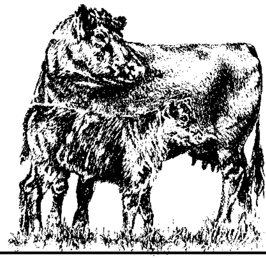

Management by Objectives

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Management by objectives is essentially a system of incorporating into a more logical and effective pattern the things managers are already doing. The primary effects of management by objectives are seen in tangible results such as improved profits, more growth, lower costs, and increased revenue. On the intangible side, results include more self-satisfaction, better morale of employees, etc.

The concept of management by objectives is based upon three underlying premises:

1. That any system of management is better than no system at all;
2. That to be workable, any management system must bridge the gap between the theoretical and the practical; and
3. That to be effective, any management system must appraise management performance in direct relation to the activities of the business (i.e., that management must be objective-oriented, and the objectives of management must be the same as the business).

With these premises in mind, let's look at precisely what management by objectives really is. Why and how do you go about managing by objectives in farming and ranching?

The Why

1. Farm management takes place within an economic system that provides the environmental situation for the individual farm or ranch. This environment has changed drastically over the past few years and imposes new requirements on farms and on individual farm managers.

   The ability to organize, get results and adapt to rapidly changing circumstances will be the primary criterion for management success in the future.

The How

2. Management by objectives is a way of management aimed at meeting these new requirements. It presumes that the first step in management is to identify, by one means or another, the goals of the firm. All other management methods and sub-systems follow this preliminary step.
3. Once organizational goals have been identified, orderly procedures for distributing responsibilities are set up in such a way that all efforts are directed toward achieving these goals.
4. Means of measurement are then set up to measure results against the established goals (i.e., measurement of what is actually achieved).

   The rest of this unit evolves around four concepts.

Concept 1: Changing Environment

Farm management takes place within an economic system that provides the environmental situation for each farm or ranch. This environment has changed drastically over the years and imposes new requirements on farms and on individual farm managers.

Many factors or trends affect the environment within which agriculture and farm managers must operate. These factors include the trend toward industrialization of agriculture, the trend toward market-oriented philosophy, the trend toward changing management philosophy, and the trend of increasing international impact on agriculture.

The Trend Toward Industrialization of Agriculture

We have been experiencing an unprecedented rate of technological advancement in agriculture. This has occurred through the substitution of improved technical inputs for the conventional inputs on the farm or ranch. We are displacing land and labor by using such technical inputs as hybrid varieties and mechanization. This process will continue and, because of modern communications, the technical improvements will be adapted even faster by agriculture. In short, we are experiencing a trend toward complex, large scale, highly capitalized production units in agriculture.

In fact, we find that technology has pushed the minimum scale of production for many commodities beyond the capital and managerial capabilities of many producers. Or, stated another way, many operators do not reach the technically optimum-size farm or ranch. Some cannot accumulate the necessary capital to achieve the optimum amounts of land and machinery. Some are part-time farmers who have non-farm jobs that prevent them from devoting the time required to operate the technically optimum-size farm. And, finally, some lack the managerial skills required to achieve growth and successful operation of the optimum farm. For these reasons, farms and ranches that are smaller than optimum size continue to exist.

The technically optimum size of crop farms has increased about 50 percent in the last 10 to 15 years, mainly because of increases in the size and capacity of tractors and other farm machines. These machines have also become technically more advanced and more automated. For example, wheat producers are using wider tillage machines and wider seeding drills, and the cutting width of the grain combine has been increased from 12 to 14 feet to 18 to 20 feet. These types of changes apparently will continue, although perhaps not on the same scale we have witnessed during recent decades. Hence, the technically optimum size farm will continue to increase in the future.

This trend has obvious implications for farm and ranch managers as well as others associated with agriculture. With the substitution of capital for other inputs, the capital requirements for farming and ranching are extremely large. In many areas, capital requirements have become so large that traditional methods of financing agriculture are becoming increasingly inadequate. Because of this inadequacy, many farm-ranch operators have had to turn to other credit sources, including some they know almost nothing about.

The ability of many farmers and ranchers to manage these larger amounts of capital is being severely tested.

The risk to capital lenders is increased as unit size increases and as individual operations become so complex that conventional lenders often lack the expertise to evaluate and to service agricultural loans. As a result, many lenders are increasingly requiring advanced assurance of markets and of profitable outcome of investments before loans are made. This has meant that managers are now exposed to contracts and forward pricing techniques as tools to provide the assurances required by lenders and these are techniques relatively new to many farmers and ranchers.

The Trend Toward a Market-Oriented Agriculture

We have been experiencing a trend toward a market-oriented agriculture—that is, an agriculture highly influenced, if not controlled in many cases, by the market and the marketing system. The implication is that the food and fiber distribution system must be responsive to final market demands. This in turn requires that production agriculture must be responsive to the demands of the distribution system. This latter response must involve more orderly supply flow processes, increased product uniformity, and more stability in raw product prices. In short, the entire agricultural system must recognize that success is, in most cases, synonymous with marketing success.

According to economic theory, price has the function of equating the quality and quantity of products supplied with the quality and quantity of products demanded. However, price has not always effectively achieved this equilibrium. This is due to many reasons but perhaps most significant would be government interference on the pricing system and the lag of production response to price changes.

As a result of price ineffectiveness, we have seen a rise of vertical integration in the form of contract farming and actual land ownership by corporate farms. A higher level of market orientation has been achieved under vertical integration than through the traditional pricing system. This is not the fault of the traditional pricing system, but rather a result of interference with the way that the pricing system should function if it were functioning in a free-market system.

The ultimate purpose of agriculture should be to create a customer at a profit. This means that the needs of the customer must be carefully attended to. We must study what the consumer is buying, or wants to buy, rather than what we are trying to sell. This challenges the traditional right of farmers and ranchers to produce raw food and fiber products without regard to market demands. And it calls for an increased degree of coordination throughout the agricultural system.

Consumers have been very concerned with the sharp rises in food costs in recent years compared with the moderate rises before 1973. Rising food costs have eroded the security of the middle class and adversely affected the diets and lifestyle alternates of the poor and those on fixed incomes. Since food is a necessity and since food prices are so visible to the consumer, the psychological impact of a rise in food prices is greater than price increases in most other products. This is particularly true since most purchases of food are on a cash basis, and most purchases of other items are on a credit basis.

In addition, real incomes of consumers have been decreasing. Since the food budget is a residual (i.e., in most homes, installment payment-type purchases are paid first and the money left over is available for purchase of food items), the opportunity for increased consumption of our higher-priced food items, such as beef, is relatively limited. Further, for years working wives demanded processed foods with built-in maid services. Higher prices may cause the housewife to switch back to home-prepared foods. This would have a tremendous impact on our total marketing system.

In the past, producers have traditionally produced without concern for changes in consumer tastes and desires. However, recent trends clearly show that producers must become concerned (i.e., decreased consumption of beef and increased use of meat substitutes). Unfortunately, one of the major outcomes of these changes has been that producers overreacted to changes in demand. This has caused instability of prices received by farmers and has not been good for either the consumer or the producer.

Farmer and rancher reactions to changes in consumer demand will have a tremendous impact on future organization of the marketing and production of agricultural products.

This trend also has obvious implications to farm and ranch managers:

- Farmers and ranchers must become thoroughly familiar with the marketing system and its requirements, or they may not survive.
- They need to know what their market is, and how to produce for it.
- They need to know both the quality and quantity of the product demanded by the marketing system.
- They need to be totally familiar with the outlook for their products including prices, trends, etc.

The Trend Toward Changing Management Philosophy

If agriculture is to become more market-oriented, which it must, there must be a change in the basic management philosophy of many producers. The alternative to a change in philosophy is to import management skills from outside commercial agriculture. Further, and this is obvious, as technology advances and capital needs increase, management capabilities must increase. Such an increase may be difficult to achieve because we know that these capabilities have already been stretched to the limits of the existing management structure of many operations.

The Trend of Increasing International Impact on Agriculture

Agriculture is one of the few U.S. industries that can compete favorably in international markets. As a result, agriculture is gaining increasing economic importance to the United States' balance of payments situation. At the same time, however, agriculture is becoming less important in the political power structure in the U.S. (i.e., farmers have much less political impact than in the past). This situation obviously poses a dilemma — the political importance of agriculture is much weaker than the economic importance would indicate.

For example, Idaho-produced products move primarily to national or international markets. Exports account for about 80 percent of the wheat, 75 percent of the dry peas, and 50 percent of the lentils produced in the state. This shows clearly that the fortune of many Idaho farmers rises or falls with world production, supply, and consumption.

The implications here for farm and ranch managers are again obvious:

- Farmers and ranchers must be constantly aware of international situations and their possible impact on their decision-making process.
- Farmers and ranchers also must take a much more active role in the political arena than in the past.

Concept 2: Identifying Objectives

> Management by objectives is a way of management aimed at meeting these new requirements. It presumes that the first step in management is to identify, by one means or another, the objectives of the firm. All other management methods and subsystems follow this preliminary step.

The essence, then, of management by objectives is to know what your objectives are. You need to know them for a number of reasons:

1. If you don't have an objective(s), you have no idea whether you are on the right road or not.
2. You can assess results only when you have prior expectations against which to measure them.
3. If you know where you are going, it's easier to find alternate routes when your chosen path is blocked.

Objectives are statements of expected outputs (results). They must be defined before inputs are released, and they should be used by management to determine what inputs are to be used. Objectives should be designed to:

1. Record the direction the business should take (expansion? How much?).
2. Predict the behavior of each unit in the business (grain operation, feeding operation, etc.).
3. Appraise the soundness of decisions when they are made (for control).

4. Improve overall business performance (productivity).
5. Provide a basis for internal control.

Generally, we classify all objectives into one of three categories.

Regular or Routine Objectives—These are objectives relating to day-to-day chores that are necessary for the firm's survival and stability. On the farm, for example, a regular or routine objective may be to conduct weekly maintenance checks on all equipment, or annual maintenance check on all buildings, or file a yearly tax statement. The end result of achieving the regular objective is that the firm maintains the status quo (i.e., no expansion or improvement in procedural results).

Problem-solving Objectives—These objectives are given a higher rating in terms of management proficiency since they are related to problems that arise as a result of the natural tendency for matters to get worse if left alone (i.e., the appearance of disease in a crop, or lowering of quality of a certain crop or livestock or a decrease in yield of a crop). Management's objective in these cases may be to uncover the reasons for the problem and reduce the adverse effects to a minimum. Such objectives call for managerial problem-solving skills of a higher order than routine objectives.

Innovative or Improvement Objectives—These objectives are awarded top priority in our hierarchy. These are objectives that make things happen. They begin with the assumption that perfect completion of routine activities and rapid solution of unexpected problems just aren't good enough. Innovative objectives specify quantum changes. They are statements of what the business wants to be. These objectives call for action decisions rather than reaction decisions.

What are your objectives in your farming and ranching business? Generally, we would find objectives in one of these areas:

- Profit
- Growth
- Survival
- Productivity
- Quality

In agriculture, we find that in addition to those general areas of objectives (and sometimes instead of them), farmers and ranchers will have objectives like the following:

- Want to be thought of as a progressive, innovative farmer/rancher.
- Want to be respected by neighbors.
- Want to raise family in country rather than city.
- Want to provide opportunity on farm or ranch for future generations.
- Save income taxes
- Save state taxes.
- Bring son or daughter into business.
- Find time to travel.
- Do less physical work.
- Retain some management duty after retirement.

All of these are valid objectives if they are truly what you want. However, to be working objectives, your objectives should have certain qualities for which we can test:

1. Objectives should provide every manager with a means of planning and measuring his own performance and that of his employees.
2. Objectives should be quantifiable. They must be stated in terms of the measures of performance you intend to apply at the end of the year.
3. Objectives should give a manager a means of knowing when he is deviating from target in sufficient time to do something about his errors.
4. Objectives should be set in every area over which the manager has control (not windfalls or tragedy).
5. Objectives should be attainable, but also challenging (have some "reach").
6. Objectives must be realistic in light of internal and external environmental constraints and trends.
7. Objectives for different parts of the operation must be mutually consistent.
8. Objectives must be up-to-date (revised annually?).
9. Objectives must be innovative. In times of rapid change, objectives that show no innovation could be a danger signal for the business.

Concept 3: Planning

Once organizational objectives have been identified, orderly procedures for distributing responsibilities are set up in such a way that all efforts are directed toward achieving these objectives.

Here we are essentially talking about planning. Without good planning, decisions you make when you are 30 may restrict your achievements at 50. You should plan for 10 to 20 years ahead. Even if you can't predict exactly what may happen to affect your plan, you can have alternatives planned to meet varying situations.

Planning is the activity designed to shape the future direction of the farm or ranch by developing actions or guidelines in the present. It is deciding in advance what is to be done, how to do it, when to do it, and by whom it should be done. We plan because we need to facilitate adjustment to changing conditions. The truly successful business is one that modifies its operations and services to correspond with the changing needs of its customers, the competitive conditions in which it operates, and with changes in general business and economic conditions.

A farm-ranch manager can modify his operations in one of two ways. He can carefully develop plans for alternative courses of action so when a change in direction is required, the next best alternative can be chosen. Or he can react to decisions and actions of competitors (random courses of action). To choose the first method means that periodic appraisals of the business operations and organization must be made and adjustments that were forecasted are made.

We need effective planning to achieve economical operation because planning substitutes jointly directed effort for uncoordinated piecemeal activity. Planning is also necessary before control can be initiated since we must have something to control.

Good planning establishes objectives and goals so that everybody can know what the business hopes to achieve. Good planning also established coordinated job descriptions so that each job will be coordinated with others, does not duplicate others, nor leave any duties undone; establishes the necessary facilities so that assigned job functions can be performed efficiently and economically, and establishes standards of control so that as the work progresses the results can be compared with the standards as a check of performance.

The principles of planning can be listed as follows:

1. Planning comes first because it:
   - establishes the objectives and goals
   - determines type of organization needed
   - determines qualifications of personnel
   - determines course of action
   - determines types of controls needed
2. Planning must contribute to objectives; if not, it is worthless.
3. Planning must be done at all levels in farm-ranch business. However, the degree of planning varies with level of management.
4. Planning should be efficient.
5. Planning must be based on consistent assumptions.
6. Planning requires proper timing. Long-range plans can involve 3 to 50 years, others 25 years. The length of plans depends on degree of certainty about the future. Also, you need to consider "lead time" between preparation of plan and implementation.
7. Planning must be done within a policy framework.
8. Planning requires communication at all levels within the farm-ranch business.
9. Planning involves delineating possible alternatives.
10. Planning must recognize limiting factors—scarcity or absence of strategic factors such as adequately trained personnel, management, capital, land resources, sales potential, etc.
11. Planning should allow for flexibility. Flexibility involves ability to change plans without undue cost or friction; an ability to detour; and an ability to keep moving toward a goal despite changes in business conditions or even failures of certain plans. Flexibility is necessary because the future is uncertain.
12. Planning requires commitment.
13. Planning involves strategy.

Concept 4: Measuring

Means of measurement are then set up to measure results against the established goals.

Here, we are talking about controls, and this is probably the most important function that a manager has to perform. A control is an indicator that will tell us if everything occurs in accordance with our objectives.

Good control devices:

1. Provide *adequate* information to the receiver. Accounting records alone do not provide adequate information for decision making; you need information about the future (outlook for both markets and inputs).
2. Provide *timely* information. Managers must receive information in time to correct deviations at once.
3. Provide information in a *form* that management understands.
4. Report data (costs) on a *responsibility* or commodity basis.
5. Are *economical*. They do not cost more than anticipated results from having controls.
6. Should indicate not only where the problem is but what should be done to *remedy* the problem.

To set up the control process, you must establish standards, appraise performance, and be prepared to correct deviations.

Establish Standards—The objective of standards is to be able to detect deviations from expected results in advance, or at least as soon as they happen. Standards should be established only in the key performance areas: procurement of inputs, production, finances, marketing, and personnel.

Appraisal of Performance—Here you are comparing performance with a standard and ascertaining the difference. You should control by the *principle of exception*, concentrating only on the exceptions to standards. Judgment must enter this appraisal, particularly as to the significance of the difference from the standards.

Correction of Deviations—Whenever significant deviations are uncovered, immediate action is imperative.

Here are the type of standards you should use in the *key performance areas*:

1. **Procurement of inputs** (the availability of a continuous, dependable supply of inputs at a reasonable price).
   - Cost per unit of input procured
   - Delivery schedules met
   - Product received in acceptable condition
   - Best product for price paid
   - Lowest price for acceptable product
2. **Production** (the combination of human, physical, and capital resources to produce efficiently marketable products).

- Average cost per unit
- Units produced per manhour or man equivalent
- Variance from planned production volume
- Safety record
- Ratio of maintenance hours to machinery operating hours
- Labor cost per unit
- Output per unit input

3. **Finances** (the ability of the business to carry out its operations, and to meet current and future obligations).
   - Tests of liquidity
   - Tests of solving
   - Tests of profitability
   - Interest rate on borrowed capital
   - Return per dollar invested
   - Working capital ratio
4. **Marketing** (products marketed in an efficient manner and at a reasonable price).
   - Selling costs per unit
   - Transportation cost per unit
   - Quality measurements
   - Price vs. average price of area
   - Net price (price-marketing expense)
5. **Personnel** (the existence of an adequate labor force to carry out operation without bottlenecks).
   - Employee turnover
   - Absentee record
   - Salary scales (compared to other similar jobs)
   - Performance reviews
   - Employee participation in net returns

In summary, management by objectives simply means that a manager systemizes his tasks of managing. He does this by setting good objectives and then, through proper planning and controlling, he makes the right choices toward the achievement of those objectives. The major objective of a business, and consequently the primary demand placed upon management, is economic survival. All other measures of farm and farm manager performance must follow and fit this goal.

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