

MIBO CAN WORK!

HOW TO MANAGE BY CONTRACT

Charles R. Macdonald



MBO CAN WORK!

How to Manage by Contract

Charles R. Macdonald

McGRAW-HILL BOOK COMPANY

New York St. Louis San Francisco Auckland Bogotá
Hamburg Johannesburg London Madrid Mexico
Montreal New Delhi Panama Paris São Paulo
Singapore Sydney Tokyo Toronto

Library of Congress Cataloging in Publication Data

Macdonald, Charles R.

MBO can work!

Includes index.

1. Management by objectives. I. Title.

HF38.M284 1982 685.4'012 81-4457

ISBN 0-07-044331-9 AACR2

ISBN 0-07-044331-9

Copyright ©1982 by McGraw-Hill, Inc. All rights reserved.
Printed in the United States of America. Except as
permitted under the Copyright Act of 1976, no part of this
publication may be reproduced or distributed in any form
or by any means, or stored in a data base or retrieval
system, without the prior written permission of the
publisher.

1234567890 DODO 8987654321

*The editors for this book were William Newton and Iris Cohen,
the designer was Naomi Auerbach, and the production
supervisor was Paul Malchow. It was set in Ballardvale
by World Composition Services.*

Printed and bound by R.R. Donnelley & Sons Company.

PREFACE

PRODUCTIVITY IS THE ISSUE

There are few more crucial and pressing issues facing management today than the need to increase productivity of the business enterprise. Evidence can be found on all sides that we are failing to come to grips with this critical problem. The core of the issue, there is reason to believe, may be in the office, the technical laboratory, and the executive suite, rather than on the production floor—as evidenced by studies which show that the productivity of higher-level employees in the typical organization is considerably below its potential.

What is worse, the low state of productivity in the workplace may be a direct consequence of this white-collar lag, because of unclear work assignments, improper staffing, blocked lines of communication, lack of discipline, and poor example setting.

Unfortunately, no quick and easy solutions are at hand. The problem is deep-seated, complex, and sensitive, and it will not be solved by some new breed of management efficiency expert. It is becoming increasingly clear, nevertheless, that the productivity of management employees *can be* improved materially—and the benefits to the enterprise in the form of increased output and profitability can be quite remarkable.

PURPOSE AND SCOPE OF THIS BOOK

This book is about managerial productivity and how to improve it. It presents and describes a methodology for making management by objectives work in the operating environment. It is written for the general manager of a business organization—whatever title the position carries—and the functional manager who aspires to become

a general manager at some time in the future. If you are the first of these, the book can help you make your total organization more productive by increasing the individual and collective productivity of managers, technicians, administrators, and professionals—the “knowledge” workers who form an increasing proportion of our post-industrial economy. If you are the latter, the book can help you make your own function more productive. In the process, you can realize greater personal job satisfaction even while enhancing your value to the organization.

The book is founded on a couple of basic principles of human resource management. One, the ultimate motivator, indeed the ultimate accolade to the individual, is for the organization to demand the very best performance of which the person is capable. To ask less or to accept less is demeaning to the individual. Second, the best goals are the goals that individuals set for themselves within an overall guiding framework of objectives that will energize and motivate people to excel. More often than not, I have found, these goals are the ones that are achieved, even while they tend to be more demanding on the individual.

Management by contract is an attempt to convert these principles into a structured process of management that will help managers of all functional disciplines and on all organization levels to develop more fully their own potential as individuals and as professional managers, while at the same time enhancing the overall productivity of the total enterprise.

MANAGEMENT BY OBJECTIVES AND SELF-CONTROL

During the past 25 years or so, the management discipline called *management by objectives* (MBO) has built a large following in American industry. During this period, MBO has generated a high degree of acceptance for the notion that results are more important than activity and has created a substantial reservoir of goodwill among achieving managers because it gives visibility to competence and promises to reward accomplishment.

This book builds on the foundation of MBO. Management by contract presents an integrated process of managerial productivity improvement using the MBO concept as a central core. It is a system of management by objectives, self-appraisal, and self-control that

finds expression in a negotiated “contract” between each manager and his or her organizational superior. The contract documents the understanding reached between them, and represents a formalizing of the commitments of each manager to the other, as well as to the organization. The contract also provides more equitable sharing of responsibility for results, fairer sharing of credit for accomplishment, and more evenhanded sharing of liability for failure.

The management process of which the contract is the centerpiece is a highly developed form of participative management, without being in the least permissive. Neither is it authoritarian. Rather, the process represents a dialogue between people in different functions and on different levels of management based on verifiable facts and conducted in an atmosphere of mutual respect and regard for individual worth.

I have taken the position—as others have before me—that management by objectives and self-control must be built into the management structure, not tacked on as a separate subsystem. Truly effective MBO should permeate every function, should govern every activity, and should be integrated into every planning and control subsystem. In this way, the MBO process becomes the process of management itself. Management by contract has been designed to meet these essential criteria. The process does so, moreover, in a nondestructive fashion—without tearing down the existing management structure in order to erect a new one in its place.

RECONCILING GOALS

Management by contract proposes a solution to a particularly troublesome problem of MBO—that of reconciling individual managers’ objectives with those of other people and with the larger goals of the total organization. This is accomplished by means of a unique process within a process, a progressive series of reconciliations that:

1. Accommodates the individual manager’s goals and plans to the personal needs and capabilities of subordinates
2. Harmonizes the manager’s objectives and improvement plans with those of colleagues in other functions with whom the manager relates
3. Meshes the manager’s objectives with the needs and goals of his or her superior, and with the goals, policies, norms, and values of the total enterprise

When this process of reconciliation is used with sincerity and sensitivity, it can produce a set of minor goals that fit comfortably under the umbrella of total corporate purpose, yet are powerfully motivative to individual managers.

AN EVOLUTIONARY STEP

It is not my intention to offer management by contract as a revolutionary process of management; it represents rather another evolutionary step in the direction of the truly productive enterprise. Only the integration of its elements is new—the elements themselves, in one form or another, are in use in most progressive organizations. The total process has been employed on a limited basis with results that suggest it has genuine potential to enhance organizational effectiveness and improve productivity. Admittedly, these benefits have not been validated by rigorous quantitative testing on a large scale. My personal experience with the process, however, has convinced me beyond all doubt that it can produce tangible benefits substantially in excess of those produced by the conventional MBO program.

CONTENTS

Preface **vii**

Acknowledgments **xi**

PART ONE	MANAGEMENT IN A CHANGING WORLD	1
	1. <i>The Challenge to Management</i>	3
	2. <i>Management and Productivity</i>	15
PART TWO	MANAGEMENT BY CONTRACT—MAKING MBO WORK	25
	3. <i>The High Promise of MBO</i>	27
	4. <i>Why Management by Contract?</i>	41
	5. <i>How to Make MBO Work</i>	57
PART THREE	TEN STEPS TO MANAGEMENT BY CONTRACT	75
	6. <i>How to Build a Foundation of Facts</i>	77
	7. <i>How to Create Your Own Challenge</i>	93
	8. <i>How to Translate Your Goals into Action</i>	109
	9. <i>How to Create Coordination with Others</i>	113
	10. <i>How to Get Your Share of Resources</i>	117
	11. <i>How to Document the Agreement</i>	123
	12. <i>How to “Get There” through Self-Management</i>	127
	13. <i>How to Cope with Change</i>	131
	14. <i>How to Get Credit for Your Gains</i>	137
	15. <i>How to Close the Objectives Gap</i>	147
PART FOUR	THE LARGER PURPOSE OF MANAGEMENT BY CONTRACT	151
	16. <i>Management by Contract in Action</i>	153
	17. <i>The Bottom Line</i>	167
	18. <i>The Essential Purpose of Enterprise</i>	179

PART
FIVEDETAILED PROCEDURE FOR THE FUNCTIONAL
SELF-APPRAISAL **183****19.** *Manager's Guide to the Functional Self-Appraisal* **185****20.** *Self-Appraisal Checklists* **209***Index* **227**

MANAGEMENT IN A CHANGING WORLD

*The accomplishments of management past are acknowledged;
the failures of management present to recognize
and respond to the changing needs and
values of society are cited; and
the obligations of management
future to become more
responsive and productive
in fulfilling these needs
are specified.*

**PART
ONE**

THE CHALLENGE TO MANAGEMENT

As the decade of the 1980s—the ninth decade of our century—unfolds, it finds the economic, social, and political institutions of America and the world in disarray. The prospect is that they will get worse before they get better. As a consequence, American industry faces challenges of a nature and magnitude never before experienced by its management.

An economy and a lifestyle built upon a bountiful supply of cheap energy are threatened by shortages and skyrocketing energy costs. Deeply embedded inflation is causing severe misallocation of capital by corrupting management's capability to evaluate economic risk and reward, by distorting the accounting for costs and profitability, and by debasing management's ability to measure organizational performance. The rapidly shifting norms and needs of our increasingly fragmented society are undermining the stability of markets and industries. And the legislative and regulatory environments in which business functions have become so unpredictable that its managers scarcely know from one day to the next what is expected of them.

All this is coupled with a raging current of change—technological, cultural, and economic—so swift it gives little or no time to adapt, and “so powerful,” says Alvin Toffler in *Future Shock*, “that it overturns our institutions, shifts our values, and shrivels our roots. . . .”¹

Our ability to meet and manage these menacing issues of the eighties is crucial to the competitiveness of our free market system. Failure to cope with them could jeopardize the very survival of the nation. Unfortunately, the experience of the recent past offers scant assurance that management is either prepared or willing to provide the leadership needed to deal effectively with the problems and perils that threaten us.

At an earlier time we would have had less cause for concern—perhaps even grounds



CHAPTER ONE

for confidence—because the achievements of professional management have until recently been one of the remarkable success stories of this century. Management has helped to bring about—indeed has been the driving force for—the extraordinary improvement in the well-being of humankind in this period. Most notably, the interval between World War II and the late 1960s witnessed unprecedented advances of management as a discipline, a body of organized knowledge, and a profession. Seemingly no task was too great, no project too vast, for management to undertake and accomplish.

During these 2 decades or so, with a resplendent outburst of innovation and energy, American industrial management created a brand new world. The U.S. gross national product soared to over \$1 trillion as a virtual cornucopia of consumer and industrial products poured out of U.S. factories. The skies of the globe were dominated by passenger aircraft bearing the label “made in America.” United States automobile assembly lines were the envy of the entire world—and the pattern that Japan and Germany followed as they rebuilt their war-torn industrial economies. American accomplishments in space enthralled the free world. And American management methods were eagerly adopted as the standards for the industrialized world.

As the decade of the “soaring sixties” gave way to the “sagging seventies,” however, a degree of disillusionment set in. As our institutions have increased in scale and complexity and the environments in which they function have become more turbulent, cracks have appeared in the management facade. The role of management has come under increasing scrutiny—and we may now be in a period of reflection and reconsideration of what management really is, and what its role in society should be.

In a number of important respects, management has failed in recent years to live up to its high promise and has fallen short of the expectations it has created. As a consequence, business as an institution and management as a profession have suffered a serious erosion of public confidence and a corresponding loss of power to attract the resources needed to accomplish demanding social tasks.

Management, in brief, seems to be experiencing an identity crisis.

LOST CREDIBILITY AND LOST POWER

Because business has apparently failed to respond to certain basic needs of society, other institutions have gathered power and taken over the task. Government is now setting standards for the quality,

safety, and performance of products—some unrealistically high, some with unrealistic target dates for compliance. These standards are causing severe disruption in the economy and are diverting massive amounts of capital from other uses. Government is also establishing, in its clumsy, heavy-handed manner, requirements for employee safety on the job, for the content of foods, for medication and health care, and for environmental protection—because business management seemingly has failed to respond effectively to society's demands for protection of workers, unadulterated food to eat, affordable health care, clean air to breathe, pure water to drink, and a planet free of chemical contamination.

Despite years of clear and unmistakable warnings that the major sources of energy are becoming less available to us, industry has continued to waste energy as though there were no tomorrow, and has failed to develop acceptable alternative sources that can be controlled. Industry has continued to produce millions of overweight and overpowered vehicles and thousands of energy-wasteful buildings, even while the technology to make them energy efficient is available.

Industry has turned its back on the decaying cities of the Northeast and the distressed areas of Appalachia—saying that social problems are not a concern of business—then has berated big government for taking away management's prerogative to locate its facilities where and when it chooses. By consistently failing to heed the economic storm warnings, and pursuing policies of expansion well into recession periods—then overreacting with massive cutbacks in capital expenditures, new product development, and marketing activities—industry has compounded the economic problem and given government a clear opening to take over more of management's obligations.

U.S. business firms show an increasing aversion to risk—preferring to service existing markets rather than to create new ones, imitating rather than innovating, looking for short-run returns, and acquiring existing businesses instead of developing new products themselves. Management has continued to consider its primary function to be that of maximizing profit, despite an overwhelming body of evidence that short-term profit maximization as an operating philosophy leads to excesses that lead, in turn, to business failure.

While politicians rush into the media to castigate business for its every transgression and "unconscionable" profits, management has been failing to tell its side of the story in a straightforward and credible way that the public will accept. Instead, business has continued to employ public relations flackery, long discredited in the minds of the public. Apparently in fear that stock values on the

exchanges will drop, companies continue to report earnings per share that are distorted and bloated by inflation. As a consequence, the public and the Congress accuse the business community of "unpatriotic" capitalism. Unfortunately, every objection by business to ill-conceived, badly framed, poorly administered government legislation and regulation is viewed as a grievance. The reluctance of business management to challenge the constraints imposed by government at all levels leads to further inroads on its ability to manage.

Management has tended to misuse and underuse its human resources, all the while lamenting that productivity is low because "people just don't want to work anymore," despite evidence that most people will respond with honest effort and high output given clear goals, forceful leadership, genuine respect, and fair treatment. Top management continues to confuse personal aggression and assertive behavior with competence, and assigns resources to individuals who demand them, not necessarily to the ones who can utilize them most productively. Activity is often mistaken for accomplishment, with the consequence that the company reward system is skewed to the task instead of the result, and corporate internal defense mechanisms use up energies that could be better employed for productive purposes.

As a consequence, a high degree of discontent and a serious measure of alienation exist among middle managers. A recent national survey of middle managers indicates that, as a class, this important group of managers feel themselves to be powerless, seriously lacking in authority, and left out of the corporate decision-making process. They believe themselves to be less informed and less respected than the groups above and below them in the corporate hierarchy, and they believe that top management is unresponsive to their needs and problems. As a result, they identify less with the mission and goals of the enterprise.

THE HIGH COST OF FAILURE

Management tends to focus attention on problems, weaknesses, and deficiencies caused by its earlier failure to plan; accordingly, yesterday's mistakes consume its energies today, while the opportunities that will sustain us in the future remain unexploited.

The ineffectiveness of management in recent years is imposing a high cost on the nation's economy—in terms of opportunities not exploited through failure to plan, opportunities lost through bureau-

cratic lethargy, and opportunities mishandled because of failure to delegate decision-making authority. The insolvencies and bankruptcies that are reported daily are merely the surface symptoms of a deeper malaise. Massive losses and erosion of capital are not the result of deceit, dishonesty, and fraud, but of well-intentioned management that is failing to plan, to control, to delegate, to make hard decisions. The largest losses are the unrecorded ones—the difference between what is and what could have been had the opportunities been seized and exploited at the right time.

Management is failing through disregard for the real purpose of the business enterprise, which is to fulfill *needs*. This is the most basic of all the management fundamentals. This factor alone may be the key to improving the productivity of management.

The “quality of life” issue that has been taken up as a rallying call by the liberals in economics and politics has been distorted into a demand that management restore to society something it once possessed but has now lost in the rush to materialism. Despite the anguished cries of the nostalgia peddlers, however, humankind has never enjoyed a life free from pollution, poverty, squalor and crowding, unequal distribution of wealth and privilege, fear, and suffering. That it ever did so is a myth. Today’s middle-class person would be appalled by the living and working conditions of the typical urban dweller and the remote farm family in the early 1900s. What society is seeking are *new entitlements*, born in large part of expectations created by management’s own earlier accomplishments. What were once only unexpressed desires and wistful hopes have now become *needs* to be fulfilled.

Fulfilling these needs is the task of management, a task that calls for a resurgence of entrepreneurial spirit in managers. The voice of the entrepreneur, the innovator, is becoming lost in the labyrinth of the contemporary organization, whether business, social, or governmental. Efforts of managers are increasingly directed toward protecting gains already made, toward defending the company’s resources rather than shifting them into more productive uses.

The large corporate structure, with its legions of staff specialists and layers of organization, tends to spin a protective cocoon around its top management, isolating it from the discomforts of the outside environment, from the changing marketplace, from *customers*—who tend more often than not to be fickle, unpredictable, unreasonable, illogical, contrary, and demanding. Market research is often conducted in the conference room, where it can be done much more tidily, free from the distractions of the real world—and where it

usually confirms management's conviction that the products and services the company is presently producing are the products the market needs most.

THE TRUE ROLE OF THE ENTREPRENEUR

Many entrepreneurial managers, to their dismay, find their efforts to force top management attention to the changing needs of people increasingly frustrated. Therefore, they break away from the establishment to create new companies and new industries: as Robert Noyce did when he left Fairchild Camera to develop the electronic marvel of the 1970s, the microprocessor (and built Intel Corporation into a \$150 million business); as Gene Amdahl did when IBM rejected his proposal to create a new supercomputer; and as Fred Smith did when he built Federal Express from a vision into a major force in distribution. Unfortunately, every time an entrepreneur departs the corporation, some of its vitality goes as well.

The corporation tends to view the entrepreneur as a gambler, a high roller, even as a predator within its ranks—one who seeks to wrest control of the company's resources away from those appointed to guard them. The true role of the *entrepreneur*, as one who directs resources from less productive into more productive investments and thereby creates wealth, has been forgotten. Most firms were single-product organizations when the early English economist, Edwin Cannan, defined the function of the entrepreneur thusly:

The power of managing industry is attributed not to the mute and inanimate capital, nor even to the owners of capital, but to the *entrepreneur . . . who directs industry into particular channels by virtue of the orders of the consumer*, whose demands must be satisfied on pain of bankruptcy.²

This conception of the entrepreneur's role as the one who responds to consumer's changing needs is still valid—even in an age of multimarket, multiproduct, multitechnology, multinational, multibillion-dollar corporations. Only when the entrepreneur is correctly perceived as *a manager who anticipates needs and seeks the resources to fulfill them*, only when management recognizes that a continuous shifting of internal resources is a necessary condition for meeting market needs, and only when the corporate structure is redesigned to accommodate the entrepreneurial manager will the entrepreneur find his or her place in the corporation and the organization become truly productive.