

# *The Loyalty Effect*

essays

on the  
relationship  
between  
loyalty and  
profits

loyalty and  
**learning:**  
overcoming  
corporate learning  
disabilities

essay # 1

**BAIN & COMPANY**

# loyalty and **l e a r n i n g** : overcoming corporate learning disabilities

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Why can't companies learn? In the early 1970's we used typewriters and carbon paper, personal calculators were expensive toys, and cellular phones were unknown. Now, twenty years and billions of dollars later, we have personal computers, faxes, voicemail and all manner of information systems and networks. The paradox: productivity, the best measure of organizational learning, continues to languish. Somehow, as technology and information advances have accelerated, personal productivity and learning have stalled.

This stall-out is not for lack of energy or desire. Business managers are constantly striving to improve productivity because of its bottom line impact. In addition to technology and information system investments, they have flattened their organizations, gotten closer to their customers, and competed on time. They have partnered with their suppliers, cut costs, and worshiped at the altar of Quality. Why hasn't productivity skyrocketed? Why can't organizations learn?

Today's accounting systems—the measurement framework which defines corporate reality and focuses organizational energy—have changed little since they were developed to meet the learning requirements of 19th century steel and textile manufacturers.

When so much energy and so many resources get hurled at a problem and have such little impact, it may mean the problem needs redefinition. Most business people, without knowing it, see the service world through the lenses of manufacturing goggles. They are influenced by historical traditions in business training, strategy techniques and organizational theory, all rooted in manufacturing. Today's accounting systems—the measurement framework which defines corporate reality and focuses organizational energy—have changed little since they were developed to meet the learning requirements of 19th century steel and textile manufacturers.

But today, 75% of our economy is made up of services. Where experience and learning once grew out of the relationship between man and machine, in services, it grows out of the relationship between employee and customer. Most firms' measurement systems, incentives and rapid job-rotation career paths ensure that this relationship rarely has time to mature. Meaningful learning is blocked.

In the 1990's, knowledge and experience cannot be captured in the architecture of a machine or the process design of a factory. It is trapped in the minds of employees and customers, built through their daily interaction to create and consume value. What drives productivity is not the cumulative experience of a firm in world-wide widget production, but instead, experience learned within specific employee-customer pairs.

In manufacturing, total quality programs have revitalized organizational learning and productivity. Service companies have invested in similar quality programs but success has been limited; witness the continuing malaise in service productivity. Should service firms just push harder on their current quality programs and invest even more in technology? Or is it time to rethink what quality means in a service company? We believe services require a new quality paradigm in order to renew productivity growth.

What is the key to productivity growth in the service world? The answer is employee and customer retention. The most important assets of a firm are its experienced customers and employees. And yet, American companies lose 10-20% of these assets every year—thus washing out most of the knowledge and experience in their human business system every five to ten years! In services, total quality means managing toward zero defections of customers and employees. The challenge for service executives is to recognize the shortcomings in their measurement systems, incentives, career paths, culture and strategies and to re-orient them to prevent customer and employee churn.

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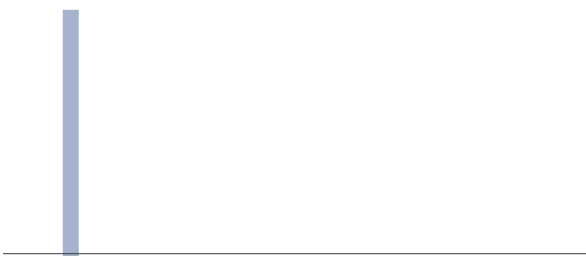
Leading companies have discovered that by retaining their good employees, learning is unleashed and continuous improvements in productivity can be achieved.

When companies have harnessed the power of customer and employee retention, they have achieved impressive results. USAA Insurance, for example, has pursued a twenty-year quest to reduce employee and customer turnover. Over a five year period, while leading its industry in customer retention, USAA reduced employee turnover by over 40% from 12% in 1985 to 7% in 1990. In the same period, productivity grew by 23%.

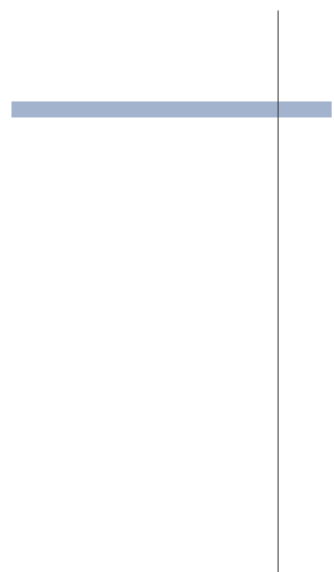
The paradigm works in other industries as well. In advertising, Leo Burnett has the lowest defection rates and it leads its competitors in productivity by more than 15%. In the grocery business, employee turnover explains more than 90% of the variation in productivity among large supermarket chains.

Leading companies have discovered that by retaining their good employees, learning is unleashed and continuous improvements in productivity can be achieved. By examining their people defections, just as the best manufacturing firms examine product defects, firms can discover and eradicate the underlying root causes. This process decreases the rate of knowledge loss from customer and employee defections. The resulting increase in organizational learning drives cost reduction and revenue growth.

If the United States is to regain its competitive-  
 ness, our service companies must overcome  
 their learning disabilities. They must abandon  
 traditional thinking about quality and productivity.  
 Manufacturing tools and technology investments  
 may be helpful, but they are not sufficient.  
 World class performance requires service  
 companies to re-engineer their learning systems  
 so they can earn the loyalty of customers and  
 employees. The investment has already been  
 made in technology and information systems.  
 To make it pay off, leaders must develop the  
 processes, systems and strategies to allow their  
 companies to manage toward Zero Defections®  
 performance—the hallmark of a learning and  
 productive company.



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**By Frederick F. Reichheld  
and Robert G. Markey Jr.,**

*Frederick F. Reichheld is a Director of Bain & Company, a leading global strategy consulting firm, and leads its Loyalty/Retention Practice. Reichheld is the author of "The Loyalty Effect" (Harvard Business School Press, 1996) and a frequent speaker to major business forums and groups of senior executives. Robert G. Markey Jr. is a Vice President in Bain's Boston office.*

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For more information, contact:

Linda Polmear

Bain & Company, Inc.

Two Copley Place

Boston, Massachusetts 02116

(617) 572-3277