Best Practice

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A great place to shop, work and invest: Measuring and managing the service profit chain at Sears Canada

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Abstract
Sears Canada's corporate goal is clear: to be a great place to shop, work and invest. Since 1997, Organizational Studies (a subsidiary of Carlson Marketing Group) has worked with Sears Canada to validate and align their measurement system with strategy. On a quarterly basis, Sears Canada publishes total performance indicators (TPI), a balanced scorecard containing measures of customer and associate (employee) loyalty as well as traditional financial indicators of corporate performance. By confirming the relationship between the associate, customer and financial metrics through empirical research, they ensure that their scorecard tracks the measures that matter. Furthermore, by tracking the value of intangible assets, they capture a greater proportion of their overall capital in their measurement system. Their comprehensive scorecard can protect them against short-term thinking encouraged by lagging financial measures alone. Sears Canada's strategic measurement system thus serves as the framework through which their entire management system operates.

Keywords: employee relationships, measurement, linkage performance improvement

Background

Value for customers resides with employees

In 1993, Sears Canada (herein called Sears) faced rising competitive pressures as well as corporate losses for the first time in its 40-year history. In response, Sears radically altered its corporate strategy by rebuilding the company around its customer. Recognising that the energy, commitment, ability and willingness to create value for customers resides with its associates, Sears adopted what Heskett *et al.*[1] refer to as the service profit chain. The service profit chain is a business process model linking corporate profit and growth to 'soft' aspects of employee satisfaction and customer loyalty. The associate-customer-shareholder model at Sears is reflected in their goal of being a great place to shop, work and invest and in the belief that engaged and loyal associates create loyal customers, who, in turn, create satisfied shareholders.

Accordingly, since 1997 Sears has included associate and customer indicators along with its financial indicators in the total performance

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indicators (TPI) published on a quarterly basis and distributed to every associate. The TPI is an integrated 'balanced scorecard' used to monitor, guide and inform associates and shareholders about the corporate strategy.

Employee satisfaction is a predictor of customer loyalty

There is considerable evidence demonstrating that customer loyalty is a leading predictor of financial results, and that employee satisfaction is predictive of customer loyalty. Research conducted by Organizational Studies[2] has demonstrated a strong and consistent relationship between employee engagement and profitability in a number of industries. In economic terms, Reichheld[3] has shown that raising customer retention rates by 5 per cent can increase the value of an average customer by between 25 per cent and 100 per cent. Arguably, customer loyalty may be a more important predictor of profitability than market share. For example, over the past 25 years, Southwest Airlines has never ranked higher than seventh in terms of market share in North America, but has consistently been the most profitable company in their industry.

Customer loyalty leads to financial success

While there are several strategies an organisation might employ in order to raise customer loyalty, perhaps the most powerful is to engage and inspire employees to serve the customer better. Research conducted by Schneider and Bowen[4] was among the first to demonstrate that employee satisfaction was related to customer satisfaction. Based on a replication of their findings in personnel from the banking industry, Schneider and Bowen[5] concluded, 'The degree to which employees believe their work is facilitated [an expression of satisfaction] yields the most consistent information about customer satisfaction.' In 1999, Carlson Marketing Group[6] examined the determinants of customer-preferred stores across four industries: department stores, supermarkets, financial institutions and petrol stations. Customers identified friendly and helpful staff as a more important determinant of their choice of store than product price or quality in all industries except petrol stations. The research also demonstrates that the customers' impression of the quality of the staff affects their perception of the company in other important ways. Customers who have a positive interaction with staff are more likely to rate the company as trustworthy, having a positive image, able to recognise their needs and going the extra mile to meet those needs. Clearly, effective staff have an important influence on customers' impressions. This is crucial, since there is often more room for organisations to differentiate themselves on service excellence than on product, price or quality.

Measurement: The enabler of strategic management

Between 1986 and 1995, the stock prices of service profit chain firms grew nearly twice as fast as those of their competition.[7] The conference board report, *Case Studies in Strategic Management*,[8] includes research indicating that companies which have adopted balanced measurement systems enjoy the following:

Research of successful companies

- they are perceived as being industry leaders;
- they report better teamwork among management personnel;
- they see more risk taking by employees;
- they were more likely to judge their last change effort as successful.

Given the overall appeal and executive support for the concept of the service profit chain business process, why have some companies, like Sears, been so successful in adopting the framework while others have failed? An important part of the answer lies in measurement. Many organisations have failed to adopt the framework because they fail to measure it; that is, they persist in measuring corporate performance primarily on the basis of financial measures, which constitute only one of the three components of the service profit chain. By focusing on financial indicators alone, economists from the Brookings Institute estimate that such organisations measure less than 40 per cent of their capital — the remainder includes intangible factors such as employees, knowledge, brand image and customer relationships. In *The Balanced Scorecard*, Kaplan and Norton[9] argue that the sole measurement of financial performance is inadequate for other compelling reasons. Financial measures are lag indicators that provide a 'rear-view mirror' approach to measuring corporate performance; that is, they measure where the organisation has been but cannot predict where the organisation is going over the longer term. With employee and customer data that are proven predictors of financial performance, an organisation can anticipate profitability in the future. Also, focusing exclusively on financial indicators tends to encourage short-term solutions to 'get the numbers up' even when those short-term solutions may mean lower employee and customer loyalty, which, in the long run, may have detrimental effects on profitability.

It's more than financial measures

By measuring the value of each of its stakeholder groups, only then can an organisation truly adopt a balanced strategy. Sears, in adopting an integrated balanced scorecard that measures the intangible capital possessed by its associates and customers, captures a greater proportion of the company's overall capital. This balanced scorecard protects the company against short-term thinking encouraged by using financial measures alone. Employee and customer indicators enable companies like Sears to set goals for the long term and develop the capabilities needed to create customer value and improve financial results over time. Rick Brown, vice-president of strategic planning at Sears Canada, argues that the TPI has transformed Sears from a cost-cutting culture to a growth culture, where greater resources are allocated towards initiatives that create greater value for associates, customers and, ultimately, shareholders. In fact, Sears's initial response to its first corporate loss in 1993 was to cut costs through downsizing and re-engineering of its procurement process. The strategy worked over the short term, but the company was continuing to lose market share. It was at this time, Brown says, that 'We realised that we couldn't shrink ourselves to greatness.'

Long-term thinking

Other companies may be slow to adopt a balanced scorecard measurement due to discomfort or lack of confidence in 'soft', non-financial measures. In fact, most executives express very little confidence in the measurement of employee and customer-related variables. In a recent survey, 85 per cent of executives said they value customer service data, but only 29 per cent believe in the quality of the data; 67 per cent of executives said they value employee performance data, but only 16 per cent believed in the quality of the data.[10] A second related explanation concerns the difficult task of defining, collecting and validating the soft measures on the balanced scorecard. Sears has invested considerable time and effort in developing the performance indicators of associate and customer loyalty. Through executive buy-in of performance indicators, a well-organised survey programme and predictive validation of the strategic indicators, Sears has managed the difficult task of measuring the intangible aspects of organisational performance.

The total performance indicators

The product of Sears' measurement system culminated in the 1997 introduction of the total performance indicators, a balanced scorecard including associate, customer and financial indicators. Measures are taken on a quarterly basis and are reported to each of Sears' 50,000 associates. The following section describes the measurement of Sears' ultimate goal: to be a great place to shop, a great place to work and a great place to invest.

A comprehensive approach

A great place to shop

Sears' criteria for a great place to shop are to:

— provide great merchandise at great value;
— provide excellent customer service from the best people;
— make Sears a fun place to shop;
— achieve excellent customer loyalty.

In order to measure these criteria, Sears created the customer loyalty index (CLI), a three-question index. The measurement of loyalty was a modification from the previous survey instrument, which measured satisfaction, an attitude that is less predictive of short- and long-term financial returns.[11] In addition to measuring customer loyalty, Sears measures attributes of the shopping experience that drive customer loyalty, as well as demographics that allow Sears to segment their customer population strategically and understand their specific needs. Customers are surveyed by randomly calling a sample on a monthly basis, then rolling these results into the quarterly TPI scorecard. They continuously set short-term stretch goals towards this achievement.

A great place to work

In becoming a great place to work, Sears has three primary objectives:

— create an environment for personal growth and development;
— provide support for ideas and innovation;
— empower and involve teams and individuals.

Sears measures these objectives using the associate loyalty index (ALI), a five-question index measuring associate engagement and loyalty that closely parallels the customer loyalty measurement. In 2000, the ALI replaced a 24-question index referred to as the associate satisfaction index

(ASI). The ALI is administered on a quarterly basis to all associates. While the ALI is published along with the other performance indicators in the company TPI scorecard, each department, unit and store receives an ALI score for their group on a quarterly basis. Sears sets short-term stretch goals towards increasing overall associate loyalty.

The Sears annual census survey also measures attributes of the Sears environment that drive associate loyalty, as well as demographic questions that allow Sears to understand the specific needs of different groups. It is then the responsibility of managers to develop action plans to address their developmental areas, as identified in the survey results.

By reporting ALI scores at every level in the organisation, Sears has developed an agreed-upon overall associate metric. Any change initiative implemented at a corporate-wide level or in a single department can be evaluated according to its ability to raise the ALI. Survey results, as well as the statistically derived key drivers of the ALI, are communicated to every manager at Sears. Unlike other organisations where managers are unable to track the impact of their change initiatives, managers at Sears receive quarterly updates about the engagement and loyalty of their associates. They can use this information to modify their action plans, since they are rewarded on achieving and maintaining high ALI scores.

A great place to invest

In its visioning process, Sears established three financial objectives:

— revenue growth;
— superior operating growth;
— efficient asset management.

The financial objectives are measured using traditional financial measures: earnings before interest and taxes (EBIT) to measure operating growth, and return on capital employed (ROCE) to measure asset management and revenue growth. Each of these measures is reported in the quarterly TPI, alongside measures of the non-financial indicators measuring great place to work and great place to shop.

Establishing the linkages between Sears' total performance indicators

The 'Value Equation'

By translating the corporate mission into a balanced set of measures, the total performance Indicators serve to communicate, track and stimulate progress towards Sears' corporate goals. In addition, the measurement system allows Sears to assess the worth of loyal associates and customers. Statistical modelling in 1999 has resulted in what Sears calls its value equation: every five-point increase in associate satisfaction is related to a 1.7 per cent increase in customer loyalty, which, in turn, is associated with a 3.4 per cent increase in earnings before interest and taxes (EBIT).

This 'linkage' work not only validates the soft measures but also enables Sears to estimate their impact on financial performance and to set goals for associate satisfaction and customer loyalty. Figures 1 and 2, respectively, illustrate the strong relationships between customer loyalty

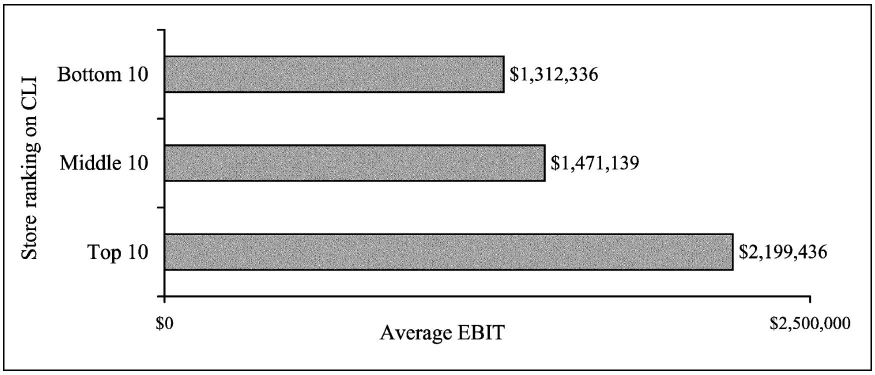

Figure 1: Earnings before interest and taxes (EBIT) by store rank on customer loyalty (CLI)

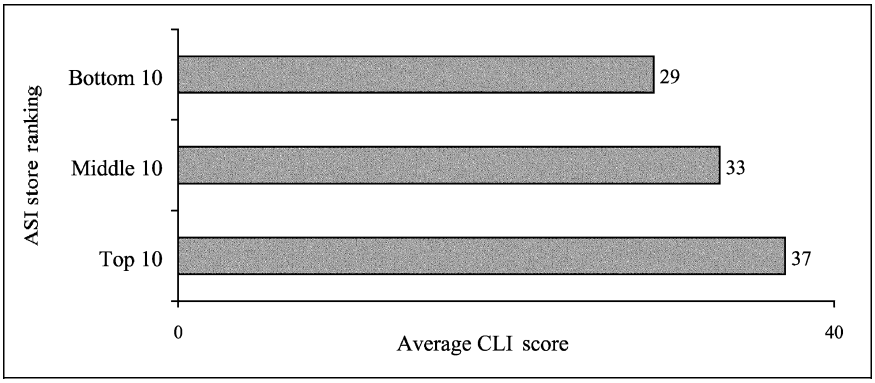

Figure 2: Customer loyalty by store rank on associate satisfaction

and financial performance and between associate satisfaction and customer loyalty. Figure 1 shows aggregated 1999 earnings before interest and taxes (EBIT) for Sears' bottom, middle and top ten performing stores on customer loyalty (CLI). At Sears, the relationship between customer loyalty and EBIT is strong, particularly at its high point. Customer loyalty scores for eight of Sears' top ten stores exceed that of their external benchmark, Nordstrom. The bottom line for the average Sears store is that, by leveraging customer loyalty and raising it to that of their top performing stores, the store could expect to increase their EBIT by an impressive 50 per cent.

Earnings can increase by 50 per cent

The other link in the associate-customer-shareholder model is the link between associate satisfaction and customer loyalty. At Sears, associate satisfaction is highly related to customer loyalty, which, as shown above, is highly related to financial results. Figure 2 shows aggregated customer loyalty scores for Sears' bottom, middle and top ten performing stores on the associate satisfaction index (ASI). The pattern is quite clear: customer loyalty is higher in stores where associates are more satisfied. Customer loyalty within these top ten stores is impressive: on average, the stores fall just three percentage points below the Nordstrom average for customer loyalty.

The pattern is quite clear: customer loyalty is higher in stores where associates are more satisfied. Sears is now in the process of conducting internal benchmarking, a process likely to prove fruitful given the quality of information and assistance available for engendering associate and customer loyalty within the organisation.

How you can make the service profit chain work for you

As outlined in this case study, Sears Canada has demonstrated what happens when an employee-customer-profit model is established within a business. For Sears Canada, it is imperative that it ensures safeguards (performance management systems) and incentives (variable pay plans) are in place so that every associate is working towards the objective of Sears being a great place to work, shop and invest. The important thing is to have overall metrics that assess your employees and customers that you can gauge on a regular basis and strive to improve over time. Clearly, the Sears example inspires us to live what we already know intuitively: employees can have a significant impact on customers and on the overall profitability of your business.

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