

## UP-TO-DATENESS OF MANAGEMENT BY OBJECTIVES

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### Abstract

Management by objectives known as MBO is one of the tools used for control of managers and completion of company results. The MBO in general is considered as a tool for setting up targets and particular control of large companies. The main aim of this work is to discuss the up-to-datedness and usability of Management by Objectives in this turbulent time. The main goal of this paper is to prove, that the MBO is not up-to-date in this time by a particular example - by a simulation of Cost-saving measure of within a manufacturing international company in which determining the specific objectives of a particular worker might bring the company higher additional costs even when seemingly fulfilled individual goals. The results of the simulation are evaluated in the context of theoretical foundations and other similar studies. On the basis of these results, there is provided a set of recommendations for the particular company. This paper is based mainly on the research of Czech and foreign literature, observation in the company for 2 years, interviews with managers and analysing internal documents of the company.

**Key words:** Management by Objectives, Simulation, Cost-saving measure, Additional Costs

**JEL Code:** M11, M12

### Introduction

Management by objectives has a strong historical background from the time of Peter Drucker's work. It is considered as one of the main mechanism companies use to control their managers. MBO is also referred to as outcome control or results control, is a control mechanism that spread as decision-making grew more decentralised in large firm during the 20<sup>th</sup> century (Chandler, 1962, Scott, 1973; Rumelt, 1974; Besson, Löning, Mendoza, 2007). Over the past few decades, both academic and professional interest in MBO systems have waned so much that this methodology is considered by some as outdated management fad (Spell, 2001). Nevertheless, MBO is still utilized very wide in public and private organisations.

## 1 Literature Review

Management by Objectives (MBO) is described in Peter Drucker's well-known work „The Practice of Management“. According to Pilařová (2008), drawings on Drucker's work, the specifications of the basic procedures of MBO are:

1. Creating the strategic objectives of the organization, this involves managers at different levels. Part of the process of defining these objectives is identifying the necessary awareness of bottlenecks and inconsistencies.
2. Individual targets are then delegated to lower organizational units. Generally, it is necessary that the targets are clearly defined, concrete and specific, including determining who is responsible for achieving the goals.
3. Feedback and monitoring is also necessary. This could be managed automatically or in a personal way.
4. If deviations are identified, it is necessary to consider the correctness of the procedures, objectives and responsibilities, as well as whether the correct responsible person has been identified.

Bělohávek, Košťan and Šuleř (2006) look at MBO from the different point of view. They regard MBO as being useful for defining the preliminary goals of senior management. Those goals influence the general state that should be achieved based on an analysis of external threats, opportunities, internal weaknesses and strengths.

Vohozka and Mulač (2012) are prominent in the literature of MBO with regard to setting up measures to evaluate progress towards achieving goals. The urgency of debate on particular goals with managers of lower levels and subordinates in consideration of their individual goals is also important. This step is followed by a very important part of the whole procedure, namely, feedback. It is necessary to deal with feedback or to evaluate the current situation regularly and to check progress towards achieving the desired results, including identification of deviations. The last phase is connected with determining particular rules and corrective measures to ensure and help with achieving better performance.

There were mentioned all the theoretical backgrounds for using MBO in theoretical way under particular circumstances. A very interesting point of view is presented by Roth (2009). He suggests that MBO is not very useful nowadays as it does not suit the current dynamic period. He offers four main reasons as to why MBO is not usable:

1. There is a steadily increasing pace of innovation in technology, on the market or in business in general. Targets that are set for a certain period may be already outdated before the deadline is reached. However, there is a possibility in the regular evaluation to consider a reassessment of the goals in light of the constantly changing conditions.
2. Another problem is also setting targets for individuals. In such a case, there are problems of definition and evaluation of whether the goals were achieved. Despite the possible selfish competition among team members - to be more visible and more have contributed to the achievement of the objectives.
3. When setting individual targets workers are quite reserved and tend to overestimate goals, in case they cannot be met. It is also evident that the setting of targets creates boundaries to achieving the objectives. The possible completion of the goals or tasks is limited.
4. One of the main problems of MBO is the situation that the worker really reaches goals, but not accessing work with maximum effort in order for the company was successful. Emphasis is on *me* meeting *my* goals, rather than on *me* remaining flexible a doing whatever it takes to make the company as a whole more successful (Roth, 2009).

Regarding many works related to MBO there is set of conditions that needs to be satisfied in case of effective implication of MBO (Johansen, 1965; Elvik, 1993a,b,2001; Anderson and Vendung, 2005; Wong et al.,2006; Rosendrants et al.2007; R.Elvik et al.,2007):

- 1) The Top management of government strongly endorse the targets and make a firm commitment to realising them.
- 2) The targets set should be challenging, yet in principle achievable.
- 3) There should not be too many targets in view of the available policy instruments designed to release them.
- 4) The agency or agencies given the task of choosing how best to realise the targets should have.

Let's take an inside look at an example of not up-to-dateness of MBO in a particular company. There was done a research and interviews with particular middle managers and some of their subordinates regarding the satisfaction with MBO in general. The research took 2 years and consists of personal experiences with the MBO in general. The most often problem is related to the goals reaching the individuals of different department.

The following simulation of Cost-saving measure approach is a practical example of such a situation where an individual worker's aim is to save a certain value on material purchase. Generally, this means either to negotiate discounts with suppliers, or the localization.

In the Cost-saving measure simulation below, it is evident that a change of supplier theoretically leads to savings in the cost of materials - generally for purchase of inventory BUT there is very often a risk that the company will be forced to pay several times higher expenditures for express transport, etc.

Here it is shown exactly what is being expressed by Roth (2009) – *My objectives have somehow come into competition with yours. Sorry about that, but since my career depends on how well I meet mine, I am going to whatever is necessary.* In this case - the worker really showed savings of buying stocks at a given value in the same volume of purchases - consumption. He/she has fulfilled their goals, but the logistics costs to company could be raised and goals in logistic dept. (to decrease logistic costs) will be influenced in negative way.

## **2 SIMULATION OF COST-SAVING MEASURE**

There is a particular international company producing an electronic device. Its goal within planning for the next fiscal year is given the task of saving 10 mil. CZK for purchased materials. To fulfil this goal it is possible either in terms of lower prices from suppliers or change of supplier. System of tracking the Cost-saving measures is set up very properly by this particular company and needs to be followed by all the divisions with the same way, rules and forms. In the following simulation there is considered a specific item from a particular supplier and after the sourcing committee it is decided that supplier will be localized to a “cheaper” one – the simulation shows a specific example of tracking of Cost-saving measure. The procedure of tracking of Cost-saving saving measure includes setting up the electronic form of it with potential expected saving in following 12 months followed by tracking the single values every month for 12 months in total.

The basic information for counting the saving is number of pieces purchased as a positive effect saving (difference between old price and new price multiplied by the amount of pieces purchased) and the additional costs as a negative effect. It can happen than by counting the final effect after 12 months of tracking, the saving is a negative value. The two alternatives show, how the saving measure can be in the negative value which means, that the additional costs were higher than the saving expected. In each alternative, there are considered not just the saving but also the additional costs as shown in the 2.Alterantive. The additional costs have to be tracked very properly as of course the gap between gain as costs (regarding purchasing and selling the particular items) tend to be as high as possible. That is the main reason, why all the extra costs for express transport, phone calls, extra personal overtime/additional effort need to be tracked.

As it is shown in Table 1 the previous price for the goods was 128.9 CZK / pcs. The supplier was reliable, never needed him to use telephone or e-mail to remind him deliveries – simply there were no problems and no additional costs related to problems with the former supplier. Its distance from the customer's warehouse was 70 km, there were no problems with delivery time and delayed deliveries due to transport unreliability.

The new price from the new supplier is 105.8 CZK / pcs. The new supplier is unfortunately located on another continent, which will take longer time to transport - a minimum of 6-8 weeks by sea transport. In case of any delay or other problems, it is necessary to use air transportation as express shipping. The former supplier in the event of delay brought the delivery by her own car, as a means of express transportation at their own expenses.

**Tab. 1: Previous and new price**

Previous price per piece	<b>128.9 CZK</b>
New price per piece	<b>105.8 CZK</b>

Source: Internal materials of company

Let's assume that consumption of the particular item in the period of 12 months was 8533 pieces in a total value of 1 099 904 CZK.

1. Alternative

In the first case is considered an ideal situation – it means that the new supplier is as reliable as the previous supplier and there are no additional costs related to additional effort.

$C_t$ .....total consumption

$P_{new}$ .....new price

$C_a$ .....additional costs

$$=C_t * P_{new} + C_a \quad (1)$$

$$= 8533 \text{ Pcs} * 105.8 \text{ CZK/Pcs} + 0 = 902\,791 \text{ CZK}$$

It is clear that with the new price and zero potential additional cost **savings** can really be on this material in the value of **197 112 CZK** as shown in the Tab.2.

**Tab. 2: Comparison of costs 1.Alternative**

In total previous price	<b>1 099 902 CZK</b>
In total – new price	<b>902 791 CZK</b>
Additional costs	<b>0CZK</b>
Difference	<b>197 112CZK</b>

Source: Internal materials of company

2. Alternative

Second alternative demonstrates the case when the new supplier is very problematic and it is even necessary to compensate the delay deliveries by air express shipments. There are already significant additional costs including costs for telephone, personal costs, costs for express transportations and other.

For explanation – costs for the express transports are 12 360 CZK/delivery; cost of the phone are the number of minutes on the phone \* 2.99CZK/min; personnel costs - staff costs in hours \* 131.25 CZK/hour.

$A_{ct}$ .....additional costs for express transport.....12 360 CZK/delivery

$A_{cp}$ .... additional costs for telephone.....2.99CZK/minute

$A_{cs}$ .... additional costs for personnel → staff.....131.25CZK/hour

Additional costs:

In this case, there were 16 express shipments, 1885 min. necessary to spent on telephone, and 3770 hours as personnel additional effort → (12 360\* Number of express transports) + (2.99 \* number of phone minutes) + (131.25 \* number of personnel hours)

$$= A_{ct} * 16 + A_{cp} * 1885 + A_{cs} * 3770$$

$$= 12360 * 16 + 2.99 * 1885 + 131.25 * 3770 = \underline{\underline{211\ 643\ CZK}}$$

The value of additional costs are 211 643 CZK plus the consumption multiplied by new price is in total **1 114 343 CZK**.

Table 3 already provides an overview of savings and costs incurred localization to a new supplier. If customers would stay with the former supplier costs for purchased goods amounted to 1 099 902 CZK as previous alternative. With the new price the customer paid for the real goods 902 791 CZK, again as in the previous alternative. The difference here is in the amount of additional costs that have value 211 643 CZK. The difference amounts at the former price and the sum at the new price and the extra costs is equal - 14 531 CZK, which implies that the supplier will pay in the worst scenario still about 14 531 CZK more due to additional costs than if the customer would stay with the original supplier.

**Tab. 3: Comparison of cost and saving of 2.alternative**

In total previous price	<b>1 099 902 CZK</b>
In total – new price	902 791 CZK
Additional costs	211 643 CZK
In total - new price + additional costs	<b>1 114 343 CZK</b>
Difference	14 531 CZK
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Previous price per piece	128.9 CZK
New price per piece	105.8 CZK
New price per piece including additional costs	130.6 CZK

In this case there were discussed the consequences of change of supplier in terms of additional costs related to logistics. They are not given the extra costs that may be associated with the selection of a supplier who fails to fulfil the requirements, such as the quality and technology of production of the goods. Possible blocking deliveries during the initial acceptance may also cause high costs of production stop, again the extra cost of additional efforts under personnel expenses in the revision of the pieces, etc.

### **3 How to avoid?**

Let's discuss the simulation Cost-saving measure above and potential solutions. The worker making the change of supplier fulfilled his/her target but the costs increased in the logistics area. So far it was never evaluated and monitored – the consequences of such fulfilling targets. What is the solution? As Roth (2009) mentioned – the key to a successful transition away from MBO is changing the reward system so that it encourages a cooperative rather than competitive environment. According to this simulation of Cost-saving measure it is also necessary to concentrate on monitoring of consequences of each goal to other areas if it means the saving or improvement/saving to the whole company in general and not only a part – meaning the precise target and if other goals of other colleagues will not be influenced.

The solution for this situation could be also higher focusing on Total cost analysis – it means analysis on the total cost in the selection - sourcing committee - of a new supplier. This analysis must examine and simulate whether the new supplier is reliable, for example, already from past experience of the company, or other divisions - not only in terms of price, but also the quality of the material logistics in terms of reliability of supply, but also technology. The solution is also greater accountability of staff for the consequences of the new measures within the localization vendors.

### **Conclusion**

In this paper, there was a discussion about the importance, up-to-dateness and function of Management by Objectives. The main focus was on the problems associated with management by objectives and a treatise on the timeliness of this procedure in the present. For example demonstrated that meet one of the objectives of the individual worker does not always lead to the benefit for the company as a whole or that goals and intentions of other colleagues even from other areas could be influenced in negative way.

Here it is worth considering whether such set goals, meaning, for example, a simple formulation "savings in material cost a certain sum" are too general. The solution here may be greater emphasis on the analysis of the total cost has been at the very tender. Very helpful here may appear as well as cooperation of other divisions and partner in sharing information about the potential suppliers.



In conclusion, therefore, there is a greater focus on the complex concept of the objective, which means not only getting the "cheaper" suppliers, but substitute suppliers in the same range as possibly better in the context of supply reliability and quality of supply and in many other respects. We can conclude that the objectives should therefore be pursued in the context of comprehensive benefits to company as a whole.

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