

Effectiveness of Performance Management System

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The purpose of the article is to understand the effectiveness of performance management system of organization. Authors have tried to extract the parameters of performance management effectiveness from employees of the organization. HR employees of the organization were facilitators. This article has based its argument on agency theory. Thus, based on the results a framework of effective performance management system (PMS) has been proposed.

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Introduction

Organizations plan, measure and control their performance with the help of a defined performance management system (PMS). The system aids them to align decisions, resources and activities with strategies to achieve required organizational goals (Bento & Bento, 2006). Employees performance can be measured, to recognize and reward excellent performance and to suggest means of improvement for poor performance (Edwards, 2002). A PMS facilitates a higher attention on targets and dismisses uncertainty and restricts goal conflict by establishing defined performance standards (Brunetto & Farr-Wharton, 2005; Hood, 1991).

Lawler (2003) defined performance management as a concept which can integrate both behavior and the results in a work system. In other words, performance management is a collective approach of managing operational activities based on agreed objectives, knowledge and skill for strategic goal achievement. The traditional performance management system was focused on “what gets measured gets done”. The performance measurement system forms the core of a performance management system which as-

sists in managing the company strategy (Lebas, 1995; Neely, 2005; Otley, 1999).

The performance measurement system forms the core of a performance management system which assists in managing the company strategy

According to Walters (1995) performance management is about directing and supporting employees to work as effectively and efficiently as possible in line with the needs of the organization. Performance management is a continuous process of setting goals, paying attention to employees' attitudes, mentor them to improve their association, measure their performance and understand the causes of deviation in performance if any. It benefits both employers and employees. The performance management therefore, includes understanding of employees' job satisfaction, commitment and perceived psychological contract level. However, there may be contradictions as the agency theory (Jensen & Meckling, 1976) suggests that if both parties in the relationship are utility maximizers there is good reason to believe that the agent (employee) will not always act in the best interests of the principal (employer). Hence, this paper focuses on revisiting performance management system from agency theory perspective and to study the process to enhance the effectiveness.

Literature Review

Performance management is achieved when each employee of an or-

ganization is responsible and accountable for his/her own actions regardless of the outcomes since the definition of objectives, tasks, standards, and performance measures, monitoring progress and developing performance, are mutual understanding between employee and organization (Armstrong & Baron, 2000). A PMS is a system that is concerned with different aspects of performance important for development and growth of an organization as a whole. The management must receive report on performance standards of the organization and the extent to which set objectives are met (Flapper et al., 1996: 27). PMS initiates all the five functions of management i.e., planning, organizing, directing, controlling and rewarding employees to achieve anticipated results (Lawler, 2003). The PMS of an organization is expected to set performance objectives, enhance performance of individuals and departments, with the aim towards enhancing organizational effectiveness (Biron et al., 2011: 1294). It contributes to bridging the gap between the employees and management interests by specifying a clear strategic direction for the organization (Huselid, & Becker, 2011).

A PMS is broader than a performance measurement in that "performance management precedes and follows performance measurement in a virtuous spiral and performance management creates the context for measurement" (Lebas, 1995:34). PMS is a means of implementing organizational strategy by communicating to employees about priorities of the organization, assigning responsibility and accountability for behavior and outcomes

and guiding to enhance performance (Biron et al., 2011; Bae, 2006). PMS has been discussed as a vital tool for improving public services (through efficiently and effectively delivering services as per performance parameters) and reinforcing accountability for good or bad performance (Audit Commission, 1999). Furthermore, the objectivity and fairness in measuring performance can improve employee involvement, commitment and motivation (Bevan & Thompson, 1991), and act as a communication tool to provide feedback on employees' contributions to achieving organizational goals (Cheng et al., 2007).

The effectiveness of the PMS lies in involvement and training of employees in the development, implementation and use of PMS.

Franco and Bourne (2005) in their research study which factors are critical in enabling organizations to effectively implement PMS. Researchers focused their attention on "knowing-doing gap" (i.e. organizations struggle to transform employee knowledge and skill into desired action). Further, researchers also tried to understand the differences between organizations which implement PMS effectively (measures performance) and with those that do not. Researchers (de Waal, 2004; 2007) advocated that the effectiveness of the PMS lies in involvement and training of employees in the development, implementation and use of PMS. The initial preparation play an important role in defining the success of performance management system in an organization.

Ackoff (1999) argued from resource-based view of the firm (Barney, 1991), that the more volatile, uncertain, chaotic and ambiguous the market environment, the more organizations shall depend on their employees as a vital resource with the requisite intellectual capital to realize the desired future. Similarly, according to the dynamic capability theory, a firm's dynamic capabilities (Bowman & Ambrosini, 2003) are crucial determinants of its ability to achieve firm performance (Shore et al., 2004) particularly in a confused, turbulent and unpredictable environment. Shapiro et al. (2004) argued that these capabilities are derived from employees' knowledge base that is developed based on experiences and the capability composition of the work force. Grant (2002) proposed that capabilities of organization build the stepping stone of competitive advantage. The organizational capabilities are integration of tangible and intangible resources in an organization. Jugdev and Mathur (2006) discussed a similar concept that capturing and understanding intangible resources are important because it is not easily copied or transferred, therefore, can lead to a competitive advantage.

Roberts et al. (2005) argued that over-emphasis on control may be counter-productive. Munene et al. (2000) also discussed that in extreme control oriented environment, employees develop ways to only meet minimum required standard. This method may not engage employees well and they will either quit or compromise on quality over quantity. PMS of an organization must have checks in place but the required flexibility to work shall

be inbuilt. Ferreira and Otley(2009), argued that feedback and feedforward information flows promotes learning. Hence, the PMS process which includes feedback system could be considered as a process where interaction and communication among superior, subordinates and peers support learning and knowledge development in the organization, having characteristics of both a tacit and an explicit forms (Mercurio et al., 2014; Vaivio, 2006). Franco-Santos et al. (2007) pointed out that while developing PMS, organizational members' are bound to learn with each other. If a PMS without such learning has been developed it may not be effective enough to yield outcomes. One primary focus of any new system design is the creation and exchange of knowledge. Development of PMS as a 'systems thinking' than as a 'command and control mechanism' would generate learning and facilitate feedback (Canonica & Brudan, 2010). The command and control mechanism emphasizes on volume production through specialization, standardization, hierarchical approach and through setting goals. Further, decision making is driven by budgets, standards and targets. Systems thinking, however, promotes a holistic approach to running organizations, emphasis is more on building relationship and creating environment of learning (Ferreira & Otley, 2009). Therefore, a system's thinking approach to performance management facilitates not only quantitative outcomes but also how the goals are achieved. Otley(1999:364) also noted that PMS provides information that should be useful to managers "in performing their jobs and to assist organizations in developing

and maintaining viable patterns of behavior". Benefits of a successfully adopted performance management system include an organization that is directly aligned to its goals and objectives and a motivated workforce where every employee understands his or her importance and role in the organization.

Agency Theory & Performance Management:

Agency relations as aspects of performance management practices in most organizations are viewed as a legal tool to have an understanding of contract between the principal (employer) and agent (employee) (Jensen & Meckling, 1976). According to Jensen and Meckling (1976), the agency theory is a phenomenon of exchanges in which the employer (the principal) assigns responsibility with objectives for a specific set of actions to employee (the agent). "Agency theory is based on the relationship between one party, the principal, who designates certain tasks and decisions to another party, the agent. The focus of agency theory stems from the assumptions that the agent will behave opportunistically, particularly if their interests conflict with the principal's" (Mitchell & Meacheam, 2011:151). The differences in interests and attitudes may lead to lack of convergence in decision-making of both the parties (Boxall & Gilbert, 2007). The divergence in decision-making would check principals' risk-taking appetite, because principal has given responsibility to employees to achieve the goals of the organization. The cooperative behavior from employees would benefit the employer but

may or may not be of equal interest to employee (Eisenhardt, 1989). However, the agency theory proposes that the dominant behavior of self-interest by employees would restrict them to respond in favor of employers (Burnham, 1941). Employers assign work to employees, expecting that employees will complete these demands in the employers' best interest (Eisenhardt, 1989; Jensen & Meckling, 1976). The goal conflict between employer and employee will result in negative economic and organizational outcome. PMS must resolve the conflict between agent and principal to reduce the undesirable consequences. Jensen and Meckling (1976) advocated that agency costs theory has originated with the notion that the interests of the organizational employees and its owners are not perfectly aligned. The conflict between employees and employers occur as employees tend to maximize their own interest rather than the value of the firm. In contrast to the notion of non-aligned relationship between agent and principal, modern agency theory posits that principal-agent relationship suggests efficient assimilation and flow of information and cost minimization by sharing of risk (Eisenhardt, 1989: 59).

Agency theory is founded on seven fundamental assumptions: self-interest, goal conflict, bounded rationality, information asymmetry, pre-eminence of efficiency, risk aversion, and information as a commodity (Eisenhardt, 1989). PMS would work in minimizing the differences between employer and employee. It would facilitate alignment of organizational and employees' interest, reducing

goal conflict, improving the flow of information, improving efficiency of employees and minimizing risk by having clarity in organizational and employees goal.

Methodology

Case based method was used to collect data and understand the process of PMS in detail. One of the researchers worked with HR department of the case organization and another researcher is a management faculty of OB and HR. The organization under study provides services in the area of ship classification, industrial inspection, management system certification and technical advisory services through its global network and operation. The employees are mainly engineers and have relevant technical background to deliver services in varied functions through its worldwide operation.

HR personnel of the organization received feedback/inputs from various stakeholders of performance management system (PMS) to make the process more effective and meaningful for all – organization, employees/appraisers, HODs/appraisers, senior management and HR as process owner of PMS. In the Monthly Review Meeting of June, 2016, one of the follow up actions was on PMS process “A mechanism for evaluating performance of all employees of the organization to be worked out towards identifying their growth potential”. Therefore, to address the query, automation of the PMS process was initiated. Automation of PMS process was

a new initiative. Considering the above points, HR personnel embarked on a study to understand effectiveness of automated PMS from stakeholders' point of view so that necessary points / aspects can be changed or incorporated for getting maximum benefits out of the PMS process.

Long Interview and Focus Group Interactions: HR personnel conducted 4 focus group discussions (FGD) and long interviews covering 30 employees across divisions, departments and designations. Each FGD had 8 members comprising surveyors and senior surveyors. Inputs from 3 Heads of Survey Stations were also received on the PMS process. Based on the 3 long interviews, HR team's experience and other senior members' inputs, we identified the important elements/aspects of the PMS. These elements formed the base for 4 Focus Group Discussions. Thematic content analysis of transcripts helped in iden-

tifying certain themes which would help in improving the PMS process.

Results & Discussion

The findings from FGD and interview have been tabulated in Table 1. The thematic content analysis helped us in identifying the pattern in the data, which further provided insights to the objectives of the study. Thematic content analysis was conducted in six phases. Researchers first got familiarization with data, identified and generated some initial codes, looked for some pattern to identify themes. These themes were then reviewed again to provide name to each theme. The final themes were then aligned with initial research questions (Virginia & Clarke, 2006). The research work has been divided into two phases. Phase 1 indicates identification of major themes and phase two indicated finding right process to solve issues raised during discussion.

Table 1 Sample Responses and Themes of PMS Process

Sr. no.	Statements/ responses/ quotes	Words	Theme/ Problem area
1	<ul style="list-style-type: none"> • Make standardized forms for the departments • Usage of standardized KRAs • Performance data should be taken from the ORS/system • Number of critical attributes to be reduced • Do more frequent PMS – quarterly or half yearly (only for KRAs review) 	Standardization, Key Result Area, System, Less KPI, Frequency, revise, continuous assessment and feedback	How to make the PMS process simpler to understand and implement?
2	<ul style="list-style-type: none"> • KRAs should be person specific and not generic in nature • Department specific KRAs /measurable should be predefined and fixed • Goals set should include inputs of local Survey Stations (local scenarios) 	Specific vs generic, predefined, goal alignment with department, coordination between employees and	How to bring objectivity in the PMS process?

	<ul style="list-style-type: none"> • KPIs for complex plan should be different than simple plan • HODs to discuss and decided the KRAs/KPIs with the employees and set the objectives • Goals to be formally communicated to all surveyors by the HOSS • Set KRAs/KPIs should be reviewed for incorporating any major change 	HODs while setting goals, revision, communication, benchmark, guidelines, competency, involvement	
3	<ul style="list-style-type: none"> • ORS/ Log Book / MIS can be used for regular monitoring of performance • People working on projects should be evaluated after closure of each project • Regular formal feedback / observation from HODs on the employee's performance is expected • Before any transfer performance evaluation should take place 	Monitoring, immediate evaluation, transfer, departmental meetings,	How to monitor performance of an employee over a time period?
4	<ul style="list-style-type: none"> • More opportunities to interact with the managers • Employee should take initiative and update managers on their performances • More face time – weekly meetings • Managers should recognize good work by patting the back of an employee • Manager can use thankyou card for good job done • Manager should have frequent informal meetings with the subordinates 	Personal Interaction, performance updates, recognition	How to enhance relationship of manager and his/her subordinate for a positive interaction?
5	<ul style="list-style-type: none"> • Manager should give regular feedback to their subordinates • Manager should give real time feedback – informally, over chat /tea /coffee • They should explain negative feedback to their subordinates, how to correct the situation • Try not to give negative feedback in public/ shouting can be avoided /firing people in from of others can be avoided 	Feedback, real time, provide negative feedback appropriately, information sharing	How to regularize performance feedback by the manager related to employee's performance?
6	<ul style="list-style-type: none"> • Appraisers are not taking this aspect seriously • The critical attributes should be customized for each role • Multiple appraisers can bring more objectivity to the assessment process • Sincerity and seriousness of the process is influenced by the objective – whether the employee is due for promotion or not 	Seriousness of appraisal process, role specific critical attributes, objectivity, involve team leader, easy evaluation, attribute measurement, training,	How to measure Critical Attributes during the PMS process objectively?

6	<ul style="list-style-type: none"> • Some appraiser completes the process in 5-10 mints. By giving average rating in all • A broad generic description of excellent performers should be drafted for easy reference /role wise • Making value addition, positive attitude, taking initiative, problem solving, proactive, willing to take additional responsibility, etc are the attributes of person who are excellent performers • If the employee has consistently performed better than the benchmark • Colleagues feedback can be taken in such cases • Grading system can be used for assessment • More frequent assessment to identify excellent and average performers 	<p>Behavioral description of excellent performer, benchmark, colleagues feedback, grading system, variation in grading system, frequency of assessment</p>	<p>How to differentiate between excellent performer and an average performer in the PMS process?</p>
7	<ul style="list-style-type: none"> • Task / job assigned should change with years of experience • KRAs/KPIs should be different for experienced and less experienced person • Levels for each role can be defined in the division – easy to complex • Customer feedback for senior employees should be mandatory • Senior employee should be given more critical and complex assignment 	<p>Task assignment, experience, role level complexity, customer feedback</p>	<p>How to measure performance of more experienced employee vs less experienced employee in the same grade/ role during the PMS process?</p>
8	<ul style="list-style-type: none"> • Divisional Head should be involved in the PMS process and bringing uniformity among HODs evaluation and rating • Measurement mechanism / KRAs /KPIs should be discussed and arrived at before initiation of PMS process, at the time of goal setting • KRAs/KPIs to be communicated and made transparent to all 	<p>Uniform evaluation, discussion based measurement, transparency, multiple input of data, benchmarks, online PMS</p>	<p>How do we bring parity of rating / evaluation among managers/ appraisers in the same Department and Division?</p>
9	<ul style="list-style-type: none"> • Training should be given as per the technical skill matrix • Practical field experience / training is very important • Number of knowledge sharing sessions • Subject matter expert (SME) can assess / review on the effectiveness of the learning of team members /employees • Professional growth need to be defined for each person • Nature of job should change on yearly basis for professional growth 	<p>Training on PMS, Technical skill matrix, knowledge sharing sessions, learning evaluation, document need for professional learning, professional growth</p>	<p>How to evaluate employee's professional growth /technical competencies during - PMS process?</p>

10	<ul style="list-style-type: none"> • ORS process can be used • MIS can be used • Audit reports can be used • Feedback from other colleagues • Monthly /weekly meetings 	Improved processes, feedback from peer, meetings	How to use other tools/ sources to bring fairness and objectivity in the assessment during PMS process
11	<ul style="list-style-type: none"> • The increment /promotion letter should be drafted in such a way that it motivates employees • Take employee's view /suggestion on matters related to his job /department during PMS process • Take new ideas from employee for organisation goals – revenue /customer focus ,etc • The HOD should listen to the employee's version and experience 	Promotion letter should be motivating, inclusive PMS process, idea generation, HoD should listen, keep promises, understand employees strength, genuine appreciation, goal clarity	How to use PMS process for building employee's morale, motivation and confidence?
12	<ul style="list-style-type: none"> • More transparency is required in this aspect • Link between inflation, performance rating and increment should be clear • Rationalisation of salary as and when there is correction in the market • In the current process there is very less difference between increment percentage of excellent and average performer • Normalised rating to be communicated • Annual increment should be partially guided by rating and partially by seniority • A minimum increment to given to all employees 	Transparency, inflation-rating-increment alignment, difference between excellent and average performance, communication, percentile based increment	How to link of performance rating and annual increment?
13	<ul style="list-style-type: none"> • More layers to be introduced in the existing hierarchy, people should feel that they are growing • Time bound promotion to be discontinued, based on consistent performance • Promotable positions should be declared before the PMS process, HOD should know about it • Criteria of each vacant position should be announced; criteria should be defined clearly • Consistency should be there in implementing any policy / guideline 	Introduction of hierarchy, performance based promotion, criteria clarity, process consistency, revision of policy every three years, appraiser appraisee communication, maintenance of history of employees	How to link of PMS and promotion decisions?

The thematic content analysis of respondents' views was classified into 13 broad questions which would refine the PMS process. Researchers evaluated each meaningful quote from transcript. Set of words were derived from the quotes. These quotes and words were clubbed into a particular theme/question. After analysis, 15 major themes and questions were generated based on similarity, repeatability, and importance of words and statements. The next step was to further prune it down to critical issues raised by participants. These issues, explained in Phase 1 below are the role of top management, involvement and participation of HoDs, goal commitment from employees, feedback and its utility, transparency in the system and training, compensation & promotion.

Phase 1

The rapidly changing business environment engenders difficult challenges in designing and implementing effective performance management systems in organizations. Therefore, organizational initiatives which can be ascertained in an organization to enhance the performance of the employees through a performance management system have been noted such as:

- *Top management.* The performance management system needs to be integrated with the strategies of the

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organization to enable high degree of success. Goal clarity among different department heads would provide transparency and direction to the PMS process. In line with agency theory the goal or target should be agreed by subordinates also. It should not have dominance of management. It would help in minimizing the differences proposed in agency theory.

- *Involvement and participation:* Involvement of managers and employees in developing and implementing a performance management system enhances trust and ownership of the performance measures. Involvement and participation would reduce the gap created by agent. In other words, employees' involvement and participation would act as a bridge between the gaps among the principal (management) and agent (employees).

People are more satisfied when they attain their goals or make meaningful progress towards them than when they fail, make little or no progress.

- *Goal Commitment:* According to Locke and Latham (2002), goals are both outcomes to attain standards for judging one's accomplishments. For instance, Locke and Latham (2005) cited in Smith and Hitt(2005:128-47)found out that people are more satisfied when they attain their goals or make meaningful progress towards them than when they fail, make little or no progress. Agency theory also highlighted that the dif-

ferences between managers and subordinate goals reduces the features of goal alignment and reduces subordinates commitment towards goal. Frese (2005) cited in Smith and Hitt (2005:102) found out that proactive goal setting better focuses on maximizing the positive effect of goals by developing specific time-bound and challenging goals to which participants feel committed (Locke & Latham (2002) cited in Smith & Hitt (200:128-47).

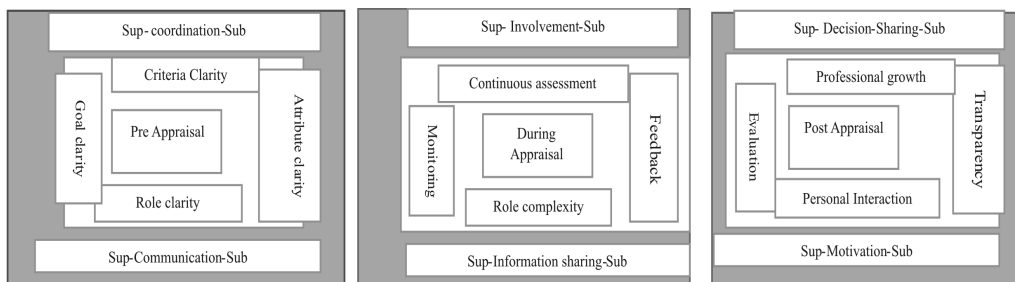
- *Review process.* The managers should be focused on continuous review of the performance management system, so as to determine whether the action plans to fill the gaps between performance measures and goals are being achieved or not. Lawler (2003:402) empirically examined the association between the link to rewards and PMS effectiveness, concluding that “performance appraisal systems are more effective when there is a connection between the results of the performance management system and the reward system of the organization”. Similarly, a number of studies have found a positive association between linking performance to rewards and performance measurement systems (Burney et al., 2009; Johanson et al., 2006; Chan, 2004), a component of PMSs.
 - *Feedback:* A prompt and formal feedback system must be enabled for successful performance measurement. Performance feedback during mid-term review would be helpful for employees to take corrective action
- and for managers to review resource allocation. Timely feedback would also control too much of self-interest by agent or by principal. As stated in agency theory both may try to reduce each other’s self-interest.
- *Promotion & Compensation:* A well defined compensation plan must be introduced for the employees so as to avoid any discrepancy. Performance linked incentive and compensation system is preferred if objectives and targets are achieved. Employees indicated these two as motivating factors for successful PMS implementation.
 - *PMS Training:* PMS training will have two fold benefits. Firstly, it will provide raters evaluation criteria, clarity and common input would reduce biasness. Secondly, it would help in identifying management representative to take ownership.
 - *Transparency:* The performance management system that measures everything achieves nothing if there is no transparency in linking PMS with rating and incentive system of organization. Transparent system will create an environment where the raters (HoDs and superiors) will have similar understanding regarding the working process of PMS. This will bring transparency in evaluation. Therefore, transparency shall be part of *planning* (formation of KRA and KPI), *process* (during measuring performance), and *evaluation* (providing rating to measured performance) of performance management system.

Phase 2

The respondents' views regarding effectiveness of PMS process were further divided into *pre appraisal process*, *during appraisal process* and *post appraisal process* (fig. 1). It was found that

not every important words identified shall be worked at all the three stages of PMS process. Therefore, different elements required for different stages were identified as well as related with agency theory by bringing in the association of superior and subordinate at different levels.

Fig. 1 Pre, During & Post Appraisal Process Elements of Performance Management System



Based on the analysis of data researchers came out with a model which divided PMS process into pre, during and post process. The subsequent paragraphs discuss each step.

Pre- Appraisal: this is the step where the performance standards are established. It provides clarity to unit heads/ superiors regarding what shall be communicated to subordinates. It is a process which sets superiors' expectations with subordinates. Superiors coordinate with subordinates and by mutual consensus set target for coming year performance. Therefore, two elements coordination and communication forms the boundary of pre-appraisal process. The coordination and communication would result in goal, role, criteria and attribute clarity.

During Appraisal: This phase is most important but widely ignored by

organisation. Superior shall involve in continuous monitoring, providing feedback and gathering data regarding performance during this phase. Timely feedback by superior to subordinate would enhance the subordinates' performance. Superior shall timely share all the information to subordinates which is directly or indirectly linked to target achievement. Superior involvement and information sharing during target achievement phase is important. It reduces role complexity.

Timely feedback by superior to subordinate would enhance the subordinates' performance.

Post Appraisal: This stage shares the measurement provided by superior to the subordinates. In this stage the superior's responsibilities do not end by providing ratings but the process of taking right decision on the measures starts.

Superior has to be transparent regarding career plan of subordinates. They have to personally discuss the charter of subordinates and motivate them for future assignments.

If the pre-during and post process of appraisal and PMS works as suggested then it is easier for agents (subordinates) to align with the goal requirements of principal (superior and management).

Many tools and frameworks have been proposed in the field of performance measurement and management but it is not necessary that all of them would give positive results. Therefore, it is necessary that the managers should select a balanced performance management system as per the requirement of the organization and its employees. The suggested PMS process would reduce the agent principal gap and subordinate and superior would set goals which will align with organizational goal. The findings are in congruence with the findings of researchers who suggested organization, superior and subordinates are equally responsible for the organization's growth and performance.

Conclusion, Implications & Future Research

The objective of this study was to capture employee responses on "How to improve PMS process?" Responses indicated many questions which shall be answered for the improvement of the process. Researchers captured themes into pre, during and post appraisal process and various elements which would

contribute in the success of PMS process. The model highlighted various elements necessary to address during different stages for effective PMS. An attempt to relate the PMS concept with agency theory was pioneering as very few researchers tried to link the expectations of management with capability and performance of employees. Further an attempt was made to study various organizational level initiatives like top management support, goal setting etc. which will contribute to the effectiveness of PMS process.

Practicing managers can take threads from this model to understand that at the 'pre-stage' the control is more of HR department as it is a process of defining and providing clarity, at the 'during process' the control of process lies with immediate superior and at the 'post appraisal process' the control stays with both the HR department and with superiors involved in the process. More organized appraisal process is possible by understanding the critical elements and factors which may improve the effectiveness manifold.

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