

The Case Against *Targets*

By Randy Spitzer

An icon of conventional wisdom in business, in government and in public education is that targets will produce better results. But, as it turn out, conventional wisdom about targets is *wrong in three significant ways*: 1) Targets *distract* people, 2) Targets are *arbitrary*, and 3) Targets often lead to *cheating*.

In the business world, targets are used for a wide variety of things including: sales increases, cost-reduction and quality improvement. Corporate giants use targets to try to improve profits. Oil companies use targets to try to increase oil reserves; and state governments try to improve public education with high-stakes student testing.

But, in 2005 a self-described “rogue economist” from the University of Chicago named Steven D. Levitt and an author of two best-selling books who writes for both the *New York Time* and *The New Yorker* named Stephen J. Dubner collaborated to produce the blockbuster hit, *Freakonomics*. Among other things, they argue that “conventional wisdom is often wrong.” We agree, particularly when it comes to subject of targets. We contend that:

1. Targets *distract* people in organizations of all kinds from staying focused on what is really important – finding a way to make real improvements in the delivery of quality products and services.
2. Numerical Targets are *arbitrary*. It’s not that reducing costs, improving quality, increasing sales, and improving education are bad ideas; they are in fact, critically important goals. Numerical targets tend to either

overestimate what is possible or significantly *underestimate* what is possible.

3. Targets often lead to *cheating*. Targets are nearly always linked with economic, social and moral incentives. But as Levitt and Dubner point out, “every incentive has its dark side,” and in this case the dark side of targets is cheating.

Let’s look at each of these issues one at a time.

Targets Distract

First, why is it that targets *distract* people from focusing on finding ways to make real improvements in delivering quality products and services? The answer to this question can best be illustrated by looking at two widely used programs in American business: ISO 9000 and Six Sigma.

ISO 9000 grew out of the “quality assurance” movement that began during World War II in bomb making factories. For obvious reasons, the manufacturers of bombs wanted to avoid explosions during the manufacturing process, so they instituted the idea of third-party inspection to accomplish that goal. ISO (International Standards Organization) made third-party inspection as a means of *assuring compliance* to quality standards for many of the world’s largest manufacturers like General Motors, Ford Motor Company, General Electric.

However, John Seddon, occupational psychologist, management thinker and author of *The Case Against ISO 9000* points out that the program “promotes the idea that you should control work by controlling procedures. Worse it promotes the idea that design should be separated from process.” And yet, as W. Edwards Deming, considered by most to be the father of the quality movement pointed out

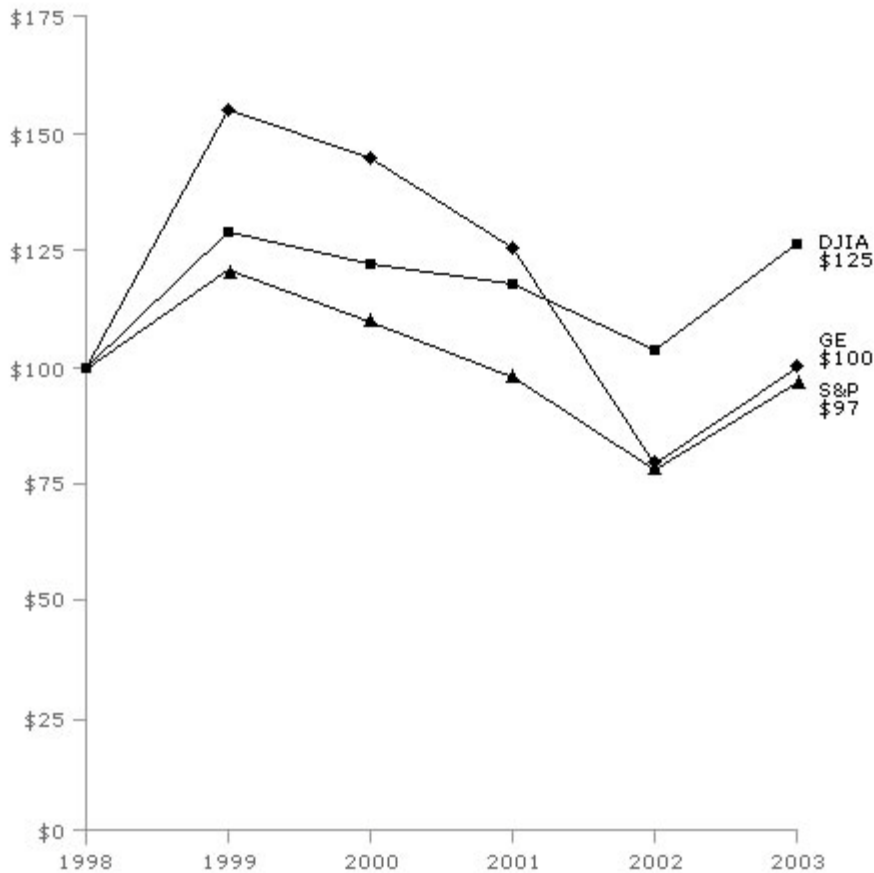
in two of his fourteen points: *Cease dependence on mass inspection* (like third party inspection programs) and *Break down barriers between staff area* (like separating design from process.) Toyota Japan, considered by most to be the model of *lean manufacturing*, experimented with ISO 9000 and concluded that “*ISO 9000 added no value to their system.*”

More recently, dismayed that ISO 9000 has *not* delivered quality as promised, organization’s have adopted Six Sigma (Six Sigma = 3.4 errors per million) as a strategy for improving quality and reducing costs. But, Six Sigma’s detractors characterize the program as “TQM on steroids.” Six Sigma, like TQM offers a measurement and analysis *toolbox*. Whereas TQM offered a small toolbox, Six Sigma offers a whole tool shed. Jack Welch, the retired CEO of General Electric was one of Six Sigma’s greatest supporters. But as writer Will Hutton points out in his book, *The World We are In*, Jack did it by “allowing the R and D spending to dwindle... everything was subordinated to ensuring that profits grew smoothly quarter by quarter. Contributions to the pension fund were reduced... accounting conventions were stretched... the company stood ready to buy back it’s own shares to ensure that they sustained a high rating, putting a total of \$30 billion into stock buybacks rather than investment in the core business.” Perhaps even more revealing is Jack’s own admission in his book, *Jack—Straight from the Gut* that he didn’t really understand the statistics.

In essence, Jack Welch and many other CEOs achieved the results they sought with Six Sigma at the expense of *distracting* management and employees from investing their energy and money in improving GE’s core business. Here’s what Jack’s strategy did to GE: (The following graph was taken from GE’s 2004 Proxy Statement.)

Comparison of Five-Year Cumulative Total Return Among GE, S&P 500 and Dow Jones Industrial Average (DJIA)

The annual changes for the five-year period shown in the graph on this page are based on the assumption that \$100 had been invested in GE stock and each index on December 31, 1998, as required by SEC rules, and that all quarterly dividends were reinvested at the average of the closing stock prices at the beginning and end of the quarter. The total cumulative dollar returns shown on the graph represent the value that such investments would have had on December 31, 2003.



Note that GE's stock price was unchanged after five years while the Dow Jones Industrial Average had risen 25%. In short, Welch's unrelenting focus on profit targets during his tenure, distracted GE's people from growing and improving their core business.

Numerical Targets are Arbitrary

Second, why do we say that numerical targets are *arbitrary*? To answer that question let's look at what happened to Shell Oil recently. According to *Energy Intelligence Group, Inc.*, Royal Dutch/Shell learned the cost of setting arbitrary measures in a big way. Here's what Jim Washer, at *Energy Intelligence* had to say, "The reserves accounting scandal that has hit Royal Dutch/Shell... can be seen as part of a trend stretching back nearly a quarter of a century -- a trend of increasing pressure on management to provide value for shareholders."

By the mid 1990s, Shell's chairman, Cor Herkstroter, established targets for finding new oil reserves. Herkstroter began using performance-related pay and scorecards, for both individuals and business units, linked to internal targets. The focus on targets became an obsession for staff whose pay was suddenly largely dependent on reaching those objectives. "When people's pay is half-dependent on very specific numerical targets, they start managing to their targets, and not working for the whole company."

Those new targets proved to be entirely arbitrary. "There were changes in corporate vocabulary," said Washer, "much talk of *moonshots* and *stretch targets*." Washer reported that at one point, Shell executives were wearing "15% growth" T-shirts on a company-wide in-house television broadcast. However, Shell's management soon discovered that this 15% target was far too aggressive, so they set a new target: 5% growth in reserves, this at a time when their own engineers were projecting *flat* production.

By 2003 the US Securities and Exchange Commission (SEC) had filed charges of corporate fraud alleging "an over-zealous pursuit of internal targets resulting in

non-compliance of oil reserve bookings.” Said one former manager, "People were clearly overenthusiastic in setting and achieving these targets."

Not only are numerical targets arbitrary, but they have proven to actually make the quality of an organization’s processes *worse* while *increasing costs* by increasing variation, a major cause of added cost. In other words, when people are focused on hitting the target, it is natural to devote less attention to the flow of the work itself.

Setting targets creates drastic and often unforeseen results. For example, why is it that most banks have adopted automated phone systems? Answer: to achieve a target of reduced customer service costs. These systems have indeed reduced the number of employees needed to answer calls from bank customers, thereby reducing payroll costs. But at what cost to customer satisfaction? In a 1990s ASQ study, a startling 68% of customers surveyed reported that the number one reason they stopped doing business with a company was that they were “turned away by an attitude of indifference.” When you’ve got a real problem that needs to be addressed, what could possibly feel more indifferent to customers than an automated phone answering system?

The bottom line is that when employees are focused on hitting targets, they’re not focused on meeting the unique needs of their customers, nor are they focused on improving their company’s products and services.

Targets Often Lead to Cheating

Finally, how is it that setting targets often leads to cheating? As Levitt and Dubner point out, “For every person who goes to the trouble of creating an incentive scheme, there is an army of people, clever and otherwise, who will inevitably spend even more time trying to beat it. Cheating may or may not be human nature,

but it is certainly a prominent feature in just about every human endeavor.” To illustrate, let’s look at the recent spate of high-stakes testing that has become the rage in public education.

The targets established by state legislators for improving test scores have radically changed the focus of teachers in public schools, giving them an incentive to cheat. Why? A teacher, a school, or a school district who’s students perform poorly on these high-stakes tests or threatened with punishment... teachers may be fired or put on probation, schools too may be placed on probation, principals and teachers may lose their jobs, and local school districts may be taken over by the state or placed under the supervision of outside contractors.

Why would a teacher, principal or school district cheat? The simplest reason is that there is little incentive not to, because this kind of cheating is rarely investigated or detected and almost never punished. How might a teacher cheat? Believe it or not, some students have reported that their teacher put the answers on the chalkboard or provide the answers in advance of the test. A more subtle approach is to give the kids a little extra time to complete the test. Some teachers and principals have even admitted to changing answers on the tests after the fact. Many teachers simply “teach to the test,” which isn’t really cheating in a strict sense, but certainly is dangerously close to the line.

Another example of the incentive to cheat in order to hit a target is the ubiquitous sales contest. If ever there was “army of people, clever and otherwise, who will inevitably spend even more time trying to beat it,” sales contests are the king. But even if no one cheats on a sales contest, sales people report that they consistently avoid taking any action that would impede their ability to earn the incentives offered, even if taking such action might be detrimental to customers and/or the company. It’s not that sales people competing for a sales incentive are indifferent

to the needs of customers or the company; they are simply taking actions for which they will be rewarded and avoiding those actions that will not reward them.

So to summarize, the conventional wisdom that targets will improve results is wrong because:

1. Targets *distract* people from focusing on customers and improving the quality of work processes.
2. Numerical Targets are *arbitrary* because they either *overestimate* what is possible or significantly *underestimate* what is possible.
3. Targets often lead to *cheating* by creating unintended incentives to do so.

Luckily, there is an alternative to targets. It's called "Outside-In" thinking. Put simply, Outside-In thinking means seeing things from the customer's point of view, from the *outside-in*. Customers want products and services that conform to their unique wants and needs. The best way to deliver what *each customer* wants is to keep your people focused on two questions:

1. What does each of my customers want?
2. How can we design systems and processes that can respond quickly to what they want?