

The Loyalty Effect

essays

on the
relationship
between
loyalty and
profits

in
search
of failure

essay # 3

BAIN & COMPANY

in search of failure

Here's a test. Over the last ten years, who would have become richer: an investor who built a stock portfolio out of the companies profiled in *In Search of Excellence*, or someone who merely matched the mediocre performance of the S&P index?

Believe it or not, mediocrity beat out excellence. In fact, two-thirds of the stocks of the publicly-traded "excellent" companies have under-performed the S&P 500 over the last decade!

"Give me a fruitful error any time, full of seeds, bursting with its own corrections." Vilfredo Pareto (1848-1923)

The Siren Song Of Success

First published in 1982, *In Search of Excellence* became the bible for a whole generation of managers. It sold five million copies and spawned a new genre of business books claiming to unlock the doors to success. The research behind the book represented the best thinking of the business establishment and included a painstaking analysis of 25 years worth of data. A Who's Who of business leaders and thinkers provided their input, and endorsed the book's ideas. In the tradition of American management "science," theories about the drivers of business success were developed by studying high-performance companies.

But ten years later, several of the companies highlighted have stumbled badly. A few are close to extinction. The majority are laggards in the stock market. And the authors acknowledge that only one-fifth of their original group remains "excellent" today; the remaining companies fall somewhere along a continuum from just "good" to downright "bad."

How on earth could this have happened? Success breeds success—right? So why did *In Search of Excellence* turn out to be a castle built on sand? People who study systems could tell you. When a system is working well, they say, it's impossible to explain why. Its success rests on the effective interactions among its subtle chain of countless rings. Which links are most important is not easily determined. Even if the key links were identifiable, their importance would change as the world around the system continued to evolve through time. That is precisely the problem with *In Search of Excellence*: While undeniably entertaining, it cannot by itself help anyone achieve (or sustain) the model of excellence it portrays.

Far too much of today's management science is based on theories which speculate on the causes of historic successes. The truth is, organizations are obsessed by success. But they should focus on failure instead. That is the paradox at the heart of organizational learning.

In a very different field, Warren Buffett, one of the most successful investors in the world, has concluded there is more to be gained by studying business failures than business successes.

Fear Of Failure

Most people understand intuitively that the greatest learning in life flows not from our successes, but from our mistakes. And systems experts would attest that when a component fails, it can cast a spotlight on the workings of an entire system, pinpointing corrections that must be made.

The airlines understand this. Airline performance in the U.S., as measured by fatality rate, actually exceeds “Six Sigma,” the demanding standard of quality pursued by many companies today. Six Sigma means 3.4 defects per million opportunities. As far as we know, the domestic air transportation industry is the only one to beat this standard. How come? When a plane crashes, investigators retrieve the flight recorder (the black box) and spend millions of dollars, if necessary, to find out what went wrong. The result is that in an extremely complex operating environment, accidents have become relatively rare.

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He says, “In my business, we try to study where people go astray, and why things don’t work ... [We] start out with failure, and then engineer its removal.” Similarly, Japanese manufacturers treat a defect as “a gift” and use failure analysis to continuously improve their operations.

If failure analysis works so well, why don’t more companies do it? Psychologically and culturally, it’s difficult and sometimes threatening. Failures are often examined for assigning blame, rather than detecting—and eradicating—the systemic causes of poor performance. Underlying the airlines’ outstanding safety performance is the fact that the decision was made to install black boxes in the first place. Someone, somehow, was able to get over the natural human fears: not just our fear of failure, but also our fear of analyzing failure.

Scale Your Failures

The difficulty of measuring failures is a further obstacle to organizations' learning from them. When you're on the edge of Terminal Failure—like bankruptcy—it's probably too late to become a learning organization! So the manager's challenge is finding the right ongoing scale—or unit of failure—to become the focus of the organization's analytical, tracking and improvement efforts.

Take a look at the best football teams in the NFL. Do the most successful coaches study the game highlights tape, as seen on the Ten O'Clock News? Of course not. Highlights are entertaining, but a good coach concentrates on searching out failures, even in victory. And for him the relevant units of failure are penalties, missed assignments, interceptions and the like. Those are what the coach and players review and discuss and what become the focus of the week's practice. Even a Superbowl season is full of instructive failures.

From Zero Defects To Zero Defections®: The MicroScan Story

In the business arena, we have found that one of the most illuminating units of failure is customer defection. When desirable customers defect, it's a signal that something in the system is amiss. In a learning organization, the departure of such a customer prompts a search for the root causes of the problem to learn more about what needs to be fixed in the business, and if possible, to re-establish the customer relationship on firmer ground.

There is a strong temptation to rationalize, of course: "Well, he wasn't really a good customer and we didn't want him anyway." Rationalization is but one of the ways to fail at failure analysis.

The MicroScan division of Baxter Diagnostics, Inc. is a successful company that faced up squarely to its failings—and has become even stronger and more profitable as a result. MicroScan is in the business of automated microbiology. It makes the sophisticated instruments used by medical laboratories to identify microbes in patient cultures and determine which antibiotics will eliminate these "bugs" most cost-effectively.

In mid-1990, MicroScan was neck-and-neck with Vitek Systems, Inc. in the race for market leadership. Both companies were growing rapidly, converting customers from manual testing methods and edging out other manufacturers of automated equipment. MicroScan had worked hard to improve quality and considered applying for the Baldrige Award.

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But first (perhaps because of its experience in diagnosing bugs inside the human body), MicroScan understood the value of applying powerful diagnostic techniques to itself and decided to identify the bugs inside its own business system.

The management team recognized that they could learn a lot by understanding why they were losing business. They analyzed their customer base, highlighting accounts that had been lost as well as those that remained active but showed a declining volume of testing. MicroScan interviewed every one of the lost customers and a large number of the “decliners,” probing deeply for the root causes underlying their change in behavior, especially when they defected to alternative testing methods.

The picture that emerged was clear, instructive, and somewhat painful to behold. There were concerns about MicroScan’s instrument features, their reliability, and the company’s responsiveness to customer problems. MicroScan managers overcame their natural feelings of denial and acted decisively on what they had learned.

They shifted R&D priorities to address specific shortcomings that customers had identified, such as test accuracy and time-to-result. They accelerated the development of a low-end model and brought it to market in record time, having learned that their instrument line was unsuitable for many smaller labs. They also redesigned their customer service protocols to ensure immediate attention was given to equipment faults and delivery glitches.

MicroScan’s willingness to learn from failure has paid off: Two years later, it has pulled away from Vitek to achieve clear market leadership and enjoys the bottom-line benefits that flow from it. Tracking and responding to customer defections has become a central part of MicroScan’s approach and a model for other Baxter divisions.

Summary

Sustained excellence will be found only through a perpetual search for and understanding of failure. A successful organization must learn how to learn from its mistakes. Like a winning football coach, the manager of a successful organization does not pursue nebulous theories of excellence—nor does he wait for disaster before adjusting his strategy.

He defines the right units of failure—such as customer defections—tracks them, analyzes them and helps his people to learn from them. For he knows: The candles of failure will light the pathway to excellence.

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Bain & Company serves clients through an 18-country network of 25 offices across six continents. Since 1973, Bain has worked with over 1500 major multinational and other corporations, from every economic sector, in every region of the world, to improve bottom-line results.

Through its diverse client assignments and research, Bain has developed an immense experience base, covering a broad range of critical business issues; together with original, proven methods and powerful tools to successfully address them. Bain is known for conceiving customized, creative and often breakthrough strategies wholly unique to each client's situation. Quantum leaps in performance are a frequent outcome.

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