

Regaining Market Leadership At
Sears, Roebuck and Company



Perhaps there is no greater example of a turnaround of a business than was achieved at Sears. Much has been written about how Sears has achieved its critical turnaround. Here is a company that is huge and complex, facing a changing marketplace and changing customer values. In this case study we will focus on how a variety of reward systems, some formal and others informal, were integrated by a set of clear themes to support the change process. In this way, we can understand how Sears was able to be successful and build fundamental commitment of its people.

Discovering the Need for Fundamental Change

For decades Sears has been part of the American culture, growing along with the country from its founding in 1886. People had personal relationships with the company and found great value in buying from its stores and catalogs. The structure of the market remained basically unchanged year after year, through the 1950s and 1960s, though the sheer volume of retail outlets increased dramatically. This long history of success and leadership may have blinded the executives, managers, and professionals about the crisis that awaited them. The problem with being successful, and being highly rewarded for it, is that a company may become oblivious to competitive change and deny the pressures growing around it. In the early 1970s, something fundamental began to change in the retail market. Sears started seeing companies like Kmart and specialty retailers providing customers with comparable products at lower costs, greater choice for items of special interest, or service levels that were qualitatively different from what people received from large department stores.

People began to change their primary retail store as an unprecedented and a number of choices started presenting themselves. For Sears, there was no single competitor. Instead, it started facing a variety of niche players, each one finding and fully meeting the needs of a particular set of customers. They provided services in a superior fashion and changed customers' traditional buying patterns. Sears did not rest during this time; it tried many strategies to regain prominence. It offered sales to compete on price and even changed pricing policies to "everyday fair pricing" in response to customer mistrust of sale prices (the customers stayed away). Sears opened stores in malls around the country and closed stores that were not showing signs of growth. It introduced many marketing and merchandising strategies, only to find that few of them worked for long. Sears was being attacked from all sides, and it was having trouble sustaining market leadership.

In 1992, Sears had sales of more than \$33 billion and more than 300,000 employees. While this size enabled Sears to remain the major force in the retail industry, it wrote off \$2.3 billion, more than the total revenues of most major companies in the United States. Sears hired Arthur C. Martinez as the new chairman and chief executive officer. His challenge was to turn this major enterprise around so that it could address the needs of a new marketplace and a new customer preference and do so predominately with the same people, store locations, and infrastructure.

Implementing a Strategy for Change

While much can be written about the renewal of Sears, there were several key strategies that emerged to guide these efforts. First, the company needed to reduce costs and align the cost structure to the revenues of the company. The actions to support this strategy led to the closing of the 101-year-old Sears catalog operations, as well as more than 100 stores, and downsizing thousands of employees. The financial and real estate companies Sears had acquired in the 1980s were divested so that the company could focus on its core business of merchandising. Second, the company needed to regain the confidence of customers and employees that Sears was an attractive place to shop. Only active executive leadership, not restructuring activities or policies, could do this. In April 1993, the CEO took a group of more than 50 executives for an offsite meeting to review the business and set a new course for the company. He directed the meeting and engaged each executive in facing the new realities of the business. The output of the meeting was an articulation of five strategic imperatives for the company's turnaround:

1. Become a compelling place to shop.
2. Develop a local market focus.
3. Focus on core business.
4. Build a winning culture.
5. Seek continuous improvement in costs.

These goals persisted throughout the first five years of Sears's turnaround, but they were distilled into a simple, memorable vision statement: Sears wants to be a compelling place to shop, a compelling place to work, and a compelling place to invest. These "3Cs" formed the basis for major organizational change. To implement these concepts, the executives began a process of engaging people from all corners of the organization to explore what could be done to improve the organization in these three areas. Through surveys, focus groups, and other intensive dialogues, thousands of people were brought into the process of change. As ideas came forward, they were not dismissed. Task forces were created and led by managers from all areas of the company.

People who had been hidden from senior management had opportunities to demonstrate their leadership and commitment to reshaping the organization. Those who waited for the change to pass became evident as well. Finally, as the process of change unfolded, two factors worked in Sears favor. First, it did not need to convince people that change was needed or important.

People were ready for new leadership and wanted to improve the performance of the company. Second, the marketplace still had a positive, trusting image of Sears as a good and honest place to shop. It still owned most of the “hearts” of the marketplace, though rapid change was needed to sustain that relationship.

Finding the Drivers to Focus Organizational Transformation

Throughout these change efforts and subsequent senior leadership meetings, a consensus was building on what was needed to be successful. The company had years of data on its financial operations, customer preferences and attitudes, and employee opinions— three data sources for which to measure progress on the 3Cs. It analyzed these factors to determine if there could be a connection, and if this could form the basis for renewing the organization. Through a yearlong process of statistical analysis, it was shown that there was indeed a strong correlation between the three factors of the business.

The company observed the following:

- Employees who were valued for their contributions behaved in ways that would . . .
- Lead to improved customer satisfaction and retention, which would . . .
- Create attractive financial returns and make Sears a good place to invest.

These three factors—employees (a compelling place to work), customers (a compelling place to shop), and shareholder returns (a compelling place to invest)—would lead Sears into a strong leadership position in the market. The executives intuitively realized that the way people were treated would directly be manifested in customer relationships and that customers would determine the company’s financial results, though the empirical connection took a good deal of work to conclusively demonstrate. Following this logic, the company developed a balanced scorecard of performance measures and used these to link all reward systems into an integrated management process. These became known as the Total Performance Indicators (TPI).

Over the years the company has continued to refine the measurement systems to capture employee/customer/financial results. It uses these factors to establish major “audacious” goals as well as integrate them into all incentive compensation plans. To illustrate, this model, which is based on rigorous correlation analysis, determined that a 5-point improvement in certain employee attitudes would drive a 1.3-point improvement in customer satisfaction, which in turn would drive a 0.5% improvement in revenues.

As applied to a typical store, a 5% improvement in employee satisfaction would result in a \$150,000 to \$200,000 increase in store revenues (and as model refinements are made, the bottom-line impact appears even stronger). Managers could apply this analytical framework to the overall company as well as at the store level. Hence, Sears found a clear, integrated tool to manage the performance of the company.

Changing Behavior

All the concepts and strategies, models and measures, would be of little value if they did not result in changing behaviors throughout the organization. The organization is composed of the actions that people take. If Sears was to ultimately be successful, people needed to embrace the changes and see a personal benefit for improving the results of the company. The payback needed to go beyond just keeping one's job. People would need to understand, be trained, and receive reinforcement continually for their contributions to improve performance. Sears took a bold and multifaceted approach. In 1996 it made a truly revolutionary step of basing all long-term incentives on the three key measures of employee satisfaction, customer loyalty, and financial results. This involved more than 200 senior managers. Their three-year incentive plan awards were based on a balance of improvements—one-third on employees, one-third on customer measures, and one-third on investor measures. The board of directors took the leap of faith of supporting this plan even though the employee and customer metrics were still being refined.

Then, these metrics were cascaded down through the organization to every associate. A significant portion of the manager's variable pay was based on target improvements in these three areas. This carried down through the district managers responsible for a major area of stores. Each manager had accountability for improvements in these factors or sustaining them at high levels of performance. In addition, initiatives were begun to engage all employees in the process of business planning and reaping the rewards of success. Sears had had a profit-sharing program since 1916. While stores had long been rewarded on their financial performance, the TPI measures expanded the focus to employees and customers as well. Finally, all 15,000 salaried associates are participating in the company's stock option program. Sears is making "owners" of its managers and professionals and is expanding that ownership to all employees through a discounted stock purchase plan.

Charting the Future of Change

We have witnessed at Sears a process of discovering what drives the success of the business. The company has then implemented these processes throughout the organization.

The results over the past five years can speak for themselves:

- Revenues have increased by more than 15% (to more than 42 billion).
- Net income has increased from a loss of \$3 billion to a gain of \$1.3 billion.
- Earnings per share have gone from a loss of \$7.02 to a gain of \$3.12.
- Employee satisfaction, as surveyed, increased at comparable levels.

Customer satisfaction scores have increased 4% while the comparative industry data has remained flat; from 1995 to 1996, customer satisfaction jumped 5.6%, more than twice than other retailers.

The involvement process has been key to Sears's success. The strategy was simple, clear, and related well to the needs of the managers and associates. The reward systems have provided the personal stake for each individual to make contributions to the turnaround efforts. Sears has once again emerged as a leading retail company. Now the efforts of change are focusing on continuous improvements. The process of change is an unending process; there is no finish line. In many competitive industries making change is not as important as the rate of change; one needs to continually stay ahead of the improvements made by one's competitors.

Sears is now facing the challenge of sustaining the momentum of change. They clearly have the building blocks and systems to implement a competitive strategy. And what has evolved is a company that is now ready for new market opportunities, as long as complacency does not emerge within the culture of the new Sears.