



## TenStep Supplemental Paper

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25 July 2005

### **Banking on Eliminating Constraints!**

*Applying the Theory of Constraints (TOC) in a service environment!*

Success eludes us most often despite doing the right things and taking the right decisions. Often, despite doing things to the best of our abilities, we come across lukewarm success. In short, we are, in some way, constrained. This happens not only in our daily activities but also in the case of organizations, irrespective of whether they are in the service or manufacturing sectors.

Constraints come in many forms and we are inevitably bogged by doubts, dilemmas and decisions prevalent within a system. It was an attempt to overcome constraints that led Dr. Eliyahu Goldratt to evolve the Theory of Constraints (TOC) and the logical thinking process. TOC is a business philosophy that focuses on achieving 'the goal' of a system by understanding the underlying cause and effect dependencies and variations within the system. The TOC thinking tools help in devising common sense solutions to problems apart from facilitating collaboration and consensus among those that are critical for resolving problems.

The manufacturing sector has been successfully applying TOC and its thinking tools for over two decades. Though originally developed for the manufacturing sector, TOC's constraints analysis, the thinking process and the logical tools are equally relevant and applicable even for marketing, sales, the service sector and paper-based transactions. Here, we look at the application of TOC principles in the banking sector.

Eastern Financial Florida Credit Union (EFFCU) based in South Florida is a full-service financial institution with USD1.8 billion in assets. In the late 1990s, interest rates for refinancing mortgages dipped to an all-time low (in 40 years). This led to an unprecedented increase in the number of loan applicants. EFFCU had to deal with the problem of mass delays in transactions. This apart, it had to address issues like:

- Failure to commit to a closing date
- Colossal work-in-process
- Extensive lead times
- Excessive expediting
- Highly stressful work environment
- Inability to process urgent requests

Employees found it frustrating to work in such conditions and the management realized the need to resolve the conflict in workflow patterns. In the year 2003, EFFCU decided to implement TOC's Drum-Buffer-Rope (DBR) principles to ensure that customers' requirements could be met without disrupting workflow. The goal was to improve services and profitability, simultaneously creating a better work environment for employees.



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A DBR design team was created comprising members from each step in the mortgage process. After undergoing TOC and DBR training, the team used TOC's Five Focusing Steps to design the new workflow.

The constraint was identified as the underwriting department. To exploit this, the team strategically provided enough work-in-process files to protect the system deliverables like closing date to members and delivery dates to investors. It was also important that the underwriting department was never starved of work. The department had thus to be protected with constant work-in-process files. To subordinate everything else to the underwriting department, protective capacity had to be provided everywhere else based on the capacity of the underwriting department. Hence files were released into the system such that they accumulated only at the planned protection points. Lastly, multi-tasking gave way to 'single-tasking' creating a 'relay runner' work culture involving clean hand-offs after every step in the process. This took away much of the imbalance in work flow patterns.

At the end of three months, EFFCU was able to meet closing dates at the rate of 99%. The 1% was due to uncontrollable external factors. Profits improved by 24% due to increase in monthly loan closings, elimination of outsourcing and reduction in employee overtime expenses. Inspired by the success, the company then implemented DBR in its Home Equity Lending Area. Training in DBR proved to be the turning point for success for EFFCU.

### **Another case of TOC in practice**

Security Federal Bank (SFB) based in Northwest Indiana had the reputation of being a secure bank despite its sloppy services. The bank primarily focused on mortgage lending and had a very little share in retail and community banking.

It was in the 1990s, when the banking industry went through revolutionary changes that things changed for SFB. Sweeping changes took place in the sector, thanks to increased customer awareness and demands. Banks, which until then had performed as they wanted, suddenly showed an urgent interest to 'listen to and understand' the needs of the customer. Increased competition from new entrants forced many of the leading banks to think 'unconventionally'. In order to increase profits, these banks had to offer better services and look for non-interest income.

In its attempt to survive amidst such fierce competition, SFB decided to look at new avenues in banking. It ventured into retail and community banking in the early 1990s. The initial years proved to be disastrous and SFB finances plummeted. Instead of attracting new customers, SFB began losing all its major existing customers. It was only in early 1996 that the management finally made a true paradigm shift in thinking. In order to give a boost to its community banking operations, SFB decided to switch from a 'transactions' attitude to a 'customer-friendly' nature. The objective was to become friends and advisors of customers rather than merely conduct transactions with them. SFB decided to implement these revolutionary changes as per the thinking tools and logical processes of TOC.



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As a first step, copies of Dr. Eliyahu Goldratt's 'The Goal' were given to all officers at SFB. Weekly meetings were held to translate the practices and procedures of TOC from the manufacturing environment to the banking environment. Three core measurements emerged for SFB. They were throughput, investment and operating expenses.

Employees were first apprised of the need to make and accept revolutionary changes and then taught the TOC Thinking Process. Rather than just process an impersonal transaction, they were made to understand the importance of working with customers to resolve conflicts. The outcomes were visible within a year. SFB achieved a 50% increase in assets. Non-interest income jumped from a mere 2% to 61% within a year of implementing TOC. Given the amazing turnaround, SFB still conducts regular meetings where the TOC Thinking Process is reviewed to ascertain that it's working.

These amazing turnarounds took place in the banking sector. What began in manufacturing went to prove equally successful for banking. Undoubtedly, the logic and the principles can be equally significant in any sector and to solve even our simple routine problems. What we need to do is understand the principles well and utilize them to derive truly common sense solutions for problems.