of Public Service, in August 2003 established a Performance Contracts Steering Committee.

The mandate of the committee included developing model performance contracts; and developing modalities for the introduction of performance contracting in the management of State Corporation (Training manual on Performance contracts in the public service, Feb 2005,).

In order to pilot the performance contracting concepts, the performance contracts steering committee identified 16 State corporations, mainly in the Finance, industrial and manufacturing sectors, who sent to a workshop high-powered teams that included their Chairmen and CEOs. All permanent Secretaries and Accounting officers were also

invited to participate, as were members of State Corporations and Advisory Committee (SCAC) (Training manual on Performance contracts in the public service, Feb 2005)

### **1.1.3 Kenya Revenue Authority**

The Kenya Revenue Authority (KRA) was established by an Act of Parliament, the Kenya Revenue Authority Act 1995 (Chapter 469 of the Laws of Kenya). Its date of commencement was 1<sup>st</sup> July 1995. The KRA is a body corporate with perpetual succession and a common seal, capable in its corporate name of doing all things as a body corporate may do, including suing and being sued, taking, purchasing or otherwise acquiring, holding, charging, or disposing of movable and immovable property, and borrowing or lending money.

Before 1995, the revenue collection functions were distributed among different ministries and/ or departments. Lacking in co-ordination, their performance was characterized by inefficiency and low levels of accountability. The rationale behind the establishment of the Authority arose from the need to reverse this trend in a critical area of the public sector. The main objective of the establishment of KRA was to streamline the public revenue collection function by bringing the relevant agencies under the umbrella of the central finance agency, the Ministry of Finance. This restructuring was expected to provide an effective administration for the enhanced mobilization of government revenue in a sustainable manner. In order to realize this mandate, the Authority administers the laws relating to revenue.

The Act made KRA “a central body for the assessment and collection of revenue, for the administration and enforcement of the laws relating to revenue and to provide for connected purposes.” The Authority is under the general supervision of the Minister of Finance as an agent for the collection and receipt of revenue. KRA currently collects around 95% of government revenue.

KRA was among the first (experimental) 16 State corporations that the performance contracts steering committee identified, from the Finance Ministry. This was so because

it was the only government agency that is entrusted with the task of collecting all the revenue due to the government and therefore a very important parastatal.

## 1.2 Problem Statement

Performance Contracts were introduced at the Kenya Revenue Authority (KRA) from the beginning of the financial year 2005/2006 in line with the Government policy to improve performance, Corporate Governance, and management in the public service. The KRA Board of Directors signed a Performance Contract with the Minister of Finance. This was cascaded down to Management level. The Commissioner General in turn signed a contract with the Board of Directors. Every Commissioner then signed a contract with the Commissioner General. The process was cascaded to Commissioners, Senior Deputy Commissioners, Deputy Commissioners, Senior Assistant Commissioners and Assistant Commissioners.

There were, however, factors or conditions necessary for performance contracting, these included, the definition of an original vision, mission and strategic objectives; establishment of an integrated performance measurement system; establishment of accountability for performance; establishment of a process/system for collecting performance data; one for analyzing, receiving and reporting performance data; and a system for using performance data to drive performance improvement. Others conditions are; that the performance criteria to be included in the contracts must be clearly defined and easily understood; targets are to be freely negotiated and not arbitrarily imposed; involvement of staff in the process and urgency of moving to an enhanced performance measurement and management regime.

The aforesaid conditions or factors were critical in developing and implementing Performance contracts. It was, therefore, imperative that organisations consider them when developing the contracts and the KRA was no exception. Thus, the success of performance contracts at KRA depended largely on the extent to which these conditions were met. Motivation for this study was the need to establish the extent to which KRA met these conditions. The pertinent research question was: to what extent were the

antecedent conditions/factors to performance contracting taken into account when developing and implementing performance contracts at KRA?

### **1.3 Objective of the Study**

To determine the extent to which the necessary conditions for developing and implementing performance contracts were satisfied by KRA.

### **1.4 Significance of the Study**

The findings of this study will be useful to:

- State Corporation in re-examining the conditions necessary for developing and implementing good performance contracts.
- Future scholars and researchers who may use it for reference and as a basis for further research.

### **1.5 Scope of the Study**

The study was limited to KRA staff based at the head office. Managers who played a key role in the development and implementation of performance contracts at the organization were interviewed.

# **CHAPTER TWO**

## **LITERATURE REVIEW**

### **2.1 Introduction**

Political and regulatory environment have had a significant effect on corporate governance systems. Jensen (1993) opines that political and regulatory forces have contributed significantly to internal control systems in modern times. Corporate governance research has identified a variety of mechanisms that are intended to ensure that management act in the best interest of shareholders. They include internal mechanisms such as performance contracting, the Board of Directors, ownership by managers, executive compensation and external mechanisms such as the market for corporate control, institutional ownership and level of debt financing.

Therefore performance contracting is part of broader public sector reforms aimed at improving efficiency and effectiveness in the management of public. Governments all over the world are increasingly faced with the challenge to improve delivery of service to the public.

### **2.2 Performance Management**

Performance management can be defined as a process designed to link the organization's objectives with those of individuals in such a way as to ensure that both individual and corporate objectives are as far as possible, met. Armstrong (1999) defines performance management as a strategic and integrated approach to delivering sustained success to organizations by improving the performance of the people who work in them and by developing the capabilities of teams and individual contributors. Gekonge (2005) quotes Norton and Robert (2004) views performance management as the process of using performance measurement information such as performance goals/objectives, measures, measurements, output and outcome evaluations, to effect positive organizational changes. The changes will involve organizational culture, systems and processes the change process will also involve setting agreed upon performance goals and objectives,



allocating and prioritizing resources, informing managers to either confirm or change current strategy, policy and program direction to meet organizational goals and objectives and sharing the results of performance in pursuing those goals and objectives.

Performance management is based on the premise that the clarification of corporate objectives, the institution of measures in pursuit of the objectives, and the empowerment of managers are all what it takes to energize organizations and orient them towards incremental productivity, cost reduction and “customer” satisfaction. However, regardless of the attention given to performance management in formal bureaucratic and in latter-day matrix organization structures, diversity in the stakeholders’ world-view constitutes a major stumbling block to productivity gains with particular reference to the African public service, whatever new performance management initiatives are contemplated should not only capitalize on the continent’s diversity but also deflect the threats that this diversity poses to organizational momentum and to the attainment of the goals of good governance and development (Balogun, 2003).

The process of performance management develops participation, awareness, a decentralized decision-making process, and responsibility for achieving the goals which have been formulated. As a consequence, there must be a goal-achievement analysis, in which the organization draws conclusions about what it is doing well, what it is not doing so well, and what can be improved. Thus, one of the main purposes of the performance management concept is to develop a learning organization culture where such systems may be seen as enablers of a circle of learning (Amaratunga and Baldry, 2002).

Performance management could be a tool that lets an organization track progress and direction towards strategic goals and objectives and should focus on whether the organization has met its performance goals and targets. By creating a performance management environment at the centre of its management systems, an organization will be able to evaluate organizational strategy in light of the recent performance management systems enable organizations to modify strategies to reflect real-time learning and the

implementation of performance management systems gives organizations the capacity for strategic learning (Amaratunga and Baldry, 2002).

### **2.3 Performance Contracting**

In the context of this study, performance contracting is process of drafting a written or negotiated agreement between government or its representative agency and the management of public enterprise and other public organizations directly delivering public services or between government and private managers of state assets wherein quantifiable targets are explicitly specified for a given period and performance is measured against targets at the end of the period (World Bank, 1995). According to OCED (1999), performance contract basically comprises two major components namely determination of mutually agreed performance targets and the review and determination of periodic and terminal performance.

Though performance contracting is but one element of broader public sector reform aimed at improving efficiency and effectiveness of public enterprises, while reducing total costs it looks at performance contracts as a range of management instruments used to define responsibilities and expectations between parties to achieve mutually agreed results OECD (1999). Performance contracts, otherwise known as performance agreements in USA, relates to performance based management, which focuses on outcomes that support short and long term objectives by providing a systematic process of defining the job, the behaviors, and the measurement criteria critical to the process. It is simply a performance based contract which the principal defines its objectives and lets the agency decide how best to meet them (PBMSIG, 2001).

The dominant economic view of performance-based contracts essentially draws from the theory of agency costs that arise due to separation of ownership and control of large corporations. In a typical agency framework the assumption is that there is a mismatch between the interest of the owners and that of management who run the day-to-day operations of the organization. A performance contract addresses economic, social or other tasks that an agency has to discharge for economic performance or for other desired results. The growing popularity towards performance contracting can be traced to the

strong persuasive influence from bilateral agencies that advocate the use of this concept as an important element of public enterprise sector reforms (OCED 1999).

According to Scott (1989), changes will have a major impact on amongst other things employees reward systems. Employers and employees will increasingly have to look for new and more appropriate ways of rewarding and being rewarded. Indeed with the advent of performance – related pay, in both the private and public sectors, there is already a gradual change from determining pay on the basis of a person's position and seniority to basing it on their contribution to the organization. These changes are being driven by four main concerns. The first is cost in the sense that the present system is too expensive for companies that must conserve resources to be competitive. The second is equity, to ensure that employees are fairly rewarded for their efforts. The third is productivity, to adopt reward systems that motivate high performance from employees. The fourth and last is entrepreneurial pressure, the present system doesn't always adequately reward entrepreneurs for their efforts.

These concerns are being approached through the application of three different though not necessarily mutually exclusive payment methods. The first is profit sharing, whereby the pay of an employee is pegged to a company's performance. This means that salaries are not fixed but instead are related by the use a predetermined formula, to the profit of the organization over a given period of time, usually the previous financial year. The second method is the use of individual performance bonuses, which are paid on top of basic salaries and are related to a predetermined performance target. This method has the advantage of enabling individuals to establish a direct correlation between their personal efforts and bonus payment they receive. The sums involved are - sometimes as much as twice basic salary. The last is the venture returns method, which represents perhaps the most radical break with the past. This is a scheme where entrepreneurs and inventors within an organization are given the opportunities to earn returns based on performance, in the market place, of the particular products or services for which they are responsible. Through this mechanism, the entrepreneur or inventor remains within the corporate fold but is paid on a similar basis to the owner of a small, independent business. The

advantage is that they get the personal satisfaction and the reward of running their “own” business, whilst the larger organization benefits from having highly motivated and innovative people in charge of part of its operations (Scott, 1989).

The picture created by new reward systems is not, of course, totally rosy. Where there are winners, there may also be losers; not everyone will have the opportunity or drive to be an entrepreneur, nor will be in a position that lends itself to some form of bonus system. Also many people who currently benefit from reward systems based on seniority and position may find they lose out. Older workers established in organizations and well down their chosen career path, could be particularly adversely affected by such changes. In addition, such payments systems may be divisive and create conflict (Scott, 1989).

Scott (1989) continues to stress that the need for teamwork, yet a situation where some members of the team are receiving high bonuses is bound to create tensions, which undermine co-operation and collaboration. It may be that profit – sharing schemes, which encompass everyone in the organization, overcome this threat to team working, but if everyone receives the same share of the profits irrespective of their individual contribution, the motivation effect is likely to be diminished. The result of these various approaches to pay could be minimal in terms of motivation, or could even be demotivating and indeed drive out the most experienced people in the organization.

Shirley and Xu (1997) argue that performance contracting assumes that government’s objectives can be maximized, and performance improved, by setting targets that take into account the constraints placed on managers. For this to occur though, they argue that the principals must be willing to explicitly state their objectives, assign to them priorities and weights, translate them into performance improvement targets, provide incentives to meet those targets (or monitor the agents without incurring significant costs), and credibly signal their commitment to the contract. GoK (2005a) concludes that the fundamental principle of performance contracting is devolved management style with emphasis on outcomes rather than processes. OECD (1999) finally concludes that a performance contract is another management tool that ensures correlation between planning and

implementation; coordination between various government agencies; an enabling public policy environment for other down stream reforms; and a fair and accurate impression about public enterprise performance.

The concept of performance contracting and its rationale varies from country to country. The widely accepted rationale for performance contracting is that public agencies have multiple objectives and multiple principals. These fuzzy objectives lead to poor financial performance in most cases. One view is that because public agencies are required to carry several functions they are unable to do any one of them very well. The other is that while a government agency may have done very well in achieving many of its objectives, its performance may be judged with reference to one objective to which it has not done well. A performance contract is a tool of remedying the situation of multiple objectives by agreeing the preferred objectives, which the owner would like achieved. It addresses the multiplicity of principals by requiring one agency to sign on behalf of all of them. The multiple principals that government agencies must deal with in fulfilling their mandates emanate from Parliament, Ministry of Finance, Ministry of Planning and National Development, Parent Ministry and the Office of the President. In addition to creating fuzzy objectives, having multiple principals results in a 'denial' syndrome in the event that things are not working as expected and no one wants to take responsibility for the failure (GoK, 2005b).

Public enterprises may pursue certain social and non-commercial goals affecting its financial one which the performance contracts clarify early with the principal: public enterprises making losses may have tools which may indicate effort put and success achieved by the management in improving its operations; a mechanism to smooth the public enterprise-government interface and increase the autonomy of the enterprise; advocated as an alternative to privatization of public enterprises which are financially viable. In essence therefore, performance contracts seek to privatize the public sector style of management without necessarily transferring the ownership of the assets to private ownership (OECD, 1999).

The improvement in the wealth of nations is premised on the realization that comparative advantage depends on resource efficiency/endowment; competitive advantage of nations depends on public sector performance and public sector performance acts as a ceiling on private sector performance (Market failure vs. Government failure) (Porter, 1980). Despite the fact that public corporations are created to ensure effective and efficient delivery of essential services, majority have been mismanaged and some had resulted to closure such as the Kenya Meat Commission, the 'Nyayo' Bus Corporation, among others. In the Standard Newspaper (July 8, 2003) Gakuru stated that the solution to the problems afflicting our nation and the proper running of government was by improving efficiency as defined by the private sector. According to him, the government has reached to the private sector to acquire the "best and brightest" that the sector has to offer to fix the numerous government failures. This has not begun with the Narc Government and it is by no means confined to Kenya. Other developing nations are doing the same especially due to pressure from the World Bank, International Monetary Fund (IMF), the European Union and other bilateral and multilateral donors.

Effective strategic management is a process of creating a productive, more profitable alliance between the nature and demands of the business environment/ the organization's culture and resource base at its disposal, the way it utilizes them and the skills it uses in utilizing them. The challenge for public corporations therefore, lies in achieving this strategic fit because the business environment has become dynamic, turbulent and unpredictable. Public corporations have been criticized for inefficiencies and mismanagement. They are said to contribute to many of the problems hindering economic growth such as public sector deficits, domestic and foreign borrowing and misallocation of resources. They are characterized by widespread misuse of funds due to lack of proper internal management and control.

Some of these criticisms are supported by studies carried out (Aharoni, 1986; Berg, 1981; Jones and Moran, 1982; Nellis, 1986; Shirley, 1983). Specific problems associated with public corporations include: poor economic performance, overstaffing, overvalued assets, high debt ratios causing constant drain on the national treasury; and non responsive top

management who are unable to take advantage of changing domestic and international commercial opportunities.

## **2.4 Types of Performance Contracts**

Mann (1995) and GoK (2005a) trace the evolution of performance contracting to France in the 1970s when the French Prime Minister commissioned a committee headed by Simon Nora to investigate relations between public enterprises and the ministers. The concept was thereafter introduced in Franco-phone Africa in the 1980s in the National Railway in Senegal. Latin America and Asian countries followed later in the same decade. Performance contracts are known by different countries such as performance agreements; *contratos de rendimientos*; *contract du plan*; *contracts de program*; framework agreement; memorandum of understanding; purchase agreement; results framework; and letter of responsibility (GoK, 2005a; Trivedi, 2005).

OECD (1999) describes the wide variety of quasi-contractual agreements used to improve performance namely: framework agreements; budget contracts and resource agreements; organizational performance agreements; chief executive performance agreements; funder-provider agreements; intergovernmental performance contracts and partnership agreements; and customer service agreements.

Framework agreements cover overarching strategies and priorities for a department or agency which provides the CEO with autonomy in managing; budget contracts and resource agreements focus on the budget levels between the central budget office of finance ministry and CEO of a department or agency; organizational performance agreements are between a minister and CEO or between CEO and senior managers, breaking down overall strategic goals into programme elements, setting specific, often detailed operational, process and output oriented targets in exchange for increased autonomy. The chief executive performance agreements are between the minister and CEO (often to complement organizational performance agreements), or between senior management and staff at various levels; funder-provider agreements focus on clarifying responsibilities by separating the role of the funder and provider of the services.

Intergovernmental performance contracts and partnership agreements are often linked to devolution of programmes or funding from national to sub-national government, providing state and local governments with funding in exchange for providing specified levels and quality of service. Finally, customer service agreements are statements of service standards provided by a programme or service to its clients specifying the quality and level of service expected (OECD, 1999).

OECD (1999) however advice that there is no agreed upon template or checklist for determining whether performance contracting is the right performance management tool for a particular management problem. They conclude that each type of contract emphasizes different objectives and priorities. They recommend that each contracting arrangement depends on a contractual or quasi-contractual approach; features of the legal and administrative systems; risk management factors; and the broader governance arrangements within which the contract would function.

Performance contracts are referred to by various names in different countries. The most popular terms include: Performance contracts, contract plan, contract De programme, and letter of engagement, performance agreement and Memorandum of understanding.

There are generally three types of Performance Contracts namely the French System, the Signalling System and Results Based Management. The French based system of Performance Contract does not allocate weights to targets. There is therefore no distinction between targets in terms of emphasis (by weighing them differently) and as such performance evaluation is affected by a high degree of subjectivity. It can only point out whether a particular target was met or not which creates great difficulty for making an overall judgment regarding agency performance. This system is practiced in France, the United Kingdom, Senegal, China, Ivory Coast and Benin (Mann, 1995; Trivedi, 2005; GoK, 2005a).

The Signaling System is based on the premise that public enterprise management should be appropriately guided to aim at improving real productivity and its efforts acknowledged and rewarded by an incentive system. It allocates weights and adopts a



system of “five point” scale and “criteria weight” which ultimately result in calculation of “composite score” or an index of performance of the enterprise. It is thus hinged on the principle that given the capital stock at hand, how efficiently can the management use it? The system aims at motivating management to maximize return on the sunk capital. A primary criterion of evaluation is therefore evolved which reflects the improvement in real productivity, which in turn leads to an increase in socially relevant profits (as opposed to privately relevant profit). A PC is signed at the beginning of the year in which management is committed to improvement in real profitability. The Signaling System is practiced in Pakistan, Korea, Philippines, India, Bolivia and Gambia (Mann, 1995; Trivedi, 2005; GoK, 2005a).

Performance management is a systematic process of planning work and setting expectations, continually monitoring the performance, developing the capacity to perform and periodically rating performance. Results based management is one type of performance management process. The concept involves formulation of outcomes and goals, selection of outcome indicators, setting of specific targets to reach and dates for reaching them, assessment of whether the targets have been met and analyses and reporting of results (Armstrong, 2003).

The concept of results based management emphasizes the need for key internal and external stakeholders to be consulted and engaged in setting outcomes, indicators and targets. Whereas performance contracts focus on outcome and results, result based management is a system that is used by government agencies to achieve specified targets by focusing on inputs, processes and outcomes. Results based management is therefore a system that is used to mobilize the entire staff in an organization in achieving the agreed targets (Dessler, 2003).

## **2.5 Conditions Necessary For A Good Performance Contract System**

Performance contracting regime is not a substitute for overall performance management as it is merely but one element of a framework for generating desired behaviors in the context of devolved management structures, which is part of an overall resource

allocation system. A comparative analysis of international experiences by the United Nations supports this view by adding that the differences in design and implementation of performance contracts and associated government policies in force in particular countries are major factors influencing the success or failure of performance contracts. It concludes that each country has its own unique legal, institutional and cultural environment, hence need to customize the approach to its own needs and circumstances (OECD, 1999).

A structured approach similar to the one used in the US, which focuses on strategic performance objectives; provides a mechanism for accurate reporting; bring all stakeholders into planning and evaluation of performance; provides a mechanism for linking performance to budget expenditures; provides a framework for accountability; and share responsibility for performance improvement. They suggest a six-step process that includes establishing a successful program which include the definition of an original vision, mission and strategic objectives; establishment of an integrated performance measurement system; establishment of accountability for performance; establishment of a process/system for collecting performance data; one for analyzing, receiving and reporting performance data; and one for using performance data to drive performance improvement ( PBMSIG 1999).

A standard performance contract should consist of three sub-systems, namely: Performance Information System, Performance Evaluation System, and Performance Sanction/Incentive System. Performance Information System relates to the need for reasonable information balance between Government and the Government Agency in the process of negotiating performance targets; Performance Evaluation System comprises of performance measurement criteria and evaluation systems; while Performance Sanctions/Incentive System relates to a system that links rewards/sanctions with measurable performance (GoK 2005a; OECD 1999; Trivedi 2004 and Mann 1995).

Fundamental or necessary conditions for the design of good performance contracts are categorized into those of criteria and those of institutional structures. On criteria conditions, the performance criteria to be included in the contracts must be clearly

defined and easily understood; they should be fair to the manager, as they should encompass only areas within the control of public enterprise management; and the criteria for evaluating public enterprise performance must be fair to the country (OECD 1999).

On institutional conditions, performance targets are to be negotiated and not imposed arbitrarily from top government; public enterprise managers are to be left free to manage the enterprise within agreed parameters once the performance targets shall have been set; performance is to be judged at end of year systematically against the targets negotiated at the beginning of the year; to carry out performance evaluation there is need to have balance in availability of information between the evaluator and the evaluated; to establish trust, evaluation need to be done by expert third party independent evaluators who can demand information and make binding recommendations; and performance is be linked to a system of incentives for good performance and sanctions for poor performance.

However, there is no step-by-step approach or process cited in the literature to be followed by public sector companies in developing countries. PBMSIG (2001), NPR (1999) and OECD (1999) however cite leadership in championing the course; existence of a strategic plan with clear organization objectives; a conceptual framework to enable the organization to focus its measures; commitment by every one since the degree of commitment will determine the degree of success; and involvement of all stakeholders, customers, and employees both by the level and timing of employee involvement individually tailored depending on size and structure of the organization as the dimensions forming major components of an integrated performance measurement system whose inclusion would result in good performance contracts and eventual successful implementation.

Other essential dimensions in this particular area would require a sense of urgency to move to a new and enhanced performance measurement and management regime; communication; ongoing feedback process to make adjustments and keep it operating efficiently; adequate resources in terms of money, equipment and people; customer

identification; learning and growth to keep the organization in tune with emerging technologies and trends; environmental scanning of both the external and internal environments; enhanced organizational capacity centered on people and processes in ensuring that inefficient and ineffective processes do not get in the way of the drive to success; and institutionalized accountability for performance and with focus on results.

# CHAPTER THREE

## RESEARCH METHODOLOGY

### 3.1 Introduction

This chapter highlights the methods and procedures the researcher were adopted in carrying out this study. It clearly defines the research design, the population, data collection methods, research procedures and data analysis methods..

### 3.2 Research Design

This was a case study. It involved an in-depth investigation of the extent to which KRA considered the conditions or factors necessary in developing and implementing performance contracts.

### 3.3 Data Collection

The data for this research project was collected mainly from primary sources through personal interview. Four (4) members of staff from KRA management, who played a key role in the development and implementation of performance contracts, were identified and targeted for interview. They were used as the key informants in the research project.

The research instruments used were open-ended interview guide. Personal interview had the advantage of being flexible, it gave the researcher greater control over the interviewing situation, ensured high response rate and helped the interviewer to collect supplementary information (Nachimas and Nachimas,1996)

### 3.4 Data Analysis Methods

The nature of data that was collected was qualitative. It was analyzed using content analysis technique. Content analysis has been defined as “any technique for making

inferences by systematically and objectively identifying specified characteristic of messages”(Nachimas and Nachimas,1996,pp 324).

## **CHAPTER FOUR**

### **DATA ANALYSIS AND FINDINGS**

#### **4.1 General Information**

This chapter presents the analysis and findings of the research. This analysis is presented in tables. The research sample comprised of 75% male and 25% female respondents, all of whom were working for KRA in the Support Services and Human Resources departments.

From the findings it emerged that 75% of the Respondents were involved in the development and implementation of the performance contracts, while only 25% were not involved. The results showed that 25% of the respondents were team leaders whereas 50% participated in pre-negotiations. 25% were involved in the development of parameters for scoring guidelines and results.

50% of the respondents, pointed out that performance contract was meant to enhance accountability, while the remaining 50% said that it was meant to improve the overall performance of KRA. Further, it also emerged that 50% of the respondents saw this system as a transition from Balance Score Card (BSC) to performance contracts, while 25% saw the introduction as timely. The remaining 25% felt that it was untimely.

#### **4.2 The Extent to which KRA satisfied conditions necessary for the development and the implementation of Performance Contract**

The respondents were asked to indicate the extent to which different cadre of employees were involved in the performance contract process. The results showed that 75% of the respondents pointed out that the negotiations were done at the highest level then cascaded down to lower cadres, while only 25% said that all the staff were involved throughout the process.

As to whether KRA had established an integrated measurement system prior to the designing of performance contract, all the respondents agreed that KRA had such a performance system and that it was 50% used as a reward based performance system and 50% as a BSC system. Further, the results indicate that a system of accountability of performance results existed prior to the designing of performance contracts. It entailed BSC system, which was the most commonly used according to 50% of the respondents. 25% of the respondents said it was a reward based performance system, while the remaining 25 % saw it as a system based on the corporate plan.

The respondents were asked to comment on the adequacy of the existing information system in place to monitor, evaluate and report on various targets in KRA's performance contract. 75% of the respondents felt that there was inadequate information system to support them to do the job, while only 25% agreed that there was adequate system. The reasons for the system being inadequate were cited by 50% of the respondents and included lack of indicators for gauging performance, while others (25%) noted that the system was not scientific. The remaining 25% of the respondents felt that it had no matrix element and thus could not give scores .

The respondents were required to ascertain as to whether the targets were based on the organization's strategic objectives and strategies. It emerged that 100% of the respondents agreed that it was the case. 50% of the respondents cited the targets as having been done as a requirement of the performance contract guidelines, while the remaining 50% saw the it as part of KRA's strategic objectives and the corporate plan .

As to whether the measurement criteria in the performance contract was fair both to the managers and the government, 75% of the respondents agreed that it was fair to both parties while 25% disagreed that it was fair at all. As to whether the performance targets and measures were freely negotiated, all the respondents affirmed that they were freely negotiated. 75% of the respondents pointed out that the negotiations with The Treasury were free, while the remaining 25% pointed out that vetting through Performance Contract Steering Committee was another way of ensuring free negotiation.



The respondents were asked to indicate whether KRA was involved in the development of the performance contract criteria. 75% of the respondents agreed that it was involved, while 25% felt that it had no input whatsoever. All the respondents agreed that KRA's strategic plan had clear objectives from which performance indicators were derived. Majority of the respondents (75%) pointed out that the BSC as a strategy, was in place to ensure adequacy and commitment of staff to the implementation process. 25% of the respondents identified training of the lower cadre staff as the strategy used.

All the respondents agreed that there was sense of urgency in the introduction and implementation of performance contracts at KRA. The reason for this was that it was a presidential decree (50% of the respondents), thus management had to ensure that it was embraced by all staff; the rest of the respondents pointed out that sensitization(25%) and training(25%) were used to involve all the staff in the process.

The researcher wanted to find out if all staff were sensitized on performance contract before it was introduced. In response, 75% of the respondents disagreed that there was sensitization of staff at KRA before performance contracts were introduced, while only 25% agreed that the staff were sensitized before it was introduced. On whether KRA, did capacity building to enhance skills and knowledge of staff on performance contracts, all the respondents agreed that KRA undertook capacity building; and training was identified by 75% of the respondents as the major capacity building exercise that was used to enhance skills for the staff, while 25% identified sensitization as the tool that was used to enhance the staff skills for this process.

The measures that were taken by KRA to ensure that its organizational culture and structure were responsive to the requirements of performance contracts included sensitization through the third corporate plan (25%), drawing up of the tax payers charter (25%) and the BSC system (25%). All the respondents agreed that there existed prior re-evaluation of processes, regulations and policies to empower employees to meet performance targets. This included the reform and modernization programme that was on going at KRA (50%), restructuring of the organization that was on going before the performance contract process (25%), the strategic plan (25%) and the BSC system(25%).

## PART I: Staff Involvement In Various Stages of Performance Contracting at KRA

**Table 4.3.1: Involvement in the development and implementation of performance contracts at KRA;**

Responses	Frequency	Percent	Cumulative Percent
Yes	3	75.0	75.0
No	1	25.0	100.0
Total	4	100.0	

From the above findings it emerged that not all respondents were involved. 75% were involved in the development and implementation of the performance contracts at KRA while 25% were not involved.

**Table 4.3.2: Role played by the respective respondents in development of performance contracts;**

Responses	Frequency	Percent	Cumulative Percent
Development of Parameters for the scoring guidelines and results	2	50.0	50.0
Pre-negotiations	1	25.0	75.0
Team Leader	1	25.0	100.0
Total	4	100.0	

From the above findings it did emerge that the respondents played different roles in the development and implementation of performance contracts at KRA. 25% of the respondents were team leaders whereas 50% were involved in the development of parameters for scoring guidelines. 25% of the respondents participated in pre-negotiations.

**Table 4.3.3: Objectives of introducing performance contracts;**

Responses	Frequency	Percent	Cumulative Percent
Enhance accountability	2	50.0	50.0
Improve overall performance of the authority	2	50.0	100.0
Total	4	100.0	

From the above findings, 50% of the respondents identified the objectives of the performance contracts was meant to enhance accountability and while the remaining 50% felt it improved the overall performance of KRA.

**Table 4.3.4: The timelines and appropriate of the introduction of performance contracts;**

Responses	Frequency	Percent	Cumulative Percent
Not Timely	1	25.0	25.0
Timely	1	25.0	50.0
Transition from BSC to performance contracts	2	50.0	100.0
Total	4	100.0	

From the above findings it emerged that 50% of the respondents saw the introduction of this system as a transition from the BSC to performance contracts, while 25% saw the introduction as timely. The remaining 25% felt that it was not timely.

**PART II: The extent to which KRA satisfied conditions necessary for developing and implementing of performance contracts:**

**Table 4.3.5: The extent to which different cadres of employees are involved in performance contract process;**

Responses	Frequency	Percent	Cumulative Percent
All staff are involved	1	25.0	25.0
Negotiations at the highest level then cascaded down	3	75.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents said that the negotiations were done at the highest level then cascaded down to lower cadres, while only 25% said that all the staff were involved throughout the process.

**Table 4.3.6: Whether KRA had an integrated performance measurement system prior to designing of performance contract and how it was used;**

Responses	Frequency	Percent	Cumulative Percent
A reward based performance system	2	50.0	50.0
BSC system with each department reporting	2	50.0	100.0
Total	4	100.0	

From the above findings, it emerged that 50% said it was a reward based performance system while 50% felt that it was a BSC system with each department reporting.

**Table 4.3.7: What was entailed in the system of accountability of performance results;**

Responses	Frequency	Percent	Cumulative Percent
A reward based performance system	1	25.0	25.0
BSC system with each department reporting	2	50.0	75.0
Corporate plan	1	25.0	100.0
Total	4	100.0	

From the above findings, it emerged that the existing systems of accountability entailed, the BSC system being the most commonly used with a response of 50%, followed by 25% who felt it was a reward based performance system . The remaining 25% said it was a system based on the corporate plan.

**Table 4.3.8: The adequacy of information system in place is adequate for monitoring, evaluating and reporting performance on various targets;**

Variable	Frequency	Percent	Cumulative Percent
No	3	75.0	75.0
Yes	1	25.0	100.0
Total	4	100.0	

From the above findings, it emerged that 75% of the respondents said the information system was inadequate for evaluating and reporting performance on various targets, while only 25% agreed that it was adequate.

**Table 4.3.9: Reasons as to why the information system in place is not adequate;**

Responses	Frequency	Percent	Cumulative Percent
The information system was not scientific	1	25.0	25.0
Had no indicators for gauging performance	2	50.0	75.0
Had no matrix elements and could not give scores	1	25.0	100.0
Total	4	100.0	

From the above findings, it emerged that 50% of the respondents identified the reasons why it was not adequate as it had no indicators for gauging performance, while 25% of the respondents noted that the system was not scientific. The remaining 25% said it had no matrix element and thus could not give scores.

**Table 4.3.10: The basing of targets on the organisation strategic objectives and structure;**

Responses	Frequency	Percent	Cumulative Percent
As a requirement of the performance contract guidelines	2	50.0	50.0
Done as per the strategic objectives and the corporate plan	2	50.0	100.0
Total	4	100.0	

From the above findings it emerged that 50% of the respondents identified the targets as a requirement of the performance contract guidelines while the remaining 50% felt it was part of KRA's strategic objectives and the corporate plan.

**Table 4.3.11: The fairness of measuring criteria in the performance structure to the managers and the government;**

Responses	Frequency	Percent	Cumulative Percent
No	1	25.0	25.0
Yes	3	75.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents agreed that the measuring criteria in the performance contract was fair both to the managers and the government while 25% disagreed that it was fair.

**Table 4.3.12: Whether performance contract were freely negotiated were;**

Responses	Frequency	Percent	Cumulative Percent
Negotiations with the treasury	3	75.0	75.0
Vetting through steering committee	1	25.0	100.0
Total	4	100.0	

From the above findings, it emerged that 75% of the respondents pointed out that the negotiations with the Treasury were free, while 25% pointed out that vetting through the Performance Contract Steering Committee was another way of ensuring free negotiation.

**Table 4.3.13: KRA's input in the development of the performance contracts criteria;**

Responses	Frequency	Percent	Cumulative Percent
No	1	25.0	25.0
Yes	3	75.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents agreed that KRA made its input in the development of the performance criteria while 25% disagreed that it had no input whatsoever.

**Table 4.3.14: The clarity of KRA’s strategic plan on organizational objectives with performance indicators and measures;**

Responses	Frequency	Percent	Cumulative Percent
Through BSC built on clear perspectives and has specific targets	2	50.0	50.0
Through the 3rd KRA corporate plan	2	50.0	100.0
Total	4	100.0	

From the above findings it emerged that 50% of the respondents identified the existence of the BSC system built on clear perspectives and having specific targets, while the remaining 50% said that the third corporate plan had a strategic plan which had clear objectives with performance indicators and measures.

**Table 4.3.15: The strategies that were put in place to ensure adequacy commitment of staff to the implementation process;**



Responses	Frequency	Percent	Cumulative Percent
Training for the lower cadre	1	25.0	25.0
Use of BSC to chart career progression	3	75.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents identified BSC as a strategy that was in place to ensure adequacy and commitment of staff to the implementation process, while 25% of the respondents identified training of the lower cadre staff as the strategy used.

**Table 4.3.16: The sense of urgency in the introduction and implementation of performance contracts at KRA and what was done by the management to ensure that it is embraced by all the staff;**

Responses	Frequency	Percent	Cumulative Percent
It was a presidential decree and hence urgent	2	50.0	50.0
Sensitization	1	25.0	75.0
Training	1	25.0	100.0
Total	4	100.0	

From the above findings it emerged that 50% of the respondents identified it being a presidential decree and that's why the management had to ensure that it is embraced by all staff. while 25%, were identified sensitization and the remaining 25% identified training as having been used to embrace all the staff in the process.

**Table 4.3.17: The sensitization of the KRA employees on performance contracting before its was introduced;**

Responses	Frequency	Percent	Cumulative Percent
No	3	75.0	75.0
Yes	1	25.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents disagreed that there was sensitization of staff at KRA before performance contracts were introduced, while only 25% agreed that the staff were sensitized before it was introduced.

**Table 4.3.18: The capacity of KRA to enhance skills and knowledge of staff on performance contracts;**

Responses	Frequency	Percent	Cumulative Percent
Sensitization	1	25.0	25.0
Training	3	75.0	100.0
Total	4	100.0	

From the above findings it emerged that 75% of the respondents identified training as the major capacity building process that was used to enhance skills for the staff, while 25% identified sensitization as the tool that was used to enhance the staff skills for this process.

**Table 4.3.19: The measures taken by KRA to ensure that its organizational culture and structure are responsive to the requirements of performance contracting;**

Responses	Frequency	Percent	Cumulative Percent
Sensitization through the strategic plan	1	25.0	25.0
Through the 3rd corporate plan	1	25.0	50.0
Through the drawing of the tax payers charter	1	25.0	75.0
The existence of the BSC system	1	25.0	100.0
Total	4	100.0	

From the above findings it emerged that KRA undertook measures to ensure that its organizational culture and structure were responsive to the requirements of performance contracts, being sensitization through the strategic plan (25%), the 3<sup>rd</sup> corporate plan (25%), drawing of the tax payers charter(25%) and the BSC system(25%).

**Table 4.3.20: The existence of prior re-evaluation of processes regulation and policies done to empower the employees meet performance target;**

Responses	Frequency	Percent	Cumulative Percent
Reform and modernization programme	2	50.0	50.0
Restructuring of the organization	1	25.0	75.0
The BSC was in place	1	25.0	100.0
Total	4	100.0	

From the above findings it emerged that 50% respondents identified the reform and modernization programme that was ongoing at KRA, 25% of the respondents identified restructuring of the organization that was on going before the process and 25% identified the BSC system in place.

# CHAPTER FIVE

## DISCUSSION, CONCLUSION AND RECOMMENDATIONS

### 5.1 Introduction

This study sought to examine the extent to which the antecedent conditions/factors to performance contracting were taken into account when developing and implementing performance contracts at KRA.

**The objectives of this study was to;**

Determine the extent to which the necessary conditions for developing and implementing performance contracts were satisfied by KRA.

### 5.2 Summary of the findings

#### Part I: General Information

The research sample comprised of majority male respondents, all of whom were working at KRA's Support Services and Human Resources departments. From the findings, it emerged that out of all the respondents, three quarters were involved in the development and implementation of the performance contracts, and that they played different roles in the development and implementation of performance contracts at KRA. One was a team leader while others participated in pre-negotiations and the development of parameters for scoring guidelines and results respectively. It emerged that the objectives of introducing performance contracts, as pointed out by half of the respondents was that it was meant to enhance accountability and to improve the overall performance of the authority respectively, and it was also seen as a transition from Balance Score Card (BSC) to performance contracts and that the implementation was timely to some of the respondents but untimely to the others.

## **Part II. The extent to which KRA satisfied conditions necessary for the development and the implementation of Performance Contract.**

On the extent to which different cadres of employees were involved in performance contract process, it emerged that majority of the respondents pointed out that the negotiations were done at the highest level then cascaded down to lower cadres, and that all the staff were involved throughout the process. While on ascertaining as to whether KRA had an established integrated measurement system prior to the designing of performance contract, all the respondents were affirmative and that it was a reward based performance system and as a BSC system with each department reporting, as pointed out by half of the respondents. It also emerged that there existed a system of accountability of performance results prior to the designing of performance contracts, and it entailed, a BSC system, which was the most commonly used.

On the adequacy of the existing information system in place to monitor, evaluate and report on various targets, majority of the respondents disagreed that there was adequate information system to do the job. The reasons for the system being inadequate were sited by half of the respondents to be that it had no indicators for gauging performance and that it was not scientific and had no matrix element, and thus could not give scores. Most of the respondents agreed that the targets were based on the organization's strategic objectives and strategies, and sited that the targets were done as a requirement of the performance contract guidelines and as per the strategic objectives and the corporate plan. Majority of the respondents agreed that the measuring criteria, in the performance contract was fair both to the managers and the government. All the respondents were affirmative that the performance targets and measures were freely negotiated, since they were freely negotiated with The Treasury.

Majority of the respondents agreed that KRA was involved in the development of the performance contract criteria and that KRA's strategic plan, had clear objectives from which performance indicators could be measured, and that BSC as a strategy was in place to ensure adequacy and commitment of staff to the implementation process. All the

respondents agreed that there was sense of urgency in the introduction and implementation of performance contracts at KRA, the reason being that it was a presidential decree, that is why the management had to ensure that it was embraced by all staff.

Majority of the respondents disagreed that there was sensitization of staff at KRA before performance contracts were introduced, and that all the respondents agreed that KRA undertook capacity building, and training was identified by the majority as the major capacity building process that was used to enhance skills for the staff.

The measures that were taken by KRA to ensure that its organizational culture and structure were responsive to the requirements of performance contracts included sensitization through the strategic plan, the 3<sup>rd</sup> corporate plan, drawing up of the tax payers charter and the BSC system. All the respondents agreed that there existed prior re-evaluation of processes, regulations and policies to empower employees meet performance targets and this included the reform and modernization programme that was ongoing at KRA .

### **5.3: Discussion of the findings**

From the research findings it emerged that the majority of the respondents were involved in the implementation and development of the performance contracts, which is a key condition necessary for a good performance contract system as can be attested from our literature review PBMSIG(1999), which states that “A structured approach similar to the one used in the US, which focuses on strategic performance objectives; provides a mechanism for accurate reporting; bring all stakeholders into planning and evaluation of performance; provides a mechanism for linking performance to budget expenditures; provides a framework for accountability; and share responsibility for performance improvement.”

On KRA having had an established integrated performance system prior to the designing of performance contract the findings were affirmative. This is a good indicator as can be

attested from our literature review PBMISG(1999) “ They suggest a six-step process that includes establishing a successful program which include the definition of an original vision, mission and strategic objectives; establishment of an integrated performance measurement system; establishment of accountability for performance; establishment of a process/system for collecting performance data; one for analyzing, receiving and reporting performance data; and one for using performance data to drive performance improvement.”

From the research findings it emerged that KRA’s measuring criteria in performance contract was fair both to the managers and the government. This can be attested by information from GoK (2005a), OECD (1999), Trivedi (2004), and Mann (1995) in our literature review which states , “ Performance Information System relates to the need for reasonable information balance between Government and the Government Agency in the process of negotiating performance targets; Performance Evaluation System comprises of performance measurement criteria and evaluation systems; while Performance Sanctions/Incentive System relates to a system that links rewards/sanctions with measurable performance”. Further to that OECD (1999) states “On criteria conditions, the performance criteria to be included in the contracts must be clearly defined and easily understood; they should be fair to the manager, as they should encompass only areas within the control of public enterprise management; and the criteria for evaluating public enterprise performance must be fair to the country”.

From the research findings it emerged that there was a sense of urgency in the introduction and implementation of performance contracts at KRA, since it was a presidential decree, a factor that makes it a good condition necessary for the development and implementation of performance contract as stated in our literature review OECD (1999 )“ Other essential dimensions in this particular area would require a sense of urgency to move to a new and enhanced performance measurement and management regime; communication; ongoing feedback process to make adjustments and keep it operating efficiently; adequate resources in terms of money, equipment and people; customer identification; learning and growth to keep the organization in tune with emerging technologies and trends; environmental scanning of both the external and

internal environments; enhanced organizational capacity centered on people and processes in ensuring that inefficient and ineffective processes do not get in the way of the drive to success; and institutionalized accountability for performance and with focus on results.”

## **5.4: Conclusion**

In conclusion the above findings show that KRA satisfactorily fulfilled the conditions necessary for developing and implementing performance contract. This has enhanced accountability and the overall performance of the organisation.

## **5.5 Recommendations**

In future whenever a new system or process is to be introduced at KRA it will require that sensitization of staff as a key priority to ensure its success.



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# APPENDICES

## Appendix I: Letter of Introduction

### LETTER OF INTRODUCTION

13<sup>th</sup> August, 2007

Dear Respondent

Re MBA Research Project

I am a student at University of Nairobi, and I am carrying a research study as a requirement for the fulfillment for award of Masters degree in Business Administration

I am conducting a case study with the sole purpose of gathering information on “*THE EXTENT TO WHICH THE NECESSARY CONDITIONS FOR DEVELOPING AND IMPLEMENTING PERFORMANCE CONTRACTS WERE SATISFIED BY KENYA REVENUE AUTHORITY*”. The population of study will constitute of 30 staff members whose job groups fall within the performance contract cadres from KRA Nairobi offices.

This study is being carried out for a management project paper as a requirement in the partial fulfillment of the degree mentioned above.

The information and data required is needed solely for academic purposes and will be available to the organization upon request.

Your cooperation will be highly appreciated.

Thank You.

Yours faithfully,

Beatrice A. Odundo (Miss)

Professor P. K`Obonyo

**Student**

**Supervisor**

## **Appendix II: Interview Guide**

### **PART I**

#### **General Information**

1. Were you part of team that was involved in the development and implementation of performance contracts at KRA? What was your role?
2. What were the objectives of introducing performance contracts?
3. Was the introduction of performance contracts timely and appropriate?

### **PART II**

#### **Extent to which KRA satisfied conditions necessary for developing and implementing of Performance Contract at KRA**

1. To what extent are the different cadres of employees involved in the performance contract process
2. Did KRA establish an integrated performance measurement system prior to the designing of performance contract?  
  
If yes how did KRA use it?
3. Did KRA establish a system of accountability of performance results prior to the designing of performance contracts? If yes explain what it entailed and the procedures for using the system?
4. If the information system in place is adequate for monitoring, evaluating and reporting performance on various targets?
5. Whether the targets were based on the organizations strategic objectives and strategies?

6. Were the measuring criteria in the performance contract fair to the managers and Government?
7. If performance targets and measures were freely negotiated?
8. If KRA had any input in the development of the performance contract criteria?
9. Does KRA's strategic plan have clear organizational objectives from which performance indicators could be measured?
10. What strategy was put in place to ensure adequate commitment of staff to the implementation of performance contracts by staff at all levels?
11. If there was a sense of urgency in the introduction and implementation of performance contracts at KRA? If yes what did management do to ensure everyone embraces this sense of urgency throughout the organization?
12. Did the organization sensitize all its employees on performance contracting before it was introduced?
13. Did KRA have capacity building to enhance skills and knowledge of staff on performance contracts?
14. What measures did KRA take to ensure that its organizational culture and structure were responsive to the requirements of performance contracting?
15. Was there prior re-evaluation of processes, regulations and polices done to empower the employees meet performance targets?

**END**

**Thank you very much for your co-operation**

### **Appendix III: List of Laws administered by Kenya Revenue Authority**

1. The Income Tax Act CAP 470
2. Customs & Excise Act, CAP 472
3. The East African Community Customs Management Act, 2004
4. The Value Added Tax Act CAP 476
5. The Road Maintenance Levy Fund Act 1993 (No. 9 of 1993)
6. The Air Passenger Service Charge Act CAP 475
7. The Entertainment Tax Act CAP 479
8. The Traffic Act CAP 403
9. The Transport Licensing Act CAP 404
10. The Second Hand Motor Vehicle Purchase Tax Act CAP 484
11. The Civil Aviation Act CAP394
12. The Widows and Children's Pension Act CAP195
13. The Parliamentary Pensions Act CAP 196.