

The Link between Performance Appraisal and Firm Performance

Robert Ng'ang'a

Kenya School of Government
P.O. Box 402-60100 Embu, Kenya

Priscilla N. Wanjiku and Dr. Maurice Sakwa

Kenyatta University of Agriculture and Technology P.O. Box 62000-00200
Nairobi, Kenya.

DOI Link: <http://dx.doi.org/10.6007/IJARBSS/v3-i9/189>

Published Date: 06 September 2013

Abstract

The purpose of the study was to investigate the linkage between Performance Appraisal (PA) as a Human Resource Practice and the firm performance of the Kenyan state corporations. The study hypothesized that; there was a positive relationship between PA and OP and therefore the need to investigate the specific linkage between the two variables relate. The study adopted an Explanatory research design. The target population was 232 HRM from which a sample of 142 respondents was selected. The research tool was a questionnaire which constituted structured or closed ended items, unstructured or open ended items and likert items.

A pilot study was conducted to help establish the reliability and validity of the research tool. Quantitative and qualitative data was generated was analyzed using SPSS. Qualitative data was operationalized by arranging the data according to emerging themes or patterns with assigned numbers to make them measurable. As far as quantitative data is concerned, Correlation coefficients will be calculated for initial exploration of the relationships between variables. This helped to measure the size and direction of the relationship between the independent and dependent variables.

The findings established that there was a significant correlation between PA and Firm's Performance and therefore recommended to the authorities of the Corporations studied to give main focus to PA function to enhance OP.

Key Words: Performance Appraisal, Human Resource Practices, Firm's Performance

Introduction

The contemporary firms are undergoing a transformation for coping against the changing needs of the environment and excelling in the business by building up their adaptive capabilities for managing change proactively. To achieve this goal, many firms have embraced the concept of Human Resources Management (HRM) since Human Resources (HR) have been identified as the source of competitive advantage for firms (Pfeffer 1994). Therefore, the management of Human Capital (HC) may be the ultimate determinant of performance of modern firms which have invested heavily in computerized systems and innovations. Such initiatives depend on stock of competencies, knowledge, social and personality attributes, including creativity, embodied in the ability to perform labor so as to produce economic value (Simkovic 2012). It is therefore important for firms to harness the productive potential of their employees in order to achieve superior performance.

Effective HR management through HRM practices, such as Performance Appraisal (PA) are frequently acknowledged to play a central role in linking employees' capability with firm performance. PA is among the most important HR practices to HR Professionals since it is used as a tool for improving performance and developing people and therefore justifies the existence of the HRM function in a firm. For this reason the study embarked on establishing the extent to which PA influences firm's performance.

Objectives of the Study

The purpose of the study was to establish the linkage between Performance Appraisal and firm performance. In order to achieve this objective, the following specific objectives were put into consideration.

- i. To establish the relationship between performance appraisal and firm performance.
- ii. To find out the effect of performance appraisal on firm performance.
- iii. To make recommendations to the management of the corporations in order to enhance the performance of state corporations in Kenya and other similar countries.

Research Questions

The study was undertaken to explore the answers to the following research questions.

- i. What is the linkage between performance appraisal and firm performance?
- ii. How does performance appraisal affect firm performance?

Research Hypothesis

Given the information gathered through literature review, the study hypothesized that; there was a significant linkage between performance appraisal and firm performance

Conceptual Framework

The study conceptualized that performance appraisal had a significant effect on firm performance under the influence of Firm's Internal Environment as a Moderating Variable. This relationship is illustrated in figure 1

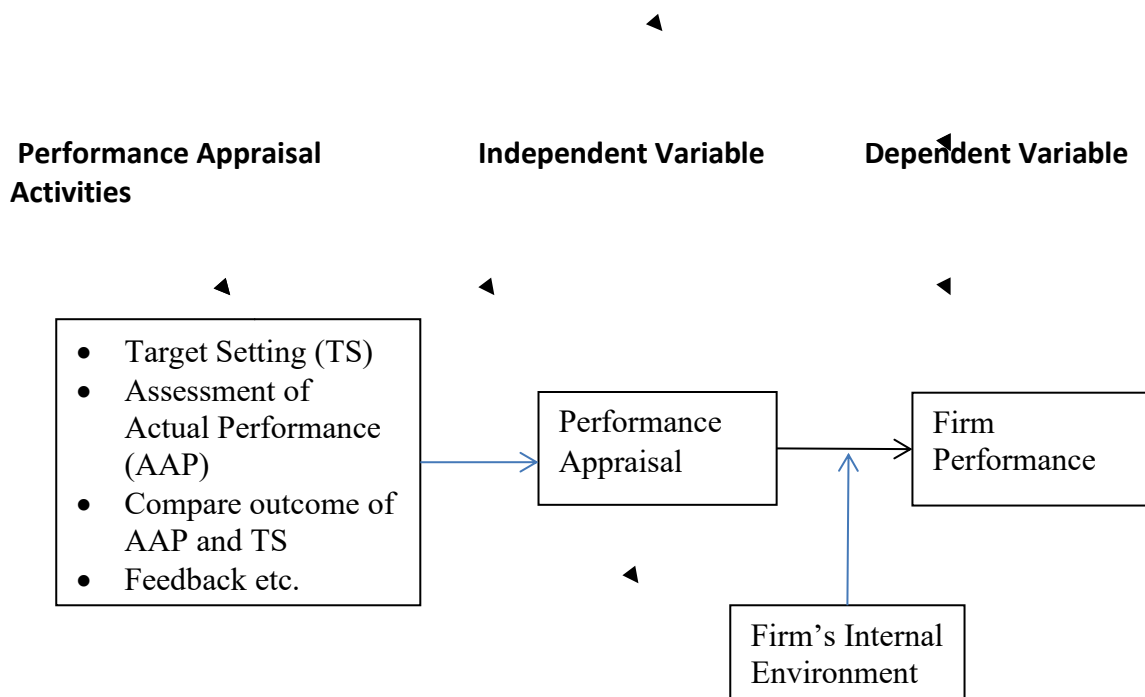


Figure 1 Conceptual Framework

Methodology

The study adopted explanatory research design. An explanatory design is a process of collecting data in order to test the hypothesis on the nature of certain relationships with an aim to differentiate between, and measure, the relative influence of the factors and explain the cause and effect relationship between them. It frequently includes descriptive elements but goes beyond this to identify and explore the causes lying behind the effects and the nature of the relationships between the two. Therefore, explanatory research attempts to investigate the causes of particular phenomena, not simply to describe them. Hypothesis testing provides an understanding of the relationships that exist between variables (Sekaran 2003 and Kothari 2004).

Population and Sample Size

There were 224 HR officers (Head of HR, HR section heads and their respective supervisors) in the 29 state corporations under the agricultural sector. This is because HR managers are the most reliable people to provide information on HR practices (Tzafrir 2006). Using a sample of 142 respondents was selected The following formula was used to get the sample size of the study:

$$n = \frac{X^2 * N * P * (1-P)}{(ME^2 * (N-1)) + (X^2 * P * (1-P))}$$

Where :

n = sample size

X^2 = Chi – square for the specified confidence level at 1 degree of freedom

N = Population Size

P = population proportion (.50 in this table)

ME = desired Margin of Error (expressed as a proportion)

Source: Krejcie and Morgan

(1970)

Substitution:

$$n = (1.96^2 \times 224 \times 0.5 \times 0.5) \div (0.05^2 \times 223 \times 1.96^2 \times 0.5 \times 0.5)$$

$$n = 141.70$$

Therefore, the sample size of the study was 142 respondents. This translates to 63% of the study population and has sufficiently surpassed the minimum threshold sample size of 10% suggested by Gay (2005), 30% considered acceptable by Stanley and Gregory (2001); Kothari, (2004); and Kerlinger (2000) and a sample size of 30 for a small population as proposed by Mugenda and Mugenda (2008). The sample size was equally divided among the 29 State Corporations where the study was to be undertaken. This means that 5 respondents were randomly selected from each one of them to respond to the study questionnaire.

Data Collection, Processing and Analysis

Data was collected by use of questionnaire which generated both quantitative and qualitative data. According to Cooper and Schindler (2003), analysis of data is a process of inspecting, cleaning, transforming, and modeling data with the goal of highlighting useful information, suggesting conclusions, and supporting decision making. Returned questionnaires were sorted to ensure their completeness and accuracy. Thereafter, quantitative responses were coded for analysis using Statistical Package for Social Sciences (SPSS).

Qualitative data was operationalized by arranging the data according to emerging themes or patterns with assigned numbers to make them measurable. Factor analysis formed the basis of analysis

As far as quantitative data is concerned, Correlation coefficient was calculated for initial exploration of the relationships between variables. Correlation is used to measure the size and direction of the relationship between two variables (Tabachnick and Fidell 2001). In this study, a correlation analysis was carried out to measure the inter-relationship between independent (training and development) and dependent (organisational performance) variables. Chi-square analysis is a goodness of fit test based on the frequency of occurrence and used in determining how well the data obtained from the study matches the expected data. Therefore, Chi-square was used to compare observed data with data the study expected to obtain according to hypothesis (Sekaran 2003; Kothari 2004).

On completion of the correlation analysis, a regression analysis will be conducted in order to further evaluate and understand the relationships between the dependent and independent variables of the study, and to test the hypotheses of the study.

Findings and Discussions

Response Rate

From the 142 questionnaires distributed, 134 were returned fully completed. This translates to a response rate of 94.37%. Babbie (1998) and Mugenda and Mugenda (2003) asserts that more than 70% response rate is very good, 60% rate is considered good and 50% is adequate. Based on the recommendations by the two scholars, the study concluded that the response rate of 94.37% for this research was “very good” and therefore a good basis of this study report.

The Linkage between Performance Appraisal and Firm Performance

Performance appraisal was an independent variable investigated on its effect on firm performance. The preliminary question on this section was if the firm had a PA system in place. Table 1 show that 86.7% the respondents indicated PA system was in place in their respective corporations. This is good for the corporations since 79.7% of the respondents said that Performance Appraisal System has a strong influence on firm performance.

However, 84.8% of the respondents said that there was need to improve Performance Appraisal System in their respective Corporations. This can be supported by the fact that only 35.6% of the respondents said Performance Appraisal System is strictly adhered to, 48.1% objectives of Performance Appraisal System are clear to all employees, 32.2% said that employees are provided with Performance Appraisal System feedback and counseling and only 32.6 have faith in Performance Appraisal System.

Other issues according to respondents that need to be addressed include; top management support for Performance Appraisal System, computation of performance level for each employee and the use of data obtained during Performance Appraisal System in decision making. All these scored relatively low scores ranging between 47% and 67% and therefore need to be addressed to have a near perfect or a perfect PAS. The need to have an effective Performance Appraisal System is supported by Ingram and McDonnell (1996); Mullins, (2002) and Verbeeten, (2008) who says that measuring the performance of employees is a compulsory task as it allows a firm to have a record of current firm activity in order to judge their progress and help refocus strategy. This information must always be compared against past performance and initial goals, as well as firms must also compare their performance with other compatible firms.

Table 1 Performance Appraisal System

Performance Appraisal System issues	Strongly	Disagree	Neutral	Agree	Strongly Agree
-------------------------------------	----------	----------	---------	-------	----------------

	Disagree				
There is PA policy in place	4.7	5.5	3.1	44.5	42.2
There is PA policy is strictly adhered to	6.3	15.7	12.6	33.1	32.3
Objectives of PA is clear to all employees	8.7	23.6	19.7	27.6	20.5
Top management support PA	4.0	12.1	16.9	38.7	28.2
Performance level can be computed for each employee	6.4	17.6	16.8	32.8	26.4
There is need to improve PA system	2.4	6.4	6.4	25.6	59.2
PA system has a strong influence on firm performance	4.7	5.5	10.2	38.3	41.4
Data obtained during PA system is used in job decision	18.9	18.9	15.0	26.8	20.5
Employees' performance is measured on the basis of objective quantifiable results	7.0	18.8	24.2	32.8	17.2
PA is employees' growth and development oriented	5.6	22.4	29.6	28.0	14.4
Employees are provided with PA feedback and counseling	21.8	25.0	21.0	24.2	8.1
Employees have faith in PA system	12.8	28.8	25.6	19.2	13.6

Factor Analysis on Performance Appraisal

Factor analysis was carried out before inferential analysis of the results on PA variable to describe variability among the observed and check for any correlated variables with the aim of reducing data that was found redundant. From the twelve items analyzed as shown on Table 2, all apart from one item, need to improve PA system, scored at least 0.3 which is the minimum requirement for inclusion of variables into the final model. Consequently, this item was thus declared redundant and was dropped from the model and not further analyzed.

Table 2 Factor Analysis on Performance Appraisal

PA Issues	Component
	1
To what extent is there a PA policy in place?	.568
To what extent is PA policy strictly adhered to?	.691
To what extent is the objectives of the appraisal system clear to all employees?	.704
To what extent does the top management support PA?	.703
To what extent do you agree that performance can be computed for individual employee?	.535
To what extent do you agree there is need to improve PA system?	.074
To what extent do you agree that appraisal system has strong influence on organisation performance?	.368
To what extent do you agree that appraisal data is used for making decisions like job rotation, training, and compensation?	.564

To what extent do you agree that performance of the employees is measured on the basis of objective quantifiable results?	.632
To what extent do you agree that appraisal system in your organisation is growth and development oriented?	.647
To what extent do you agree that employees are provided with performance based feedback and counseling?	.674
To what extent do you agree that employees have faith in the PA system?	.712

Reliability test was carried out on the remaining eleven items and the Cronbach's Coefficient Alpha was 0.839. Cooper & Schindler (2008) assert that a Cronbach's alpha coefficient of 0.7 is adequate for a newly developed tool. Therefore based on their recommendations the eleven items can be retained on the study questionnaire that will now have adequate internal consistency and is reliable for the study and its results can be used to generalize on population characteristics.

Pearson Correlation Coefficient Firm Performance and Performance Appraisal

Based on the findings in table 3, the Pearson Correlation coefficient (ρ) between firm performance and performance appraisal, was found to be 0.480 at $p = 0.000$. This indicated that the strength of linear relationship was significant since p at 0.00 is less than 0.05. The linear relationship between the two variables is illustrated in figure 2.

Table 3 Correlation Coefficient on Firm's Performance and PA

		FIRM PERFORMANCE	PERFORMANCE APPRAISAL
Firm Performance	Pearson Correlation	1	.480**
	Sig. (2-tailed)		.000
	N	134	134
Performance Appraisal	Pearson Correlation	.480**	1
	Sig. (2-tailed)	.000	
	N	134	134

** . Correlation is significant at the 0.01 level (2-tailed).

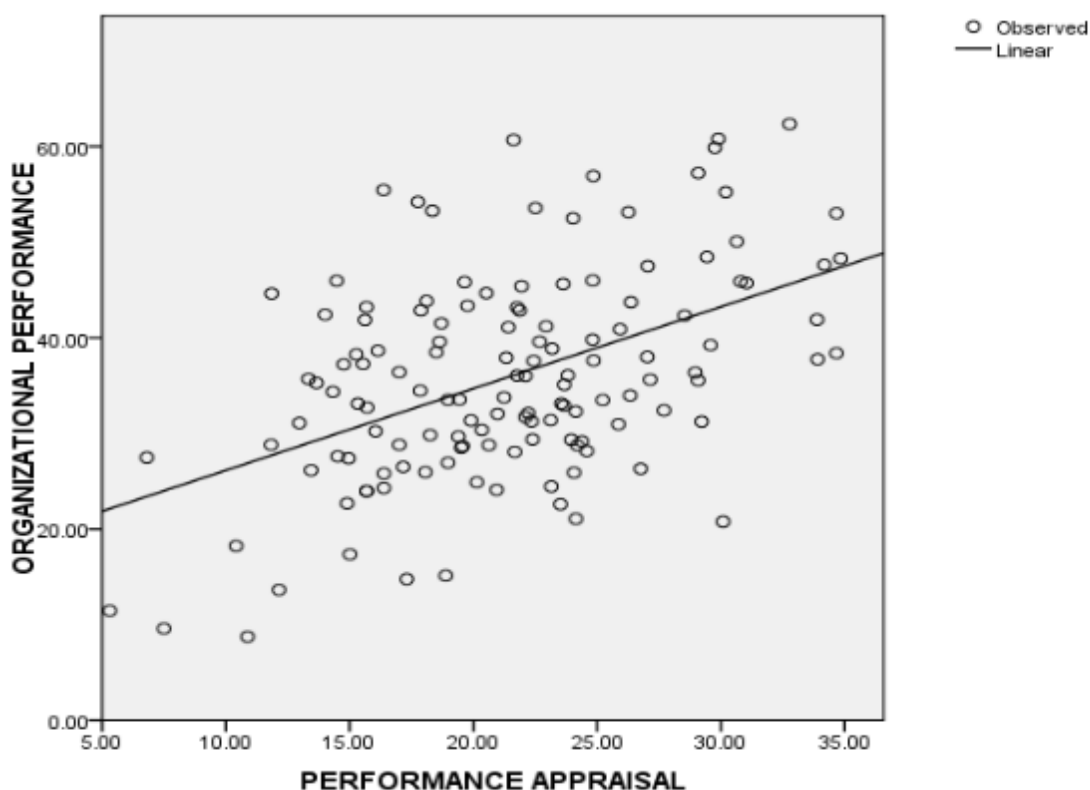


Fig 2 Linear Relationship between Firm Performance and Performance Appraisal

The findings indicate a positive relationship between Performance Appraisal and firm performance. Mullins (1999) argues that Performance Appraisal involves a continuous judgment on the behavior and performance of staff. It is important that employees know exactly what is expected of them, and the yardstick by which their performance and results will be measured. A formalized and systematic appraisal scheme will enable a regular assessment of the individual's performance, highlight potential and identify Training and Development needs. Most importantly, an effective appraisal scheme can improve the future performance of staff. The appraisal scheme can also form the basis for a review of financial rewards and planned career progression.

Being a systematic process to evaluate the performance of an employee after certain period Performance Appraisal influences other HR practices such as recruitment and selection, Training and Development, compensation, and employee relations. Since it may lead to pay raise, promotion, and training; the findings confirms the assumptions that better Performance Appraisal has a positive effect on firm performance.

Effect of Firm's Internal Environment on the Implementation of HR Practices

The study established the effect of firm's internal environment on the implementation of HR practices. This was necessary to understand why HR practices might not be easily implemented which could affect the firm's performance. From the findings on table 4, the main issues of firm's internal environment include: office infrastructure with 72.7% indicating it either affected them to a moderate, large or very large extent. Bureaucratic structures were also found to challenge the implementation by 72.1% being affected either moderately, largely or very large extent. Employee-employer relationship was also rated by 82.8% either moderately, largely or very large extent meaning it was challenging implementation of PA as

HR practice. Firm's culture was rated 82% either moderately, largely or very large extent while other issues were rated 74% either moderately, largely or very large extent. These findings showed that all the investigated issues were affecting implementation of PA as a HR practice.

Table 4 The Effects of Firm's Internal Environment on the Implementation of HRM Practices

Firm's Internal Environment Influencing the Implementation of HRM Practices	Not at All	Small extent	Moderate extent	Large extent	Very large extent
Management commitment and support	6.0	12.7	34.3	30.6	16.4
Infrastructure (IT, office space etc.)	5.2	22.4	30.6	32.1	9.7
Bureaucratic structure	3.7	24.6	34.3	20.9	16.4
Employee-employer relations	2.2	16.4	32.8	34.3	14.2
Firm's culture	3.7	14.9	30.6	32.8	17.9
Financial Situation	3.0	32.1	41.0	14.2	9.7

Moderating Effect of the Controlled Variable

The study conducted correlation analysis to establish the moderating effect of firm's internal environment on the relationship between independent and dependent variables. It was established that controlling had positive effects on Performance Appraisal which had a variation of $r = 0.008$ between Uncontrolled Firmal Performance (0.480) and Controlled Firmal Performance (0.488)

Results of Hypotheses Tests

The study hypothesized that PA has a positive effect on OP. The regression results support this hypothesis ($t=5.703$; $p=0.000$). The findings are consistent with other studies Lee and Lee (2007), Sang (2005), Ahmad and Schroeders (2003) among others who found out that, the higher an firm engages in PA related activities, the higher the OP will be.

Summary of the Findings

The study sought to find out if there was a significant relationship between PA and OP preliminary results indicated that 86.7% the respondents said PAS was in place in their respective corporations. This was good for the corporations since 79.7% of the respondents said that PAS has a strong influence on firmal performance. However, 84.8% of the respondents said that there was need to improve PAS in their respective Corporations. The Pearson Correlation coefficient (ρ) between PA and OP, it was found to be 0.480 at $p = 0.000$. This indicated that the strength of linear relationship was significant since p at 0.00 is less than 0.05.

A further analysis indicated that Regression Analysis Results on Performance Appraisal for the model equation $y = \beta_0 + \beta_1 X_1 + \varepsilon$ explained 23% goodness of fit as. This means that Performance Appraisal explained 23% of the variation in Firm Performance. This is a strong relationship and suggested that Performance appraisal contributes a significant role on firm performance while a correlation of all variables PA recorded the highest correlation, $r = 0.480$.

On hypothesis testing, the study had hypothesized that Performance Appraisal had a significant effect on Firm Performance. The regression results supported this hypothesis ($t=5.703$; $p=0.000$) and therefore, it was accepted.

Conclusions and Recommendations of the Study

On the findings on Performance Appraisal, the study concluded that; it played a key role in improving the overall value of a firm and hence a significant relationship between it and the firm performance. In today's workplace, performance improvement and the role of performance management is an increasingly popular topic. This can be attributed to Business pressures that are ever-increasing and firms are now required to become even more effective and efficient, execute better on business strategy, such as performance appraisal, and do more with less in order to remain competitive. Properly constructed appraisals should represent a summary of an ongoing, year-round dialogue. Focusing only on an annual appraisal form leads to misunderstanding and under appreciation of the benefits of performance management.

An effective performance management process enables managers to evaluate and measure individual and team performance and to optimize performance and productivity. In order to capture the effectiveness of the PA process, managers should take steps to successfully address any negative view of performance management. They should implement innovative solutions that ensure processes deliver real results and improve performance. Therefore, the study recommended that managers should embrace the following performance management practices including:

- Put into consideration the cognitive perceptions of supervisor and the employee that may influence the effectiveness of the PA process.
- Providing individuals and teams with clear, constructive feedback.
- Defining and communicating clear performance objectives and standards.
- Reviewing performance and delivering incentives in a fair and consistent manner.
- Providing relevant learning and development opportunities.
- Recognizing and rewarding strong individual and team performance.
- Linking performance to compensation and recognition.
- Identifying clear career progress routes for employees.

References

1. Ahmad, O. & Schroeder, R.G. (2003), 'The Impact of Human Resource Management Practices on Operational Performance: Recognizing Country and Industry Differences', *Journal of Operations Management*, Vol.21, pp.19-43.
2. Babbie, Earl R. (1998). *The Practice of social research*. Wadsworth Pub. Co. (Belmont, CA)
3. Cooper, D. R. and Schindler, P. S. (2003) *Business Research Methods* Boston: McGraw-Hill/Irwin
4. Ingram, H. McDonnell, B. (1996). 'Effective Performance Management –The Teamwork Approach Considered', *Managing Service Quality*, 6(6):38– 42 MCB University Press.
5. Kerlinger, F.N. & H.B. Lee, (2000, 4th Ed). *Foundations of behavioral research*. Wadsworth.
6. Kothari, C. K. (2011) *Research Methodology: Methods and Techniques (2nd Revised Edition)* New Age International Publishers, New Delhi
7. Krejcie, R. V. and Morgan, D. W. (1970) Determining Sample Size for Research Activities Educational and Psychological Measurement 1970, 30, 607-610.

8. Lee, Feng-Hui, & Lee, Fzai-Zang. (2007). The relationships between HRM practices, Leadership style, competitive strategy and business performance in Taiwanese steel industry, Proceedings of the 13th Asia Pacific Management Conference, Melbourne, Australia, 2007, 953-971.
9. Michael Simkovic, www.ssrn.com/abstract=1941070 Risk-Based Student Loans] (2012)
10. Mugenda, O. M. and Abel G. Mugenda, A. G. (2008) Research Methods: Quantitative and Qualitative Approaches: Nairobi, African Centre for Technology Studies
11. Mullins, J. L. (2002). Management and Firmal Behaviour, Prentice Hall.
12. Pfeffer, J. 1994. Competitive advantage through people. Boston: Harvard Business School Press.
13. Sang, C. (2005). Relationship between HRM practices and the perception of organisational performance, roles of management style, social capital, and culture: comparison between manufacturing firms in Cambodia and Taiwan, National Cheng Kung University, Taiwan, Taiwan.
14. Sekaran, U. **(2003) Research Methods for Business: A Skill-Building Approach (4 Ed.) John Wiley and Sons**
15. Tabachnick, B.G. and Fidell, L.S. (2001). Using Multivariate Statistics. (4th edition), New York: Harper Collins College Publishers.
16. Tzafrir, S. S. (2006), A Universalistic Perspective for Explaining the Relationship between HRM Practices and Firm Performance At Different Points In Time: Journal of Managerial Psychology, Vol. 21, No.2, pp. 109-130.
17. Verbeeten, F. H (2008). Performance Management Practices in Public Sector Firms Impact on Performance, Accounting, Auditing Accounting. J. 21(3): 427-454.