

Management by Objectives

Management by objectives (MBO), or management by results (MBR), has drawn considerable attention of both academicians as well as practitioners because of two reasons. *First*, it focuses sharply on the objectives or results which a manager is expected to achieve within a specified period. *Second*, it emphasizes participative management, an approach which provides high motivation to individuals in an organization. The term MBO was coined by Peter Drucker in 1954 when he emphasized the concept of managing by objectives.⁶ Since then, many organizations, both business and non-business, have adopted this in some form or the other. Though there are some variations in the practices of MBO and, therefore, its definitional aspects, MBO is defined as follows:

MBO is a comprehensive managerial system that integrates key managerial activities in a systematic manner, directed towards the efficient and effective achievement of organizational objectives.

The integration of individual and organizational objectives through MBO has been emphasized by Chakraborty when he has defined MBO as follows:

"MBO is a result-centred, non-specialist, operational managerial process for the effective utilization of material, physical, and human resources of the organization by integrating the individual with the organization and organization with the environment."⁷

Based on the definition of MBO, its features can be identified as follows:

1. MBO is an approach and philosophy to management and not merely a technique. A management technique can be applied in selected parts of the organization and will have limited implications for its other parts. For example, various control techniques like standard costing, inventory control, etc. have their implications in their respective fields and they have very remote effect on other elements of the organizational processes like recruitment and selection process, promotion, etc. On the other hand, MBO is likely to affect every management practice in the organization. MBO employs several techniques but it is not merely the sum-total of all these techniques. It is a particular way of thinking about management.
2. As an approach to management, with objective orientation as its essence, MBO is bound to have some relationship with every management technique. Certain degree of overlapping is there. In fact, often MBO provides the stimulus for the introduction of new techniques of management and enhances the relevance and utility of the existing ones. MBO is the joint application of a number of principles and techniques. It works as an integrating device.
3. The basic emphasis of MBO is on objectives. Whereas the various techniques of management help in measurement of results in terms of resource utilization, MBO is also concerned with determining what these results and resources should be. This is possible because MBO tries to match objectives and resources. Objectives are established organization-wide and provide the means for integrating the organization with its environment, its subsystems and people.
4. The MBO is characterized by the participation of concerned managers in objective setting and performance reviews. Therefore, each manager takes active part in setting objectives for himself and also in evaluating his performance about how he is performing. The total management process revolves around the objectives set jointly by the superior and the subordinate. Therefore, managers have the opportunities for clarifying their job relationships with peers, superiors, and subordinates. This process clarifies the role very sharply in terms of what one is expected to achieve.
5. Periodic review of performance is an important feature of MBO. The performance review is held regularly, normally once a year. It emphasizes initiative and active role by the manager who is responsible for achieving objectives. The review is future-oriented because it provides basis for planning and corrective actions.
6. Objectives in MBO provide guidelines for appropriate system and procedures. Resource allocation, delegation of authority, etc. are determined on the basis of objectives. Similarly, reward and punishment system is attached with the achievement of the objectives.

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.

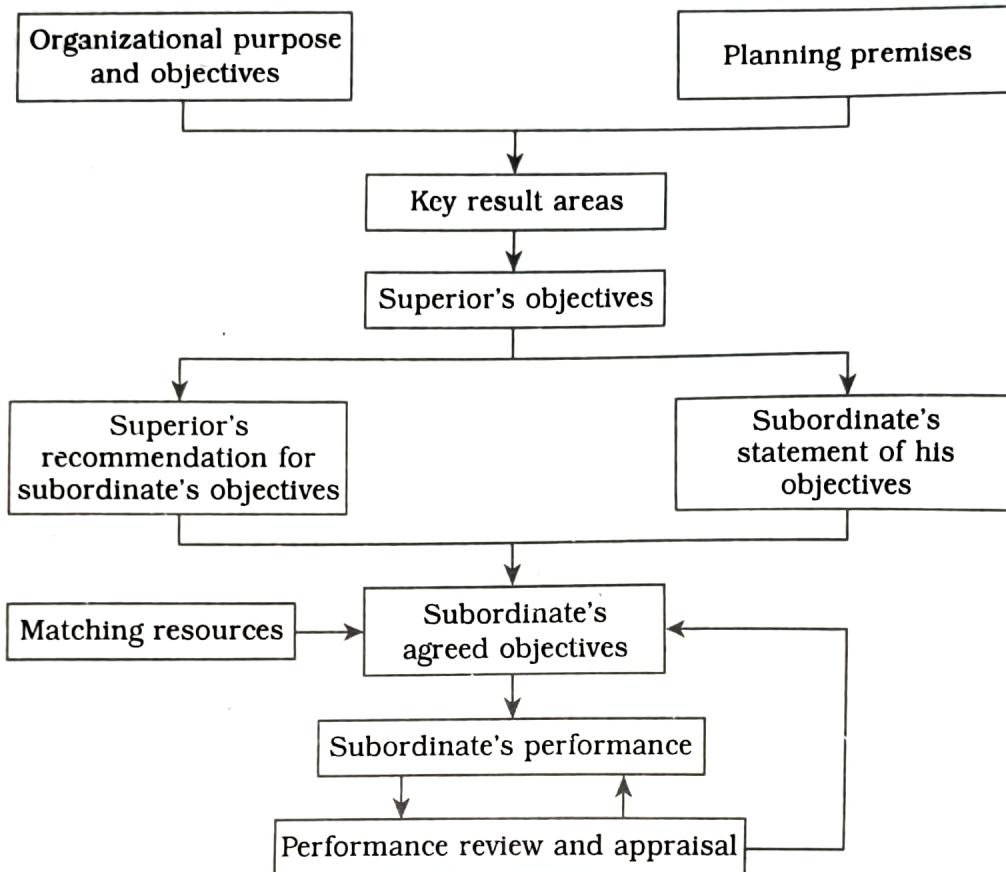


FIGURE 6.3: Process of MBO

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 be 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 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.

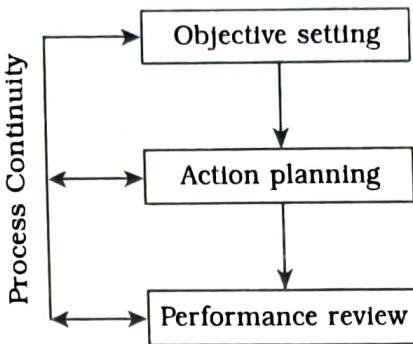


FIGURE 6.4: Process continuity aspect of MBO

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 Hilimar 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 or 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,

and for themselves in terms of career advancement. If the rate of change is slower than expected due to any reason, managers begin to feel frustration and even disenchantment with MBO.

In spite of these obstacles and problems in MBO, it continues to be a way of managing the organization. In fact many of the problems and weaknesses of MBO can be overcome by implementing it properly.

Prerequisites for Installing MBO

MBO is a philosophy, rather than mere a technique. As such, its installation requires a basic change in the organizational culture and environment. Many of the organizations could not use MBO successfully because of the lack of appreciation of this fact. Many of the organizations are designed so as to undermine the MBO philosophy. This is because they could not create the proper environment required for the adoption of MBO. Stated below are some of the prerequisites and problems contained therein for installing the MBO:

1. Purpose of MBO. MBO is a means rather than an end. It has to achieve certain things in the organization; it has to solve some problems. Thus, the organization should be very clear about the purpose for which it is being implemented. There are three basic purposes of MBO: management appraisal and development, improvement of the productivity and profitability, and long-range planning. Thus, an organization facing serious competition, both in its product and factor markets and is in the grip of secular decline, will tend to use MBO primarily for immediate improvements in productivity and profitability. On the other hand, an economically affluent organization might contemplate using MBO to change its management style so that it conforms to a more advanced and germane model of man-in-the-organization. In both these cases, the details and emphases of the system will vary. Thus, if the purpose of MBO is not precisely defined and particular techniques in MBO suitable to the purpose are not emphasized, there is every possibility that MBO does not produce the results as anticipated.

2. Top Management Support. The presence or absence of top management support is a critical factor in determining the degree to which an MBO programme will be successful. Many studies on MBO suggest that out of the several factors determining the success or failure of MBO, no single factor had greater correlation than the subordinate's perception of superior's attitude toward MBO. Thus, subordinates who can see their superiors as having a positive approach towards MBO are themselves likely to show a positive attitude. MBO is a year. Vigorous involvement of the top management is essential and this must be seen and perceived as such throughout the organization.

3. Training for MBO. Another critical factor in implementing MBO is the existence of some type of training programme for people who will be operating under it. Systematic training is required in the organization for disseminating the concepts and philosophy underlying MBO. The training should start with the concepts, philosophy, and need for MBO. Another type of training, a major one in MBO programme, should be in the area of intragroup, intergroup, and interpersonal relationships because MBO entails a lot of such elements. Educational components of OD (Organization Development) are quite useful for MBO. Thus, training sequence may be structural change-behavioural change. An alternative sequence may be structural change-behavioural change-attitude change. MBO is an effective method for bringing about organizational changes in its structural aspects. Such changes may cause

behavioural changes because of the new configuration of authority-responsibility relationship. The basis for super-subordination interaction in MBO system may require that both superior and subordinate change their behaviour to adjust themselves in the new role requirements.

4. Participation. MBO requires continuous participation between superiors and subordinates. This can be done by adopting participative management. A change to participative management involves the establishment of a situation in which people are active rather than passive, responsible rather than irresponsible, and basically more independent than dependent. In evaluating whether participation will work or not, following questions should be asked:

- (i) Has the type of participation required been carefully thought out?
- (ii) Does higher management really mean to share certain managerial prerogatives that supposedly go with their rank?
- (iii) Is participation perceived as a trap by subordinates?
- (iv) Have subordinates the right skills and knowledge in order to shed their defences and participate meaningfully?

5. Feedback for Self-direction and Self-control. One of the strong points in MBO is that in this system, a person can direct and control his own performance. For such a purpose, the person, who has performance objectives and knows how well he is achieving them, should know 'where he stands' and 'where he is going' so that he can make necessary adjustments to achieve the desired results on his own. As such, feedback is necessary. Feedback is an essential ingredient in sustained learning and improvement in situations. By feedback, here, is not meant merely the regular supply of control information to each manager. The interpersonal aspect of feedback is equally important. Feedback under MBO should take two forms. *First*, the individual should get periodic reports on where he stands on an overall performance basis. This is required specially when the subordinate requires help from the superior. *Second*, feedback is necessary in the form of periodic counselling and appraisal interview. The superior helps to evaluate progress, to identify problems, and to offer suggestions.

6. Other Factors. Besides the above major considerations, there are several other factors that influence the success of MBO. To the extent those responsible for MBO implementation are aware of the various problems, they can make provisions in advance to overcome these. These are as follows:

- (i) **Implementing MBO at Lower Levels.** If the full benefits of MBO are to be realized, it must be carried all the way down to the first line of the organization.
- (ii) **MBO and Salary Decision.** One of the most elusive aspects of MBO is to tie the organization's compensation system with the MBO programme. Though this problem does not arise at the initial level, later on, this becomes a crucial issue. Therefore, if MBO and salary decision are to be linked, an objective approach must be adopted.
- (iii) **Conflicting Objectives.** One of the outcome of MBO programme is that, to a degree, it builds a competitive climate. This is so because MBO generates competitive rivalry with respect to claims on the scarce resources of the organization. Therefore, some educational effort is needed to enable managers to adopt an overall approach to performance reviews at regular intervals if the human dynamics reveal sub-optimal behaviour.