
Multiple corporate objectives and performance contracts:

The case of Philippine government financial institutions

Al-Habbyel Yusoph, CPA

Instructor, Department of Accounting and Finance, School of Business

PhD (Economics) Student, School of Economics

University of the Philippines Diliman



Multiple *conflicting* corporate objectives and performance contracts:

The case of Philippine government financial institutions

Al-Habbyel Yusoph, CPA

Instructor, Department of Accounting and Finance, School of Business

PhD (Economics) Student, School of Economics

University of the Philippines Diliman



Outline

- Motivation
- Overview of Literature
- Research Setting and Methods
- Discussion and Analysis
- Conclusion and Next Steps

Motivation

Background on Philippine SOEs

- **SOEs or GOCCs (Government-Owned and Controlled Corporations)** are important sources of income for the national government (NG), **a quarter (25.3%) of total non-tax revenues.**
- **In 2009, the national government extended financial aid to GOCCs amounting to PhP23.8 billion or 1.7 percent of the NG budget.**
- Because GOCCs require significant amount of transfers from the state, **they constitute a heavy drain on the public sector's finances.** From 1998 to 2008, they have accounted for an average of 30 percent of the outstanding public sector debt.

Motivation

Problems of SOEs World Bank (1995)

- Lack of clarity in the role of government as owner
- Multiple or conflicting objectives
- Soft budget constraint

Motivation

The multiple objective conflict

- The **poor financial condition** of the GOCCs mostly arises from operational factors and **inconsistent policy objectives** of government. **GOCCs are often mandated to provide services with social objectives.** (Senate Economic Planning Office, 2010)

The multiple objective conflict

- “[T]he ambiguity of objectives provides the managers further discretion to pursue their own interests. In the private sector, there is one over-riding concern: profits. In the public sector, there may be a multiplicity of objectives – economic (such as employment) as well as non-economic (national security). **Managers can always claim that the reason they are losing money is not that they are inefficient or incompetent, but that they have been pursuing other goals.** And it is virtually impossible for an outsider to judge the validity of those claims.” (Stiglitz, 1989)

SUSTAINABLE DEVELOPMENT GOALS



Research Question:

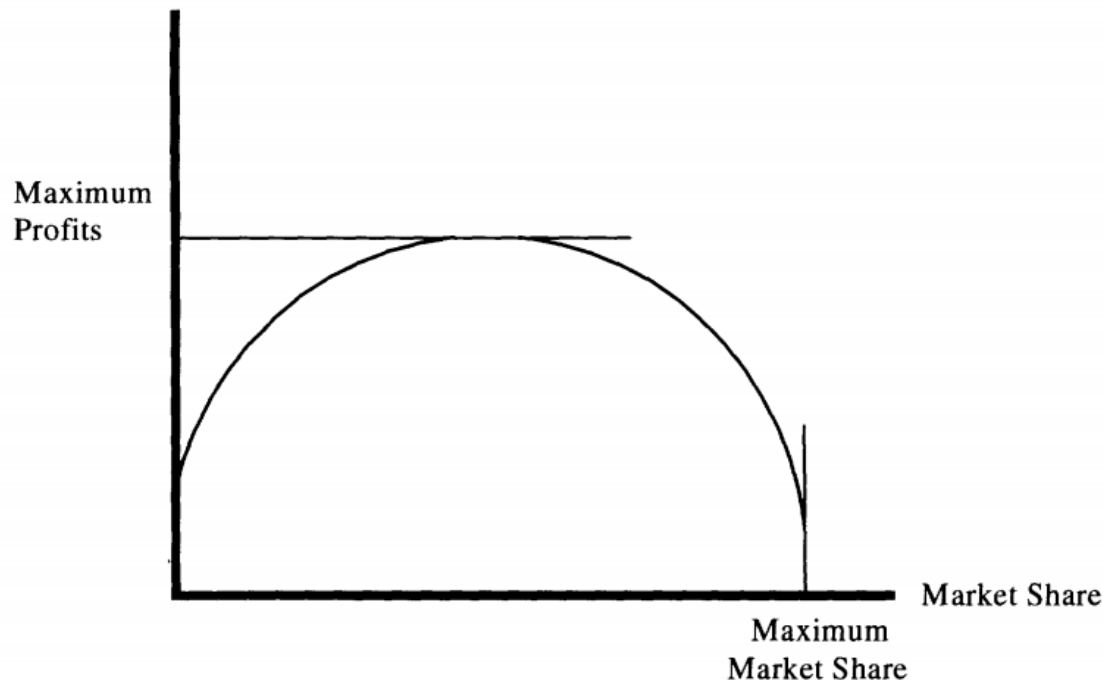
How do we solve the multiple corporate objective conflict?

Overview of literature

- Issues with multiple objectives
- Performance contracting
- Balanced scorecards

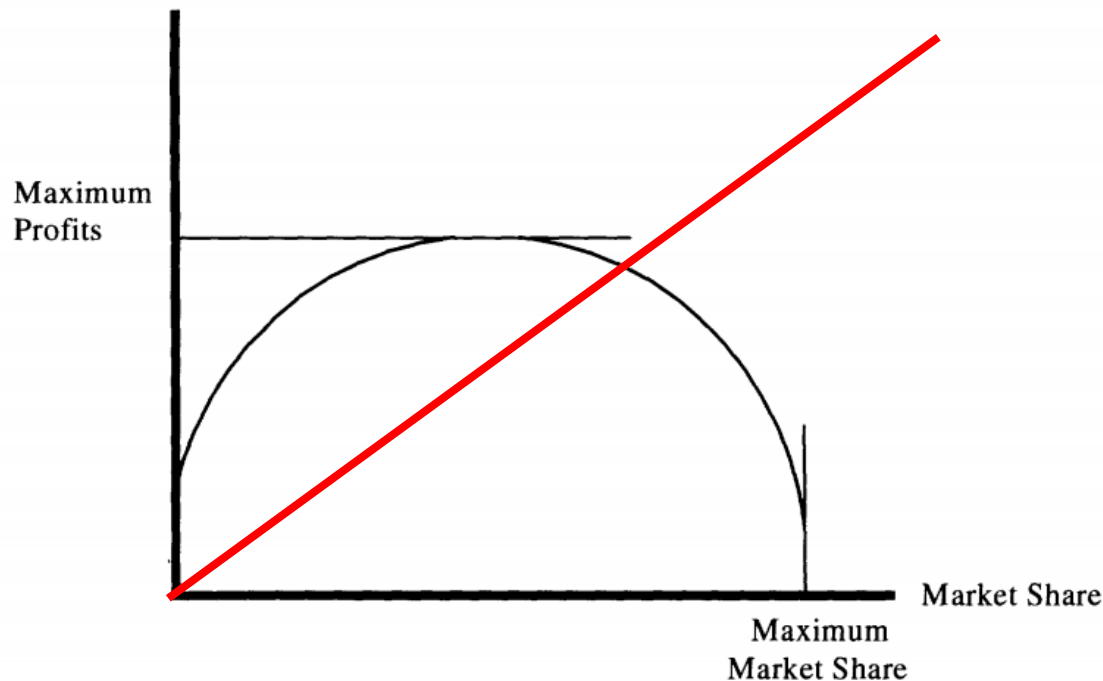
Issues with multiple objectives

- Multiple objective is not objective. Impossible to maximize in more than one dimension at the same time unless the dimensions are **monotone transformations** of one another. (Jensen, 2002)



Issues with multiple objectives

- Multiple objective is not objective. Impossible to maximize in more than one dimension at the same time unless the dimensions are **monotone transformations** of one another. (Jensen, 2002)



Issues with multiple objectives

(Jensen, 2002)

- A firm can resolve the multiple-objective problem by specifying an **overall objective function** which specifies the **tradeoffs** among different dimensions.

$$V = f(w, x, y, z)$$

where V is overall objective and w, x, y, z are the different dimensions where a managers performance is measured. $f(\cdot)$ specifies the tradeoff.

- If the function is chaotic, it will be difficult for the manager to find the overall maximum.

Issues with multiple objectives

(Jensen, 2002)

$$V = f(w, x, y, z)$$

- Suppose increasing z decreases x . What will happen to V ?
- Solution: Specify **tradeoffs** by having **weights** for each objective.

Performance Contracts in SOEs

- Throughout the 1970s, the French state engaged in a process of “contracting” with the SOEs – developing elaborate arrangements that specified what the enterprise would be expected to achieve in each of the different categories of objectives. (Heath, 2002)
- Usually used by World Bank and other development orgs.
- These contracts, however, proved difficult to negotiate, and even more difficult to enforce (Lewin, 1982)
- **Contract theory:** Information Asymmetry
- **Result:** Targets negotiated are easy (soft), resulting in what is known as “**ratchet effect**” (Weitzman, 1980).

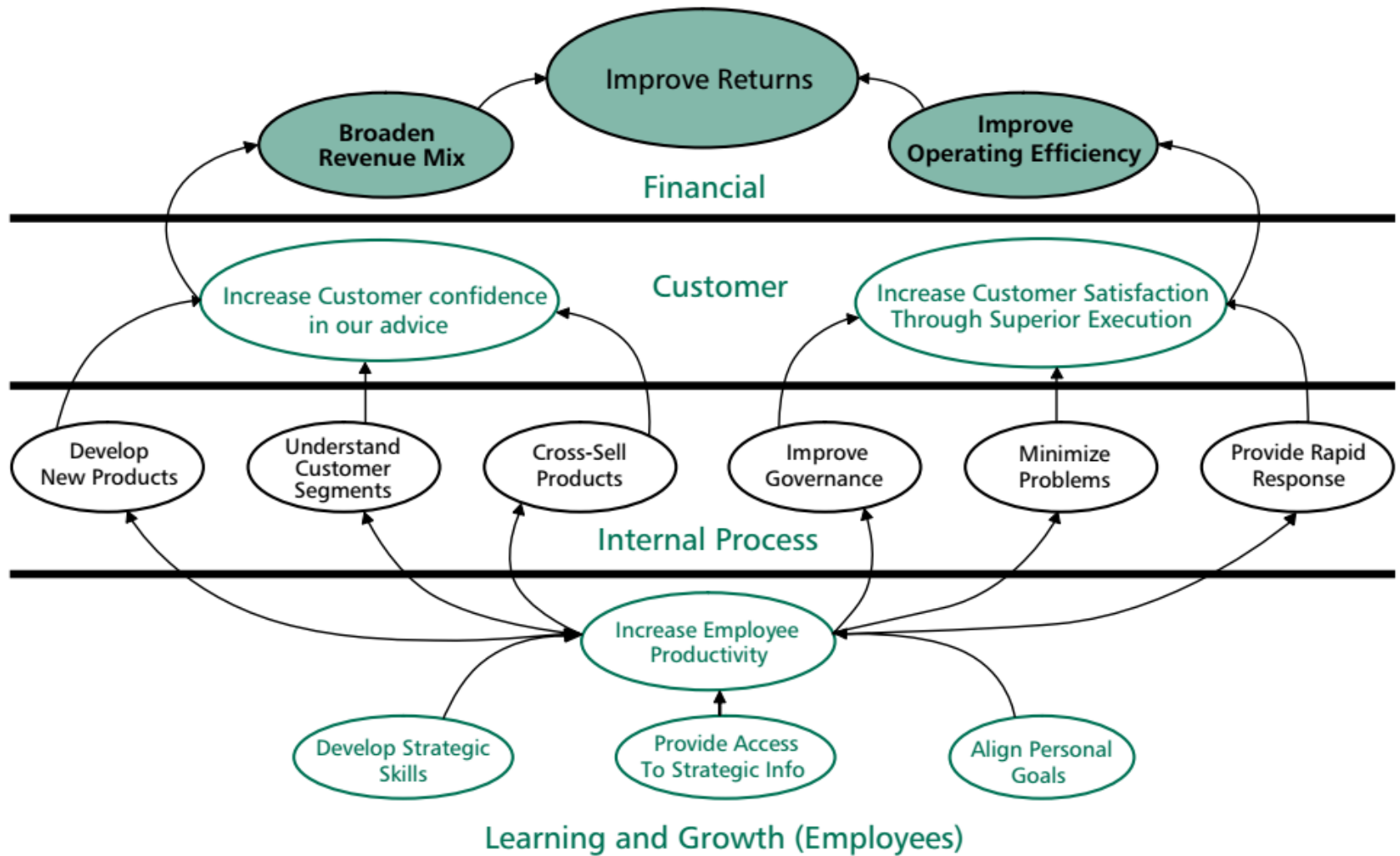
Balanced Scorecards in SOEs

- Comprise four financial and non-financial performance management dimensions which have **causal relationship** with each other: **innovation and learning, internal business process, customer, and financial**. (Kaplan and Norton, 1996)
- Some proposed that weights should be **equal among perspectives**. For SOEs and non-profit institutions, social goals are expected to have bigger weights than financials.
- Put greater emphasis on **process measures**, because the process perspective is the primary domain through which organizational strategy is implemented. (Norton, 2000)
- The BSC does not consider the tradeoffs between multiple goals and **a typical manager cannot behave purposely and will just be confused**. The BSC **does not provide a single score**, which will serve as the overall objective function. (Jensen, 2002)

Ideal scorecard? Norton (2000)

Perspective	#of Metrics	Weight
Financial	5	22%
Customer	5	22%
Learning and Innovation	5	22%
Internal Processes	9	34%
24 measures		100%

Source: Norton, David. 2000. Beware: The Unbalanced Scorecard.



Source: Norton (2000)

Research Setting

- The GOCC Governance Act of 2011 recognizes the role of GOCCs in supporting national development goals and programs. Created the **Governance Commission for GOCCs (GCG)**.
- In 2014, the GCG released the Performance Evaluation System (PES) Framework which changed how GOCCs create scorecards.
- The Performance Scorecard format required resembles that the Balanced Scorecard, as proposed by Kaplan and Norton.
- Focus: **Government Financial Institutions (GFIs)**

Government Financial Institutions (23)

Banking Institutions

- Al-Amanah Islamic Investment Bank of the Philippines
- DBP Data Center, Inc. (DCI)
- LandBank of the Philippines (LBP)
- LBP Resources and Development Corporation
- Philippine Postal Savings Bank

Social Security

- Employees' Compensation Commission
- Government Service Insurance System
- Home Development Mutual Fund
- Occupational Health and Safety Center
- Philippine Health Insurance Corporation
- Social Security System

Non-Banking Institutions

- DBP Leasing Corporation
- Home Guaranty Corporation
- LBP Leasing and Finance Corporation
- LBP Insurance Brokerage, Inc.
- Masaganang Sakahan, Inc.
- National Development Company
- National Home Mortgage Finance Corporation
- National Livelihood Development Corporation
- Philippine Crop Insurance Corporation
- Philippine Deposit Insurance Corporation
- Small Business Corporation
- Social Housing Finance Corporation

Research Method

1. **Review documents and regulations** related to the objectives of GFIs and the **performance contracting process**
2. Analyze the **2015 Performance Scorecards / Balanced Scorecards** (structure and content) of twenty-three (23) GFIs

Discussion & Analysis:

The case of Philippine Government Financial Institutions

Why were SOEs created?

- “Government-owned or controlled corporations (GOCC) may be created or established by special charters in the interest of the common good and **subject to the test of economic viability.** “ (Philippine Constitution)
- “The State recognizes the potential of government-owned or-controlled corporations **as significant tools for economic development.**” (Republic Act 10149)
- There is a need and pressure to improve and rationalize operations. (Republic Act 10149)

Performance Evaluation System

- **Performance Evaluation System (PES)** provides a framework for setting organizational goals of a GOCC
- Achievement of targets (at least 90%) shall serve as basis for:
 - Determining grant of Performance-based Incentives
 - Determining whether Appointive Directors are eligible for reappointment
- **Performance Agreements** is between the GOCC (represented by board of directors) and the State (represented by the GCG)
- **PES** are not immune from principal-agent problems caused by information asymmetry, i.e. moral hazard, adverse selection.

VISION: By 2018, LANDBANK will be the top universal bank that promotes inclusive growth and improves the quality of life especially in the countryside through the delivery of innovative financial and other services in all provinces, cities and municipalities

MISSION

To our Clients and Publics:

We will use the best technology solutions to deliver responsive financial and support services to our clients, while promoting sustainable development and environmental protection.

To our Employees:

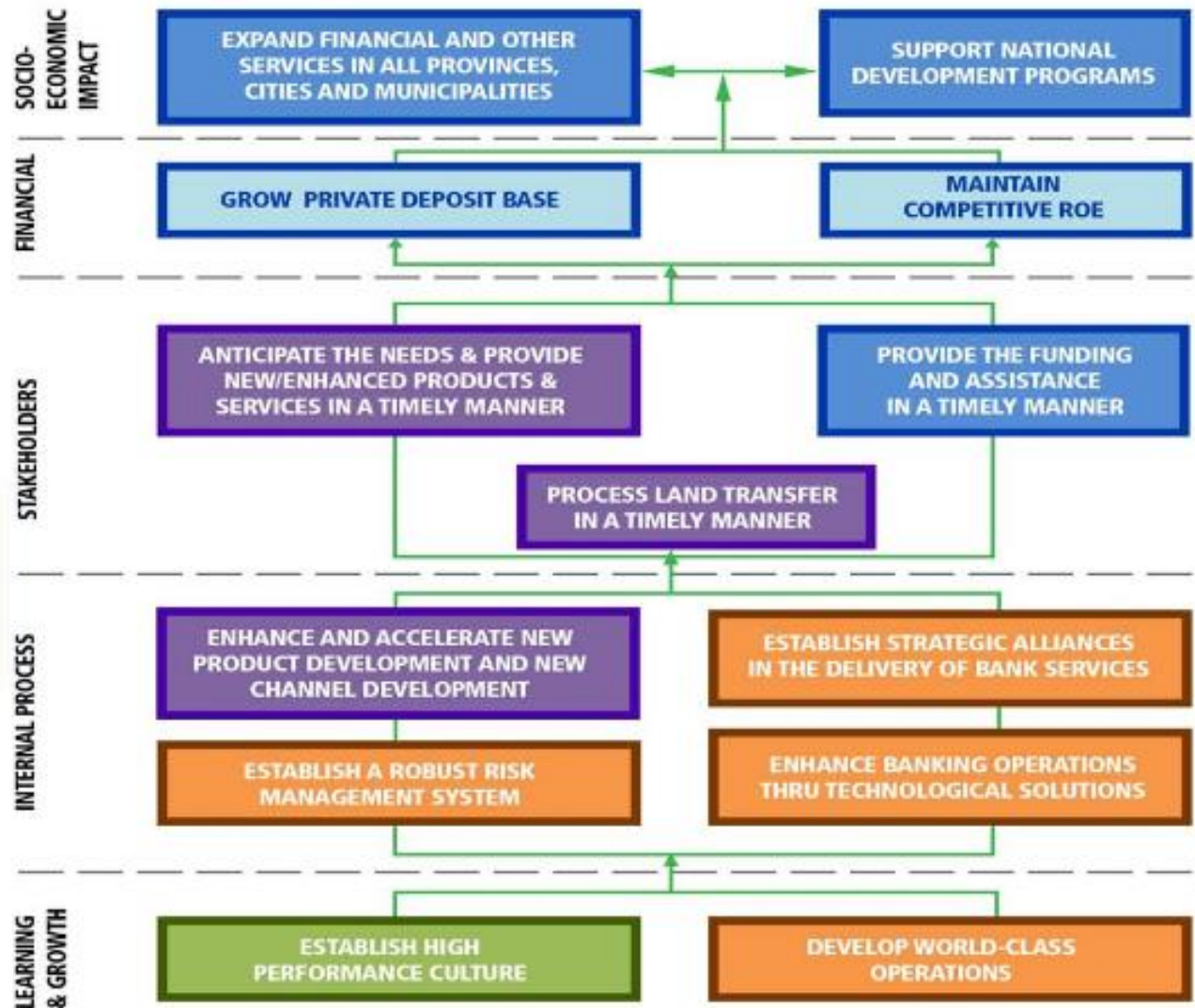
We will develop and nurture talents that will exemplify the highest standards of ethics and excellence consistent with the best in the world.

CORE VALUES:

- Social Responsibility
- Trust
- Excellence
- Professionalism



LANDBANK
WE HELP YOU GROW.



ACTIVE PARTICIPANT IN NATIONAL DEVELOPMENT PROGRAMS

SERVICE EXCELLENCE

FINANCIAL VIABILITY AND SUSTAINABILITY

OPTIMAL BUSINESS PROCESSES

AGILE ORGANIZATION

Performance Scorecards

- Has four or five perspectives
 - Socio-Economic Impact (optional)
 - Stakeholder/Customer
 - Financial
 - Learning and Growth
 - Internal Process
- Each perspective has Strategic Objectives and each Strategic Objective has Strategic Measures
- Each strategic measure is weighted.
- A grade of at least 90% should be achieved.
 - single objective score

Sample Performance Scorecard (Social Security)

COMPONENT			WEIGHT	RATING SYSTEM	2015 TARGET
FINANCIAL	SO 1	Viability of Social Security Institution Sustained			
	SM 1	Amount of Contribution Collections	10%		128.5 Billion
	SM 2	Net Revenue	10%		38 Billion
	SO 2	Effectively Manage the Fund			
	SM 3	Return On Investments	10%		6%
	SM 4	% of Operating Expenses to Charter Limit	5%		≤ 70%
		Sub-total	35%		
STAKEHOLDERS	SO 3	Improve Customer Satisfaction			
	SM 5	ARTA Rating	5%		90%
	SM 6	3rd Party Customer Satisfaction Survey Rating	5%		Establish Baseline (Satisfactory)
	SO 4	Adopt a Service Quality Framework			
	SM 7	Initial Implementation Date of ISSA Service Quality Framework	5%		November 2015 (following the ISSA Guidelines on Service Quality)
		Sub-total	15%		

Sample Measures and Targets (Land Bank)

- **Social:** Amount of loans to small farmers and fishers (Php 36B)
- **Finance:** ROE higher than industry rate
- **Stakeholder:** Customer satisfaction (75% satisfactory rating)
- **Internal Process:** No of new IT projects implemented (6)
- **Learning and Growth:** Establishment of Quality Management System

Discussion and Analysis

Hierarchy of Perspectives

Order of Perspectives					Number of GOCCS
	Stakeholder	Financial	Internal Processes	Learning & Growth	4
Social	Stakeholder	Financial	Internal Processes	Learning & Growth	5
	Financial	Stakeholder	Internal Processes	Learning & Growth	7
Social	Financial	Stakeholder	Internal Processes	Learning & Growth	4
	Social	Financial	Internal Processes	Learning & Growth	1
	Stakeholder	Internal Processes	Learning & Growth	Financial	1
Social	Stakeholder	Internal Processes	Learning & Growth	Financial	1

Discussion and Analysis

Number of Measures & Objectives

	Number of Measures	Number of Objectives
Social	2.81	1.63
Stakeholder	3.91	2.45
Financial	2.87	1.95
Internal Process	3.35	2.26
Learning and Growth	2.48	2.00
Total	13.78	9.35

Discussion and Analysis

Weighting of Perspectives

	Banking	Non-Banking	Social Security	TOTAL
Number of GOCCS	5	11	6	22
Social	6.00%	16.64%	6.67%	11.50%
Stakeholder	22.50%	25.80%	32.33%	26.83%
Financial	38.50%	25.18%	19.67%	26.70%
Internal Process	18.00%	18.75%	30.83%	21.88%
Learning and Growth	15.00%	13.64%	10.50%	13.09%

Achievability of Targets

- All GFIs achieved as score of at least 90% with an average score of 95.18%.

	Failed Measures (Number of GOCCS)
Social	6
Stakeholder	13
Financial	14
Internal Process	13
Learning and Growth	1

Summary

- GFIs and the State through the use of performance contracts were able to solve the multiple objectives problem.
- Performance scorecards with a single objective score were able to balance the trade-offs between multiple objectives by specifying weights for each strategic objective.
- There is heterogeneity in the weight assignment among GFIs, possibly due to the nature of business and other characteristics.
- The Performance Evaluation System is not immune from the usual principal-agent / information asymmetry problems.

Policy Implications

- For Government Financial Institutions, there's should be explicit policy on how to determine the primacy of financial goals over non-financial goals; e.g. *two-tiered performance evaluation system where level of financial goals should be met first before non-financial performance will be considered.*
- The performance negotiation process (goal setting) should have control measures in order to prevent the gaming, “ratchet effect”, and other contracting problems.
- Future research: Quality of Performance Standards/ Objectives set; Study on the effects of performance contracting to Philippine GOCCs' performance; Corporate Social Responsibility vis-à-vis Performance Contracting