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Identify Critical Factors to Turn Workforce Satisfaction into Bottom-Line Results

Center for Advanced Human Resource Studies

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Abstract

KEY FINDINGS

· While practitioners and researchers assume that higher employee satisfaction equals higher sales and profits, analysis shows that there is no direct link between the two.

· Between the beginning point of employee satisfaction and the endpoint of profitability lie three crucial intervening factors: employee retention, employee responsiveness to customers, and customer satisfaction.

· By understanding the interplay among these factors, organizations can target their HR efforts to positively affect the bottom line.

Keywords

Employee Engagement, HR Strategy, Financial performance, employee satisfaction, retention, customer satisfaction

Comments

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Identify Critical Factors to Turn Workforce Satisfaction into Bottom-Line Results

THE TOPIC: DO HAPPY WORKERS EQUAL BIGGER PROFITS?

Organizations are perennially seeking to optimize HR practices to improve their financial performance. To this end, HR professionals and researchers have long been interested in the effect that employee satisfaction has on a business's bottom line.

The relationship between workforce satisfaction and financial performance may seem obvious—satisfied employees provide better service, leading to satisfied customers, who bring substantial business to a store. However, the path from satisfied workforce to profitability is not a direct one. In fact, there are crucial junctures in between, and how each of these is managed will significantly affect the organization's profits.

This study broke down the relationship between workforce satisfaction and financial performance, examining each link in the chain (employee behaviors and customer satisfaction) to determine ways in which HR practices can be designed to enrich an organization's financial results.

KEY FINDINGS

- **While practitioners and researchers assume that higher employee satisfaction equals higher sales and profits, analysis shows that there is no direct link between the two.**
- **Between the beginning point of employee satisfaction and the endpoint of profitability lie three crucial intervening factors: employee retention, employee responsiveness to customers, and customer satisfaction.**
- **By understanding the interplay among these factors, organizations can target their HR efforts to positively affect the bottom line.**

THE STUDY QUESTIONS

In this study, researchers asked the following questions:

- **To what extent does the level of workforce satisfaction affect a firm's bottom line?**
- **Will increased employee satisfaction necessarily yield better financial performance?**
- **If not, how can HR policies and procedures be retooled to improve financial performance?**

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THE RESULTS

While financially successful businesses tend to have satisfied employees, the reverse is not necessarily true. Workforce satisfaction does not lead directly to better financial performance.

If the relationship between employee satisfaction and financial performance was "direct," workforce satisfaction would lead directly to profitability, and intervening factors would simply affect the relationship in various ways. On the contrary, each of the intervening factors (employee retention, employee responsiveness to customers, and customer satisfaction) is vital to financial performance.

In addition, the farther one travels along the path, the more likely it becomes that financial performance will be affected by non-employee related factors, such as customer expectations or economic conditions.

The missing link

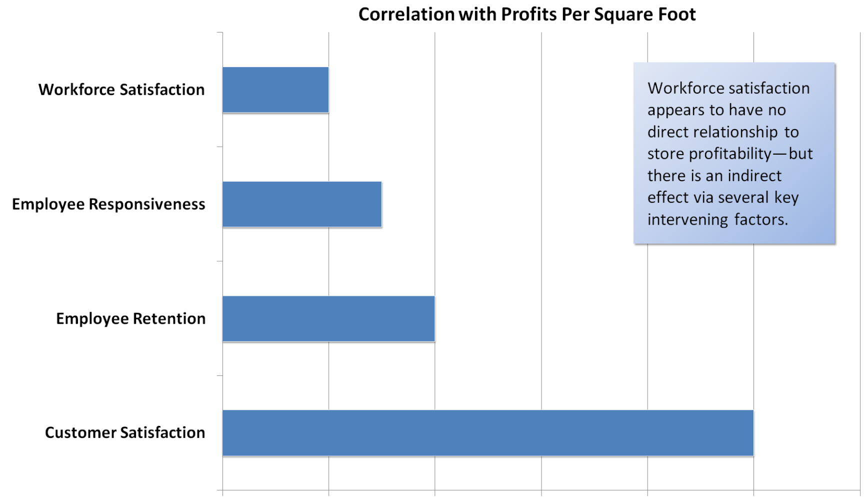
Many previous studies have been unable to establish a strong relationship between workforce satisfaction and customer satisfaction. By contrast, this study found evidence of a significant relationship between the two by recognizing a crucial intervening variable: employee behavior.

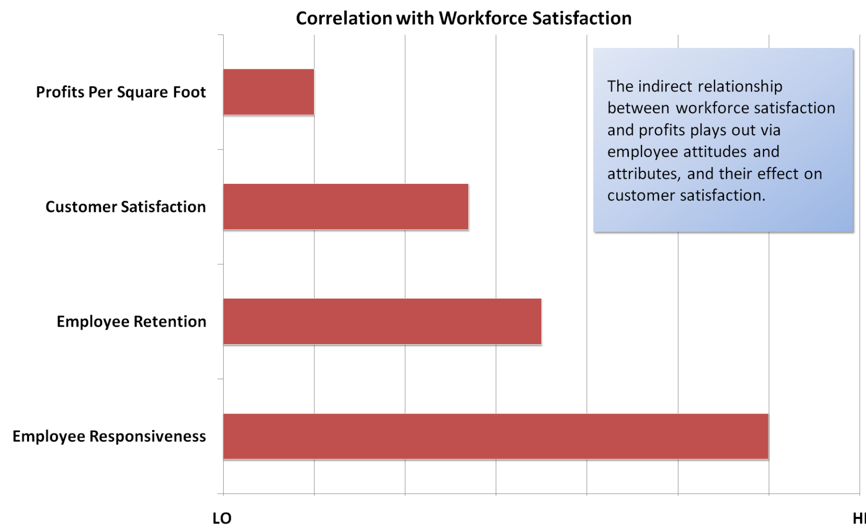
Understanding the importance of employee behavior (specifically, employee retention and responsiveness to customers), and its place in the chain, is crucial to uncovering the keys to profitability.

Satisfied employees typically stay with a store longer, resulting in employees building up their bank of knowledge and skills. This, in turn, improves the store's ability to provide high-quality service, resulting in satisfied customers.

In a similar vein, satisfied employees tend to provide better service; at the store level, employees providing improved service tend to encourage similar efforts by fellow workers—again leading to increased customer satisfaction.

And, finally, satisfied customers generally lead to greater profitability, through increased repeat business, customer retention, and referral of new customers (Heskett, et al., 1994)[3]. This last link in the service-profit chain has been illustrated through evidence of profit and sales (Bernhardt, Donthu, & Kennett, 2000)[2] and return on investment (Anderson, et al., 1994)[1].





Weighing relevant factors and evaluating context

Because workforce satisfaction is not directly related to financial performance, targeted efforts to improve employee satisfaction will not necessarily translate into bottom-line improvements. Managers should instead focus on patterns across different measures of organizational performance, and address and assess each of these to enhance financial performance.

Since this study was limited to one U.S.-based retail chain of home-improvement stores, the researchers point out that their findings are somewhat dependent on context. The link between operational performance and profitability may be stronger in other settings, especially those in which employee interactions are particularly important for achieving organizational outcomes.

In a consulting firm, for instance, teams of employees—configured specifically for each engagement—must deliver a range of operational outcomes, customer service, and bottom-line results. Thus, improved customer service in this situation is more likely to lead to bigger profits.

Another example is a small manufacturing firm, in which employees work interdependently to produce efficiencies, top-quality products, and profits. Improvements in worker satisfaction should increase operational efficiency, most likely resulting in improved financial performance.

Applicability to various industry settings

This study used data from multiple sources—employee and customer input, company financial records, and data from the U.S. Bureau of Labor Statistics. In addition, it focused on employee satisfaction and performance at the store level, offering observations on the behavior of a store's employees as a unit.

The researchers point out that they may have overlooked other significant factors, such as employee commitment, organizational citizenship, or organizational climate. However, they suggest that their findings are most likely relevant across many different types of organizations.

In addition, the researchers highlight the fact that they were able to see complex relationships from data gleaned almost exclusively from company records. Managers are likely to have just as much valuable information readily available—the raw materials they need to uncover the keys to converting workforce satisfaction into measurable financial results.

THE TAKEAWAY

How can HR practitioners retool their policies and procedures to improve financial performance through workforce satisfaction?

- **An investment in improving workforce satisfaction will not necessarily translate directly to the bottom line; rather, managers should start with the bottom line and trace a path backwards, searching for factors that might affect profits and be affected by workforce satisfaction.**
- **In retail firms, such as the one studied, efforts to increase employee satisfaction at the store level would probably manifest initially as improved employee retention and better employee responsiveness to customers. The best scenario would be to have a workforce with varying levels of experience, since relatively new employees tend to provide better customer responsiveness, but senior ones tend to provide more knowledgeable and personalized service.**
- **Once employee turnover is under control and customer responsiveness and service begin to improve, the store would expect to see incremental improvements in customer satisfaction, and, after a while, improvements in revenues as customers return more often, spend more, and bring in friends. Eventually, the result would be better financial performance.**
- **Virtually all firms of any size have the information they need to track this type of indirect path, and can use the metrics to show the ongoing effects of efforts to improve not only workforce satisfaction, but other employee attitudes and attributes as well.**

THE DATA SOURCE

Data came primarily from the extensive records of a large U.S.-based home-improvement retailer, comprising about 96,000 employees in 782 stores. Data were obtained for fiscal years 2003 (Year 1) and 2004 (Year 2).

Employee satisfaction was measured by 12 items scored on a 5-point scale (1=strongly agree, 5=strongly disagree; "no opinion" was also an option). The items addressed store-level management practices and employees' perceptions of their work. Individual responses were aggregated up to the unit level.

Employee retention was calculated at each store by comparing the number of employees who remained in a given store from Year 1 to Year 2 versus the number of employees in the store in Year 1. Employee responsiveness was measured as the average time employees took to respond to customer requests for assistance.

The company measured customer satisfaction with phone- and internet-based surveys (future discounts were offered as an incentive). The questions, on a seven-point scale (1=completely dissatisfied; 7=completely satisfied), addressed customers' satisfaction with the company over time and their satisfaction with the company versus its competitors.

Financial performance was defined as profit per square foot, and scaled by square footage, since larger stores are expected to generate more profits because of economies of scale and a wider product offering.

Control variables from the company's records included store age, number of employees, and transactions per square foot. A final control variable was unemployment-rate data, obtained from the U.S. Bureau of Labor Statistics.

THE RESEARCHERS

This study was conducted by:

- Jake Holwerda, Ph.D. candidate, ILR School, Cornell University
- Lee Dyer, Professor of Human Resource Studies and Chairperson of the Department of Human Resource Studies, ILR School, Cornell University

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For an in-depth discussion of this topic, see:

Holwerda, Jake and Dyer, Lee. Unit-Level Satisfaction and Performance: Intervening Variables and Indirect Relationships. Accepted for presentation at the 2010 Academy of Management Annual Meeting, August 2010.

◇ Questions about this research should be directed to Lee Dyer at ldd3@cornell.edu.