

Management Control System – MBO

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Abstract

Every business needs to operate successfully and to attain its full potential in terms of sales and profits, it is necessary to establish managerial planning and control systems. It is the purpose of this paper to introduce the basic concepts of delegation and Management by Objectives (MBO). Specific methods to apply these techniques are also discussed. The paper argues that execution of MBO needs dynamic and transformational leadership at the top level, and commitment of management at all levels starting from the top-down to the operating level. Finally, this paper provides directions for future research.

Keywords: management by objectives, goals, delegation, control, responsibility, managers

1. Introduction

Management by objectives (MBO) is a successful philosophy of management. It replaces the traditional philosophy of “management by domination.” It was popularized as an approach to planning by Peter F. Drucker in 1954 in his famous book *The Practice of Management*. Since that time it has acquired momentum and of late it has become a movement.

There are many MBO type programs like “management by results”, “goals management”, “work planning and review”, “goals and controls”, “appraising by results.” These programs are similar in nature in spite of the difference in names.

The concept of MBO has passed through different stages of management development, viz.:

- MBO for performance appraisal.
- MBO for integrating the individuals with the organizations.
- MBO for long range planning.

Management by objectives has been defined as “a result-centered, 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.” (Flamholtz, 2009)

In other words MBO is a process by which managers at different levels and their subordinates work together in identifying goals and establishing objectives consistent with the organizational goals and attaining them. Thus, MBO is not only an aid to planning but also motivating factor.

2. Work, Responsibility and Delegation

It may be difficult for you and your managers to “let go” of portions of the decision-making power – and especially so for many owners of small businesses. It is necessary to achieve a fine balance. You should retain operating control so that the business can continue to run smoothly without your being present. At the same time, you should delegate sufficient responsibility and concurrent authority to subordinates so that the business functions smoothly on a day-to-day basis and subordinates feel that they are part of your business. The problem of delegation requires consideration of several important factors. (Bruce and Robert, 2008)

1) It is most important for you and your managers to be aware of the business goals and see that they are being met. This implies the necessity for developing controls and a system to provide accurate feedback of information. Feedback must be timely so that corrective action can be taken before a situation “gets out of control.” You must orient yourself to “management by exception” and to planning and control. (Koontz, O'Donnell, and Weihrich, 2007)

2) Sufficient authority should be delegated to get the job done, to allow key employees to take initiative, and to keep operations moving in your absence. When delegating responsibility, it also is necessary to delegate sufficient authority to do the job. Hence, the limits of authority should be clearly defined—especially in those areas involving expenditures of funds (approving overtime and making purchases).

3) You and your managers cannot become involved in details at all levels of the operation. There are not sufficient hours in the day. You must spend much time in planning and seeing that the plans are met. You need to have dependable help to attend to the details. You make sure they are accomplished, but let others to do the work. (Mannan, 2009)

4) The best managers are not necessarily the best teachers. Managing may sometimes involve instruction and coaching, but the best managers tell employees what to do and when to do it, not how. Good managers are good scorekeepers, but they need not be good teachers. You must learn to keep score—to see who is performing, who is making the profits for you.

5) There is no “best” management system. One style may work well for you, but not for your subordinates. Good managers do not impose management styles or judge performance on whether the job was done the way the manager would have done it. Results, in terms of profitable output, are the goals worth measuring and rewarding.

6) Channel your energies to meet your abilities, but keep score on every activity. Each of us has special interests and abilities. You should capitalize on these as a manager and let your subordinates do the same. However, if your flair is for marketing and you, therefore, elect to delegate financial duties, it is absolutely necessary for you to establish financial control systems that you understand completely and can monitor frequently. The reverse is also true, if finance is your primary interest. Delegation need not imply loss of ultimate responsibility. (Carnegie, 2006)

7) Those persons to whom you delegate responsibility and authority must be knowledgeable and competent in the technical area for which you hold them accountable. Also, they must be honest—persons of integrity. Other qualities of importance include initiative, interest, self-motivation, imagination, drive, and decisiveness. Choose managers with these primary qualities in mind.

8) Managers must be managers. Some managers will avoid making decisions by bringing problems to you. In fact, some people deep their jobs by always being at the center of a crisis and thereby getting attention. One way to stop this is to require a manager to provide three feasible alternate solutions to any problem he or she brings to you. This, at minimum assures you that the problem will be well thought out, and usually solved, before reaching you. You want the people who work for you to bring you solutions, not problems.

9) People like to know exactly what is expected of them. Consequently, it is every important for you to prepare a list of job duties for each person and especially for managers, which clearly defines his or her area of control and authority. Preparation of these position descriptions has an added advantage of helping you to avoid overlaps. It will aid you in coordination of all job activities and thereby increase productivity. There should be no doubt as to who is responsible for specific jobs and who should take corrective action if it is necessary. (Friedmann, J., 2005)

10) A primary responsibility of every manager is to train his or her replacement. This process should start at the time a manager is placed in a position. At any time there should be at least one person trained to take over each manager’s position, and that must include your own. This ongoing training avoids crises and Permits managerial flexibility and growth. The list of possible replacements for each job should be kept in a personnel file, as well as In the Business Plan Personnel Section, and should be updated annually. (Weihrich, H., and Buhler, D., 2009)

11) Good communication—both horizontal and vertical – is essential to your business. Both Facts and the thinking of you and your employee must be conveyed. Feedback is essential if you are to be a good record-keeper, and one primary characteristic of a good manager is the ability to listen. (Taylor, S., 2005)

- Delegate while retaining operating control.
- Keep score on everything.
- Measure profit frequently.
- Hold your managers accountable for profits.
- Make your managers manage—don’t do their work.

- Let people know what you expect of them.
- Clearly define areas of authority.
- Train replacements.
- Communicate–listen.
- Plan for orderly, profitable growth.

Although there does not exist a “best” management system or organizational structure, the above guidelines have proven very useful. Each organization must be developed around its people – people make up the organization. Individual personal strengths and weaknesses will impact your business as a whole, and the potential must be available for employ. Hence, flexibility is required. Further, as your business grows, your initial organizational structure may not be able to accommodate the needed changes. You should plan to permit orderly, profitable growth of your business and the people who make up your business (Kerzner, 2009).

3. Management by Objectives

We have discussed some of the aspects of delegating responsibility and authority, but have not yet actually defined what it is a manager does. Most management texts consider the management process as consisting of five functions: planning, organizing, directing, controlling, and coordinating. Many smaller businesses suffer from a lack of planning and control. Management by Objectives (MBO) provides an operational system to strengthen these functions by the establishment of goals and then monitoring progress toward their successful completion. MBO breaks with the traditional job descriptions, which describe processes, and substitutes clearly defined goal-oriented results for simple lists of activities.

Traditional position descriptions are a shopping list of activities without stated goals or objectives. MBO provides measurable objectives and thus correlates activities to the goals of the business—and especially to profit.

MBO provides a formal process to measure performance of at least the key people (and preferably everyone) in your business in an organized, specific, and objective fashion. It requires the establishment of clearly defined, quantifiable, and measurable goals, and then monitoring progress toward their completion. MBO is easy to understand and implement, and, if done well and fairly with monetary rewards tied to performance, it will substantially improve employee motivation, morale, and performance. (Wehrich, 2007)

4. The Basic Steps in Establishing and Operating an MBO Program

1) Rather than emphasizing activities, each manager’s job is defined in terms of several clearly defined and measurable goals. These goals are probably best established by asking the manager to propose his or her goals to you. Then, you review them together, modify them as required to be consistent with overall company objectives, agree on each goal, and put them in writing, each goal statement consists of three parts:

a) the results to be achieved

b) the method to be used to measure progress toward and completion of the goal

c) time frames for completion of major parts of the goal and the entire goal. (Whitmore, 2009)

2) Once goals are set, the measurement system is put to use, and you now are able to measure specific progress at specific intervals. This helps you with your work as record-keeper. The intervals will depend on the type of job. In some cases they may be daily; in other instances, weekly, monthly, or whatever. The key to the selection of the reporting periods is to allow sufficient lead time for corrective action on your part if something goes wrong. There are tradeoffs. Reporting too frequently is expensive – it takes up valuable managerial time and it may frustrate the manager reporting to you. Waiting too long for reports may permit production slippages that cannot be recovered, or recovered only at a high cost. Of course, in addition to reporting at regular intervals, if a manager predicts a crisis, he or she should be instructed to report it to you (along with proposed solutions)immediately.(Cascio,2008)

3) If goals are not being met or are not on target, remedial action needs to be taken. In some instances, the goal may have been unrealistic to start with, or business conditions may have changed during the reporting period, or the manager may just not be doing the agreed-upon job. By receiving interim reports, you can take remedial action of several kinds to prevent damage to your other goals – and specifically your profit picture. You may need to allocate additional resources, change the timing for completion of the goal to be more realistic (and this may necessitate changing other goals as well – coordination will be necessary), abandon the goal entirely if it is no longer financially consistent with business conditions, put pressure on the manager, or increase the frequency of the reporting periods until the crisis is passed. Keep in mind that one way to get the kinds out of the hose is to

turn up the pressure. Sometimes this is necessary. (Hamner, 2009)

When goals are being met or exceeded, either both in terms of time and/or measured level of accomplishment, MBO provides an excellent basis for establishing employee reward and incentive systems. It is a simple matter to identify those who are meeting expectations and to reward them appropriately. Further, those who are not meeting expectations know what it is they have to do. Managers are not placed in competitions know what it is they have to do. Managers are not placed in competition; everyone can be a winner – and there is no question as to how to be successful. Also, the losers are easy to identify and do not just get buried in an unprofitable corner. (Griffin, 2006)

Each part of the MBO system is discussed in further detail to emphasize how you may implement the system and maintain it as an ongoing management tool.

1) Goal setting

The establishment of goals is the first and crucial part of the program. Goals must be consistent with the objectives of your business. This forces you to review and update your objectives regularly. Further, the goals must be consistent among the various levels of management. This has the great advantage of assuring that **everyone is going in the same direction**. (Robbins and DeCenzo, 2003)

2) Learning period

When any new management system is established, it takes time to overcome inertia; many people are reluctant to change. To set up an MBO system, it is probably wise to start with only a few goals for each manager or each employee and to select a limited group of key employees. Although you want employees to stretch to attain their goals, the goals should not be beyond individual capabilities. Don't set the system up to fail or cause frustration. Frequently, managers tend to set goals that are overly ambitious. It will take some time for people to learn how to plan and measure their performances effectively, and they must learn how to cope with problems that threaten the achievement of their goals. (Griffin, 2006)

3) Stating the goals

The steps in actually starting a goal may be broken into several parts:

- The specific statement of the **end result**—what you want them to accomplish, both in terms of quantity and quality.
- The **primary steps** in completing the job.
- The **benchmarks** that will be used to measure progress at important intervals and the time associated with each step toward completion.
- A statement of **major anticipated problems**—red flag items that you and your manager foresee so that he or she can start working to solve them now.
- A statement of the **superior's goal**—the goal at the next highest level of management that relates directly to the manager's goal. Such a statement assures clear communication of both facts and thinking (Robbins & DeCenzo, 2003).

In complex management situations—such as the management of large construction projects where many activities are going on simultaneously, the use of actual time charts showing activities and end points may be desirable. Two such methods have been developed and extensive literature is readily available describing them in detail: Program Evaluation and Review Technique (PERT) and Critical Path Method (CPM) (Ahuja, 2007).

4) Types of goals

There are four different types of goals you will want your managers to establish:

- **Regular work goals**—relating directly to the normal day-to-day activities of the manager; should be designed to improve output, quality, efficiency, and primarily profit.
- **Problem-solving goals**—established to help each manager clearly define problem areas and eliminate the problems. The objective is **to increase profits**.
- **Developmental goals**—developing employees to take on added responsibilities and whenever possible, preparing them for leadership roles; critical to the long-term health of your business. Goals in this area relate to the growth of each employee reporting to a manager. Remember that one good employee may be worth as much to you as three marginal workers—and cost half as much. Develop and reward.
- **Innovative goals**—relating to finding better or more efficient or less costly ways to operate. This type of

goal is especially useful in carrying out the capital acquisition program. It encourages and rewards creative thinking (Martinussen, 2007).

5) Progress reporting

The reporting of progress needs to be more than just a report on the current stage of completion of a goal. It should also be a time for review of **how the progress was made**.

- What resources were utilized?
- Were efficiencies increased?
- What unexpected problems arose and how were they solved?

It will help identify organizational restrictions, inadequate measures of goal achievement, personal strengths and failures, and so on. The reporting of progress can be educational experience for the manager, his or her supervisor, and you. (Islam, 2008)

4. Conclusion

MBO is a philosophy rather than a technique. Hence, its installation requires a basic change in the organization's culture and environment. To be effective, an MBO program requires the following:

- 1) The purpose and the area of MBO should be defined clearly, as MBO is a means but not an end in itself.
- 2) Since the top management plays a crucial role, its favorable attitude and support is a must.
- 3) The people who will be involved in the program should be prepared mentally and psychologically for it. This requires a systematic training and management development program.
- 4) Participation of superiors and subordinates in setting organizational objectives, superiors' objectives, subordinates' on-going performance, periodical review of progress and final review and appraisal of the performance is highly essential.
- 5) Each employee should be provided with feedback information for self direction and self-control.
- 6) The MBO programs should be implemented at all levels including the departmental level and its grass-root level and its grass-root level. Formally, there should be direct linkage between MBO and reward system.

The implementation of MBO is critical to its success. It may be desirable to hold a meeting with your managers to explain fully the rationale and mechanics of the program. Your involvement is critical. This is often the failure area. Some owners have difficulty setting goals and simply do not want to be measured against them. Further, business objectives may be unclear. Fuzzy objectives lead to confusion in goal setting. Aside from the difficulties (all of which can be overcome), MBO is perhaps the most useful and productive management system yet developed—and it is especially useful for small firms like yours, which may have limited people and money resources. The whole MBO approach, however, will have only a limited value unless identifiable rewards are tied directly to performance—promotions, salary adjustments, bonuses, or supplemental compensation awards.

MBO is an extremely popular management of changes intervention. MBO ties together the underlying theory Y philosophy of management of changes, the behavioral learning of sensitively training and practical management planning and control technique. There is a relation between MBO and management of changes as it aims at improving managerial performance not only by introducing changes in perceptions, values and structure including MBO. MBO contributes to management of changes by developing the openness, interpersonal relations and team approach in planning and controlling, problem-solving approach between the superiors and subordinates.

5. Exercise in MBO

Prepare an MBO object following these step-by-step directions:

1) Define the category of the goal

- a) Regular work – goals that relate directly to day-to-day activities.
 - b) Problem solving – goals designed to solve clearly defined problems.
 - c) Developmental – goals designed to develop employees.
 - d) Innovative – goals designed to find more efficient and less costly operating methods.
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2) Specifically state the end result you desire and the person who will accomplish it.

3) State the steps necessary to complete the goal. List them in order of occurrence and date.

- a) _____ Date _____
- b) _____ Date _____
- c) _____ Date _____
- d) _____ Date _____
- e) _____ Date _____

4) State the benchmarks you will use to measure each step in number 3.

5) State the major problems you predict and possible solutions.

6) State how completion of the goal fits into your goal structure.

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