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## The Impact of The Implementation of Goal Setting Theory and Agency Theory on Performance: Evidence from Indonesian Public Sector Organizations

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*Abstract: The aim of this study is to give empirical evidence about the impact of the implementation of goal setting theory and agency theory on the performance of local governmental units in the Special Region of Yogyakarta Province. The samples were the SKPD's chairmen or chairwomen who lead the governmental services at the province level (D I Yogyakarta) and the regency level (Kota Yogyakarta, Kabupaten Sleman, Kabupaten Gunung Kidul, Kabupaten Bantul, and Kabupaten Kulon Progo), and they must be in their term of office for at least one year. This study analyzed their perceptions about the statements in the questionnaire. The data were analyzed by partial least square (PLS) with Smart PLS Version 2.0. The findings showed empirical evidence of the impact of clear and measurable goals on qualitative and quantitative performance, and the impact of performance measurement indicators on quantitative and qualitative performance are consistent with goal setting theory, but the impact of decentralization on the quantitative and qualitative performance is inconsistent with goal setting theory. The results show that the impact of incentives on the quantitative and qualitative performance is inconsistent with agency theory.*

**Keywords:** *goal setting theory, agency theory, local government performance, PLS*

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## 1. Introduction

Efforts by governmental organizations around the world to reinvent the government and improve the performance of public organizations (known as new public management/ NPM) are now focused on the implementation of performance management (PM) practices (Hood, 1995, 1991). By applying the PM practices, an organization tries to realize its organizational objectives and optimize the potential of its employees. The PM practices include specifying which goals to achieve, allocating decision rights, and measuring and evaluating performance (Heinrich, 2002; Ittner and Larcker, 2001; Otley, 1999; Kravchuk and Schack, 1996; Birkley *et.al*, 1995 in Verbeeten, 2008). Defining clear and measurable goals, performance measurement and incentives, constitute important elements of performance management that are expected to encourage the local government institutions to be better in their performance (Verbeeten, 2008; Heinrich, 2002; Kloot, 1999).

Robertson (in Mahmudi, 2005) reveals that performance measurement is a process of assessing work progress against the achievement of the determined objectives and goals, including information on the use of resources in producing goods and services, quality of goods and services, comparison of activity results with the targets, and effectiveness of action in reaching the objectives. Performance measurement is described in the performance indicators existing in the government's performance measurement design. The performance indicators then become standards of performance achievement and are followed by performance evaluation. Evaluation is intended to find out whether performance achievement can be valued and learned to improve the program/activity implementation in the future (LAN, 2004).

Similarly, performance evaluation can be a basis of granting reward and punishment. Reward and punishment are given in relation to the achievement of performance targets (Outley in Kloot, 1999). One kind of reward is an incentive. Incentives will encourage individuals to perform better, though in the administrative context, they should not be seriously considered because the main task of the government is to serve the needs of the people (Propper and Wilson, 2003). In Indonesia, this issue is clearly stated in the Internal Minister's Regulation concerning the Management of Local Finance in Article 39 governing the extra income for the employees on the basis of work performance. Performance improvement is supported by the existence of the decentralized managerial system in the local governments.

The Indonesian government has tried to implement the PM practices in public sector organizations. This is shown by the effort to set clear and measurable goals, decentralization, indicators of performance measurement, and the granting of incentives, as included, among others, in Law No. 32 of 2004, Law No. 33 of 2004, Internal Minister's Regulation No. 13 of 2006, and Government Regulation No 58 of 2005. However, the performance of public organizations in Indonesia is still poor. In Semester II of 2010, the Supreme Audit Agency implemented performance audits of 147 objects or 20% of total audit objects in that Semester II, which comprised 46 audit objects in central government organizations, 89 audit objects in local government organizations, 3 State-Owned Companies (*Badan Usaha Milik Negara/BUMN*), and 9 Local-Owned Companies (*Perusahaan Daerah*

*Air Minum/PDAM*). The results of performance audits generally reveal that an activity or program is poorly performed. This is, among others, indicated by the conclusion of investigations into regional governments which, in general, show that the implementation of their activities has not yet been effective. Meanwhile, the service of granting new permits at the Integrated Permits Service Agency or Badan Pelayanan Perijinan Terpadu (BPPT) at Kabupaten Lombok Timur is not only ineffective but it is also categorized as inefficient because the policy, procedure and performance indicator of the service activity are inappropriate.

This study refers to the research by Verbeeten (2008) that observed the impact of implementing the PM practices on the performance of public sector organizations in the Netherlands, both in local government and other organizations. However, this study will analyze the implementation of PM practices viewed from the goal setting theory and agency theory perspective, where these theories are consistent with the PM practices. In other words, this study aims at examining and finding out some empirical evidence of the impact of the implementation of goal setting theory and agency theory on the performance of local government in Special Region of Yogyakarta. The findings are expected to contribute to the development of theories and benefits of local government authorities as inputs in order to take necessary measures for the improvement of their organizational performance.

## 2. Theoretical Framework and Hypothesis Development

### 2.1. Implementation of Performance-Based Management in Public Organizations

Mahmudi (2005) states that performance-based management constitutes a method to measure the progress of a program or an activity performed by public organizations in achieving the outcome needed by clients, customers and other stakeholders. Performance-based management can be defined as a process of setting goals, deciding strategies to reach the goals, allocating decision making authority, measuring and appreciating criteria (Kravchuk and Shack, 1996). In performance-based management, the main focus on which the management pays attention is outcome. This is so because the public or community needs end results, benefits, positive impact perceived or obtained from the government. The application of performance-based management is expected to increase organizational performance. Performance improvement is also supported by a decentralized management system in local governments. Decentralization given to the Local Apparatus Task Force (or *Satuan Kerja Perangkat Daerah/SKPD*) in the management of local assets and decision-making can promote performance in satisfying the stakeholders' needs. The dimension of performance-based management includes: clear and measurable goals, decentralization, the performance measuring indicators, and incentives.

### 2.2. Goal Setting Theory and Agency Theory

Goal setting is the underlying explanation for all major theories of work motivation (Lunenburg, 2011). Goal setting theory provides a behavioral explanation for the hypothesized relation between clear and measurable goals and performance (Verbeeten, 2008).

The underlying premise of goal setting theory is that one's conscious goals affect what one achieves (Latham, 2004). An agency theory relationship exists when one or more individuals (called principals) hire others (called agents) in order to delegate responsibilities to them (Baiman, 1990). The focus of agency theory is on determining the optimal incentive contract; agency theory may provide an economic explanation for the impact of PM-practices on performance (Verbeeten, 2008). Table 1 provides a summary of the main characteristic of goal setting theory and agency theory:

**Table 1.**  
**Main Characteristic Of Goal Setting Theory and Agency Theory:**

	<b>Goal setting theory</b>	<b>Agency theory</b>
<b>Similarities</b>	Clear and measurable goals are required Incentives are positively related to performance Decentralization and performance measurement systems are important for high performance Complexity complicates the achievement of high performance	
<b>Differences</b>		
Main driver of performance	Goals	Incentives
Goals	Clear and measurable goals motivate managers to achieve these goals	Clear and measurable goals are necessary in order to decentralize decision rights, develop adequate performance measures and provide adequate incentives
Decentralization	May block the implementation of adequate actions in order to achieve the goals	Part of an "optimal configuration" in order to mitigate control problems
Performance measurement system	Provide feedback to managers in order to improve performance	Provide outcome information as the basis for contracts, respectively provide indications of managerial behaviour
Incentives	May provide meaning to the goals provided	Motivate managers
Complexity	Complexity (task complexity) reduces the relation between clear and measurable goals and performance	Multiple goals and stakeholders affect the applicability of high-powered incentive systems
Important characteristics of public sector employees	Ability and commitment to goals affect performance	Intrinsic motivation, self selection and professionalism affect marginal costs of incentives

Source: Verbeeten, 2008

### 2.3. Local Government Performance

The local government involves governor, regent, and/or mayor and local apparatus as the elements in organizing local government (Internal Minister's Regulation No. 13 of 2006 juncto Internal Minister's Regulation No 21 of 2011). Pursuant to Internal Minister's Regulation No 13 of 2006, the local government functions to provide the community with services as a manifestation of administrative roles in certain areas that are performed to achieve national goals. The SKPD is the local instrument of local government as the budget/goods user (Internal Minister's Regulation No 13 of 2006 juncto Internal Minister's Regulation No 21 of 2011). Internal Minister's Regulation No 21 of 2011 also reveals that the budget user is the authority holding the power of utilizing the budget for implementing the major tasks and function of SKPD under their control, then, the head of SKPD has the

authority to use the goods owned by the local government and to manage them for promoting the community's welfare.

Performance is an output of a program that will be or has been achieved in relation to the use of budget of measurable quantity and quality (Internal Minister's Regulation No. 21 of 2011 Article 1, Section 37). The performance of public organizations is divided into two areas: quantity performance and quality performance. Quantity performance refers to the quantitative aspects of performance, for example the use of resources (budget depletion, or economy), number of outputs produced, and efficiency (Carter et al., 1992 in Verbeeten, 2008). Though the latter aspect relates to output to input, but it can be assumed to be an indicator of quantity performance because efficiency usually does not include quality indications. Quality performance refers to both "operational quality", (for example, accuracy; Carter et al., 1992) as well as "strategic capacity" (for example, innovation and long-term effectiveness; Newberry and Pallot, 2004; Kaplan, 2001; Klootand Martin, 2000).

#### *2.4. Theoretical Framework and Hypothesis Development*

The implementation of performance-based management is expected to improve the local government performance, including that of their employees. Previous literature review demonstrated that it is important to differentiate quantity and quality performances. Pollitt (1986 in Verbeeten 2008), Carter et al. (1992), Kloot and Martin (2000), De Lancer Julnes and Holzer (2001), Pollanen (2005 in Verbeeten 2008), and Pollitt (2006 in Verbeeten 2008) find empirical evidence that the measures of quantity performance tend to disregard the quality aspect of service provision, since performance quality is more difficult to measure than quantity. The result of a meta-review by Jenkins et al. (1998) indicates that the increased quantity performance is generally achieved by sacrificing quality performance. They find that there is a positive effect of PM practices on quantity performance, yet it by no means influences performance quality.

##### *a. The Effect of Clear and Measurable Goals on Performance*

Goal-setting theory also asserts that people with specific hard goals (often called "stretch" goals) perform better than those with vague goals such as "do your best" or specific easy goals (Latham, 2004). Challenging goals are usually implemented in terms of specific levels of output to be attained (Locke and Latham, 1990 in Verbeeten, 2008). Thus, goal setting theory assumes that there is a direct relation between the definition of specific and measurable goals and performance; if managers know what they are aiming for, they are motivated to exert more effort, which increases performance (Locke and Latham, 2002, 1990 in Verbeeten, 2008). A study by Verbeeten (2008) shows that the perceptions of the targets evidently promote quantity performance. The findings of a study by Sotirakou and Zeppou (2006) show that performance measurement contributes to the increased performance of public organizations in Greece. A study by Indudewi (2010) demonstrates that clear and measurable goals have significantly a positive relationship with performance. The first hypothesis of this study is as follows:

**H1a.** *Clear and measurable goals have positive effect on quantity performance.*

The findings by Cavalluzzo and Ittner (2004) indicate that metric difficulties (i.e. difficulties determining meaningful measures, results occurring too far into the future to be measured, difficulties distinguishing between results produced by the program and results caused by other factors, and difficulties determining how to use performance information to improve the program or to set new or revise existing performance goals) significantly dampen the extent of the US government's performance measure development. This suggests that US agency managers believe that the use of PM-practices may not improve performance in situations where ambiguity of objectives is high (Verbeeten, 2008). Locke and Latham (1990) acknowledge that task difficulty (which is associated with difficult to measure goals) reduces the impact of clear and measurable goals on performance (in Verbeeten, 2008). Empirical findings (Pollitt, 2006, 1986 in Verbeeten 2008; Pollanen, 2005 in Verbeeten 2008; De Lancer Julnes and Holzer, 2001; Klootand Martin, 2000; Carter *et al.*, 1992) show that quantitative performance measures tend to ignore the quality aspect of service delivery since qualitative performance is much more difficult to measure. Based on the study mentioned above, the second hypothesis will thus be stated as follows:

**H1b.** *Clear and measurable goals have no effect on quality performance.***b.** *The Effect of Decentralization on Performance*

Decentralization is a system of mandating authority for decision making in regards to the allocation of resources and providing services to the people (Miah and Mia, 1996; Halachmi, 2002). In Indonesia, as set out in Law of the Republic of Indonesia Number 33 year 2004, decentralization is defined as an assignment of government authority by central government to autonomous local government to manage and administer the governmental affairs in the framework of the Republic of Indonesia (Kuncoro, 2009). This means that decentralization constitutes a delegation of authority and responsibility (of the public functions) from central government to local government. It accommodates the participation of all work units in local government. The participation of each work unit in the goal setting process is highly required to enable the local governments to acquire accurate, clear, measurable and specific goals as needed by the people.

The purpose of decentralization is to enable the government institutions to provide immediate and quick services for the fulfillment of the needs of the people and other stakeholders and to obtain feedback for the improvement of performance of the relevant public organizations. Goal setting theory suggests that goals are less likely to be achieved if there are situational constraints blocking performance than if there are no such constraints (Locke and Latham, 1990 in Verbeeten, 2008). One of these "situational constraints" may be the lack of decision rights meaning the authority and responsibility for making particular decisions (Kaplan and Atkinson, 1998 in Verbeeten, 2008). On the basis of the definition of decentralization and its correlation with performance and with previous study findings, the third hypothesis is thus as follows:



**H2a. Decentralization has a positive effect on quantity performance.**

The empirical findings of Pollitt (2006, 1986 in Verbeeten 2008), Pollanen (2005 in Verbeeten 2008), De Lancer Julnes dan Holzer (2001), Klootand Martin (2000), Carter et al. (1992), show that quantitative performance measures tend to ignore the quality aspect of service delivery since qualitative performance is much more difficult to measure. The results from a meta-review by Jenkins et al. (1998) indicate that, in general, this may be the case; they find that there is a positive effect of PM practices on performance quantity (e.g. the number of unit produced or assembled) yet not necessarily on performance quality (e.g. supervisor rating, accuracy) (Verbeeten, 2008). A study by Indudewi (2010) shows that decentralization does not have a significant effect on performance. Based on the findings mentioned above, the fourth hypothesis will thus be stated as follows:

**H2b. Decentralization has no effect on quality performance.****c. The Effect of the Performance Measuring Indicators on Performance**

Goal setting theory suggests that feedback (i.e. information from the performance measurement system) may provide the opportunity to set more demanding goals in the future, provide information regarding better task strategies, and be a basis for recognition and reward (Locke and Latham, 2002 in Verbeeten 2008). Agency theory recognizes that the performance measurement system provides the input for decision-making, as well as for incentives (Abernethy et al., 2004 in Verbeeten 2008). Performance indicators enable the government to achieve the determined goals and to evaluate the programs and activities performed. The implementation of the performance measurement system will help the government to measure the effectiveness that has been achieved (Verbeeten, 2008; Zeppou and Sotirakou, 2003; Kloot, 1999). The study findings of Indudewi (2010) demonstrate that performance measurement has a significant and positive effect on performance, but this study does not separate the quantity performance and the quality performance.

In view of the above description, the fifth hypothesis will be as follows:

**H3a. Performance measurement indicators have a positive effect on the quantity performance.**

Based on the study findings of Pollitt (2006, 1986 in Verbeeten 2008), Pollanen (2005 in Verbeeten 2008), De Lancer Julnes dan Holzer (2001), Kloot and Martin (2000), Carter et al. (1992), and Jenkinset al. (1998) as described above, the sixth hypothesis will be stated as follows:

**H3b. Performance measurement indicators have no effect on the quality performance**

#### d. The Effect of Incentives on Performance

Agency theory assumes that individuals are fully rational and have well-defined preferences and beliefs that conform to the axioms of expected utility theory (Bonner and Sprinkle, 2002). Furthermore, each individual is presumed to be motivated solely by self-interest (Baiman, 1990). This self-interest can be described in a utility function that contains two arguments: wealth (monetary and non-monetary incentives) and leisure. Monetary incentives frequently are suggested as a method for motivating and improving the performance of persons who use and are affected by accounting information (e.g. Atkinson, Banker, Kaplan, Young, 2001; Horngren, Foster, & Datar, 2000; Zimmerman, 2000 in Bonner & Sprinkle, 2002), and their use in organizations is increasing (Wall Street Journal, 1999 in Bonner & Sprinkle, 2002).

Incentives can be defined as extrinsic motivators where pay, bonuses or career perspectives are linked to performance (Bonner et al., 2000). Permendagri No. 13/2006 states that regional governments can give additional income to the civil servants by objectively considering their financial capability and upon the approval of DPRD as governed by the legislation. The purpose of the additional income is to increase the employees' welfare based upon their workload or profession shortage or work condition or work place or work performance. Therefore, agency theory assumes that incentive plays a fundamental role in motivating and controlling performance. The study finding by Verbeeten (2008) reveals that incentive has a positive effect on the quantity performance. A study by Indudewi (2010) indicates that incentive has a positive and significant effect on performance. Thus, the seventh hypothesis will be as follows:

#### **H4a.** *Incentive has a positive effect on the quantity performance*

According to the findings of Pollitt (2006 in Verbeeten 2008), Anthony and Young (2003), Burgess and Ratto (2003), Dixit (2002, 1997), Dewatripont *et al* (1999), Kravchuk and Schack (1996), Gupta *et al* (1994), Tirole (1994), Hofstede (1981), the public sector has some specific characteristics that make the design of incentive schemes quite complex. First of all, delivering incentives is complex in public sector organizations which generally have multiple stakeholders (principals) with multiple goals; each principal will offer a positive coefficient on the element(s) (s)he is interested in, and negative coefficients on the other dimensions (Dixit, 1997). The aggregate marginal incentives coefficient for each outcome is decreasing with the number of principals (Burgess and Ratto, 2003); as a result, incentives are weak (Dixit, 1997).

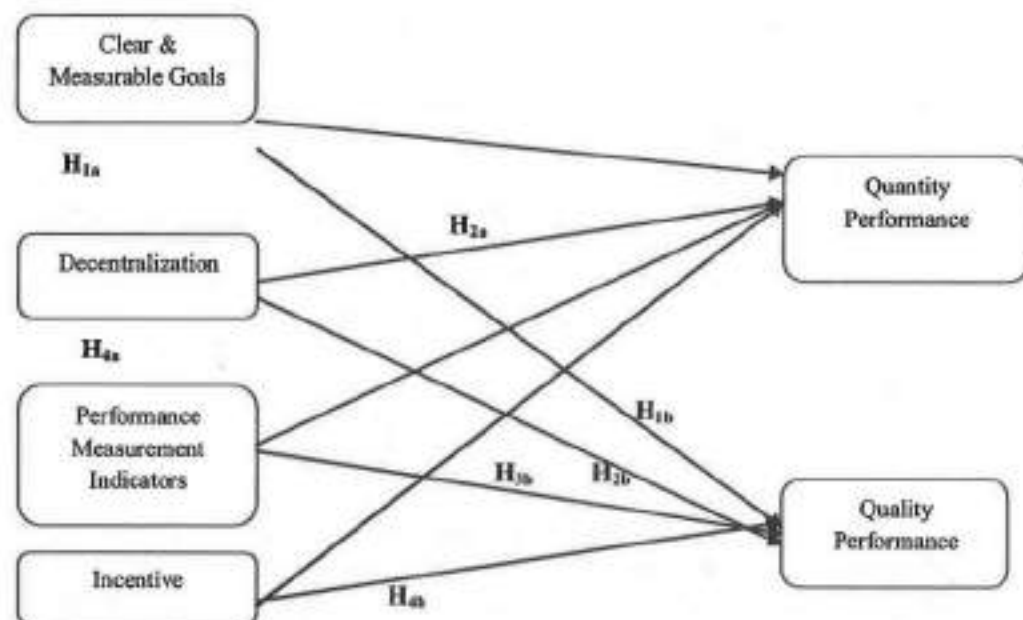
Second, according to the findings of Burgess and Ratto (2003) and Tirole (1994) (in Verbeeten, 2008), only those dimensions of performance that are easy to measure are included in the incentive scheme, which may have undesirable effects on overall performance. Third, agency theory assumes that an agent gets utility solely from the incentives, and disutility from the effort (s)he exerts on behalf of the principal. In reality, agents in public sector organizations may get utility from some aspects of the task itself, and agents in the public sector may be motivated by the idealistic or ethical purpose served by the agency ("intrinsic motivation"), which may result in a match of

workers and public sector organizations (Verbeeten, 2008). As a result, organizations can use so-called "low-powered incentives" (i.e. incentives are not based on performance) if the goals of the worker are aligned with those of the organization (Dixit, 2002). The study finding of Verbeeten (2008) demonstrates that incentive has no effect on the quality performance. In view of above description, and based on study by Verbeeten (2008), the eighth hypothesis will be:

**H4b.** *Incentive has no effect on the quality performance*

The framework of this study can be described as follows:

Figure 1. Clear & Measurable Goals



The above figure indicates that independent variables, i.e. the effects of clear and measurable goals, decentralization, performance measurement indicators and incentive, will all be tested for their impact on both quantity and quality performance.

### 3. Research Methods

#### 3.1. Population and Sample

The population of this research was the local governments of the Special Region of Yogyakarta, including the local government of the Special Region of Yogyakarta, City of Yogyakarta, Sleman Regency, Gunung Kidul Regency, Bantul Regency and Kulon Progo Regency. The sampling method used was judgment sampling (as part of purposive sampling), with a criterion that the heads of SKPD should have been in their posts for a

minimum of one year. Therefore, the samples used in this study were those heads of the SKPDs in the Special Region of Yogyakarta who have been for minimum one year in their position.

### 3.2. Type and Data Collection Method

Data used in this study were primary data in the form of respondent responses to the statement list in the questionnaire. These data were obtained through a survey performed using a physical questionnaire. This questionnaire was delivered to the respondents and then directly retrieved by the author. It consisted of two parts: Part I contained some statements concerning the respondent's identity; and Part II contained statements regarding the research instrument with response measurement using a Likert 5 – Scale.

### 3.3. Operational Definition and Variable Measurement

The instrument or measurement used in the study was adapted from those instruments already used by earlier researchers that were accorded with the conditions in Indonesia. The variables in question were:

#### a. Clear and Measurable Goals

Clear and measurable goals, in this case, relate to the setting of vision, mission, objectives and objectives in the work units of respondents and whether the goal setting gives clear description to the respondents relating to the results to be achieved. The instrument for measuring such clear and measurable goals is that developed by Verbeeten (2008). The clear and measurable goal variable includes the respondents' agreement level with some statements relating to the vision, mission, objectives and goals of the SKPD. This variable/construct consists of 8 indicators illustrated in the statements of the questionnaire (CMG.1-CMG.8).

#### b. Decentralization

Decentralization is, in this case, the level of authority held by the SKPDs in relation to budgeting and decision-making in the fields of finance and operation, the improvement of employees' quality, and the allocation of account and human resource. The decentralization instrument is based on the one developed by Mia and Mia (1996 in Verbeeten 2008). This construct consists of 5 indicators illustrated in some statements of the questionnaire (DEC.1-DEC.5).

#### c. Performance Measurement Indicators

Performance measurement indicators constitute a managerial tool used to evaluate the achievement of objectives and goals (Whittaker, in Lembaga Administrasi Negara Republik Indonesia, 2004). In this case, performance measurement is a standard in assessing the achievement of goals. The instrument of performance measurement is based on that developed by Cavaluzzo and Itner (2004) and includes various performance indicators such as input indicators, efficient operational indicators, community satisfaction, quality standard of service, and the impact of the results achieved. This construct consists of 6 indicators illustrated in some statements of the questionnaire (PMI.1-PMI.6).

#### d. Incentive

Incentive is additional income for civil servants that is given on the basis of performance achievement (Internal Minister's Regulation No 13 of 2006). The incentive instrument used in this study was that developed by Keating (1997) that used by Verbeeten (2008). Incentive is used to know its role in obtaining performance. The instrument of statements includes the relationship between incentive achievement with the realization of expenditure budget, program implementation and achievement of service quality. This construct consists of 8 indicators illustrated in the statements of the questionnaire (ICT.1-ICT.8).

#### e. Local Government Performance

Performance here is the work achievements of work units in realizing the determined targets. The instrument used to measure performance was that developed by Verbeeten (2008). This instrument was developed by Van de Ven and Ferry (1980 in Verbeeten 2008) and specially designed to measure the public sector organizations and has already been used by Dunk and Lyson (1997 in Verbeeten 2008); Williams (1990 in Verbeeten 2008). Performance construct encompasses 10 indicators as described in 3 statements concerning the quantity performance (QUAN.1-QUAN.3) and 7 statements on the quality performance (QUAL.1-QUAL.7). The quantity performance indicates the dimensions relevant to the achievement of the performance target of a program, the agreement of budget realization with budget, and the achievement of operational efficiency. The quality performance indicates the dimensions relating to the result accuracy and agreement, level of program achievement, impact of activity results on the people life and moral of the employees.

For validity and reliability tests, firstly a pilot study was done with 20 respondents on 27 July 2011. The respondents were the local government employees who were studying with the Master Program of Developmental Economy of Gadjah Mada University of Yogyakarta. The tried-out instrument was then analyzed using the PLS software. The instrument is considered reliable and valid if the scores of composite reliability and cronbach's alpha are 0.6 and those of average variance extracted (AVE) and loading factor are  $e^{>0.5}$  (Hartono, 2009). The results of this pilot study indicates that the scores of AVE and communality are  $> 0.5$  and approach 0.5, the scores of cronbach's alpha and composite reliability are  $> 0.6$  and  $> 0.7$ . The results of this pilot study also indicates that the scores of loading factor are  $> 0.5$  (practically, validity is significant), and based on the table of cross loading, it can be concluded that each indicator of a latent variable (construct) has the highest loading factorscore in the target construct compared to the score in another construct. This shows that the indicators that will be used in this study are valid and reliable.

### 3.4. Data Analysis Technique

This study used many dependent and independent variables (complex model), therefore, it used partial least square (PLS) to examine the hypotheses. The PLS is a variant-based Structural Equation Modeling (SEM) technique which can test the measurement model simultaneously with the test of structural model (Hartono, 2009). The PLS de-

mands a minimum requirement for the measurement scale, sample size, variable distribution and residual distribution (Chin, et. all., 2003). The PLS' characteristics are very suitable for use in this study because they comprise complex combinations and models and they can also use a relatively small sample size to anticipate the poor response rates from the target local government. The tool used was the SmartPLS-Version 2.0 program taken from [www.smartpls.de](http://www.smartpls.de)

## 4. Results

### 4.1. Respondent Overview

The respondents of this study were the heads of SKPDs in the Special Region of Yogyakarta who had been in their posts for a minimum of one year. The questionnaires were delivered to the respondents on 20 August 2011 and the time limit for their collection was 21 September 2011.

The overview of the sample of the respondents was as follows:

Table 2.  
Details of Response Rate and Usable Response Rate

Remarks	Total
Delivered Questionnaires (directly delivery)	138
Returned Questionnaires	102
Unused Questionnaires	21
Usable Questionnaires	81
Response rate	73.91%
Usable response rate	58.70%

Table 3.  
Respondent Profiles

Remarks	Total (People)	Percentage (%)
<b>Gender</b>		
Male	59	72.84%
Female	22	27.16%
	81	100.00%
<b>Age</b>		
30 - 40 years old	0	0.00%
41 - 50 years old	39	48.15%
51 - 60 years old	42	51.85%
	81	100.00%
<b>Education</b>		
D3	0	0.00%
S1	37	45.68%
S2	44	54.32%
	81	100.00%
<b>Term Duration</b>		
1 - 5 years	69	85.19%
5,1 - 10 year	10	12.35%
> 10 years	2	2.47%
	81	100.00%

Source: Primary data processed in 2011

#### 4.2. Data Analysis and Hypotheses Testing

Data analysis was conducted upon the omission of the two indicators (PML4 and PML6). Both indicators were omitted due to their low loading scores.

#### 4.3. Evaluation of Measurement Model

The following is the result of analysis of the measurement model (path analysis) using the PLS algorithm iteration:

Table 4.  
Overview of the PLS Algorithm Iteration

	Convergent Validity		Reliability		R Square
	AVE	Communality	Cronbachs Alpha	Composite Reliability	
DEC	0.487447	0.487448	0.779171	0.822888	
PMI	0.506300	0.506300	0.674388	0.800070	
ICT	0.695243	0.695243	0.943477	0.947884	
QUAL	0.517493	0.517493	0.844547	0.881419	0.221143
QUAN	0.659716	0.659716	0.741845	0.853212	0.279614
CMG	0.497800	0.497800	0.858943	0.887302	

Source: Output SmartPLS of 2011

Table 5.  
Cross Loadings

	DEC	PMI	ICT	QUAL	QUAN	CMG
DEC.1	0.714656	0.027614	0.248833	0.107239	0.026659	0.079976
DEC.2	0.732395	0.251998	0.287220	0.177685	0.141330	0.187173
DEC.3	0.853754	0.067189	0.250333	0.257728	0.194787	0.127729
DEC.4	0.566465	0.038599	0.252166	0.032214	-0.016620	0.059673
DEC.5	0.583371	0.060718	0.264370	0.037608	0.065672	0.086601
PML1	0.091479	0.740788	-0.019811	0.270039	0.417710	0.441652
PML2	0.131040	0.727695	0.080827	0.166723	0.262465	0.384208
PML3	0.100493	0.822163	0.104996	0.379167	0.427796	0.542123
PML5	0.140800	0.520520	0.105976	0.263027	0.198070	0.263426
ICT.1	0.286566	0.144881	0.897772	0.312470	0.141414	0.188210
ICT.2	0.287376	0.179342	0.839116	0.181320	0.198981	0.171662
ICT.3	0.281625	0.037809	0.899903	0.102222	0.059470	0.072666
ICT.4	0.147538	-0.002753	0.826788	0.084688	0.012191	0.043868
ICT.5	0.330956	-0.073708	0.781893	0.141632	-0.042399	-0.010135
ICT.6	0.356708	-0.031222	0.783438	0.062536	-0.034333	0.050454
ICT.7	0.378814	0.010227	0.862975	0.172776	-0.009823	0.093039
ICT.8	0.239906	0.020039	0.767184	0.131793	-0.085417	0.067773
QUAL.1	0.197639	0.146803	0.216671	0.732470	0.369363	0.191238
QUAL.2	0.287234	0.318857	0.254022	0.812401	0.571726	0.316528
QUAL.3	0.226113	0.331225	0.128545	0.803168	0.667498	0.346109
QUAL.4	0.066936	0.199327	0.032851	0.659938	0.220285	0.157200
QUAL.5	0.162407	0.254230	0.037005	0.599655	0.351945	0.197318

QUAL.6	0.176118	0.272808	0.220749	0.730522	0.320016	0.224810
QUAL.7	0.050555	0.393177	0.163671	0.672381	0.334840	0.229725
QUAN.1	0.157485	0.348553	0.065345	0.473126	0.808055	0.373154
QUAN.2	0.155377	0.410815	0.076348	0.373372	0.838447	0.360204
QUAN.3	0.128062	0.419508	0.069515	0.602910	0.789430	0.345554
CMG.1	-0.014229	0.313959	-0.148006	0.045022	0.294962	0.607733
CMG.2	0.043250	0.397214	0.107950	0.170882	0.308162	0.727012
CMG.3	0.089453	0.313360	-0.050469	0.119404	0.318757	0.626138
CMG.4	0.139308	0.452037	0.100423	0.225200	0.351330	0.785452
CMG.5	0.187599	0.427945	0.071440	0.171681	0.209475	0.702063
CMG.6	0.150646	0.304899	0.141247	0.173074	0.208729	0.675745
CMG.7	0.200652	0.443871	0.227100	0.311363	0.354634	0.771451
CMG.8	0.143503	0.573331	0.171077	0.482907	0.370505	0.728611

Source: Output SmartPLS of 2011

#### a. Construct Validity Test

##### i. Convergent Validity Test

The parameters used in the convergent validity test are the scores of loading factor, AVE, and communality. Viewing Table 5 above, it can be seen that the loading scores in each indicator item have qualified in terms of convergent validity, that is each item has loading scores greater than 0.7 (high level of validity) or greater than 0.5 (practically significant validity). In general, the high loading scores show that the indicators used contribute much to the measured constructs.

In addition, the measurement model has also qualified in terms of convergent validity based on the review of the average scores of variance extracted (AVE) and communality. The lowest score of AVE and communality is 0.487447 derived from the decentralization construct. Although, ideally the score of AVE is higher than 0.5, the score 0.4 is still tolerated (Lai & Fan, 2008; Vinzi et. al., 2010: 463).

##### ii. Validity Test of Discriminant

The parameters used in the discriminant validity test are the scores of cross loading. The discriminant validity is satisfied if each indicator of a latent variable (construct) has a higher loading score in the target construct compared to the score of any other constructs. Table 5 above shows that all indicators in the measurement model have met the requirements for discriminant validity.

#### b. Reliability Test

The reliability test can be viewed from the scores of cronbach's alpha and composite reliability with the minimum requirements being  $>0.6$  and  $>0.7$  (Hartono, 2009), respectively. Table 4 above demonstrates that the scores of cronbach's alpha and composite reliability have met the requirement of their respective minimum score, thus all constructs can be considered as reliable.

In general, it can be said that the research instruments are valid and reliable, thus they qualify for hypothesis testing.



#### 4.4. Evaluation of Structural Model (Inner Model)

Evaluation of the structural model or inner model is assessed based on R Square ( $R^2$ ) scores resulted from the PLS algorithm iteration (Table 4). The research model proposed in this study can explain the variable of the quantity performance of 27.96%, and that of the quality performance of 22.11%, while the remaining are explained by other variables out of the proposed model.

##### a. Hypotheses Testing

The results of hypotheses testing can be seen from the results of the structural model evaluation and the line coefficients resulting from the bootstrap process. The following is a path coefficient table produced by the bootstrap process:

Table 6.  
Path Coefficients; Mean, STDEV, T-Values

	Hypothesized direction	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (O/STERR)
DEC → QUAL	0	0.130013	0.154139	0.158720	0.158720	0.819135
DEC → QUAN	+	0.091338	0.130889	0.152669	0.152669	0.598279
PMI → QUAL	0	0.283078	0.269869	0.121631	0.121631	2.327351***
PMI → QUAN	+	0.336555	0.323352	0.092317	0.092317	3.645651***
ICT → QUAL	0	0.136081	0.121364	0.130952	0.130952	1.039169
ICT → QUAN	+	-0.005607	-0.052584	0.152944	0.152944	0.036664
CMG → QUAL	0	0.135512	0.139201	0.117373	0.117373	1.154541
CMG → QUAN	+	0.226746	0.221524	0.089649	0.089649	2.529277***

Source: Output SmartPLS of 2011

Note: \*\*\*=highly significant;

T-table=1.64 for  $P < 0.05$  and T-table=2.33 for  $P < 0.01$  (one-tailed)

For confidence level of 95 percent, the value of T-table for one-way hypothesis is 1.64 (Hair et al., 2006 in Hartono, 2009). Eight of tested hypotheses, three hypotheses are statistically supported because of having a T-statistics value higher than that of T-table, which is  $\geq 1.64$  (alpha 5 percent). The positive value of the path coefficient (original sample) shows that the independent variable has a positive effect on the dependent variable, and the negative value of path coefficient shows that the independent variable has a negative effect on the dependent variable.

The analytical results indicate that clear and measurable goals are positively associated with quantity performance, but not with quality performance. This result is in accordance with both H1a and H1b. Supporting the finding of Verbeeten (2008), it is known that the impact of clear and measurable goals on qualitative aspects of performance is lower compared to the impact on quantitative aspects of performance ( $\beta = 0.135512$  for quality performance and  $\beta = 0.226746$  for quantity performance, respectively). The result of this analysis shows that decentralization does not relate to both quantity and quality performance. This does not confirm H2a, but it does confirm H2b. The impact of decen-

tralization on the quantitative aspects of performance is lower than the impact on the qualitative aspects of performance ( $\beta = 0.091338$  for quantity performance and  $\beta = 0.130013$  for quality performance, respectively).

The analysis result shows that the performance measurement indicators are positively associated with both quantity and quality performance. This result is in accordance with H3a, but in conflict with H3b. The impact of performance measurement indicators on quantitative aspects of performance is higher than for qualitative aspects of performance ( $\beta = 0.336555$  for quantity performance, respectively  $\beta = 0.283078$  for quality performance). The analysis results show that incentives are negatively associated with quantity performance and do not relate to quality performance. This result of analysis does not confirm H4a (inconsistent with the finding by Verbeeten, 2008), but does confirm H4b (supporting the finding by Verbeeten, 2008). The impact of incentives on the quantitative aspects of performance is lower than the impact on the qualitative aspects of performance ( $\beta = -0.005607$  for quantity performance and  $\beta = 0.136081$  for quality performance, respectively).

## 5. Conclusion, Implication and Limitation

### 5.1. Conclusion

The analysis of the empirical data of the local governments of the Special Region of Yogyakarta, City of Yogyakarta, Sleman Regency, Gunung Kidul Regency, Bantul Regency, and Kulon Progo Regency, shows that the impact of clear and measurable goals on qualitative aspects of performance is lower compared to the impact on quantitative aspects of performance is consistent with the goal setting theory. The result that shows the impact of performance measurement indicators on quantitative performance to be higher than the impact on qualitative performance is consistent with goal setting theory. Inconsistent with goal setting theory is the finding that the impact of decentralization on the quantitative performance is lower than the impact on the qualitative performance. The result that shows the impact of incentives on the quantitative performance to be lower than the impact on the qualitative performance is inconsistent with agency theory. On the other side, the results from the path coefficient analysis indicate that clear and measurable goals and performance measurement indicators are positively associated with quantity performance. The factors (variables) influencing the quality performance of the local governments are performance measurement indicators.

### 5.2. Limitations

This research has some limitations that may influence the findings. First, the data were obtained from an instrument based on the respondents' perceptions. This will lead to problems when the perceptions are different from the real conditions. Second, most of the respondents (the heads of SKPD) delegated the questionnaire to their subordinates, which potentially results in inconsistencies between the expected respondents and real respondents which in turn produces bias in this study. Third, the assessment of the quantity performance did not include the quantitative data from the Report of Governmental Institution's

Performance Accountability (or *Laporan Akuntabilitas Kinerja Instansi Pemerintah/LAKIP*) to support the assessment of the quantity performance.

### 5.3. Discussion and Suggestions

The findings demonstrate that incentives have negative influence on the quantity performance. This empirical evidence does not confirm the agency theory. Similar to the finding by Verbeeten (2008), this finding is consistent with the notion that incentives may not be helpful to stimulate effort when goals are ambiguous or performance is difficult to measure. Although the implementation of the performance measurement system has been regulated, its implementation is still problematic because the capacity of the performance measurement system to promote performance and performance accountability of government agencies is frequently debatable and questionable (Nurkhamid, 2008). According to Sihalohe (2005) and Akbar (2010), the problems may arise at the development stage of the performance measurement system and in using the results of its implementation stage. Therefore, further research is required into the relationship between the capacity of performance measurement system and the results of its implementation (incentive grant) in a public sector organization. The finding of the research showing that the relationship between decentralization and quantity and quality performances is inconsistent with the goal setting theory, indicates that further research is necessary on the application of decentralization in the public sector organization. This research is conducted only within the territory of the Special Region Yogyakarta whose characteristics are probably different from other regions. Therefore, in the process of public policy development in connection to the implementation of goal setting theory and agency theory, similar studies need to be carried out in other regions so that the public policy can be generally applied in Indonesia, particularly in each region. It would be better if future research uses mixed methods approaches.

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## Appendix

Table 7. Research Questionnaires

Variables	Indicator	Symbol
<b>Dependent</b>		
Clear and measurable goals	1. The visions of work units are clearly stated in writing.	CMG1
	2. The visions of work units have been clearly formulated.	CMG 2
	3. The missions of work units are stated in writing.	CMG 3
	4. The missions of work units are stated and communicated both internally and externally.	CMG 4
	5. The goals of work units are consistent with the organizational mission.	CMG 5
	6. The goals of work units are documented specifically and in detail.	CMG 6
	7. The number of goals to be achieved describes the results to be obtained.	CMG 7
	8. Performance measures are clearly stated and consistent with the goals of work units.	CMG 8
Decentralization	1. The authority and responsibility of work units are related to financial problems.	DEC1
	2. The authority and responsibility of work units are related to operational problems.	DEC2
	3. The authority and responsibility of work units are related to the improvement of employees quality.	DEC3
	4. The authority and responsibility of work units in fund shift.	DEC4
	5. The authority and responsibility of work units in the management of human resources.	DEC5
Performance measurement indicators	1. Performance indicators to measure input.	PMI1
	2. Performance indicators are connected with the quantity of products/services.	PMI 2
	3. Performance indicators stating operational efficiency.	PMI 3
	4. Performance indicators are related to the level of people satisfaction.*	PMI 4
	5. Performance indicators are related to the standard of service quality.	PMI 5
	6. Performance indicators are connected with the <i>outcome</i> .*	PMI 6
Incentive	1. Budget performance is related to total compensation.	ICT1
	2. Compensation is related to the level of budget realization.	ICT2
	3. The implementation of activity number is related to total compensation.	ICT3
	4. Efficiency achievement is related to total compensation.	ICT4
	5. The level of people satisfaction with the government service is related to total compensation.	ICT5
	6. The achievement of the service quality standard is related to total compensation.	ICT6
	7. The increase of achievement of any activity is related to total compensation.	ICT7
	8. <i>Outcome</i> is related to total compensation.	ICT8
<b>Independent</b>		
	1. The achievement of performance target of any activity of a program.	QUAN1
	2. The consistency of budget realization with budget.	QUAN2
Quantity performance	3. Operational efficiency.	QUAN3
Quality performance	1. The accuracy of the result of an activity with the program.	QUAL1
	2. The consistency of the result of an activity with the program.	QUAL2
	3. The level of program achievement.	QUAL3
	4. The impact of the outcome of any activity on the people life.	QUAL4
	5. Innovation or new ideas of work units.	QUAL5
	6. The reputation "excellent performance".	QUAL 6
	7. Moral (the improvement of employee attitudes in their performance after their participation in a training).	QUAL 7

Note: \*cancelled questions due to having low loading score and decreasing the AVE score