THE CHALLENGES OF PERFORMANCE ASSESSMENT IN ROMANIAN STATE-OWNED ENTERPRISES

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Abstract. *The process of setting proper key performance indicators to managers of state-owned enterprises is a critical issue in developing the premises for increasing the efficiency of the public sector activity, as well as the management's accountability. Managerial strategies and the impact of the decision on business achievements are actively debated in nowadays literature. The necessity of law amendments is of constructive interest for several perspectives, such as improving the global regulatory framework and, at the national level, for state control bodies recommendations. The Performance Measurement Mechanism presents a dual approach and a two-way challenge. On the one hand, quantifying performance implies establishing measurable managerial obligations in order to achieve business profitability and strengthen the process of economic and efficient use of resources. From a managerial perspective, fulfilling the imposed criteria may present a motivational challenge, because the level of accomplishments directly determines the level of remuneration. The "final beneficiary" who may actually acknowledge the fulfillment of goals and the quality of the services provided by SOEs are in fact the ordinary people who experience and appreciate, ultimately, the effect of the managerial strategies and the outcome of the managerial act. In this context, the method of setting key performance indicators is of paramount importance. Our paper proposes a performance quantification model in the Romanian SOE field, which allows a fast and intuitive identification of a minimum set of performance criteria, adaptable to the specifics of the enterprises' activities. Through a methodological approach to regulations, considering a representative pool of Romanian SOEs. We believe that the precursors of a balanced configuration of the basic key performance indicators in SOEs sector can be set. The study is significantly important from the perspective of the calculated results, which sets the premises of developing future analyzes. The proposed model strives to become a valuable reference in formulating key performance indicators in the Romanian SOEs*.

Keywords: *governance monitoring; key performance indicators; cluster analysis; SOEs.*

Introduction

Transparency and accountability are prime topics directly related to the managerial decision-making process. The quality and values of long-term strategies are highlights and precursors of sustainability and business development potential. In such a context, the managerial responsibility is being analyzed through diverse and continuously expanding concerns, along with the need to implement performance measurement techniques able to bring comparison grounds in a rapidly expanding economic society.

The powerful link between law and useful monitoring models that can "breathe life into the duty of care" inspired Dent, in 1981, to encourage the "revolution in corporate governance" and to draw concern to the effects of managerial passivity on company goals. Although courts of law are empowered to enforce certain legal standards to board members or management factors when flaws in duty are being denounced, Dent draws attention to the importance of consciousness in hierarchical monitoring. His study reveals that neither the market, nor the law has the adequate means to enforce monitoring, but the function of board monitoring models (Dent,1981).

Furthermore, the nexus between corporate governance and financial performance has been documented (Westphal, 2002; Leblanc & Gillies, 2003). The linkage between these two concepts gains special significance when it comes to public sector entities since state-owned enterprises (SOE) gain more and more attention. The contribution of SOE in the gross domestic profit of every country is significant (Bruton et al., 2015; Bernier, 2015), hence the debates on the decision-making process and corporate efficiency need to be thoroughly analyzed (Clatworthy, 2000).

Under the OECD's recommendations, the European countries contributed to the implementation of world practice standards that allow harmonization of public management assessment. The ultimate aim of the “governance revolution” was to initiate a comprehensive legislative reform process to harmonize internal regulations within European countries, with special regards to the public sector. (OECD, 2004)

Literature focusses on further expanding the contribution to a better understanding of the governance mechanism (Kettl, 2000), by addressing studies to internal audit processes and role (Ferry et al., 2017), control systems, external auditing and auditing committees (Deloitte, 2013). Almqvist et.al. observe various studies conducted in corporate governance and accountability assessment and signal the need to further investigate the relationship between various elements of the public governance sector. (Almqvist et al. 2013)

Based on these assumptions, the current study explores the possibility of creating a primary set of performance assessment model for the public sector, by combining law specific requirements with methods of setting key performance indicators and benchmark indicators. The study is conducted on Romanian SOEs, based on the public information available on the site of the Romanian Agency for Fiscal Administration.

Reflections on performance assessment models

In time, monitoring models have been analyzed and developed from various perspectives. The assessment objectives directly influenced the techniques and measures of models, together with the concern for the development of performance governance frameworks in organizations. Thus, the monitoring model specifics are accustomed to the sector where the company activates, the organizational structure and shareholders’ interests, the typology of provided services or activities, the economic context and controllability. Starting from the requirements and projected outcomes of monitoring models design, the usefulness of framework assessments has been long debated. Various studies reveal that sometimes managerial assessment models can prove to be useless or untrustworthy if listlessness or secondary interests of managers come to pass (Dent, 1981; Butcher, 2000).

The “traditional model” of corporate governance assessment is based on the principle that the affairs of an entity are managed by the board of directors, not by the executive officers/directors (Eisenberg, 1976). The former concept has evolved in time, thus being generally accepted that business is managed “under the supervision of” board managers. Several studies concentrated on the importance of proper settlement of managerial duties and competence in setting independent assessment models: primarily, the law is the starting point to regulating conflicts of interest and may clearly settle statements of duties (Sugarman, 1999).

The perspective of stricter regulations may enhance and better settle the issue of directors’ duties (Butcher, 2000; Elson, 2004; Slorach, 2004). A figurative statement clearly attacking the lack of active implication or passivity of managers was made by Irving Olds, the Chairman of US Steel: “Directors are like parsley on fish – decorative but useless”. The critics were made in a period when controversies arose with respect to the issuing of a Canadian report on corporate governance, that drew controversial responses for the lack of proper attention to real governance problems and for the politicization of corporate managers (Leblanc & Gillies, 2003).

The “modern” mechanism of governance assessment proposes a series of techniques meant to allow the harmonization of company outcomes in order to contribute to a better understanding of standardized solutions to better achievement of economic goals.

In the public sector, the performance assessment techniques consist of budgeting, balanced scorecard, controlling, strategic planning and monitoring (SWOT analysis) or other. Literature show there is a strong belief that key performance indicators (KPI) are critical for improving the effectiveness of governance systems and are a mean that actively contributes to achieving company targets.

The quality of an appropriate group of key indicators is testified by their ability to adapt to business specifics and to correctly appreciate the value of the managerial act. At the same time, previous studies demonstrate the contribution of the qualitative preliminary analysis of the optimal methodology to set key performance indicators and benchmark indicators to a good design of the obtained results. One of the most important factors that influence performance is the human resources and their understanding of the role and effects of a professional management. (Grigorescu, 2008; Grigorescu & Bob, 2010)

Are monitoring models necessary and useful?

The question on necessity and usefulness of managerial assessment seems to have a straightforward affirmative answer. Nevertheless, the current Romanian context, the political influence on public governance constantly debated in media and the day-to-day reality in public services seem to suggest the to further reflections before giving a straight answer to such question.

The current study highlights the raising awareness of the Romanian public opinion on the role of performance assessment in the public sector. At the same time, we carefully analyze the evolution of the legal framework in Romania regarding the state-owned enterprises, the strategies and the objectives projected for corporate governance in the public sector, the general economic context, as well as the stratified approach of the economic branch of the selected SOEs pool. The findings are interpreted and reunited in order to set the basis and explore the possibilities of formulating the key performance indicators in an efficient and structured way. We actively aim at meeting the general requirements of transparency, SMART analysis, alignment to business objectives and operations and to address a dedicated section to the enterprises' specifics.

The principles and benefits of a quality management system are anchored in the competitive evolution of financial and non-financial results reported by the Romanian pool of SOEs. In order to comply with OECD regulations, Romania struggled to implement, at least on a formal basis, the legal framework for managerial assessment in public entities. The formal approach on managerial measurement standards was long criticized, even by the state control institutions, that reported little improvement in public sector and highlighted the insufficient political support, lack of transparency in public governance or vision opaqueness in evaluating the force of managerial assessment (European Commission, 2018; Ministry of Romania Public Finance, 2014).

In Romania, the legislation regarding the need to implement corporate governance in public entities has developed over time in the sense of harmonization with the requirements of the European Union. Thus, since the Emergency Ordinance no. 109/2011 on corporate governance in public enterprises, the public interest for the importance of participative governance began to increase. Furthermore, the regulations extended the requirements on management monitoring procedures, by setting milestones regarding the assessment process. A first step in this direction was to settle mandatory procedures in order to formally address the independence of managerial appointments. Also, in order to set the grounds for managerial monitoring, regulations regarding key performance indicators were implemented on a two-basis perspective: on the one hand, the key performance regulations were set with the purpose to increase the achievement of corporate goals and, on the other hand, KPY was supposed to become a motivational remuneration objective for the appointed managers.

The following table synthesizes the main regulations regarding governance measuring framework in Romania:

Table 1 Regulatory framework regarding corporate governance in Romania (author's compilation from Romanian legal regulations)

Main governance regulatory requirements	Regulations on benchmark and key performance indicators
• the general framework and selection conditions for the members of the management of public entities were settled • publishing governance reports became compulsory • the appointment of managers in public entities may be possible only on the mandate contracts basis • obligations regarding advertising of the identity and professional training of management	Emergency Ordinance no. 109/2011 on corporate governance in public entities
• settling selection criteria, conditions for shortlisting for up to 5 candidates for each post, ranking, final appointment procedures • establishing the financial and non-financial key performance indicators and the variable component of the remuneration of the board of	Decision no. 722/2016 regarding the methodology and norms for Ordinance no. 109/2011

Main governance regulatory requirements	Regulations on benchmark and key performance indicators
directors or, as the case may be, the benchmark indicators of directors	
• reporting obligations regarding the state of implementation of corporate governance standards • defining areas of interest and reporting deadlines • in order to ensure monitoring of corporate governance, managerial requirements were established regarding broadcasting information on how to proceed with the selection of directors, the approval of management plan, advertising annual reports to ensure transparency, auditing financial statements, performance indicators and about the variable component of remuneration	Decision no. 2874/2016, repealed by Decision no. 1952/2018 for monitoring Ordinance no. 109/2011

The concept of corporate governance in the Romanian public sector extended the duties of shareholders. The new regulations brought transparency and hierarchical reporting obligations for managers and set the grounds for governance accountability. Key performance indicators seem to become an active ingredient to assess governance efficiency, although the consequences of flaws in duty are not very clearly determined. According to current regulations, key performance indicators have also a motivational purpose and should be settled within the mandate contracts of board directors in order to determinate the variable component of managerial remuneration. Nevertheless, if such a variable component is not defined within the managerial along with the appointed key performance indicators, the law seems to not propose a sanction or monitoring procedure.

Although complex and highly promising in appearance, the corporate governance regulations brought little visible improvement in public services and governance policies. Media also contributed to the monitoring process, by loudly debating various situations of illegal human resources procedures in public entities or faulty managerial appointments. Gradually, the public opinion became aware of the efficiency requirements and transparency principles of corporate governance. Still, the positiveness of such awareness confronts itself with "but". The population becomes aware, but the lack of regulations regarding the faulty implementation of corporate governance standards still raise an obstacle in achieving a value-based culture in public services or public resources allocation.

The author considers that the primary need for a better improvement of governance monitoring and managerial assessment derives precisely from the real need to acknowledge the importance of legitimate regulations in public sector and of a proper undertake of consequences in faulty managerial duties.

Rudimentary monitoring models, nonrealistic analysis of corporate activities or context, political or personal interests, scarce details regarding managerial duties or lack of maturity in risk analysis are issues that require thorough solutions. The proper vision to provide a satisfactory response to such problems is the trigger to formulating effective monitoring models that can bring added value to corporate operations and thus to reside in service improvement and economic progress.

Developments in public measurement models

The main goal of measuring the performance of public enterprise management is to increase efficiency in public service, to develop new strategies in the better procurement and allocation of public resources and strengthen the participative governance. Measuring performance can also bring a breakthrough in better organizational structuring, client satisfaction categorized as people's satisfaction when it comes to publicly owned companies and, furthermore, a better way of life.

The process of setting performance indicators is closely correlated with the public entity's mission, its objectives and the actions proposed by management while considering the available resources.

According to current regulations, the classification of performance indicators is done in two broad groups:

- benchmark indicators that are established in relation to the activity of the public enterprise. These indicators allow the company's results to be measured against the targets and make it possible to compare the enterprise's indicators with those of other similar companies.
- key performance indicators that are set for managers and according to which the variable remuneration component is allocated. Key performance indicators also consist of financial and non-financial indicators (which are operational and corporate governance).

On a graphical basis, the first steps in developing a monitoring model in public entities are to set the key performance indicators and the benchmark indicators, as in Figure no.1.

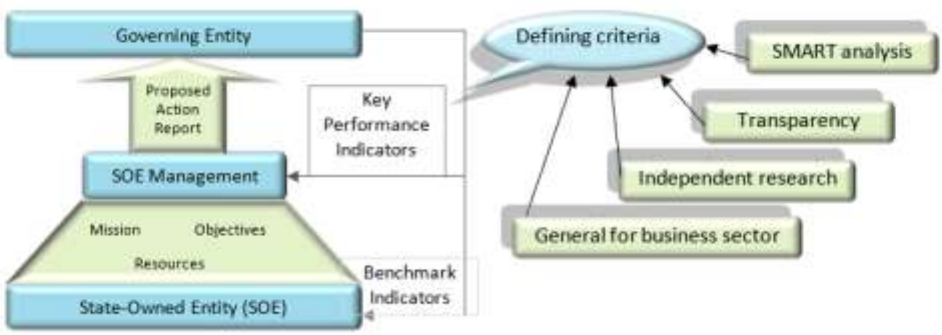

Figure 1. The process of managerial assessment

From the above figure, we can observe that performance indicators are set on a hierarchical basis, downwards. The defining criteria for setting proper performance indicators should consider the corporate mission, governance objectives and resources of the public institution following a rigorous analysis of the action plan or management of the subordinate institution's management. Among the key criteria underlying the establishment of a set of effective indicators are the premises of transparency and the acknowledgment of independent research. Proper transparency procedures give access to information to every interested party and create possibilities for every individual to conduct monitoring procedures on specific data.

According to Romanian regulations on free access to information of public interest, public entities have the obligation to submit an annual activity report from which interested parties may find out information on performance indicators and their degree of achievement. Advertising the performance report is a legal obligation for managers derived from the principle of decisional transparency. Advertising the performance report is mandatory, also by publishing it on the public institution's website.

Figure 2. Typology of KPI (Source: Government Decision no.722/28.09.2016)

The process of selection of key performance indicators allows the governing entity (or the higher hierarchical institution) to choose from a high number of indicators. The regulations advice on selecting a set of specific KPI from each category of financial, non-financial and governance corporate KPI (Government decision no.722/2016). Nevertheless, the Romanian National Agency for Fiscal Administration (hereby called the Romanian IRS), the institution empowered with the centralization of KPI data, shows that not every reporting public entity has been appointed with KPI from each category: certain entities have not been appointed with corporate governance KPI, because such indicators may already be perceived as requirements according to law. (ANAF, 2016)

Establishing indicators is a dual challenge. A set of effective selected indicators can actively contribute to the efficiency of the subordinate entity's activity and, at the same time, it is supposed to be an important motivation tool for its management.

The main focus of the current study was to analyze whether the so far used KPIs in Romanian SOEs may be linked by relevance into incentives to validate the principle of continuous activity or into typologies that may be attributed to certain domains of activity. The premises of the study were that financial KPIs may represent reliable indicators to predict or assess the managerial accountability concerning business development.

Previous studies demonstrated that using Clustering techniques, relevant observation may be obtained regarding the relationships between KPIs (Guo et.al., 2016), with specific attention to corporate governance KPI (Kocmanova and Simberova, 2012). In Romanian literature quantitative studies on corporate governance, KPI needs to be further developed in order to provide typologies and reliable monitoring models useful in the SOEs sector.

Methodology of research

We used all the available Romanian IRS economic reported indicators, providing 1065 local state-owned enterprises in 2013, increasing to 1381 in 2016. Based on the analyzed indicators, the methodological approach of the current study was developed in two main stages. In the first stage, we tried to find out if the reported key indicators centralized by the Romanian IRS can be categorized into significant typologies depending on the active or inactive status of the reporting SOEs. According to Romanian IRS, the reported indicators can be categorized into indicators reported by active SOEs and inactive SOEs, with or with no comparable data recorded in their financial statements during the analyzed period of time. The Non-Hierarchical Cluster Analysis was used with SPSS software. The in-active firms were considered to be the SOEs with obsolete financial difficulties, as the SOEs in insolvency procedure or that was declared bankrupt. During the next stage of research, we also tried to analyze if certain KPIs can be identified to be most likely to be utilized depending on the domain in which active companies activate, based on all the available information collected from the 1186 active SOEs in 2016 (out of a total population of 1381 across all local SOEs). The available data were compiled into representative KPIs for assessing business profitability. The Hierarchical Cluster Analysis was used in this stage.

Discussions and results

In order to achieve a robust analysis of the selected data, this study focused on identifying similarities between reported KPIs in order to observe patterns or typologies that may become specific to active or in-active firms. The economic indicators were observed in order to assess how groups of KPIs may be related to each other on premises of activity continuation. A K-Means Cluster Analysis was performed. The variables used in the analysis were the active companies with comparative data within their reported financial statements (coded SOEs active CD), the inactive companies with comparable data in their financial statements (coded SOEs inactive CD), the active companies with no comparable data (compared to previous reporting periods) in their financial statements (coded SOEs active NoCD) and inactive companies with no comparable data in their financial statements (coded SOEs active NoCD). The companies with no available data were removed from the study. The research aimed to obtain a three-cluster standardized result.

The observed indicators for active companies differed substantially in comparison to those reported by inactive companies, both for categories of companies with comparable or non-comparable data in reported financial statements (for example, active companies reported positive earnings before taxes, while inactive companies reported negative earnings before taxes). Thus, for a reliable result of the analysis, the data was standardized by calculating Z-scores for the considered variables.

Table no.2 Final Cluster Centers

	Cluster 1	Cluster 2	Cluster 3
Zscore: SOEs active CD	-.40322	1.93528	-.19252
Zscore: SOEs inactive CD	-.26528	1.00397	.19185
Zscore: SOEs active NoCD	-.41017	1.59101	-.01292
Zscore: SOEs inactiveNoCD	-.18754	-.01567	5.93901

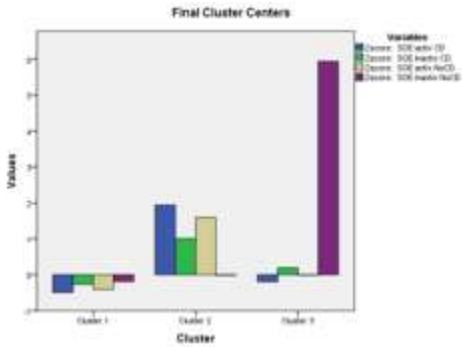

Figure 3. Final Cluster Centers

On a standardized scale, the SPSS calculated data as per Table 2. The results show that cluster one has lower results (also negative on a standardized scale) for active entities with comparable data than clusters two and three. Similarly, cluster 1 has lower negative results on a standardized scale for inactive entities with comparable data than clusters two and three. From the calculated Cluster centers, it can be observed that cluster three for inactive entities with no comparable data in their financial statements has the highest number of results for the same category than the other two clusters. The K-Means Cluster Analysis conducted to mixed results of calculated standardized Zscore. As per figure 3, the third cluster does not seem to gather relevant results with regards to similarities between the Zscores calculated for KPIs attributed to this cluster. The obtained results were not conclusive as to allow a standardized statistical result able to present incentives on a typology of KPI in active or inactive SOEs, considering reported KPIs compiled from their financial statements.

The second stage of the research compiled the financial indicators reported by SOEs in 2016 and calculated corporate governance financial KPIs, used according to Romanian law during the process of settling the variable component on remuneration for SOE board of directors. The compiled profitability KPIs that could be determined in this stage, based on available data (ANAF, 2017) are:

Table 3. Financial KPIs for profitability assessment (author's compilation)

Financial KPI – profitability assessment	Calculating formula
Earnings before interest and taxes marginal (EBIT marginal)	EBIT / Turnover
Earnings before interest and taxes and amortization marginal (EBITDA marginal)	EBITDA / Turnover
EBITDA per equity	EBITDA / Equity
Rate of return on capital	Earnings before interest (EBT) / Equity
Gross result in total sales	EBT / Turnover

The study considered the compiled data as variables obtained in different domains of activity and analyzed them using Hierarchical Cluster Analysis. The previous statistical check was not considered in this stage, with the intent of observing similarities between the calculated variables that would allow highlighting a typology of indicators which would be more suitable to use in certain business domains (Andel & Hebak, 1987).

The limitation of the study consists primarily of the limited data available regarding public sector KPIs. Although the current regulations settle compulsory requirements on the transparency of KPIs, remuneration and performance reporting, the current practice in Romanian SOEs shows that compliance in this sector is scarce and, in most cases, basically formal.

The cluster analysis relied on centroid linkage method in order to be able to obtain clusters of different dimensions that may offer incentives on KPI appropriateness in relation to different business domains. Previous studies reveal that underlying models regarding KPIs in the public sector have been developed over time, but still, the policies of governance require flexibility and thorough local economic assessment in order to become effective. (Shen et al., 2015)

The calculated data are hereby presented in figures 4 and 5.

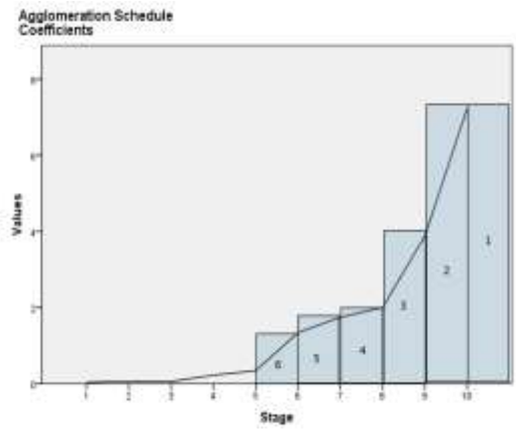

Figure 4. Agglomeration Schedule Coefficients

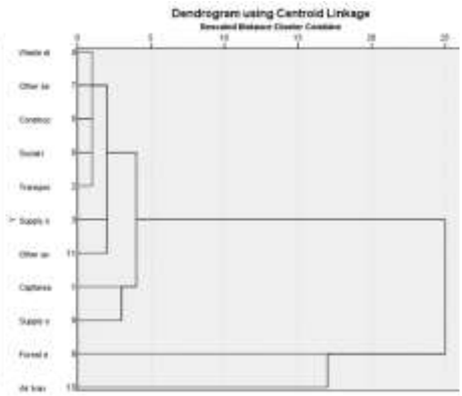

Figure 5. Dendrogram using Centroid Linkage

The calculated coefficients during hierarchical clustering model showed that the general assessment of KPI in relation to all business domains may not result in reliable profitability KPIs clustering. In Figure no.4, the Agglomeration Schedule Coefficients statistically compute how much new data is provided by each additional cluster.

In order to verify if the computed information is trustworthy, the graphical representation of coefficients was furthermore processed in order to provide a bigger picture of the highlighted clusters. For a better use of such purpose, squares have been added to the linear representation of coefficient obtained with SPSS program. The designed squares show that a two-cluster division of KPIs may provide more data than a three-cluster model, but for such information to be of better interest, than a five-cluster model may be more appropriate. The pattern observed in figure no.4 is also supported by the dendrogram in Figure 5. The visual interpretation of hierarchical clustering suggests that a reliable link between profitability KPIs and business domains may not be generalized. The measuring model for choosing appropriate KPIs in SOEs seems to be more effective when the appointment of profitability KPIs is sustained by a comprehensive analysis of the SOEs' business context, on environmental risk, regulations, client satisfaction, business risk, and market conditions.

Conclusions

The current study shows interesting outcomes related to the design of corporate governance assessment models in Romanian SOEs. The value of the findings resides in the fact that real compliance with corporate governance regulations in setting key indicators may actively contribute to public services improvement and effective procurement and use of public resources. The obtained results, together with the current governance practice seem to suggest several possible scenarios:

- the procedures for setting KPIs should have an important impact on managerial remuneration together with corporate development prospects. In reality, the law does not sufficiently discern between the purpose of compensation and any injunction for disregard of settlement for variable remuneration in mandate contracts. In other words, according to Romanian IRS reports, although there have been observed various situations in which the KPIs have not been achieved or when variable remuneration has not been decided (ANAF, 2017), the measures undertaken by authorities in order to correct such situations are not very clearly disseminated.
- The measuring models should contain KPIs in all required fields: financial and non-financial. Also, for the non-financial KPI projection, both operative and corporate governance KPIs should be considered. Day-to-day reality reveals that corporate governance is not always a KPIs settlement concern (ANAF 2017), thus implying a formal feature to the regulations in force. The managerial accountability should be measured not only through financial results but also by directorial implication, vision, ethics, and professionalism.
- The financial KPIs analyzed, although limited in detailed data and not completely reliable for general assessment, suggest a stringent need to enhance transparency and public reports in Romanian public entities. In broad terms, the financial KPIs appointed without a proper support from non-financial KPIs may be directly affected by potential error or fault in financial statements. Also, in SOEs with long-term profitable activity, financial KPIs appointed to new managers may not be very relevant or accurate, because the activity may follow an inertial trend, with no necessary active implication from assigned new managers.

The current study strives to raise the interest in developing future research on the relevance of governance assessment in the public sector, based on the importance of cost-effectiveness and public service to quality of life. The performance assessment models of SOEs should not be considered an issue that requires addressing, but a challenge that eventually will lead to development. The further concern should also be attributed to enlarge dataset for accountability or transparency KPI. The augmentation of case study literature and development of econometric models for prediction purposes may also be of great value in the SOE sector.

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