

# How employee engagement drives profit

Positioning the sales service profit-chain



# Foreword by Simon Morden, CEO of Prosell Learning



There is little doubt that recruiting and retaining talented teams is key to the long-term success of an organisation. Engaged people can lead to greater customer satisfaction and superior profits.

But why is employee engagement so important to an organisation's performance? And what are the factors on which management teams should focus to ensure that their people are satisfied?

The model "The employee-customer-profit" chain, adapted from the well known "Service-Profit Chain" concept, explores the importance of internal service quality, external service value and company growth in the retail sector. The aim for management teams is to create a compelling place to work and a compelling place to shop, which in turn creates a compelling place in which to invest.

If you would like to discuss any aspect of this whitepaper in greater detail, please do get in touch. We would be delighted to hear from you.

## Summary

This whitepaper explores how engaged employees generate customer satisfaction and loyalty as well as the correlation between profit, customer loyalty, service and productivity.

Independent research discovered that:

- Organisations with engaged employees have an average sales growth rate of 23.1%, while control group companies have only 14.5%.
- Engaged employees display up to 57% increased discretionary effort and up to an 87% reduction in the desire to leave the company.

Finally, the whitepaper looks at how to further engage employees within the organisation, such as to:

- Give employees the feeling of working on useful and challenging tasks.
- Trust and commit to employees.
- Offer good training and development opportunities.
- Reward and recognise.
- Implement strategies that promote positive workplace relationships.

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# Introduction

In our rapidly changing environment, the ability to build and sustain a competitive advantage has become increasingly difficult for organisations. Faced with intensely competitive markets and changing buyer behaviours brought on by increased consumption of social networking and user-generated reviews (Google Zero Moment of Truth, 2012), organisations need to acknowledge that it is no longer sufficient to have merely satisfied customers (Chaffey et al. 2006, p. 6).

With the retail landscape becoming broader and consumers being presented with greater choice, today's customers demand greater value and will only remain loyal if they are completely satisfied (Bonanno, 2008).

Extensive research by Jones & Sasser (1995) revealed that in markets where competition is intense, there is a tremendous difference between the loyalty of merely satisfied and completely satisfied customers in terms of financial gains. Given the high levels of competition in the UK retail sector, companies must raise the level of customer satisfaction from satisfied to completely satisfied in order to secure customer loyalty and generate superior long-term financial performance.

# 1 Positioning

Achieving this competitive advantage through superior customer responsiveness, however, is not just a matter of doing a better job of delivering the same value or by differentiating based on price. Securing loyal and completely satisfied customers through delivering superior customer service requires an engaged workforce that is both emotionally and intellectually committed to the organisation (Saks 2006, p.601).

Only engaged employees exert the necessary levels of discretionary effort that attains loyal customers (Frank et al. 2004).

Creating and managing an environment where employees exhibit high amounts of discretionary effort in their jobs poses many managerial implications. Discretionary effort implies the additional effort that engaged staff are willing to give. Research by Geary and Rummier (1998) tells us that up to 40 percent of employee effort is discretionary, depending on levels of engagement.

This paper will outline and discuss Heskett et al.'s service profit chain (1997), which stipulates a direct and strong relationship between employee engagement and financial performance; and provide research to support the credibility of the model. This paper will then go on to discuss the issues and challenges surrounding employee engagement and discretionary effort, whilst also highlighting the best practices.

Engagement also has a significant impact on employees' intentions to stay with an organisation. Given that much research has supported the fact that employee turnover is a high predictor of employee satisfaction, organisations need to pay considerable attention to managing turnover through engaging their employees, in order to manage customer satisfaction (Hurley & Estalami, 2007).

It should be noted that the views presented in this paper are not those of Prosell, but are those drawn from the research and statistical proof of comprehensive studies.

The practices that are outlined here in how to achieve this competitive advantage through people draw on Prosell's 30 years' experience of improving the performance of major companies around the world.



## 2 The service profit chain

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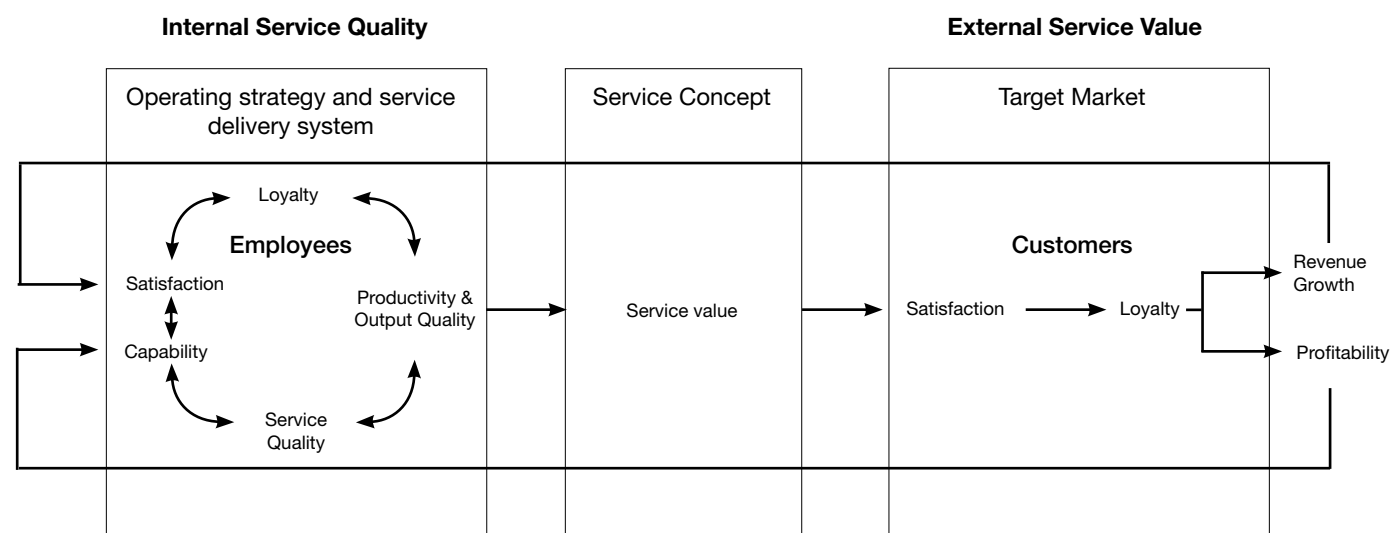


Figure 1.0 Service Profit Chain  
Source: Heskett, Sasser and Schlesinger, 1997

The service profit chain, shown in figure 1.0, is a widely recognised model explaining the sustainable competitiveness attained by organisations that have an engaged workforce. The model proposes that growth and profitability are derived from loyal customers who are completely satisfied with the perceived value of the service they receive. That service value is almost always only created by engaged employees that exhibit high levels of discretionary effort because they enjoy the quality of work life provided by the organisation (Lau 2000, p.423).

Quality of work life is defined by the favourable conditions and environments of a workplace that support and promote employee satisfaction by ensuring that rewards, including compensation, promotion, recognition, development, and meaningful work, meet or exceed their expectation (Hackman & Oldman, 1980). Heskett et al (1997) proposed that high quality of work life would create satisfied, committed, and productive employees, which in turn would ignite a chain effect leading to an organisation's growth and profitability.

In essence, the service profit chain postulates that the satisfaction and loyalty of engaged employees translates into customer satisfaction and loyalty, which in turn generates improved business performance (Pritchard & Silvestro 2005, p. 338).



# 3 The service profit chain tested

Heskett et al. (1997) collected empirical evidence from some 20 large organisations giving credibility and support to many of the linkages in the chain; in particular the relationship between employee and customer satisfaction. However, it was not until the exploratory study conducted by Silvestro and Cross (2000) into the strength of the relationships, that any single organisation had been subjected to an analysis of all of the linkages in the service profit chain.

The entire model was applied to one of the UK's leading grocery retailers in order to question the key assumption of the service profit chain, namely, that engaged employees in turn generate customer satisfaction and loyalty. The results showed real and definite correlations between profit, customer loyalty, satisfaction, service value, internal service quality, output quality and productivity.

A separate study by Lau (2000) tested part of Heskett et al.'s model. Lau's study did not attempt to provide any statistical evidence to validate each individual linkage; but rather it explored the direct linkage between performance in growth and profitability, and quality of work life. This is a proxy for engaged employees in the service profit chain model.

## 3 The service profit chain tested

Lau's study indicated that quality of work life and engaged employees had a significant influence on growth and profitability. The study contrasted the performance of companies with a reputation of high quality of work life to a control group of S&P 500 companies.

The results indicated that these quality work life companies indeed did enjoy higher growth rates than those of the S&P 500 companies, and that these differences are statistically significant. On average, the organisations with engaged employees have an average sales growth rate of 23.1 percent, while control group companies have only 14.5 percent, suggesting that quality work life companies are growing close to 60 percent faster than average S&P 500 organisations (Lau 2000, p. 432).

In addition, these companies enjoyed 7.9 percent growth per year for their return on assets while the control group companies had only a 3.7 percent growth, indicating that profitability of the quality work life organisations is growing more than twice as much as that of the companies in the control group. This research lends much support to Heskett et al.'s notion that quality of work life, which develops engaged employees, creates a chain effect that results in higher growth and profitability.

Pritchard and Silvestro's (2005) research into the service profit chain sought to test the linkages between employee perceptions and performance, customer perceptions and behaviour, and financial performance. The study was based on a UK home improvement store chain. Measures of each of the variables in the service profit chain were collected and analysed using Pearson's correlation coefficient.

Results indicated service value and quality were correlated positively with employee satisfaction, suggesting employees that are committed and loyal exhibit higher levels of discretionary effort, given that engaged employees create higher levels of service value.

Service value was found to be strongly positively correlated with both customer satisfaction and loyalty. Furthermore, stores with highest loyalty levels were generating the highest perceived service value.

The most significant finding of the study was the strong positive correlation between employee satisfaction and growth. This suggests that employee empowerment and the creation of a positive working environment will generate financial benefits (Pritchard & Silvestro 2005, p. 347).

In conclusion, it would be incomplete of any discussion of the service profit chain to ignore some potential caveats to Heskett et al.'s research and findings. Of prime consideration might be the danger that a total focus on the service profit chain to the exclusion of all else might constrain management's understanding of all the complexities of performance (Pritchard & Silvestro 2005, p. 351). Any generic model needs to be adapted to take into account industry, company size and trading conditions.

However, what is not in doubt is that these studies have revealed many significant performance linkages between variables in Heskett et al.'s service profit chain model, and have heightened the value of promoting the cooperative efforts between employees and employers. These partnership relationships have been shown to have the dramatic impact of increasing financial performance and competitiveness; revealing the importance of fostering partnership relationships between management and employees.

The saying, if you take care of your people, your people will take care of your customers, and your business will take care of itself (J.W. Marriot) has never been made more apparent or more clearly demonstrated than through this research.

# 4 Employee engagement & discretionary effort

## Why is it crucial?

A meta-analysis conducted by the Gallup Organisation concluded that the most profitable divisions of companies have employees doing what they do best, with people they like, and with a strong sense of psychological ownership for the outcomes of their work (Luthans & Peteron 2002, p. 376). Employee engagement; that is where employees are emotionally and intellectually committed to the organisation, is a significant predictor of desirable organisation outcomes including customer satisfaction, retention, productivity, and profitability.

With overwhelming empirical evidence of employee engagement resulting in desirable organisational outcomes, organisations need to recognise the importance of generating and maintaining employee engagement.

A survey of more than 50,000 employees at 59 organisations around the world, conducted by Corporate Executive Board (2004), found that engagement plays a significant role in both the levels of discretionary effort exhibited by employees and their intent to stay with an organisation. As shown in Figures 1.1 and 1.2, engaged employees display up to 57 percent increased discretionary effort and up to an 87 percent reduction in the desire to leave the company.

## 4 Employee engagement/discretionary effort

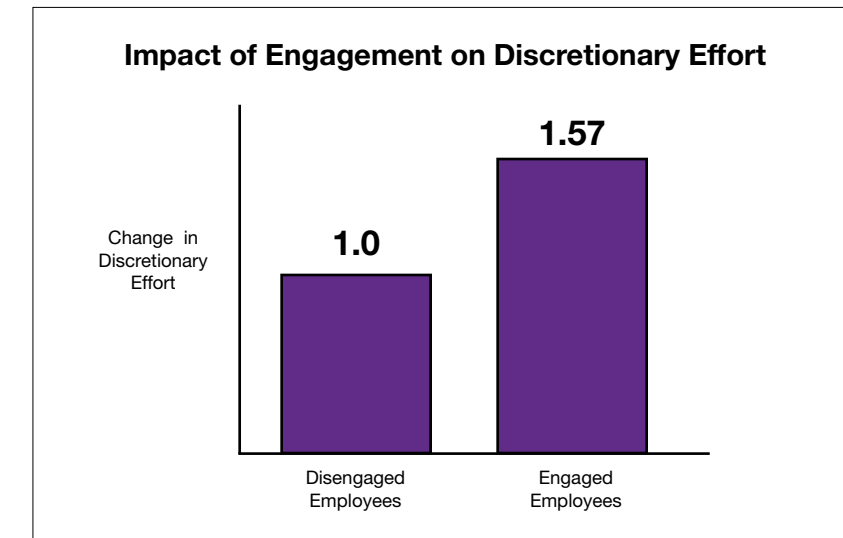


Figure 1.1 Impact of engagement on discretionary effort  
Source: Corporate Executive Board, 2004

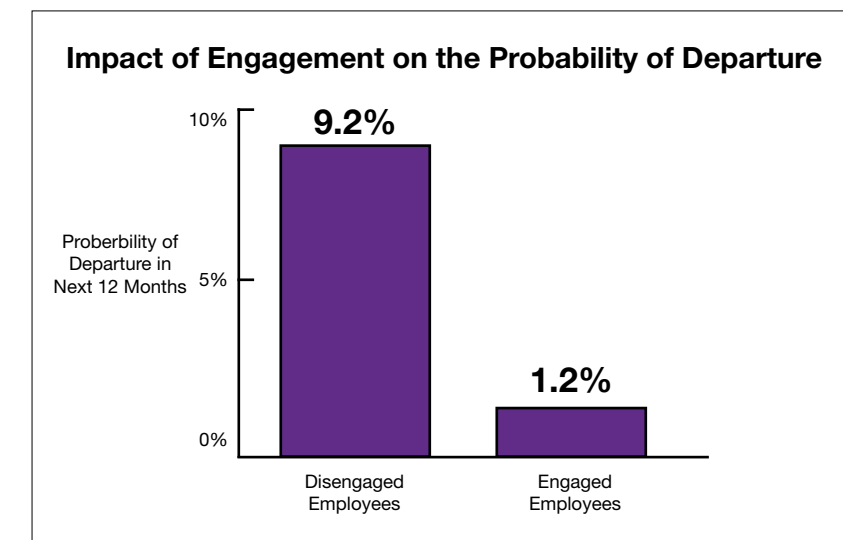


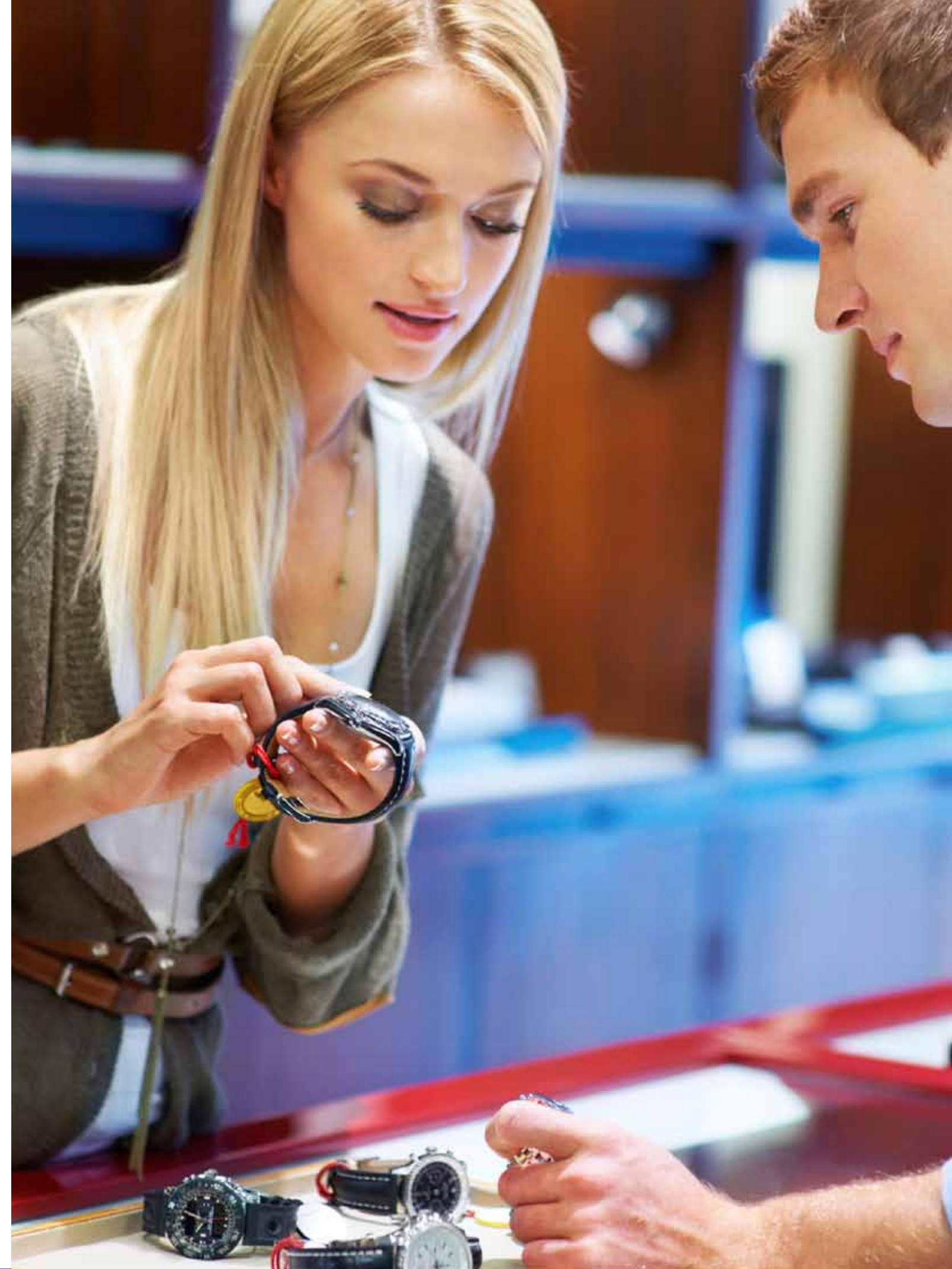
Figure 1.2 Impact of engagement on the probability of departure  
Source: Corporate Executive Board, 2004

With the dramatic influence engaged employees have on financial performance and growth being clearly demonstrated by the service profit chain, it becomes evident why human resources and how they are managed deserves increased attention. In particular, UK retailers facing increasingly competitive markets need to start investing seriously in their core assets - being people (Bonanno, 2008). Employees play a crucial role in transforming an organisation. Motivating employees to contribute their best ability and knowledge in work requires clear and nurturing policies. However, too often management fails to provide sufficient quality work life.



Organisations need to understand that the development and involvement they provide to all their employees will not only make them more able and more valuable to the organisation, but will also be a powerful incentive for them to stay (Woodruffe 2006, p. 3). Of course there is always the risk that these employees will leave, taking with them their new skills, but management needs to accept that employees are more inclined to leave if they are not developed. Finding ways for people to want to keep working at your organisation is key to creating an engaged workforce. Engaging talented people should be of upmost importance because these are the people that will keep your customers completely satisfied and loyal.

The increased consumption of internet media has facilitated a rapid growth in customer feedback websites. The shoppers-of-tomorrow are using websites to decide where they shop, eat or stay. Thanks to extensive reach of these websites, a business can quickly fall from grace, as a result of bad feedback being posted. With the impact of poor quality service being amplified by the internet, it becomes increasingly evident why having an engaged workforce is so crucial not only to attain loyal customers, but also to delight these customers.



# 5 How do we achieve employee satisfaction?

Monetary benefits are typically not the major contributing factor to employee satisfaction or loyalty, though they do play a significant role. The most important factors for employee commitment and engagement are non-financial.

A summary of best practice for retaining and engaging employees is given by the UK Institute of Management. Many of these conclusions are well known to management. The key is to be able to implement a comprehensive strategy and to be able to measure and correct each element in terms of its contribution to improved profitability.



## 5 How do we achieve employee satisfaction?

- Give employees the feeling of working on useful and challenging tasks. Staff that feel no purpose or meaning in their jobs are more likely to leave the organisation.
- Genuinely trust and commit to employees. Trust and effective commitment are important in building relationships. Employees that feel trusted are more likely to feel useful and are more likely to confer loyalty to the organisation.
- Offer good training and development opportunities. Employees that are not developed are more likely to leave the organisation.
- Reward and recognise. Employees like to be valued and recognised.
- Implement strategies that promote positive workplace relationships. Employees that have good relationships with their co-workers and manager are more loyal than those that do not.

Whilst these are effective starting points for engaging employees, these solutions are no more than a start. Achieving an engaged workforce is not always an easy task. It requires the commitment and efforts of management, and a genuine passion for their customers and their staff.



# 6 The Journey

The starting point is a commitment on behalf of management to implement a long-term strategy that puts its staff and customers at the centre of their focus. What is needed is a genuine passion for both staff and customers, which is supported by specific practices.

As shown in Figure 1.3, the three inter-relationships between management, customers and employees are marked A, B and C. Traditionally, organisations have put their focus on relationships A and B. What is too often the case is that relationship C is neglected as organisations fail to recognise the importance of developing and involving their staff. However, as much research has indicated, fostering a partnership relationship between management and

employees produces significant benefits in terms of financial performance and growth. Prosell's experience tells us that in order to be at the top and reap increased profits and growth, we need to measure, manage and constantly improve these three relationships.

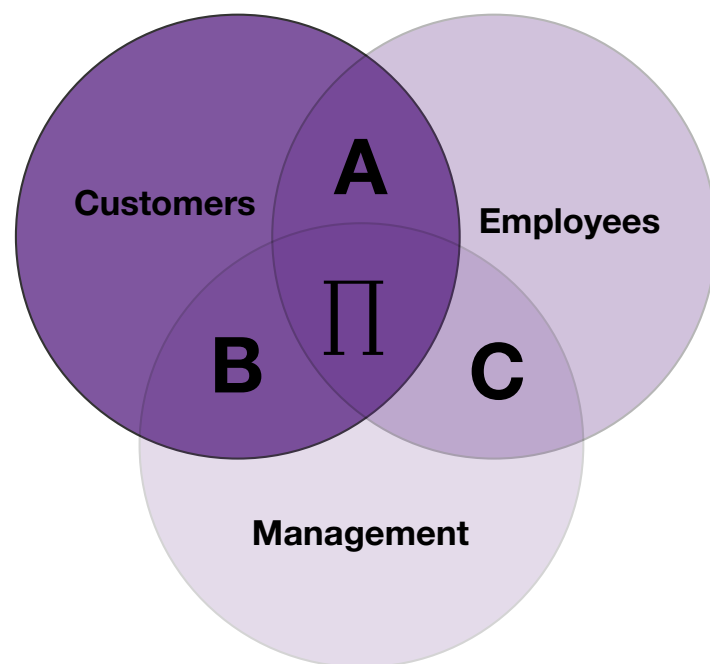


Figure 1.3 Retail relationships  
Source: Prosell, 2013

There is also an intelligent sequence to the correct events and practices. Everything starts with diagnosis; a process designed to work out 'where we are' with a clear view of 'where we need to be'. From that, specific recommendations on recruitment solutions, policy and procedural structures, measuring and auditing tools, sales and service models, and feedback mechanisms can be made so as to develop a full program design.

Following recommendations is the planning of the implementation process. The vision, beliefs and practices of management are evaluated and realigned, if necessary, to be both customer and employee centric. Champions are identified and nominated, and once a tailored tool kit is developed, a rollout strategy is determined. For this implementation stage to be effective, it is vital that communication is present throughout the whole process. Given this, it is important to understand and improve the attitude of all employees. Attitude surveys are used consistently to give comparisons and add valuable insight.

The performance of the rollout strategy needs to be consistently appraised and reviewed to find out which areas need tweaking and what is not working. For example:

- Both management and staff need to be involved in this process to determine which parts of the process need to be refined.
- Internal and external marketing needs to be assessed to ensure that both are congruent.
- Employees need to be appropriately rewarded and recognised.

To sustain and maintain this strategy, both management and staff must be fully committed. The power of this commitment is ultimately shown when the organisation can use its employee relationships as a powerful PR tool and a point of focus for its executives' media contact.

# 7 Conclusions

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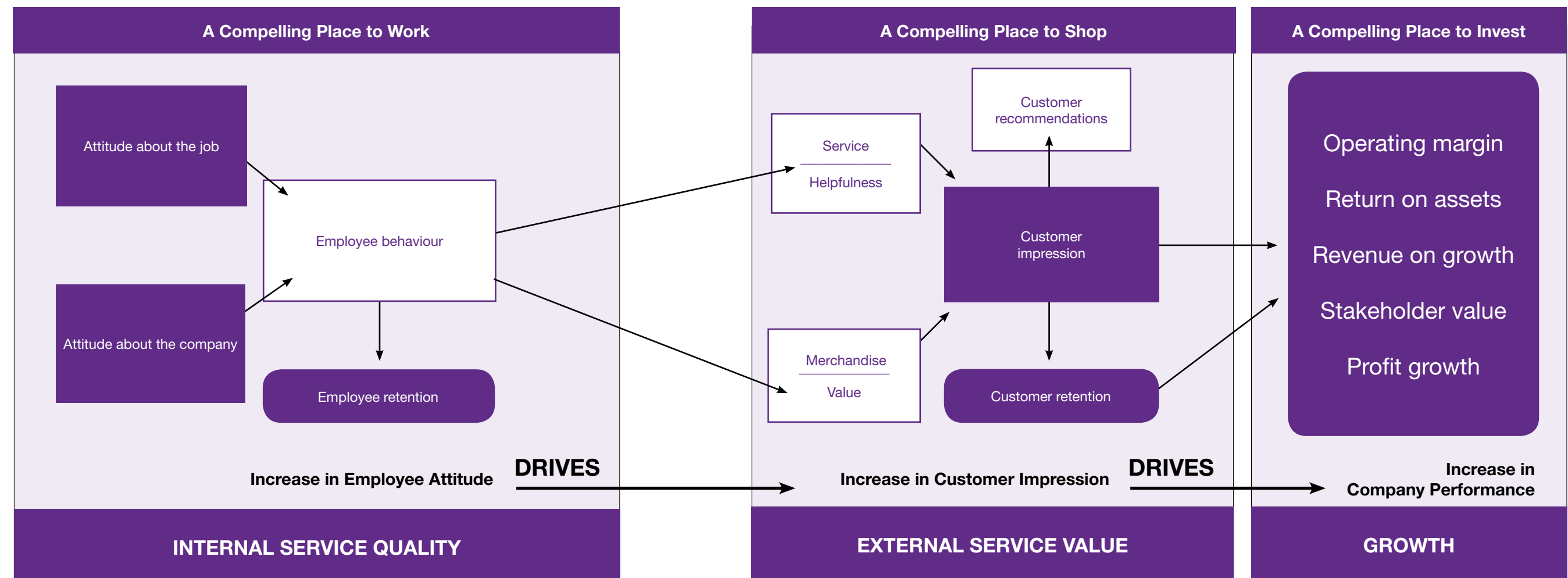
The areas in purple are those that can be statistically measured and are used as the fundamentals to drive growth. The areas in white are the ones that can be developed and assessed through other forms of data capture.

It is the organisations that recognise that you have to create a compelling place to work, before any initiatives to drive service levels (training, incentives etc) have any tangible benefit, that are the ones that produce above average growth and profit in their industry.

## The employee-customer-profit chain

Shown below in Figure 1.4, Prosell have taken the service profit chain concept and adapted it to create a range of tools, measures, training interventions and management practices that gives organisations intelligent implementation methodology.

Figure 1.4 Employee-customer-profit chain  
Source: Adapted from Heskett et al.'s service profit chain, 1997



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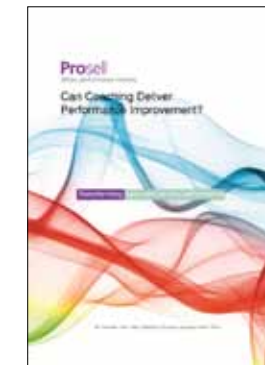
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