

Implementation of Management by Objectives in Volkswagen Sarajevo Ltd.

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- **Compile the theoretical information about Management By Objectives.**

II. Practical part

- **Analyse Volkswagen Sarajevo Ltd. with a special accent on the management system of the company.**
- **Prepare the project with exact steps of implementation of Management By Objectives according to the analysis of the company.**
- **Submit the project to risk and cost analysis.**

Conclusion

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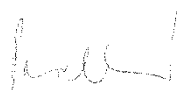
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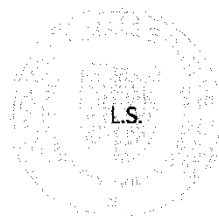
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ABSTRAKT

Cílem každé společnosti je najít vhodný a efektivní systém řízení, který by vedl k dosažení daných obchodních cílů a úkolů. Volkswagen Sarajevo se snaží zavést řízení pomocí úkolů jako specifický systém managementu. Hlavním cílem a podstatou mé diplomové práce je zjistit současnou situaci Volkswagen Sarajevo se specifickými body zaměřenými na implementaci nového systému řízení do společnosti. Tato práce popisuje konkrétní fáze implementace tohoto systému a poukazuje na možné bariéry při zavádění, stejně tak jako navrhuje možné způsoby, jak se těmto bariérám vyhnout.

Klíčová slova: řízení pomocí úkolů, systém managementu, dlouhodobý motivační program, úkoly, cíle, indikátory, řízení lidských zdrojů, implementace projektu.

ABSTRACT

It is the goal of every company to find an appropriate and effective management system that will ensure the achievement of certain business goals and objectives.

Volkswagen Sarajevo Ltd. Has the intention to implement Management by Objectives as a specific management system.

The purpose and the main aim of my Master Thesis is to conduct and elaborate the current situation in Volkswagen Sarajevo Ltd. with the specific points relevant for the implementation of a new management system in the company.

This work develops and defines specific phases of implementation and additionally points out the existing and potential barriers to successful implementation as well as the suggestion of the ways of handling with those.

Keywords: management by objectives, management system, long-term incentive program, objectives, targets, indicators, human resources management, project implementation.

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INTRODUCTION

My master thesis will refer to the implementation of Management by Objectives in Volkswagen Sarajevo Ltd., a plant of Volkswagen Aktiengesellschaft (herein there referred to as Volkswagen AG). In the first, theoretical part of my master thesis, I will conduct the theoretical background of this specific management system, regarding the specific points relevant for the implementation in a certain company.

In order to successfully implement Management by Objectives (herein there referred to as MBO) as a management system that is related to setting specific goals and objectives on the general company level and the individual level of each and every employee with the goal of the company employees' awareness and higher motivation towards achieving those objectives, it is essential to make a broad and deep analysis of the company. In my master thesis, this analysis will concern the already existing management system with a special focus on the flaws and dysfunctional parts of that system, since they represent the exact reason for the obvious need of another, better and more effective management system.

The practical part of my master thesis, as well as the project elaborated, will concern the exact process of implementation of MBO. The precise steps, in my opinion, necessary for the effective and successful implementation of MBO will be defined and presented after conducting the previously mentioned analysis of Volkswagen Sarajevo Ltd.

The implementation of MBO in Volkswagen AG in 2009 represents a strong basis for the implementation of this system in Volkswagen Sarajevo Ltd. The practical part of my master thesis will, accordingly, contain the analysis of the system developed and implemented in Germany. Since it is theoretically impossible to apply the same system mechanisms in Volkswagen Sarajevo Ltd., my master thesis will also refer to the comparison and necessary modifications of the system applied in Germany in order for them to be coordinated with specific circumstances in Volkswagen Sarajevo Ltd.

The new management system will, of course, find certain obstacles to its implementation, so this part of my master thesis will elaborate the existing ones and deal with over-coming of potential obstacles to successful implementation of MBO in Volkswagen Sarajevo Ltd.

According to these analyses, exact steps of successful implementation, in my opinion, will be defined and presented.

I. THEORY

1 THEORETICAL BACKGROUND OF MANAGEMENT BY OBJECTIVES

"MBO is one of the rational schools of management's successful products."

The Economist

Fast changing environment, unpredictable and dynamic business processes make it extremely important for managers of companies to choose the right course of action when deciding on how to lead and manage their companies. One thing comes first- the success.

In order to be successful, managers should always choose a way which directly leads them to the achievement of goals and objectives of the company.

Theoretical part of my master thesis will refer to the theoretical background of Management by Objectives as a specific management system. In this part, I will elaborate all the relevant theoretical points of this system, with the special accent on the exact steps of implementation which could, after detailed analysis of the company, be implemented in Volkswagen Sarajevo Ltd.

Management by Objectives (MBO) was first mentioned by Peter Drucker in 1954 in his book "The Practice of Management". "Peter Ferdinand Drucker is revered as the father of modern corporate management. He was often called the world's most influential business guru. His thinking transformed corporate management in the latter half of the 20 century." (1000 Advices, 2006)

According to Peter Drucker (2003), Management by Objectives (MBO) represents a systematic and organized approach that managers use in order to have a full focus on achievable goals and objectives and in order to use the available resources in a way that provides and ensures the best possible results. MBO features and characteristics aim to increase organizational performance by coordinating and alignment of the goals and objectives throughout the organization. Employees should, theoretically, get a strong input for identifying their objectives, the time lines for completion and other necessary elements for successful implementation and execution of this system. MBO system includes constant tracking and feedback concerning the whole process of reaching the objectives set (Drucker, 2003).

Managers should “avoid the activity trap” (Drucker, 2003), getting so involved in their day to day activities that they forget their main purpose or objective. Instead of just few top managers, all managers should (Drucker, 2003):

- participate in the strategic planning process, in order to improve the implementability of the plan and
- implement a range of performance systems, designed to help the organization stay on the right track.

MBO managers focus on the result, not the activity. They delegate tasks by "negotiating a contract of goals" with their subordinates without dictating a detailed roadmap for implementation. Management by Objectives (MBO) is about setting objectives and then breaking these down into more specific goals or key results (Drucker, 2003).

The main principle of Management by Objectives (MBO) is to make sure that everybody within the organization has a clear and transparent understanding of the aims and objectives of the organization, as well as awareness of their own roles and responsibilities in achieving those objectives. The complete MBO system is to get managers and empowered employees acting to implement and achieve their plans, which automatically achieve those of the organization (Drucker, 2003).

The MBO style is appropriate for knowledge-based enterprises when the staff is competent. It is appropriate in situations where there is a wish to build employees' management and self-leadership skills and tap entrepreneurial creativity, tacit knowledge and initiative (1000 Advices, 2006).

This type of management system has not been known forever. As mentioned, this system that seeks to align employees' goals with the goals of organization. This ensures that everyone is clear about what they should be doing and how is that beneficial to the whole organization. It is quite easy to see why this type of managing makes sense – when the parts work in unison the whole works smoothly too. By focusing on what you are trying to achieve, you can quickly discriminate between tasks that must be completed and those that are just a waste of valuable time (Mind Tools Ltd., 2003).

Management by Objectives gained a great deal of attention and was widely adopted until the 1990s when it seemed to fade into obscurity. Partly, the idea may have become a victim of its own success; It became so much a part of the way business is conducted that it no

longer may have seemed remarkable, or even worthy of comment. Management by Objectives was partly evolved into the idea of the Balanced Scorecard, which provided a more sophisticated framework for doing essentially the same thing (Mind Tools, 2003).

Balanced Scorecard, its use and effectiveness will be elaborated further on.

1.1 Implementation of Management by Objectives

Peter Drucker (2003) outlined the five-step process for MBO shown below. Each stage has particular challenges that need to be addressed for the whole system to work effectively.

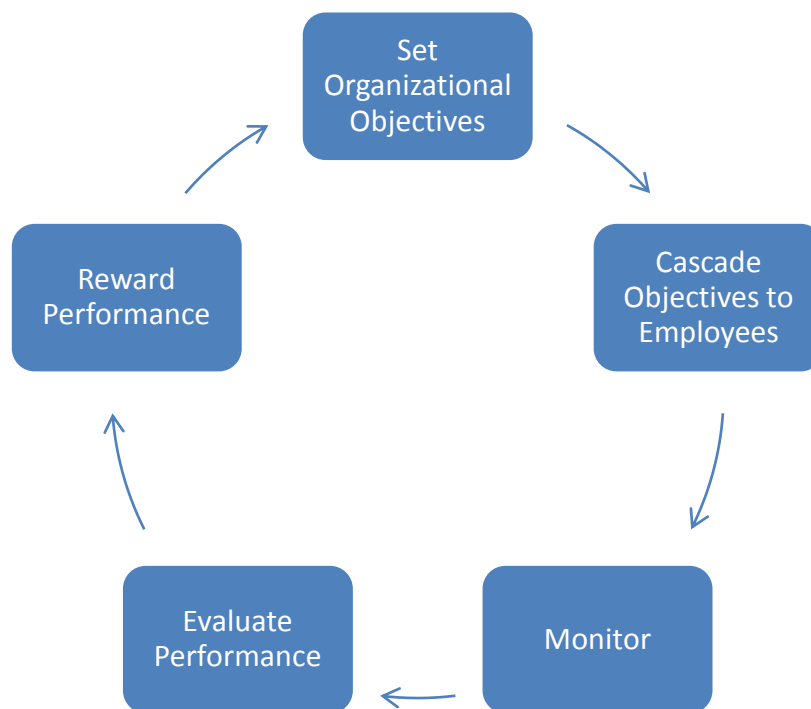


Figure 1: 5 steps of MBO process(Drucker, 2003)

1. Set or review organizational objectives

MBO process starts with the phase that refers to setting clearly defined and transparent strategic organizational objectives. If the organization is not clear about where it is going,

no one working there will be either, which makes this phase essential for the whole process to begin and to be completed successfully (Mind Tools, 2003).

2. Cascading objectives down to employees

To support the mission, the organization needs to set clear and transparent goals and objectives, which then need to be cascaded down from one organizational level to the next until they reach every employee, since every employee has to be directly involved in this system and the whole MBO process.

To make MBO goal and objective setting effective, Drucker used the SMART acronym to set goals that were attainable and to which people felt accountable. He said that goals and objectives must be:

- specific
- measurable
- agreed (relating to the participative management principle)
- realistic
- time related

Notice the “A” in SMART is “agreed”. This is sometimes referred to as “achievable” but, with MBO, agreement about the goals is a critical element. It is not enough for the goals and objectives to be set at the top and then handed down. They must flow or trickle down through various stages of agreement. The only goal that is going to be met is one that is agreed on (Mind Tools, 2003).

The company should establish clear targets and performance standards for each objective. The company should be able to monitor the progress throughout the organization by using these. These are also important for communicating results and for evaluating the suitability of the goals that have been set (Mind Tools, 2003).

3. Encourage participation in goal setting

Everyone needs to understand how their personal goals fit with the objectives of the organization and how do they contribute to them. This is best done when goals and objectives at each level are shared and discussed, so that everyone understands why things are being done and then sets their own goals to align with these (Mind Tools, 2003).

This increases people's ownership of their objectives. Rather than blindly following orders, managers, supervisors and employees in an MBO system know what needs to be done and thus do not need to be ordered around. By pushing decision-making and responsibility down through the organization, people are motivated to solve problems they face intelligently and give them the information they need to adapt flexibly to changing circumstances(Mind Tools, 2003).

Through a participative process, every person in the organization will set his or her own goals, which support the overall objectives of the business unit and the objectives of the organization(Mind Tools, 2003).

In MBO system, employees are more self-directed than boss-directed. If the company expects this type of independent performance from employees, it has to give them the tools they need(Mind Tools, 2003).

Once the company established what it is that someone is accountable for, it must provide the information and resources needed to achieve results. The company should also create a mechanism for monitoring progress towards the goals agreed (Drucker, 2003).

4. Monitor progress

Because the goals and objectives are SMART, they are measurable. They do not measure themselves though, so a certain monitoring system that signals when things are off track needs to be created. This monitoring system has to be timely enough so that issues can be dealt with before they threaten goal achievement. With the cascade effect, a goal is set in isolation, so not meeting targets in one area will affect targets everywhere(Mind Tools, 2003).

On the other hand, it is essential that one ensures that the goals are not driving adverse behaviour because they have not been designed correctly(Mind Tools, 2003).

Badly-implemented MBO tends to stress the goal setting without goal monitoring. There should be a clear path marked by accountability checkpoints. Each goal should have mini-goals and a method for keeping on the top of each one(Mind Tools, 2003).

5. Evaluate and reward performance

MBO is designed to improve performance at all levels of the organization. To ensure this happens, the company should put a comprehensive evaluation system in place.

As goals have been defined in a specific, measurable and time-based way, the evaluation aspect of MBO is relatively straightforward. Employees are evaluated on their performance with respect to goal achievement. All that is left to do is to tie goal achievement to rewards and perhaps compensation and provide appropriate feedback(Mind Tools, 2003).

6. Repeat the Cycle

Having gone through this five-stage process, the cycle begins again, with a review of the strategic, corporate goals in the light of performance and environmental monitoring.

When you reward goal achievers you send a clear message to everyone that goal attainment is valued and that the MBO process is not just an exercise but an essential aspect of performance appraisal. The importance of fair and accurate assessment of performance highlights why setting measurable goals and clear performance indicators are essential to the MBO system(Mind Tools, 2003).

Implemented on a team level, MBO shows itself in clear team briefing, in effective goal setting, in successful use of reviews, in effective delegation and in the giving and receiving of feedback. These are many of the key techniques needed for effective team management. Implemented on an organizational level, MBO needs the full commitment of the organization, and an underlying system for tracking goals and performance. Because goals must be transmitted from level to level with agreement, goal transmission can inevitably be slow. Full implementations of MBO can therefore be slow and difficult, particularly if non-accounting-based goals are included. This is perhaps why MBO has evolved into the idea of the Balanced Scorecard: MBO on its own may too-easily slip into being nothing more than a financial management mechanism(Mind Tools, 2003).

MBO is essentially a management process. It should not be used as a replacement for good leadership: The two should work together(Mind Tools, 2003)!

1.2 Unique features and advantages of the MBO process

According to Drucker (2003), there are some unique features and advantages of the MBO, which make the system effective if applied (True to business, 2011):

- **Increased Motivation;** It provides clear objectives for managers which they need to achieve and allows for the prioritisation of activities which leads to improved time

management. This enables them to achieve their own objectives and the objectives of the business as a whole. This makes management by objectives act as a motivator because individuals can measure their performance against their agreed targets.

- **Indication of performance;** Management by objectives provides a performance indicator for the business. The objectives set act as a control mechanism due to the ability to check an individual's performance against their targets. This makes it easier for the business to identify when performance does not meet the required targets, making it easier to decide on what action to take to rectify the problem.
- **Increased focus;** Due to the way that management by objectives works, all employees should be working towards the same goal. This would therefore ensure that all activities undertaken by employees should benefit the business.

Management by Objectives is a powerful tool for aligning employees actions with an organization's goals. Its overarching premise is that of employee empowerment. By empowering employees to take responsibility for their performance and allowing them to see how their achievements impact the organization as a whole, you increase people's motivation, dedication, and loyalty. When you bring that full circle and link performance to evaluation and appraisal, you have a strong system that supports and values employees and facilitates great performance (Mind Tools, 2003).

2 STRATEGY, STRATEGIC MANAGEMENT AND GOAL SETTING

According to Pietersen (2002), creating an adaptive organisation, one that is capable of continuous change in response to our ever-changing environment is, perhaps, the most significant challenge any business faces.

However, it is not always clearly understood what a strategy really is. The very word is derived from the Greek word “strategia” which means “generalship”, which consists of two words: “stratus”, meaning “army” and “agein”, meaning “to lead”. In military science, strategy refers to the large-scale plan how the generals intend to fight and win a war.

A strategy gives an answer to a question how to achieve the goals and objectives of a company. A good strategy is the ones that gives the right answer.

“Company’s strategy defines how you will win.” (Pietersen 2002)

According to Willie Pietersen (2002) the two most important goals are:

- Greater value for customers,
- Greater profits for company and its shareholders.

These two goals that may seem distinct are closely related. Unless company creates greater value for its customers, it will not retain its business for long period of time, and the eventual loss of revenues will soon make it impossible to generate profits for itself and shareholders. Thus, an effective strategy is one which provides answers how and where to apply company’s limited resources in the pursuit of both goals.

In his book “The hare and the tortoise”, Kay (2006) goes deeper into the matter and says that business strategy is concerned with the match between the internal capabilities of the company and its external environment. He further reinforces this view by setting that strategy is not planning, visioning or forecasting but that it is a set of analytic techniques for a better understanding and, consequently, the ability to influence a company’s position in its actual and potential marketplace.

Not until the publication of Michael Porter’s Competitive advantage (1985), which is, according to Financial times considered to be the most influential book of the past quarter century, did economists attempt to reassess the field of strategy. The methods of strategy and its central questions branch out from Porter’s description. The methods require analytical approach to assessing the characteristics of the company and the related industries

and markets which it operates in. This consideration, according to Kay (2006) opens into two main issues: what are at the root the origin and characteristics of the successful fit between characteristics and the environment and how can companies and their managers make that fit more effective.

Thus, it is inevitable that the process through which effective strategies had been formulated and how effective strategy should be designed are two inseparable core issues.

Kay suggests that goal setting comes from the strategy. The equilibrium point of aligning strategy with its goal setting is that the management must first look inward and identify the distinctive capabilities in the market which it operates in. According to Kay (2006), the process of strategy formulation and its implementation are bound together.

The resource-based view of strategy, which emphasizes rent creation through distinctive capabilities, has found its most widely accepted popularization in the core competencies approach of C.K. Prahalad and Gary Hamel (1990). Kay (2006) elaborate that this application has been made problematic by the absence of sharp criteria for distinguishing between core and other competencies, and adds that core competencies become pretty much what senior management of the corporation want them to be. Characteristics such as size, strategic vision, market share and market positioning, all commonly seen as sources of competitive advantage, are all ultimately reproducible by firms with competitive advantages on their own, can be clearly seen as the result, rather than the starting point, of competitive advantage. In that regard they can be looked at as the ultimate goals of an effective strategy.

According to Kay (2006), it is the distinctive capabilities that are at the heart of competitive advantage, and every firm should explore how to create their own distinctive capabilities. Strategy should be viewed with the emphasis on the fit between those characteristics shaped by such distinctive capabilities and environment. Furthermore, organizations which have their capabilities matched to the requirements they are faced against, emerge from the strategy setting processes with significant and relevant which provide favorable feedback for setting of goal which are well-suited to their environment.

Because strategy is about the intelligent use of limited resources, the formation of a winning strategy requires that the company makes a set of difficult decisions. In fact, the point of the strategy is to create an intense focus on the right things (Pietersen, 2002). After all, in the words of the personal productivity guru and renowned author David Allen, “You can do anything. But you can’t do everything”. This very sentence drives me to the idea how

important goal setting for the company is and to what extent it can affect the creation of organisational strategy. To further elaborate my idea, I will use an example of chess game, where the goal is to preserve one's resources, i.e. the pieces with which one starts the game, especially the most important figure, king. Likewise, in business, resources are not only to be preserved but to be leveraged and multiplied in the creation of the added value. Therefore, if strategy is about winning, organisations should be very clear about their goals that will lead them to success.

2.1 Performance measurement and management as a tool for implementing the strategy

In many organisations, performance measurement and management systems are little more than HR bureaucracies with forms, rules and review layers. These paper-driven systems are burdens to managers and hence are compelled marginally, if at all. They are typically seen by raters as extra work and by rates as at best irrelevant, at worst demotivating. Most performance measurement and management (further referred to as PMM) improvement efforts centre on the most visible aspect of PMM- the form. But these quick fixes attempt to treat symptoms (e.g. leniency), while diseases (e.g. lack of managerial accountability for performance improvement or development) go unchecked (Scheiner, Shaw, and Beatty, 1992).

Rather than periodic revisions to the rating scales, PMM can be made relevant by linking it to strategy execution by signalling what is really important, providing ways to measure what is important, fixing accountability for behaviour and results and helping to improve performance. PMM should be described as a process that begins with identification of Critical Success Factors (CSFs) derived directly (Scheiner, Shaw, and Beatty, 1992).

PMM is central to business operations and critical to success, both individually and organizationally.

PMM facilitates execution of business strategy (Scheiner, Shaw, and Beatty, 1992).

1. Signalling what to measure
2. Determining appropriate ways to measure
3. Fixing accountability for performance on the measures

Unless all three of these activities occur, strategy execution is in jeopardy. People will focus on the wrong measures, fail to know when or agree if targets are reached, aim too low and achieve too little and or see no consequences for missing the targets (or perhaps for hitting them).

Performance and commitment are words which summarize two key variables that are of importance where individual employees are concerned (Boxall and Purcell, 2007). Traditional personnel management (also called Micro HRM), (Boxall and Purcell, 2007) and the discipline of industrial psychology have always been concerned with managing individuals within given framework of the company's work system and its employee relations management. The main point of focus has mostly been on how to use individual HR practices (such as particular selection, appraisal or training techniques) to build employee performance and commitment.

Specific goal setting requires also specific set of performance measurement tools or models.

The major systems for performance measurement that are being applied today are given below:

- The Balanced Scorecard
- Activity-based costing and management
- Economic Value Added (EVA)
- Quality management
- Customer Value analysis/Customer Relationship management
- Performance Prism

Furthermore, in order to evaluate the business results, there are certain requirements necessary to measure business and executive performance (Mercer, 2009):

- Performance metric selection (the measures used as an indicator of success)
- Linkage - the organizational level, (e.g., corporate, business unit, functional group, individual) to which the measure applies.
- Goal setting (the desired level of performance on the selected measures)

- Time horizon (the period of time over which the performance is measured)

According to Mercer (2009), getting each of these elements right will enable company to accurately assess performance results. A well designed performance measurement system can also help drive business results. By focusing efforts on key metrics and setting internal performance targets that meet shareholder expectations, the measurement system instructs employees how to create shareholder value (Mercer 2009). In this, way an effective performance measurement system can provide a company with sustainable competitive advantage by providing a sound framework for decision making. There is no standard system for measuring performance, so the objective is to choose from among the many available metrics that provide the best fit with organization and with the objectives of motivating and rewarding of management.

“What exists is not what is needed.”(Schein, Shaw, and Beatty, 1992).

What most companies have...(Schein, Shaw, and Beatty, 1992).

1. A staff-driven rating scale and forms,
2. A supervisor-driven ratings,
3. A focus on evaluating performance after the fact,
4. Measuring generic aspect of people or jobs,
5. Consequence of performance centred around base compensation,
6. Human resources accountability for “fixing” the systems,
7. Ambiguity and inconsistency around what it takes to make it in different units, at different levels, for different managers; uneven expectations,
8. Performance hurdles to set too low or not set at all, given what is required for the organization to compete successfully.

What most companies need... (Schein, Shaw, and Beatty, 1992)

1. A management tool and process,
2. Subordinate, supervisor, team member, customer-driven assessment,
3. A focus on setting expectations up front, coaching, developing and improving performance continually,
4. Measuring those “critical success factors” that assure goal attainment, strategy execution,

5. Positive and negative, financial and nonfinancial consequences and performance utilized effectively,
6. Managerial accountability for designing, operating and improving the process, with human resources technical assistance,
7. Clarity about success for individuals, teams, units, across the company,
8. Performance hurdles set to stretch people, over increasing, reflecting customers' ever-increasing demands and competitors' ever increasing skills.

In this part I shall deal more with the underpinning theory on the management of individual performance and commitment that will enable top management and upper management to take a more strategic approach to the management of their employees in the company. Starting from an argument (Boxall and Purcell, 2007) that performance management and employee development needs to be adjusted to cope with different types of managers effectively. All companies need to find the right blends of “stars” and “solid citizens” while at the same time trying to minimize the numbers of those who fall into category of “marginal performers” and “chronic under-achievers”. In knowledge intensive industries (where Volkswagen AG belongs in), such individuals as star managers have that sort of qualities that are important for innovation and path-finding. Therefore it is worthwhile considering very carefully about their rewards, development and retention.

As much as it is vital and substantial (Hunter, 2000), ability is not the only factor that explains performance. Employees must choose to apply their capabilities with some level of effort and consistency in order to produce required performance. Motivated capability is the quality that companies most require on individual level. This implies that companies must offer to its employee's adequate incentives to attend work and provide expected results. Both employer and employee are motivated to enter into employment relationship when (Boxall and Purcell, 2007):

- The benefits of doing so (wages, intrinsic factors, social standing) outweigh the costs (increased stress, fatigue and travelling costs),
- Alternatives to the offered employment (alternative job or staying at home)

The crucial question is in finding the way in which companies can create the motivational environment that suits them most.

There are so many theoretical approaches that could be cited here and one must be very selective. Therefore, I shall take into account two perspectives that can help highlight critical issues for management: agency theory and the theory of psychological contract.

While economists recognize the role that different levels of ability or “human capital” play in lifetime earnings of workers (Boxall and Purcell, 2007), by far their main focus in performance management is on the question of motivation. In organizational and personnel economics, the problem of individual performance is largely seen as one of aligning the incentives of employers and employees (Tomer 2001, Grimshaw and Rubery 2007).

Quality of alignment between business and employee interest	Short-term business Context	Long-term business context
Weak	Likely to have chronic HR problems (e.g. high labor turnover, low productivity) which create, or contribute to business failure	Likely to become victim of major market changes because of loss of key value generators and low motivation among remaining staff
Adequate	Likely to recruit and retain a competent workforce but motivational levels are unlikely to support any forms of “human resource advantage”	Likely to survive as a credible member of the industry but not develop any leadership position through human resources
Strong	Helps create the motivational basis to move beyond basic viability issues and develop superior short-run productivity.	Helps to create the motivational basis to secure the employees likely to play a decisive role in the long-run direction industry change.

Table 1: Likely implications of different levels of employment mutuality (Boxall, 1998)

According to Purcell (2007) employer-employee relationship is seen as a class of principal-agent relationship, all of which is defined by the fact that the interest of the both parties may diverge at some point of time.

The standard prescription that agency theory suggests is that employers should find ways of ensuring win/win outcomes with their employee agents. The employee that is taken as

typical is manager, and the standard context is where the principal knows less than manager about running the firm. In this case, it is possible that managers could behave opportunistically, looking solely for their own interest and at the same time damaging the profit of the organisation. One of the key techniques advanced to deal with this possibility is the individual bonus or incentive scheme (Grimshaw and Rubery 2007). The main idea is to ensure that the agent benefits only when the principal benefits. Thus, the agency theory argues (Boxall and Purcell 2007) that extrinsic rewards matter to employees and that making such rewards contingent on some of measured performance will help the firm perform better. As Boxall and Purcell have logically dissected this proposition into two parts, first part is certainly something that employers should always keep in mind. The main reason for working is the need to earn money to live, also called “provisioning motive”. This should of course never be underestimated, since the primary motive for changing jobs is to get higher levels of income. Hence, second part of the agency proposition, is that contingent rewards, performance –related pay (PRP) systems are suitable for companies but needs careful qualification. It is important to look under the conditions under which PRP schemes will work well and as a result will produce positive outcome. In that regard, it is vital to approach critically the LTI model of VW AG, since it will be the backbone of its long-term reward system. One of the more useful contributions in this regard is contained in a study of worker bonuses conducted by Edward P. Lazear (1999). He conducted a study in a company which installs automobile window glass, and therefore it can be very well related to VW AG study. In his study Lazear as able to demonstrate that the firm benefited in two ways: high-potential workers have increased their output (“incentive effect”), and the (“sorting effect”), where the rate of labor turnover of higher performers dropped and more workers of higher ability were attracted to the company. The result was that at the same time those employees of lower ability tended to leave in search of more secure payments elsewhere. This proved to be functional labor turnover. This study is valuable because Lazear (1999) notes cases where the individual bonuses will work well, and the work can be transparent.

Of course the major risk in bonus systems is that they may create “perverse incentives” (Boxall and Purcell 2007), behavior which produces rewards but which channels the employee’s actions too narrowly and which does not help to build a more flexible and comprehensive awareness of the company’s unfolding needs (Kessler and Purcell 1992).

What companies can do in order to minimize the potential managerial PRP schemes to get out of hand; one US study conducted by Martell and Carroll (1995) has suggested some directives to be followed. Their study obtained detailed responses on HR Practices for managing top management members, as well as assessment of business performance, in a sample of 115 strategic business units based in 89 Fortune 500 companies.

The study found that the practices associated with better management performance were:

- Very selective recruitment (whether executives were hired from within or outside the group did not have an impact),
- High external relativity in pay (implying that companies should pay the executives well in terms of the current labor market),
- Rigorous use of performance planning and appraisal.

This study suggests that the desired results of bonus systems can be achieved more effectively by focusing on performance planning and rightful feedback. Boxall and Purcell (2007) suggest that with individual bonuses, employees are able to reach high performance through their own efforts, and companies should at certain point consider introducing sort of team or company-wide incentives, taking into consultation with the managers and their employees. Here it is important to mention how the issue of incentives is one of the most sensitive areas in HRM, and how the context of stakeholder's interests should be carefully examined.

While agency theory tries to understand individual performance management taking into consideration economic perspective, theory of psychological contracting tries to capture it from the more psychological and social perspective. According to Schein (1978) psychological contract is a set of unwritten reciprocal expectations between an individual employee and the organization. He was the advocate of a model that in order to have an successful employment, organizational needs must be matched with the needs of an individual (Schein 1978). In addition to his model, Purcell and Boxall (2008) support the fact that long-term employment requires an on-going alignment of interests between employer and employee. Need of each individual manager are seen to be changing across early career, mid-career and late career phases. Denise Rousseau (1995) one of the most important writers on psychological contracting in employment relationship, defined it as an individual belief about the terms of their relationship with the organization that employs them. The

example that portrays in its simplest form how psychological contract is formed is shown in the following figure 2. For Rousseau contract is fundamentally psychological, where it exists in the eye of the beholder (1995).

The rectangular boxes indicate thinking of individual manager and work orientations while the words in the ovals indicate the processes from the organizational point of view. The formation of individual’s psychological contract is shaped by recruitment claims and organizational policies but also by the social cues in the work environment (Purcell and Boxall 2007). This diagram helps to illustrate how certain difficulties can arise. The individual in this case forms the view that they are being promised early promotion in exchange for hard work.

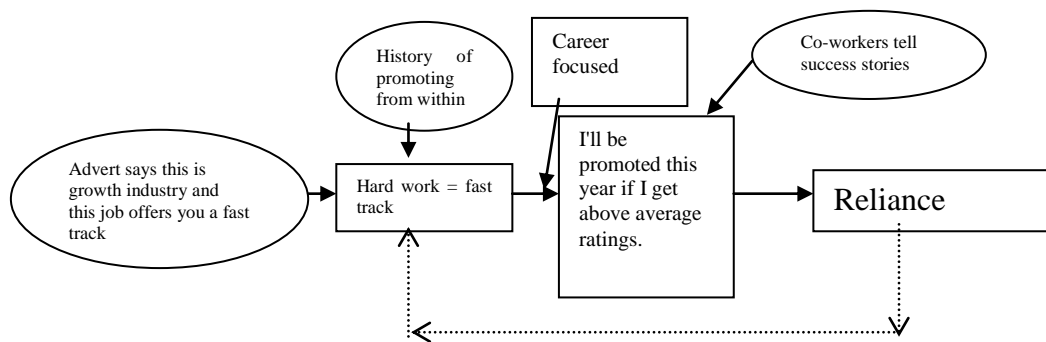


Figure 2: Model of psychological contract (Rousseau, 1995)

Managers often misunderstand “hard work” with performance, concepts which may overlap but which do not coincide because of the ability and resourcing differences (Purcell and Boxall 2007). Psychological contracts are the backbone of employee commitment and they undermine the option of premature leave of valuable managers. Their long term stay Organ (1988) calls “organizational citizenship behavior”, which includes a range of cooperative and caring behaviors that can be valuable to collegial relations, teamwork and client service in company. For Volkswagen AG it is of utmost importance to have managers who perceive good organizational support in their employment relationship, and respond with increased trust in management and greater commitment to the organization.

As Purcell (2007) states that the theory of psychological contracting helps to highlight all the important questions of how to sustain employee motivation. It is beneficial to make distinction between intrinsic and extrinsic sources of manager motivation. Intrinsic sources are more related to the nature of the work and the extent to which the manager find it enjoyable and how well they operate in their internal environment, while extrinsic factors are more related with the benefits that job brings (level of the pay, prospect of promotion, job security, etc.).

Purcell and Boxall (2007) underline how important for the companies it is to have individuals that possess motivated capability. They stress that recruitment and selection activities are critical for all the companies. This implies that the greater the investment in staffing, the greater the benefits are to be gained through strong training and development. Moreover they highlight that the large companies should aim for greater validity in performance appraisal, particularly in work with high levels of multitasking. It is obvious that the task of getting rated performance as close as possible to “objective” performance is as much a problem of managing organizational politics (Purcell and Boxall, 2007) as it is a technical one of improving system design and managerial training.

The concept of the psychological contract has attracted considerable academic and management interest and is currently utilized in a various ways in a wide range of scenarios. Psychological contract is changing as the nature of work changes, and also due to changes across manager’s life cycle. It is possible that, in the light of social and employment trends work-life issues will become increasingly significant in contemporary understanding of psychological contracts, and contracts in general.

HR systems enable management to build the human and social capital the firm needs to reach its overall goals in HRM (Purcell and Boxall, 2007). Generally managers are trying to ensure that the HR systems are designed in such a way that they fit in with the given environment. These “best” organizational fits contain the need to adapt to laws and cultural norms, industry rules and organizational factors. Every firm needs to create its unique form of fit in HR systems that will create “human resource advantage”.

For Kepes and Delery (2007) internal fit is seen as critical to a high quality performance in HRM. Authors that are discussing the internal fit are usually making an argument for high level of coherence among HR policies and practices adopted within an HR system. One of such authors is Macduffie (1995), who in his scholarly paper uses a set of unique interna-

tional data of 62 automotive assembly plants talks of the need for positive “bundling” in the HR practices which are supporting work reform in these plants. He argues that flexible production systems have a “organizational logic” that integrates bundles of HR practices with manufacturing practices in pursuit of simultaneous improvements in productivity and quality (1995). For MacDuffie (1995) a flexible production plant reduces inventory levels and other potential buffers, while at the same time increasing interdependence in the production process. In order to deal with these problems in effective manner requires motivated, skilled and adaptable employees. Combination of reducing the “buffers” and development of employee’s characteristics, these flexible production systems create conditions under which innovative HR practices are more likely to yield effective economic performance. He focuses on one specific industry, automotive, providing many advantages for testing his argument.

Delery (2007) also states that it is vital to consider the consistency which overlaps with coherence in HRM with regard to the internal fit. According to Boxall and Prucell (2003) companies should not neglect to rightly emphasize the value of the various forms of coherence and consistency, which help to build stability and trust within organization. At the same time multiple goals of HRM may bring a range of strategic tensions. There may be tensions between economic goals and the need for social legitimacy. Other tensions that may arise are between economic performance in the short run and the preparation for the long run. As these authors suggest it is necessary to seek for equilibrium point in coherence among HR policies aimed at particular group of employees and consistency in their application. Where, management aims to bring new style of working for major group of employees, such as one that implies higher levels of skill and creativity.

It is crucial to find the HR system that fits most to the organizational framework and that it will serve its strategy. According to the HR typology of Purcell and Boxall (2007) I shall single out one type that suits Volkswagen AG.

Type of HR system	Defining characteristics	Typical context and key HR goals
<i>Industrial model</i>	Highly specialized, low-discretion (Taylorised) jobs, set within a hierarchy of management authority but linked to bureaucratic rules that bring standardization and various career features (internal labor markets). Trade unions are common.	Developed in the late nineteenth century and in the early to mid-decades of the twentieth century to support efficiency-oriented mass production with greater workplace stability and higher levels of social legitimacy.

Table 2: typology of HR system (Purcell and Boxall, 2007)

This “industrial model” as Osterman (1987) calls it, grew out of the informal type (Boxall and Purcell 2007). In the time when the workers were gathered in the factories around a common power source in the nineteenth century, a process of specialized working was introduced. Jobs that were low in discretion, responsibility and scope were created, so called “Taylorised” jobs and workers had to be submissive to a hierarchy of management authority, where reinforced bureaucratic rules brought standardization to employment conditions. Workers were not immune to lay-offs but were protected through rules that were negotiated with unions. This model was designed to support the efficiency advantages of high degree of specialization and economies of scale in mass production. However, as Boxall and Purcell (2007) note that reformers within management circles and pressure coming from the side of trade unions helped to ensure that the wages and employment conditions were drastically improved. Further on they note that the core features of specialized jobs that were embedded in strong “Internal labor markets” expanded into large scale companies. One of the bonus results of the industrial model is the “salaried system” (Pinfield and Berner, 1992). This was introduced in order to manage the managers and “white collar” specialist who were of utmost importance to the factories and other large scale companies. Under salaried system employee receives annual salary rather than a wage calculated on the basis of actual hours worked (Boxall and Purcell 2007). In this way managers and specialist enjoy higher levels of discretion, responsibility and security as compared to other employees. Career development is nurtured within the company. Top management

is being attracted with bonuses and share options, and individual strengths were recognized through merit-based pay.

Over the last thirty years the economic and technological context has changed drastically, and one of the results of these changes is that various companies have made a transitional move from industrial HR model to a high-involvement one. This was particularly a case among manufacturers in high-wage countries who needed more effective response to competition, while delivering at the same time a lower cost per unit. Leading examples of such manufacturing companies emerged in automobile industry (MacDuffie, 1995).

Generally HR strategies in organizations typically incorporate a range of HR systems. In that regard organizations and HR systems are seldom equivalent (Boxall and Purcell 2003). It is very rare to have a single HR system that covers all employees in a company. I shall therefore extract organizational model from another topology that identifies the most common HR systems across major types of organizations according to Boxall and Purcell (2007) that can be related to Volkswagen AG.

<p>Classical bureaucracies</p>	<p>Salaried, industrial and craft systems</p>	<p>Classical bureaucracies include the large private and public sector organizations that grew strongly in the early to middle decades of the twentieth century. Salaried career managers lead a large workforces which are predominantly managed through and industrial model (while some groups are employed on craft model). Trade unions are commonly involved and tend to heighten bureaucratic standardization and restrain management power. There are three main variants: the industrial bureaucracy (typical in a large a manufacturers), the service bureaucracy and the public sector bureaucracy.</p>
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Table 3: Organisational typology (Boxall and Purcell, 2007)

The term “classical bureaucracy” is used to describe the large organizations that have emerged in the nineteenth century and the early middle decades of the twentieth century. In these types of organizations shareholders were remote and salaried, and career oriented managers took the lead over the large workforces. In these organizations trade unions were common. Unions did not oppose to the high levels of job specializations, but helped in lifting wages, control of management power and fostering of “internal labor markets”. Taylorist and Fordist philosophies made their marks in large manufacturing companies and the main HR systems were industrial models for waged workers and salaried models for managers and management specialist (Jacoby, 2004).

It is important to mention here that VW AG as well follows the similar pattern that is presented in the previous text, and the organization is trying to find the HR system that will fit all of its car brands.

In order to design appropriate HR system it is necessary to have quality investments in managers. Different HR systems send different messages, internally as well as externally. Some are more oriented toward achieving low labor cost with adequate levels of effectiveness, others are up to achieving high levels of employee commitment and expertise level performance. Question arises at this point of research, is there some common factors in how HR systems should operate in order to support the strategy of an organization, and are there some key links that all HR models need if they are to reach strategic goals set. This is what most HR researchers call the “black box” problem (Kinnie, 2003), in setting the right order of links from HR policies with respect to firm performance, and how better HR practices lead to better financial results. Despite the variations in the goals of HR systems, there are some important principles in particular relevance to large bureaucratic organizations (VW AG) where tall hierarchies, change in ownerships (takeovers of MANN, Porsche, Bugatti), and swings in philosophy can threaten coherence and consistence in HR strategy. Majority of scholars who specify causal chain between HR policy and organizational performance see manager attitudes and behavior as the critical linking mechanism. This is both on individual and group level. In order to fulfill strategic objectives and goals, management needs to influence individual employee ability and motivation. One of the most elaborated models that link HRM and organizational performance is proposed by Wright and Nishii (2006). Their causal chain proposes: 1. Intended HR practices, leading to 2. Actual HR practices, leading to 3. Perceived HR practices, leading to 4. Employee reaction, and finally leading to, 4. Organizational performance.

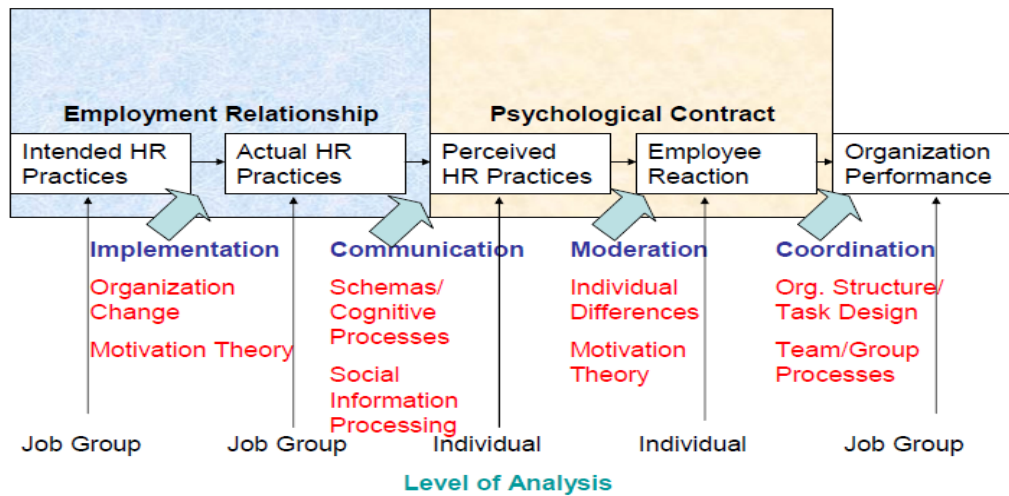


Figure 3: HRM and organizational performance (Wright and Nishii, 2006)

In figure above first concept are intended HR practices, which represent the outcome of the development of an HR strategy that seeks an HRM system or practice that the company’s decision makers i.e. managers believe will have effective response from their employees. This may be related directly to the business strategy (Wright and Nishii, 2006). The next box is labeled “actual HR practices”. This recognizes that not all of the intended HR practices are actually implemented, and those that are implemented can differ from the initial intention, i.e. there is a difference between realized strategy and what leaders say their strategy is. The following box is “perceived HR practices”, where actual practices must be perceived and interpreted subjectively by each employee, and thus the process moves down to the level of the individual. The last box “employee reactions” describes how each employee will react based on perceived HR practices of that particular organization.

This model underlines the fact that there can be major gaps between management intention and action that can have damaging effect on the organizational performance.

In conclusion, it is important to underline that performance appraisal of senior management and more effectively developed internal relationships are beneficial for individual and work unit functioning in order to produce many positive outcomes related to organizational performance. Thus, the consistent HR system in the company can enable effective performance appraisal of senior management.

2.1.1 Complexity of performance measurement and goal setting

It is crucial to understand why measuring and organization's performance is both necessary and vital. According to Johnson (2003) an organization operating without performance measurement system is like an airplane flying without a compass or a CEO operating without a strategic plan. For Johnson (2003) the purpose of measuring performance is not only to know how a business is performing but also to enable it to perform better. The ultimate aim of implementing a performance measurement system is to improve the overall performance of an organization so that it may better serve its customers, employees, owners and stakeholders.

He further implies, that if performance measurement is gauged rightly, then the data generated will tell where the business is, how it is doing, and where it is going. In short it is a report card for a business that provides an overview of the various performance measurement systems used today by enterprises to drive improvements in overall organizational performance. A performance measurement system enables an organization to plan, measure, and control its performance according to a pre-defined strategy (Johnson 2003).

Goal setting has always presented an effective technique to motivate performance in an organization (Ordonez, 2009). Five theories of motivation in organizational behavior have goals as key variables: Maslow's (1943) need hierarchy, Fishbein and Ajzen's (1975) theory of reasoned action, Bandura's (1986) social cognitive theory, Locke and Latham's (1990) goal setting theory, and Carver and Scheier's (1998) control theory. Voluminous empirical research shows that goals affect a person's choices; they give direction to which a person is committed increases effort, prolongs persistence, and cues people to search for strategies to attain it (Locke and Latham, 1990). Thus, an employee who is committed to a goal will try harder to achieve it. Proper goal setting is a regulatory mechanism for monitoring, evaluating, and adjusting the performance within organization. In his article "Toward a theory of task motivation and incentives" (1968) Locke states that employees were motivated by clear goals and appropriate feedback. Locke went on by saying that working toward a goal provided a major source of motivation to actual reaches the goal, which in turn improved performance. His research showed that there was a relationship between how difficult and specific goal was and employee's performance of a task. The whole point of goal setting is to facilitate success. Therefore management wants to make sure that the conditions surrounding goals don't frustrate or inhibit their employees from accomplishing their objectives.

2.1.1 The debate on goal setting

In order to illustrate the connection between organizational performance and goal setting and the positive/negative side effects goals may have I shall present the debate: Locke and Latham VS. Ordóñez (2009).

Ordóñez, Schweitzer, Galinsky and Bazerman (2009) struck first. In their article (2009) they “contend that goal setting has been overprescribed”. In particular they argue that goal setting has powerful and predictable side effects. They state that goal setting is one of the most replicated and influential paradigms in management literature. Hundreds of studies conducted in numerous countries and contexts have consistently demonstrated that setting specific, challenging goals can powerfully drive behavior and boost performance. According to them advocates of goal setting have had a substantial impact on research, management education, and management practice. In their article (2009) they argue that the beneficial effects of goal setting have been overstated and that systematic harm caused by goal setting has been largely ignored. Through some “disastrous” examples, e.g. Enron and Ford Motor Company (Ackman 2002), they suggest that the harmful effects of goal setting have received far too little attention in the management literature. Although prior work has acknowledged “pitfalls” of goal setting (Latham and Locke, 2006), they argue that the harmful side effects of goal setting are far more serious and systematic than prior reviews have acknowledged. Although specific, challenging goals can produce positive results, Ordóñez et al (2009) argue that often these same characteristics cause goals to “go wild”. They describe how the use of goal setting can degrade employee performance by narrowing focus to neglect important but non-specified goals, motivating risky and unethical behaviors, inhibiting learning, corroding organizational culture, and reducing intrinsic motivation.

In their opinion narrow focus can blind employees to important issues that appear unrelated to the goal. The tendency to focus too narrowly on goals is compounded when managers chart the wrong course of setting the wrong goal. Pursuing multiple goals at a time, especially when quantity and quality goals are concerned, in most cases leads employees to focus on goals that are easier to achieve and measure (quantity). When discussing about unethical behaviors they relate to Barsky (2007) who states that aggressive goal setting within organization increases the likelihood of creating climate for unethical behavior.

They also argue that, in many situations the damaging effects of goal setting outweigh its benefits. Their conclusion is that rather than to dispense goal setting as benign, “over the counter” treatment for motivation, managers and scholars need to conceptualize goal setting as “prescription-strength medication” that requires careful dosing (Ordonez et al 2009).

Locke and Latham (2009), responded that Ordonez et al (2009) in their critique of goal setting have breached the principles of good scholarship. Rather than conducting or integrating research, they chose to draw their central theme from anecdotal evidence.

To Locke and Latham goal setting has always presented an effective technique to motivate performance, and as a “soothing ointment” and certainly not as “panacea” for every problem, as Ordonez et al (2009) have implied by their metaphors.

Furthermore, Ordonez et al employ unrepresentative citations from literature, misreporting results, and use “emotionally laden metaphors” rather than “dispassionate language”. Locke and Latham relate to their prior work, where they state that an incentive may increase goal commitment (1990) and that bonuses for goal attainment may undermine performance if the goals are viewed as unattainable. For Locke and Latham (2009) “the trigger for incentives needs to be longer term in nature”. Bonuses could still be paid annually but based on the average performance over several years. In a qualitative study, Charan (2005) suggested that the key to organizational effectiveness is tying a CEO’s monetary incentives to the right goals, provided the correct strategy for attaining these goals.

Organizations cannot thrive without being focused on their desired end results more than an individual can thrive without goals to provide a sense of purpose (Locke and Latham 2009). According Locke and Latham, goal setting can be a standard for assessing one’s personal effectiveness.

Through this debate it can be seen how goal oriented incentives can affect entire organizational performance and provoke long term results.

For me this debate was a fascinating exchange of theoretical approaches. On one hand, Latham and Locke indeed have hundreds published studies supporting the positive effect on motivation and performance of setting specific, challenging goals, and the robustness of these findings does command respect.

On the other hand it is known that there are numerous cases where intense pursuit of ambitious goals led people do dysfunctional outcomes, for their organizations and for themselves. Moreover, Latham and Locke themselves have discussed this situation in a number of papers, providing their practical recommendations for practitioners.

2.1.2 Goal acceptance and goal commitment

It is not questionable if the theory of goal setting is one of the most important and useful theories concerning the organizational science.

However, in order for the goal setting to be effective, employees must be committed to the goals set.

The demonstration of the big importance of goal commitment has so far been given in several studies. The study of Erez and Zidon from 1984 has shown a significant drop-off in performance as goal commitment declined in response to increasingly difficult goals (Locke, Latham, and Erez, 1983).

Coch and French made a classic study of participation in 1984 that was designed in order to make a comparison of different procedures for overcoming resistance by factory workers to changes in work standards or specific goals that are in accordance with product change (Locke, Latham, and Erez, 1983).s. Elaboration and understanding of different factors that affect the goal commitment in a positive or negative way is of great theoretical and practical importance.

Reviews on literature have shown that there is certain confusion between the term goal acceptance and goal commitment. Although there were different interpretations of these terms in the past, it is quite clear what they actually represent now. Goal commitment is an inclusive concept because it refers to one's attachment or determination to a certain goal achievement, regardless of the goal's origin. Goal acceptance is also one way of commitment. It specifically refers to commitment to a goal which has been assigned (Locke, Latham, and Erez, 1983)..

Although distinctions can be found and identified, they have not turned out to be useful.

The study of Early and Kanfer from 1985 showed that goal commitment and acceptance for one highly homogenous index ($\alpha=95$).

To conclude, in order to be successful, a company must make sure that the goals and objectives it has set as the organizational (general) or individual ones are both accepted and being committed to.

3 BALANCED SCORECARD

The Balanced Scorecard is a theoretical management approach proposed in the Harvard Business Review by Robert S. Kaplan and David P. Norton (2001). Subsequently the book, *The Balanced Scorecard* was published (2001) following their article. The most recent refinement of theory appeared in Kaplan and Norton's book *The Strategy-focused Organization*. In this part I shall attempt to present an overview of this management theory, along with some historical background and development.

As defined by Kaplan and Norton (2001), "the BSC translates an organization's mission and strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system". Hence, this strategic management system measures organizational performance in "balanced" perspectives:

- Financial – summarizes the readily measureable economic consequences of actions already taken; answers the question how should we appear to our shareholders in order to succeed financially,
- Customer – contains measures that identify the customer and market segments in which the business unit will compete and the measures of the business unit's performance in these targeted segments; answers the question how should we appear to our customers in order to achieve our vision,
- Internal business process – measures the critical internal process in which the organization must excel; answers the question what business processes must we excel off in order to satisfy our shareholders,
- Learning and growth – measures the infrastructure that the organization must build to create long-term growth and improvement; answers the question how will we sustain our ability to change and improve.

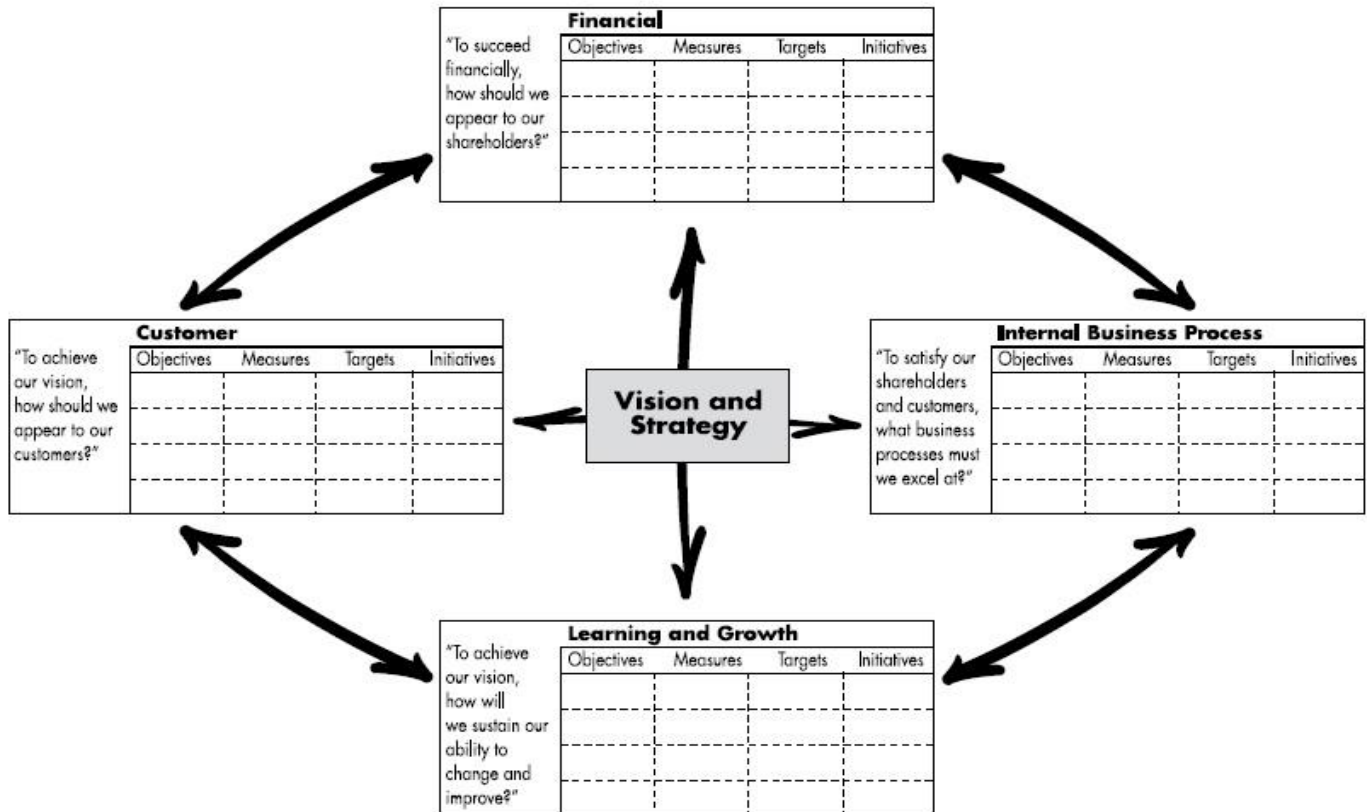


Figure 4: BSC 4 perspectives (Kaplan and Norton, 2001)

In order to design adequate BSC, organization’s management translates the mission, vision and strategy of the company into a scorecard. This scorecard measures should represent long-term and short term success in strategy execution. Measures are arranged in the four perspectives. The scorecard should contain both outcome measures that indicate excellent prior performance, along with the performance- drivers that can enable successful future performance.

This “balanced” framework enables a management team to execute the following four strategic management processes (Kaplan and Norton 2001) :

- Clarify and translate vision and strategy.
- Communicate and link strategic objectives and measures.
- Plan, set targets, and align strategic initiatives.

- Enhance strategic feedback and learning.

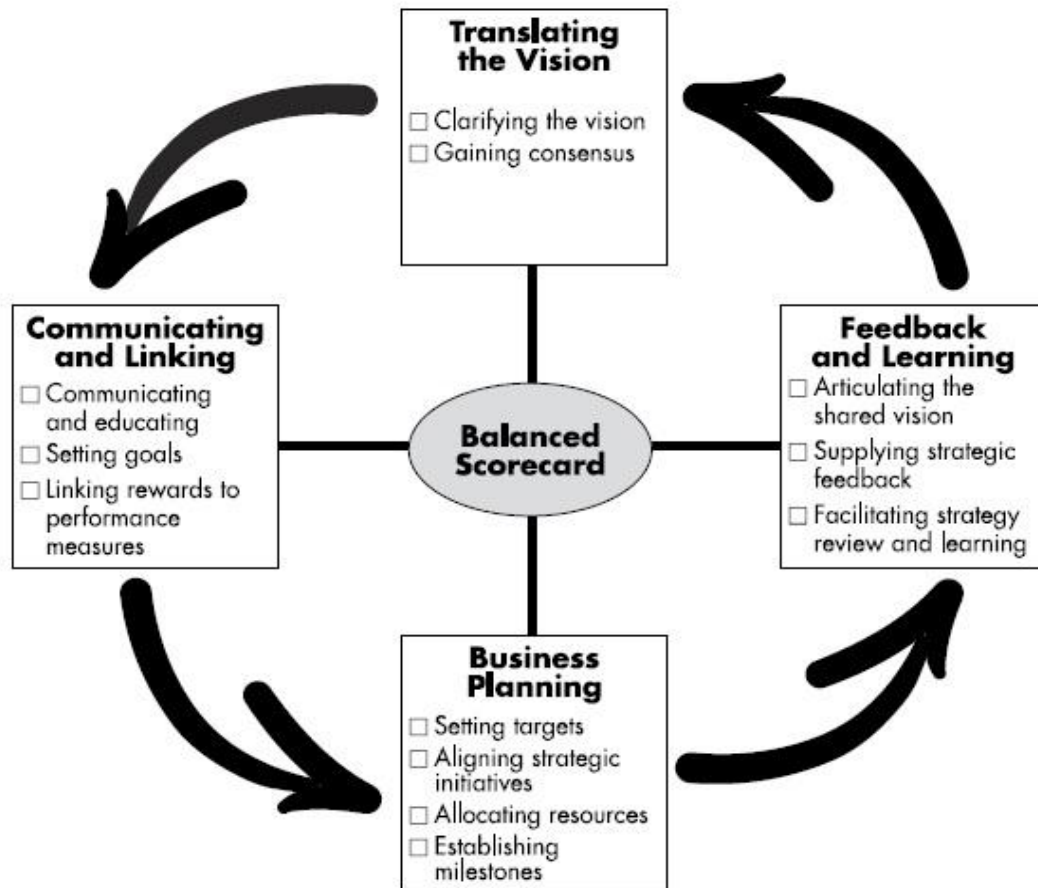


Figure 5: 4 BSC strategic processes (Norton and Kaplan, 2001)

Above mentioned management processes are the keys to the BSC theory. In the latest refinement of this concept which was developed from the vast experiences of companies implementing the BSC into their strategic management processes, Kaplan and Norton found out that implementation of strategy is as important as its development (Kaplan and Norton 2001). They proposed that successful strategy implementation incorporates following five strategic management principles (Kaplan and Norton 2001):

- Translate the strategy to operational terms
- Align the organization to the strategy

- Make strategy everyone's everyday job
- Make strategy a continual process
- Mobilize change through executive leadership

Within these five principles there are several elements which add the following new sections to the theory: Strategy Maps – strategy aligned with the value proposition, Personal Scorecards – strategy aligned with personal objectives, Balanced Pay checks – incentive compensation aligned with team-based goals (scorecard), Strategic and operational budgeting – strategy funded, Open reporting – all employees get the information and management meetings held to discuss performance, Change management – the BSC is a change management program, enabled by the scorecard.

One of the most important additions to the BSC theory is the BSC strategy map (Kaplan and Norton 2001). A well-designed strategy map clearly presents the organization's strategy and the measures of success for the strategy. Template for a strategy map is illustrated in the following page.

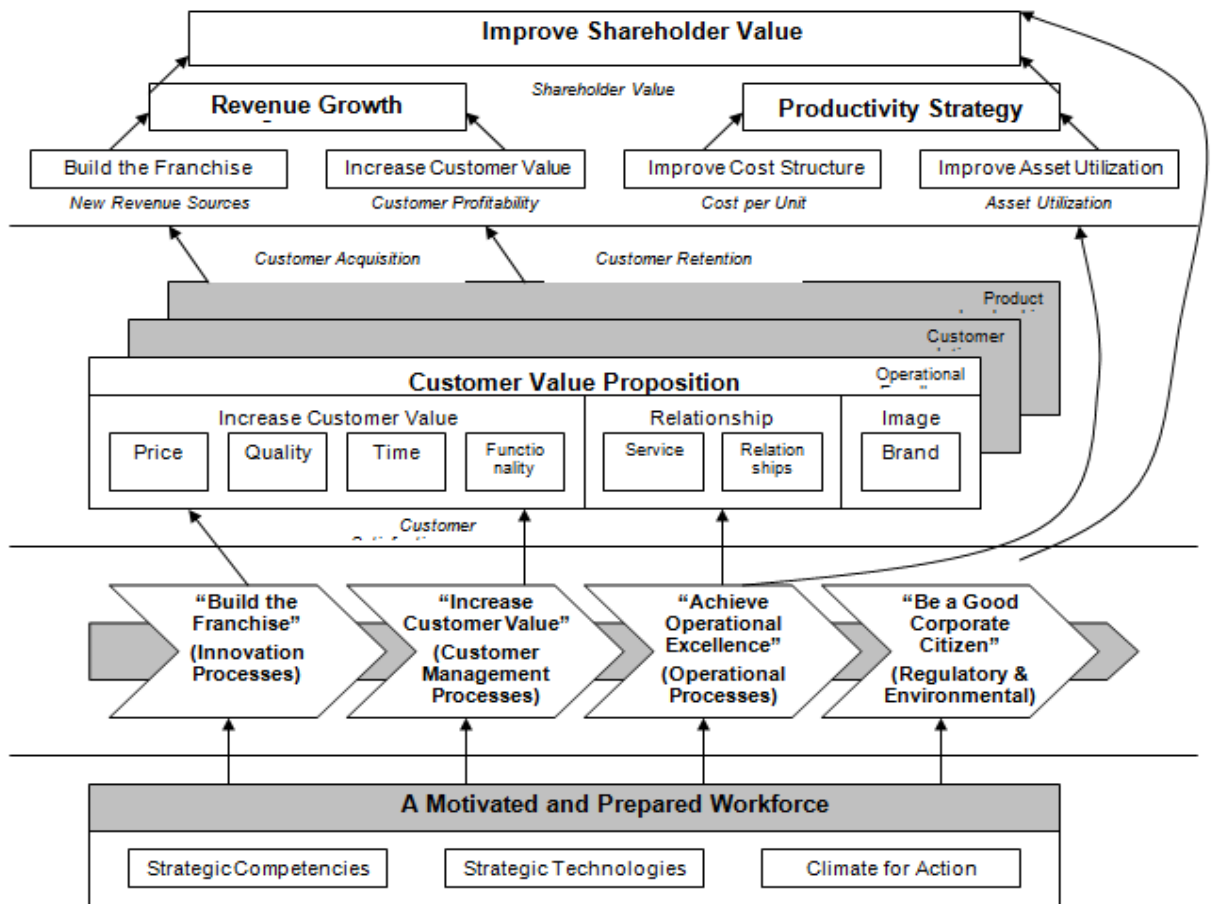


Figure 6: BSC Strategy map (Norton and Kaplan, 2001)

The BSC concept uses a “strategic measurement system” as the backbone of the theory. One of the most widespread measurement and management practices is “Management by objectives”. In *The Practice of Management* (1954), Peter Drucker introduced a concept called Management by Objectives (MBO). As defined George Odiorne (1965), this concept is “a process whereby the superior and subordinate managers of an organization jointly identify its common goals, define each individual’s major areas of responsibility in terms of the result expected of him, and use these measures as guides for operating the unit and assessing the contribution of each of its members”. In his definition the key is that subordinates participate in the goal setting process.

Another key foundational concept of BSC is that employees are motivated by having a clear sight of their activities that will facilitate strategy of the organization. Employees want to understand the connection between what they do, and what is organization’s mis-

sion and strategy. In that respect it is important for VW managers to communicate and coordinate organizational goals that are aligned with organizational strategy.

It is necessary to realize the linkage between employee's commitment to organizational strategy and objectives to motivation and employee satisfaction. Company must foster this commitment through careful and purposeful strategy integration into the BSC as a mean of performance measure. Considering that BSC is extremely effective in communicating overall as well as divisional and individual goals and expectation to all parts of the company, it would serve as an excellent tool by which company can gauge performance and consequently tie compensation based on that performance (Garrison, Noreen and Brewer, 2008). Tying bonuses and other incentives to scorecard performance measures should be used, however Garrison (2008) states that it should only occur once the BSC has been used within the organization for a minimum of one year, and if the strategy of the organization has been well integrated into the BSC. In that case the organization can be confident that all managers have communicated the information that is represented in the scorecard, and further employ this information in decision making and process changes (Garrison, Noreen and Brewer 2008).

The balanced scorecard is known for helping companies identify and implement changes that are necessary to meet their business goals. In order to be effective, this tool must be linked to a well-defined corporate strategy. If a company's business units are not aligned around the same core principles, it is unlikely the scorecard will produce the results the organization desires.

Used properly, however, the balanced score card can address this issue very well. Simply selecting the score card's measures often can create the required communication and organization needs to get its business units aligned. As a company continues to review its progress in these chosen areas, previously isolated leaders can quickly find themselves working together to meet shared strategic goals.

II. ANALYSIS

4 INTRODUCTION TO ANALYSIS

4.1 Research purpose

This study is addressed to the use of Management by Objectives in Volkswagen Sarajevo Ltd.

The Thesis is dedicated to exploring and analysing the current situation in the company with a special accent on its management system which is a direct subject to the implementation of this specific management system.

Analysis also refers to examining the appropriateness of the system, the like hood of motivation caused by its implementation and to existing and potential obstacles that this system may run into.

In order to accomplish this purpose, the study will focus on following research questions:

1. Why is MBO an appropriate management system and how will its implementation contribute to the company's success?
2. How should MBO be implemented in Volkswagen Sarajevo Ltd., according to broad and deep analysis of the company?
3. What cost and risk issues can and will be related to the implementation of MBO in Volkswagen Sarajevo Ltd.?
4. What are the existing and potential obstacles to successful implementation of MBO and how should the company overcome them?

The study will be carried out through the case of Volkswagen Sarajevo Ltd., a part of Volkswagen Aktiengesellschaft by interviewing managers of the company's various sectors that are subjects to the implementation of MBO.

The interest for this particular topic derives from my interest in automotive industry and the intention of Volkswagen Sarajevo Ltd. to follow the trends of the industry, especially when it comes to the mechanisms and systems previously applied in Volkswagen AG and the linear implementation of those systems in all the parts of the Group.

4.2 Significance of the study

This study will give an insight into the MBO system and a new long term incentive programme used in automotive industry, which is designed in such a way that it should enable fulfilment of organizational strategic goals.

Since the majority of literature and research conducted on management systems and motivation in big automotive companies focuses on individual performance of its top managers, it at the same time, in most cases, ignores the performance of the entire sector.

However, high and quality performance of the company depends on the top performance of each and every employee. In order to have employees who are, in this sense, constantly contributing to the company's overall success, the company has to ensure that the employees are highly motivated.

In that regard, I wish to look at the area of management system that ensures appropriate management motivation, which then produces group motivation and success.

Once the companies set general goal and objectives, they tend to struggle with defining a proper set of performance measurement parameters that would ensure the proper measurement of the progress made towards achieving the goals and objectives set.

According to the literature, strategy and performance measurement are the dominant criteria used to determine the success of a management strategy implementation through achievement of its goals.

For that reason, one of the issues to be explored is how the organisational performance can be evaluated objectively. Hence, for such companies, it is vital to think carefully about the link between human resource management and organisational performance.

The outcome of a manager's success should not only be evaluated according to the individual result but also according to the manager's ability to increase employee motivation, therefore, initiate positive development of employees that would correspond to customer satisfaction, sales and profit.

Managers who are subjects to MBO and its evaluation and performance measurement systems should communicate its effects and way of functioning in order to raise the acknowledgement and motivation towards it on both individual and the group level.

Volkswagen Sarajevo Ltd. should manage individual performance and commitment and design performance incentive that may facilitate the achievement of organizational goals. This shall, among other ways, be done by taking into consideration the literature that debates on the issue of goal setting.

4.3 Research methodology

For smooth and accurate study, it is important to have certain rules and regulations that have to be followed. The impute for my master thesis was collected from two sources- primary and secondary. Primary sources were: practical desk work, face to face conversation with the employees and top management of Volkswagen Sarajevo Ltd. and direct observations during the internship in Volkswagen Sarajevo Ltd. Secondary sources were: annual report of the company, files and folders, daily observations made and wrote down by me during the internship, various publications of the company, company's website.

The details of the work plan are furnished bellow:

Data collection method: Relevant data for my master thesis were collected primarily by direct observation and investigation of different company personnel during my internship.

Data processing: Data collected from the secondary sources were manually processed. Throughout my master thesis I have used qualitative approach in general as well as the quantitative approach in certain cases.

Data analysis and interpretation: Collected and processed data have been used as the base and a quality approach has been adopted for data analysis and interpretation.

5 PROFILE OF VOLKSWAGEN AKTIENGESELLSCHAFT

The Volkswagen Group with its headquarters in Wolfsburg is one of the world's leading automobile manufacturers and the largest carmaker in Europe. In 2011, the Group increased the number of vehicles delivered to customers to 8.265 million (2010: 7.203 million), corresponding to a 12.3percent share of the world passenger car market (Volkswagen AG, 2011).

In Western Europe just over one in five cars (23.0 percent) comes from the Volkswagen Group. Group sales came in 2011 to 159 billion euro (2010: 126.9 billion). Profit after tax in the 2011 financial year amounted to 15.8 billion euro (2010: 7.2 billion)market (Volkswagen AG, 2011).

The group is made up of nine brands from seven European countries: Volkswagen, Audi, SEAT, Skoda, Volkswagen Commercial Vehicles, Bentley, Bugatti, Lamborghini and Scania.

Each brand has its own character and operates as an independent entity on the market. The product range extends from low-consumption small cars to luxury class vehicles. In the commercial vehicles sector, the product offering spans pick-ups, buses and heavy trucks.

The Volkswagen Group is also active in other fields of business, manufacturing large-bore diesel engines for marine and stationary applications (turnkey power plants), turbochargers, turbo machinery (steam and gas turbines), compressors and chemical reactors and also producing vehicle transmissions, special gear units for wind turbines, slide bearings and couplings as well as testing systems for the mobility sectormarket (Volkswagen AG, 2011).

The Group operates 94 production plants in 18 European countries and a further eight countries in Americas, Asia and Africa. Each working day, 501 956 employees worldwide produce some 34,500 vehicles, are involved in vehicle-related services or work in other fields of business. The Volkswagen Group sells its vehicles in 153 countriesmarket (Volkswagen AG, 2011).

It is the goal of the Group to offer attractive, safe and environmentally sound vehicles which are competitive on an increasingly tough market and which set standards in their respective classesmarket (Volkswagen AG, 2011).

5.1 Strategy

The strategy of Volkswagen AG pursues a clear objective: By 2018 Volkswagen Group is to be the world's most successful and fascinating automobile manufacturer- and the leading light when it comes to sustainabilitymarket (Volkswagen AG, 2011).The actions and the strategic guidelines that smooth the path to this goal are described in the frames of this strategy. 4 main goals that the Group wants to achieve in this sense are:

1. Top Customer Satisfaction
2. Top employer
3. Sales
4. Profit

5.2 Human resources

Volkswagen's group is based on the qualification and personal commitment of around 501,956 people (2012) who are employed by the Volkswagen Group. A company will only be able to survive in the face of international competition if it has a top team, characterised by a high level of competence, dedication, inventiveness and fitnessmarket (Volkswagen AG, 2011).

Competence is created from good basic training and life-long willingness to learn. Dedication ideally means entrepreneurial thinking and actions, not only by management staff. Active contribution of ideas and participation are expected of all members of staff. The success factors are encouraged in our human resources processed and in projectsmarket (Volkswagen AG, 2011).

5.3 Basic principles

5.3.1 Top performance

To survive in the face of competition and to achieve top performance, the Volkswagen Group needs employees who enthusiastically give their best. A good balance between demands and ability (the so-called "flow channel") is the best basic precondition for optimum performance and results. For this reason, Volkswagen AG does not want its employees to be overstretched,, so that they are able to deliver top performance, but also understreched, so that they are able to deliver top performance and advance the success of the company-market (Volkswagen AG, 2011).

5.3.2 Leading by example

The management assumes a decisive role in this entire process. VW's principle is to "Lead, Demand and Promote". The Group will only be able to achieve its goals with exemplary leadership and constructive cooperation between management and workforce. This includes both targeted and continual personnel development and work organisation, which we continue to develop with the so-called "Volkswagen Way" market (Volkswagen AG, 2011).

5.3.3 Active involvement

A standard survey of employees across the Group was introduced in the form of the so-called "mood-barometer". The "mood-barometer" gives employees the opportunity to anonymously voice their opinion and so to become actively involved in the organisation of the company. The results form the basis for continually developing our strengths and for exploiting potential that is brought to light. The high rate of participation shows that employees have positively accepted this instrument as an expression of their esteem. In this way, they make a contribution to the continued development of the company market (Volkswagen AG, 2011).

5.3.4 Social responsibility

Not only does Volkswagen's corporate culture focus on people, it also represents the sustainability of economic and social goals, "corporate social responsibility". The "Declaration on Social Rights and Industrial Relations" expresses Volkswagen's global understanding of social responsibility on the basis of minimum standards. This includes Volkswagen's active cooperative conflict resolution between Works Council and the company management. Volkswagen created European Global Works Councils early and without any statutory obligation. We do not cling to traditional questions of co-determination. Rather, Volkswagen discusses the development of the company with its Works Council representatives. This is the way from co-determination to shared responsibility market (Volkswagen AG, 2011).

5.3.5 Development paths

The Volkswagen Group will only be able to satisfy growing demands with respect to flexibility, processes, quality and costs if it views the dynamic processes of change as a permanent challenge. To be successful, we also require the active and independent participation

of all members of staff. It is precisely here that systematic personnel development begins. From the trainee to the top manager. From the very first day to the lastmarket (Volkswagen AG, 2011).

5.3.6 Promoting development potential

It is the goal of Volkswagen Group to recognise and uphold the performance and learning potential of each and every member of staff and to promote all employees in line with the company strategy and in accordance with their personal development potential. Personnel development measures range from technical seminars in automotive engineering and automation technology, IT, quality management and productivity, through supervisor development programmes for the Volkswagen Passenger Cars brand, to interdisciplinary training in subjects such as self management and communicationmarket (Volkswagen AG, 2011). In addition, the Volkswagen subsidiaries Volkswagen Coaching GmbH, the Audi Akademie and Volkswagen Bildungsinstitut GmbH are able to offer a broad and diverse range of seminars. These include, for example, modules dealing with personnel management, leadership competence or international development programmes. Volkswagen Coaching GmbH is one of the largest providers of vocational and advanced professional training in Germany and is active not only for Volkswagen Group but also on the open market(Volkswagen AG, 2011).

Volkswagen AG has a mission to be the world's largest carmaker till 2018- both economically and ecologically. Four main goals of the Strategy 2018 are in a direct relation with this mission and everything that the company does- it does in order to achieve these goals and to accomplish this missionmarket (Volkswagen AG, 2011)

6 ANALYSIS OF VOLKSWAGEN SARAJEVO LTD.

Analysis of Volkswagen Sarajevo Ltd. will conduct the general information about the company (also available on the official website of Volkswagen Aktiengesellschaft) as well as observation and information which I gained during my internship in the company.

As previously mentioned, this internship made me able to have a direct insight in the business process. Elaboration of the work of every of the company's departments was extremely important for me to understand the process and to, accordingly, to try to define a way in which all of this can be translated into a system that would eventually ensure the achievement of the goals and objectives set.

While doing this, it was important to analyse both the past and the current situation that the company finds itself in, since the past reflected on the present in a high extend.

6.1 History

TAS (TvormicaAutomobila Sarajevo) was established in 1970 in cooperation between Volkswagen AG and UNIS. CKD assembly of the Volkswagen Beetle started in Sarajevo in 1972, followed by CKD assembly of the Golf and Jetta in 1976 and the Caddy in 1982. 1989 was a record year for the Sarajevo plant, with the total of 3,500 employees assembling 37,000 vehicles. However, the plant was destroyed as a result of the war in Yugoslavia and all processes were halted until 1997. Volkswagen and UNIS succeeded in recommissioning the plant in 1998 and since 2001 Prevent Group Joined Volkswagen as a new Joint-Venture-partner in Volkswagen Sarajevo, instead of Unis D.D. (Volkswagen Media Services, Volkswagen Sarajevo d.o.o., 2011).

6.2 Production

At its Sarajevo plant, the Volkswagen Group produces components that are installed on engines and vehicles of the Group brands. The Sarajevo is the sole supplier of sub axles for the PQ24, PQ23 and also produces wheel hubs, wheel flanges and flywheel ring gears. In 2010, the plant produced about 1, 85 million stub axles, 800.000ring gears and 552.000 wheel hubs and wheel flanges (Volkswagen Media Services, Volkswagen Sarajevo d.o.o., 2011).

The plant of Volkswagen Sarajevo Ltd. has a total surface area of 166,871 square meters, with production an assembly covering 92,391 square meters (Volkswagen Media Services, Volkswagen Sarajevo d.o.o., 2011).

6.3 Sustainability and responsibility

In January 2009, Volkswagen Sarajevo was one of the first companies in the metal-working industry of Bosnia and Herzegovina to be awarded an environmental permit. This is a mandatory certificate that demonstrates that companies operate in accordance with the environmental regulations laid down by the state. In 2011 Volkswagen Sarajevo Ltd. was named best employer for disabled persons in Bosnia and Herzegovina (Volkswagen Media Services, Volkswagen Sarajevo d.o.o., 2011)..

Superior value, social responsibility and a practical commitment to sustainability are hallmarks of VW's corporate culture. VW's takes a far-sighted approach to the key issues of the future, such as climate change. VW's pursues a broad range of research and development activities and generate the pioneering technology that the mobility of future will demand (Volkswagen Media Services, Volkswagen Sarajevo d.o.o., 2011).

As well as Volkswagen AG, Volkswagen Sarajevo Ltd. should not focus its attention on financial results and the share price only. If we speak in the terms of the long-term efficiency, in my opinion, it is far more important for the company to put an accent on the main goals, which should firstly be related to customer satisfaction, because it automatically relates to market share, sales and profit.

Since Volkswagen Sarajevo Ltd. currently finds itself in a hard situation, it is crucial to establish both short-term and long-term goals which will bring prosperity and success for the company in the future (in the long-term).

Good financial results, which are, of course, desirable and important, will come as a consequence of the achievement of the goals and objectives set.

This is the exact the reason why Management by Objectives is a management system that should, in my opinion, bring positive and satisfactory results to Volkswagen Sarajevo Ltd. once it is implemented.

As mentioned before, MBO and LTI system developed and implemented in Volkswagen AG will represent a strong basis for the implementation in Volkswagen Sarajevo Ltd.

6.4 Plans for the future

In accordance with my internship done in Volkswagen Sarajevo Ltd. and the interviews done with the managers of the company, I shall conduct and represent some of the company's plans for the future.

Future plans of the whole Group are directly related to the Strategy 2018. The strategy of Volkswagen AG pursues a clear objective: By 2018 Volkswagen Group wants to be the world's most successful and fascinating automobile manufacturer- and the leading light when it comes to sustainability. The actions and the strategic guidelines that smooth the path to this goal are described in the frames of the Strategy 2018, which has 4 main goals which refer to having top customer satisfaction, being the top employer, profit and sales.

All the future plans of Volkswagen Sarajevo Ltd. are, of course, in accordance with the plans of the concern, yet translated into plans made in accordance with specific circumstances in existence of the company.

As previously explained, Volkswagen Sarajevo Ltd. puts the biggest accent on the quality of production which will eventually ensure new production lines for the company. When concerning the already existing ones, VW will continue in delivering quality car parts due date in order to keep its internal customer- Volkswagen AG satisfied. Some of the company's future plans are connected with the time and costs improvement, which would require new and more modern technical solutions and financial investments.

However, the company's crucial intention concerning the future is the technical improvements in the factory which will reflect the ability of the company to produce new and more complex car parts, which is why all of its efforts will be made in extend of this intention.

In 2012, results of the hard work in the past years appeared. Volkswagen AG has been searching for a better solution concerning the internal transport of car parts inside of the factories. The management of the Group wanted to replace the already existing machines used in this sense, which were expensive, produced a lot of dirt and caused industrial accidents and injuries in the working place. The Group then set a task for all of its subsidiaries requiring the best proposal and the best solution for the existing problem. They asked for a better and a cheaper solution and for one that would be in accordance with the laws of the European Union. A lot of solutions found and proposed included expensive technology-robots, mechanics orpneumatic machines. Engineers of Volkswagen Sarajevo Ltd. have

designed a machine called “KippTrolley” and it took them only two months to do so. KippTrolley was designed so that it could easily move and transport the parts inside of the factory and more important- it can lift heavy palettes and other heavy parts in the car industry. The machine designed appeared to be in accordance with all the regulations of the European Union and mechanically perfect concerning the requirements given.

In March of 2012, the solution was presented in a German town Braunschweig, a symposium has been held and the solution given by Bosnian engineers has been presented. Martin Winterkorn, the CEO of Volkswagen Group was extremely fascinated with what he saw. Right after the symposium in Germany, the production of KippTrolley started in Volkswagen Sarajevo as well as the implementation of this system in other factories. The first one where KippTrolley will be used is the Braunschweig factory.

By the end of April, KippTrolley will be presented in Hannover and in SEAT factory in Spain, where logistics managers of Volkswagen factories will be held. CEO of Volkswagen Sarajevo Ltd., Jan Masak, proudly says that the company made a product that will be used by all of the employees of Volkswagen worldwide.

KippTrolley represents the first acknowledged innovation in Volkswagen Sarajevo Ltd. after the war period, it is a great step forward and a big saving for Volkswagen. The fact that all VW factories in the world need thousands of KippTrolleys speaks a lot for itself.

The biggest possible production of KippTrolley will for sure be one of the main goals for the future, since this type of production will bring better reputation of the company in the eyes of the Volkswagen Group, which will eventually lead to more production lines approved. It will also bring bigger profit for the company needed for the technical improvement in the factory and the technical improvement is also connected with the new production lines in the future, so it all makes a circle in which every elements is related and crucial in a way.

Future plans of Volkswagen Sarajevo Ltd. in particular will be presented in the frames of MBO implementation since the system should be used to achieve the specific goals that the company has for the future period.

6.5 SWOT analysis of Volkswagen Sarajevo Ltd.

SWOT analysis is a commonly used tool for the strategic planning process. This method refers to defining and analyzing Strengths, Weaknesses, Opportunities and Threats which are involved in a certain business move or a project.

SWOT analysis is important to conduct as, in a way, a starting point for a certain activity and used as an indicator for realistic and eventually successful goals and objectives setting.

Therefore, defining SWOTs is considered to be crucial when it comes to planning steps of objectives achievement that are, in this sense, derived from this analysis.

SWOT analysis refers to both internal and external factors that in some way affect the company's performance and success.

Volkswagen Sarajevo has only one customer and it is an internal one- Volkswagen AG. This fact in particular, among with those that refer to the absence of influence of any external factors on implementation of MBO in Volkswagen Sarajevo Ltd., represent an argument for analyzing only the internal factors that may influence the success of the implementation of this system. These factors are derived from the analysis of strengths and weaknesses of Volkswagen Sarajevo Ltd.

In order to analyze only what is relevant, I shall define and present the main and most significant strengths and weaknesses of the company. The analysis made will be directly connected to the MBO system, since the strengths of the company should be bigger and the weaknesses should be eliminated once the MBO system is implemented.

Strengths:

- being a part of VW concern
- experience in automotive industry
- human resources and human capital
- high and quality educated employees
- innovative engineers
- high and quality audition of VW AG's top management

Weaknesses:

- bad organizational structure
- lack of human resources
- lack of financial means

- small number of production lines
- bad infrastructure
- lack of credibility in the eyes of VW AG

Strengths and weaknesses of the company listed above are the most important ones and ones that in every way reflect on its business performance and success. As mentioned, the MBO system will be implemented according to this analysis, with the goals of improving the strengths and eliminating the weaknesses. The weaknesses of Volkswagen Sarajevo Ltd. are also considered to be the risky points and the barriers for successful implementation. This will be elaborated further on in the risk analysis of the project.

7 LONG TERM INCENTIVE FOR THE MANAGEMENT OF VOLKSWAGEN GROUP

In this part, I shall present and analyse the Long Term Incentive program developed and used by Volkswagen AG. This program represents the basis for the implementation of this type of system in all of the Group's parts.

The Long Term Incentive was made in accordance with several remuneration components which will be presented and elaborated further on. One of those components is directly connected to MBO as a system which actually represents the target achievement and performance evaluation. Therefore, it is important to understand the characteristics of the LTI program in order to be able to develop and define a remuneration system for Volkswagen Sarajevo Ltd. based on this program in particular.

In September 2009 the supervisory Board of Volkswagen AG decided to replace the former Stock Option Plan with the Long-term bonus (Long-term incentive= LTI) as a variable remuneration component for the Group board members. Consequently, the Group Board decided that the LTI should also apply for the entire Group management.

As mentioned before, unlike its competitors, Volkswagen AG deliberately developed a concept which is not purely based on financial results and the share price; rather, it has focused its attention on the Group Strategy and its corresponding targets in the fields of customer satisfaction, employee attractiveness, sales and profit.

At Volkswagen the strategy is not just written on paper, it is lived by brands throughout the Group. In 2004 the systematic strategy process began at Audi with the conference in Salzburg and then continued at Volkswagen in Dresden in 2007. In the other brands, there are also similar activities involving the participation of management and the work councils. Taking this into account, it was only consistent to introduce the LTI not only for the Group Board but also throughout the complete management of the Group.

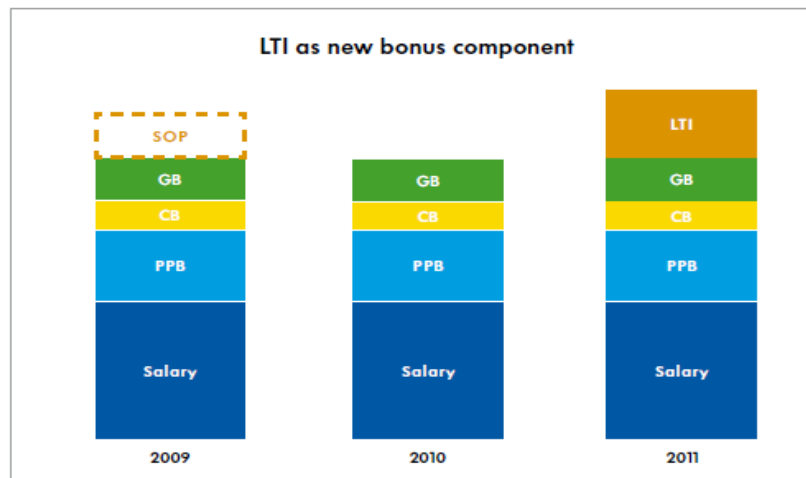


Figure 7: LTI- Introductory phase (Haffner, Puls, Campbell, 2011)

Until now, the variable remuneration for the Volkswagen Group management consisted of the following components(Haffner, Puls, Campbell, 2011):

- the personal performance bonus (PPB)
- the profit sharing, consisting of two components, the group bonus and the company bonus (GB/CB) and
- the stock option plan (SOP).

The last grant of the stock option plan expired in 2009. In September 2009 the Volkswagen AG Supervisory Board decided to replace the former Stock Option with the Long-term bonus (Long-term Incentive= LTI) as a component of the variable remuneration. Consequently, the Group Board decided that the LTI should apply also to the Group management as a whole(Haffner, Puls, Campbell, 2011).

The LTI is variable remuneration component, which is paid on top of the fixed salary and bonus. It rewards the progress made towards achieving the goals of the Strategy 2018.

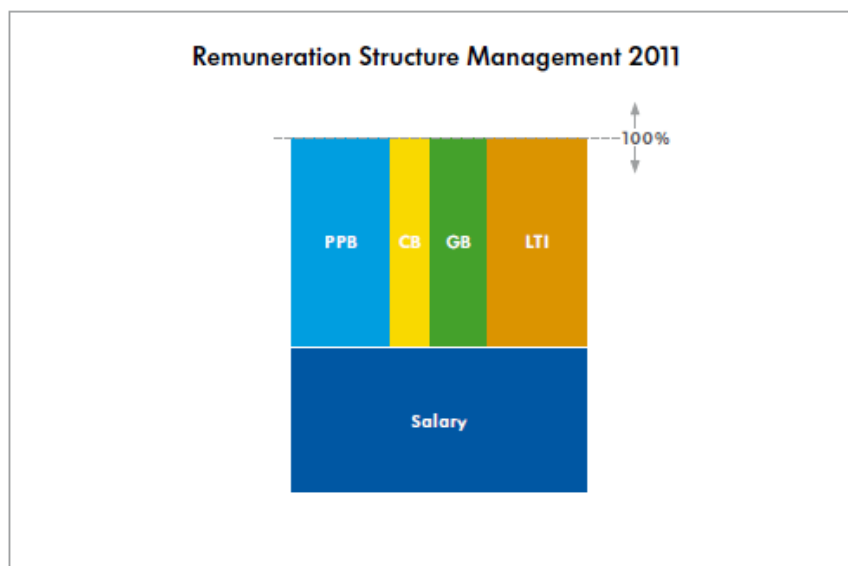


Figure 8: Remuneration structure management 2011 (Haffner, Puls, Campbell, 2011)

The diagram above illustrates the various remuneration elements for management in the Group. This consists of the fixed monthly salary as well as the variable remuneration components (Haffner, Puls, Campbell, 2011):

- Personal Performance Bonus (PPB) which is oriented on the target achievement (MBO) and the performance evaluation of the individual manager
- Company Bonus (CB) and Group Bonus (GB); The CB varies with the operating profit of the brand of the region, the GB with the financial result of the Group
- Additionally, there is now the LTI, which provides a direct link to the Strategy 2018.

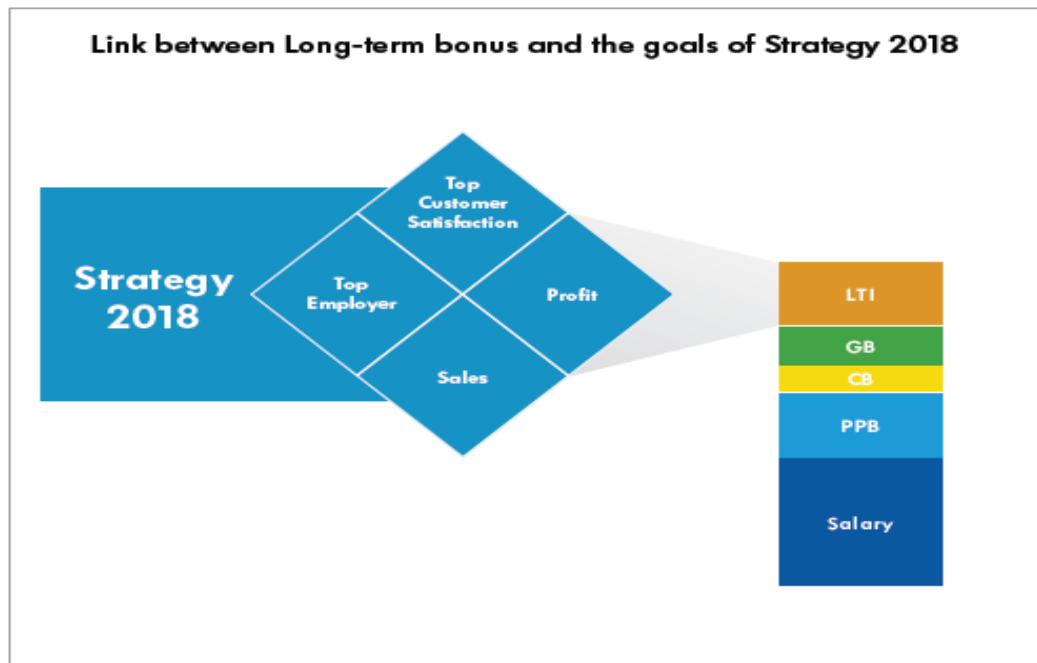


Figure 9: Link between LTI and the goals of The Strategy 2018 (Haffner, Puls, Campbell, 2011)

The LTI is directly linked with the goals of the Strategy 2018. It rewards the progress made by the management towards achieving the goals of the Strategy 2018:

- Top customer Satisfaction
- Top employer
- Profit
- Sales

4 Targets, 10 Indicators and 4 Indices		
Targets	Indicators	Indices
Top Customer Satisfaction	1. Dealer 2. Car 3. Service	Customer Satisfaction index
Top Employer	4. Workforce with productivity 5. Participation opinion barometer 6. Opinion index	Employee index
Sales	7. Deliveries to customers 8. Global market share	Growth index
Profit	9. Return on sales 10. Dividends	Profit index
		LTI index

Figure 10: LTI Targets (Haffner, Puls, Campbell, 2011)

10 indicators are allocated to the 4 strategic targets of the LTI. 4 partial indices are calculated for the 10 indicators. The calculation of the LTI index is derived in two steps (Haffner, Puls, Campbell, 2011):

- Customer satisfaction index, employee index and growth index are firstly added together and then divided by three creating an average
- In the second step the average of the partial indices is manipulated with the profit index

7.1 Target Top Customer Satisfaction

This target has been put first for a good reason: a high level of customer satisfaction is the most important prerequisite for company success.

Using recognised studies, this target area measures how satisfied Volkswagen Group customers are:

- with dealers
- their new cars and
- the service.

This basis is drawn from customer surveys in Germany, France, Great Britain, Italy, Spain, Brazil, China, Russia and the USA (Haffner, Puls, Campbell, 2011).

The answers of the customers are gathered from three questions. The answer scale ranges from 1-10 where 10 represent the highest score.

7.2 Customer Satisfaction Volkswagen Group

The Group total for customer satisfaction results from the partial results of the brands Volkswagen, Audi, SEAT and Skoda, each weighted according to their share of total sales volume.

In 2010 the total result for customer satisfaction was 8.44 which was set in 2009 at the basis for 2010 was not achieved. Thus, the index for customer satisfaction amounts to 92.

In the concept design of the LTI, targets for 2018 have been allocated to all indices. For the customer satisfaction index the target is set at 8.81. This correlates with the value of the top premium car producers, which we want to achieve as an average within the Group, taking into account its forecasted development over the coming years.

The calculation of the customer satisfaction index is derived in three steps (Haffner, Puls, Campbell, 2011):

1. The results of the brand Volkswagen, Audi, SEAT and Skoda are calculated per country and accumulated into a country result. Example Audi; Country result Germany 8.6.
2. The nine country results are totalled for each brand and combined into an overall result for the respective brand. Example Audi: Total result 8.49
3. Finally, the customer satisfaction results of the brands are aggregated into a Group result. Here by, the result of the brands are weighted according to the share of the total sales volume respective to the overall sales volume of the Group. Customer Satisfaction VW Group: Result 8.41

7.3 Target Top Employer

In the target area Top Employer two equally weighted components are evaluated to derive the employee index:

The first component is the fluctuation in the workforce correlated to productivity. Only successful business creates jobs. For this reason, the employee index of the LTI takes the permanent creation of secure jobs as well as the increase in productivity into consideration. Consequently, not a mere increase in the work force but only a creation of volume-related jobs resulting from increasing productivity is rewarded. As a second component the results from the opinion barometer flow into this target area. This partial index includes not only the participation of the employee on the survey (participation rate) but also the measured satisfaction (opinion index) as a whole.

The discussion about these results which take place during so called “action weeks” set the foundations for the continuous improvement process and the optimisation of processes, structure and leadership. By repeating this standardised survey annually, changes in the employee satisfaction can be easily evaluated.

In 2010 the participation rate for the Group was 8 % and the opinion index 75 %. Up until 2018 targets have been set to increase the participation rate to 95 % and the opinion index to 85 %. This represents the values of the top 10 % of the best organisational areas in the year 2010 (Haffner, Puls, Campbell, 2011).

7.4 Target Sales

The Volkswagen Group wants to be world leader in market share and deliveries to customers (D2C). Both indicators influence the long-term bonus through the growth index.

The index takes world market share (passenger cars) with 80 % weighting into account, while deliveries to customers are weighted with 20 %. The Volkswagen Group delivered 7.14 million cars without light commercial vehicles in 2010 and achieved a global market share of 11.41 % based on passenger car deliveries. The sales volume should increase to over 10 million cars by 2018 (Haffner, Puls, Campbell, 2011).

7.5 Target Profit

Return on sales and the dividend per share serve as indicators for the profit index.

Here, an important precondition of the LTI design has been put into place: the long-term bonus will only be paid out if the return on sales rises above 1.5 %. This ensures that the LTI is only paid when the company is financially successful(Haffner, Puls, Campbell, 2011).

Return on sales is the pre-tax profit divided by sales revenues. It includes the success of all parts of the company including the Group division Financial Services.

The amount of the dividend is oriented on the company's profit after tax.

Return on sales is weighted with 80 % and the dividend per share with 20 % in the calculation of the profit index(Haffner, Puls, Campbell, 2011).

In the financial year 2010 the return on sales was 7.1 %. The target for 2018 is 8.5 % (Haffner, Puls, Campbell, 2011).

7.6 LTI Partial Indices

The Group is on the right track with the Employee Index with a result of 103. The target of the Growth Index in 2010 could not be achieved by Volkswagen Group due to lack of production capacity.

The Profit Index has a base value of 1.00 representing a return on sales of 5 %. The Group was able to achieve a value of 1.22, as the return on sales was higher(Haffner, Puls, Campbell, 2011).

The average of the values arising from the customer satisfaction index, the employee index and the growth index results in a value of 93. This average value is then multiplied by the profit index of 1.22. The result for the LTI index for 2010 is thus 113. The LTI total index calculated in this manner is the basis for the payment of the long-term bonus. If the LTI total index is 100, the long-term bonus payment corresponds to the Group and company bonuses in the respective bonus group (100% bonus niveau)(Haffner, Puls, Campbell, 2011).

7.7 The First Payment of the LTI

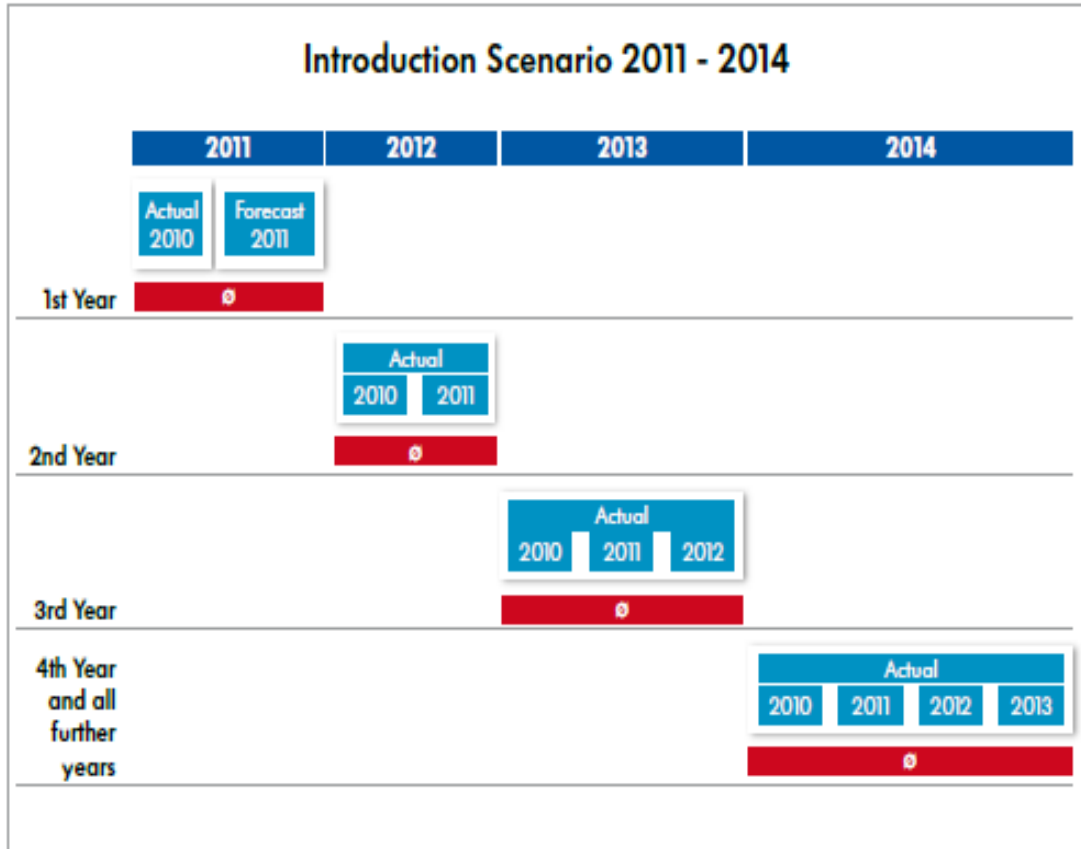


Figure 11: Introduction scenario 2011-2014 (Haffner, Puls, Campbell, 2011)

In order to ensure a long-term evaluation period even in the first year of payment, the calculation of the LTI total index will be based on the results for the business year 2010 and the forecasted results of 2011.

After the financial year has ended, should the actual results of 2011 prove to be better or worse than forecast, and then the LTI payment will be adjusted accordingly.

The LTI is fully established when the LTI total index is calculated and paid out on the basis of the results of the last four business years. This will be the payment year 2014.

The LTI will be implemented in all Group companies, which means that all the employees will profit from the success of the Volkswagen Group.

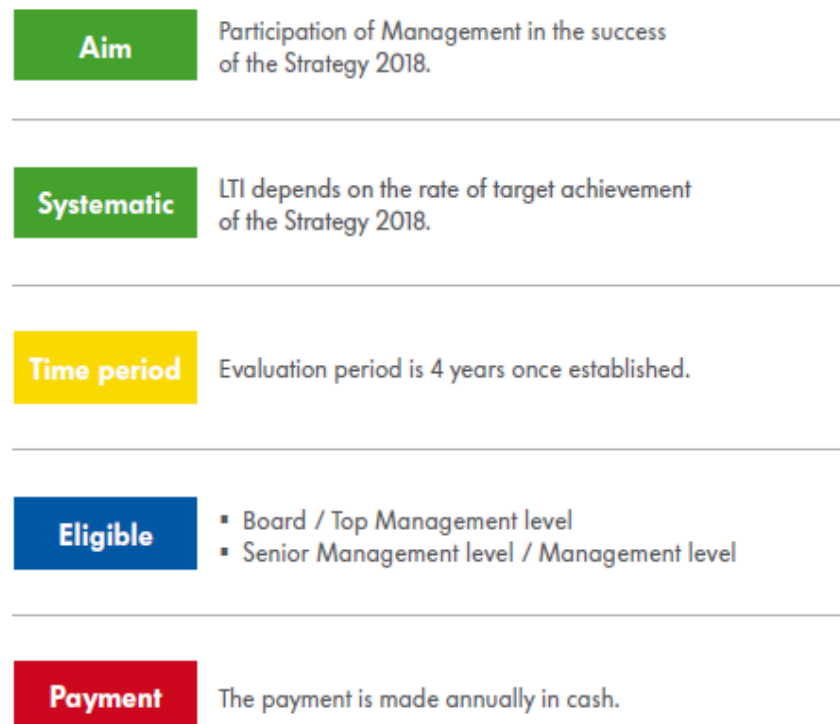


Figure 12: LTI overview (Haffner, Puls, Campbell, 2011)

From 2012 onwards the variable remuneration system will be simplified by one step:

The Group bonus was up until now weighted more than the company bonus (30:20). By implementing the LTI, which is also based on Group results, the weighted of the Group components has taken an upper hand. From 2012 onwards the GB and CB will be merged into a Company bonus and the LTI will thus become the Group bonus (Haffner, Puls, Campbell, 2011).

From 2010 the Personal Performance bonus, the Company bonus and the LTI represent three equally weighted elements of the variable remuneration. This way, the personal performance, the performance of a brand or region and the performance of the entire Group will be rewarded.



Figure 13: LTI 2012 (Haffner, Puls, Campbell, 2011)

7.8 The link between the Strategy 2018 and Volkswagen Sarajevo Ltd.

As seen from above, LTI method applied and used in Volkswagen AG is an instrument for direct measurement of the progress which is made towards achieving the goals defined in the Strategy 2018. There are 10 indicators and 4 indices all allocated to the 4 strategic targets of the LTI.

The starting point for the development of this system was, of course, the Strategy 2018 with all of its specific goals.

Unlike Volkswagen AG, Volkswagen Sarajevo Ltd. does not have a clearly defined and elaborated strategy, especially since the Supervisory Board is currently in the process of transition. Although it is hard, even impossible to compare the business climate in Volkswagen Sarajevo Ltd. with the one in the Concern in Germany, it is possible to compare the goals and objectives of the business in Bosnia and in Germany. The goals of the Strategy 2018 can easily be translated into the goals of the strategy of Volkswagen Sarajevo Ltd., yet slightly modified according to the fact that Volkswagen Sarajevo produces car parts; it does not sell cars as finished products. Modifications should also be done in accordance

with specific circumstances and business environment concerning Volkswagen Sarajevo Ltd.

However, MBO can be successfully implemented only after specific goals and objectives are set. This should be done on the level of the top management of the company and then communicated to each and every employee of the company. By doing this, the management of the company achieves awareness and acknowledgment of the main targets of the business between all of the company's employees, which is crucial for the achievements of the goals and objectives set. Once the employees are aware of all the company's goals and objectives, top management can establish specific objectives with each employee, according to the field of work he operates in, and, of course, in accordance with the general goals of the company set at the very beginning.

Volkswagen Sarajevo Ltd. currently finds itself in a tough situation. The current situation is a direct consequence of the war in Bosnia 20 years ago. Before the war, TAS was one of the former country's most successful companies. However, it was destroyed in war and all the production processes were stopped till 1997.

Nevertheless, Volkswagen Sarajevo has managed to continue with its production process. The company has got new production lines and is always working on getting more and more of them. Volkswagen Sarajevo moves slowly, yet safely towards its main goals for the future period- bigger production and bigger profit, which is why it is crucial to define these goals in a clear, transparent and measurable manner and to further on define the steps that will lead to the successful achievement of these goals.

8 PROJECT FOR IMPLEMENTATION OF MBO IN VOLKSWAGEN SARAJEVO LTD.

The aim and the goal of this project is to develop and define the basic steps for implementation of MBO in Volkswagen Sarajevo Ltd.

The main purpose is to provide sound and congruent frame for the implementation of this specific management system and to further define and evaluate the proposed project and its characteristics against potential barriers, risk and uncertainty.

The project starts with the identification of the first and most important phase in the process- setting organizational objectives, followed by the description of an appropriate method for cascading the objectives to employees, according to the specific circumstances defining the business climate in the company.

The project continues with detailed and deep analysis of the monitoring and performance evaluation system and comes down to end with the elaboration of the final phase- rewarding the performance.

The concluding part of the project highlights the existing and potential obstacles to successful implementation of MBO and points out the potential risks and barriers, as well as the ways, methods and approaches for the elimination of threats.

Conclusively, the project introduces time analysis for the project implementation. An overall evaluation is done in the end.

8.1 Management by Objectives in Volkswagen Sarajevo Ltd.

As mentioned previously, Volkswagen Sarajevo Ltd. did not have clearly defined goals and objectives or an accordingly developed strategy in the past period. This has, of course, affected the business negatively and created an imperative of setting the goals and creating a following strategy.

When doing that, Volkswagen Sarajevo has in many ways used Volkswagen AG's Strategy 2018 as a starting point and leading example in making its own strategy according to specific circumstances and business climate.

After conducting a deep and broad analysis of the company, all of its departments and the whole business process, I have focused my attention on the currently existing intentions of the managers of the company that refer to specific goals and objectives that the company

will try to achieve in the future period. Although not clearly defined or transparent, I tried to summarise all the findings, connect those with the Strategy 2018 and to define the main general goals of Volkswagen Sarajevo Ltd. for the next 5 years.

8.1.1 Activity plan

Main activities concerning the implementation of MBO in Volkswagen Sarajevo are given in the table below. These activities refer to main phases of the MBO process as well as on some under phases needed in order for the implementation to be successful. The table also explains who is in charge with the execution of given activities and when should they be executed, taking in concern a period of one year- starting with September 2012.

ACTIVITY:	DONE BY:	TIME:
Introduction and presentation of MBO system	Top management	September 2012
Explanation of specific intentions regarding implementation and the benefits it brings to the company and its employees	Top management	September 2012
Participative setting of organizational objectives	Top management and employees	September 2012
Making the objectives clear and widely transparent	Top management	October 2012
Cascading objectives to employees	Top management and employees	October 2012
Collecting feedback on the employees' understanding and acceptance of the objectives given	Top management and employees	October 2012

Introduction and presentation of monitoring system	Top management	October 2012
Monitoring the performance	Top management	October 2012- September 2013
Presentation and explanation of findings	Top management	October 2012- September 2013
Introduction and presentation of performance evaluation system	Top management	October 2012
Evaluation of performance	Top management	October 2012- September 2013
Presentation, explanation and comments on findings	Top management	October 2012- September 2013
Suggesting and recommending regarding performance for the future	Top management and employees	October 2012- September 2013
Performance rewarding	Top management	September 2013
Giving an overall evaluation of the cycle	Top management and employees	September 2013
Repetition of the cycle	Top management and employees	October 2013

Table 4: Activities concerning the implementation of MBO

8.1.2 Setting organizational objectives

The first and the main step of implementation of MBO in Volkswagen Sarajevo Ltd. should be to set the goals and the objectives of the company for the future period, since, as mentioned in the analysis of the company, these were not clearly defined or transparent,

which is in every way crucial for every company to be able to define its course of action in order to be successful.

These goals and objectives should represent the general goals of the company and the direct reflection of desired achievements concerning the field of work.

Top management of Volkswagen Sarajevo Ltd. should set the objectives according to the current situation, the forecasts done and the realistic expectations concerning the future period. All objectives should be SMART, according to the Drucker's principle explained previously.

In order to do this, the company should make deep analysis of the current situation, which is unfavourable in many ways. However, the most important parts of this analysis should be the reasons that led to it. Based on the findings, the company should find a way to eliminate the existing barriers and open the road to successful achievement of the objectives. Only when you know the disease can you find the cure.

The cure should be formulated as a clear objective with the exact prescription for usage in order to be effective. Objectives should be realistic; however, it is important for the company and its management to be ambitious in this sense and to always look and strive for more. This should and can be done with the highest possible level of dedication of all of the employees, their knowledge, capabilities and competencies should not be questionable. It should be the starting point of every intention of this type.

Main goals of Volkswagen Sarajevo Ltd:

1. QUALITY GOALS

- respected Quality standards
- Smallest possible quantity of bad pieces produced

2. FINANCIAL GOALS

- 100 million euro TTO (total turn-over)
- 6.5 % return on sales
- smaller material costs for 15 %
- productivity +15 %,

3. HUMAN RESOURCES GOALS

- 450 employees

- Opinion Index (OI) = 1.9 %
- participation of workers in Opinion Index +80 %
- 3.3 % absence (smaller than current 4 %)

Quality goals

As mentioned before, Volkswagen Aktiengesellschaft has certain quality standards which are developed inside the concern and which represent an imperative when it comes to production in all of the Volkswagen factories around the world.

There can be no deviation from these standards, otherwise, parts and cars produced are considered to be bad and can not be sold.

Bad car parts, among other issues, represent additional costs for Volkswagen, therefore, the group invests high amounts of financial means in order to keep the quality of its production and to improve it in the future.

Quality of production is the main general goal of Volkswagen Sarajevo Ltd. since the company has only few competitive advantages in comparison with other factories. Basically, production lines in Volkswagen Sarajevo Ltd. exist and it is possible to get new ones only because the factory has shown that it is able to produce fine and quality car parts which eventually become a part of cars produced.

Accordingly, quality is and will continue to be the main priority for Volkswagen Sarajevo Ltd. in order for the company to work successfully and to be more profitable in the future.

In the year 2011, there have been 3 reclamations from the side of Volkswagen AG which were related to the same product. These reclamations and the whole process that occurs consequently when something is considered to be a bad part, as previously mentioned, cost a lot and require even higher costs in the future since, in this case, Volkswagen AG demands bigger control that then refers to the check-up of each and every part produced in the frame of that specific production line.

One of the specific and measurable goals which are directly related to the quality of production is to keep bad parts production percentage as low as possible.

However, it is evident that there is a lack of specification when it comes to certain quality standards that eventually affects the quality of produced car parts and this exact specification and coordination should also be one of the main priorities of the factory in the future

period, all in order to improve the quality of production and the business process as a whole.

The Strategy 2012 targets and the MQB- Volkswagen's new Platform present major challenges for Quality Assurance, too. The number of vehicles produced and the complexity are increasing. For this reason, the speed and precision with which defects are identified, analyzed and remedied is more important than ever. Another challenge is the growing number of sub-suppliers and their locations as well as the complexity of the supplier chain at the various levels and across geographical borders.

Volkswagen needs employees with specialist skills to handle these complex processes- experts who provide suppliers with assistance and training.

The Strategy 2018 refers to the whole group, which means that each and every part of it should consider the goals of the strategy as its own, of course, slightly modified and adapted to specific circumstances of the business environment that a part of the Group operates in. Every of the 4 goals of the Strategy 2018 are only possible to achieve if there is a top quality in the production process.

Financial goals

According to Martin Winterkorn, CEO, 2011 was an extremely challenging year for Volkswagen but, above all, a very successful one, referring, for example, to the Volkswagen's brand new delivery record of over five million vehicles.

Volkswagen AG has, according to the financial statements and reports from previous years, set some specific goals which are related to the financial performance of the Group. These goals are incorporated in the Strategy 2018. As shown below, the Group wants to have 9% return on sales and 21 % return on investment in 2018. The percentage of 21 is given by the multiplication of the return on sales and the capital turnover of 3.6.

Volkswagen Sarajevo Ltd. should, accordingly, set financial goals related to the ones of the whole group, but, of course, significantly smaller ones due to significantly smaller level of the business process. Therefore, Volkswagen Sarajevo Ltd. should, in my opinion, set a goal of 6.5 % return on sales and the total turn-over of euro 100 million.

In Dresden 2007, a decision was made to focus on a target of 21% return on investment for the Volkswagen brand in 2018

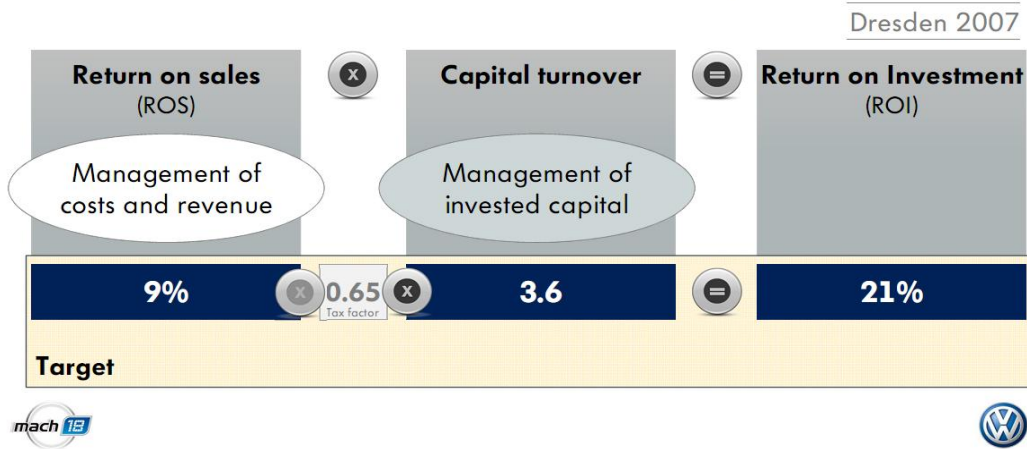


Figure 14: Financial goals (Volkswagen AG Management conference, 2011)

Despite the dramatic increase in commodity prices, FMK consistently achieved positive results

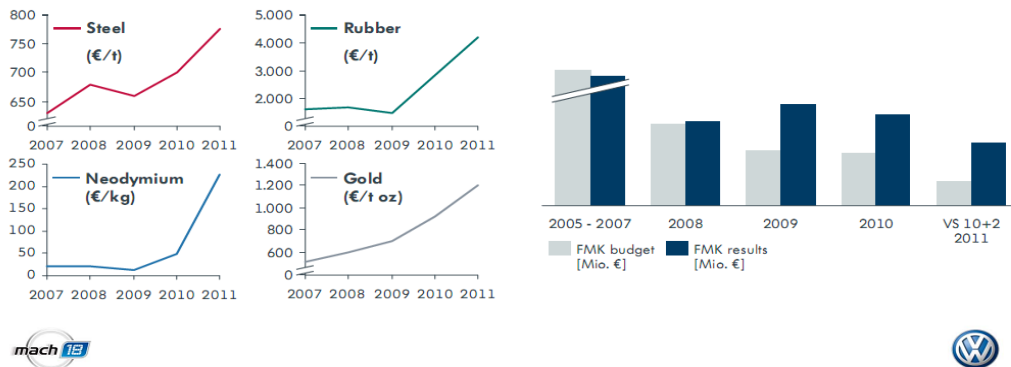


Figure 15: Material costs in 2011 (Volkswagen AG Management conference, 2011)

One of the main goals set and being wanted to achieve through the implementation of MBO in Volkswagen Sarajevo Ltd. is a continued development, measurably and specifically defined as the previously mentioned total turn-over of 100 million euro.

Robust and sustainable economics are the basis for raising competitiveness as a tool for achieving the goal and extending profitability as the result. As global economic trends become more uncertain, these factors become all the more important.

In light of this, Volkswagen should be robust and able to withstand a crisis at all times in order to meet its responsibility towards the organization and the employees. There was a significant improvement in break-even, a key indicator of a company's ability to weather a crisis in 2011 as a result of improved capacity utilization and strict cost discipline. That should also be the goal for coming years. It is the responsibility of each individual to work towards this goal, since each and every employee bears responsibility for the continued development of the organization and for safeguarding its future.

This can, among other ways, be achieved if the material costs are smaller for 15 % and the productivity is bigger for 15 %. It should be possible to have smaller material costs due to the fact that, although the prices of material costs increased in the past period, they still managed to achieve positive results.

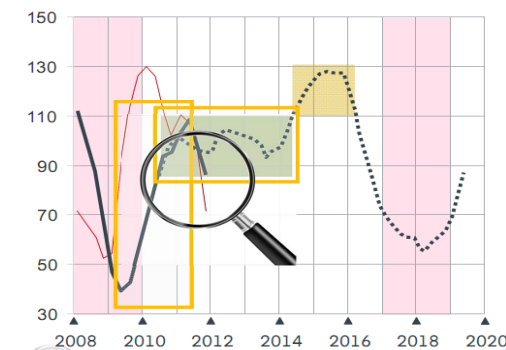
Bigger productivity can be achieved if the machines that the factory owns work more hours per day than they do now. This is, among other issues, related to the daily breaks that workers have. Volkswagen Sarajevo Ltd. currently works on finding a way how to keep the machines working during these breaks and a possible solution is to make a different schedule of the breaks and to make a change that refers to the fact that the machine should never be turned off during the shift and that there should always be a worker supervising the work of the machine while other workers are on a break. This way, it is possible to produce more parts a day, which would eventually result in smaller costs of production and bigger profit for the company.

In order to be able to achieve the financial goals set, Volkswagen Sarajevo Ltd. should put an accent on getting new production lines for the production of parts of the new MQB platform, which is considered to be the future of the brand. New technologies, innovations, standardization and synergies contribute to Volkswagen's economic strength and are therefore the foundation for economic progress. One key for the Group's success in going forward is the previously mentioned modular transverse toolkit (MQB) and the Volkswagen brand is responsible for its success. Product Management, Technical Development, Procurement, Components, Production and Quality Assurance reports on how is Volkswagen discharging this responsibility.

Optimistic expectations are, among other things, related to the research done and the forecasted flow and movements in global economic cycles in the future period. According to this, consolidation is expected in the next few years.

A phase of consolidation can be expected over the next few years

Global economic cycles 2008-2020
Index (2005 = 100)



Current situation

- Global economy entered a **new economic cycle in 2010**
- First slowdown from mid-2011
- This **type of slowdown is normal** compared to previous economic cycles
- **A relapse into recession would be atypical at this point, but ...**

>> ... the next downturn will come



* Based on average figures from economic cycles 1984 - 2010
Source: ifo World Economic Survey, IHS Global Insight, own analyses



Figure 16: Global economic cycles(Volkswagen AG Management conference, 2011)

Human resources goals

“262,000¹ people now work towards the daily success of the Volkswagen brand. Full of appreciation, we can say this: we can rely on our employees. We are a strong team that will continue to master the coming challenges in responsible fashion.”

Horst Neumann, Member of the Board of Management of Volkswagen AG for Human Resources and Organization

¹This number refers to the number of employees of Volkswagen in Germany

Further growth is expected on the global automotive market in the long term. In order to take advantage of these market opportunities, Volkswagen is planning the highest investments over the coming years, together with a significant rise in employee levels worldwide. These investments in products, technologies and plants go hand in hand with a growing responsibility for the company and its workforce.

Volkswagen Sarajevo Ltd. has a long-term goal on having 450 employees. The company currently has 358 employees and the current workforce is sufficient according to the needs of the company. However, if the company wants to have a bigger turn-over, it will simply have to, therefore plans to ensure new projects and new production lines which will then ensure bigger production and bigger profit for the company. New production lines will, of course, require bigger workforce.

However, in order to successfully achieve the goals set, Volkswagen Sarajevo Ltd. should not only rely to the increased number of employees. It should work on developing a great personnel management. Personnel management means leading people responsibly, developing staff into a top team and giving each employee the opportunity for excellent performance.

In Volkswagen, every employee counts. When setting specific goals for each end every employee to ensure the achievement of general goals of the company, it is not only excessive demands that can pose risk to individual employees. The same applies when people are not challenged enough. Individual personnel development therefore includes cultivating employees and giving them the opportunity to gain skills and develop in manner that creates value. Every employee should be given the opportunity to gain qualifications within the vocational families where teacher and trainees work together closely to organize skills development and foster employees' talents further.

Responsibility for the human resources department should remain with the manager. The personnel officer has the task of assessing people, their potential and any limitations. This knowledge of employees and their talents makes personnel officers' important sparring partners for managers and allows them to work trustfully with codetermination partners as well. Small personnel management units should allow managers the space to deal with the concerns of the department. This is a gain for both parties: for individual employees, who can be deployed in a way more suited to their personal qualifications and fitness, and for

the department, which will have more motivated and productive employees, which in turn increases health condition and reduces absenteeism.

Reduction of absenteeism is also one of the main goals included in the general goal of the company that refers to the company’s personnel. Current absenteeism rate is shown in the diagram below:

Absenteeism rate in 2011

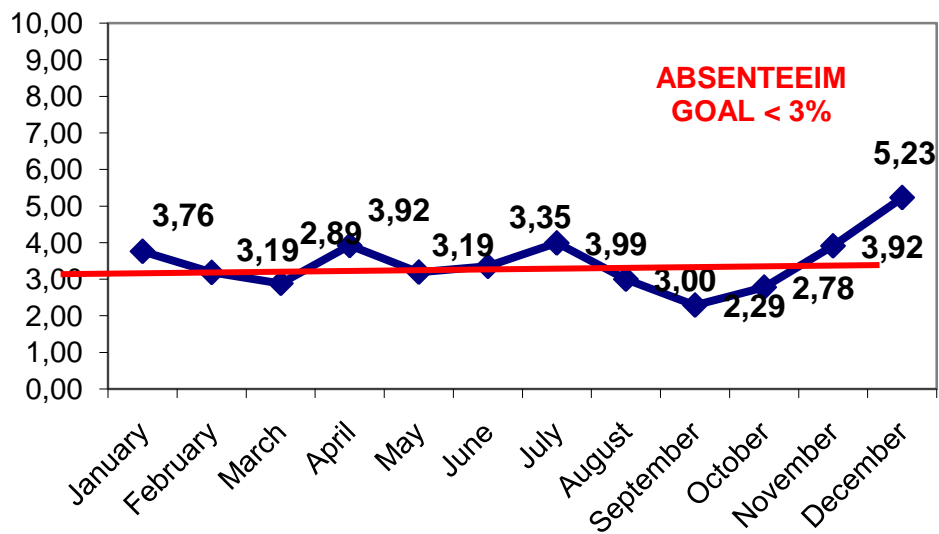


Figure 17:Absenteeism rate in 2011 (Volkswagen Sarajevo Ltd., 2011)

In 2011, the absenteeism rate was 3.4525 %. The absenteeism rate was conducted and defined as an average that refers to the absenteeism rate through 12 months. Volkswagen has a goal of keeping this rate under 3 % and should make further efforts in order to achieve it.

The smaller rate of absenteeism will require better working conditions for workers which will positively affect their health condition, since relatively bad current conditions affect it negatively. Improvements in this specific field will require certain financial means necessary in order to provide better working environment, especially when it comes to the production zone.

A great team, however, requires more than health and skills. Great motivation that promotes dedication is indispensable and motivation increases as each individual becomes better informed, and this is exactly where MBO should take place. Accordingly, being in-

involved in goals and objectives setting process and being aware and absolutely familiar with the decision making process and the results of it should make the employees more motivated and eventually dedicated to the achievement of the goals and objectives set.

Opinion index is an extremely useful and commonly used instrument in the rows of Volkswagen, which is exactly why Volkswagen Sarajevo Ltd. wants to have a bigger percentage of Opinion index and it classifies it as a part of the general goals of the company related to its personnel. The opinion index derived from the Opinion barometer, which is developed according to different opinions of the workers. The company has a goal on having 80 % of Opinion index. The goal is ambitious; however, possible to be achieved in the long-term if an appropriate introduction of the idea and ways to realize it is done between the employees of the company, in order for them to be aware of its importance, therefore willing to accept it. The Opinion barometer and Opinion Index and the annually repeated standardised survey make it easy to evaluate the changes in the employee satisfaction, which is, in a way, crucial for the company's success.

8.1.3 Cascading objectives to employees

Once set, objectives should be cascaded down to all the employees of the company in order for the objectives to be clear, understood and transparent in the company.

Volkswagen Sarajevo Ltd. set long-term objectives that will be elaborated and worked on during the period of 5 years. However, MBO in the company should refer to an annual period and then be repeated afterwards in order to bring positive results and the achievement of all of the objectives set.

When referring to this specific phase of implementation of MBO in Volkswagen Sarajevo Ltd., top management should firstly drive corporate annual objectives from the top down through each tier to each individual employee.

So, to start with, corporate annual objectives need to be visible and on of each employee's annual objectives must be aligned with one of the corporate annual objectives (Fidler, 2009).

As I already mentioned, it is extremely important that the objectives set must be SMART for each employee. Even from the lowest level, achievements feedback up and accumulate in order to meet corporate objectives. In this phase, regular feedback plays an important

role, since it allows employees to appreciate the importance of their contribution through the year.

There is no costs appearance in this phase of MBO implementation, however, the benefits and a great impact is present. Core objectives are shared and met and sharing common goals fosters and improves team-work.

In order to properly cascade and align the objectives, it is crucial to introduce them within all of the departments of the company. As in any other company, different departments in Volkswagen Sarajevo Ltd. represent entities the company has formed in order to organize people and their performance and to work in a way that best supports successful accomplishment of the company's objectives. Brief description of VW Sarajevo's departments is given below:

- **Human resources and legal department**

Human resources department is organized to provide effective policies, different processes and procedures and to guide and support people in a friendly way. Besides this, this department has a function in serving to make sure that the company vision, mission, values, important principles that lead the company to success are optimized.

Legal department of Volkswagen Sarajevo Ltd. deals with legal issues which come up in the business process, whether it concerns drafting waiver forms for employees or handling different legal suits and other legal issues.

- **Logistics and supply department**

The logistics department has the responsibility of ensuring that the whole logistics process that regularly goes on is developed and maintained in accordance with the company's goals and objectives. There are several tasks and obligations of logistics department, such as: storage, warehousing, distribution of goods from one place to another, the delivery of goods. This department handles the process of planning, managing, controlling and coordination that refer to the main principles of logistics- goods have to reach the right place, at the right time, in the right condition and for the right cost.

The procurement department of Volkswagen Sarajevo Ltd. is in charge of buying everything that the company needs to operate. Before purchasing, the supply department needs to make sure that the purchase benefits the company. Procurement department deals with

purchase planning, the selection of the supplier, price negotiation, the purchase itself, inventory controls and check-ups and other related functions.

- **Controlling department**

Controlling department of Volkswagen Sarajevo Ltd. uses accounting information to provide the managers of the company with basis to make decisions according to that information and to make them better equipped in their control and management functions.

This type of accounting, the managerial accounting, is usually confidential and is used by managers of the company, since it was essentially developed according to their needs. It generally gives the base and supports the decision making process for the managers of Volkswagen Sarajevo Ltd.

The controlling department has several objectives. Those are: planning, organizing, controlling, decision making and time saving.

- **Finance department**

The finance department of Volkswagen Sarajevo has its main function in managing the money flow and making financial reports and statements accordingly. There are several general functions of this department such as: planning and organizing, auditing, accounting and an overall controlling of the company's finance.

- **Central planning**

One of the main activities of the central planning department is the planning phase and the realization of projects. This department follows and controls the already existing projects (production lines). These projects refer to the serial production of parts that regularly goes on in the factory. The process of production is highly complex, therefore, needed to be monitored and supervised in a certain way.

Besides this, central planning takes care of the new projects (new production lines) that are to be introduced in the factory as well as the production lines that already existed in Volkswagen Sarajevo Ltd. or some other factory that will go through certain modifications, but still remain similar to the original one.

- **Maintenance and quality assurance department**

This section, as its name says monitors and evaluates the production. Maintenance firstly refers and is primarily in charge of making sure that all the machines work properly. Employees of this department are obliged to immediately repair the machine or fix a certain break down of the machine when necessary.

The main goal of this department is to have such a successful monitoring and quality assurance that, after controlling the process of production and final products, the company has as small number of bad parts as possible. This department takes care of making sure that the quality of production is in accordance with quality standards given by Volkswagen Sarajevo Ltd.

In order to achieve this goal, employees should do production line check-ups both during the process and at the end of the process. Volkswagen Sarajevo Ltd. should also insist on buying newer machines to assure that the quality assurance control is quality and valid.

- **Infrastructure and investment department**

This specific section is a part of the central planning section which refers to the infrastructure as one of the most important elements of the whole system of Volkswagen Sarajevo Ltd. as it is in any other fabric of Volkswagen AG in the world.

There are several experts that work on this specific field in Volkswagen Sarajevo Ltd., since it is crucial for the fabric to have a flawless infrastructure system in order to function properly, although, unfortunately, this is not the case. Engineers that work in this department are in charge with the electricity and hydro-installations which represent the base points for any production of this type. Several problems occurred during years. Many of them are related to the bad condition that the fabric found itself in after the war in Bosnia and Herzegovina happened. A big and extremely important part of these installations was ruined, which made it necessary for the fabric to invest a lot in their reparation, since it was unavoidable for the business process to continue. However, Volkswagen Sarajevo Ltd. was not able to do this according to the lack of financial means disposable.

The investment part of this department deals with the investment in the field of infrastructure and handles the issues previously mentioned.

8.1.4 Monitor performance

An aspect of MBO solutions that is of great importance is the performance monitoring. This specific phase should be done at the end of a performance cycle. Monitoring system as a part of implementation of MBO in Volkswagen Sarajevo Ltd. should actually represent a feedback on how did VW's employees perform on a certain milestone at anytime.

Performance monitoring makes VW's employee's contribution visible and obvious and ensures that it will not be forgotten when the time for evaluation comes.

Once the objectives are set so that the company's general objectives are aligned with the objectives of each and every employee who will work towards achieving them, top management gets to play its role in performance monitoring. The monitoring phase should be done in cooperation between the top management of the company and the chiefs of different departments in the company listed in the previous part. Chiefs of departments should make monthly reports on the progress that is done towards achieving the objectives set according to the reports made by every employee on their specific task and the level of achievement.

In order to monitor the performance of its employees, Volkswagen Sarajevo Ltd. should pay attention on the following relevant key items related to the employee's performance:

- quality
- quantity
- effectiveness
- goals achievement
- team work
- individuality
- work under exertion

Since it can not be considered as a common practice in Volkswagen Sarajevo Ltd., managers of the company should make a big effort in making it one. They should, in a way, monitor the monitoring system in order to make it regular and effective and a consistent part of the working process. Consistency in monitoring is an element that should be worked on in a high extend. It is important that the monitoring system and the whole practice in this sense is accepted as, in a way, a crucial phase, since it is an extremely important part of the whole chain. This phase reflects the previous ones and represents a jump-off point for execution of next phases in the MBO process.

8.1.5 Evaluate performance

Evaluation of performance is the next big piece of MBO system that is to be implemented in Volkswagen Sarajevo.

Top management of Volkswagen Sarajevo Ltd. should evaluate the performance of all employees in accordance with the previous phase of implementation- monitoring the performance. These two phases are and should always be directly related. The evaluation of performance phase should record the final observations referring to the previous phase conducted by managers of Volkswagen Sarajevo.

Monitoring phase is a phase where managers should record how well did an employee performed a certain task, how did he handle a certain situation and how well did he attained a certain objective. In this phase, the evaluation phase, managers should quantify and finalize his conclusion on how well did an employee performed against a certain task given. This should be done by using a numerical scale or a percentage as a way of quantifying the findings.

Quantified and detailed evaluation of performance should represent the strongest base for managers of Volkswagen Sarajevo to get to the next phase of MBO process- the rewarding of employees according to the quality of their performance, which is why a big accent should be put on evaluating it consistently, properly and objectively.

8.1.6 Reward performance

The rewarding of performance is, in a way, the final phase of the MBO process and its implementation in Volkswagen Sarajevo. "In a way" refers to the need of repeating the cycle in order to achieve all the goals and objectives set.

Rewarding of employees should absolutely be in accordance and in respect with the progress made towards achievement of specific goals and with the quality level of performance recorded.

Volkswagen Sarajevo Ltd. should reward its employees on yearly basis, giving them a financial bonus that is, as mentioned, in accordance with their performance in achieving the objectives they have set as their own. Among other solutions and systems, MBO represents a very effective and practical one when it comes to evaluating and rewarding performance, since it sets clear goals and objectives and develops a system of monitoring and evaluating the progress in achievement of these goals and objectives.

The system of rewarding will, of course, represent a strong motivation for every employee, since financial rewarding has always been more desirable and effective than other kinds of rewards.

During my internship in Volkswagen Sarajevo, I have found that employees constantly work on improving the business process in every kind of way. Yet, employees think that there is a lack of acknowledgement and appreciation for their effort. More important, the employees of the company find the fact that the company so far did not have a financial rewarding system extremely demotivating. Accordingly, high employee motivation is something every company strives for, which is why the MBO process, once implemented, should bring positive changes in this area in particular, therefore, its implementation is even more desirable.

A rewarding system should be developed according to the LTI program for Volkswagen Group developed in the previous years, elaborated and analyzed in this Thesis.

However, the LTI program was developed according to specific business circumstances that are actually not present in all Volkswagen subsidiaries in the world. As seen in the analysis part, the calculation of LTI index is derived in two steps. Customer satisfaction index, employee index and growth index are firstly added together and then divided by three creating an average. In the second step, the average of the partial indices is multiplied with the profit index.

Target Top Customer Satisfaction has following indicators: dealer, car and service. The only indicator that is valid for Volkswagen Sarajevo Ltd. is the dealer indicator.

Target Top employer has following indicators: workforce with productivity, participation opinion barometer, opinion index. All three indicators can be used in Volkswagen Sarajevo.

Target Sales has following indicators: deliveries to customers and global market share. The first indicator can be used in Volkswagen Sarajevo Ltd.

Target Profit has following indicators: return on sales and dividends. Volkswagen Sarajevo Ltd. does not operate with dividends, so the only valid indicator is the first one.

8.1.7 Repeat the cycle

Once the first cycle of MBO process ends, Volkswagen Sarajevo Ltd. should make an evaluation concerning the achievement of the goals and objectives set. Since some of the

objectives of the company are long-term objectives, the company will work on their achievement for a certain period of time. However, every step towards achieving those objectives is an important one and, in a way, crucial for the company. It represents a strong base for choosing the next course of action needed in order to completely achieve the goals and objectives set at the very beginning.

Next courses of action, developed and defined according to the previously mentioned evaluation of the work done at the point of the final phase of the MBO process, will actually represent the new cycle of MBO process in Volkswagen Sarajevo.

The company should then repeat the whole process, go through every phase of the cycle over again, but this time with new specific objectives as milestones that will lead to a successful achievement of all of the objectives of the company.

The repetition of the cycle allows Volkswagen Sarajevo Ltd. to improve the performance of its employees in ways which should be directly related to a certain possible lack of performance recorded in the process of evaluation of the first cycle of MBO.

The next cycles of MBO process will contain specific objectives and actions that will lead to their achievement. All of the cycles should eventually lead Volkswagen Sarajevo Ltd. to the point where the company will successfully achieve all the goals and objectives set for the period of next 5 years.

8.2 Cost and risk analysis

In this specific part, I shall present the findings regarding cost issues as well as the risks and barriers that do or may exist when the company starts with the implementation of MBO.

8.2.1 Cost analysis

Almost every business move and every project implementation involves costs as an inevitable figure. However, the implementation of this specific management system in Volkswagen Sarajevo Ltd. will not involve high expenditures and financial injections such as projects most often do. The biggest cost of implementation is the bonus paid out in the end of the year. The amount of this bonus will depend on several elements mentioned previously and can only be guesstimated at this point. I shall elaborate this further on.

The main general goals of Volkswagen Sarajevo are given in the previous parts of the Thesis. In order to achieve them, the company will of course have to invest. If it wants to have a bigger total turn-over, the company has to, among other things, realize new projects and introduce and start producing within new production lines. In order to get new production lines, Volkswagen Sarajevo has to buy the production lines and all machines necessary. In order to place and start using new production lines, the company needs to improve its infrastructure in several regards.

However, all of these costs that will eventually appear are operational costs; they will appear on an operational level. The implementation of MBO concerning specific processes that will occur, will not involve direct costs.

Nevertheless, this specific issue can also be put in another sense. The managers of Volkswagen Sarajevo Ltd. who will mainly be in charge of the implementation of this process, of course, in direct cooperation with all employees of the company, are going to be paid. However, this action will not be accounted as an additional payment. Their work will be financially “rewarded” in the frames of their regular salary. In this regard, it is only possible to calculate the part of their working hours dedicated to this implementation, and, e.g., say that 2 hours per day will refer to this activity and to calculate the payment regarding these two hours.

Since Volkswagen AG has implemented the MBO system years ago and developed the LTI program, top management of the Concern has the intention on educating managers of its subsidiaries around the world in order to make them able to successfully implement the system. Several conferences and seminars have been held in Germany with this purpose; however, managers of Volkswagen Sarajevo Ltd. have not had the chance to participate in those yet. This type of education and preparing the managers for successful implementation will be necessary and will represent the costs of this implementation.

As mentioned, financial reward (bonus) that will be paid out in the end of the year is the biggest and most direct expenditure that Volkswagen Sarajevo will have when it comes to the implementation of MBO in the company.

The mentioned analysis refers to the main and biggest expenditures that Volkswagen Sarajevo Ltd. will have once it starts with the implementation of MBO. Other costs that may appear are the cost of software improvement and office material costs.

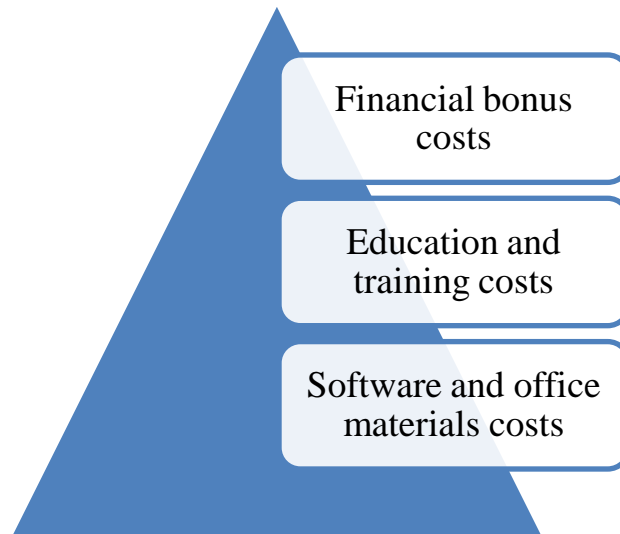


Figure 18: Costs of MBO implementation

8.2.1 Risks and barriers concerning successful implementation and elimination of unfavourable issues

Before implementing the MBO as a specific management system, top management of Volkswagen Sarajevo Ltd. should introduce and present this system with all of its relevant characteristics, ways and mechanisms of functioning, its use, effectiveness and all the positive features of the system that would bring positive results and contribute to the successful business of the company.

The strongest incentive for Volkswagen Sarajevo Ltd. concerning the MBO implementation is to have an objective driven management system that will ensure employees maximal awareness and dedication to company's objectives and its achievement, which will increase their dedication and motivation once they get to be financially rewarded and, even more important- lead to the company's business success reflected in bigger production and profitability.

Barriers to successful implementation are endogenous in character. The implementation of MBO in Volkswagen Sarajevo Ltd. will not require financial expenditures. Even though the objectives of the company include financial investments in order to be reached- that refers to the operational level within the company, not to reforms in the general way of managing the company.

So, once the financial risk is eliminated, I should stick to the risk that refers to the acceptance and acknowledgement of a new management system within the company (between the employees).

Major implementation barriers are:

- bad structural organization of the company
- bad cooperation channels, information flow and delegation of obligations between top and middle management and employees in different departments
- the mentality of employees of Volkswagen Sarajevo Ltd. (Balcan nations are proven to have a special “business mentality” and a certain resistance towards the western way of doing business and all of its characteristics)
- bad reaction to reforms in the management system
- lack of understanding of the new management system that is to be implemented in the company
- lack of awareness of its use, effectiveness and contribution to the company’s overall success
- inefficient recognition of the personal benefits that will occur according to their personal contribution once the system is successfully implemented.

Before the process of implementation starts, it is extremely important that both managers of Volkswagen Sarajevo and all employees are well educated when it comes to both theoretical background of the MBO system and the ways of its implementation in practice. In this regard, the process of implementation can start only after this has been processed.

First two points defined as risky ones and the ones that could be considered to be barriers to the successful implementation of MBO in Volkswagen Sarajevo are the points that the company should work on and improve them in the highest possible extend.

The process of Supervisory Board transition should, among other things, results in a better structural organization of Volkswagen Sarajevo Ltd. Certain organizational and operational rules should be established in order for the departments of the company and each and every employee to be highly aware of all of their duties, obligations and responsibilities. This should improve the delegation of obligations also mentioned as a barrier in this sense. Specific job descriptions and detailed obligations and responsibilities classification should improve the channel of cooperation, information flow and the delegation of obligations and specific tasks in existence.

Since the company does not have former experience with MBO system, the risky point of its implementation can be the time that it will take for employees of the company to become aware of the change that has now started to define all courses of action and to start functioning properly accepting that fact. During this period, it is crucial to make big efforts in order to record and deal with difficulties that may appear in this field in particular. This is an obligation of each and every employee of Volkswagen Sarajevo Ltd., not only the top management of the company that will, however, be the main generator and initiator.

When it comes to eliminating the existing and the potential barriers to successful implementation of MBO process, in my opinion, the answers can partially be found in given questions.

In order to eliminate unfavourable situations, efforts should be directed in following ways:

- increase the awareness and necessity of execution of the demand given by Volkswagen AG to implement this system in all VW subsidiaries in the world
- make a broad and detailed analysis and presentation of the system with a special accent on the advantages, positive features and desired consequences of its implementation
- make extreme efforts in education of employees pointing out the practical examples of MBO implementation and its effectiveness in order to get them to acknowledge and accept the system as a system that will only bring benefits for the company and for them personally
- put an accent on the personal benefits of employees given in the financial rewarding system as a part of the MBO system as a source of high dedication and motivation towards achieving the goals and objectives set.

Every business move and every project that is to be realized carries a certain risk and uncertainty that refers to its success. In order to be able to successfully and timely eliminate the risk and unfavourable situations related, managers must deeply analyse and elaborate an intention of a certain system implementation. While doing this, it is crucial to come up with the optimal way of doing it, according to specific circumstances give. However, they should be even more careful when it comes to the already existing and potential barriers and obstacles to successful and desired implementation. Once they do this, they should be well prepared to handle those and to be successful in their essential intention.

8.3 Time analysis

In order to make the approximation of the project completion time, PERT and critical path method is used to show optimistic, most likely and pessimistic time. This analysis is done according to the previously mentioned activity plan and a guesstimated number of weeks necessary for their accomplishment.

The table bellow represents those activities and their predecessors in order to have three mentioned scenarios shown.

Activity Number	Activity Name	Immediate Predecessor (list number/name, separated by ',')	Optimistic time (a)	Most likely time (m)	Pessimistic time (b)
1	A		1	1	2
2	B	A	1	1	1
3	C	B	2	3	4
4	D	C	3	4	5
5	E	D	2	3	4
6	F	E	2	2	2
7	G	F	1	1	2
8	H	G	10	10	10
9	I	H	3	4	5
10	J	I	1	1	2
11	K	J	1	1	2
12	L	K	1	1	1
13	M	L	1	2	3
14	N	M	2	2	2
15	O	N	2	3	4
16	P	O	11	12	13

Figure 19: Volkswagen’s projected activities and time periods

The solution and the result given by PERT analysis is presented in Appendix I, indicating those activities that are critical in terms of time.

Finally, the analysis depicts that the project completion time is approximately 51, 667 weeks.

04-29-2012 19:52:36	Activity Name	On Critical Path	Activity Mean Time	Earliest Start	Earliest Finish	Latest Start	Latest Finish	Slack (LS-ES)	Activity Time Distribution	Standard Deviation
1	A	Yes	1.1667	0	1.1667	0	1.1667	0	3-Time estimate	0.1667
2	B	Yes	1	1.1667	2.1667	1.1667	2.1667	0	3-Time estimate	0
3	C	Yes	3	2.1667	5.1667	2.1667	5.1667	0	3-Time estimate	0.3333
4	D	Yes	4	5.1667	9.1667	5.1667	9.1667	0	3-Time estimate	0.3333
5	E	Yes	3	9.1667	12.1667	9.1667	12.1667	0	3-Time estimate	0.3333
6	F	Yes	2	12.1667	14.1667	12.1667	14.1667	0	3-Time estimate	0
7	G	Yes	1.1667	14.1667	15.3333	14.1667	15.3333	0	3-Time estimate	0.1667
8	H	Yes	10	15.3333	25.3333	15.3333	25.3333	0	3-Time estimate	0
9	I	Yes	4	25.3333	29.3333	25.3333	29.3333	0	3-Time estimate	0.3333
10	J	Yes	1.1667	29.3333	30.5	29.3333	30.5	0	3-Time estimate	0.1667
11	K	Yes	1.1667	30.5	31.6667	30.5	31.6667	0	3-Time estimate	0.1667
12	L	Yes	1	31.6667	32.6667	31.6667	32.6667	0	3-Time estimate	0
13	M	Yes	2	32.6667	34.6667	32.6667	34.6667	0	3-Time estimate	0.3333
14	N	Yes	2	34.6667	36.6667	34.6667	36.6667	0	3-Time estimate	0
15	O	Yes	3	36.6667	39.6667	36.6667	39.6667	0	3-Time estimate	0.3333
16	P	Yes	12	39.6667	51.6667	39.6667	51.6667	0	3-Time estimate	0.3333
	Project Completion Time	=	51.67	weeks						
	Number of Critical Path(s)	=	1							

Figure 20: Project completion time

8.4 Project evaluation

The project presented deals with the implementation of MBO process in Volkswagen Sarajevo Ltd and presents an overall picture of the whole process and its characteristics.

The project elaborates most relevant issues such as: the overall context, analysis of Volkswagen Sarajevo Ltd., the company’s past and the Volkswagen Group as a whole, company’s main goals and objectives, the project implementation with the definition of every phase of the MBO process, the risky points of implementation and its elimination and, in the end, the project deals with the implementation time which, however, could not concern the exact starting or finishing time, according to the specific business circumstances. Yet, the project strongly points out the recommendation that the company should start with the project implementation as soon as possible.

The evaluation briefly puts an accent of the use and effectiveness of MBO system and the positive results that its implementation will bring to Volkswagen Sarajevo Ltd.

8.5 Suggestions and recommendations for the future

Suggestions for the further firstly refer to pursuing in investigating how clearly operational goals are delegated from top and middle management to all employees and how well did management at all levels understand and cascaded the strategic goals and objectives.

Existing research could serve as a basis for longitudinal study.

It is not questionable if this management system will be implemented, it is questionable how well it will be done and how effective will it turn out to be.

Theoretical background and presumptions given stand for a strong base for its implementation and expectations related to its effectiveness and positive results that the system's implementation should record. However, practice is what counts.

I find it crucial to consistently monitor the whole process. Managers of Volkswagen Sarajevo should devote extreme efforts in precisely following the reactions of employees once they start to work under these conditions. They should collect feedback and give their own regarding certain improvements of employees' performance. According to these findings, managers should point out the mistakes and put an accent on the correct steps that should be realized in order for the whole process to be successful.

CONCLUSION

This Master Thesis analyzed the current situation in Volkswagen Sarajevo Ltd. in the light of implementation of a new management system- Management by Objectives, with a special accent on the points relevant for this specific project to be successfully implemented and realized.

Analysis of Volkswagen Sarajevo's profile described the characteristics of the company, the situation that the company currently finds itself in and the future plans in accordance.

The current management system and the current situation in its reflection were found to be inadequate in regards to specific goals and objectives that the company wants and tries to achieve.

It is appropriate and important to mention that Volkswagen Sarajevo did not have clearly set transparent goals or a following strategy to be executed to ensure the achievement of those.

Therefore, Volkswagen Sarajevo Ltd. appears to be the perfect field for the implementation of MBO, according to the specific characteristics of this specific management system in regards with the improvements desired and needed in order to make its business more successful.

Future plans and intentions of Volkswagen Sarajevo Ltd. could generally be described as improvement in every way. In order to achieve its main objectives for the future- bigger production and bigger profitability, the company should improve its management system and make it a more objective-oriented one. The company should also devote efforts in order to increase employees' dedication and motivation, all in order to achieve the mentioned goals and objectives that the company has set.

This master thesis elaborated the MBO process and gave a broad and deep description of this system with all of its phases that need to be executed properly and successfully in order to achieve the results wanted. Volkswagen AG has already developed and implemented this system years ago. Top management of the Group has requested all of its subsidiaries to do the same. Volkswagen Sarajevo Ltd. will start with its implementation in the close future period, right after the transition of the Supervisory Board that currently goes on finishes. This Thesis contains the exact and precise steps of implementation developed and iden-

tified according to specific business circumstances which are present in the company and which define it in every way.

Once Volkswagen Sarajevo Ltd. implements MBO, starts using it as a regular management system and begins to record positive results coming from its implementation, it will continue to gradually improve its performance all in order to consistently reach and achieve company's short and long-term goals in a better and higher extend.

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LIST OF ABBREVIATIONS

VW AG Volkswagen Aktiengesellschaft

MBO Management by Objectives

PMM Performance Measurement and Management

LTI Long Term Incentive Programme

HR Human Resources

HRM Human Resources Management

BSC Balanced Scorecard

PERT Program Evaluation and Review Technique

e.g. *exempli gratia* – “for example”

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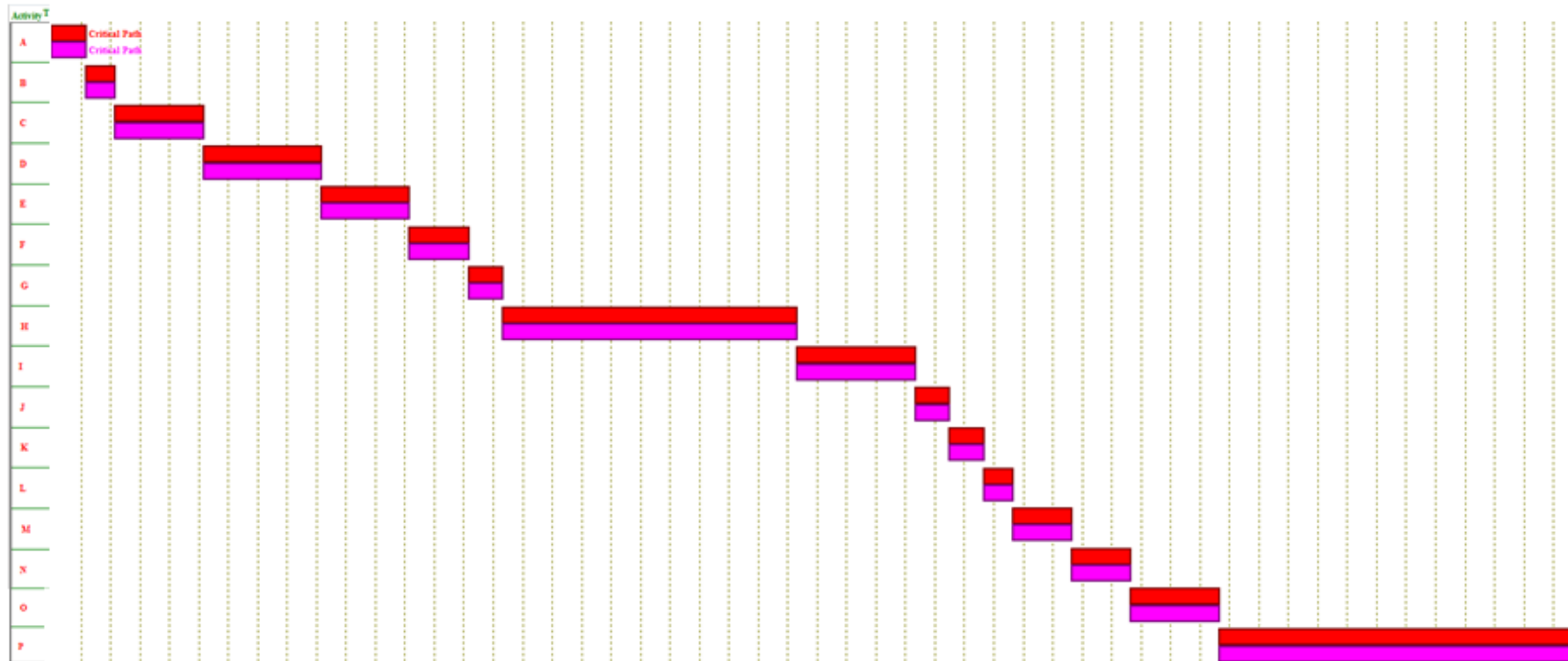
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Appendix II: The scheme of Volkswagen Sarajevo Ltd. and its production lines

APPENDIX P I: GANTT CHART FOR THE ACTIVITIES CONCERNING THE IMPLEMENTATION OF MBO



APPENDIX P II: THE SCHEME OF VOLKSWAGEN SARAJEVO LTD. AND ITS PRODUCTION LINES

