

The New Pay System Requires Encouraging and Performance-oriented leaders: Experiences of performance related pay in three Finnish State Government Organizations

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Yeni Ücretleme Sistemi Teşvik Edici ve Performansa Yönelik Önderler Gerektirir: Finlandiya’da Üç Kamu Kurumunda Performansa Göre Ücretleme Deneyimi

Abstract

Performance related pay (PRP) intends to make the civil service perform better. It can foster individual motivation by recognizing efforts and achievements and rewarding them. PRP can help improve performance when it is applied properly in the right managerial context. In this article the PRP is viewed as a management tool. The leader is expected to facilitate change and adaptation for result-orientated culture, and to discuss about work performance and results. The leader should also create an improved employee-manager dialogue and a climate that supports organizational and individual learning. As a coach the supervisor helps subordinates constantly reaching better results.

Key Words : Performance Related Pay System, Leadership and Management Roles.

JEL Classification Codes : M59.

Özet

Performansa göre ücretleme (PGÜ), memurların daha iyi iş-başarımını göstermelerini amaçlamaktadır. Uygun yönetsel ortamda doğru uygulandığında, kişisel çaba ve başarıları tanıyarak ve ödüllendirerek performansın geliştirilmesine yardımcı olabilir. Bu çalışmada, PGÜ bir yönetsel araç olarak görülmektedir. Önderin, sonuçlara yönelik kültüre geçişte değişimi ve uyarlanmayı kolaylaştırması beklenmektedir. Ayrıca, önder iyi bir personel-yönetim diyalogu ile kurumsal ve bireysel öğrenmeyi destekleyen bir iklim oluşturmalıdır. Koçluk rolünü üstlenen bir yönetici, astlarının sürekli daha iyi sonuçlar almasına yardım eder.

Anahtar Sözcükler : Performansa Dayalı Ücret Sistemi, Önderlik ve Yönetici Roller.

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Beyan

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1. The Continuation of Managerial Reforms

The quest for a better, as well as smaller, government has led many countries to carry out major public sector reforms. As a management doctrine, New Public Management has had a broad influence on attitudes towards the development and reforms of Finnish public administration during the past twenty years. The modernization of the Finnish public sector has included strong efforts to improve the productivity of public service and to develop the management capabilities of higher level civil servants. This has meant challenges for those involved in the reforms. They must determine how best to build a successful government; one which is restricted, well-performing, transparent, and responsible for results. Due to these reforms, traditional governmental culture has partially changed to something which is nearer to managerial business culture. Or, at least the expectations for a modern civil servant are clearly different from earlier times. Today, he or she is expected to be innovative, performance-oriented, and service-minded. (Lähdesmäki, 2003)

Performance-related pay (PRP) is a natural continuation of managerial reforms in public administration. In Finland, the system is known more commonly as the New Pay System (referred to from this point as NPS). The formal name of the system is The State Employer's Salary and Wage Policy Programme. The development of performance-related pay in state administration began in 1992. It is mandatory for all organizations in the state government to implement NPS during 2006. The scope of NPS is wide and it encompasses all personnel in state-run organizations, all the way from secretarial staff to middle managers. Top managers are excluded from NPS. There is a certain management agreement and performance bonus system for senior civil servants. (OECD, 2005b; Ministry of Finance, 2007)

Performance-related pay intends to make the civil service perform better. The most important objective of the pay reform has been to improve employees' motivation and at the same time to increase productivity and performance. The new pay system can foster individual motivation by recognizing efforts and achievements and rewarding them. Performance reviews and the assessment of individual work performance is part of the system. Performance-related pay can help improve performance and promote organizational development when it is applied properly in the right managerial context. (Kiikka, 2002; OECD, 2005a.)

Productivity is one of the top priorities in the public sector at the moment. Van Wart and Berman emphasize that successful change requires good leadership and a new kind of leadership skills (Van Wart & Berman 1999: 340). In order to be effective in public service, individuals need capable leaders (Baroukh & Kleiner, 2002: 33–35).

In this article, NPS is viewed as a means for leadership. I will examine what kind of demands the New Pay System appoints for executives and superiors and what kind of leadership roles they create. The empirical data has been collected by interviewing leaders and superiors in three different state government organizations in Finland. These organizations are: Road Administration (Vaasa Regional Administrative Department), Seinäjoki District Police, and Vanha Vaasa Hospital. A starting point for the study is the assumption that in order to work appropriately, the New Pay System presumes skilful leadership.

2. The New Pay System

The aim of performance-related pay (PRP) is to make the public service perform better and more effectively. In the “old system” civil servants were given pay increases based on the length of service, regardless of how well they did their jobs. The three main elements of salaries and rewards in the New Pay System are: 1. Pay according to the demands of the job 2. Pay according to individual performance and 3. Result-based rewards (RBR) allocated at the team or unit level (bonuses). The first element of the pay relies on an *ex ante* evaluation of “anticipated” performance based on job demands while the others relies on *ex post* evaluation. (Valtion Työmarkkinalaitos, 1996; Valtiontalouden Tarkastusvirasto, 2002; OECD, 2005a, b) The system can also include some other supplements (depending on experience, working conditions etc. It is worth noting that organizations can tailor the pay system to fit in their own operations. However, the basic structure is common for all organizations.

PRP is being increasingly used in public administration. More than two-thirds of OECD countries have now introduced performance-related pay for at least part of their civil service. However, there is no single model of PRP across the board. The models are diverse and vary according to the nature of the civil service system and the pay determination system. Finland is one of the few countries which have an extended formalized PRP policy. (OECD, 2005b)

There are a number of reasons why governments have turned to performance-related pay. The main argument is that it can foster individual motivation, by recognizing effort and achievement and rewarding it in a concrete way. It is also seen as a signal of change for civil servants and as a way of indicating to citizens that performance is regularly assessed in public administration. (OECD, 2005a)

The adoption of performance-related pay in the public sector reflects the influence of the private sector culture of incentives and individual accountability on public administration. The renewal of the pay system is connected to Finnish governmental strategies to enhance the competitiveness of the public sector. (Äijälä, 2001; Lähdesmäki, 2003)

The development of managers and persons in positions of leadership is a central element of the general development of personnel management within public administration in Finland. It is closely linked to other areas of development, such as the development of values and ethical modes of action in public administration, as well as the development of work communities, personnel and rewarding systems. (Valtiovarainministeriö, 2006)

The implementation of the performance-related pay system has had a mixed reception in Finland. Top management has generally accepted it and is committed to its implementation. Employee organizations and unions have principally accepted the system. Employers in agencies feel that PRP is a very good incentive, as a tool for organizational development, for example. (OECD, 2005b).

According to the study (Lähdesmäki, 2006), the New Pay System is a welcome change. The interviewed representatives of the leaders and middle managers feel it to be very well suited to a modernized, performance-centered public administration. The best parts of the new system are that it supports productivity, and it also enhances more feedback and discussion about performance. For younger, skilful civil servants it has also brought an increased salary.

3. Motivational Factors in Work

The New Pay System has strong effects on the motivation of an employee. Money is not necessarily the crucial factor. Recently, there have been changes in employee attitudes and values toward work. Individual employees demand conditions tailored to the person. This applies to job content (especially the authority to make decisions and interest in the work opportunities for development), career opportunities, work scheduling and salaries (especially the possibility of connecting salary to qualifications and competencies). (Mäkipeska & Niemelä, 1999)

The nature of public service motivation (PSM) is one of the biggest questions in public management (Behn, 1995: 318–319; Brewer & Selden & Facer, 2000: 254.) According to Brewer, Selden and Facer (2000: 260–261) the motives for performing public service are mixed.

Public service can be defined as work being done for the public good (Baroukh & Kleiner, 2002: 29.) Public service motivation can be categorized as rational, norm-based, and affective. *Rational* motivation means, for example, that participation in the process of policy formulation can be exciting, dramatic, and reinforcing an individual's image of self importance. *Norm-based* motivation refers to a desire to serve the public interest. Commitment to a programme may emanate from a genuine conviction about its social importance (*affective motivation*). (Baroukh & Kleiner, 2002: 32–33.)

According to Baroukh and Kleiner (2002: 33–34) there are some potential behavioral implications of public service motivation:

1. The greater an individual's public service motivation, the more likely the individual will seek membership in a public organization.
2. In public organizations, public service motivation is positively related to individual performance.
3. Public organizations that attract members with high levels of public service motivation are likely to be less dependent on utilitarian incentives to manage individual performance effectively.

According to Moore and Heneghan (1996: 172–173) clearly defined performance requirements and performance measurement can effectively produce additional benefits. It will focus the attention of public employees on the performance of the things being measured. If the things being measured are also the high-value performance requirements of the organization, then public employees will focus their attention directly on producing the outcomes of high value to the public.

Superiors need to understand what motivates employees. Feedback about performance is a remarkable motivational factor. Every employee and every superior needs feedback on their work. It helps direct work contribution towards the desired goals and develops competencies further. If an employee feels that they get enough appreciation and support, it positively affects their working capacity. This kind of feedback culture is composed of openness, trust, respect for people, plentiful communication, and a tolerance of mistakes, seeing them as a possibility to grow. (Mäkipeska & Niemelä, 1999: 61; Sydänmaanlakka, 2001: 63)

The pressure to work effectively and produce good services with fewer resources has proliferated. Employees are often encumbered with customers' demands. Despite this, I do not regard performance-related pay as a threat for public service motivation. More so, it can be a possibility to perfect and develop capabilities and know-how, assess success and work performance, receive feedback, and, most of all, to lead better.

Brewer, Selden and Facer (2000: 261–262) point out a very interesting question. According to them, individuals who are strongly motivated to perform public service may be difficult to manage. Such individuals feel a primary responsibility to the people they serve and to the nation, and a lesser responsibility to public managers and policymakers. Therefore, policymakers and public managers have to make bureaucracy more democratic by relaxing rigid bureaucratic structures, including employees in decision making processes, and trying to forge and maintain a broad consensus on what is in the public interest. In the end, this might not be very problematic, because development discussions

offer the opportunity to change ideas about the mission and goals of the organization and the employees' proportion in this task (Lähdesmäki, 2006).

4. Has Good Leadership The Answer?

As Hondeghe and Vandermeulen (2000: 351) state:

“Public managers should not only be experts in the policy field, but should have management and leadership skills and capacities. This implies a change in the organizational culture.”

With the term “leader” I refer to any person who has subordinates at any level of the organization. Leaders depend on followers to do the work. Leaders have to get work done and work through people. Therefore, it follows that training, motivation, maturation, continued development, and overall satisfaction are critical to production and organizational effectiveness. Like Dickson (1995: 10) notes, “Leadership is not just a matter of leading others”. Leadership is the ability to identify organizational needs, to introduce new ideas that satisfy those needs, to define the strategic direction, and to gain a shared commitment to the success of the change initiative.

There are different ways to understand what leadership could be in a public administration context. The key element to administrative leadership is its service focus. Administrative leaders need to be responsive; open, aware of competing interests, and dedicated to the common good, so that they can create a sense of public trust for their stewardship roles. (Van Wart, 2003.) Most employees expect that good leadership includes a culture characterized by co-operative leadership, open communication and co-operation.

The term “public leadership” refers to special characteristics and demands which are typical for leadership in the public sector context. Ingraham, Coleman Selden and Moynihan (2000) have developed some “theses” about the challenges of public leadership. They are: 1) Valuing people; 2) Performance is the Driver; 3) Leaders are the Glue.

Ingraham and others (2000) argue that the notion of people as resources of government must be valued more highly and developed more carefully than current practice allows. Employees are not only a cost, but a critical investment to be carefully developed and managed. In the past, New Public Management reforms might have treated civil servants as cost factors which have to be cut down.

In linking rewards to performance, public organizations give a signal to employees to make work contribution more effective. Employees must accept a new set of responsibilities as well. If they are to be viewed and rewarded as an investment, they must

commit to provide a measurable return for that investment. (Ingraham, Coleman Selden & Moynihan, 2000)

Further, these researchers impress that public work has to be valuable, challenging, and a contribution to effective government. Performance is even becoming a way of life and a critical part of the culture of public organizations. (Ingraham et al., 2000). The performance related pay system is an attempt to go in that direction. However, the desired change will not happen in a trice. According to the interviewed leaders, most employees are enthusiastic about the performance related pay and act energetically to fulfill the performance targets and development purposes. Especially younger experts experience it as a welcomed renewal. (Lähdesmäki, 2006)

The responsibility of leaders for the performance of their employees and their organizations has to be recognized. Leaders are part of an organization culture and its reward structure. They are in a key position to define and clarify the goals and objectives of the organization. (Ingraham et al., 2000) When performance-related pay schemes have a strong focus on goal-setting and organizational objectives it can provide a vehicle through which managers can communicate the new set of objectives to employees.

One of the “big questions” in public management according to Behn (1995) is how public managers can motivate public employees to work energetically and intelligently towards achieving public purposes. He sees that the responsibility of the public manager is not only to understand the behavior of public agencies but also to improve the performance of these agencies.

There is a window of opportunity for wider management and organizational changes along with the performance-related pay system. These include effective appraisal and goal setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue and more team work. (Lahti, Tarumo & Vartiainen, 2004; OECD, 2005a, b)

In his study Kiiikka¹ (2002) posited that performance-related pay is an excellent tool in keeping up and improving employees’ motivation and those who use these “tools” (i.e. executives and superiors in public administration) are in a crucial position. However, the motivating effect of the performance-related pay system is connected to the whole system and the overall motivating effect of its parts, not merely the motivating effect of the money. According to the study, performance-related pay has not improved motivation as expected in these organizations. The reasons for this are that the employees did not receive enough information about the pay system and they did not have a clear enough vision of the performance objectives, and the yearly employer-employee discussions lacked

¹ *The empirical material of his research has been collected by a survey in the Kuopio Police Department and the Jaeger Brigade.*

intensity. (Kiiikka, 2002) It is important that employees feel that they are treated fairly and objectively when they are assessed. It has a very strong connection to work motivation. (Lahti, Tarumo & Vartiainen, 2004: 12–14)

The Public Service approach holds that systems of productivity improvement and performance measurement are seen as important tools in designing management systems, but that such rational attempts to control human behavior are likely to fail in the long term if, at the same time, insufficient attention is paid to the values and interests of the individual members of an organization. Those “softer” values and leadership are needed to build responsible, engaged and civic-minded employees. According to the Denhardts: “If public servants are expected to treat citizens with respect, they must be treated with respect by those who manage public agencies.” (Denhardt & Denhardt, 2000). In an environment where employees are valued and their thinking is encouraged, most people will contribute their loyalty, commitment and enthusiasm (Management Development Review 4/1997).

5. Development Discussions as a Forum to Consider Performance and Create Prerequisites for Success

Performance reviews and assessment of individual work performance are part of the New Pay System. It becomes easier to give feedback if both of the parties involved know what is expected or required. For that reason, duties and development plans are agreed upon in these performance reviews.

The aims set for performance reviews and assessments of individual work performance are to:

- encourage discussion and interaction within the unit,
- improve the correspondence between duties and performance, and pay,
- help employees to improve their competence,
- support employees in seeking more demanding work,
- improve the atmosphere at work and employee well being.

The performance reviews and assessment of individual work performance are usually carried out once a year. Supervisors have a huge responsibility to hold performance reviews with their subordinates.

Performance rating systems rely more on assessing pre-identified objectives and dialogue with line management than on strictly quantifiable indicators or standard criteria for a job. There is a slight chance that performance-related pay might add to pressures for

short-term results. Employees can end up looking after their own interests rather than working to see that the group as a whole succeeds. (Management Development Review 4/1997)

The general principle is that assessment of individual work performance is based on the skills and knowledge required for the job. The various separate criteria may have a different emphasis in regard to different jobs, and their content may vary. These criteria can be: competencies and technical skills, quantity and quality of work results, implementation of agreed upon tasks, sense of responsibility, interpersonal skills and teamwork and development potential (attitude to new assignments, self-improvement, participate in workplace development). (Lahti, Tarumo & Vartiainen, 2004; Lähdesmäki, 2006)

Development potential primarily assesses innovativeness and activity in developing work and assignments, and ways in which an individual strives to contribute to helping the group and unit function better. It also means assessing the person's attitude to new assignments. Is he or she prepared to accept new assignments and how easy is it to learn new things? Development potential also comprises self-improvement. Does the employee maintain her or his occupational skills and employment potential?

The criteria for assessing managers' performance are additionally leadership and management skills. Managerial and leadership skills are emphasized in the training of senior civil servants.

6. Experiences from a Police Office, a State Mental Hospital and a Road Administration

Performance-related pay system is considered a prospective reform in these organizations. It improves the pursuit of productivity and especially remunerates younger experts. The leaders emphasize development discussions and ethical appraisals of work performance. The new system enables a discussion of outcomes, an opportunity to give feedback and a venue to consider ways to improve expertise and performance.

There are some novel roles and duties which a leader is required to adopt. According to the study (Lähdesmäki, 2006) these roles are: reformer, booster, trend-setter, facilitator, and coach. Table 1 describes the leadership roles and their contents adapted in the New Pay System and considered by the interviewees.

Table: 1
Leadership Roles in a Performance-related Pay System

Reformer

- Is an agent for the new performance culture
- Takes the lead
- Creates readiness for change

Booster

- Clarifies and communicates the basic tasks of the organization
- Sets goals for the intended performance and assets results
- Discusses accomplishments and targets

Trendsetter

- Provides and mediates information
- Assures needed resources
- Acts as a spokesman

Facilitator

- Supports organizational learning processes
- Nourishes ethical ways of action
- Commits and helps others to commit to the goals of the organization

Coach

- Spurs one on to reach better results
- Encourages employees to acquire competencies
- Acts as effectively and dynamically as possible

Source: Lähdesmäki, 2006: 91.

Managers see themselves as key leaders of this transformation. A **reformer** is expected to facilitate change and adaptation for a result-orientated culture. Leaders also lead by their own example. To be credible leaders they have to learn and develop their capabilities constantly. It is important that leaders commit themselves to the changes and developments they agree upon with their subordinates. The leader is expected to be a positive force for change and to be able to convince others that the reform is necessary and desirable. He or she demonstrates “player”, not “victim” behavior. (Lähdesmäki, 2006; Quinn etc., 2002; Viitala, 2005)

A manager might have a difficult dilemma sometimes, as they need to adjust to reforms that may not be welcome, and at the same time they must present the change to the employees in a manner that helps them to make the adjustment as well. (Quinn etc., 2002: 239.) That is a challenge which some of the interviewees pointed out when they talked about the New Pay System. It also means a conscious effort to eliminate psychological resistance to change.

Providing and distributing information is the basic duty for a leader as a **trend-setter**. He or she is willing to work out a decision which fulfills both sides. It is important that the leader is aware of all the facts related to the pay system and he or she keeps subordinates in touch. **The booster** emphasizes performance targets and notices progress. He or she is expected to be task-oriented and work focused and to have high interest, motivation, and personal drive for his/her own work and also to maintain high personal productivity. (Quinn etc., 2002: 16). The booster communicates information about merit and performance to a higher degree and more often than prevalent usage has permitted. He/she is result-oriented because of a sense of personal mission. Many of the interviewees judged this role as the most important duty of a leader in a modern public administration.

The facilitator is able to create improved development discussions (between employer and employee) and a climate that supports organizational and individual learning. An important part of this dimension is how the leader tries to clarify the needs for knowledge and capabilities needed in the future. It is necessary that leaders should manifest the importance of continual learning and recognize the progress and give positive feedback. These aspects have something to do with an individual's motivation for learning and sense of ability to learn. The leader's challenge is to strengthen them. (Viitala, 2005) During the development discussion both the supervisor and the employee talk through performance, competencies and needs to improve them. Interviewees emphasized that the supervisor is obligated to give an example on how to qualify oneself. Public managers play an essential role in promoting good ethical behavior and in initiating ethical discussions within their organizations (Salminen, 2003).

It is expected that ethical leaders will treat their employees fairly. Followers' perceptions of being treated fairly should affect both their job attitudes, such as satisfaction and commitment, and organizational outcomes. (Zhu, May & Avolio, 2004: 17)

A manager is anticipated to build commitment, identity, pride, and spirit in the organization. He or she must also stimulate an interest in work and develop the capabilities in his or her subordinates. (Boyatzis, 1992: 265)

According to Quinn and others (2002) a mentor (here, a facilitator) is engaged in the development of people through caring. In acting out this role, the manager gives compliments and credit, and helps with skill building, provides training opportunities and plans for an employee's individual development.

As a **coach**, the supervisor helps subordinates constantly reach better results. He or she looks at and treats employees as an important human resource and takes care of their comprehensive welfare. It is also important that the leader creates an environment for others to excel and in which people are proud to work. (E.g. Viitala, 2005)

7. Conclusions

Performance-orientation has become one of the major criteria for measuring civil service. Results can be expected to grow in a work community where employees are treated and managed fairly and supportively. The development discussion is a forum to debate and agree about performance and development targets and examine progress made. Feedback is very useful for employees and many of them would like to receive more of it. In addition to increased productivity, the performance-related pay system also encourages an improvement in leadership. With this article I try to review the demands of the New Pay System for leadership. The superior must adopt new kinds of leadership roles in assessing and guiding subordinates to work and be motivated to advance the targets. The leaders and managers that I interviewed in three different state government organizations impressed that the performance related pay system is a very welcome renewal. However, it takes time to follow through the reforms. They are aware of their positions and act enthusiastically, trying to encourage employees to do their best.

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