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# MANAGEMENT BY OBJECTIVES

Performance Management Series Part III

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## What is Management by Objectives?

Management by objectives (MBO) is the joint setting of performance objectives between a manager and his or her employees. This process is used to set performance objectives an employee agrees to complete within a designated time period and establishes the methods by which these objectives are to be carried out. It also determines the standards or measures for deciding whether, in fact, these objectives have been satisfied, as well as the procedures for the assessment of the objectives. Although not limited to the appraisal of management personnel, MBO is most often used for this purpose. It can also be used to manage the performance of exempt professionals. Other names for MBO include *appraisal by results, target coaching, work planning and review, performance objectives,* and *mutual goal setting.*

## The MBO Process

*Planning Analysis*—A four-phase planning analysis is normally conducted to initiate the performance management planning process. This involves an analysis of the internal environment and includes a review of the strengths and weaknesses of the organization and the opportunities and threats confronting it—sometimes referred to as a SWOT analysis. This is followed by an analysis of the external environment, which requires an examination of those factors that can influence an organization's success or failure, such as economic trends, the actions of competitors, technology and sociopolitical changes. An analysis of the organization's past performance to identify any gaps or overlaps of significance is conducted in phase three. Finally, in the last and fourth phase, a forecast of the political, economic, social, cultural and technological influences that could impact the organization is conducted. While the analysis from each of these phases may be based to some extent on judgment and insight, making it part art, there is no question that corporate memory, industry and management experience contribute greatly to the expertise an individual is able to contribute during this stage of the process.

*Objectives*—Using the data obtained during the planning analysis phase as a baseline, the next step in the process is to set the objectives for the organization year during the strategic planning cycle. The objectives should include both project and improvement objectives related to operations, as well as objectives focused on self-development. As a rule of thumb, it is recommended that each manager be given no more than two to five significant objectives in order to assure that sufficient time can be allocated to the development and management of action plans.

*Standards of Performance*—An important cornerstone of the MBO process is identifying the routine aspects of an individual's job that should be subject to *standards of performance.* Standards of performance are *descriptions of output conditions that exist when a job is being performed acceptably.* To the extent possible, standards of performance should be established in both quantitative and qualitative form. Once standards are agreed upon, managers should ensure that feedback systems are in place to let the subordinate know when performance standards are being met and/or when improvement or corrective action is required. In addition, during the negotiation portion of the objective setting process, it may be necessary for some performance standards to be negotiated horizontally, i.e., between peers, to ensure compatibility and support. In managing performance standards, if the feedback process is designed properly, the manager will receive the information he or she needs to know regarding performance delivery outcomes. If performance has been acceptable, the manager does not need to pursue discussions regarding the ongoing routine aspects of job operations. However, if performance is deemed unacceptable, action and regular follow-up must occur until the matter is resolved.

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*Action Plans*—Action plans are essential for accomplishing objectives. An objective without a formal action plan is little more than an aspiration. Some of the pitfalls in action planning that can be avoided with forethought and preparation are:

1. Allowing insufficient time for action planning.

2. Failure to involve the right people in the planning and analysis phase.

3. Lack of attention to detail or specificity.

4. Disregard for action plan timelines and/or failure to hold people accountable for deadlines.

5. Focusing too much time and attention on the action plan to the detriment of the project.

6. Failure to realize that some project activities can run concurrently, i.e., not making the most of the time available.

7. Inadequate frequency rate for conducting project reviews, i.e., missed opportunities to identify errors or delays sooner.

8. Failure to evaluate overall project performance at regular intervals, i.e., missed opportunities to recognize that the project is not on schedule or take remedial action.

9. Failure to take advantage of a group component in goal setting and milestone meetings.

Just one or two of these practices can temporarily slow or even derail an otherwise credible objective or its implementation. A project manager who allows such practices to exist without taking corrective action is engaged in ineffective management behavior.

*Progress and Performance Reviews*—The last step in the MBO performance management process is the performance review. If the system has been established and implemented properly, several benefits should accrue to the organization. First, the payoff from a more intense and consistent scrutiny of organizational performance should be the prevention of unsatisfactory or mediocre performance in the future. Second, clear and unambiguous performance objectives established in a participative environment should provide for the enhanced productivity of people and allow for a more equitable basis for administering pay increases and rewards. Third, the process can serve as a diagnostic tool for the organization in determining priorities for development at both the organizational and the individual levels. Finally, the long-term success of the performance management system is dependent on the establishment of an appropriate feedback system that provides for the necessary data to assess overall corporate progress and performance on a continuous basis.

**Key MBO Assumptions**

Four key assumptions underlie the MBO performance management system:

- First, a higher level of commitment and performance will result if the employee participates in the planning and setting of the performance objectives and the performance standards on which he or she will be evaluated.

- Second, if the performance objectives identified are clear and precise, the employee will do a better job of achieving the desired results. Ambiguity and confusion, i.e., less effective performance, will result when a manager determines performance objectives for an individual without his or her participation. By participating in the process, an employee achieves a more accurate understanding of what is expected.

- Third, performance objectives should be measurable and should define specific results, performance outcomes or deliverables.

- Fourth, vague generalities such as "initiative" and "cooperation," which are common in many subjective-based appraisals, should be avoided. Objectives are composed of specific actions to be taken or work to be accomplished and should be as explicit as possible. Sample performance objectives are provided in Figure 1.

**Figure 1**

**Sample Performance Objectives**

- Submit regional sales report by the fifth of every month in accordance with sales division

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guidelines.

- Prequalify and activate a minimum of five new customers per month; maintain existing customer accounts; develop action plan to up sell a minimum of five existing accounts per month in accordance with division sáles incentive guidelines.

- Maintain client supply costs at a ratio not to exceed 15% of sales revenue per quarter.

- Maintain manufacturing scrap loss at less than 5% of total expenditures for raw materials annually.

- Fill all organizational job vacancies within 30 days after the personnel requisition is authorized.

**MBO Critique**

No performance management tool is perfect, and certainly MBO is not appropriate for all employees or all organizations. The MBO process seems to be most useful with managerial personnel and employees who have a fairly wide range of flexibility and control over their jobs. For example, an attempt to impose this system in a rigid or autocratic management environment would almost certainly fail. This is because an extreme emphasis on penalties for failure to meet objectives would defeat the development and participative nature of MBO. However, intervention and objective setting in a negotiated forum open up the decision-making process to new possibilities. Both managers and employees move out of their traditional roles and move away from stereotyped responses. As accountability increases for both the manager and the employee in this process, so, too, does the risk factor. While both participants have a good deal at stake in this process, they also have a good deal to gain.

**Goal Setting Literature and Research**

- *The Dysfunctional Evolution of Goal Setting:* Management has long struggled with the most effective way to establish organizational goals. For years, a top-down approach was used. This seemed to make perfect sense because senior management had access to all the right information and had the necessary authority to make most decisions. The problem was that this approach usually failed to consider the input of many of the key stakeholders who were crucial to the long-term success of the organization. This was because the senior managers were just too far removed from the lower levels of the organization to fully understand how front-line employees create customer satisfaction and value. To overcome this limitation, business theorists created an alternative to the top-down approach to goal setting: the bottom-up approach. As one may imagine, this approach didn't work much better. The view from the bottom to the top was not any clearer than the view from the top to the bottom. What management has learned over time is that crucial communication between organizational levels must take place on a regular basis. Senior leaders are responsible for ensuring that operating employees are informed about what is going on in the organization so that they can intelligently participate. By avoiding this information-sharing, senior executives miss the opportunity to benefit from the knowledge of key experts who can contribute and add value to the strategic process on a sustained basis.[1]

- *Achieving Outstanding Performance Through a Culture of Dialog:* Organizations with effective performance management processes encourage two-way communication in which individuals and groups question, challenge, interpret and, ultimately, clarify goals and engage in regular performance dialogue to ensure that employees' actions are aligned with the organizations' goals. According to a Hay Group survey, a key reason people leave their organizations is that companies lack direction—only 27% said their organizations have a clear sense of direction. Once goals are clear, organizations need to create processes to ensure that people get the right messages, such as budget and planning sessions, staff and team meetings to discuss goals, performance management meetings, and talent review sessions. Organizations that have effective performance management programs also excel at aligning and differentiating their reward and recognition programs.[2]

- *Half of the Decisions We Make Are Wrong. Why*? Half of the decisions managers make fail because they employ failure-prone tactics. This occurs for a number of reasons. First, even though the appropriate tactics are known, they are simply not utilized. Second, decision makers take shortcuts to save time. Third, problems in the workplace are not always easy to define and are quite often open to interpretation. So what can be done to improve decision-making ability? First, managers are encouraged to resist a quick fix—accept uncertainty and ambiguity, and recognize subtleties in what works and what does not. Second, setting objectives is "commonly known, but uncommonly practiced." Direct intervention is even more rare, but the most successful. This author suggests the following tactics: 1) personally manage decision-making; delegation to experts may give you more time for other responsibilities but will decrease the likelihood of success; 2) search for understanding; signals that capture your attention are usually significant—time spent reflecting on them can be

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important; 3) establish your direction with an objective; the outcome must be specific if it is to open up the search for new ideas; and 4) manage the social and political forces that can block your success.[3]

**In Brief**

According to a recent performance management survey by Watson Wyatt, a leading human capital consulting firm, only three out of 10 U.S. workers agree that their company's performance management program actually does what it is intended to do: improve performance. Only two out of 10 workers say their company helps workers with poor to marginal performance improve performance, according to the same study. Why is this? An organization's performance management process represents an essential element of its overall human capital value system and is one of the most effective tools it has to influence personal behavior within the framework of the culture of the organization. What sets the MBO process apart is that the manager and employee partner with each other to set goals and objectives that are clear and unambiguous right from the start. If the performance management system guidelines are followed, the manager and employee commit to working closely with each other not only on a periodic basis (e.g., quarterly) to ensure that action plans, goals and objectives remain on target, but on an as-needed basis as well. In other words, a support system is in place to ensure that the best interests of all participants—the manager and the employee, as well as the organization—are taken into consideration. A systems approach in and of itself does not ensure a continuum. However, if senior management is fully committed to a performance-managed culture, the MBO process will ultimately become an essential part of the organizational culture and result in improved performance for the individual and, as importantly, for the organization.

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**Footnotes**

**1** Humphreys, J. (2003, Summer). The dysfunctional evolution of goal setting. *MIT Sloan Management Review*, 44, 96.

**2** Rodriquez, E. (2002). Achieving outstanding performance through a culture of dialogue. *Workspan*, 45, 9, 24-29.

**3** Nutt, P. (2001). Half of the decisions we make are wrong. Why? *Across the Board*, 38, 2, 63-66.

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