# KPIs that break silos: more Goldratt[1] Gold

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*"I'm just working through my team's KPIs"*
*"We need to get our KPI's sorted"*
*"Once we've got the KPI's worked out, we can get started".*

Common sentences.  All showing some sort of mystical faith in three letters to make things better.

This is not wrong - as Eli Goldratt was fond of saying "show me how you measure me, and I'll show you how I behave".

## THE START

This makes sense on a deep level - we humans rely on connection from our first seconds on the earth to survive.  This never goes away (despite our various versions of dominance and dependence we all play out in an effort to pretend it will!).  Work provides connection - if we produce something someone else values - they might stay with us.  And what's an easy way to demonstrate this?  Hit your measure.

Which means for those in charge of how the show runs (be it an individual or a modern-day self-managing group), setting the measures is not an irrelevant activity.  Far from it.  Then why do we get it wrong?

It starts from a good place - that it's not fair to hold someone accountable for something they don't have authority over.  So in an effort to be true to this, we create individual KPIs.  Fair.  To the individual.  But here's the problem - each individual maximising their KPIs will not automatically create the best system outcome.  It's that old thing about taking the best component from each car in the world then assembling it into the one car will only make an expensive piece of junk.

Why is this?  Because **system success depends on how it all works together.**

## THE TRAP

So now we're trapped.  On the one hand, system success depends on how it all works together, but it's unfair to hold people accountable for things they can't control.  We have ourselves a conflict.  (Or as I prefer to say - a pickle.  This slight reframing reminds us we can actually solve it!).

## THE SOLUTION (PART ONE)

What do we do?  Again, I'll turn it over to Eli Goldratt:

***We allocate the total throughput of the system to every individual work centre that was involved in creating that throughput.***  Now, here's the key: no dividing!  If the throughput of the system was, say, gross profit of $30m, then each individual work centre gets an allocation of $30m!

Yes!  $30m for each.  So if you have five work centres that combined to produce the gross profit, then all five of them **each** get $30m.  As Goldratt said: "*Even if one of them only contributed one screw*"!

"*But that would add up to $150m*" you say.  Correct.  And the answer, as Goldratt beautifully points out is....who cares!  We don't calculate gross profit by allocating it then adding it back up!  We already know it!  It's $30m!

At this point we need to remind ourselves about what measures are for - **to make it easier for people to make**

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[1] Various ideas of Dr Eliyahu Goldratt are used in this article, in particular, see the books *The Goal*, the audiobook *Beyond the Goal* and the *TOC Self-Learning Program* available at toc-goldratt.com

*choices that will benefit the full system*. That's the purpose. Not to make it easier for people to take actions that will make themselves look better to the detriment of the whole system.

Remember - customers and those that fund you don't care how you are organised internally, they only care about the output of the full system. Combine this with "*show me how you measure me and I'll show you how I behave*" and we have ourselves a powerful information device that can work either way.

So - *we allocate the throughput of the system to each work centre involved in the creation of that throughput.*

## THE SOLUTION (PART TWO)

But that's not enough. Because we need to control costs. And where are costs incurred? At a local level. This is the Goldratt gold.

Take a process such as insurance that requires developing policies, marketing them, selling them, maintaining customer relationships and, when required, fulfilling the promises made when a claim is lodged. If all of this is done well - we get profit, renewals and growth.

What's the system throughput? It will be premium received less claims paid - the gross profit. Only expenses incurred because of a sale are included here - I call them 'materials'. All other expenses - 'operating expenses', are ones that we incur whether or not there is a policy sold or a claim made - salaries, buildings, depreciation etc.

**Creating that system throughput is a system-wide effort.** It's tempting to make the claims department solely accountable for losses paid (money paid out under the policies), but this ignores the reality that it's a full-system effort between underwriting to create the promise, marketing to create the expectation, sales to ensure understanding of the promise, and claims to then administer the policy as intended. A breakdown in any one of these sees loss ratios move in a bad direction, and then the traditional finger-pointing starts.

At the same time, **each department has its own local operating expenses.** The most common one is salary. Look at this like the electricity that runs the machines - if any given machine works more efficiently, it reduces the electricity bill for the whole

organisation. But if it does so by halving production (and it's the pacesetter machine) - we lose throughput.

This gives us a clue for how we can combine things:

*Allocate the total amount of the gross profit made to each department. Then....divide this by the controllable operating expense of that department.*

## EXAMPLE

For example, let's take gross profit of $30m. That's the number that goes to each department. $30m. Say you're running claims, and your controllable operating expenses (salaries, equipment depreciation etc.) are $6m. Then your ratio is 30/6 = 5.

Now let's say your colleague in underwriting has controllable operating expenses of $750,000 with their small team. Their ratio is therefore 30/0.75 = 40.

What does this mean? Is underwriting 'better' than claims? No way! It means nothing yet! Because the point is to **compare the same ratio in the next period**. And...the expectation is that each area raises their number. How do they do this? By working together to increase throughput dollars...and doing what they can to reduce their operating expenses in their area at the same time.

## WHAT DO WE GET?

Now, no illusions here - this alone does not magically make people strum the guitar and sing kumbaya. But it does two important things:

1. It makes sure the measurement system itself is not the source of the angst
2. It generates the right conversations, which leads to better solutions and it also becoming very obvious if someone is not thinking on behalf of the full system.

So that time you're spending on KPIs - spend even more time. But use these concepts above to come up with a powerful way to align the external tangible world with the mindsets and relationships you're looking to create.

Then make sure you're meeting regularly with this information on the table, and you have given yourself a great chance of operating as the one system, while still providing the opportunity for individuals to shine as they help the team win.

**IN SUMMARY**

1. People will behave according to how they're measured so they can stay connected
2. The purpose of measures is to make it easier for people to make choices that will benefit the full system
3. It's therefore incumbent on those setting measures to make sure at a minimum that the measures are not encouraging local optimums, then get them to encourage full system thinking

4. System throughput is what customers and funders care about (not individual areas)
5. System throughput requires all players in the system to combine well
6. So each area involved in the throughput must be allocated the full throughput - no dividing according to a formula
7. Throughput is revenue less costs incurred directly in creating the revenue ('materials')

8. Operating expenses (those paid regardless of throughput) are managed locally
9. So each area is measured on the *ratio* of throughput to operating expenses
10. Measures are not done in comparison to other areas, but to the same areas each period, with the goal being improvement

11. These measures are public and discussed at very regular forums with the 'whole system in the room'.

*ABOUT*

*Since 2012, Adam has been hired by CEOs, Owners, Executives and Managers to help them put in the structure, culture and leadership practices needed to set their people up to do great work.*

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