EFFECTS OF PERFORMANCE CONTRACTING ON INNOVATION: A CASE OF KENYA REVENUE AUTHORITY

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ABSTRACT

The public service of any country and in particular the civil service plays an indispensable role in the effective delivery of public services which is key to the functioning of a national economy. It becomes imperative on the public service sector to look into production of new services or just an improvement of the current services and products or process which calls for innovation. The study’s objective was to determine the effects of performance contracting on innovation of the employees at Kenya Revenue Authority. Case study research design approach was adopted on a target population of 1052 employees at KRA headquarters. Using stratified sampling technique, 105 employees were selected from five departments and questionnaires administered. Descriptive and inferential analysis using chi-square and linear regression using ordinary least square method were adopted. The study found out that KRA employees have signed performance contracts whose terms they are moderately involved in drafting. Performance contracts enhanced employees’ ability to discharge duties, thus, service delivery. Besides, though they were rewarded when they improved the performance, promotions were not pegged on their innovativeness. The study concluded that performance contracting has had positive effect on process innovation though little effect on service or market innovations. The study recommends that employees should not feel bound by the terms in the performance contracts but their actions or performance should be motivated by moral obligation and personal ambitions; besides, the contracts’ targets or goals should be raised each year to encourage employees to aim higher and improve service delivery.

Key Words: Performance Contracting, Performance Management, Innovation, Contract, Parastatals

INTRODUCTION

Performance Contracting is a branch of management science referred to as management control systems and is a contractual agreement to execute a service according to agreed-upon terms, within an established time period, and with a stipulated use of resources and performance standards. Performance contracting is one element of broader public sector reform aimed at improving efficiency and effectiveness, while reducing total costs (Domberger, 1994). A performance contract constitutes a range of management instruments used to define responsibilities and expectations between parties to achieve mutually agreed results. It is a useful tool for articulating clearer definitions of objectives and supporting innovative management, monitoring and control methods and at the same time imparting managerial and operational autonomy to public service managers. It is therefore a management tool for ensuring accountability for results by public officials, because it measures the extent to which they achieve targeted results (Elmore, 2007).
Governments are increasingly faced with the challenge to do things but with fewer resources and above all, differently performance contracts can be defined as a range of management instruments used to define responsibilities and expectations between parties to achieve mutually agreed results. Performance contracting provides a framework for generating desired behaviour in the contest of devolved management structures. Employers 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 (Klages and Elke, 1998).

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 to mention just a few. In Kenya the concept of performance contracting was first introduced in the management of State Corporation in 1989 as a way of responding to the needs of the taxpayers. This was against the backdrop of the government’s key priorities of implementing and institutionalizing public sector reforms that would lead to an efficient, effective and ethical delivery of services to the citizens. 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 policies that were recommended to streamline and improve the performance of State Corporations. These policies were 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.

The first two parastatals to be on performance contracting were Kenya Railways in April 1989 and National Cereals and Produce Board signed in November 1990. The PC’s of Kenya Railways Corporation and the National Cereals and Produce Board failed because of lack of political goodwill to drive this process (it was perceived as donor-driven), the PC’s did not conform to the requirements of the three sub-systems of PC’s as they lacked the performance incentive system and there was no provision for the impact of external factors such as changes in GoK policy, inflation, exchange rate fluctuations that would have made evaluation fair (Kobia and Mohammed, 2006).

Kenya decided to re-introduce performance contracting in 2003. The initiative to introduce PC’s in Kenya came from H.E. the President and was clearly spelt out in the Economic Recovery Strategy for wealth and Employment Creation (ERSWEC). In August 2003, the government appointed a committee to spearhead the introduction and implementation of performance contracts namely the performance contracts steering committee. The government made a decision to introduce PC in state corporations on a pilot basis in 2004. Sixteen state corporations signed the PC’s by December 2004. The criteria for selecting the pilot companies included representation of diverse sectors and corporations, the government

Kenya Revenue Authority (KRA) is a state corporation established by an act of Parliament of July 1st, 1995 Cap 469 as a central revenue body. The authority is charged with the responsibility of collecting revenue on behalf of the government of Kenya. KRA’s role is assessment, collection, administration and enforcement of laws relating to revenue; therefore restoring economic and political independence through elimination of budget deficits and reducing reliance on donor support. Since its inception, KRA has undertaken several strategic changes. In response to managerial concerns and need for performance evaluation, KRA introduced performance contracts for employee appraisal.

PURPOSE OF THE STUDY

The purpose of this study is to determine the effects of performance contracting on innovation of the employees at Kenya Revenue Authority and looks at how the former affects service, process and market innovations.

LITERATURE REVIEW

Transaction Cost Perspective of Performance Contracting

An important strand within the theoretical literature argues that there are at least partial solutions to governance problems. They come into play because real-world actors acknowledge the bounds on their own rationality and because they take into consideration the uncertainties that confront them whenever they have to make a decision or to design an organization to make decisions on their behalf. In this realistic perspective, neither hierarchical nor market governance is frictionless. Therefore, actors have a strong incentive to consider the transaction costs involved before they decide how to set up the organization responsible for the delivery of policy. In purely economic terms, these transaction costs are "the comparative costs of planning, adapting, and monitoring task completion under alternative governance structures" (Williamson 1985). The argument is that variations in transaction costs explain why economic entrepreneurs often choose forms of organization that deviate from neoclassical claims about the superiority of the market. Under certain conditions, hierarchy may be a more efficient solution than a market solution because it economizes on transaction costs.
One corollary is the existence of a wide variety of organizational solutions. Another corollary is that whatever the form of organization, it involves a contractual relationship where the partners handling a particular set of tasks agree on the conditions for their future cooperation. According to conventional thinking, this is clearly the case when an entrepreneur agrees with another entrepreneur on the delivery of goods and services. Often such contracts are more complex in content and define the terms of cooperation for a long period. Ultimately, the superior–subordinate relationship prevailing in a hierarchical organization can be seen as a long-term contract defining the mutual rights and obligations between employer and employees, management and staff. A final corollary is that entrepreneurs rarely have at their disposal a perfect solution to their governance problems. This may imply that the arrangement actually chosen leaves certain problems open to be solved discretionarily. It may also imply the combination of different forms of organization. Of particular interest is the possibility to combine formal hierarchical governance with a negotiated order intra-organizational contracting - between the executive and the operational parts of the organization (Williamson 1985).

Transaction cost theory basic claim is that entrepreneurial concern for efficiency accounts for organizational differentiation because different forms of organization minimize the sum of production and transaction costs given variation in transaction characteristics. Maybe this holds for private firms. However, as Moe has argued "politicians are not primarily motivated by productive efficiency or the public interest in making such decisions. This means that, when politicians choose between public bureaucracy and contracting out, they are generally not choosing on efficiency grounds—nor are they in the conventional sense, seeking an optimally balanced set of hierarchical controls and monitoring mechanisms in designing the details of the contractual arrangement" (Moe 1984, 761; 2005). Therefore, transaction costs should be conceived in political terms as the opportunity costs facing politicians in terms of votes lost or won, coalition opportunities opened or forgone, executive capacity bound or free, and executive discretion restricted or protected through more or less flexible forms of organization. Since the 1990s, political transaction cost theory has gained considerable ground in the study of public policymaking and public sector governance (Dixit 2004, Moe 2005 and Williamson 1999). Recent advances in the study of delegation within democratic systems even rely on transaction cost theory and use political transaction costs as their central heuristic concept (Huber and McCarty 2004, Pollack 2003 and Macher and Richman, 2008).

**Agencies, Departments and Relational Contracting**

Transaction cost theory sees hierarchy as the dominant form of organization when it comes to handling the core tasks of government. Still hierarchy takes many forms. According to transaction cost economics, the basic distinction is between unitary organizations, where all tasks are handled in functionally specialized subunits ultimately reporting to a single executive, and multidivisional organizations where operational tasks are delegated to divisions, specialized according to geographical or product criteria. Their managers who
report to headquarters are responsible for corporate strategy and coordination, but enjoy considerable autonomy in the management of their divisions (Williamson 1985). The theoretical claim is that the unitary hierarchy with its high degree of functional specialization involves higher transaction costs than the multidivisional organization (Whitford 2006). Further, the multidivisional organization is the result of institutional innovation, and this more modern form of hierarchy has spread as experience brought evidence of its comparative efficiency. This point is at the core of the theory of the firm. Its public sector parallel is the discussion of whether the public bureaucracy should be organized on a unitary or on a two-tier basis. In the former case, administration is concentrated in a hierarchy reporting directly to departmental ministers. In the latter, departmental ministers are advised by ministerial departments on policy and political issues, while policy implementation is delegated to agencies with their own management, their own budget and staff, but also with agency activities coordinated and overseen by the department.

Like its private sector parallel, the agency model is often presented as a more innovative form of organization. Again, the claim is that it is comparatively superior, even if it varies whether this superiority is the result of higher efficiency or higher effectiveness. However, transaction cost economics has generally neglected the increased risk of agency problems when substantial managerial authority is delegated to divisional managers (Cooley 2005). Similarly, the two forms of organization may have implications for the types and amount of conflict referred to higher levels in the hierarchy (Whitford, 2006).

The multidivisional organization may be particularly prone to such agency problems because delegation of authority to divisional managers involves a reallocation of capacity. As a result, not only managerial capacity but also the information and expertise of agencies are strengthened at the expense of ministers and ministerial departments. This is a situation similar to the one envisaged by Huber and McCarty (2004), but unlike them, we argue that bureaucratic capacity not only differs between more or less developed institutional systems. Rather, bureaucratic capacity may be a design parameter with intended and unintended consequences to be weighed against each other. Delegation of authority within a multidivisional ministerial organization may create a highly specialized organization minimizing duplication of work. However, by building up such specialized capacity at the divisional level, the risk is that an agency with a strong policy mission may follow a line that neither departmental ministers nor their departments have the capacity to check. These concerns may be balanced differently from portfolio to portfolio. This, as we shall show, is mirrored in varying organizational designs within central government. Therefore, organizational capacity is an important variable to consider in the analysis.

Innovation

According to Darroch and McNaughton (2002), innovation can be considered as a necessary ingredient for firms simple wanting to remain competitive and postulated that to be
successful; the main task of a firm is to determine the perceptions, needs and wants of the market in order to create services and products with a superior value. Given that this superior value is highly subjective and exists only in the minds of customers, it is essential to learn their opinions about the usefulness of the product, i.e. their perception of what they get and what they must give in exchange. In this sense, organisations may be viewed as information-processing organisms operating in a complex and dynamic context, which use this information to reduce their uncertainty in the decision-making process regarding innovation (Lievens and Moanert, 2000). To do so, organisations constantly scan the horizon for new opportunities to satisfy their customers and being capable of innovating to provide solutions to those market needs (Weerawardena, 2003). This implies that a firm that effectively manages and motivates knowledge, coming from internal sources, brings better information for the decision-making and thereafter better offers to the consumers; that is, responding to changing markets often requires the introduction of new products (Shoham, Rose and Kropp, 2005).

Product Innovation

Product innovation refers to the improvements made on the mix of products of the company that is, the choice of new products and their development. It is thus involves the introduction of a good or service that is new or substantially improved which includes but is not limited to, improvements in functional characteristics, technical abilities, or ease of use. Product innovation is often made in technology driven companies and helps companies in their competitive positioning while retains market presence, not only in radically changed products but also in differentiating the offerings (Craig and Hart, 1992).

Product innovation provides the most obvious means for generating revenues. Process innovation, on the other hand, provides the means for safeguarding and improving quality and also for saving costs. Improved and radically changed products are regarded as particularly important for long-term business growth (Hart, 1996). The power of product innovation in helping companies retain and grow competitive position is indisputable. Products have to be updated and completely renewed for retaining strong market presence.

Process Innovation

Process innovation embraces reengineering the business process (Cumming, 1998) and therefore implies the improvement of the internal operations and capacities. The importance of process innovation is quite well understood, especially in companies under threat since it may help to improve the company productivity.

An efficient supplier who keeps working on productivity gains can expect, over time, to develop products that offer the same performance at a lower cost. Such cost reductions may, or may not, be passed on to customers in the form of lower prices. Process innovation is important in both the supply of the core product as well as in the support part of any offer.
Both components of an offer require quality standards to be met and maintained. In the case of services, which by their very nature rely on personal interactions to achieve results, the management of process innovation is a particularly challenging activity (Johne and Storey, 1998).

**Market Innovation**

Market innovation is concerned with the mix of markets of the company and how chosen markets are best served while accurately interpreting buying preferences (Johne, 1999). This directly influences the sales and lately the company results. Market innovation is concerned with improving the mix of target markets and how chosen markets are best served. Its purpose is to identify better (new) potential markets; and better (new) ways to serve target markets. Identification is achieved through skilful market segmentation. Market segmentation, which involves dividing a total potential market into smaller more manageable parts, is critically important if the aim is to develop the profitability of a business to the full. Incomplete market segmentation will result in a less than optimal mix of target markets, meaning that revenues, which might have been earned, are misread.

**Innovation and Performance**

Innovation is a key element in corporate strategy and firm-level performance (Kay, 1993). An innovation can introduce scarce, high value-added products and the individual firm can reap super-normal profits from its introduction. It allows the firm to develop new products and exploit new markets; in addition, it can allow the firm to improve its cost base and increase profit margins without increasing its price. Innovation and new product development are crucial sources of competitive advantage (Hamel and Prahalad, 1994)

Quinn et al. (1997) states that developing streams of innovation, building ambidextrous organizations, the role of the senior management team in building and integrating this diversity, and senior management’s role in managing large system change associated with strategic innovation, these are all crucial competencies for sustained improved performance; for building from today’s to tomorrow’s competitive strength. Many industrial and sectional analyses reveal large differences in productivity, innovative capacity and business performance between firms in the same industry (Prais, Jarvis and Wagner, 1989). There are linkages between innovation and organizational research (Hamel and Prahalad, 1994).

**RESEARCH METHODOLOGY**

**Research Design and Sampling**

The study adopted a case study research design since it’s an in-depth investigation of an institution or phenomenon; KRA (Mugenda and Mugenda, 2003). The population of the
study consisted of all the officers in the Kenya Revenue Authority based at the KRA headquarters. Although by 2012, there were 4,200 employees, 1,052 were at KRA headquarters. A sample size of 105 was selected using stratified sampling technique since the target population consisted of employees in different departments whose terms of contract was different. The population was stratified into five (5) departments from which a sample of 10% of the target population was drawn using simple random sampling technique. Primary data was collected through structured questionnaires.

**Data Analysis**

The data collected was analysis using statistical package for social sciences. Quantitative data was analyzed using descriptive statistics while qualitative data was analyzed using content analysis. Descriptive statistics involves the use of absolute and relative (percentages) frequencies, measures of central tendency and dispersion (mean and standard deviation respectively). Chi-square analysis was used to establish the innovative disposition of the senior and management staff with regards to performance contracting.

The ordinary least square linear regression analysis was conducted to determine the relationship between dependent (service, market and process innovation) and independent variables (performance contracting).

\[ Y = \beta_0 + \beta_1 X \]

Whereby Y is innovation as proxied by service, product and process innovation, \( \beta_0 \) is regression constant obtained from the \( y \)-intercept, \( \beta_1 \) is the regression coefficients and \( X \) is performance contracting subscription. The data was presented in tables and figures (charts and graphs) while explanations were given in prose.

**RESEARCH FINDINGS AND DISCUSSION**

The research findings revealed majority of the employee respondents had worked for at least 6 years with the frequency being skewed towards 11 years and above and were at least graduates. It was also established that KRA moderately involved its employees in drafting their performance contract. Performance contract was found to have had enhanced employees’ ability to discharge duties (61.1%). This effect was more profound for senior than middle level managers. The employees of KRA were rewarded when they perform something to improve the performance of KRA (73%). However, promotions were not pegged on innovation as only 1.1% of the employees had been promoted on those grounds. Other forms of rewards at KRA were recognition and recommendations. The study indicated that the middle level management were rewarded more than senior management for innovations.
It was established that performance contracting has enhanced the ability of employees to discharge their duties (77.9%). Although it had enhanced the ability of senior management (80%) to discharge their duties than it had for middle management (76.9%). It was established that there were efficient processes through which employees discharge their duties at KRA (87%). Thus, carrying out of PC terms was not impeded by work environment. This had enhanced the sufficiency of services offered by KRA to its clients (68.4%). This is in line with performance contracting objective of enhancing service delivery in public sector. It was also established that introduction of performance contracting had enhanced flexibility of action and free will to act without sticking to certain prescribed methods or work plan (76.6%).

On innovation and performance contracting, the study established that majority of employees had come up with new ideas to improve on the process of carrying out work at KRA (80%). On the flip side, minority (40%) had proposed or implemented a new service for KRA clients, 31.6% of the employees who had signed performance contracting had identified new clients for KRA to collect revenues from, 47.4% of the employees had suggested new law or regulation at KRA and 38% had identified problem in areas outside their departments. The study, thus, found that performance contracting had enhanced process innovation more followed by market innovation and service (product) innovation. It was further established that senior management were more apt on process innovation, market innovation and problem solving skills (innovation) than middle level management.

The study established that performance contracting had improved service delivery, staff performance and productivity more than it had enhanced innovativeness and creativity. Performance contracting effect on innovation was viewed as either low of negative. The study established that employees innovation was motivated by moral obligation (42.1%), personal ambition (26.3%) and added duty (15.8%) than performance contract (12.6%). Although most of the KRA employees’ innovative ideas are implemented, some are not, owing to lack of framework for identification of new ideas, the idea being too expensive to implement or due to the idea being outside the performance contracts.

Table 1 shows presents a Pearson Chi-square value of 13.873 was established at p = 0.031. This depicts a significant association between performance contracting and discharge of duties with regards to level of management.

**Table 1: Chi-square - KRA Grade versus Ability to Discharge Duties**

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
<th>df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Chi-Square</td>
<td>13.873a</td>
<td>5</td>
<td>.031</td>
</tr>
<tr>
<td>Likelihood Ratio</td>
<td>16.266</td>
<td>5</td>
<td>.012</td>
</tr>
<tr>
<td>Linear-by-Linear Association</td>
<td>.496</td>
<td>1</td>
<td>.481</td>
</tr>
<tr>
<td><strong>N of Valid Cases</strong></td>
<td><strong>94</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. 8 cells (66.7%) have expected count less than 5. The minimum expected count is .41.
From the table below, a chi-square value of 11.864 is obtained at \( p = .037 \) depicting no relationship between involvement in performance contracting and flexibility of action or freewill to act. Thus, staff involvement in performance contracting has significantly enhanced flexibility of action and freewill to act without sticking to certain prescribed methods or work plan.

**Table 2: Chi-Square - Flexibility of Action and Freewill to Act**

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
<th>df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Chi-Square</td>
<td>13.864</td>
<td>5</td>
<td>.037</td>
</tr>
<tr>
<td>Likelihood Ratio</td>
<td>15.139</td>
<td>5</td>
<td>.056</td>
</tr>
<tr>
<td>Linear-by-Linear Association</td>
<td>1.305</td>
<td>1</td>
<td>.253</td>
</tr>
<tr>
<td><strong>N of Valid Cases</strong></td>
<td><strong>94</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. 11 cells (73.3%) have expected count less than 5. The minimum expected count is .20.

**Regression Analysis**

The regression analysis sought to determine the influence of performance contracting on market, process and product innovation at KRA. Table 3 shows that there is a good linear association between the dependent and independent variables used in the study. This is shown by a good correlation (R) coefficient of between 0.635 and 0.644. The coefficient of determination as measured by the adjusted R-square presents a moderate linearly strong relationship between dependent and independent variables given a value of between 0.403 and 0.415. This depicts that the model accounts for 40.3% to 41.5% of the total variations in staff innovativeness while more than 50% are explained by other factors other than performance contracting.

**Table 3: Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted Square</th>
<th>R</th>
<th>Std. Estimate of the Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.635</td>
<td>.403</td>
<td>.393</td>
<td>.12495</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>.639</td>
<td>.408</td>
<td>.397</td>
<td>.12067</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>.644</td>
<td>.415</td>
<td>.404</td>
<td>.11514</td>
<td></td>
</tr>
</tbody>
</table>

The ANOVA statistics presented in Table 4 was used to present the regression model significance. An F-significance value of 0.013, 0.002 and 0.008 was established in service, process and market innovation models respectively. This shows that there is a probability of less than 5% of the regression model presenting a false information. Thus, the regression models are significant at 95% confidence level.
Table 4: Analysis of Variance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>2.044</td>
<td>1</td>
<td>2.044</td>
<td>2.4132</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>78.805</td>
<td>93</td>
<td>.847</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>80.849</td>
<td>94</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Regression</td>
<td>3.968</td>
<td>1</td>
<td>3.984</td>
<td>4.3636</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>84.881</td>
<td>93</td>
<td>.913</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>88.849</td>
<td>94</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Regression</td>
<td>3.744</td>
<td>1</td>
<td>3.744</td>
<td>3.782</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>92.105</td>
<td>93</td>
<td>.990</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>95.849</td>
<td>94</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

From the model, unit change in performance contracting adoption and implementation would lead to a 0.737, 0.556 and 0.631 increase in service, process and market innovations respectively. The t-test shows that the coefficients were significant at 95% confidence level; service (p = .013), process (p = .002) and market (p = .008) innovations.

Table 5: Regression Coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1.362</td>
<td>.129</td>
<td>1.593</td>
</tr>
<tr>
<td></td>
<td>Service Innovation</td>
<td>.737</td>
<td>.034</td>
<td>.635</td>
</tr>
<tr>
<td>2</td>
<td>(Constant)</td>
<td>1.395</td>
<td>.129</td>
<td>1.823</td>
</tr>
<tr>
<td></td>
<td>Process Innovation</td>
<td>.556</td>
<td>.091</td>
<td>.639</td>
</tr>
<tr>
<td></td>
<td>(Constant)</td>
<td>1.503</td>
<td>.136</td>
<td>1.066</td>
</tr>
<tr>
<td>3</td>
<td>Market Innovation</td>
<td>.631</td>
<td>.096</td>
<td>.644</td>
</tr>
</tbody>
</table>

CONCLUSION

The study aimed at investigating the effects of performance contracting on innovation at Kenya Revenue Authority (KRA). Based on the findings, it can be concluded that performance contracting has increased service delivery to clients especially in the service sector. Performance contracting has also enhanced employees’ productivity and discharge of duty.

Performance contracting has not necessarily led to improvement in employees’ innovativeness. That is, although the PCs promoted innovative ideas, it is restricted to the area of immediate concern to the employee. It encourages officers to concentrate on their core business, restricting themselves to the immediate delivery of the contractual terms. Performance contracting has had positive effect on process innovation as it deals directly
with employees meeting set target. Process innovation deals with improvement of the internal operations and capacities of an organization, thus, employees would look at how work processes would enable him/her achieve his/her performance targets (in the contract). They would, as a consequence, tend to be more innovative on work processes.

Performance contracting had little to do with neither service nor market innovations. Market and service innovation has got to do with identification of better (new) potential markets and better (new) ways to serve target market through product development and positioning. Reduction in its effect on innovation becomes less pronounced as one moves from process to market (taxpayer recruitment) innovations explaining the reducing interest in process and market innovation which are perceived to have midterm to long term effects to performance. Thus, performance contracting tends to limit employees’ mental ‘loci’ to terms set out in the contract and would not innovatively look for new market segments. This is evidenced by many employees having not had identified nor introduced new services, clients and laws and regulations that will enable KRA serve more clients and products.

**RECOMMENDATIONS**

While performance contracting is essential in enhancing service delivery especially in public sector which isn’t, sufficiently or in totality, in direct competition with private sector, its terms tend to limit employees’ innovativeness to the contract signed. This owes to the fact that it encourages rigidity; employees are not flexible. Thus, it is recommended that employees should not be bound by the terms in the performance contracting alone, but moral obligation should also be capitalized. For example, rewards should not be solely pegged on the terms within the performance contracts, but on how far the employee goes beyond the limits of the latter.

The study found that staff are moderately involved in setting targets for performance contracts. The study recommends that employees should be highly involved by liaising with the managers in charge to set targets which should incorporate coming up with new ideas or engage in service delivery without sticking to certain prescribed methods or work plans. Besides, the targets should be raised each year so as to improve service delivery.

**REFERENCES**


