

Behind “the softer side of Sears” is a set of rigorous leading indicators that measure attitudes, impressions, and future performance.



THE EMPLOYEE- CUSTOMER- PROFIT CHAIN AT SEARS

by Anthony J. Rucci,
Steven P. Kirn, and
Richard T. Quinn

IT IS NO LONGER NEWS that over the past five years, Sears, Roebuck and Company has radically changed the way it does business and dramatically improved its financial results. Much has been written about the Sears turnaround, detailing the company's strategic shifts and its transition from big losses to big profits. But the Sears transformation was more than a change in marketing strategy. It was also a change in the logic and culture of the business. In fact, the process of altering the logic is what changed the culture.

Led (and pushed) by CEO Arthur Martinez, a group of more than 100 top-level Sears executives spent the better part of three years rebuilding the company around its customers. In the course of rethinking what Sears was and wanted to become, these managers developed a business model of the company that tracked success from management behavior through employee attitudes to customer satisfaction and financial performance. Along with its measurement system, this *employee-customer-profit model* is rigorous

enough to serve as an integral piece of the management information system and as a tool that every individual in the company can use for self-assessment and self-improvement. Moreover, the work of creating the model and the measures made such demands on the managers involved that it changed the way they think and behave. That cultural change is now spreading through the company.

The basic elements of an employee-customer-profit model are not difficult to grasp. Any person with even a little experience in retailing understands intuitively that there is a chain of cause and effect running from employee behavior to customer behavior to profits, and it's not hard to see that behavior depends primarily on attitude. Which is not to say that implementing an employee-customer-profit chain, or model, is easy. One big problem is measurement. Unlike revenues and profits, soft data are hard to define and collect, and few measures are softer than customer and employee attitudes, or "satisfaction." In many businesses, it is difficult to measure even relatively hard behaviors like customer retention, and the inevitable result is that many companies are unwilling to expend the time, energy, and resources to do it effectively. Not surprisingly, many companies do not have a realistic grasp of what their customers and employees actually think and do.

Sears does. By means of an ongoing process of data collection, analysis, modeling, and experimentation, we have developed and continue to refine what we call our Total Performance Indicators, or TPI—a set of measures that shows us how well we are doing with customers, employees, and investors. We understand the several layers of factors that drive employee attitudes, and we know how employee attitudes affect employee retention, how employee retention affects the drivers of customer satisfaction, how customer satisfaction affects financials, and a great deal more. We have also calculated the

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lag time between a change in any of those metrics and a corresponding change in financial performance, so that when we see a shift in, say, employee attitudes, we know not only *how* but also *when* it will affect results. Our TPI makes the employee-customer-profit chain operational because we manage the company on the basis of these indicators, with remarkably positive results. But the system is a good deal more complex—and a good deal harder to imitate—than this glimpse suggests.

Any retailer could copy the Sears measures—even our modeling techniques—and still fail to achieve an operational employee-customer-profit chain, because the mechanics of the system are not in themselves enough to make it work. It goes without saying that you must be able to measure and manage the drivers of employee and customer satisfaction, and we will explain how we do this at Sears. But

two additional elements are indispensable. First, a company must build management alignment around the model and the measures—which, for all practical purposes, make up a single system. Because this system is to be the cornerstone of management decision making, it is critically important that every manager—especially those at the top of the company—understand the system and buy into it wholeheartedly. Second, it is essential to deploy the system properly in order to create a sense of ownership among sales associates and

staff. Deployment is easy to shrug off. It looks like a simple communication challenge, but it is a good deal more. It is an issue of trust and of business and economic literacy. Unless employees grasp the purpose of the system, understand the economics of their company and industry, and have a clear picture of how their own work fits into the employee-customer-profit model, they will never succeed in making the whole thing work.

Making an employee-customer-profit chain operational is therefore a challenge in three parts: creating and refining the employee-customer-profit model and the measurement system that supports it; creating management alignment around the use of the model to run the company; and deploying the model so as to build business literacy and trust among employees. At Sears, there was no distinction between parts one and two. Managers themselves created the model and aligned themselves with it as they did so, since people automatically

Anthony J. Rucci has been executive vice president for administration at Sears, Roebuck and Company since November 1993. Steven P. Kirn is vice president of human resources planning and development at Sears. Before his retirement in 1996, Richard T. Quinn was vice president for transformation and total performance indicators. He is now president of the Quinn Consulting Group in Long Grove, Illinois.

buy into systems they invent. Part three, deployment, followed. The three together were a radical response to a 10-year business downturn that threatened the survival of the Sears retail business—a 111-year-old American institution.

Turnaround

The year 1992 was the worst in the history of Sears. On sales of \$52.3 billion, the company's net loss was \$3.9 billion, almost \$3 billion of which came from the merchandising group. Worse yet, 1992 was no anomaly but the culmination of bad trends, most of them directly related to the company's lack of focus. For a century, Sears had flourished on the strength of its adaptive ability to understand and serve U.S. consumers and their changing needs and wants. Beginning in the 1980s, however, Sears diversified into insurance, financial services, brokerage, and real estate, while other retailers, notably Wal-Mart, were focusing fiercely on the retail consumer and were capturing market share with remarkable speed. The Sears response was to sell or spin off all its nonretail businesses and return to its roots.

Arthur Martinez arrived in September 1992 to head up the merchandising group. (In August 1995, when Sears had divested everything but merchandising, he became chairman and CEO.) Martinez had been vice chairman and a director of Saks Fifth Avenue, as well as group chief executive for the retail division of BATUS, where he was responsible for Saks, Marshall Field, J.B. Ivey, and Breuners. But no retailer in history had ever succeeded in effecting a turnaround of the kind and scope that Sears required, perhaps even to survive. Martinez and his leadership team needed to make some quick decisions about product lines, store types and locations, strategies, asset allocations—even about the company's basic identity as a retailer. Two factors worked in Sears's favor. First, we would not have to invent a crisis to get the attention of employees, who were hungry for improved performance. Second, the company's heritage was an asset. Research showed, almost surprisingly, that through years of turmoil—and despite specific customer-satisfaction ratings that were very low—American families had maintained a positive, trusting image of Sears as a good, honest place to shop.

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Within 100 days of his arrival, Martinez initiated a comprehensive turnaround plan. For decades, the underlying assumption had been that Sears was a man's store, but market data showed that an extremely high percentage of buying decisions were being made by women. Martinez refocused marketing on "the softer side of Sears" and introduced new private-label lines of apparel and cosmetics. He expanded and accelerated existing plans to move into off-mall specialty stores, including Sears hardware stores and HomeLife furniture stores. He slated 113 stores for closing, reducing the number of mall-based stores to about 800; those that remained were to be thoroughly renovated over five years at a cost of \$4 billion. He also terminated the 101-year-old Sears catalog, which was losing more than \$100 million a year. Store operations were reengineered, with a heavy emphasis on training, incentives, and the elimination of administrative and other non-selling tasks for sales personnel. Staffing was adjusted to put more of the best people in the stores during evenings and weekends, when the best customers were shopping. The company's entire service strategy was revamped to make it more responsive to busy women and their families. Sears began offering Sunday deliveries and a long list of new services, including repairs on any brand of appliance. Martinez decreed that Sears would accept all major credit

cards instead of limiting itself to Discover and the Sears card.

The results were spectacular. In 1993, the company's merchandising group reported net income of \$752 million, a sales increase of more than 9% in existing stores, and market share gains in apparel, appliances, and electronics. Sears as a whole had one of its most profitable years ever. The resurrection produced a total shareholder return for the year of 56%.

Transformation

Business turnarounds are remarkable events, but all too often they are only skin deep. They are exciting, certainly. Management introduces a new strategy, speaks with great conviction about empowerment and customer focus, and lavishes a great deal of attention on the workforce. But few rank-and-file employees ever really understand the point of all

the activity or grasp their own role in it. Moreover, the turnaround means a lot of extra work and can tire everyone out. So once the energy and excitement—and the results—have peaked, many companies fall back in relief and reassume bad habits.

We were determined to keep this pattern from repeating itself at Sears. Once the company was making money again, there was a widespread, perceptible sense of “Glad that’s behind us,” and we realized that success could become our enemy. The task we faced was substantial: to transform the company, turn its short-term survival program into a platform for long-term excellence, and, in the process, engage the creative power of employees in the vital task of shaping the company’s future. We knew that Sears had to listen to its customers and respond to their needs. We also understood that no plan we devised and imposed from above was ever going to work. If Sears was to undergo a transformation—if attitudes and behavior were to change and a new sense of urgency and purpose were to spread through the company—senior management as a whole would have to take the lead. As Martinez saw it, his job was to coax or compel his senior managers to come up with a plan.

In March 1993, he called the first of several off-site meetings in Phoenix, Arizona, for about 65 senior managers. (This group, known as the Phoenix Team, grew steadily until it included roughly 150 people—the entire senior echelon.) In an intensive two-and-a-half-day session, Martinez presented five new strategic priorities—core business growth, customer focus (“Make Sears a compelling place to shop” was the way he put it), cost reduction, responsiveness to local markets, and organizational and cultural renewal—and then led the discussions himself. You are the future leaders of Sears, he said in effect, and as you go, so goes the company. Back at Sears headquarters in Chicago, the Phoenix Team continued to meet one Saturday a month to discuss the priorities and work on implementation.

At the November meeting later that year, Martinez wanted to know how the five strategic priorities were progressing, and a general discussion followed. Everyone agreed that the priorities made sense to top-level managers, but the rest of the company thought it was all a lot of “M.B.A. stuff.” “They nod their heads when you talk about cus-

tomers focus,” someone said, “but they don’t know what they’re supposed to be doing differently.” And then one candid and courageous soul stood up and said, “To be completely honest about it, I don’t know what I’m supposed to be doing differently.” People shifted uneasily in their seats, and a few nodded in agreement. It was a startling moment. Here was the Phoenix Team, whose job it was to design a corporate transformation and generate renewal among 300,000 employees at more than 2,000 locations, and no one seemed to have a clear sense of what, exactly, that might require.

In most companies, in most situations, it is the eight or ten most senior executives (along with the strategic planning department and various consultants) who ask the big strategic questions: What business are we in? Whom do we serve? How do we compete? What is our value proposition? As a rule, the 100 to 200 people in the second management layer take the answers to those questions on faith. What gets lost as a result is cross-functional dialogue, questioning, cooperative planning, creativity, and ownership. At Sears, the 1992 turnaround strategy—as well as the five strategic priorities—were developed and deployed more or less according to the old top-down paradigm, with strong initial results but without the broad ownership and employee engagement that Martinez wanted. In 1992, there had been no real alternative—the

company was teetering on the edge. And the turnaround strategy worked. Then, in 1993, Martinez had needed a set of priorities he could use to make a direct, almost personal bid for the hearts and minds of his senior managers. He had won their hearts, it appeared, but he still needed to give them an opportunity and a compelling reason to think outside the old Sears box and figure out for themselves what they should be doing differently.

What followed was more than a year of careful but intense pressure on those senior managers. There were plenty of ideas on the table. The problem was getting members of the Phoenix Team to explore the possibilities until they themselves could develop a plan for Sears that would work because it was their own creation.

We began by asking each member of the team to write a “news story” about where Sears would be in five years and how it got there. At the Phoenix meeting in March of 1994, task forces were formed

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around four recurring themes in those stories: customers, employees, financial performance, and innovation. The new groups were asked to define *world-class status* in their areas, identify obstacles to achieving it, and establish metrics for measuring progress. The task forces met for two-and-a-half days, then presented their findings to the whole assembly. Martinez told them it was a good start. But since the company was going to bet its future on their initiatives, they would need to spend more time, gather more information, and make specific recommendations.

When the team got back to Chicago, a lot of people complained about the extra workload. They had no time to spend on task forces, they insisted, because they had to run the company. The message came back that they had to do both. They had to find the strategic answers and create an operational strategy. For several weeks, everyone struggled. As the deadline for recommendations approached, the sense of urgency grew. The task forces began meeting weekly, usually at 7 A.M. or earlier. (Months later, when many people wondered if the 7 o'clock grind had to go on forever, they needed to be reminded that no one ever told them they had to meet at that hour, or every week, or at all. Urgency and involvement had scheduled all those early-morning meetings.)

The four task forces grew to five: customers, employees, financial performance, innovation, and values. The financial task force built a model of the drivers of total shareholder return over a 20-year period and drew inferences about what Sears would have to do to be in the top quartile of *Fortune* 500 companies. The innovation group did outside benchmarking, undertook a research project into the nature of change, and suggested an effort to generate one million ideas from employees. The values group gathered 80,000 employee surveys and identified six core values that Sears's people felt strongly about: honesty, integrity, respect for the individual, teamwork, trust, and customer focus. The old command-and-control culture was too parental and didn't value people enough. Performance should count more than effort.

The customer task force studied customer surveys going back several years and conducted 80 customer focus groups across the country, videotaping the sessions so that every member of the task force could watch. They asked the focus groups why they shopped at Sears, what they wanted, what they expected, what they disliked. Sears had always talked a great game on customer focus: "Satisfaction guaranteed or your money back" had been a Sears watchword for a hundred years, and "Take care of the customer, take care of the customer" was a kind of Sears mantra. Much of it was hollow, however, and it often seemed that no one at headquarters had



The company's entire service strategy was revamped to respond to busy women and their families.

been listening to customers. Across the country, the task force heard endless stories about how we failed to meet customers' expectations. Merchandise was out of stock, sales associates were hard to find, returns were time consuming, service was bad. The big surprise was that, in spite of it all, people basically liked Sears. One of our great assets was the American public's persistent wish to see the company succeed.

The employee task force conducted 26 employee focus groups and studied all the data on employee attitudes and behavior, including a 70-question opinion survey given to every employee every other

year. What the group heard, again and again, was that employees took a great interest in the company's success. They were proud to be at Sears. "It's not a job," someone said. "It's my life's work."

While the task forces were busy gathering data, we set up an additional group to produce a vision and values statement. It had predictable difficulties. After talking to 80,000 employees, the group came up with a set of values that sounded like the Boy Scout oath. We were going to be the world's leading retailer, practice charity and kindness, end world hunger, and achieve peace in our time. All fine ambitions, but what did they have to do with retailing? We turned to outside professionals, and they came up with a vision statement that sounded like every other company's vision statement.

Then it struck us that we had been staring at it all along. Early in the process, Martinez had talked about making Sears a "compelling place to shop." We also wanted Sears to be a compelling place to work. And if we could achieve both of those goals, Sears would certainly become a compelling place to invest. So "Sears, a compelling place to work, to shop, and to invest" became not our vision, exactly, but a clear statement of what we wanted to be known for, internally and externally. We called it the "three compelling" and later just the three C's. We combined it with three shared values that we came to call the three P's: "passion for the customer, our people add value, and performance leadership." Some people in the company thought all of this was far too simplistic, but to most of us, simplicity was its strength. The three C's and the three P's were simple, yet they amounted to a wonderfully concise version of the entire employee-customer-profit chain, from motivated employees to satisfied customers to pleased investors. No one would have to carry around a little printed card to remember what Sears was all about.

Measurement

Times of crisis like the ones Sears had gone through make corporate transformation necessary and, ironically, somewhat easier. People know that change is required because they can easily remember when pieces of the sky were raining on their heads. But change to what? Change managed how,

especially in a large organization? And change perpetuated how, as a dynamic process rather than as a onetime event?

The task forces had spent months listening to customers and employees, studying best practices at other companies, thinking about what would constitute world-class performance at Sears, and establishing measures and objectives. As a result, they had at least a partial answer to the first question: Change to what? The customer task force had established four goals: to build customer loyalty, to make Sears a fun place to shop, to provide excellent customer service by hiring and holding on to the best employees, and to offer the right merchandise at the right prices. The employee task force came up with three: to build a workforce of involved and empowered employees, to encourage new ideas, and to create an environment in which employees

could realize their personal goals and develop their skills and abilities. The financial task force had four goals: to increase operating margins, to improve asset management, to raise productivity, and to grow revenues.

While the separate task forces were formulating those objectives, the Phoenix Team as a whole was beginning to think in terms of a business model that would link employees, customers, and investors into a single logical entity. In fact, it was a short step from "compelling place to work, to shop, and to invest"

to the same thought expressed as a formula for the company's success: $work \times shop = invest$. This simple algorithm looked more like a slogan than an operational strategy, but there was more to it than met the eye. In the first place, the formula took into account our conviction that for Sears to succeed financially, we had to be a compelling place *both* to work *and* to shop—that is, $work \times shop$, not $work + shop$. The right merchandise at the right prices would get us nowhere if our employees were poorly motivated. Second, it was a formula made up of leading, not lagging, indicators. It is now a truism that financial results are a rearview mirror, that they tell you only how you did in the last quarter and not how you will do in the next. But few if any companies have ever come up with dependable predictive metrics, and that's what we were after.

The objectives formulated by the task forces gave us a set of preliminary measures, on which the task forces had already begun to gather data. (See the

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exhibit "The Initial Model: From Objectives to Measures.") We now formed a new team to convert those measures into an econometric model. The measurement team's task was to come up with a kind of balanced scorecard for the company—the Sears Total Performance Indicators, or TPI. But we wanted to go well beyond the usual balanced scorecard, commonly just a set of untested assumptions, and nail down the drivers of future financial performance with statistical rigor. We wanted to assemble the company's vast body of interview and research data—some of it from the task forces, much of it collected routinely over the course of years but never used strategically—then analyze it, draw connections across the data sets, and construct a model to show pathways of actual causation all the way from employee attitudes to profits. We wanted a set of nonfinancial measures that would be every bit as rigorous and auditable as financial ones. To make that happen, we had to take this first version of the employee-customer-profit model and elaborate and refine it until we had tested and proved the measures it was built on.

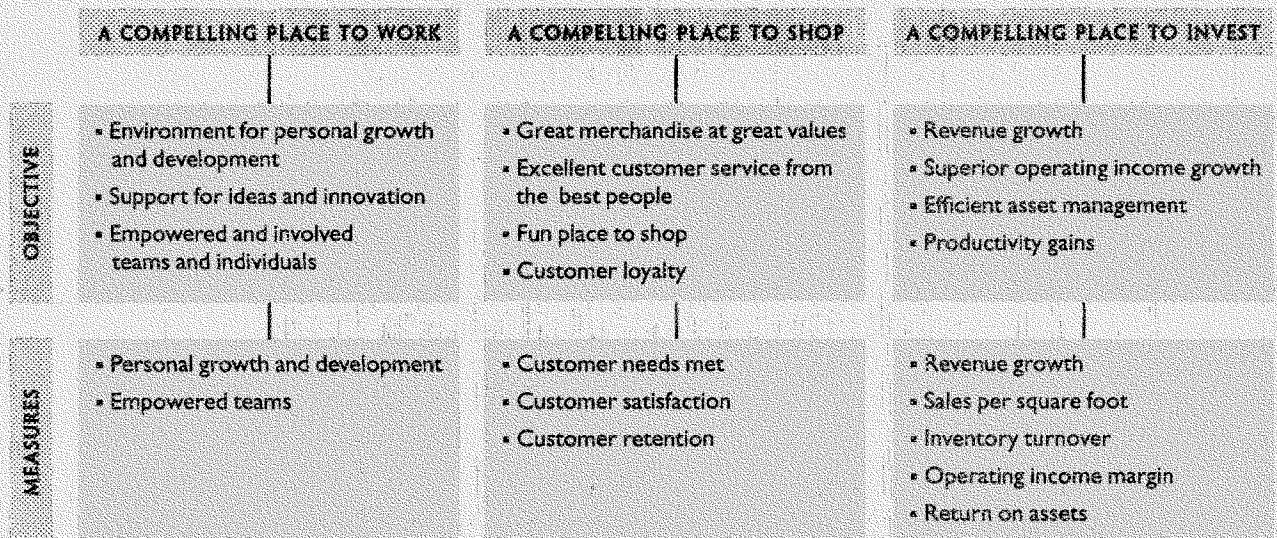
It was a task that struck many people as utopian, but even the skeptics understood that dependable information about causation would be invaluable if we could get it. Suppose, for example, that we

wanted to spend some money to increase sales associates' knowledge of the products they sell. Would customers notice? Would the investment lead to increased customer retention, better word of mouth, higher revenues, greater market share? If so, how long would it take? Or, even more to the point, suppose that we wanted to measure the effects of an improvement in management skills. Because 70% of our employees work part-time, and part-time employees have a high turnover rate, we know that management skills are critically important. The model and the TPI could tell us *how* important those management skills actually were, measured in terms of employee attitudes and customer satisfaction. We wanted a chain of causation that would answer all those questions and more—a working model of the employee-customer-profit chain that would help us run the company.

For customers and employees, some of the metrics were brand-new. Personal growth and development was not something Sears had ever measured before, and neither was customer retention. We had to invent the measures and the new measurement techniques that went with them. Once we had defined our new measures, we spent the first two quarters of 1995 gathering metrics of every kind, old and new; in the third quarter, we gave our huge

THE INITIAL MODEL: FROM OBJECTIVES TO MEASURES

The first step in creating an employee-customer-profit model was to devise a set of measures based on our objectives in our three categories: a compelling place to work, to shop, and to invest.



collection of survey and financial data to a firm of econometric statisticians for analysis. The methodology they use is called *causal pathway modeling*—as distinct from regression analysis, which examines data and observes correlations without establishing causation. The experts took our two quarters of data from 800 different stores, compared the results across time and place, and, using statistical techniques like cluster and factor analysis, found linkages and impacts in the data. A month later, they gave us their report, having found some strong and some weak connections, and some connections we had never expected or imagined. We made the appropriate adjustments in our model and went on collecting data for a new iteration at the end of the next quarter.

It was exciting stuff. We could see how employee attitudes drove not just customer service but also employee turnover and the likelihood that employees would recommend Sears and its merchandise to friends, family, and customers. We discovered that an employee's ability to see the connection between his or her work and the company's strategic objectives was a driver of positive behavior. We learned that asking customers whether Sears is a "fun place to shop" told us more than a long list of more specific questions would. We were also able

to establish fairly precise statistical relationships. We began to see exactly how a change in training or business literacy affected revenues.

We also found that two dimensions of employee satisfaction—attitude toward the job and toward the company—had a greater effect on employee loyalty and behavior toward customers than all the other dimensions put together. We still use the 70-question employee survey to gather information about working conditions, satisfaction with pay and benefits, and so forth; but for econometric purposes, a mere 10 of those 70 questions captured the predictive relationship between employee satisfaction and customer satisfaction. Moreover, those 10 questions amounted to a report card on management, which reemphasized the importance of management skills in achieving company goals. (See the exhibit "A Compelling Place to Work.")

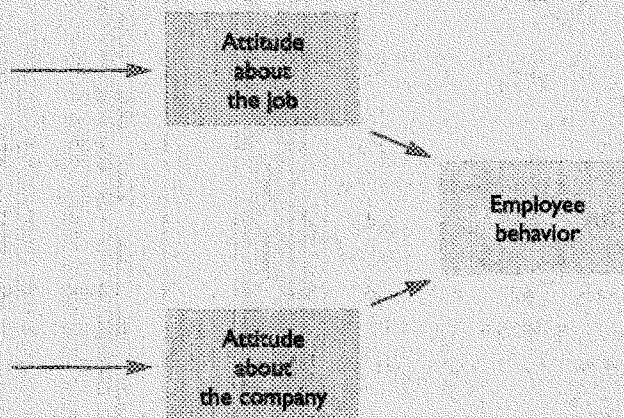
Conversely, the statisticians could find no direct causal pathway from two of the measures we had put into our tentative model—*personal growth and development* and *empowered teams*—to any of our customer data. We believe that growth, empowerment, and teamwork matter, but clearly something about the way we measured them was flawed. However important they might be, the measures we had did not lie on a predictive pathway from

A COMPELLING PLACE TO WORK

We discovered that responses to these 10 questions on our 70-question employee survey had a higher impact on employee behavior (and, therefore, on customer satisfaction) than the measures we devised initially: *personal growth and development* and *empowered teams*.

1. I like the kind of work I do.
2. My work gives me a sense of accomplishment.
3. I am proud to say I work at Sears.
4. How does the amount of work you are expected to do influence your *overall attitude* about your job?
5. How do your physical working conditions influence your *overall attitude* about your job?
6. How does the way you are treated by those who supervise you influence your *overall attitude* about your job?

7. I feel good about the future of the company.
8. Sears is making the changes necessary to compete effectively.
9. I understand our business strategy.
10. Do you see a connection between the work you do and the company's strategic objectives?



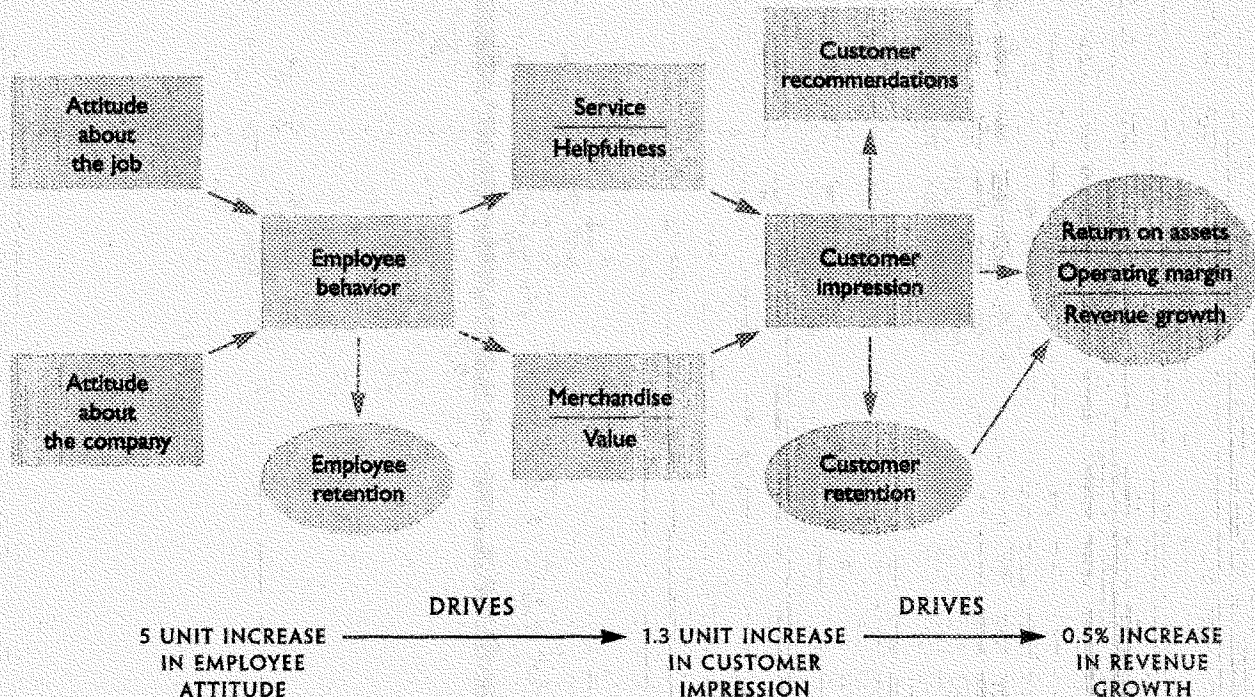
THE REVISED MODEL: THE EMPLOYEE-CUSTOMER-PROFIT CHAIN

This is the model we use today. The rectangles represent survey information, the ovals, hard data. The measurements in blue are those we collect and distribute in the form of the Sears Total Performance Indicators.

A COMPELLING PLACE TO WORK

A COMPELLING PLACE TO SHOP

A COMPELLING PLACE TO INVEST



employee attitudes to customer satisfaction to shareholder value. So in the next version of our employee-customer-profit model, we replaced those initial measures with the 10 questions about the job and the company.

In the 18 months from mid-1994 to the end of 1995, we produced a model; refined it three times, and created a TPI for the company as a whole, but the process of improvement continues. We conduct interviews and collect data continually, assemble our information quarterly, and recalculate the impacts in our model once a year to stay abreast of the changing economy, changing demographics, and changing competitive circumstances.

The TPI is not a perfect system and never will be, despite our steady improvements. (See the exhibit "The Revised Model: The Employee-Customer-

Profit Chain.") It tells us less than we would like to know—and less, probably, than we need to know. The point is that we know vastly more than we once did, that all that information helps us run the company, and that some of it has given us a decided competitive edge. Take the example about the quality of management as a driver of employee attitudes. Our model shows that a 5 point improvement in employee attitudes will drive a 1.3 point improvement in customer satisfaction, which in turn will drive a 0.5% improvement in revenue growth. If we knew nothing about a local store except that employee attitudes had improved by 5 points on our survey scale, we could predict with confidence that if revenue growth in the district as a whole were 5%, revenue growth at this particular store would be 5.5%. These numbers are as rigorous

A NEW DAY ON RETAIL STREET

HOW LEARNING MAPS TEACH

Learning Maps™ provide information and encourage employees to think about the industry and the company they work in. At Sears, groups of roughly ten employees walk through each map aided by a written guide, questions, and one member of the team who acts as leader. The actual maps are 3' by 4'6".

This scaled-down version of Map 1—**A New Day on Retail Street**—includes an excerpt from the introduction and three detailed enlargements alongside their corresponding questions from the guide.

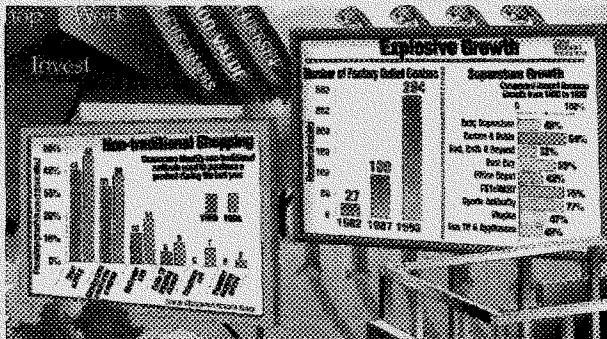


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Welcome to **A New Day on Retail Street**. This is a small group-learning and discussion process. This learning process allows you to share your thoughts and insights with fellow Sears associates.

On this first map, we'll take a look at the big picture of the retail marketplace. Sears has long been a major force in retailing. But now there's a new day on retail street. Changing customer needs along with an explosion of new competitors have changed the retail marketplace. Your group will explore many of these key retail-market changes on this learning map.

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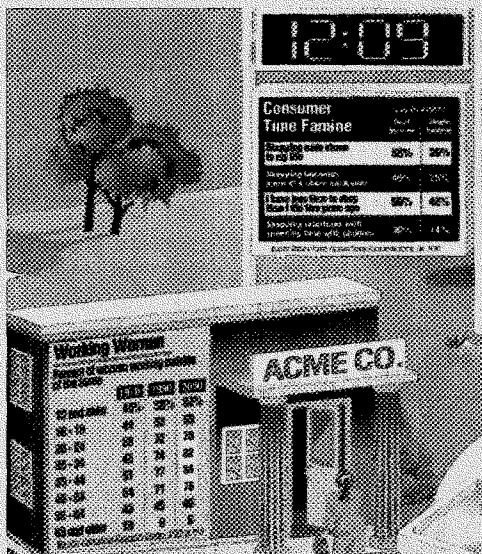


Find the chart labeled **Explosive Growth** at the top right side of your map. Have someone in your group read aloud the information on the chart.

What do you believe is behind the rapid growth of the superstore and factory outlet concepts?

Next, locate the **Nontraditional Shopping** chart at the top right of your map. Have someone in your group read aloud the information.

Do you believe these emerging nontraditional shopping methods are an opportunity or a threat to Sears? Discuss this in your group.



Find the building with the chart entitled **Working Women** at the left side of your map. Have someone in your group read aloud the information on the chart.

What impact do you believe these changes will have on retailing in the future?

Locate the **Consumer Time Famine** sign on the digital clock at the upper left of your map. Have someone in your group describe the information.

What changes do you think retailers will face as a result of these perceived time pressures?

Now, locate the **mall building** at the right side of your map. Have someone in your group read aloud the information on the **Shopping Centers in USA** chart.

How has the increased number of stores and amount of retail shopping space per U.S. citizen impacted the competitive scene?

Now, locate the chart entitled **Structural Shift** at the top right of your map. Have someone in your group read aloud the information on the chart.

What do you believe is responsible for these shifts?

Now find the **Retailers' Graveyard** at the the right side of your map.

Why do you think these organizations are no longer in business?

Can you think of any other retailers that could end up in the graveyard? If so, which ones?

What do you think Sears will have to do to stay out of the Retailers' Graveyard?



as any others we work with at Sears. Every year, our accounting firm audits them as closely as it audits our financials.

Deployment

By mid-1995, as we began making the TPI operational, we had invested nearly two years in the transformation of senior management, a group of 100 to 200 people. We now had to build the same kind of ownership and engagement in the entire Sears workforce—a group of 300,000 people—in a much shorter period of time.

As we mentioned earlier, deploying the employee-customer-profit chain and the TPI throughout the company was more than a question of communication. In fact, only a few years earlier, the communication challenge had been the reverse. Before the turnaround, frontline employees sometimes seemed to be the only people in the company who understood that Sears was in trouble with its customers, and somehow they couldn't get the message through to management. Now that the financial turnaround had succeeded, what sales associates needed to be told was not just that the customer mattered but that *they* mattered, too—that the company could not survive without their active help and participation. We needed to take our statistical model in all its intellectual purity and bring it down to earth. We needed to change the perceptions and attitudes of our workforce, augment its grasp of how the business worked, and focus every individual's attention on his or her behavior in front of the customer.

To begin with, employees misunderstood what was expected of them, and that was a real barrier to effective change. Consider the experience of a top-level Sears executive who toured stores across the country and asked hundreds of employees, "What do you think is the primary thing you get paid to do here every day?" In more than half the cases, the answer was, "I get paid to protect the assets of the company." For two good reasons, that answer was a serious problem. In the first place, it is not an answer people would give you if you woke them out of a sound sleep at 2:30 in the morning. Someone had taught them that line. In the second place, it is the *wrong* answer. Sears is a retailer, not Fort Knox. The sort of answer we needed to hear was, "I get

paid to satisfy the customer." And it needed to come from the heart.

Misunderstanding is also a barrier to trust. The same executive asked people a second question: "How much profit do you suppose Sears keeps on every dollar of revenue that goes through the register?" The median response was 45 cents. The real answer was 2 cents. How could we expect people to react well to a variety of necessary changes if they thought the company was rolling in wealth? We decided to address both misconceptions with a program we called "town hall meetings," which included learning maps, dialogue, and action plans.

Learning maps were not original with Sears—they were developed by a company called Root Learning of Perrysburg, Ohio—but combining them with town hall meetings was our own idea. The combination seemed ideally suited to our needs.

Learning maps are easy to use and require no prior training or special skills, yet they draw people into the content, make substantial demands on their analytical reasoning, raise their economic literacy, and increase their understanding of how the company works. Town hall meetings expand that learning and convert it into action.

A learning map is a large picture of a town or a store or, in one instance, a river that leads small groups of participants through a business or historical process. The learning map that appears in this article was designed to walk people through the changing demographics, economics, and competitive circumstances of the retail trade. (See the exhibit "A New Day on Retail Street.") The charts and graphs sprinkled through the picture provide relevant data, and the historical element gives context, but the accompanying questions—for instance, What are the implications for our business and our team?—are meant to stimulate hard thinking about the company's future, not to communicate dogma. Moreover, the maps demonstrate that we trust employees to reach their own sound conclusions.

Every Sears employee from top management on down goes through the learning maps with a group of eight to ten colleagues. Then the group joins other groups for a town hall meeting and action-planning session, which the unit manager opens by saying, more or less, "In light of what you've learned and heard in studying the learning maps, what is

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one thing we could start doing in this store (service center, warehouse, or office) tomorrow to improve our competitive position? Or what could we stop doing? Or what could we simplify?" The only eligible suggestions are ones that can be implemented at the local level, which automatically excludes anything that company headquarters would have to approve. The goal is to reject as few ideas as possible and to act on the others at once, partly because so many of them are surprisingly good and partly because seeing the company take action on your own suggestion is a very positive experience.

We launched the town-hall-meeting process with the Phoenix Team, which now included 60 district managers, in April 1995. Later, the district managers held town hall meetings for their store managers, who then took charge of cascading the process down to the in-store associates. Every map is rolled out at a town hall meeting in the same manner—from the top of the company on down. The second map, "Voices of Our Customers," came along toward the end of 1995 and dealt with the way consumers see Sears and its principal competitors. Our third map, "The Sears Money Flow," appeared in early 1996 and gave employees a look at where revenues actually go and why it is that even today only about 3 cents of every dollar flows all the way through company operations to emerge on the other side as profit. Quite recently, we rolled out a new map called "Ownership," which leads people through the TPI and helps them see how measurement can enable them to do better and more rewarding work.

Town hall meetings are designed to be part of an ongoing engagement process with employees that goes well beyond learning maps. The goal of learning maps is economic and business literacy—but business literacy in the service of the larger goal of behavioral change. We want managers to change their behavior toward employees, to communicate the company's goals and vision more effectively, and to learn to make better customer-oriented decisions, because we cannot do well financially unless we do well in the eyes of the customer. We want frontline employees to change their behavior toward customers—to become more responsive, take more initiative, and provide better service. (To help them do so, we also give them greater decision-making authority. At Sears hardware stores, for

example, sales associates can make refunds and adjustments of up to \$25 in value without approval from their supervisors.) The learning maps were only a first step. Full-scale, meaningful, operational deployment of the employee-customer-profit model and the TPI involved three additional initiatives: a concerted effort to alter leadership behavior, changes in our reward and compensation systems, and a new initiative to bring the benefits of the TPI to departments and individual sales associates.

Changing Leadership Behavior. For managers in particular, a grasp of the TPI is indispensable because the TPI is so fundamental to corporate performance—and therefore to management—and therefore to the selection, promotion, and compensation of managers. We have talked a great deal about those 100 to 200 top-level managers because they are the people responsible for strategic implementation, operations, and resource allocation. But there is more to leadership than resource allocation, however strategic and insightful. We need leaders at every level of Sears who take responsibility not only for the company's business performance but also for the culture that keeps the new model alive and working.

In 1995, consequently, we set about creating a leadership model that would incorporate every aspect of the transformation: the employee-customer-profit chain, the TPI, the three

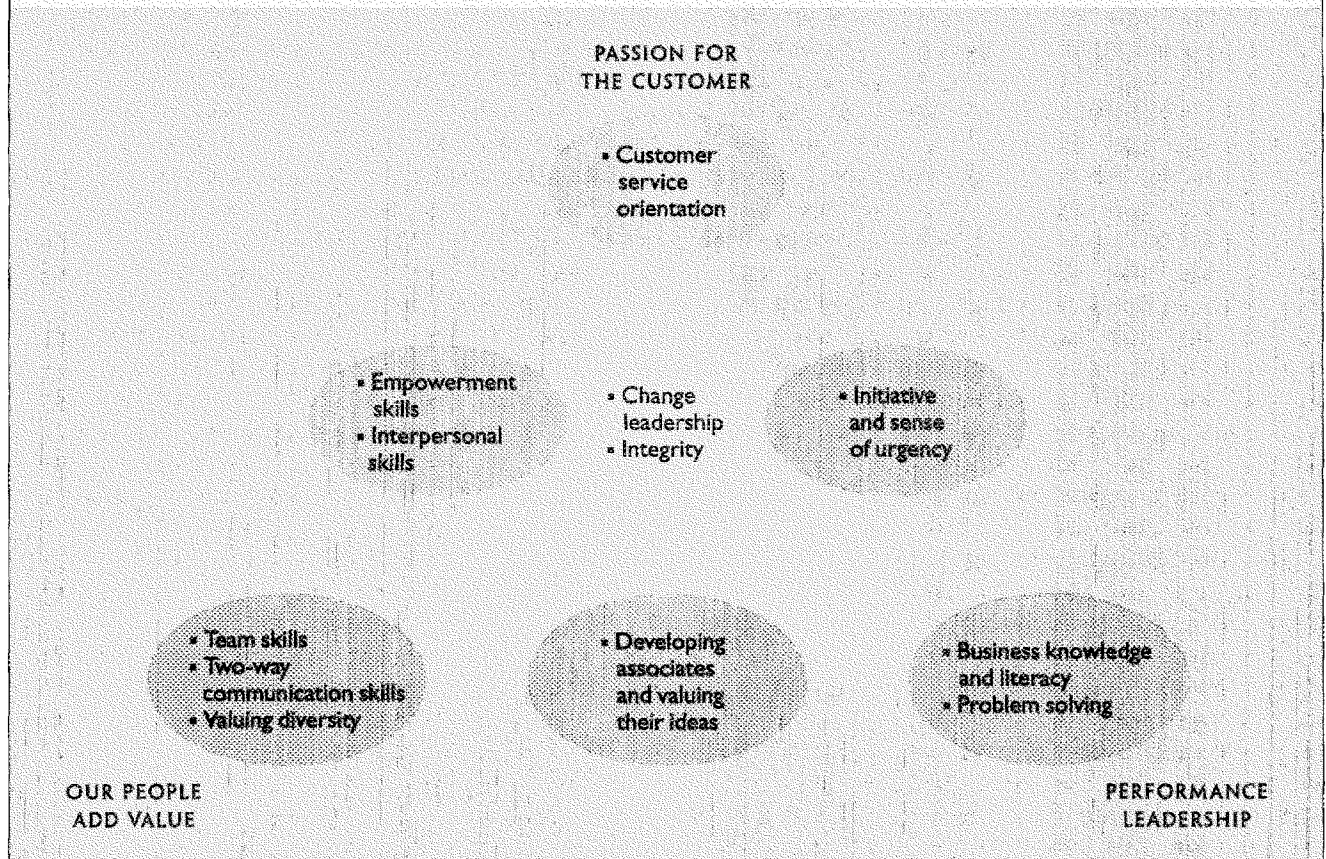
C's, and the three P's—plus, of course, operational competence. Our first step in developing the model was to ask the team of 15 executives at the top of the company to list the skills and qualities they looked for in appraising their own direct reports. We pared that list of 35 criteria down to 12, grouped around the three P's. (See the exhibit "Leadership Skills at Sears.") We announced that all of our 19,000 managers would get an annual performance appraisal by their boss and by small groups of their peers and subordinates. These 360-degree reviews, as they're called, rate managers on the 12 criteria. We use the 12 leadership skills as the basis for promotion, we use them in hiring future managers from college campuses, and we use them in training.

On January 1, 1995, we established Sears University, with a central campus in Chicago, seven regional centers around the country, a permanent staff of instructors, and a curriculum of course offerings in every subject we consider essential to

Executive incentives at Sears are based on nonfinancial as well as financial performance.

LEADERSHIP SKILLS

Every manager at Sears is hired, promoted, and appraised on the basis of these 12 criteria, grouped in relation to the three P's.



the operation of the TPI and the employee-customer-profit model. All courses are also linked to one or more of the 12 leadership skills, which enables managers to identify the programs that will help them meet a specific development need.

Since opening our university, we have trained more than 40,000 Sears managers. We also operate a strategic-retail-management program, which 250 senior executives have attended in groups of about 30 at a time. The program was explicitly designed to create constructive discontent by requiring executives to do case studies of other retailers that have achieved world-class status on some critical dimension of retailing.

Altering Rewards and Compensation. For the 200 managers at the top of the company, Sears took a truly revolutionary step in 1996 by basing all long-term incentives on the TPI. This means that for the first time in any corporation, as far as we know, long-term executive incentives are based on nonfinancial as well as financial performance—one-third on employee measures, one-third on customer

measures, and one-third on traditional investor measures. The board of directors took a leap of faith in agreeing to this plan, which rests on the reliability of the TPI as a leading indicator.

Recognition of the importance of nonfinancial measures has made its way into the annual incentives of nearly all field managers as well. A significant portion of these managers' pay is at risk, based on targeted improvements in customer satisfaction. Moreover, in goal-sharing pilot programs at more than 45 locations, hourly associates are being given the opportunity to earn variable incentive pay that is almost always based on improved customer satisfaction.

Cascading the TPI. Ultimately, if the TPI methodology is to be fully effective, we must make it available at the local unit level. One current step in that direction is a new touch-tone telephone survey that we have now put in place. A random selection of customers receive a coupon worth \$5 toward their next purchase if they will call an 800 number and answer 24 questions about their shopping experience.

rience. Some of the questions are tied to the performance of the company, store, and department; some relate to the behavior of the sales associate; and all are statistically significant with regard to customer satisfaction and retention. The data are aggregated nationwide, but we are beginning to make them available by district, store, department, and, soon, by individual sales associate as well. (The associate's employee number is on the transaction ticket, and the customer punches it in before punching in answers to the questions.) Our goal is to make it possible for managers and their sales associates to have constructive discussions about individual strengths and weaknesses *as seen by the customer*, and we are currently evaluating various approaches to the use of such information so that we can encourage and empower employees at the same time that we give them insight into how they are perceived.

From Employees to Customers to Profits

In one limited sense, the deployment of the Sears model and measures is virtually complete. We use the TPI at every level of the company, in every store and facility; and nearly every manager has some portion of his or her compensation at risk on the basis of nonfinancial measures. In a broader sense, of course, we still have a long way to go.

Deployment, for example, is an unending effort. Normal turnover rates in the retail industry require

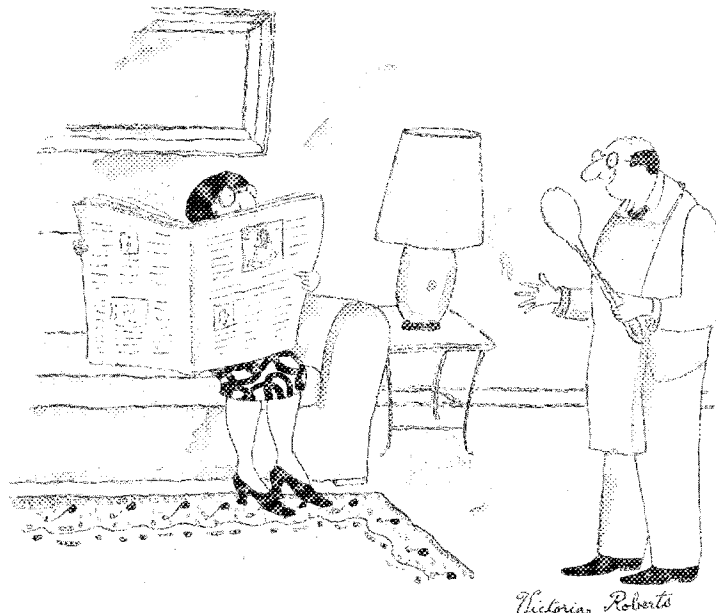
continual reorientation of new employees in both the three C's and the economic literacy maps. Even without turnover, communicating with 300,000 employees at thousands of locations is a challenge.

We have been working at this transformation for less than four years, and it seems to us that our track record so far is remarkable. But how much change can a company the size of Sears absorb in so short a time? And does the system work? Are we changing our employees' and our customers' perceptions of Sears?

To answer that question, let's look at some statistics. Independent surveys show that national retail customer satisfaction has fallen for several consecutive years, but in the course of the last 12 months, employee satisfaction on the Sears TPI has risen by 4%, and customer satisfaction by almost 4%. That may seem a trivial improvement. But if our model is correct—and its predictive record is extremely good—that 4% improvement in customer satisfaction translates into more than \$200 million in additional revenues in the past 12 months. At our current after-tax margin and price-earnings ratio, those extra revenues increase our market capitalization by nearly one-quarter of a billion dollars. Even more impressive from our point of view is what our model tells us: it is our managers and employees who, at the moment of truth in front of the customer, have achieved this prodigious feat of value creation. ♡

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"Hear ye! Hear ye! The onions are caramelized."