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## AN IMPACT OF PUBLIC POLICY ON THE FINANCIAL PERFORMANCE OF PUBLIC INSTITUTIONS

**Fuad Cergic** 

University of Tuzla, Bosnia and Herzegovina  
E-mail: [fuad.cergic@untz.ba](mailto:fuad.cergic@untz.ba)

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### Abstract

Each country pays great attention to the public sector both in terms of the budget and its impact on social life, macroeconomic stability, employment and in general on the national economy. An analysis of the impact of public policies is very important for decision - makers to understand what kind of wanted and / or unwanted effects these policies bring, and it is particularly important to understand what effects will be on the performance of public institutions. Public policies are basis of each community whether it is a unit of local self-government or the entire state. Without well-established public policies, we cannot expect the effective functioning of any community. The general aim of the research is to determine an impact of different types of public policy on the financial performance of public institutions.

**Keywords:** Public Policy, Public Sector, Financial Performance

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### 1. Introduction

Efficiency in the public sector is a problem which most governments have to face, and which is determined, mainly, by the existence of some major deficits, a bureaucracy that makes it hard to collect money to the budget and their redistribution as soon as possible, but also as a result of implementing some public programs which are based on some performance objectives (Mihaiu *et al.* 2010)

Taking into account the technical - technological development, and higher citizen's awareness as well as the higher level of citizens education, the expectations of the citizens are increasing more and more, while on the other hand, possibilities of the state are limited. In order for the state to be able to respond to these circumstances, a process of creating public policies has to respect the principles of efficiency, economy and effectiveness, and on the other hand, the social dimension should not be ignored.

The problem that this research needs to solve is to find the optimal relationship between public policies and public institutions, which will result in improving financial performance. The basic research hypothesis is: 'The consistent application of well-designed public policies can improve the efficiency, effectiveness and cost-effectiveness of public sector institutions.'

The first part of this paper deals with previous researches related to this topic. Thus, the author's conclusions range from those who claim that measuring of performances is used for

budgeting and allocation of resources (Wholey and Hatry, 1992), to those who claim that the performance paradox marks an existence of a weak correlation connection between performance measures and real performances (Meyer and Gupta, 1994). In the theoretical part of the paper are defined public policy definitions by recognized authors and their impact on financial performance. In the part of the paper describing the methodology, it has been shown that using multiple regression analysis led to conclusion of this paper. In the fifth part of the paper are presented results and discussion based on the survey of people from different parts of the public sector.

## **2. Literature review**

Performance management is not a new term in public policy sphere. When ethics and values were emphasized in the 1960s, performance management also appeared. It included planning, programming, and budgeting as a type of program evaluation. It was popular in the 1970s for measuring performance throughout legal processes such as audits and other monitoring. This process was known as performance auditing for the purpose of cost reduction and to establish innovative management (Heinrich, 2002).

In the creation of public policies, it is very important that short-term policy is coherent with long-term policy, meaning that the general objectives should be divided into operational objectives. Managers' preoccupation with short-term profits is detrimental for the firm because long-term value creation is ignored. Kaplan and Norton (1992) introduced the Balanced Scorecard (BSC) as a performance measurement system believed to mitigate this short-term myopia.

The Balanced Scorecard is the product of dissatisfaction with existing financial measures in the private sector of the economy and evolved into a strategic management tool widely accepted and utilized by both private and public sectors of the economy. Dissatisfaction with having only financial measures for evaluating business performance has existed as far back as 1951, when then General Electric Chief Executive Officer (CEO) Ralph Cordiner commissioned a task force to identify key corporate performance measures (Eccles, 1991).

In order to evaluate the financial performance of public sector entities that prepare and present their financial statements in accordance with accounting requirements based on an accrual accounting, it can use financial analysis tools used by private sector entities but with the necessary degree of critical thinking that respects all the differences between the public and private entities sector and also the differences between individual reporting entities within the public sector (Propper and Wilson, 2003).

According to Kettl (2005, p. 22): "Reformers have transformed measuring of performances into managing of performances by linking the performance evaluation process with a managing of the state strategies and tactics". Although it is undisputed that, in countries where performance measurement systems have been in operation for more than two decades, the intended purpose of their implementation (improvement of efficiency, effectiveness and public accountability of public sector entities) has been well implemented, it must be noted as well that the application of the system evaluation of performance is associated with some problems and unwanted consequences. The most significant problems and unwanted consequences are caused by the phenomenon called the performance paradox. According to Meyer and Gupta (1994, p. 323), "the paradox of performance indicates the existence of a weak correlation between performance and actual performance."

Budget funds are usually allocated to their beneficiaries on the basis of the goals they fulfill, not on the basis of the efficiency and effectiveness of the public sector operations. It is often more political rather than a business decision. On the other hand, taxpayers expect from budget users the results achieved by the use of their funds.

Performance measurement of any sector (and even the public sector entities) can be used for a variety of purposes, the purpose of which is determined by the needs of an entity that uses performance information. However, generally speaking, information about public sector entity performance can be used for two basic purposes: making of economic decisions and meeting public accountability requirements. Wholey and Hatry (1992, p.604) emphasize "that it

has begun a process of using system for monitoring performances during creation of budget and allocation of resources, motivation of employees, arranging procurement of service on the basis of performances, improvement of provision of public service and improvement of communication between citizens and the country". This point of view is confirmed by the previously stated claim that the purpose of evaluating performance is always determined by the information requirements of their users.

According to Ullrich (2000) social and cognitive psychology research provides evidence that social factors, such as accountability, can motivate decision-makers to exert effort. Performance measurement is used by managers to communicate and execute strategy and to assist in making decisions to maintain or alter patterns of organizational activities in the future. The importance of effectively communicating and executing strategy through the use of non-financial performance measures was evidenced through a variety of studies on strategic performance measurement (Zanini, 2003).

In practice, more and more companies are adopting comprehensive management control systems. These systems intend to influence individuals in the organization to balance their efforts toward achieving all strategic goals simultaneously (Simons, 1995). Sandor and Raboca (2004) stated that financial perspective shows the results of the financial terms. Unlike the private sector, public organizations do not pursue profit, but efficiency, i.e. providing services at a reduced cost. According to Aashis (2017) like any other developed country India too has different types of business incubators but among them central government sponsored and non-profit TBIs are in majority and widely scattered according to geographical diversity of India. The concept of Business Incubator and Incubation has been promoted, advocated and practiced with a great zeal by academicians, administrators, policy makers and politicians too. Since the initial days of Business incubation concept at 'Industrial Centre of Batavia' at New York in 1958 the concept travelled across globe and been evolved too. As immense government funding are dedicated to TBIs their performance measurement are obviously desired. In a management control system context, reporting performance information to superiors can induce accountability in individuals.

### **3. Theoretical framework**

Public policies can be defined as the deliberate action of authorities that are changing society and economy and affect them. An important component of the definition of public policies is who is responsible for their adoption and who decides about them. The simplest public policy can be defined as everything that the authority decides to do or not to do. (Dye, 1987, p.23).

According to Bobrow (2006), there are the constraints of social and cultural factors on public policy, but according Schmidt (2002) the rule of law plays the important role in quality democracy and related good governance. Quiggin (2006) studied the constraints of economic constraints on public policy.

Public servants encounter constituencies whose preferences are ambiguous, dynamic and shaped significantly by and through their relationship with the public bureaucracy itself. Political bureaucrats have an obligation to do more than satisfy customers. They must identify and aggregate preferences in ways that sustain political legitimacy and minimize political inequality (Fountain, 2001)..

The primary objective of the public sector entity functioning is a production of services and goods, which are public goods by its character, in favor of all goods that make a particular social community (and thereby create value for all its members), namely the achievement of a certain level of social well-being. Due to such determined aim of functioning, the public sector entities are responsible in front of social community not for the amount of gain they have but for the efficient and effective use of the collective resources entrusted to them. For this reason, it is very important to allocate public goods, and to measure the success of the implementation of public policies.

The range of public policies depends on the shape of the political regime and the quality of democracy. First, political stability is very important for quality long-term economic, social and educational policies as well as policies in other areas. Economic and other problems that arise

in authoritarian regimes, as well as anti-citizen repression, most often produce political instability. An example of China, politically stable and economically successful authoritarian regimes, is today an exception, not a rule. Secondly, the quality of democracy is also important. The countries of Western Europe and North America, where high-level democracy, have mechanisms that restrict corruption, and thus facilitate the quality of public policies.

#### **4. Data and methodology**

Secondary and primary sources of data have been used in this research, and research has started from secondary data sources such as books in the field of public finances, legal and subordinate legislation, articles and doctoral dissertations that deal with the issues that we have mentioned in the paper, sources from the Internet and other numerous literature and research in this area that have been carried out so far. The descriptive and bivariate statistical analysis, multiple regression analysis was also used. Primary data sources are collected using method of testing - a questionnaire as a data collection form.

The survey lasted from March 2018 to Jun 2018. We received a response from 25 people out of the total 35 respondents. People of different profiles and from different institutions were surveyed. During the month of September 2019, an additional 20 people were interviewed, of which 11 responded. Finally, we received a response from 36 people out of the total 55 respondents that represents a return rate of 65,45%

#### **5. Results and discussion**

We analyzed the arithmetic mean and the standard deviation on the sample of 36 examinees as a part of descriptive statistical analysis. Table 1 shows the results.

**Table 1. Descriptive statistical analysis**

Topics	Mean	Std. Deviation	N
Public policies are very important for one country:	3.50	1.558	36
Public policies are being adopted by the government:	3.58	1.360	36
The basic function of the public sector is to meet the public needs and the broader social interest:	3.78	1.376	36
Citizens participate in creation of public policies:	2.50	1.483	36
Political stability is essential for making efficient public policies:	3.47	1.558	36
Public policy influences the financial performance of public institutions:	3.56	1.382	36
Measures of public policy can influence the cost-effectiveness of public institutions:	3.92	1.519	36
Measures of public policy can influence the efficiency of public institutions:	3.92	1.360	36
Measures of public policy can influence the effectiveness of public institutions:	3.86	1.457	36
Good public policy affects the optimal allocation of public goods:	3.56	1.382	36
Measuring the performance of the public sector can put pressure on public institutions to make them more effective in implementing public policies:	3.64	1.376	36
To measure the financial performance of public institutions, the same methods can be used as in the private sector:	2.81	1.191	36
In the public sector, the effectiveness of implemented public policies does not depend on the level of profit:	3.36	1.313	36
Efficiency, effectiveness and cost-effectiveness of public institutions depends on the quantity and quality of the objectives met:	3.50	1.483	36
The success of the implementation of public policies depends on decision-makers or public institutions:	3.50	1.231	36

Table 1 shows an average scores and the standard deviation of all the variables obtained during the empirical study of the impact of public policy on the financial performance of public institutions. During the research, the most commonly used mean value is the arithmetic mean. In everyday life, the term average or average value is used for this mean. It is obvious that the arithmetic mean ranges from 2.50 to 3.92 (on a scale from 1 to 5, 1 - completely disagree, 5 - completely agree), implying that respondents have neutral attitude on the impact of public policies on the financial performance of public institutions. Table 1 also lists standard deviation values that measure the dispersion of sample data (a total of 36 examinees were tested). Table 1 shows that standard deviation values are greater than 1, in the interval between 1.191 and 1.558, indicating that the average deviation from the arithmetic mean is statistically significant.

After the descriptive statistical analysis below we will show an obtained results using the Pearson coefficient of correlation, which represents one of the most commonly used bivariate statistical analyzes. Analyzing a sample of 36 respondents, we tried to establish a correlation between public policy variables in order to improve the performance of public institutions. In considering the relationship between the variables, it is necessary at the beginning to determine what their correlation is, or to determine the inter-correlation of the selected variables included in this analysis. That is why we have examined and tested the statistical significance of their correlations. The Pearson correlation coefficient was used as an indicator of strength and direction.

Table 2 shows the correlation coefficients between the variables. We used a correlation analysis, whose task is to measure the degree of correlation between observed variables. It is shown that the correlations between variables are statistically significant at 1%. Highest correlation is found to be in between the variables Var2 and Var3 (0.942), respectively Var5 and Var7 (0.937). Thus, there is a significant correlation between public policies and performance in the public sector, which differs from the comprehension of Meyer and Gupta (1994) by which there is a weak correlation link between performance measures and real performance. There are cases of performance paradox which refers to a weak correlation between performance indicators and performance itself; these paradoxes result from the "discrepancy between the policy objectives set by politicians and the goals of executive agents" (van Thiel and Leeuw , 2002, p 271 and 275)

We can observe that the variables analyzed are mutually linearly positively correlated to each other, i.e., we have determined that there is a statistically significant positive correlation between public policy variables in order to improve the performance of public institutions.

The results of the correlation analysis showed:

- Very high correlation (correlation coefficient greater than 0.9) exists between the next variables: Var2 and Var3 (0.942), Var5 and Var7 (0.937), Var4 and Var5 (0.921), Var4 and Var7 (0.919). Var6 and Var7 (0.917)
- High correlation (correlation coefficient between 0.8 and 0.9) exists between the next variables: Var1 and Var2 (0.816), Var2 and Var5 (0.868), Var2 and Var7 (0.806), Var3 and Var5 (0.825), Var3 and Var8 (0.818), Var4 and Var6 (0.846), Var5 and Var6 (0.882), Var5 and Var8 (0.812), Var5 and Var10 (0.856), Var6 and Var8 (0.800), Var7 and Var8 (0.848)

## **6. Conclusion**

The purpose of this research was to establish the link between public policy variables in order to improve the performance of public institutions. Based on the research conducted, we can conclude that there is a significant influence of public policies on the performance of public institutions, but not complete correlation.

The results of these researches should certainly be considered in the context of the fact that budget funds are usually allocated to their beneficiaries on the basis of the objectives they meet, and not on the basis of the efficiency and effectiveness of the public sector business, and that the public sector function satisfies public needs and wider public interest.

The quality of public policies and their consistent application are of great importance given that the public sector, by its scale and structure, has a major impact on the overall economy with the volume of resources generated through the fiscal mechanism and the volume of resources allocated to the corporate public sector.

**Table 2. Pearson's correlation coefficient**

	Var1	Var2	Var3	Var4	Var5	Var6	Var7	Var8	Var9	Var10
Var1	1	0.816**	0.760**	0.756**	0.779**	0.681**	0.724**	0.703**	0.646**	0.742**
Var2	0.816**	1	0.942**	0.795**	0.868**	0.768**	0.806**	0.780**	0.741**	0.758**
Var3	0.760**	0.942**	1	0.713**	0.825**	0.738**	0.797**	0.818**	0.741**	0.742**
Var4	0.756**	0.795**	0.713**	1	0.921**	0.846**	0.919**	0.746**	0.634**	0.780**
Var5	0.779**	0.868**	0.825**	0.921**	1	0.882**	0.937**	0.812**	0.751**	0.856**
Var6	0.681**	0.768**	0.738**	0.846**	0.882**	1	0.917**	0.800**	0.701**	0.701**
Var7	0.724**	0.806**	0.797**	0.919**	0.937**	0.917**	1	0.848**	0.672**	0.747**
Var8	0.703**	0.780**	0.818**	0.746**	0.812**	0.800**	0.848**	1	0.709**	0.585**
Var9	0.646**	0.741**	0.741**	0.634**	0.751**	0.701**	0.672**	0.709**	1	0.651**
Var10	0.742**	0.758**	0.742**	0.780**	0.856**	0.701**	0.747**	0.585**	0.651**	1

**Note:** \*\*Correlation is significant at the 0.01 level (2-tailed). Var1 - Public policies are very important for one country; Var2 - Public policies are being adopted by the government; Var3 - The basic function of the public sector is to meet the public needs and the broader social interest; Var4 - Public policy influences the financial performance of public institutions; Var5 - Measures of public policy can influence the cost-effectiveness of public institutions; Var6 - Measures of public policy can influence the efficiency of public institutions; Var7 - Measures of public policy can influence the effectiveness of public institutions; Var8 - Good public policy affects the optimal allocation of public goods; Var9 - Measuring the performance of the public sector can put pressure on public institutions to make them more effective in implementing public policies; Var10 - Efficiency, effectiveness and cost-effectiveness of public institutions depends on the quantity and quality of the objectives met

Public policies need to solve problems that exist in a community. First of all, it should be mentioned that government brings public policy, and citizens can influence what public policy will be made. In democratic societies, every member of society has the right to judge public policies and directly participate in their creation.

Public Service Organization is an organization that does not distribute its surplus funds to owners or shareholders, but instead uses them to help pursue its goals. Examples of Public Service Organizations include charities and public arts organizations. Most governments and government agencies meet this definition, but in most countries they are considered a separate type of organization and not counted as Public Service Organizations (Martin II, 2011, pp.15-16).

The contribution of this research is reflected in the importance of the successful realization of public policies in order to encourage all the creators of public policies to conduct and monitor the public policies advocating.

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