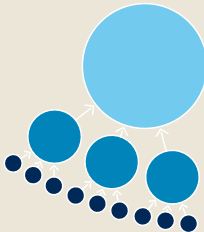


THE ALIGNMENT PUZZLE

WHITE PAPER

The history and development of Management By Objectives (MBO)



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1. The origins of MBO

One of the most influential concepts for task assignment is Management By Objectives (MBO), which was developed in the 1950s. What were the basic ideas and assumptions behind MBO, and how do they still influence organizational alignment today? In this chapter, we delve deeper into this.

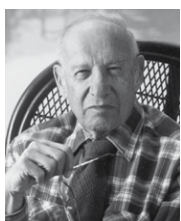
The man widely regarded as the father of all management gurus, Peter Drucker (1909–2005), first described the basic concepts of Management By Objectives (MBO) in 1954. Drucker published more than thirty books and was born in Vienna. He fled Europe when the Nazis came to power, just like other famous scientists such as Albert Einstein and Edgar Schein.

Drucker joined General Motors (GM) in 1943, where he conducted social scientific research by interviewing managers and attending board meetings. At the time, GM was the largest company in the Western world and produced no fewer than six different car brands, the best known being Chevrolet and Cadillac.

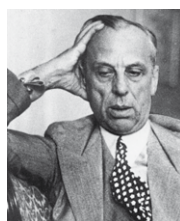
1.1 ROI

The boss of GM was the legendary Alfred P. Sloan (1875–1966), who introduced new management ideas such as the divisional structure with business units and performance metrics like Return on Investment (ROI). During his tenure, GM performed significantly better than its main competitor, Ford. When the young Henry Ford II took over leadership from his father in 1945, he adopted many of GM's management principles and methods and applied them to business operations within Ford.

Peter Drucker had great respect for Alfred Sloan, but he certainly could not fully agree with his management principles. Sloan strongly emphasized a corporate business structure with strict accountability mechanisms. He viewed the company primarily as a money-making machine that had to be managed in a technical and rational manner by a straightforward manager. Drucker saw no merit in this financial-technocratic approach. He regarded a company primarily as a system of people.



Peter F. Drucker
(1909 - 2005)



Alfred P. Sloan
(1875 - 1966)

1.2 Self-management

Largely based on his experiences at GM, Drucker presented a new ‘Philosophy of Management’ in his book *The Practice of Management* (1954)¹. Management By Objectives (MBO) was to replace Management By Control (MBC). Managers no longer needed to be directed by their superiors in the old-fashioned way—they could manage themselves, provided the targets or objectives were clearly defined. Drucker was convinced that effective self-management would render top-down control unnecessary and that this would be accompanied by enormous progress in effectiveness and management performance. He also believed that every manager, at any level in the organization, should apply MBO and self-management, based on normal human action, behavior, and motivation.

1.3 Core principles

The core idea behind MBO is to make the shift from ‘accountability based on tasks’ to ‘accountability based on results’, where managers themselves are allowed to determine how they want to achieve those results. Peter Drucker described the core principles of MBO as follows:

1. All managers, at every level of the organization, have their own clear objectives, which are carefully determined in close consultation between the manager and the supervisor, and which are fully consistent with the common goal of the organization.
2. These clearly defined objectives determine:
 - for which performance the manager’s department is responsible,
 - what contribution this department makes to helping other departments achieve their objectives to reach, and
 - what contribution the manager can expect from other departments to his to achieve own objectives.
3. His superiors evaluate the manager’s performance based on the objectives and give the manager the freedom to decide how the desired results are achieved, within the limits of the law and applicable rules. Such self-management can only lead to ‘true freedom under the law’.

When setting up an MBO system, the objectives must be formulated in such a way that they are ‘SMART’ (Specific, Measurable, Assignable, Realistic and Time-Related)².

1.4 The president’s Gestapo

To make self-management effective, every manager must gather all the information needed to measure themselves and the team. So-called ‘hidden’ information that only would be available to senior management is unacceptable. Peter Drucker emphasizes the openness of information.

1 Peter F. Drucker (1955). *The practice of management*. Chapter 11 – Management by Objectives and Self-control. Butterworth-Heineman.

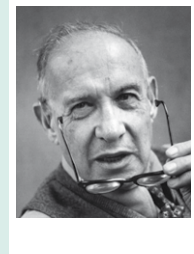
2 G. T. Doran (1981). There’s a S.M.A.R.T. way to write management’s goals and objectives. *Management Review*. AMA FORUM. 70 (11): 35–36. Wiley-Blackwell.

At competitor Ford, things were very different. There, a special audit department existed that reported only to the CEO, without informing the managers of the department in question. How those managers felt about this becomes immediately clear from the nickname they used for that special audit department: the president's Gestapo.

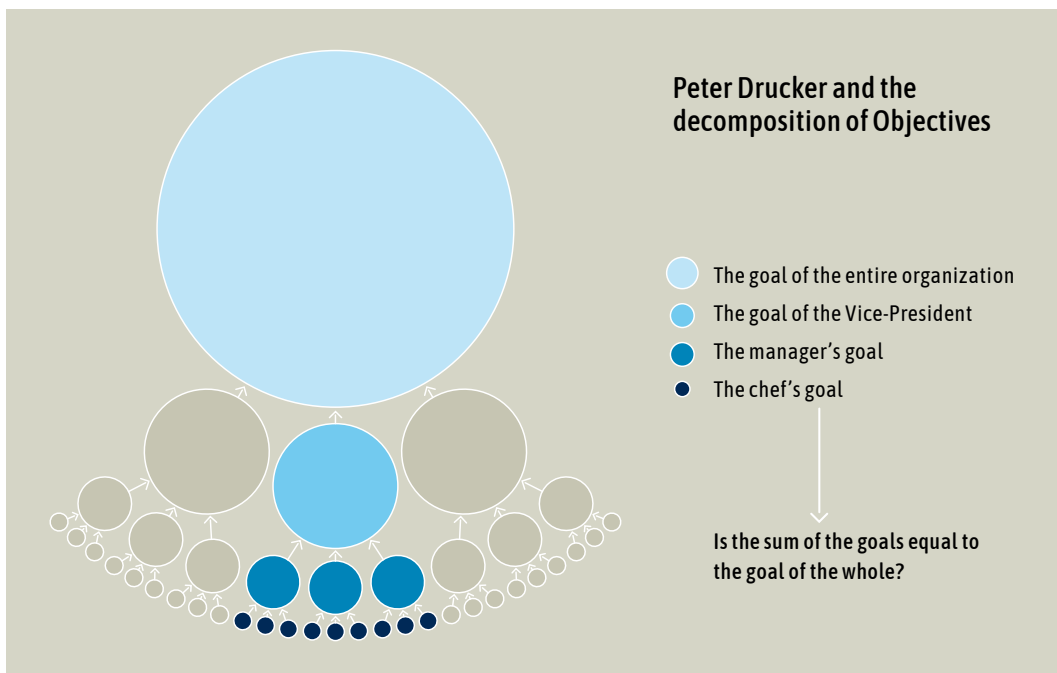
Peter Drucker and the decomposition of Objectives

'Each member of the enterprise contributes something different, but they must all contribute towards a common goal, and each manager's job must be focused on the success as a whole.'

– Peter Drucker (Vienna 1909 - 2005 California)



Drucker could not emphasize enough that the objectives of all managers must be geared towards the common goal of the organization. In his aforementioned book, he makes this point in dozens of places in various ways. His primary concern was preventing mismanagement by the boss and ensuring that no small, self-contained kingdoms would emerge within the company that concerned themselves only with their own goals and thus lost touch with the rest of the business.



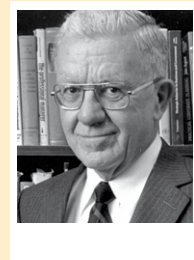
2. The development of MBO

After its publication in 1954, the concept of MBO was further developed by various other authors. One of the best known among them is George S. Odiorne (1920–1992), a student of Peter Drucker in New York and inspired by his vision. He later became a professor in Michigan.

In 1965, Odiorne described a practical method for implementing MBO³. The system must not be too complex or philosophical and must not be dominated by mechanical considerations. It must be understandable and as self-regulating as possible.

Examples of MBO Objectives

General Management	Profit
Sales	Revenue, margin
Service	Unit price for delivered service
Production	Cost per product produced
Office / Research	Promised budget



Source: George S. Odiorne (1965). *Management by Objectives* (Pitman Publishing).

He also describes the relationship between MBO and manager evaluation and the impact on his salary and promotions. His motto was that subordinates can only be successful if they help their superior succeed. But he also warned: ‘You can hold goals accountable for results, but don’t let it smell like old-fashioned incentive pay.’

Like many other authors, George Odiorne pays little attention to the danger of self-contained mini-kingdoms and local optimization. Nor does he address the necessity for managers to help other units achieve their objectives—in short, the pitfall that Peter Drucker so emphatically warned against.

3 George S. Odiorne (1965). *Management by Objectives. A system of managerial leadership.* Pitman Publishing.

3. Critics of MBO: Which objectives? Whose?

MBO seemed very attractive in its early years, but unfortunately, there are not many known success stories regarding MBO implementations since the 1970s. In many companies, the system failed due to excessive meetings, paperwork, and reports. Implementing the system properly involved a great deal of hassle. Moreover, it was sometimes used to dump unrealistic goals on managers. Naturally, this led to frustration and demotivation.

And because a strong link was too often made with salary and promotion, that ‘smell of old-fashioned performance-based pay’ always lingered.

3.1 Dangerous

William Edwards Deming, the spiritual father of Quality Management, argued that a lack of understanding of systems leads to the incorrect application of objectives. A one-sided focus on objectives when using MBO is dangerous. ‘What is measured is done, and the rest is forgotten.’ Setting production goals in terms of daily numbers, for example, will encourage employees to achieve those goals using all necessary means, which usually results in poor-quality products.

It speaks in Peter Drucker’s favor that he himself recognized the limitations of his brainchild in practice. In the 1990s, he himself stated that MBO is not a miracle cure:

MBO is simply a tool. It is not the cure for management inefficiency. MBO works if you know the objectives. But in 90% of cases, you don’t know them.

3.2 Human nature

In 1970, Harry Levinson, professor of psychiatry at Harvard, demonstrated even more convincingly the vulnerability of setting linear objectives and managerial evaluation systems. He published an article on MBO whose title speaks for itself: *Management by whose objectives?*⁴

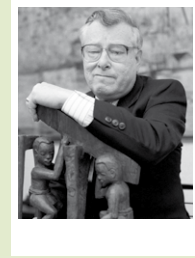
According to Levinson, MBO does not work well for one important reason: the system overlooks the human aspect. Self-motivation only arises when the needs of the individual and the demands of the organization coincide. He advises anyone applying the MBO principle to have managers be regularly evaluated by their own subordinates.

4 Harry Levinson (July 1970). *Management By Whose Objectives?* *Harvard Business Review*, page 125-134. Harvard Business Publishing.

Which objectives? Whose?

“Management by whose objectives? Management performance appraisal systems don’t take employees’ aspirations into account. Is it any wonder they fail?”

1970, Harry Levinson (1922 - 2012)



3.3 Meaningful

Linda Hill, also a professor at Harvard, described the task of a manager in 2010 as ‘supportive autonomy’⁵. Like Peter Drucker, she points out how important it is that all employees and managers fully understand their share in the company’s success and that no one starts acting for their own benefit. Goals must be meaningful and connected to the organization’s mission and objectives.

Hill warns that the superior’s objectives should not be the sole guideline for formulating goals. An interesting finding from her research is that the personal ambitions of young managers sometimes overlap more with the common good than with the objectives of that young manager’s superior.

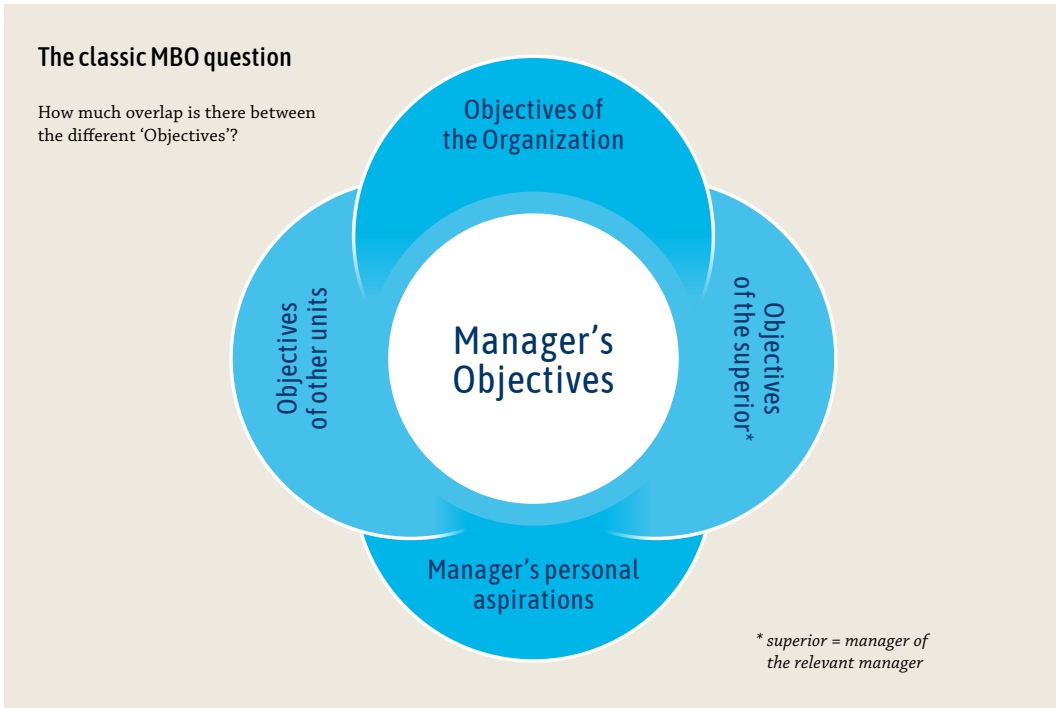
3.4 Balance of power

The balance of power between employer and employee has changed over the past fifty years. Employees no longer expect their managers to merely hand out rewards, but also to solve problems, protect them, and support their personal growth.

In short: care about them. Only good bosses in well-managed organizations can retain good people. New employees at a company usually take the job because they choose that company. But employees who leave a company usually do so because they want to leave their boss.

All in all, one must conclude that the main weak point of MBO lies in the first step: determining and defining the ‘Objectives’.

5 Linda A. Hill, and Kent Lineback (2011). Being the boss – The 3 imperatives for becoming a great leader. *Harvard Business Review*. Harvard Business Publishing.



People too easily assume that the manager and his or her superior put their heads together in perfect harmony and subsequently determine objectives that perfectly serve the company's goals, plus the superior's objectives, the goals of other departments, and the manager's personal ambitions. In reality, of course, that is not how it works. Differences almost always remain that can lead to misalignments and mutual friction.

3.5 Goals gone wild

In 2009, Harvard Business School published a paper titled Goals Gone Wild⁶. It contained a long list of examples of problems arising from the use of local goals, such as limited focus, sub-optimization, and even unethical behavior. As a playful initiative, the Harvard team developed a warning label to highlight the dangers associated with setting goals.



6 Lisa D. Ordóñez, Maurice E. Schweitzer, Adam D. Galinsky, and Max H. Bazerman (February 2009). Goals Gone Wild. *Academy of Management Perspectives* 23 (1). Academy of Management, United States.

4. iMBO or Objectives & Key Results (OKR)

A more contemporary version of MBO was developed in the 1980s by Andrew S. Grove (1936–2016). Grove was one of the founders of Intel, the world’s largest semiconductor manufacturer. He is widely regarded as the most influential manager of the 20th century. What the legendary Alfred Sloan was to the automotive industry in the 1950s, Andrew Grove was to the IT industry in the 1990s.

At a young age, Grove escaped communist Hungary in 1956, arriving penniless in the US. In 2001, he wrote in his memoirs:

“By the time I was twenty, I had endured a Hungarian fascist dictatorship, a German military occupation, the Nazi Final Solution, the siege of Budapest by the Soviet Red Army, and various communist regimes, plus a popular uprising during which I came under fire. (...) Many young people were killed, countless others ended up in prison. About 200,000 Hungarians managed to escape to the West. I was one of them.”⁷

4.1 Intel-MBO

As a variant of Peter Drucker’s MBO, Grove developed a system to align managers and employees and enable them to collaborate. He initially called his system Intel-MBO or iMBO, but later changed the name to OKR, which stands for Objectives and Key Results.

Every manager or employee must have 3 to 5 objectives, and each objective must lead to 3 to 5 key results. The OKRs are transparent and public. This also applies to the OKRs of top management. OKRs have a limited lifespan and can be modified or removed at any time. They must not be linked to a bonus system and must not be imposed top-down. Instead, they must be developed bottom-up and often laterally as well, in consultation with colleagues or other parts of the organization.

According to Grove, the essence of a healthy OKR culture lies in the combination of ruthless intellectual honesty, disregard for self-interest, and dedicated loyalty to the team.

7 Andrew S. Grove (2001). *Swimming Across*. Warner Books.

4.2 More flexible

The most important advantage of OKR over MBO is that it is much more flexible. Flexibility is an absolute necessity in the rapidly changing and highly volatile world of IT. It is also more suitable for highly educated employees who enjoy being challenged and want to take responsibility, and is therefore more easily accepted.

According to John Doerr, a student of Grove and the man who later introduced the system at Google, the main differences between classical MBO and OKR are as follows:

MBO	iMBO (=OKR)
What	What and how
Annual	Monthly
Private and in silos Top-down	Public and transparent
Top-down	Bottom-up or sideways
Linked to a reward	Usually separate from reward
Risk-averse	Aggressive and ambitious

In 1999, John Doerr was about to invest \$12 million in a small startup named Google. He was enthusiastic about the amazing technology, the entrepreneurial energy, and the sky-high ambitions of the two founders, Larry Page and Sergey Brin. But he saw a problem in the fact that there was no business plan or management system. He decided to give a presentation to the young entrepreneurs about OKRs and how these had worked for Intel.

Later, Larry Page said about this: 'John gave us a great gift. OKRs have helped us grow ten times faster.'

OKR is the 21st-century version of classic MBO. While MBO was developed against the backdrop of the assembly lines of the American automotive industry in the 1950s, OKR was developed for the IT world of the 1980s and 1990s. These are two very different worlds; just look at the average education level of the employees and the dynamics of the product life cycles. Two different management styles also belong in those two different worlds.

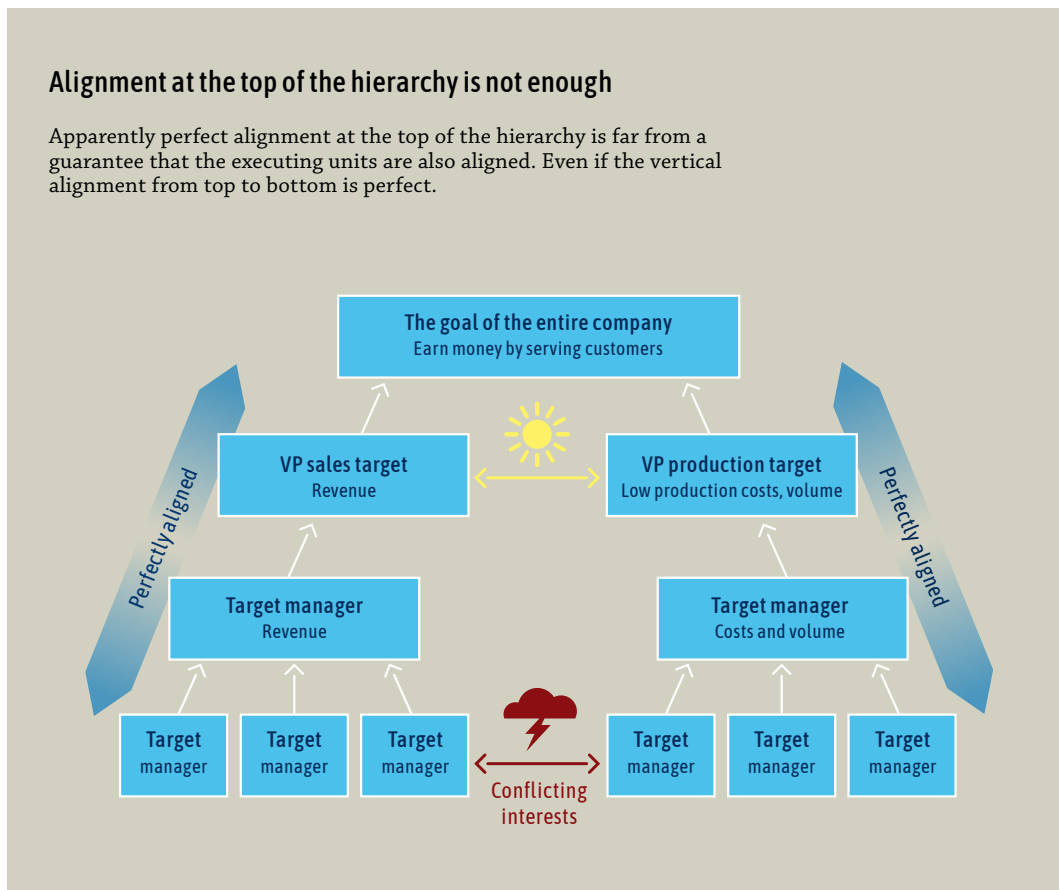
5. Alignment in the boardroom does not yet mean alignment on the work floor

Much criticism of MBO has already been described, but in this final paragraph of this chapter, we would like to raise a point that is often overlooked. A rather fundamental point.

MBO contains the hidden assumption that if high-level goals are not contradictory, lower-level goals are automatically not contradictory either. But this is simply not true.

The following example illustrates this. Profit is the difference between revenue and costs. So, if you want to make a profit as a company, you can consider making one person responsible for the highest possible revenue and another person for the lowest possible costs.

At first glance, there seems to be no problem: if they both do their job well, we will automatically achieve the highest possible profit. But in daily operations, countless conflicts will arise because the two goals are contradictory in many situations. Do we use expensive, high-quality raw materials or cheaper ones? Do we work overtime to make a customer extra happy?



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The questions of which goods must be produced, when, in what quantity, and to what quality standard, yield a different answer if you think from the perspective of a cost budget than when you think from the perspective of a revenue target.

When assigning revenue and cost targets, artificial conflicts of interest are created regarding matters such as batch sizes, production planning, lead times, safety stocks, customer promises, and quality control. If trade-offs at a higher level are not properly made and there are no clear boundaries and guidelines for the playing field, conflict and struggle quickly arise.

And those misalignments lead to losses on both sides: high costs and negative consequences for customer service.

Peter Drucker foresaw this problem. That is why he kept emphasizing that the contributions managers make to the whole (vertical) are just as important as the contributions managers make to help other managers achieve their objectives (sideways). Unfortunately, this rarely worked out well.

Our conclusion is that it is insufficient to agree on the distribution of tasks and responsibilities at the highest level. Alignment is not a boardroom matter, but something that must apply to the entire organization. You will need to translate this to lower levels to prevent the emergence of various conflicts of interest that lead to problems during implementation.



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Read *The Alignment Puzzle*, the new standard work on alignment in organizations.

www.alignmentpuzzle.com

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