THE IMPACT OF PERFORMANCE CONTRACTING ON OPERATIONAL PERFORMANCE IN THE BANKING INDUSTRY: A CASE OF MULTINATIONAL BANKS IN KENYA

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A Management Research Project Submitted In Partial Fulfillment Of The Requirements For The Award Of The Degree Of Master Of Business Administration, School Of Business, University Of Nairobi.

2008

DECLARATION

This project is my original work and has not been submitted for a degree in any other University.

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This project has been submitted for examination with my approval as the university supervisor.

Signed:..Date 19/11/2008

S O Nyamwange
Supervisor

2008

DEDICATION

I dedicate this project to my Son Khaleed and to my wife Markaba who gave me encouragement throughout this research process. I want to recognize the sacrifice made by my father, mother, brothers and sisters for their patience and unfailing support. To my friends such as Madey and Kibet and classmates, I say Asante Sana for your moral and material support that you accorded me during the research process

May Allah bless you abundantly.

Mohammed Abdirahman Sheikh.

ABSTRACT

This study sought to determine the extent performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya; and. to establish the challenges of implementing performance contracting by multinational banks in the banks' operations and delivery of service.

This research surveyed all the multinational banks in Kenya whose head offices are based in Nairobi. A multinational bank is defined as a bank operating in more than one country with the goal or objective of maximizing stockholders' wealth or the stock price. This study surveyed the impacts of performance contract in Banks in Kenya using a case study of multinational banks. Both primary and secondary data was collected for the study. The data analyzed showed the non-financial performance indicators as well as the qualitative indicators of performance contracting.

The study results indicated that performance contracts increases performance. It also revealed that banks have adopted PCs in order to reveal information and motivate managers to exert effort. Implementation of these measures has improved governance, transparency, Accountability and operational efficiency in the management of bank affairs, and as a result, made the private sector is more effective in its delivery of services as part of its commitment to ensuring efficiency. In this study, the results revealed that 80% of all the banks that adopt PCs have increased growth in terms of turnover. In addition, the banks that use performance contracts are more likely to retain their employees than those that do not use. This is because the evaluation is more objective and hence employees would be more likely satisfied with the results of the evaluation process.

ACKNOWLEDGEMENT

I wish to acknowledge and thank my supervisor, Mr. S O Nyamwange and my moderator Mr. M Mwangi, whose incisive reading and constructive critiques of the project in progress have been invaluable. They have been remarkably patient, considering the time this research project has taken to come to fruition, providing consistent guidance, constructive feedback and helpful advice during the successive stages of this work.

I am also deeply indebted to the Employees of the banks under study who graciously gave their time in providing data that led to successful completion of the project.

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LIST OF ABBREVIATIONS

CBK	- The Central Bank of Kenya
CMA	- Capital Markets Authority
CWSA	- The Community Water Supply Agency
CSOs	- Community Service Organization
ERSWEC	- Economic Recovery Strategy for wealth and Employment Creation
FY	- Financial Year
GOK	- Government of Kenya
ICPAK	- Institute of Certified Public Accountants of Kenya
KCB	- The Kenya Commercial Bank Nairobi Stock Exchange
MOU	- Memorandum of Understanding
NAOD	- National Audit Office of Denmark
NGO	- Non-Governmental Organizations
NSE	- Nairobi Stock Exchange
OECD	- Organization for Economic Co-operation and Development
PCs	- Performance contacts
PC	- Performance contact
RBM	- Results based Management
USA	- United States of America
UK	- United Kingdom
SOEs	- State-Owned Enterprises
PCSC	- Performance Contact Steering Committee
RBM	- Results Based Management
RPE	- Relative Performance Evaluation

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CHAPTER ONE: INTRODUCTION

1.1 Background

Over the past decade, a number of developments have taken place in business management. The transformation of the value chains influences on the global competition into the way business is done, the effects of liberalization of the economy's changing patterns of employment; and changes in the organizational structure are among other salient developments in business management. Globalization of the markets and operations, liberalization and deregulation, together with changes within the political and social arena have forced organizations to evolve strategic options which give them competitive advantage over others in their ever changing and turbulent environment. These global trends have had profound and cyclical impact on company management styles and responses (Daniels and Redebaugh, 1995; Winslow, 1996; Lynch, 2000).

Since the seminal work of Berle and Means (1932), the conflict between the owner and the manager of the firm is in the spotlight. If ownership is dispersed, there will be rider problem leading to higher agency costs of capital and lower firm performance. In the last decade, new attention is given to misuse of so-called corporate governance; defined as the manner in which firms are directed and controlled. Agency problems that arise in firms 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 this mechanism is to align the interest of managers or board members with the interest of shareholders. Increase in agency conflict has led to various mechanisms that are aimed at reducing these conflicts. Measures such as Board structure, use of audit committees, executive compensation, corporate takeovers and performance based contracting have been used to mitigate against agency costs arising from separation of ownership and management.

A more recent mechanisms aligning management interests with those of owners of the firm is performance contracting. The importance of performance based contracting as a mechanism for corporate governance has been a matter of considerable academic debate in both theoretical and empirical literate. The issue has also received renewed attention among the policy makers in both developed and developing countries engaged in reforming internal corporate governance mechanism (Ghash, 2002). The dominant economic view of performance based contracting and firm performance essentially draws from the theory of agency costs. Such costs arise due to the separation of ownership and control in largely held firms. In a typical agency theory framework, the assumption is that there is a mismatch between the interests of the shareholders and that of management who run the firms on their behalf.

A performance contract is an agreement between an employer and an employee, which establishes general goals for the organization, sets targets for measuring performance and provides incentives for achieving these targets (Ogangah, 2008). These kinds of contract are now considered an essential tool for enhancing good governance and accountability in employment. Performance contracting is the process of identifying and measuring the results, outcomes or products obtained from a contract through the use of measurable indicators (Rosen, 1992). The use of performance contacts (PCs) has been acclaimed as an effective and promising means of improving the performance of private enterprises as well as government departments (Rosen, 1992). Essentially, a Performance Contract is an agreement between an agent and an agency or an employer an employee, which establishes general goals for the agency, sets targets for measuring performance and provides incentives for achieving these targets. They include a variety of incentive-based mechanisms for controlling public agencies-controlling the outcome rather than the process. The success of PCs in such diverse countries as France, Pakistan, South Korea, Malaysia, India, and Kenya has sparked a great deal of interest.

A large number of governments, private and international organizations are currently implementing policies using this method to improve the performance of enterprises in their countries. PCs represent a state-of-the-art tool for improving both public and private sector performance. They are now considered an essential tool for enhancing good governance and accountability for results both in the public and private sector (Stiglitz 1974). High-performing banks measure performance dynamically, against competitors and internally against peers. Instead of focusing on changes against plan, they compare themselves against prior periods and reward managers when performance improves against peers and competitors over time. This of course, requires extensive benchmarking competencies as well as the capability to ensure that each unit being measured bears the full cost of the resources it consumes. This does not mean that target setting falls by the wayside. It is important not to substitute targets for fixed performance contracts

(Wiersma, 2003). However, short and medium-term targets can be established with respect to strategic needs and competitive position in order to provide a long-term goal--post towards which each business can strive. Providing quality information to enable business units to better manage their operations is clearly a laudable goal, and aligns well with an empowerment philosophy. A common infrastructure for financial platform can be a critical enabler of efficient finance processes. Where the information is used as a stick however, by providing 'drill-downs' to minute levels of operational detail, or by building information "dashboards" to better enable central control, they will work against this empowered approach. A negotiated incentive contract is viewed as a device to reveal information and motivate managers to exert effort.

1.2 Performance Contract

Different scholars have defined performance contacts (PCs) differently. However, they seem to hold similar views on the contents of PCs. Performance contract is an agreement between two parties that clearly specifies their mutual performance obligations, intentions and responsibilities (Blasi, 1999). The increased interest in PCs coincides with demands for greater accountability. Neilis (1989) observes that PCs are negotiated agreements for both public and non public enterprise and the stakeholders in which the intentions, obligations and responsibilities of the two parties are freely negotiated and then clearly set out. Shirley (1998) advocates the view that the PCs seem to be a logical solution since similar contracts have been successful in the private sector. This has led to shifting them from ex anticontrol to ex-post evaluation; thus giving managers the autonomy and the incentives to improve efficiency. Xu (2005) observes that PCs 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.

A PC addresses economic, social or ones tasks that an agency has to discharge for economic performance desired results. It is organized 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. PCs comprise of mutually agreed performance targets, review, and evaluation of periodic and terminal performance (Shirley (1998)). PCs have their origin 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 problem that have inhibited the performance of government agencies are largely common and have been identified as excisions controls, multiplicity of principles, frequent political inference, poor management and outright mismanagement (England, 2000).

Mann (1995) advances the view that mechanism of performance contracting is among the multiple ways of improving efficiency of public enterprises. Malathy (1997) argues the adoption the PCs 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 developed management style where emphasis is management by outcome rather than management by processes. It therefore provides a framework for changing behaviour 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. PCs 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). Shirley (1998) and Okumu (2004) studied the causes of failure of PCs and found out the causes as: information asymmetry; insufficient commitment for both parties to the contract; poor incentives; impositions by government, no prior negotiations and contract terms willingly agreed to; managers having various stakeholders who include politicians, which then bring about conflicting objectives.

Studies by Gichira (2001) and Odadi (2002) focused on different contexts and themes about performance management. Performance based contracting has been identified by both the private and public sectors as an effective way of providing and acquiring quality goods and services within available budgetary resources (Mapelu, 2005). Whereas within a private sector profit orientation, operational efficiencies and competitiveness have necessitated the introduction of PCs, the pubic sector has taken long to embrace the practice especially in the developing countries (NPR, 1997). Performance contracting has been widely used in the public sector as well as private sector by the developed countries such as New Zealand, USA, the Netherlands, and France among others with marked success (PRMSIG, 2001). The experiences in developing countries though, citing case studies in China, India, Morocco, South Africa, Cote D'Ivoire and Gambia among others, have shown mixed results (Shirkey, 1998).

Performance contracts (PCs) are widely used to reform state-owned enterprises (SOEs).The World Bank (1995) found that there were, as of June 1994, 565 such contracts in 32 developing countries, where they are principally used for large utilities and other monopolies, and another estimated 103,000 in China, where they are used in manufacturing SOEs. PCs are written agreements between SOE/private company and employees, who promise to achieve specified targets in a given time frame, and government or management which (usually) promises to award achievement with a bonus or other incentive. PCs are a variant of pay for performance or incentive contracts, which have been often used to motivate private managers, and suggested as a way to improve central government agencies or private companies (Mookerjee, 1997).

The rationale for incentive contracts such as PCs is largely based on principal/agent theory (Ross 1991). The principal (in the case of private companies, the management officials) can only observe outcomes and cannot measure accurately the effort expended by the agent (the employees) or distinguish the effects of effort from other factors affecting performance (LafTont, 1986; Tirole, 1993). A negotiated incentive contract is viewed as a device to reveal information and motivate managers to exert effort. Proponents argue that the contract can translate multiple objectives into targets measured by specified criteria and given weights to reflect priorities (Ramamurti and Vernon, 1991). By specifying targets and evaluating results ex post, the PC is seen by its advocates as a way to encourage management to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Banks have adopted PCs in order to reveal information and motivate managers to exert effort (Ramamurti and Vernon, 1991). Implementation of these measures has improved governance, transparency, Accountability and operational efficiency in the management of bank affairs, and as a result, made the private sector more effective in its delivery of services as part of its commitment to ensuring efficiency (Ramamurti and Vernon, 1991). In his study, Vernon (1991) reveals that 80% of all the banks that adopt PCs have increased growth in terms of turnover. In addition, he points out banks that use performance contracts are more likely to retain their employees than those that do not use. This is because the evaluation is more objective and hence employees would be more likely satisfied with the results of the evaluation process.

1.3 Performance contracting in Kenya

In Kenya, performance-contracting concept can be traced to early and mid-1990s when a few state corporations (Kenya Railways, national cereals and produce Board, Kenya Airways, Mumias Sugar Company and the defunct Kenya Post and Telecommunications Corporation) attempted to develop variant PCs. These were however, not implemented or when implemented were found unsuccessful. A new approach of performance-contracting concept in line with the objectives of Economic recovery strategy for wealth employment creation (2003-2007) has been initiated with selected public enterprises on a pilot basis being subjected to PCs from October 2001. The Government of Kenya started sensitizing the public sector corporations on the concept of performance contracting using performance contract sensitization manual (GOK 2005a) and thereafter developed an information booklet on PCs (GOK 2005b) to guide the process of performance contracting.

In addition, several seminars and workshops have been organized by various organizations among them the government, Capital Markets Authority (CMA), the Central Bank of Kenya (CBK) and professional bodies such as institute of Certified Public Accountants of Kenya (ICPAK). One of these was a PCs sensitization workshop organized by the government held on 17^{th} and 18^{th} June 2004 at Safari Park Hotel. This was a follow up to various initiatives by the performance contract steering committee intended to move the performance based process forward. Thereafter, such seminars have continued to be held in Kenya as in the case of sensitization workshop organized by the government held on 2006 at Serena Hotel in order to encourage companies to adopt performance contracting as a means of increasing accountability and productivity (PCSC, 2005).\Generally, during 2006, the best trophy for the best performing ministry went to the Ministry of Agriculture, the Ministry of National Heritage was second while the Ministry of Tourism and Wildlife was third. On the other side of State Corporation, Kenya Seed Company scooped the first position; Kenya Pipeline was second while National Oil Corporation came third.

In the private sector, and particularly the banking industry, employees also sign their performance contract. This is aimed at improving performance as well reducing the agency conflicts. The rationale for incentive contracts such as PCs is largely based on principal/agent theory (Ross, 1991; Stiglitz, 1974; Sappington, 1991). The principal can only observe outcomes and cannot measure accurately the effort expended by the agent or distinguish the effects of effort from other factors affecting performance (Laflont, 1986 Tirole, 1993). A negotiated incentive contract is viewed as a device to reveal information and motivate managers to exert effort. In the case of private enterprises, PCs are also touted as a way to clarify the objectives of the multiple principals who govern private corporations, and hence make it easier to set goals and evaluate achievements. Proponents argue that the contract can translate multiple objectives into targets measured by specified criteria and given weights to reflect priorities (Ramamurti and Vernon, 1991).

Moreover, targets can be set to take into account circumstances where bank managers have more control over their firms than comparable managers do in the public sector. For example, performance might be judged against the firm's past trends, rather than against an industry standard, to take account of situations where the firm's performance is sub-standard because of parent company's imposed constraints. By specifying targets and evaluating results ex post, the PC is seen by its advocates as a way to encourage private companies to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

In the banking sector in Kenya, (especially multinational banks; Appendix1) management and the employees do sign the PCs. The PCs are based on specific criteria units and criteria values. The private sector through the PC has also improved their performance. For instance, Kenya Commercial Bank has won an award. The award follows years of a turnaround process that has transformed the bank from a struggling enterprise to a blue chip organization. KCB won the prestigious award following a year of superb performance on the Nairobi Stock Exchange (NSE) during which the stock gained 97% compared to about 22% gains recorded by the entire Kenyan market. The awards took into account the stock's performance during the one-year period to March 2007 as well as price movement, the turnaround of KCB and its first quarter 2007 results, the bank's corporate governance performance, the improving debt portfolio, large branch network, wide range of products and services and the liquidity of the shares in the NSE (Kobia, et al, 2007).

1.4 Statement of the Problem

Performance based employment contracting in large organizations has been attracting much debate in part generated by the findings of various bodies such as the commonwealth, World Bank, and Capital Markets Authority (Kobia, et al. 2007). In Kenya, Choke (2006) studied the on the perceived link between strategic planning & performance contracting in Kenyan state corporations and found out that most managers perceive PCs as a management tool useful in achieving set targets. Wanjiru (2006) on the other hand studied the management perception of performance contracting in state corporations and achieved the same results. Korir (2005) studied the impact of performance contracting in state corporations a case of East African Portland Cement. In his study, he found out in the presence of PCs there is an improvement in firm's performance.

The above cited studies showed that performance contracting can lead to both improved and unimproved performance. This was attributed to other external factors such as favorable or unfavorable source of funds, monopolistic nature of the company or favorable or unfavorable economic trends within the industry, than the performance contract itself. The researcher therefore believed that PC leads to improved performance. In this study, performance contracting was viewed as a management tool for measuring performance that establishes operational and management autonomy between the parent banks and their subsidiaries, reduces the quantity of controls and enhances quality of service, focusing on service delivery and not processes, measures performance and enables recognition and reward for good performance and sanctions bad performance. It is in this light that the researcher endeavored to fill the gap in this area of study by answering the question: "What is the impact of performance contracting on bank's operational performance as applied by multinational banks in Kenya?"

In order to analyze this problem, the study seeks to determine whether PCs have an impact on the performance of the multinational banks and the challenges multinational banks face in light of the introduction of PCs.

1.5 Objectives of the Study

The study aimed at achieving the following objectives:

(i) To determine the extent performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya; and,

(ii) To establish the challenges of implementing performance contracting by multinational banks in the banks' operations and delivery of service.

1.6 Importance of the Study

1.6.1 Shareholders

The findings of the study will enable the owners understand the impact of performance contracting in their bank operations and service delivery.

1.6.2 Policy makers

It will also aid policy makers in designing guidelines that promote good corporate governance practices by providing an insight into the current performance based contracts in multinational banks in Kenya.

1.6.3 Academicians

The study in addition to the above-mentioned points will contribute to existing literature and provide a basis for further research in the area of corporate governance, agency costs and performance-based contracts.

CHAPTER TWO: LITERATURE REVIEW

2.0 Introduction

The use of Performance Contracts has been acclaimed as an effective and promising means of improving the performance of public and private enterprises as well as government departments (OECD, 1997). International experience with multinational banks suggests that the process of implementing a well-thought-out expansion program is a lengthy one. Therefore, in the interim, it is imperative that immediate steps be taken to increase the operational efficiency of the multinational banks and reduce further drain on the company's financial resources resulting from losses. A rigorous performance contract exercise reveals the "true" costs and benefits associated with a particular multinational bank. This, in turn, provides a valuable basis for signing performance contracts (Kumar, 1994). Therefore this study will review the origin of performance contracting, international experience, challenges of performance contracting in banks and make a critique in order to identify the knowledge gap of the study.

2.1 Performance Contract and its origin

Performance Contract System originated in France in the late 1960s. It was later developed with great deal of elaboration in Pakistan and Korea and thereafter introduced to India (OECD, 1997). It has been adopted in developing countries in Africa, including Nigeria, Gambia, Ghana and Kenya. The definition of PC itself has been a subject of considerable debate among the scholars and human resource practitioners. A Performance contract is freely negotiated performance agreement between Government, organization and individuals on one hand and the agency itself (Kenya, Sensitization Training Manual, 2004). It is an agreement between two parties that clearly specify their mutual performance obligations, and the agency itself.

Kumar (1994) defines performance contract as a Memorandum of Understanding (MOU). MOU is rooted in an evaluation system, which not only looks at performance comprehensively but also ensures forces improvement of performance managements and industries by making the autonomy and accountability aspect clearer and more transparent. OECD (1999) defines Performance Contract as a range of management instruments used to define responsibility and expectations between parties to achieve mutually agree results. While Smith (1999) argues that a common definition of performance contracting can be found, there are a considerable variety of uses and forms for quasi-contractual arrangements. In this paper performance, contracting is used as a management tool to help public sector executives and policy makers to define responsibilities and expectations between the contracting parties to achieve common mutually agreed goals.

2.2 International experiences with implementation of PC's

Starting in France in the 1970's. Performance Contracting has been used in about 30 developing countries in the last fifteen years. In Asia, the Performance Contract concept has been used in Bangladesh, China, India, Korea, Pakistan and Sri Lanka. In Africa, PCs have been used in selected enterprises in Kenya, Benin, Burundi, Cameroon, Cape Verde, Congo, Cote d'Ivoire, Gabon, the Gambia, Ghana, Guinea, Madagascar, Mali, Mauritania, Morocco, Niger, Senegal, Togo, Tunisia and Zaire. In Latin America, they have been used at different times in Argentina, Brazil, Bolivia, Chile, Colombia, Mexico, Uruguay and Venezuela. Others include Malaysia, United Kingdom, U.S.A, Canada, Denmark and Finland among others (Kobia et al, 2006).

Public Enterprises in Africa are suffering financially and many are seeking financial assistance. Their problems stem from unclear and conflicting objectives, and a lack of autonomy and accountability. The results of performance contracting have been mixed. In some countries, there has been a general and sustained improvement in Public Enterprises, while in other countries some Public enterprises have not responded or have been prevented by government policies from responding. In implementing PCs, the common issues that were being addressed include to improve performance to deliver quality and timely services to the citizen, improve productivity in order to maximize shareholders wealth, reduce or eliminate reliance on the exchequer, instill a sense of accountability and transparency in service delivery and the utilization of resources and give autonomy to government agencies without being subjected to the bureaucracies and unnecessary procedures (Kobia et al , 2006).

2.3 The contract plan experience in Africa

In little more than a decade, Ghana has transformed the structure and strategy of its rural water supply sector. By 2000, district assemblies and communities played a significant role in planning supplies. The new policy and structure has attracted extra funds, and work is accelerating. This reform process started with an extended dialogue with the major stakeholders in the sector, out of which a new rural water and sanitation policy was developed. The policy was then implemented in several large pilot projects, supported by a number of external agencies, and finally the lessons from those projects were incorporated into the national performance contract program itself. The success of this approach was because national and international NGOs were contracted to build the capacity of local-level NGOs and CSOs. The Community Water Supply Agency (CWSA) was created as a facilitating agency rather than an implementer. CWSA, as a semi-autonomous public-sector agency, signs an annual performance contract with the State Enterprise Commission. It is committed to staying efficient and lean, below a 200 size staff, and highly decentralized to its ten regional offices (World Bank 2002).

The evolution of contract plans in Swaziland can be traced back to the early 1990's a period that witnessed the promulgation of the Public Enterprise (Control and Monitoring) Act of 1989 (Musa, 2001). The latter sought to establish viable control mechanisms for Swaziland's parastatal sector amid a national outcry that public enterprises were continuing, unabated, to be a financial as well as an administrative burden on the government (Musa, 2001). However, the performance agreement of the early 1990's failed to achieve its stated objective i.e. to improve the performance of the Public enterprises. This was because of widespread use of consultants in the formulation of contract plans, including the determination mechanisms for their monitoring and evaluation; Public enterprise management did not develop the necessary sense of ownership and commitment to the success of the enterprise contracts. Lessons of experience with regard to the use of outside consultants, expert or advisors, especially from developed countries, in the formulation of development plans, have shown that while they may be knowledgeable about certain issues and areas that are generic to their field of specialization, they often lack an intimate knowledge of the unique socio-political and economic circumstances confronting individual countries, especially those of the third world (Musa, 2001)

The performance contract system for public enterprises was introduced in Gambia in 1987. As a prelude to identifying those Performance Enterprises to come under the performance contract system, the Public Enterprise sector was divided in to three schedules: Enterprises in which the government is a minority shareholder; Enterprises in which the government is a majority shareholder or has 100% shareholding; and, Strategic corporation/departments. Only Public Enterprises under schedule three were identified as suitable candidates for PCs. Under the first phase in 1987, the PCs were developed for three Public Enterprises only.

2.4 Result Based Performance Management Cycle

The figure below illustrates the performance management cycle and identifies the position of performance contracting in the cycle.

Figure 2.1: Performance Management Cycle

Source: *Budde, Jorg. Measure Congruity (2006-12-20). Journal of Accounting Research, Vol. 45, Issue 3, pp 515-539, June 2007.*

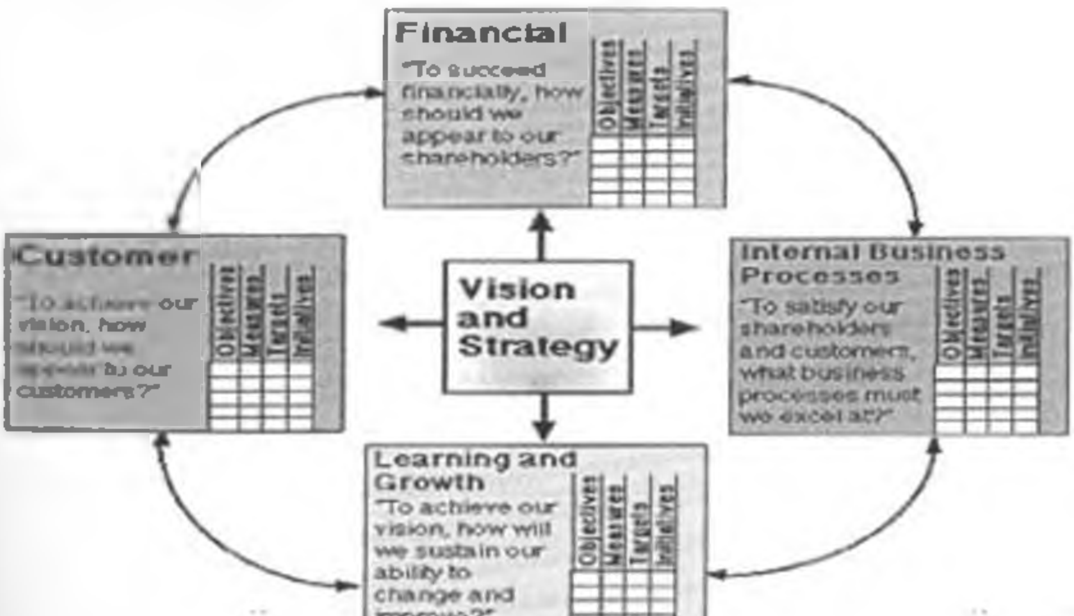
2.5 Types of performance contracts

PCs 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 management and memorandum of understanding (MOU). There is the general consensus that there are only two main types of contract and all other managements fall under one or the other (Behn et al, 1999). They identify two systems as: the French based system and the signaling system.

The difference between the two is that typical French contract plans allocate weight (and point calibrations) to targets. Thus there is no distinction between targets in terms of emphasis by weighting them differently and as such, performance evaluation is affected by a degree of subjectivity. This system is practiced in France, Senegal, Benin, Morocco and Latin America. The signaling system is popular in Asia e.g. Pakistan, South Korea, and Bangladesh, Africa (Ghana, Nigeria, Kenya and Gambia) and Latin America. It should be noted that both systems may be practiced concurrently in the same country such as the case in India where the initial Memorandum of Understanding (MOU) were based on French systems, while those singed more recently follow the signaling system (Trivedi, 1992).

2.6 Contents of a performance contracts

Kaplan and Norton (1992, 1993, 1996a, 1996b) have introduced the balanced scorecard at the enterprise level. Their basic idea is that the evaluation of an organization should not be restricted to a traditional financial evaluation but should be supplemented with measures concerning customer satisfaction, internal processes and the ability to innovate. These additional measures should assure future financial results and drive the organization towards its strategic goals while keeping all four perspectives in balance. They propose a three-layered structure for the four perspectives: mission (e.g., to become the customers' most preferred service provider), objectives (e.g., to provide the customers with new, well thought products) and measures (e.g., percentage of turnover generated by new products). The balanced scorecard can be applied to the IT function and its processes as Gold (1992, 1994) and Willcocks (1995) have conceptually described and has been further developed by Van Grembergen and Van Bruggen (1997) and Van Grembergen and Timmerman (1998).



In the private sector, benchmarking is a recognized instrument for uncovering potential performance improvements and for spreading innovation and efficient practices. In a number of agencies, benchmarking is included as a requirement in the performance contract. Comparing performance with similar institutions is expected to improve efficiency and to strengthen the process of setting ambitious yet realistic targets when performance contracts are negotiated. This implies that the balance score card has non-financial elements which address the aspect of performance contracts (Gold, 1992).

2.7 Rationale for Reintroduction of PC's

Performance Contracts were re-introduced on 1st October, 2001 in 16 largely commercial State Corporations. In 2005/2006, all the then 35 Government Ministries/Departments, 116 State Corporations and five pilot Local Authorities signed Performance Contracts and were evaluated in September 2006. However, private companies have also followed the suit (PCSC, 2007). PCs originated from the perception that the performance of the Public Sector has been consistently falling below the expectations of the Public. Performance Contracting is part of broader Public sector reforms aimed at improving efficiency and effectiveness in the management of Public service. The problems that have inhibited the performance of government agencies are largely common and have been identified as excessive controls, multiplicity of principles, frequent political interference, poor management and outright mismanagement (RBM Guide, 2005). While several approaches have been used to address these challenges, it is hoped that performance contract will be an effective tool for managing productivity and operational efficiency.

A Performance Contract is a management tool for measuring performance against negotiated performance targets (PCSC, 2007). It clearly specifies the intentions, obligations, responsibilities and powers of the parties. It addresses economic, social and other tasks to be discharged for Economic or other desired gain. 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 all over the world view performance contracting as a useful vehicle for articulating clearer definitions of objectives and supporting new management monitoring and control methods. This will at the same time leave day-to-day management to the managers themselves. It organizes and defines tasks so management can perform them systematically, purposefully and with reasonable probability of achievement. PCs are based on the premise that what gets measured gets done; if you cannot see and measure success, you cannot reward it; if you cannot recognize failure, you cannot correct it and if you can demonstrate results, you can win public support (Musa, 2001).

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2.8 Challenges of Performance contracting in operations

Clearly defined standards regarding the quality, quantity and timeliness provide objective data in evaluating contract performance (PBMSIG, 2002). For all service contracts, contract managers can use performance contracting to improve program performance, identify programs that work and those that do not, direct resources to those models or contractors that produce the desired results, improve service quality by sharing best practices throughout the system and support contract management decisions. The effective implementation of performance contracting requires us to focus on the What the outcome or change that we are looking for as a result of this contract, how we can measure and evaluate if the result has been achieved; and, how performance contract affect our management decisions.

However, PC has some challenges. First is the effectiveness measure which examines whether the outcomes achieved were worthwhile and contained any long term benefit may be difficult to measure it objectively. In other words, effectiveness measures look at the extent to which the program yielded the desired outcomes. This is a great challenge to multinational banks in those monitoring costs for their subsidiaries (PBMSIG, 2002).

Another challenge of PC is the failure to articulate precisely how the specific performance measure will be defined, calculated and reported during the contract duration. For example, if the output requires a number, the measure field should specify duplicated or unduplicated count and any other information necessary to ensure that all contracts are reporting the information in the same manner. If the outcome requires the reporting of a percentage, the measure field should define both the numerator and denominator of the calculation (PBMSIG, 2002).

Departments may establish performance goals for the duration of the contract or may identify goals on an annual basis (either by year of the contract or by fiscal year) and amend the contract based on experience, available funding, changes in target population or other variables. Departments have three options to consider when identifying goals: actual performance data, contract specific goals for groups of contracts or for each individual contract to account for unique client needs, geographic consideration, funding levels or other variables that impact on performance and organization wide goals for all employees (PBMSIG, 2002).

In some cases, it may be difficult to identify concrete outcomes or "results" for a service. For example, training and education services might be provided with the goal of disseminating information and modifying people's behavior. however, it may be difficult or impossible to track participants and determine whether the training helped people to think and act differently. In these cases, the development of or output measures such as the number of people served or the number of training sessions or outcome measures to evaluate the impact of the training effort such as pre/post test scores should be developed. If a department is unable to identify performance outcomes for a specific service type, a meeting with head of the section and other departments may be useful to stimulate new ideas and share best practices (PBMSIG, 2002).

In order for performance measures to be useful, it must be clear to everyone precisely what is being measured and how the measures are calculated. Achieving this degree of clarity between both the procuring department and the contractor is one of the most difficult and challenging aspects of performance contracting. Any ambiguities about what and how performance is being measured should be eliminated before the contract is executed. This will ensure that a contractor understands its responsibility and the data collected will be reliable. For example, there must be common agreement on how the numerator and denominator will be calculated (Sundaram, 2002).

2.9 Genesis of Performance Contracting in Kenya

The concept of PC was first introduced in the management of state corporations in 1989. A Parastatal Reform Strategy Paper, which was approved by cabinet in 1991, was the first official recognition of the concept of Performance Contracting as it was part of the following policies that were recommended to streamline and improve the performance of State Corporations: divestiture or liquidation of non-strategic parastatals, contracting out Commercial activities to the private sector, permitting private sector competition for existing state monopolies; and, improvements in the enabling environment of all strategic parastatals including removal of potentially conflicting objectives (RBM Guide, 2005).

PCs, where applicable will be used to make transparent the cost of social services and to compensate the parastatals for their net costs. The first two parastatals to be on Performance Contracting were Kenya Railways Corporation and the National Cereals and Produce Board. Kenya Railways signed PC's in April 1989 and National Cereals and produce Board signed in November 1990 (PBMSIG, 2002).

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2.10 Impacts of Performance contracting in operations

Implementation of the Process of Performance Contracting began only in 2004. The real impact of the process is yet to be fully visible. However, there is clear evidence of radical improvement particularly in the following aspects of the management of Public Service: remarkable and unprecedented improvement in profit generation for commercial state corporations, significant improvement in service delivery and operations by such ministries as immigrations and registration of persons, Agriculture, Provincial Administration and Internal Security, Health, finance and Water, significant improvement in operations and services by Nairobi City Council, Kisumu City Council and Nakuru Municipality and unprecedented improvement in service delivery and operations by the bulk of state corporations and statutory boards, among them, KenGen, Kenya Power and Lighting Company Limited, Kenya Ports Authority, Kenya Utalii College, National Oil Corporation of Kenya, KICC (PBMSIG, 2002).

In general, Performance Contracts expanded from a pilot group of 16 commercial public enterprises in 2004, to eventually cover the entire public service in Kenya, comprising the following institutions 38 Ministries and Accounting Departments,130 Public Enterprise and 175 Local Authorities (i.e. municipalities, local, county, and urban councils).

In the global context, relative performance evaluation has long been an aspect of contractual relations. Even when it is not explicitly written into a contract, RPE may be a part of the implicit agreements that guide long-term remuneration. Gibbons and Murphy (1990) found that upward revision of CEO salaries tends to be positively related to firms performance, but negatively related to industry or market performance as a whole. Lakonishok et al. (1992) found positive correlation between the relative performance of funds and inflow of new investment funds.

Similarly, Chevalier and Ellison (1997) and Sirri and Tufano (1998) found a positive, if nonlinear, relationship between performance and inflow of new funds to mutual funds. Given that management fees are an increasing function of the size of managed funds, outperforming the market leads to higher rewards in the future. Holmstrom (1982) was among the first to argue that relative performance evaluation (RPE) is valuable if agents face some common uncertainty. To be precise, RPE is useful if other agents' performance

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Dye (1992) pointed out such contracts may distort choice by persuading managers to select projects where their relative talent, rather than their absolute talent, is the greatest. Aggarwal and Samwick (1999) show that when firms compete in product markets, use of high-powered incentives may result in excessive competition: the need to soften the intensity of competition may induce principals to dilute incentives. And, even when the net benefit of RPE contracts is positive, they may be difficult to implement, say, if individual performance (as opposed to team performance) is hard to measure. Bhattacharya and Pfleiderer's (1985) seminal paper on delegated portfolio management has been followed by an extensive literature on the impact of the delegation fee structure on portfolio choice.

Grinblatt and Titman (1989) and Das and Sundaram (2002) focus on the differences between symmetric, fulcrum contracts (which penalize under-performance just as they reward out-performance), and asymmetric, incentive contracts (which reward out-performance without penalizing under-performance). Brennan (1993) provides an early attempt to study the general equilibrium implications of contracts that reward managers according to their performance relative to a benchmark portfolio. In this spirit, Cuoco and Kaniel (2001) examine the impact of such RPE contracts on equilibrium prices.

2.11 Performance contracting in banks

Banks have adopted PC's in order to reveal information and motivate managers to exert effort (Ramamurti and Vernon 1991). Supporters believe that pay-for-performance contracts create a set of clearly defined goals for the employees to focus on. Instead of blindly embracing one reform after another, employees can concentrate their efforts on improving specific issues. Performance incentives set the destination and provide bankers with a road map to get there (Murphy and Pimentel, 1996). Performance contracts provide a detailed system of evaluation that rewards administrators and managers for accomplishing goals (Murphy and Pimentel). Implementation of these measures has reveals information about an agent's unobservable choices that cannot be inferred from his own measured performance. Of course, RPE-based contracts do not always work in the interest of the principals. Within organizations, basing reward on relative performance creates incentives to sabotage the measured performance of co-workers, to collude with co-workers, or to self-select into a pool of low ability workers.

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The PCs are based on specific criteria units and criteria values. The private sector through the PC has also improved their performance. For instance, Kenya Commercial Bank has won an award. The award follows years of a turnaround process that has transformed the bank from a struggling enterprise to a blue chip organization. The Kenya Commercial Bank (KCB) has won the inaugural Africa Investor Award for the best performing company in Africa. The award, for the best performing Ai40 Company, was presented to Martin Oduor-Otieno, KCB chief executive at a ceremony at the London Stock Exchange. The Ai40 Index Awards are the only international pan African awards that recognize the achievement of African stock exchanges, listed companies, fund managers and analysts that monitor African equities. KCB won the prestigious award following a year of superb performance on the Nairobi Stock Exchange (NSE) during which the stock gained 97% compared to about 22% gains recorded by the entire Kenyan market. The awards took into account the stock's performance during the one-year period to March 2007 as well as price movement, the turnaround of KCB and its first quarter 2007 results, the bank's corporate governance performance, the improving debt portfolio, large branch network, wide range of products and services and the liquidity of the shares in the NSE (Kobia, et al. 2007).

2.12 Performance contracting in multinational banks

Human resource processes and practices within organizations determine, to a large extent, the relationship between employer and employee (Rousseau and Greller, 1994). Performance management processes, in particular, play a key role in creating a framework within which the performance contract between employer and employee is determined. Performance contract is usually taken to comprise three key elements: (i) the setting of objectives, derived from corporate and business unit (or divisional) strategies;

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(ii) the evaluation of performance; and (iii) the linkage between evaluated performance and development and rewards, in order to reinforce desired behaviour (Storey and Sisson, 1993).

The contract making features of performance contract in multinational banks include the understanding of job role, the fair, timely and accurate evaluation of performance, and the fair distribution of pay and development opportunities and the provision of feedback to employees (Rousseau and Greller, 1994). To ensure that the performance of employees is aligned with the banks needs, individual objectives should be derived from the organization's strategy and the departmental strategy where appropriate (Storey and Sisson, 1993; Bevan and Thompson, 1992). As Rousseau and Greller (1994) state, appraisal interviews are opportunities for contract creation, maintenance or change.

Alhadeff and Alhadeff (1964) compared the growth of the top 200 banks in the US over the period 1930-60 to the growth of total bank assets. They found that the top 200 grew more slowly than the total did. Within the top 200, the bottom segment grew more rapidly than the top, but showed greater variance in growth rates. Rhoades and Yeats (1974) replicated this study for the period 1960-71. They too found that the largest multinational banks grew less than the system as a whole. Unlike these two studies, Tschoegl (1983) treated banking as a world industry and therefore analyzed the world's 100 largest multinational banks every second year from 1969 to 1977. The results of his study suggest that the variability of the growth rate of bank assets declines with the size of the accompanying bank. They attributed the growth of the bank to be as a result of performance contracting.

2.13 Conclusion

The literature indicates that there is a correlation between performance contracting and operational efficiencies but little is documented by local academic research on the impact of performance contracting in the banking industry with particular interest in Multinational Banks operating in Kenya. This study therefore aims at filling this gap.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter outlines the research design and methodology followed in conducting this study. It describes the entire process that the researcher used to obtain the sample from the population, as well as the data collection methods, and data analysis.

3.2 Research Design

This research surveyed all the multinational banks in Kenya whose head offices are based in Nairobi. A multinational bank is defined as a bank operating in more than one country with the goal or objective of maximizing stockholders' wealth or the stock price. This study sought to survey the impacts of performance contract in Banks in Kenya using a case study of multinational banks.

3.3 Population of the study

The study consisted of all the multinational banks operating in Kenya as indicated in appendix 1. The multinational banks are chosen because all of conduct PCs unlike some of the local banks such as National bank, which do not conduct them. The target population in each bank consisted of the retail managers, operations managers and credit managers. This implies that there will be three respondents from a bank's headquarter and one of its branch in each bank leading to 48 respondents. The data collected was both primary and secondary data. Secondary data collected from the banks' audited accounts while the primary data will be collected by use of structured questionnaires.

3.4 Data Collection

The data collected for the study was both primary and secondary data. Secondary data was collected from the banks' audited accounts while the primary data was collected by use of structured questionnaires. The structured questionnaires (see Appendix 3) was used to obtain general information of the respondent in each bank, negotiation of performance contracting, implementation of PCs, evaluation and monitoring and operational performance of performance contracts. Field data collection involved use of semi-structured questionnaire administered dropping and picking later. In addition, the questionnaires focused on the objectives of the study, that is, to determine the extent to which performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya; and, to establish the challenges of implementing performance contracting by multinational banks in operations and service delivery.

3.5 Data Analysis

The researcher edited questionnaires for completeness, accuracy and consistency. Data was then entered into a computer system and analyzed. The data analyzed showed the non-financial performance indicators as well as the qualitative indicators of performance contracting. Since the instruments yielded both qualitative and quantitative data, these data was analyzed using descriptive statistics to address each research objective.

To analyze qualitative data, unstructured questions were carefully coded and transcribed. The results were presented in the form of written reports. Qualitative data was used to supplement, explain and interpret qualitative data. Quantitative data analysis was analyzed using the SPSS computer software package. More specifically, a descriptive measure was to describe and summarize the data. These were presented in a narrative form in order to determine the extent performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya; and, establish the challenges of implementing performance contracting by multinational banks in operations and service delivery.

CHAPTER FOUR: DATA ANAYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The study aimed at determining the extent performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya: and, to establish the challenges of implementing performance contracting by multinational banks in the banks' operations and delivery of service. The response rate achieved for the study is 100%.

Table 4.1 General information

	N	Mean	Std. Deviation
Which department do you fall?	48	6 0625	24482
For how long have you been in the department?	48	1 4375	1 00861
Do you set targets in your department?	48	1 20833	.410414
For how long have you been using performance contracts?	48	1 1042	30871
What is the number of employees in your department?	48	2 9375	1 86121
If your answer in 3 above who develops those targets?	48	3 0000	98930
Do you base your targets on performance contract signed with the management?	48	1 0625	24482
Do you have a specific department/section that deals with performance contract?	48	1 1042	30871
Valid N (listwise)	48		

Source Research data

In relation to the general information, the respondents were asked which department do fall in. The results show that most of the respondents indicated that they work in retail banking as indicated by a mean of 6.0625 in table 4.1. In addition, they indicated that they have worked in the department for less than 2 years (1.4375). When respondents were asked on whether they set their targets in their department most of them said yes (1.20833). This implies that when employees set their targets they are likely to own and try to achieve them and hence improved performance. The respondents also indicated that they have been using performance contract for less than 2 years (1.1042). The use of performance contract for less than two years may not be sufficient to be used as long-term projection of the company's performance. The number of employees in each department averaged 12 (2.9375). In most of the responses the management executive develops performance contracts (3.000). If management develops the performance contracts without involving employees from the initial stages may not motivate the employees to work towards the attainment of these targets. The whole process should be inclusive. Further when asked whether they based their targets on performance contracts signed with the management, all the responses were affirmative (1.10625). This is a confirmation that the contracts are standard and uniformly applied across the departments. In the end this will help in objectively evaluating employees. The respondents also indicated they have departments/sections dealing with performance contracts (1.1042). Having separate departments dealing with performance contracts implies that banks have known the impact that performance contracts have in business. Furthermore, such departments will help in correcting deviations from the expected results as well as handling complaints from employees relating to performance contracts.

Negotiating contracts is critical to good performance. All the respondents' agreed that their departments are involved in setting up of objectives/targets agreed upon in performance contract (Table 4.2 mean of 1.6667). However, they also indicated that performance contracts are not freely negotiated and agreed upon (1.6875). This emphasizes that that the board influences the targets (mean of1.6458). The respondents also agreed that the team involved in negotiating contracts is not adequate (mean of 1.5208) and that other shareholders should be involved (1.880). Finally, most of the respondents suggested that it is the management team that comes up with the responsibilities and commitments of the employees (mean of 1.1667). The above results indicate that without negotiating performance contracts freely between employees and the Board may not yield the desired results. The results further shows that the team involved in negotiating performance contracts are not enough and this implies that the set targets are not fully agreed upon by all employees. By specifying targets and evaluating results ex post, the PC is a way to encourage private companies to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Table 4.2 Negotiating performance contracts

	N	Mean	Std Deviation
Is your department involved in setting up of objectives/targets agreed upon in the performance contract?	48	1 6667	47639
Are the performance contract freely negotiated and agreed upon?	48	1 6875	46842
If performancecontracts are freely negotiated, who influences these targets?	48	1 6458	75764
Do you think the team involved in negotiating are adequate?	48	1 5208	50485
If the answer to the question above is NO, who do you think should be incorporated?	25	1 8800	72572
In the performance contract, who comes up with the responsibilities and committment of the employees?	48	1 1667	37662
Valid N (listwise)	25		

Source: Research data

The respondents were asked to rate the performance in the first year of performance contract. The ratings range from poorly rated to highly rated where: Highly rated (1), above average (2), moderately rated (3), lowly rated (4); and poorly rated (5). The study shows that in all the factors mentioned above, they have above average rating as indicated by means less than three. The overall performance rating also stood at a mean of 1.8958 which implies that it is above average on rating across the banks. Specifically, the results show that performance rating in relation to non-financial factors is has the lowest rating. This indicates the importance that social issues such as employee motivation have in the performance of banks. Operational factors have the highest rating (mean of 1.500) which implies that the operation department has helped the employee to work hard towards the achievement of the set targets.

Table 4.3 **Bank performance in year one**

	N	Mean	Std. Deviation
How do you rate the performance of Non-financial factors in the first year of performance contracting?	48	2 2292	.72169
How do you rate the performance of operational factors in the first year of performance contracting?	48	1 5000	.87519
How do you rate the performance of Dynamic/Qualitative factors in the first year of performance contracting?	48	1 6458	.75764
How do you rate the overall performance in the first year of performance contracting?	48	1 8958	.66010
Valid N (listwise)	48		

Source. Research data

The respondents were asked to rate the performance in the second year of performance contract. The ratings range from poorly rated to highly rated where: Highly rated (1), above average (2), moderately rated (3), lowly rated (4); and poorly rated (5). The study shows that in all the factors mentioned above, they are moderately rated as indicated by means of more than two but less than four (Table 4.2.2). The overall performance rating also stood at a mean of 2.4375 which implies that it is above average rating across the banks. This emphasizes that performance might be judged against the firm's past trends, rather than against an industry standard, to take account of situations where the firm's performance is sub-standard because of parent company's imposed constraints. This is particularly to multinational companies such as the multinational banks.

Table 4.4 Bank performance in year two

	N	Mean	Std. Deviation
How do you rate the performance of Non-financial factors in the second year of performance contracting?	48	2 5208	94508
How do you rate the performance of operationall factors in the second year of performance contracting?	48	2.1667	1.15470
How do you rate the performance of dynamic/Qualitative factors in the second year of performance contracting?	48	2 2500	1 24627
What is the overall rating In the second year on performance contracting?	48	2 4375	94320
Valid N (listwise)	48		

Source. Research data

The respondents were asked to rate the performance in years one and two of performance contract. The ratings range from poorly rated to highly rated where: Highly rated (1), above average (2), moderately rated (3), lowly rated (4); and poorly rated (5). The study shows that performance is moderately affected by external factors such as government regulations (Mean of 2.5625). However, unrealistic targets such as targets beyond reach of employees are highly rated (mean of 1.6042). The results also show that performance contracting is moderately affected by exceptional items such as trade unions activities (mean of 3.0417) .The effect of performance contracting is above average on operating environment (mean of 2.0417). The effect of performance contracting is highly rated due to the effect on competition within the industry (mean of 1.5). The results also shows that the general trend of the performance of the department is highly rated this could be the effect of the introduction the performance contract (mean of 1.6042). and due to the high rating of the performance contracting, the bank's/ department's contract was not signed as scheduled (mean of 1.000)

Table 4.5 Bank performance in year one and two

	N	Mean	Std. Deviation
How does performance in the first and second year of performance contracting afffected by external factors such as Government regulations?	48	2 5625	1.38235
How does performance in the first and second year of performance contracting afffected by unrealistic targets such as targets beyond reach of employees?	48	1 6042	79197
How does performance in the first and second year of performance contracting afffected by exceptional items such as trade unions activities?	48	3.0417	1 09074
How does performance in the first and second year of performance contracting afffected by changing operating enviroment?	48	2 0417	87418
How does performance in the first and second year of performance contracting afffected by competition within the industry?	48	1 5000	.71459
What is the general trend of the performance of the depertment after the introduction of the performance contract?	48	1 6042	.49420
Was the bank's or department's contract signed as scheduled?	48	1.0000	00000
Valid N (listwise)	48		

Source: Research data

Table 4.6 Application of balance score card

	N	Mean	Std. Deviation
How effective is the performance contract be in employee training?	48	1.2917	.71335
How effective is the performance contract be in corporate cultural attitudes related to both individual and corporate self-improvement ?	48	2.3125	46842
How effective is the performance contract be in resolving of support and mission oriented problems?	48	1.2917	.65097
How effective is the performance contract be in treatment?	48	1.4583	.68287
How effective is the performance contract be in provision of funding data?	48	1.3958	67602
Valid N (listwise)	48		

Source. Research data

In executing the performance contracts, banks expects that positive results are realized. Therefore they apply the aspects of the balance score card which include learning and growth perspective, the Business Process Perspective the Customer Perspective and the Financial Perspective in analyzing this effectiveness. For each of the variables stated in the table, the respondents were asked to rate how effective has the performance contract is. Of which the respondents state that the rating was highly rated with employee training with a mean of 1.2917, most of the respondents were above average on rating the corporate culture attitudes related to both individual and corporate self-employment (mean of 2.3125). There was a high rating by respondents on the relation of resolving of support and mission oriented problems on the issue of performance contracting (mean of 1.2917). When the respondents were also asked to state the effectiveness on performance contract on the treatment, there was a high rating with a mean of 1.4583. From the table, also there was an indication that there was a high rate of respondents on performance contract to the provision of funding with respondents mean of 1.3958.

The results attest to the fact that the 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. This will at the same time leave day-to-day management to the managers themselves. This leads to organizing and defining tasks so that management can perform them systematically, purposefully and with reasonable probability of achievement. Furthermore, the results emphasis that the balanced scorecard incorporates feedback around internal business process outputs, and also adds a feedback loop around the outcomes of business strategies.

In executing the operational performance, banks expects that positive results are realized. Therefore they apply the aspects of the balance score card which include learning and growth perspective, the Business Process Perspective the Customer Perspective and the Financial Perspective in analyzing this effectiveness. For each of the variables stated in the table, the respondents were asked to rate how operational aspects of the operational performance are. There was a high ranking by the respondents on all the factors/ aspects with quality provision of services by the bank with a mean of 1.325. There was also a high rate of operational performance on the speed of provision of service by the bank (mean of 1.6875). The respondents also shows a high rate on operational performance contract on cost of providing services by the bank (mean of 1.2292).the respondents had a positive rate of ranking of the operational performance to the reliability of the services and on the dependability of the services by the bank with a mean of 1.3125 each. There was also a high rate on the operational performance to the innovation of services by the bank by most respondents with a mean of 1.4792. When the respondents were asked to state position where the operational performance has helped the organization, the ranking was above average by most of the respondents with a mean of 2.6042.finally there was a moderate ranking by most of the respondents when asked to state the rate of operational performance on flexibility of services by the bank with a mean of 3.6364, based on the level of importance.

Table 4.7 Operational performance

	N	Mean	Std. Deviation
How do you rank the quality provision of services by the bank?	48	1.3125	.58913
How do you rank the quality provision of service by the bank?	48	1.4167	.61310
How do you rank the speed of provision of services by the bank?	48	1.6875	.74822
How do you rank the cost of providing services by the bank?	48	1.2292	.55504
How do you rank the reliability of the services by the bank?	48	1.3125	.58913
How do you rank the dependability of the services by the bank?	48	1.3125	.58913
How do you rank the reliability of the services by the bank?	48	1.4167	.76724
How do you rank the innovation of services by the bank?	48	1.4792	.77156
Where has the performance contract helped in the organisation?	48	2.6042	1.63394
What problems has performance contract solved?	44	3.6364	2.14683
Valid N (listwise)	44		

Source. Research data

For each of the variables stated in the table, the respondents were asked to rate how performance contract implementation is. There was implementation at the beginning of the financial year as per the respondents which had a mean of 1.3958 as indicated in the table. The respondents stated that the managements (executives) are responsible for the implementation of the contracts (mean of 1.4167). Most of the respondents responded that they experienced practical problems in the implementation of the contract (1.6458).

The respondents were asked on how they rank frustration with lack of real progress in reforming the public sector. They provided low rating as indicated by a mean of 3.5394. In relation to other factors they provided the following ratings: political/ socio-economic/legal content (3.00), focus on outcome instead of output (1.2353), unrealistic implementation strategies (2.00); and uncoordinated performance contract programmes (2.2941).

Table 4.8 Performance contract implementation

	N	Mean	Std. Deviation
When do you implement the performance contract?	[illegible]	1.3958	
Who is responsible for the implementation of the contract?	48	1.4167	.49822
Did you experience any practical problems in implementing the contract?	48	1.6458	.48332
How do you rank the frustration with lack of real progress in reforming the public sector?	17	3.5294	1.50489
How do you rank the political/socio-economic/legal context?	17	3.0000	.70711
How do you rank the focus on outcome instead of output?	17	1.2353	.43724
How do you rank the unrealistic implementation strategies?	17	2.0000	.70711
Uncoordinated performance contract programs	17	2.2941	1.31171
Valid N (listwise)	17		

Source: Research data

Evaluation and monitoring of performance contract is very critical for any organization. this step ensures that deviations from the targets are identified and corrected. In this study the respondents were asked on how often they report to their headquarters or the executive management. The respondents indicated on average they report to the headquarters or the executive on quarterly basis (2.1875).the management in most of the respondent is responsible for reporting, evaluating and monitoring of performance contracts (1.4167). The respondents were also asked to rate the impacts of performance contracts on political patronage (interference), overstaffing, bureaucratic process, staff remuneration, transparency and accountability, corporate governance and multiplicity of objectives. They provided the ratings as moderately rated (2.75), moderately rated (3.0417), lowly rated (2.6667), lowly rated (2.2917), lowly rated (2.00), lowly rated (2.374), lowly rated (1.9583), and lowly rated (2.215) respectively.

Table 4.9 Evaluation and implementation

	N	Mean	Std. Deviation
What is the impact of performance contracts on the political	48	2.7500	1.46583
What is the impact of performance contracts overstaffing?	48	3.0417	1.57045
What is the impact of performance contracts bureaucratic process?	48	2.6667	1.38891
What is the impact of performance contracts staff renumeration?	48	2.2917	1.12908
What is the impact of performance contracts procurement procedures?	48	2.0000	.82514
What is the impact of performance contracts transparencyand accountability?	48	2.3750	.98121
What is the impact of performance contracts corporate governance?	48	1.9583	.82157
What is the impact of performance contracts multiplicityof objectives?	48	2.1250	1.08422
Valid N (listwise)	48		

Source: Research data

Table 4.10 Challenges of Evaluation and Implementation

	N	Mean	Std. Deviation
How do you rate lack of standard evaluation technique in evaluating performance contracts?	48	2.1667	1.11724
How do you rate presence of the demerits of evaluation tools such biasness from evaluator?	48	2.3333	.95279
How do you rate failure to fully compare actual results against expected results?	48	3.2500	1.60451
How do you rate maintaining a positive	48	3.1667	1.69270
Valid N (listwise)	48		

Source: Research data

Implementation of performance contract posses some challenges. In line with this the respondents were asked to rate the key challenges they experienced in evaluating the result of the contracts. Failure to fully compare actual results against the expected results were highly rated (3.25) as the key challenge affecting the evaluation of performance contract this was followed by the ability to maintain a positive approach to work(3.167). Lack of standard evaluation technique is lowly rated (2.1667) after the presence of demerits of evaluation tools such as biasness from evaluator.

CHAPTER FIVE: SUMMRRY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presented the summary, conclusions, recommendations and suggestion for further research for the study. The chapter summarizes the findings of the study in relation to the objectives of the study. The study aimed at achieving the following objectives: determine the extent performance contracting as a control mechanism impacts operations and service delivery in multinational banks in Kenya; and, establish the challenges of implementing performance contracting by multinational banks in the banks' operations and delivery of service.

5.2 Summary

The results show that the respondents have worked in their departments for less than 2 years (1.4375). This implies that they may not have sufficient information concerning long-term performance of the banks due to the signing of performance contracts by employees. Negotiating contracts is critical to good performance. All the respondents' agreed that their departments are involved in setting up of objectives targets agreed upon in performance contract. However, they also indicated that performance contracts are not freely negotiated and agreed upon which shows that the board influences the targets. The respondents also agreed that the team involved in negotiating contracts is not adequate (mean of 1.5208) and that other shareholders should be involved (1.880). Finally, most of the respondents suggested that it is the management team that comes up with the responsibilities and commitments of the employees (mean of 1.1667). This implies that the set targets may be unrealistic because the employees are not fully involved. Fully involving employees motivates them to attain the set targets.

The rate of performance in the first year of performance contract is lowly rated. The overall performance rating also stood at a mean of 1.8958 which implies that it is above average on rating across the banks. In year two, the overall performance rating also stood at a mean of 2.4375 which implies that it is above average rating across the banks. However, rate of performance in years one and two of performance contract. The results also shows that the general trend of the performance of the department is highly rated this could be the effect of the introduction the performance contract (mean of 1.6042), and due to the high rating of the performance contracting, the bank's/department's contract was not signed as scheduled (mean of 1.000). This show that performance of banks improved in year two as compared to year one since in year two, employees will have understood their expectations as stipulated in the performance contract.

In executing the performance contracts. banks expects that positive results are realized. Therefore they apply the aspects of the balance score card which include learning and growth perspective, the Business Process Perspective the Customer Perspective and the Financial Perspective in analyzing this effectiveness. Evaluation and monitoring of performance contract is very critical for any organization, this step ensures that deviations from the targets are identified and corrected Implementation of performance contract posses some challenges.

5.3 Conclusions

The study shows that performance contracts increases performance. In addition, it revealed that banks have adopted PCs in order to reveal information and motivate managers to exert effort. Implementation of these measures has improved governance, transparency, Accountability and operational efficiency in the management of bank affairs, and as a result, made the private sector is more effective in its delivery of services as part of its commitment to ensuring efficiency. In his study, the results reveal that 80% of all the banks that adopt PCs have increased growth in terms of turnover. In addition, the banks that use performance contracts are more likely to retain their employees than those that do not use. This is because the evaluation is more objective and hence employees would be more likely satisfied with the results of the evaluation process.

The results also showed that a negotiated incentive contract is viewed as a device to reveal information and motivate managers to exert effort. These results also showed that PCs are touted as a way to clarify the objectives of the multiple principals who govern private corporations, and hence make it easier to set goals and evaluate achievements. Proponents argue that the contract can translate multiple objectives into targets measured by specified criteria and given weights to reflect priorities

5.4 Recommendations

The findings of the study indicated that there are a number of issues to be addressed based on the conclusions. It is important that all the employees are involved in the implementation of performance targets so that the impact of performance contracts practices within the organization can be realized resulting to achievement of desired goal and objectives within the organization. From the results, it was evident that employees were not fully involved in negotiating on the performance targets. In addition, the results showed that teams involved in negotiating contracts are insufficient. Therefore the organization should develop performance contracts that are all-inclusive.

5.5 Limitations of the Study

The data collected using questionnaires in some instances were not fully completed and the researcher had to supplement this through the use of secondary data. In addition, the research was limited by the inability to carry out face-to-face interview in order to further probe and have an in-depth understanding of some issues.

5.6 Suggestions for further research

Therefore, the researcher suggests that further research should be carried in the following areas:

1. A research should be carried to cover all the 52 banks operating in Kenya so that a conclusive and generalized study can be obtained.
2. In addition, it is recommended that a further research involving bank branches be carried out so that a more representative result is attained.

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APPENDICES

Appendix 1: Introduction Letter

University of Nairobi, School of business

Department of Operations Management

P.O Box 30197,

Nairobi.

To Whom It May Concern:

Dear respondent

Re: Data Collection For Research Purposes

I am an MBA student in the above-mentioned University. As a partial fulfillment for the requirements of completion of my course, I am required to carry out a research. Therefore I am conducting a research on a project entitled. "*The impact of performance contracting on operational performance in the banking industry: A case of multinational banks in Kenya*"

For the purpose of completing my research, I am required to collect filed data. Attached herewith is the questionnaire that will facilitate the collection of the said data. I shall be grateful if you assist me by completing and returning it to us for the purposes of data analysis. The research is carried out purely for academic purposes and all the information obtained from you will be treated with confidentiality it deserves. It is only the researcher and the project supervisor who will have access to the information given. Upon request, the summary of the results will be made available to you after the information collected is duly analyzed.

Thank you very much for your valuable time and co-operation.

Yours faithfully,	Lecturer/ Supervisor
Mohammed A Sheikh,	Mr. S. O. Nyamwange
MBA Student	School of Business
School of Business	Department of Management Science

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Thank you very much for your valuable time and co-operation.

Yours faithfully,
Mohammed A Sheikh,
MBA Student
School of Business

Lecturer/ Supervisor
Mr. S. O. Nyamwange
School of Business
Department of Management Science

APPENDIX 2:

QUESTIONNAIRE

Please freely answer the question below. The information provided will be treated with the highest degree of confidence.

SECTION I: GENERAL INFORMATION

1. In which department do you fall?

   Finance ( )

   Information technology ( )

   Accounting ( )

   Purchasing and supplies ( )

   Corporate banking ( )

   Retail banking ( )

   Others (specify) ………………………………………………………………………

2. For how long have you been in the department?

   Less than 2 years ( )

   Less than 5 years ( )

   Less than 10 years ( )

   Above 10 years ( )

3. Do you set targets in your department?

   Yes ( )

   No ( )

4. For how long have you been using performance contracts?

   Less than 2 years ( )

   Less than 5 years ( )

   Less than 10 years ( )

   Above 10 years ( )

5. What is the number of employees in your department?

   Please specify?……………………………………………………………………………

6. If your answer in 3 above, who develops those targets?

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QUESTIONNAIRE

Please freely answer the question below. The information provided will be treated with the highest degree of confidence.

SECTION I: GENERAL INFORMATION

1. In which department do you fall?

   Finance ( )

   Information technology ( )

   Accounting ( )

   Purchasing and supplies ( )

   Corporate banking ( )

   Retail banking ( )

   Others (specify) ……………………………………………………………………

2. For how long have you been in the department?

   Less than 2 years ( )

   Less than 5 years ( )

   Less than 10 years ( )

   Above 10 years ( )

3. Do you set targets in your department?

   Yes ( )

   No ( )

4. For how long have you been using performance contracts?

   Less than 2 years ( )

   Less than 5 years ( )

   Less than 10 years ( )

   Above 10 years ( )

5. What is the number of employees in your department?

   Please specify?……………………………………………………………………

6. If your answer in 3 above, who develops those targets?

Self ( )

Board of directors ( )

Management Executive ( )

Head of department ( )

Others (specify) ( )

7. Do you base your targets on performance contract signed with the management?

    Yes ( )

    No ( )

8. Do you have a specific department/section that deals with performance contract?

    Yes ( )

    No ( )

SECTION II: NEGOTIATION OF PERFORMANCE CONTRACTING

1. Is your department involved in setting up of objectives/targets agreed upon in the performance contract?

    Yes ( )

    No ( )

2. Are the performances targets freely negotiated and agreed upon?

    Yes ( )

    No ( )

3. If answer to 2 above is no, who influences the targets?

    Management ( )

    Board ( )

    Parent company ( )

    Other (specify)..

4. Do you think the team involved in negotiating are adequate

    Yes ( )

    No ( )

5. If answer to 4 above is no, who do you think should be incorporated?

    Management team ( )

    Other shareholders ( )

    Others (please specify) ....

6. In the performance contract, who comes up with the responsibilities and commitment of the employees?

   Management team ( )

   Board ( )

   Parent bank ( )

   Owners (please specify) ……………………………………………………………

7. The following statements relate to performance rating of the bank in the **first year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					

Others (specify) ……………………………………………………………………………

8. The following statements relate to performance rating of the bank in the **second year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					
4.	Overall rating					

Others (specify) ……………………………………………………………………………

6. In the performance contract, who comes up with the responsibilities and commitment of the employees?

Management team ( )

Board ( )

Parent bank ( )

Owners (please specify) ……………………………………………………………

7. The following statements relate to performance rating of the bank in the **first year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					

Others (specify) ………………………………………………………………………………

8. The following statements relate to performance rating of the bank in the **second year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					
4.	Overall rating					

Others (specify) ………………………………………………………………………………

6. In the performance contract, who comes up with the responsibilities and commitment of the employees?

   Management team ( )

   Board ( )

   Parent bank ( )

   Owners (please specify) ....

7. The following statements relate to performance rating of the bank in the **first year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					

Others (specify) ....

8. The following statements relate to performance rating of the bank in the **second year** of performance contracting in each of the following categories. Mark appropriately with X in spaces provided in the table, which signify to what extent you rate based on the factors given.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Non-financial factors.					
2.	Operational factors.					
3.	Dynamic/Qualitative factors.					
4.	Overall rating					

Others (specify) ....

9. Which of these factors do you think greatly affected performance rating in the first and second year of performance contracting? (Please tick).

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	External factors such as government regulations					
2.	Unrealistic targets i.e. targets beyond reach of the employees					
3.	Exceptional items such trade union activities					
4.	Changing operating environment					
5.	Competition within the industry					

Others (specify) ....

10. What can you say as the general trend of the performance of the department after the introduction of performance contracting (tick one)

Excellent ( )

Good ( )

Fair ( )

Poor ( )

11. Was the bank's or department's contract signed as scheduled?

Yes ( )

No ( )

SECTION III: OPERATIONAL PERFORMANCE OF PERFORMANCE CONTRACTS IN BANKS

1. In executing the performance contracts, banks expects that positive results are realized. Therefore they apply the aspects of the balance score card which include learning and growth perspective, the Business Process Perspective the Customer Perspective and the Financial Perspective in analyzing this effectiveness. For each of the variables, indicate how effective has the performance contract is.

		Highly rated	Above	moderately	lowly rated	poorly rated
The Learning & Growth Perspective	Employee training					
	Corporate cultural attitudes related to both individual and corporate self-improvement					
The Business Process Perspective	Resolving of support and mission oriented problems					
The Customer Perspective	Treatment					
Financial Perspective	Provision of funding data					

2. The following are some of the operational aspects of performance contracts. Please rank by ticking the following factors based on their level of importance.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Quality provision of service by the bank					
2.	Speed of provision of services by the bank					
3.	Cost of providing services by the bank					
4.	Reliability of the services by the bank					
5.	Dependability of the services by the bank					
6.	Reliability of the services by the bank					
7.	Innovation of services by the bank					
8.	Flexibility of services by the bank					

3. Where has Performance contract helped in the organization?

....

....

....

4. What problems has Performance contract solved?

....

....

....

....

SECTION IV: IMPLEMENTATION STAGE

1. When do you implement the performance contract?

    Beginning of the financial year ( )

    2-3 months after the s tart of financial year ( )

    4 – 6 months after the start of financial year ( )

    Others (please specify) ( )

2. Who is responsible for the implementation of the contract?

    Management (executive) ( )

    Head of department ( )

    Others (please specify)..

3. Did you experience any practical problems in implementing the contract?

    Yes ( )

    No ( )

4. If the answer to 3 above is yes, please tick the answer.

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Frustration with lack of real progress in reforming the public sector					
2.	Political/socio-economic/legal context					
3.	Focus on outcome instead of output					
4.	Unrealistic implementation strategies					
5.	Uncoordinated performance contract programs					

Others (specify) ....

Section VI: Evaluation and monitoring

1. How often do you report to he headquarter or the executive management?

On monthly basis ( )

On quarterly basis ( )

On half yearly basis ( )

Annual basis ( )

Others (please specify) ( )

2. Who is responsible for reporting, evaluation and monitoring?

Management ( )

Head of department ( )

Parent bank ( )

Others (Please specify) ……………………………………………………

3. In your own view, what are the impact of performance contracts on the following problems

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Political patronage (interference)					
2.	Over staffing					
3.	Bureaucratic process					
4.	Staff remuneration					
5.	Procurement procedures					
6.	Transparency and accountability					
7.	Corporate governance					
8.	Multiplicity of objectives					

Others (specify) ……………………………………………………………………………

4. What are the key challenges that you experienced in evaluating this results of contracts? (please tick)

		Highly rated	Above	moderately	lowly rated	poorly rated
1.	Lack of standard evaluation technique					

2.	Presence of the demerits of evaluation tools such biasness from evaluator					
3.	Failure to fully compare actual results against expected results					
4.	Maintaining a positive approach to your work					

APPENDIX 3

List of multinational banks

1. Bank of Baroda, Nairobi.
2. Bank of India, Nairobi.
3. Barclays Bank of Kenya, Nairobi.
4. Citibank, Nairobi.
5. Habib A.G Zurich Bank, Nairobi.
6. First American Bank of Kenya, Nairobi.
7. Stanbic Bank, Nairobi.
8. Standard Chartered Bank , Nairobi.