

# Reflections on Some Complex Management Methods: Management by Objectives and Management Based on Profit Centres

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## **Abstract**

*Management methodologization is undoubtedly the most important means of professionalizing managers and management, as well as a major direction of optimizing the organization's management. This statement is supported by two important arguments: the first refers to the content of the methodological component of management – the management instruments and the methodologies for designing, redesigning and maintaining the operation of the management system and its subsystems – , and the second one refers to the functions that this component fulfils within the organization's management – scientizing the performance of managers and ensuring the methodological support for the performance of management processes. If the management instruments that should be used by those leading and managing the organization or its organizational subdivisions include management systems (complex methods), methods and techniques, such as management by objectives, management based on profit centres, management by projects, management by exception, diagnosis, SWOT analysis, dashboards, decision-making methods, creativity methods, cost management methods, etc., the methodologies used are both general (the managerial reengineering methodology, the strategic management methodology) and specific (the methodologies of redesigning each management component, the methodologies of promoting and using management systems, methods and techniques, etc.) .*

*Management by objectives and management based on profit centres stand out both as management instruments, as well as through the methodologies that they focus on. The content, characteristics, manner of operationalization and use, implications for the functionality, efficiency and efficacy of the organization and its management are just a few specific elements of the two management systems that we are going to refer to.*

**Keywords:** *management methodologization, management by objectives, management based on profit centres, business format, management centre, knowledge spiral.*

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## **1. Brief considerations with regard to management by objectives and management based on profit centres**

Management by objectives (MO) and management based on profit centres (MCP) are two of the most complex and sophisticated management instruments, that are used in order to define, measure and achieve the organization's objectives, from fundamental to individual objectives. Since management based on profit centres represents a development of management by objectives, as another complex management method, i.e. management by budgets, is encountered much more prominently in the methodology for its promotion and use, we shall attempt to discuss them together. There are numerous common elements, compared to the specific elements, that cannot significantly differentiate the respective complex management methods.

### **1.1 Coordinates**

With regard to the dimensional and functional characteristics of these complex management methods, major similarities can be observed, meaning that they both stand out through the same coordinates. One can observe certain differences with regard to the manner in which some of the coordinates are manifested, such as the complexity (which is superior in the case of management based on profit centres, due to the inclusion of management by budgets and certain methods of management by costs), managerial and economic decentralization (more obvious in the case of management based on profit centres, where the management centres and budgets developed at their level are much more suggestive). The first of the coordinates is the high level of complexity, due to the fact that their application targets all of the procedural and structural components of the organization and their actual use can involve many other management methods and techniques, depending on the problems associated with the substantiation, establishment and achievement of the objectives. The managerial dimension, i.e. the management decentralization within the organization, given the appearance of new "actors", referred to as management centres, characterized through duties, responsibilities and powers that are superior to those of simple organizational subdivisions (activities or compartments), is an undeniable advantage of the two complex management methods. Management centres, in their two forms - profit centres and expense centres – becomes fundamental structural or procedural components within the economy of the organization (private company or public enterprise), especially in the case of MCP, with a high level of decision-making and operational autonomy.

The economic dimension supplements the previous characteristic, being ensured by the use of the budget as an important economic-financial instrument in management. This is drafted, launched, implemented and monitored both at the level of the enterprise, and at the level of the management centre. For this purpose, the use of other economic levers, with great motivational characteristics (profit,

salaries, prices, etc.) is facilitated. Added to this are the participatory dimension, meaning that, when establishing the objectives and other components of the budget, the active and responsible participation of the managers of the management centres and of other managers and providers within them is necessary and facilitated, and the motivational dimension, represented by the correlation of rewards/sanctions with the degree of achievement of the individual objectives of the management centre and the organization (enterprise), as well as with the degree of involvement, participation of each employee in their achievement. The concept of individual, group and organizational performance becomes the central element of the motivational mechanisms promoted by the complex management methods that we are referring to.

## 1.2 Components

With regard to "components", there are no differences between MO and MCP. Both have identical components: the system of objectives, action programmes, deadline calendars, instructions, budgets and management methods/techniques that can be used in order to achieve the objectives. If the system of objectives includes fundamental objectives, 1st degree derived objectives, 2nd degree derived objectives, specific and individual objectives, the supporting elements necessary for their achievement – action programmes, containing the decisions that are to be made, the initial actions for their application and the allocated resources, the deadline calendars, instructions, management instruments used and the budgets that are substantiated, drafted, launched, implemented and monitored at the level of the organization and management centre– are identical for the two complex management methods. In the case of MCP, one must note that the budgets are much more important compared to MO, as the sectorisation of the organization into management centres and the drafting of budgets at the level of such centres is extremely important, thus ensuring a significant managerial and economic decentralization (see Burciu, 1999).

## 1.3 Promotion and use methodology

The methodological scenario for the promotion and use of the MO and MCP consists in several stages, the observance of which is mandatory in order to ensure the success of these complex management methods. The comparatively higher complexity of MCP compared to MO is due to the fact that it makes use of some specific methodological methods:

- *management by objectives*, from which it takes its manner of breaking down objectives ("top-down", starting with the fundamental objectives and, cascading from there, continuing with the derived and specific objectives and ending with the individual objectives), the supporting

elements necessary for the achievement of the objectives (action programmes, deadline calendars, instructions, budgets etc.);

- *management by budgets*, which provides it with the methodology for substantiating, drafting, transmitting, implementing and analysing budgets, at the level of the organization and management centre;
- *the labour-hour-rate system (SCOP)*, i.e. the completely new methodological means of determining the overall costs and the product-level costs (by calculation items, other than those that use the calculation by calculation items recommended by the Law on accounting: raw materials, materials, collaborations (third-party efforts) and labour-hour-rate expenses (own operating expenses). We would like to mention that using SCOP is only possible for companies with products and a technology that are of medium to high complexity.

A first stage is dedicated to determining the fundamental objectives, the achievement of which both its present and, especially its future depend on. Fundamental objectives are quantified and/or qualitative expressions of the purpose for which the organization was established and is operating. More often than not, the fundamental objectives are associated with increasing/maintaining/optimizing the profit. They are the starting point for establishing the other categories of objectives (derived and specific, in which case "team-based" MO and MCP can be invoked and derived, specific and individual objectives, in which case "individual-based" MO or MCP shall apply). The two stages ensure the configuration of the system of objectives, the accuracy and realism of which shall be essential for the following methodological sequences of the operationalization and use of the complex management methods that we are referring to.

The third stage is the substantiation of the supporting elements necessary for the achievement of the objectives: action programmes, deadline calendars, instructions and budgets, with the latter being essential for the economic-financial success of the use of MO, but especially of MCP. Of course, a distinct stage is the substantiation and drafting of the general budget of the organization, with a content structured into four chapters: objectives (fundamental and first degree derived objectives), expenses, revenue and financial results. From the perspective of managerial and economic decentralization within the organization, it's necessary to delimit and establish the dimension of the management centres (expense and profit centres); the management centre is a procedural or structural component of the organization, with a high level of decision-making and operational autonomy, which has its own budget. Thus, the delimitation criteria area: the procedural criterion, the structural-organizational criterion (the most widely-used) and the mixed criterion (procedural and structural-organizational). After the management centres are delimited and their dimension (technical, economic etc.) is established, the most important sequence is the substantiation and drafting of their budgets; the budget structure consists of the same four generic chapters: objectives (2nd degree derived objectives and specific objectives), expenses (easier to identify when using SCOP), revenue (also easy to identify in the case of enterprises specializing in

objects, compared to enterprises specialized in technology) and economic-financial results (the profit or the contribution of the management centre to the profit of the enterprise).

After the budgets are drafted, they are launched, by drawing up the launch documents. This is followed by the implementation of the budget, which, naturally, focuses on achieving objectives. In practice, the allocation of the resources the dimension of which was established through the action programmes takes place, at the same time as the operationalization of the means of achieving the objectives. During the budget implementation, what is very important is to coordinate and monitor the achievement of the objectives, achieved through management by exception (for large volume or mass production enterprises) or the dashboard.

The penultimate sequence of the methodology consists in evaluating and analysing the results, comparing them with the undertaken objectives (at the level of the organization, management centres and position), identifying the causes that generate economically favourable or unfavourable deviations and determining the "guilty parties". This sets the scene for the last stage, motivating the personnel, based on the level of achievement of the individual objectives, the level of achievement of the objectives of the management centre and the level of achievement of the objectives of the organization.

## **2. The stage of implementation and use in Romanian organizations**

Upon superficial consideration, it would seem that many of the medium and large enterprises, either public or private, plus some devolved public institutions, have proceeded to operationalize MO (of these, a few could even be said to have operationalized MCP in the methodological version that we presented in the previous pages), since the practice of such socio-economic entities circulates and actually makes use of methodological elements and concepts such as: objectives, budgets, performances, economic decentralization, managerial decentralization, differentiated motivation, etc. Upon careful consideration, however, the reality turns out to be different. It's true that the concepts that the two complex management methods, MO and MCP, but especially MO, make use of are often invoked in the analyses performed with regard to the state of the management. However, their operationalization is marked by many limits, that we are going to discuss further.

Our first observation is in relation to objectives, a major component of both management system that we are discussing, and the result of the forecasting function, together with the means of achievement, the necessary resources and the achievement deadlines. The limits that mark the establishment of objectives are associated with the very concept of objectives – when presenting the list of objectives, one frequently encounters wordings that create confusion with regard to certain procedural components required by (in) their achievement, such as the duties or tasks that must be set into motion by a position or compartment – as well as their cascading, meaning the outlining of a system of objectives that contains

fundamental, derived, specific and individual objectives. The lack of coherence in the successive substantiation of the five types of objectives and the procedural elements required for their achievement leads to the appearance of a "mix" of objectives that are poorly defined and insufficiently connected to the structures responsible for their achievement and, of course, to inevitable difficulties in obtaining the expected results. Even in the case of organizations that use more pretentious wordings, such as "performance objectives", these are limited to a list of objectives that are insufficiently substantiated and are not synchronized with the official and personal authority of the person involved in their achievement. From this point of view, even management agreements or contracts of mandate sometimes suffer considerably in relation to objectives, since their inconsistency or confusion with the performance criteria end up generating a hindrance for the holder of such contract or agreement.

Our second observation refers to the level of managerial and economic decentralization within the organization applying MO or MCP. The instrument used by the companies that take themselves seriously is referred to as a "budget". But does a situation where the budgets are drafted based on the management centres (often delimited based on the structural-organizational criterion) create favourable conditions to invoke a genuine economic decentralization? Our answer to this is negative, since such budgets, even though they contain information with regard to the expenses and, partially, to the revenue of the structural component treated as a management centre, do not substantiate them in accordance with its objectives (2nd degree derived and specific objectives). In addition, neither the monitoring, nor the evaluation of the budgets ensures the informational feedback necessary for superior managers, capable of substantiating appropriate correction or updating decision.

Our third observation is that, in applying and using MO and especially MCP, even partially, the technological characteristics of the beneficiary enterprises are not considered. These enterprises come in two forms: enterprises specialising in objects and enterprises specialized in technology. Where those that are part of the first category obtain finished products at the level of structural components organized as profit centres, those specializing in technology can obtain a product that is structurally and technologically complex through the contribution of several procedural or structural components. These aspects should be considered both with regard to the establishment of objectives, and with regard to the budgets of the management centres. Another thing that is not considered is the particularities generated by the novel character of the manufactured and marketed products, the manner of substantiating the prices and costs, the stage of the life cycle of each product (Deac et al., 2017, p.34).

A fourth observations: why are the managers of organizations that exercise their position based on a management agreement and are responsible for the achievement of certain objectives branded with the label of "faulty management" if such objectives are not achieved? If a genuine managerial decentralization were truly in place, such as in the case of MO and MCP, such situations would not

occur, since it's not only the CEO of the enterprise or institution that is responsible for this, but also other persons holding inferior positions, who were in charge of a certain type of objectives. Were the use of management and service provision agreements extended within the organization that uses MO and MCP, each profit or expense centre manager would be accountable and maybe the mandate that such an agreement is associated with would not be as short as it currently is.

Finally, an observation that only refers to public enterprises and devolved public enterprises that use MO or MCP. For public enterprises (national companies, autonomous administrations, etc.), Emergency Government Ordinance 109/2011 was issued and applied in order to prevent the politicisation of the management. It was unsuccessful. They remain, just like the public institutions that we referred to, at the mercy of the political factor, with the actual application of certain complex management instruments, such as MO or MCP, being conditioned by a certain temporal consistency, i.e. enough time, required by their management to correctly apply and enjoy the benefits of using one of the above-mentioned complex methods. However, this is not the case in the management practice. The political instability is generating a managerial and legislative instability, with an unfavourable impact on the functionality and performance of these types of organizations.

### **3. New developments in the promotion and use of MO and MCP**

The experience accumulated during recent years in using these management instruments in certain Romanian organizations (enterprises and public institutions), as well as the research in the field, have allowed us to highlight several innovative elements that we shall discuss briefly, noting that some of these are closely connected to the transition to knowledge-based organization and management:

- The amplification of the „areas” of promotion and use of MO, from private enterprises (known as belonging to the SME sector), to public enterprises (in accordance with Emergency Government Ordinance 109/2011, these come mainly in the form of national companies, autonomous administrations, financial and credit institutions) and even to public institutions with a professional bureaucracy (higher education institutions, hospitals etc.) or to fiscal administration institutions (regional directorates or tax offices). In this regard, one can observe a paradigm shift in the managerial approach of some national agencies/authorities and public institutions subordinated to them, according to which ”performance objectives” represent the standard based on which the results of the managers of the respective organizations are evaluated. Thus, objectives become the fundamental condition for the success of the two complex management methods. The attention paid to them focuses, on one side, on the observance of certain requirements (known as SMART, i.e. specific, measurable, approachable, realistic and observing the timeframe) and, on the other side, on a ”top-down” cascading of these objectives that is as realistic as possible, from fundamental to individual

objectives, specifying the procedural components directly involved in their achievement. The answer to such challenges is the prioritization of the management forecasting function, the exercise of which involves the establishment of objectives, means of achievement, necessary resources, and the specification of the interim and final achievement deadlines. The expression associated with the forecasting function - "the most important management function", is justified by the importance of objectives in the economy of the organization and its management, as none of the other functions – organization, coordination, engagement or control-evaluation - is possible without reference to the objectives!

- The optimization of the relations between centralization and decentralization within the organization based on: its economic power, its position on the market, the opportunities and dangers of the national and international environment, the type of organizational structure, the predominant management styles, the organizational culture. The use of MO or its more evolved version, MCP, allows for the consolidation of certain procedural components (mainly activities) or structural components (compartments or directorates/departments) from an economic, commercial and managerial point of view. These become genuine management centres, with their own budgets, their own objectives, etc. This may be the case of production workshops or sections in an enterprise, medical departments in a hospital, faculties or departments in a university, public institutions subordinated to a governmental authority or agency or certain distinct activities (business processes) in private or public enterprises.

- An increase in the level of individual and group accountability due to: the amplification of the operational and decision-making autonomy of the management centres; the establishment of realistic and mobilising objectives for all of the "actors" of the work processes; the transformation of certain expense centres into profit centres, by establishing the dimension of the contribution to the company's profit; the reconsideration of auxiliary and functional compartments as providing managerial, economic, commercial, technical and other consultancy services for the organizational subdivisions that generate economic substance. Objectives represent the starting point for any complex organizational and/or managerial change endeavour. Based on their volume, complexity and diversity, the management human resources, methodological, informational, decision-making components, structures, processes are designed or redesigned. (Verboncu, Serban, 2015). Fundamental (strategic) objectives, together with the other categories determined through their cascading, require that certain processes be "set into motion". These processes are rigorously delimited, and their dimension is established from a corresponding structural-organizational, informational and human point of view. They can be encountered as functions, activities, duties and tasks. Since the processes need an appropriate structural-organizational support, it's just as necessary to delimit and establish the dimension of certain structural components that, in the context of MO or MCP, become management centres. Peter Drucker, the initiator and promoter of MO, states that "each manager, from the big boss to the foreman and head of clerks, needs clear objectives. These

objectives should refer to what must be achieved by each unit subordinated to a manager...These objectives should always be derived from the objectives of the lucrative enterprise..., (Drucker, 2010, p.103).

- The promotion of the management agreement within the organization that uses MO and especially MCP, as a legal instrument for the accountability of the CEO and the management centre manager, the first with regard to ensuring the necessary conditions for the achievement of the objectives and the second with regard to the results achieved in relation to the undertaken objectives. What is very important from the perspective of taking responsibility for the achievement of the objectives included in the management agreement is the type of objectives included in this document. In order to avoid mistakes on the part of the employer (that also organizes the contest for the selection of the natural person manager), we propose that the management agreement concluded by the manager that is declared the winner of such contest include the fundamental and 1<sup>st</sup> degree derived objectives of the respective organization, as specified in the management programme, while the management agreements concluded with the managers of the management centres refer to the 2<sup>nd</sup> degree derived and specific objectives. We believe that this "detail" is extremely important for an approach based on stages of the level of achievement of the agreement. If this "detail" is not considered, this may lead to the performance of the manager being branded, sometimes without justification (see the frequent cases in public enterprises with private management, in some devolved public institutions or in hospitals or other structures subordinated to the local public authorities).

- The promotion and use of service provision agreements between providers of technical services (maintenance and repair of production equipment, utility provision), commercial services (ensuring and managing material resources, sales, marketing etc.), economic-financial services (accounting, record-keeping) etc., on one side, and the beneficiaries of these services, i.e. the management centres within the field of production. Thus, a system of managerial and economic connections, with a favourable impact on the state of order, discipline and rigour, necessary for the promotion of MO or MCP, is formed.

- Ensuring a high procedural and structural-organizational mobility, including through job enrichment and enlargement – efficient means of mitigating or eliminating the phenomenon referred to as the "silo effect", specific to a mechanistic bureaucratic organization.

- The improvement of the organizational climate and the organizational culture in general, from the perspective of achieving operational excellence at the level of the management centres in the field of production and, implicitly, managerial and economic performance. Both MO and MCP are genuine providers of efficiency and efficacy, of performance at the level of the enterprise and management centres, through the promotion of the characteristics of order, discipline and rigour, through the high organizational and decision-making autonomy of management centres or through the significant accountability of the

management centres or through the significant accountability of the managers and providers in the achievement of objectives.

- The promotion of motivational mechanisms focused on the level of the achievement of objectives and on (individual, group and organizational) performance. Thus, one of the defining characteristics of motivation as a support for engagement, i.e. its differentiation, becomes possible.

- The promotion of a new concept and a new management practice: the business format. In the case of medium and large enterprises, it's recommended, as mentioned above, to use MCP and other complex management methods, such as management by projects, separately or together. Given the fact that many of these methods specialize in technology, as well as objects (the semi-finished products obtained after each sequence of the technological process can be marketed as such, as finished products, or can continue their route until the finished products that the company specializes in are obtained), the first novel element appeared and was consolidated: each of the delimited profit centres turned into a "business format", led and managed by the manager, who is responsible for the achievement of the objectives (Florescu, Luca, 2007, pp. 309-354). Since such a profit centre has a high, but not full, operational and decision-making autonomy, the first condition that is imposed is being "part of a whole", i.e. participating in the achievement of the enterprise's fundamental and 1<sup>st</sup> degree derived objectives. After fulfilling its obligations to the parent undertaking, the profit centre can produce "for itself", without exceeding the limit of the existing production capacity and the market demand, with the surplus being used for the additional motivation of its components. Any boycott from a profit centre is not permissible, since a management agreement is concluded between the management of the company and the manager of each profit centre. This agreement contains firm rights and obligations for each of the parties.

- The franchising of the business formats, led by entrepreneur managers.

- Reconsidering certain organizational documents, such as the regulation on organization and operation and the job description, from the perspective of transforming them into genuine management instruments, supporting the managerial and economic decentralization and the efficient operation of the business formats. For the first time, one can speak of the regulation on the organization and operation of the business format, its organizational chart, the decision-making-informational document of the manager of the business centre etc.

- Management by costs reaches a new level, especially when promoting and using MCP, by using some means of substantiation, evaluation, control and analysis of the costs that are much closer to the place and cause of the appearance of an expense category. From this perspective, the labour hour rate system (SCOP) is the best in terms of responding to the managerial requirements with regard to realism, appropriateness and rigour of the costs.

- MO and MCP are directly involved in management methodologization, which is also one of the main means of professionalizing managers and

management, together with continuous management training, management consultancy and the improvement of human resources management.

- In the context of managerial reengineering, MO and MCP represent elements that trigger the methodological-managerial redesign and, through the connections with the other management components, decisively influence their dimensional and functional characteristics.

#### 4. Conclusions

The dynamics of the organizations and the national and international surrounding environment make it necessary to use a truly scientific, professional management, that generates economic, commercial, social performance. Management methodologization is one of the most important and efficient solutions for the optimization of any type of organization. The promotion and use of management systems, methods and techniques that are evolved and appropriate for the conditions under which they operate, together with rigorous, tested methodologies for designing/redesigning and maintaining the operation of the management ensure the transition from amateurism to professionalism, from empiricism to science and, implicitly, the creation of suitable conditions for rapid responses to multiple endogenous and exogenous challenges. Both management by objectives and management based on profit centres, that is just a dimensional and functional development of the former, place objectives at the centre of the preoccupations of socio-economic entities. Objectives are the quantified or qualitative expressions of the purpose for which these entities or their procedural or structural components were established and operate. In addition, the results obtained from their achievement – at organization, group or individual level – become decisive motivational criteria. The operationalization of MO or MCP is closely connected to the sequences of a management cycle (forecasting, organization, coordination, engagement and control-evaluation), as well as the systemic approach of the management of the organization, since each of its subsystems, from the methodological one to the decision-making, informational, organizational and human resources management is significantly influenced in relation to its finality and means of operation. The mutations in the system of values, the behavioural changes in individuals and groups of individuals, the managerial and economic-financial order, discipline and rigour generated by using MO or MCP complete the list of favourable effects of these complex management instruments, recommended in appropriate methodological formulas and for knowledge-based organizations.

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