Process of MBO

MBO is a system for achieving organizational objectives, enhancement of employee commitment and participation. Therefore, its process should facilitate translation of basic concepts into management practice. The MBO process is characterized by the emphasis on the rigorous analysis, the clarity and balance of objectives, and the participation of the managers with accountability for results. The MBO process is not as simple as it appears to be. Managers need training and experience for developing the required skills. The process has many nuances which can be understood from Figure 6.3 and its explanation.

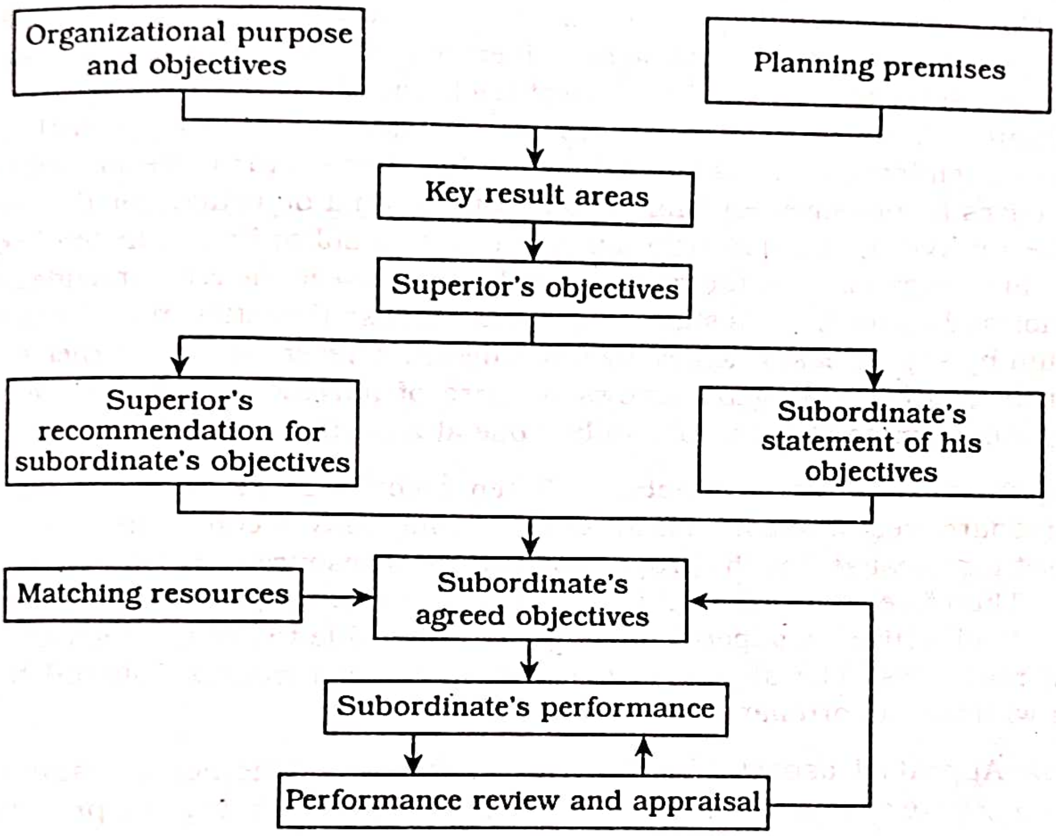

FIGURE 6.3: Process of MBO

1. **Setting of Organizational Purpose and Objectives.** The first basic step in MBO is the definition of organizational purpose and objectives. Questions, such as, "why does the organization exist?" "what business are we in?" and "what should be our business?" provide guidelines for the statement of purpose. This, in interaction with external factors, then determines the long-range strategic objectives like (*i*) whether to achieve growth through expansion in the same line of business or diversify; (*ii*) what should be blending of trading and manufacturing activities; (*iii*) what should be the degree of vertical integration; and so on. Usually, the objective setting starts at the top level of the organization and moves downward to the lowest managerial level. This goes in a sequence like this (*i*) defining the purpose of the organization; (*ii*) long-range and strategic objectives; (*iii*) short-term organizational objectives; (*iv*) divisional/departmental/sectional objectives; and (*v*) individual manager's objectives.

2. **Key Result Areas.** Organizational objectives and planning premises together provide the basis for the identification of key result areas (KRAs). Key result areas, also known as key

performance areas, are those aspects of an organization or any of its unit that must function effectively for the organization or unit to succeed. These areas usually involve major organizational activities or group of related activities that occur throughout the organization or unit, for example, product quality, cost, sales volume, distribution network, cash flows, etc. Even though KRAs are most durable, the list of KRAs gets considerably changed over the period in response to new needs and opportunities. Sometimes, the achievement in a particular KRA also provides the impetus for a new KRA in future.

3. Setting Subordinates' Objectives. The organizational objectives are achieved through individuals. Therefore, each individual manager must know in advance what he is expected to achieve. Every manager in the managerial hierarchy is both superior and subordinate except the person at the top level and the lowest level. Therefore, there is a series of superior and subordinate relationships. The process of objective setting begins with superior's proposed recommendations for his subordinate's objectives. In turn, the subordinate states his own objectives as perceived by him. Thereafter, the final objectives for the subordinate are set by the mutual negotiation between superior and subordinate. In the beginning of MBO process in an organization, there may be wide gap between the recommended objectives by the superior and subordinate's stated objectives because the latter may like to put lesser burden on him by setting easily achievable objectives. However, with the experience gained over the period of time, this gap narrows because of narrowing down of perception of superior and subordinate about what can bé done at a particular level.

4. Matching Resources with Objectives. When objectives are set carefully, they also indicate the resource requirement. In fact, resource availability becomes an important aspect of objective setting because it is the proper application of resources which ensures objective achievement. Therefore, there should be matching between objectives and resources. By relating these to objectives, a superior manager is better able to see the need and economy of allocating resources. The allocation and movement of resources should be done in consultation with the subordinate manager.

5. Appraisal. Appraisal aspect of MBO tries to measure whether the subordinate is achieving his objective or not. If not, what are the problems and how these problems can be overcome. Appraisal is undertaken as an on-going process with a view to find out deficiency in the working and also to remove it promptly. It is not taken merely to punish the non-performer or to reward the performer. It is taken as a matter of system to ensure that everything is going as planned and the organization is able to achieve its objectives.

6. Process Continuity. Though appraisal is the last aspect of MBO process, it is used as an input for process continuity. Objectives are neither set at the top and communicated to the bottom, nor are they set at the bottom and go up. Objective setting is a joint process through interaction between superior and subordinate. Therefore, what happens at each level may affect other levels also. The outcome of appraisal at one level is used to see if the objectives have been set properly at the level concerned and also at the next higher level. This can be presented in Figure 6.4.

The three aspects involved in process continuity include setting of objectives at various levels, action planning in the context of those objectives, and performance review. Each of these aspects gives basis for others. For example, objectives give basis for action planning which, in turn, gives basis for performance review, and performance review gives basis for objective setting and action planning. This process goes on a continuous basis.

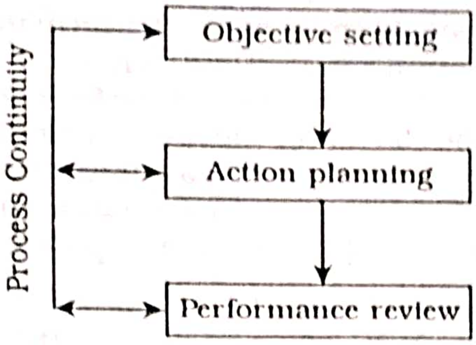

FIGURE 6.4: Process continuity aspect of MBO

Benefits of MBO

The experience of many organizations suggests that when used as an approach to management, MBO has a wide range of benefits. For example, Beck and Hillmar have given as much as thirty-five reasons why MBO is a better and effective concept for managing an organization.[8] This is possible because MBO can be applied in several aspects of organizational activities like performance appraisal, organizational development, long-range planning, integration of individual and organizational objectives and so on. Therefore, the benefits of MBO can be seen in the following terms:

1. Better Managing. MBO helps in better managing the organizational resources and activities. Resources and activities are put in such a way that they result in better performance. There are five basic assumptions about what improves performance. These are (*i*) clarity of objectives, (*ii*) role clarity, (*iii*) periodic feedback of performance, (*iv*) participation by managers in the management process, and (*v*) realization that there is always scope for improvement of performance in every situation. Taking these assumptions, MBO tries to improve performance in five ways:

(*i*) The relationship between clarity of objectives and improvement of performance is cornerstone of MBO philosophy. People do better when they know what exactly they have to do because they can focus their attention exactly at where it is required. Further, objectives aid in planning and facilitate evaluation and control, resulting in corrective action.

(*ii*) Clarity of roles, including the areas of authority and responsibility, leads to improved performance. The clarity of roles helps a manager to appreciate his own contributions as well as the contributions of others who are directly related to him. This facilitates increased cooperation on both vertical and lateral levels and help in avoiding unnecessary friction. Role clarity is achieved much better by MBO.

(*iii*) Periodic review helps in better performance by giving feedback about one's action and its results. Existence of objectives without a system of review of performance is useless. Periodic review provides opportunities for taking stock of the situation and planning future course of action. Periodic review of performance is an integral part of MBO.

(*iv*) Participation in MBO process is expected to ensure achievement of objectives. Participation elicits commitment of people and motivates them. They have a sense of feeling that they are achieving their own objectives. This commitment enhances the chances of getting better performance.

(*v*) MBO provides a base for the philosophy that there is always scope for improved performance. This feeling is provided by MBO because objectives are evaluated very frequently and managers become keen for setting performance at higher level because of their motivation and commitment. However, it is not suggested that the performance must improve in the same terms. Performance is multi-dimensional and improvement can take place on one or more dimensions, while other dimensions may remain constant. Thus, performance can improve in four different ways: decreased time, decreased resources, increased quality, and increased quantity. All these factors for performance improvement are generated if MBO is followed properly.

2. Clarity in Organizational Action. MBO tends to provide the key result areas (KRAs) where organizational efforts are needed. Since organizational objectives are defined very clearly, they help in relating the organization with its environment. A key factor in objective setting is the external environment in which the organization operates. Therefore, any change in environmental factors is taken care of at the level of objective setting itself. Thus, it provides basis for long-range planning in the organization. The organization can look forward to what it intends to do in future, in short run as well as in the long run. Besides the external factors, internal factors can also be taken suitably, while formulating plans as all internal factors are made explicit in terms of what the organization can do, where it lacks, and how this gap can be overcome. All these factors lead to define the organization properly in the environmental context as well as in the context of its various competitors.

3. Personnel Satisfaction. MBO provides greatest opportunity for personnel satisfaction. This is possible because of two closely related phenomena: participation in objective setting and rational performance appraisal. When the individuals are involved in objective setting, they derive satisfaction because of the feeling that they are important to the organization. They enjoy considerable authority which is a source of inspiration for better performance. Besides these, they are very sure that their performance will be measured in terms of their actual performance and will not be affected by managerial prejudices, biases, and other personal factors. When performance appraisal is based on some specified criteria with commensurate rewards leaving least scope of personal factors, there is no unnecessary politicking of activities. In fact, in many organizations, people do not perform to the level of their potential because of absence of these positive factors and often there is high rate of managerial turnover.

4. Basis for Organizational Change. MBO stimulates organizational change and provides a framework and guidelines for planned change, enabling the top management to initiate, plan, direct, and control the direction and speed of change. In any organization, change is required because of change in external factors or in internal factors or changes taking place in both the factors simultaneously. Therefore, to cope up with the change, the organization has to change itself appropriately. However, this change is not automatic but requires efforts on the part of the managers, particularly at the top level. A very difficult problem comes in the way of organizational change because people resist it. If MBO is applied, the change process becomes easier because there is lesser amount of resistance to change as people become more innovative and dynamic and changes can be incorporated very easily as compared to rigid system of objective setting and performance evaluation by the superior alone.

Problems and Limitations of MBO

MBO is not without its problems and weaknesses. MBO is, generally, taken as panacea for all problems or magic wand which can deliver everything. On the contrary, many organizations have been overwhelmed by the problems of MBO and have failed to derive the expected results. Some of the problems are inherent in MBO system itself while others emerge because of wrong implementation. Each organization is likely to encounter specific problems in MBO practice but some of the common problems are given here:

1. **Time and Cost.** MBO is not as simple as it looks to be. It is a process which requires large amount of the most scarce element in the organization—time of the senior managers. This is particularly so at the initial stages when MBO is seen as something over and above the normal work. Sometimes, managers get frustrated and feel overburdened. Further, MBO generates paper work because large number of forms are to be designed and put into practice. Therefore, there is a problem of communication overload. However, such problems are transitory and emerge only at the initial stages. Once MBO becomes a part of the organizational life, these problems disappear.

2. **Failure to Teach MBO Philosophy.** MBO is a philosophy of managing an organization in a new way. However, managers fail to understand and appreciate this new approach. They have a number of doubts about MBO like what purpose is served by MBO, how the performance is to be appraised, and how organization will benefit. MBO demands rigorous analysis as an integral element of the management process but the organization may not be used to such a rigour. Frequently, both the base data and the expertise for analysis are not available. If corrective action is not taken early, the objectives become imprecise, control information may not be available, and one would not know if something was achieved. This is done on a systematic basis and managers seldom appreciate this. They take MBO as another tool for control. Moreover, their old way of thinking puts difficulty in introducing MBO because they may not appreciate the full view of MBO.

3. **Problems in Objective Setting.** MBO requires verifiable objectives against which performance can be measured. However, setting such objectives is difficult at least in some areas. Objectives are more in the form of statement rather than in quantitative form. Of course, some objectives can be quantified and can be broken in terms of time period but others lack this characteristic for further course of action.

4. **Emphasis on Short-term Objectives.** Sometimes, in order to be more precise, there is a tendency to emphasize short-term objectives usually for a year on even less. No doubt, this may help in performance appraisal but there is always a danger in emphasizing short-term objectives at the cost of long-term objectives. Sometimes, an organization's short-term and long-term objectives may be incompatible because of certain specific problems.

5. **Inflexibility.** MBO represents the danger of inflexibility in the organization, particularly when the objectives need to be changed. In a dynamic environment, a particular objective may not be valid for ever. In the context of revised objectives, changed premises, or modified policies, it is useless to follow the old objectives. However, many managers often hesitate to change objectives during a period of time. Thus, inflexibility created by applying MBO may cause more harm than what it may contribute.

6. **Frustration.** Sometimes, MBO creates frustration among managers. This frustration may be because of two reasons: *First*, as experience shows, many organizations could not implement MBO properly, resulting in utter chaos. In this case, the organization is not able even to work with its old system. *Second*, introduction of MBO tends to arouse high expectation for rapid change, particularly among the young and junior managers. They begin to see the vision of a new world for their organization in terms of growth, profitability,

each project keeping in view savings, sales, or profit potentialities. Research and development being a highly technical activity is also controlled indirectly. This is done by improving the ability and judgement of the research staff through training programmes and other devices.

11. Control over Foreign Operations. Foreign operations are controlled in the same way as domestic ones. The tools and techniques applied are the same. The only difference is that the chief executive of foreign operations has relatively greater amount of authority.

12. Control over External Relations. External relations are regulated by the public relations department. This department may prescribe certain measures to be followed by other departments while dealing with external parties.

13. Overall Control. Control over each segment of the organization contributes to overall organizational control. However, some special measures are devised to exercise overall control. This is done through budgetary control, projected profit and loss account and balance sheet. A master budget is prepared by integrating and coordinating budgets prepared by each segment. The budget committee reviews such budget. This budget acts as an instrument for overall control. Profit and loss account and balance sheet are also used to measure the overall results.

Controlling and Management by Exception

One of the most important ways of tailoring controls for efficiency and effectiveness is to make sure that they are designed to point out exception. In other words, by concentrating on exceptions from planned performance, controls based on the time-honoured exception principle allow managers to detect those places where their attention is required and should be given. This implies the use of management by exception particularly in controlling aspect. Management by exception is a system of identification and communication that signals to the manager when his attention is needed. From this point of view, management by exception can be used in other management processes also though its primary focus revolves around controlling.

Management by exception has six basic ingredients: measurement, projection, selection, observation, comparison, and decision making.

1. Measurement assigns values to past and present performances. This is necessary because without measurement of some kind, it would be impossible to identify an exception.
2. Projection analyses those measurements that are meaningful to organizational objectives and extends them into future expectations.
3. Selection involves the criteria which management will use to follow progress towards organizational objectives.
4. Observation stage of management by exception involves measurement of current performance so that managers are aware of the current state of affairs in the organization.
5. Comparison stage makes comparison of actual and planned performance and identifies the exceptiions that require attention and reports the variances to management.
6. Decision making prescribes the action that must be taken in order to bring performance back into control, to adjust expectations to reflect changing conditions, or to exploit opportunity.

Thus, it can be observed that management by exception is inseparable from other management essentials in many ways. However, the major difference lies in the fact that the superior's attention is drawn only in the case of exceptional differences between planned performance and actual performance. In other cases, decisions are taken by subordinate manager. However, what is exceptional requires the completion of whole process.

BENEFITS OF MANAGEMENT BY EXCEPTION

There are various areas where precepts of management by exception are used such as statistical control of product quality, economic order quantities and order points for control of inventories and supplies, break-even points for determining operating levels, trends in ratios of indirect to direct labour used in apportioning overhead, attitude surveys for gauging employee morale, etc. The use of management by exception is prevalent because of the following factors:

1. Management by exception saves executives' time because they apply themselves on fewer problems which are important. Other details of the problems are left to subordinates.
2. It concentrates executives' efforts on major problems. Instead of spreading managerial attention across all sorts of problems, it is placed selectively where and when it is needed. Thus, it ensures better utilization of managerial talents.
3. It facilitates better delegation of authority, increases span of management and consequently provides better opportunities for self-motivated personnel in the organization. It lessens the frequency of decisions at the higher levels of management which can concentrate on strategic management rather than engaging themselves in operational management.
4. Management by exception makes better use of knowledge of trends, history, and available business data. It forces managers to review past history and to study related business data because these are the foundations upon which standards are derived and from which exceptions are noted.
5. It identifies crises and critical problems and thus avoids uninformed, impulsive pushing of the panic button. It helps in identification of crises because the moment any exceptional deviation occurs, the attention of higher-level managers is drawn. In this way, it also alerts management to appraise opportunities as well as difficulties.
6. Management by exception provides qualitative and quantitative yardsticks for judging situations and people. Thus, it helps in performance appraisal by providing more objective criteria and provides better motivation to people in the organization.
7. It enhances the degree of communication between different segments of an organization. With its focus on results, it seeks to relate causes, regardless of their place in the organization, with overall organizational results. As such, it encourages exchange of information between functions and also between a function and cost centre or profit centre to which it reports. Degree of communication determines the organizational cohesiveness and leads it to achievement of objectives.