Setting Corporate Objectives as a Basis for Action

*G. J. Pearson**

This paper states that the purpose of corporate objectives is to initiate management action. If they do not change what management does they are worthless.

There is a hierarchy of corporate needs analagous to Maslow's human needs. The corporate entity should define its objectives for each level of the hierarchy.

Objectives for the lower levels should be to satisfy needs. To do more than this is wasteful.

Objectives for the top, purposive level should define in practical terms a leadership position that is to be achieved by positive concentration of management effort and all other available resources.

Objectives should be action orientated, unambiguous, readily understood and widely communicated.

Introduction

A recent paper on setting objectives (H. Redwood, *Long Range Planning*, December 1977) provided a description of the process as, no doubt, practised in many large companies. The style is familiar. The ideal of top management involvement is achieved. Individually and in groups they have toiled to produce the ultimate distillation of their wisdom in the statement of corporate objectives. By a superhuman effort, some form of words is agreed for the objectives which, though perhaps short on action requirements, offends no one and could possibly last for a hundred years.

This performance is probably repeated by top management in most major companies, despite its results apparently being so slight. What could possibly be the explanation?

The process of setting objectives contains in it a clear threat to the individual manager's freedom of action. Participants therefore take place in the process not in order to give positive direction to the business, but rather to protect their own freedoms. Under these circumstances it is inevitable that any objective finally agreed will be devoid of any action implications and therefore utterly fruitless. So might the cynic answer.

This paper suggests a different, more action orientated approach based on the hierarchical organization of corporate needs.

Why Bother?

In the most trivial acts we perform tasks methodically to achieve known aims. We don't combine tea leaves and boiling water in a haphazard attempt to brew beer. We all set objectives.

Furthermore, in business, we are all attuned to the general aims of profitability and growth. We have a normative framework which tells us very generally that profits are good and losses bad. In this uncertain world we must aim to achieve a certain margin of profit if losses are to be avoided with any confidence. Moreover we know that we are in a competitive position where there is no such thing as stability—in order not to fall back we must strive to move forward. Thus we must aim to achieve positive growth in profits.

Having speculated an objective of profit growth it can be defined rather more precisely in relevant terms: to the shareholder growth in earnings per share, to the manager return on assets. It can be defined numerically, if desired, in order to make precise monitoring possible and, of course, inflation can be defined out. On the face of it a set of perfectly sound objectives can be built up in this way with little difficulty.

The 'why bother' question relates not to the basic validity of objective setting but to the expensive paraphernalia of corporate planning: the expensively trained specialists, the mountains of additional paperwork, the intrusions on executive time. Only if a formal objective setting process offers significant benefits over and above a process of armchair speculation is it going

*The author is Administration Director of Clay Cross (Iron & Foundries) Ltd., Clay Cross, Chesterfield, Derbyshire.

to be worth the bother. Where managers are more interested in preserving their own freedom of action, the formal process will probably be a waste of time, or worse, positively damaging.

The much quoted Avis objective[1] was 'to become the fastest growing company with the highest profit margins in the business of renting and leasing vehicles without drivers'. This offers clear benefits not provided by the armchair approach. It's an action initiator. It's relevantly specific in terms of growth and margins. Moreover it has two great virtues of immediate appeal to any professional manager:

(i) it requires *concentration* on specific activities,

(ii) it aims at a *leadership* position at least in terms of margins and growth.

An objective like Avis's must be worth the sweat, time and time again. Over the past 20 years there have been endless similar instances written up all illustrating the power of objectives that concentrate on achieving a leadership position.[2]

But is formal corporate planning worth the hassle?

What are Corporate Obectives?

Corporate objectives are clearly not short term and they do not refer merely to small parts of a business. They are strategic. That is they relate to the corporate entity and to the long term.

Being too pedantic over terminology is futile but the term 'corporate entity' needs definition. For the present purpose it is defined as either the whole or part of a business for which real corporate objectives can be derived. In these terms Avis is clearly a corporate entity, but no diversified holding company would meet the definition.

The industrial holding company is a legal and financial entity but it cannot have a single set of objectives of operational significance to its subsidiaries, because by definition they are in different businesses where different game rules apply. The only objectives that can apply generally are the purely financial ones and these rarely have any direct action implications for operating managers.

Real corporate objectives are the specific and unambiguous action initiators that form a system of communication, prompting and guiding action throughout the corporate entity. Communication is vital—only if they are widely communicated can they lead managers, specialists and workers to concentrate their efforts on achieving common and consistent aims.

There is always disagreement over whether or not objectives should be expressed quantitatively. Many planners advocate that quantitative targets are the only ones that are susceptible to measurement and precise monitoring. Contrarily it is argued that a qualitative statement is preferable so that the objective will not be outdated too quickly. Certainly a generalized, qualitative objective will be unlikely to ruffle any feathers, but it seems also less likely to initiate action. To this extent a quantitative expression must be preferred.

In summary, corporate objectives should be:

(1) Strategic to the real corporate entity.

(2) Action initiators.

(3) Specific and unambiguous (quantitative if possible).

(4) Concise and easily understood.

(5) Widely communicated.

Though this is hardly revolutionary its widespread practice would be. Probably much nearer the norm is the company that sub-titles its long range plan 'a document for discussion' and restricts its circulation to the Main Board. Surely an exercise of supreme futility!

What are we in Business for?

In the beginning business was all about creating surplus wealth out of a subsistence economy; wealth production and business were inextricably intertwined. For the small business just getting off the ground, or the mature one falling on hard times, they still are. Creating an addition to wealth remains the fundamental *raison d'etre* for business.

Happily, for most businesses most of the time survival is not the dominant issue and, consequently, for them it is less clear what their objectives should be.

Theories abound.

Early economic theories were based on the mathematically convenient but hopelessly unrealistic concepts such as profit or sales maximization. Attempts at realism were made with various multiple objectives using both classical and modern quantitative techniques. But these were of little practical use to the operating manager.

The famous behavioural model[3] was at least based on reality. It showed that major decisions tend to be made by compromise among coalitions of managers aiming to satisfy the minimum requirements of all interested parties. Not only did this lack tractibility for the economist it was also clearly devoid of any prescriptions for management.

In practice it is too often the dead hand of the accountant that has called the tune. Maximizing the shareholders' wealth is common to a number of approaches[4] but suffers all the faults of profit maximization.

The need for multiple objectives has been common ground among management for decades. Drucker, in 1955, cited the necessities for objectives in the following eight areas:

(1) Market standing

(2) Innovation

(3) Productivity

(4) Physical and Financial Resources

(5) Profitability

(6) Manager Performance and Development

(7) Worker Performance and Attitude

(8) Public Responsibility

This practical approach to multiple objectives presents a complex picture where often objectives will be in opposition to each other: maximizing one will inevitably mean failure with another. Thus any single maximization objective is unreal: a company cannot in practice afford to maximize any one.

The systems approach[5] presents the firm as a complex open system having a constantly changing relationship with its various environments.

These environments are:

☆ product markets

☆ suppliers

☆ technological environment

☆ stock market and financial environment

☆ labour (including managerial) market

☆ government

☆ society

Management's job is to control the boundary conditions of the firm, i.e., its relationship with its environments.

The idea of boundary management gives a rather different slant to the other models. For instance, it is immediately clear that one should not seek to maximize shareholder's wealth, but manage the share so that its price movements are sufficient to permit the achievement of adequate performance in the other boundary areas. Increasing the shareholders' wealth by more than is necessary is just as wasteful as overdesigning a product. Thus a Company does not exist for the benefit solely, or even primarily, of its shareholders.

Translating boundary management ideas into a set of objectives produces much the same result as Drucker's eight objective areas.

In recent years the social responsibilities of industry have been stressed and in some cases suggested as the prime *raison d'etre* of the firm. This may be putting it a bit strong, but social responsibilities undoubtedly have an important role in the hierarchical system of corporate objectives, either as constraints or more positively as initiators of action.

Table 1 summarizes some of the main corporate objectives' systems that have been proposed.

Table 1. Corporate objectives systems

System	Use in economic theory	Realism	Use in management practice
Economic models			
Profit maximization	Yes	Slight	None
Sales maximization subject to min. profit constraint	Yes	Slight	None
Managerial discretion models, e.g. maximize some function of profit, sales and remuneration	None	Slight	None
Multiple objectives—linear programming approaches	Yes	Some	Slight
Financial models			
Maximize shareholders' wealth—by dividend or capital growth	Yes	Some	Some
Return on assets	n.a.	Yes	Some
Profit growth	n.a.	Yes	Some
Prescriptive approaches			
Performance in Drucker's eight areas	n.a.	Yes	Yes
Boundary management	n.a.	Yes	Yes
Pragmatic approaches			
Survival	Yes	Yes	Sometimes
Satisficing	n.a.	?	Sometimes
Volume or asset growth	n.a.	Yes	?
Satisfying financial needs while maximizing social contribution	n.a.	Slight	Slight

Table 2. Hierarchical organization of needs

Maslow's hierarchy of human needs		Proposed hierarchy of corporate needs
	Lowest level	
Physiological needs, e.g. food, sex, sleep, etc.	↓	People, money, machines, raw materials, customers
	Level two	
Safety	↓	Survival, from bankruptcy or take-over. Cash flow and share performance are of prime importance.
	Level three	
Love	↓	Active approval of internal stakeholders, i.e. employees. The need is to satisfy, motivate and develop the firm's employees.
	Level four	
Esteem	↓	Active approval of external stakeholders, i.e. shareholders, customers, society, etc, i.e. the firm's social responsibilities.
	Top level	
Self-actualization		Need to achieve and maintain a leadership position in a chosen field.

Why should there be so many conflicting approaches? Clearly when a business is threatened with extinction its corporate mind is concentrated wonderfully. But does confusion have to reign when no such threat exists?

An explanation can be offered by drawing an analogy with Maslow's work on human motivation.[6] Table 2 summarizes Maslow's familiar hierarchy of human needs and suggests a parallel hierarchy of corporate needs.

Maslow's rules of hierarchical satisfaction and prepotency apply. Thus the lowest level needs clearly have first to be satisfied. Without these basic requisites the business cannot exist and should it at any time run short of any, the need will quickly dominate all higher level needs.

The level 2 need for survival is almost as fundamental. If the lowest level is satisfied the company will concentrate attention on its short, medium and long term survival. This is essentially a defensive need and will almost certainly be expressed in financial terms such as profit, profitability liquidity, gearing, etc, etc, etc. Maximization has no relevance for this survival need.

If both levels 1 and 2 are satisfied then the firm's aims will rise towards the 3rd level. This is analagous to Maslow's so called love need. It is specifically related to the satisfaction, motivation and development of the people in the firm. If the firm's survival is threatened then level 2 will become prepotent and while the threat exists employees' satisfaction will inevitably take a secondary place.

The distinction between levels 3 and 4, might at first appear unclear and it is certainly true that they frequently interact. But it is appropriate that, of all the stake holders, employees come first. Putting them ahead of shareholders, customers, society, etc., more closely follows the Maslow hierarchy. Moreover such an ordering appears to be more in tune with contemporary attitudes. But perhaps the main reasons for separating employees at level 3 is that they are, by a long way, the most important stake holder in the firm, both as to their potential beneficial impact and as to their actual cost. The contribution to be made by a motivated team of management, specialists and workers is almost unlimited and the styles, policies and practices that contribute to this are now better understood.[7]

Again when level 3 needs are satisfied then level 4 needs become dominant, i.e., satisfying, the shareholders, customers, etc., and finally if all levels 1, 2 and 3 and 4 are satisfied then level 5 inevitably becomes dominant. If at any time one of the lower level needs is threatened it becomes prepotent.

An interesting comparison can be made of Tables 1 and 2. Most of the theories, models or pragmatic aims listed on Table 1 can readily be seen in a broader context on Table 2. The two largely support each other, the only exception being maximization which has no place on Table 2, except as a probably non-financial criterion at the top level.

Corporate Self-actualization

The top level, analagous with what Maslow called self-actualization, requires special consideration.

Self actualization is pigeon American for realizing one's potential, becoming everything one is capable of becoming. The need was exampled by saying 'a musician must make music, an artist must paint, a poet must write'.

At first glance it may seem the analogy is at this stage becoming fanciful, but in reality this top level of the hierarchy is the key to the whole thing.

Most individuals and most companies, woefully under exploit their potential. Those that do achieve self-actualization are almost by definition the leaders in their field and must aim to be just that. 'A musician must make music', but before he starts to exploit his potential he must select his instrument. Then he may also choose to specialize in a particular style of music or even a single composer. Having chosen his specialism he will concentrate his limited resources of time and talent on achieving pre-eminence. Otherwise, unless he is a genius, he will inevitably be just another also-ran.

So the need for self-actualization can only be satisfied by first defining the area of specialism and then concentrating all available efforts on becoming pre-eminent.

This is hardly a revolutionary prescription for management action.[8] Leadership has long been held up as a valid aim in itself. In the last few years Boston Consulting Group's empirical work[9] has indicated the worth of cumulative experience as represented by relative market share. Elsewhere leadership has been defined more widely than just market share. Very possibly market share is most often the result of a causative leadership position in, say, technology or marketing expertise etc., rather than the cause itself. If so the expensive business of buying market share may be quite irrelevant. British Leyland's cumulative experience of making cars is several times that of British Ford but only in areas where the company still has a particular leadership position is it really profitable. Buying market share has done Leyland no good at all.

The Avis objective quoted earlier has all the elements referred to above. It defines the area of specialization. It defines the leadership position that is to be concentrated on. Presumably great care was taken to ensure the leadership aim was appropriate to the available resources, achieving out and out market leadership was impracticable.

Financial and Non-Financial Objectives

The preceding discussion has put corporate objectives in a context where the question of whether they should be financial or non-financial becomes almost irrelevant. Within the hierarchy some objectives will inevitably be expressed in financial terms and some not. Survival is in essence an ability to pay bills and must be expressed financially, but a top level aim expressed in financial terms, e.g. to increase profits, will be about as effective as Harold Wilson's white hot technology.

Yet clearly the industrial holding company is stuck with financial objectives because finance is the only common language—it has to control its subsidiaries (the corporate entities) by demanding specific levels of financial performance at levels 2 and 4 on the hierarchy. Cash flow and profitability performance has to be controlled. But in all other respects the operating subsidiaries should be given as much freedom as possible in order to achieve their own top level objectives. In many respects the system of organization and control implied above follows similar lines as that operated by GEC, to name one successful holding company.

But the real corporate entities, whether or not they are part of such an enterprise, should specify objectives up to and including the all important, purposive top level, some in financial terms, others not. For these businesses, profit is not a real objective in itself, it is rarely an initiator of action. Profit is only an enabler, permitting real objectives to be achieved.

Objective Setting in Practice

An example of the management process is briefly described below.

The company is a publicly quoted manufacturer of wood and wood substitute domestic furniture. Its main manufacturing operations are shaping, finishing and assembly. About 20 per cent of turnover is bought-in as finished parts and a similar proportion of total direct cost is accounted for by packaging. The trend growth of the market sector has been static but with increasingly wide cyclical ups and downs. Currently the industry is depressed and the firm is operating at about its break-even point of 2/3 capacity operation. This break-even is relatively high since the recent purchase of expensive, new, highly automated plant. The company's markets are lead by one major manufacturer with around 30 per cent of the market, the example firm with about 6 per cent, leads the second division. The company carries no debt and its shares are quoted at lower than sector average multiples of earnings.

The above thumbnail sketch provides sufficient data for the present purpose. Now what should its objectives be? How should management go about the process of setting objectives?

Table 2 can be used as a check-list. At the lowest level of the hierarchy the company needs people, money, machines, raw materials and customers. Does the company have any unsatisfied needs at this level? It has already been stated that the company is currently working at 2/3 capacity along with the generally depressed industry which would seem to indicate that most of these basic needs are well satisfied. Presumably both people and machines are under utilized, and there are more than sufficient raw material supplies. As the firm has no debt, money is not a constraint on returning to to 100 per cent capacity operation and while sales are down there remains a substantial number of customers who will take up full production when the depressed conditions recede. Presumably this is so, but in reality the company will measure each requirement and ensure that it is so. In some cases new measures will have to be established. Is there any problem with the availability or quality of any trade or skill? Is plant being adequately maintained? Are supplies of raw materials secure? Is the spread of customers appropriate (the 2/3 capacity could be kept rolling largely on the basis of a single customer)? For now it is assumed these lowest level needs are satisfied.

Survival is the second level on the hierarchy. How vulnerable is the business to bankruptcy? Again, as the company has no debt it is, presumably, secure in the short/medium term at least. On the other hand its share price under-performs the sector average, possibly making it vulnerable to take-over. What proportion of shares are secure? If only a small proportion are controlled then the company has an overriding need to improve the relative performance of its shares. Although there may be several window dressings that might superficially achieve the desired result, it is assumed here that the best way of achieving a lasting improvement in share performance is to fundamentally improve the financial performance of the company. This means increasing profits and, despite the complicating factors of historic cost accounting and deferred taxation treatments, it means increasing the earnings per share relative to other companies in the sector. In the example this might be done by either improving efficiency (e.g. reducing KD sales thereby lowering packaging costs, by increasing capacity utilization by substituting a proportion of bought-in items or by further capital investment in improved plant), by increasing sales volume or by acquisition.

At this stage in the process it is merely noted that the prepotent objective is at level 2 and relates to improving share price performance to reduce vulnerability to being taken over. At level 3 is the need to satisfy, motivate and develop the firm's employees. In the example case the firm is operating at only 2/3 capacity and may or may not have already undertaken some redundancies. Clearly making employees redundant can be seen as a betrayal and can only be highly damaging to satisfaction of level 3 needs. But so is the possible alternative of chronic overmanning. Management has a clear responsibility to employees and to the company to look far enough in front of their noses to avoid having to face the alternative of either chronic overmanning or redundancy. Moreover management has a similar responsibility to make sure the company can sustain short term overmanning. This is the rather negative side of level 3 which is appropriate in the example company's particular situation. However, the more positive aims should also be specified. In the present process of objective setting clearly the company's needs under level 3 should guide the actual strategy to achieve satisfaction at level 2. For instance if the company has not so far made any people redundant and believes it can avoid the overmanning situation becoming chronic, it should adopt a strategy to improve share performance which will most accord with increasing the company's work load. On the face of it acquisition, which may be highly attractive to the financial analyst, will achieve nothing in this respect and will therefore not be the preferred choice.

The level 4 objective defines the levels of performance needed to gain active support of the outside stakeholders. This means in terms of shareholders the level of fundamental performance which will see the firm's shares perform at a significant premium over the sector average; in terms of customers the levels of product performance and customer service which will return a premium price or an increasing market share; in terms of society the level of social responsibility, however defined and measured, which will have a beneficial rather than detrimental effect on the general corporate image. This last area of social responsibility is a vast and still bubbling topic and the statement is thus deliberately general. In the specific case there may be particular areas of concern notably with some industries in the areas of public health and safety.

Again having regard to aims at lower levels the level 4 aims may guide the choice of strategy. For instance reducing KD sales to lower packaging costs may have short term attractions to satisfy level 2 aims, but may well constrain the future achievement of higher levels of performance to satisfy level 4 needs. Thus reducing KD sales would not be a preferred course of action.

The top level need, as has already been emphasized, is the key to the whole system and it may be difficult to hypothesize objectives. Given the brief snap shot data provided on the example company it would appear that there are two possible solutions to the problem.

By the process already defined it is apparent that improving sales volume is the desired solution to the underlying problem. Despite any likely improvements in efficiency, the real improvement in performance that will permit all objectives at levels 1–4 to be achieved, is only likely to come from attaining higher capacity utilization. How can this be achieved?

Being only a fifth the size of its major competitor the company lacks the sheer marketing muscle to force up its market share across the board. However there are some identified areas of the market where the company could improve its penetration and indeed in bedroom unit furniture it is particularly strong.

Alternatively it might be possible to utilize additional volume, selling into non-domestic markets—office furniture for example has the added benefit of being a little less cyclical than domestic. On the face of it this approach may seem to be the lowest risk option, but it is in fact the antithesis of *concentrating* efforts on achieving a *leadership* position.

The process, as should have emerged by implication, includes a thorough going audit of threats and opportunities and strengths and weaknesses. From this analysis it is clear that relevant furniture products are not sharply differentiated and therefore the market leader is able to make full use of its scale. The need to differentiate the company's products might result in a decision to hire external design consultants to design new, distinctive and 'up market' ranges of bedroom furniture. The top level objective might thus be expressed as,

> To achieve and maintain 85 per cent capacity utilization and a continually growing market share with the best designed domestic bedroom furniture on the market.

Such a statement appears to include all the essential attributes of a top level objective discussed previously.

Thus the hierarchy of objectives can be specified, each level being compatible with the others. They can all be specific and measurable and they can be recorded in varying degrees of detail according to the purpose: a brief version being given wide circulation, a fully detailed version being used for monitoring.

Objective setting is essentially a management process, very much better carried out by top management, not by the staff specialist. The latter's help may or may not be useful, but if he is so central to the process that he feels the need to persuade his top management of the virtues of setting objectives, he's already lost his case. He had better move on.

Of course there are snags and pitfalls in practice. The process of deciding what the real corporate entity is may be problematical. Without doubt it will be very demanding of time and effort for busy managers to agree an action orientated top level objective which will motivate when widely communicated and will produce a concentration of effort on the achievement of a leadership position. But all these aspects must be met for the exercise to be worthwhile.

It may also be difficult to establish appropriate measures so that the firm can know how it is performing against objectives at the different levels on its hierarchy. The aim is to satisfy, not wastefully over achieve—any surplus effort should be devoted to achieving the next objective up the hierarchy. Measurement is vital. It may be true that a musician must make music but he has a convenient built in mechanism that tells him when he is hungry. But a firm has no such device unless it is deliberately put there. Only when measurements are established can a firm know at what level on the hierarchy it is currently performing and how this position changes over time.

Conclusion

It is hoped that this particular slant on the hierarchy of corporate needs is an aid to approaching objectives methodically. The management prescriptions that it confirms may not be revolutionary, but they are practical:

(i) The real corporate entity should first be defined.

(ii) Objectives should be agreed for all levels of the hierarchy. Levels 1 and 4 set at levels which will satisfy. Level 5 should be action orientated and define practically and concisely the leadership position on which resources are to be concentrated.

(iii) Objectives should be clear, concise and communicated as widely as possible.

References

(1) Robert Townsend, *Up the Organisation.*

(2) See, *The Practice of Management,* P. F. Drucker (1954) (quotes many including Sears, IBM and Ford).

(3) Cyert and March *A Behavioural Theory of the Firm,* (1963).

(4) Samuels and Wilkes, *Management of Company Finance,* (1971).

(5) See, Emery & Trist, The casual texture of organisational environments, *Human Relations,* **18** (1), (1965).

(6) A. H. Maslow, A theory of human motivation, *Psychological Review,* **50,** (1943).

(7) See, Roethlisberger and Dickson, *Management and the worker,* Mayo's Hawthorne experiments, (1949).
F. Herzberg, *Work and the Nature of Man,* (1966). D. McGregor *The Human Side of Enterprise,* (1960). R. Likert, *New Patterns of Management,* (1961).

(8) P. F. Drucker, *Managing for Results,* (1965). ('Economic results are achieved only by leadership'.)

(9) *Perspectives on Experience,* Boston Consulting Group.