Quality of work life

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Abstract

Service profit chain is a well-received model to explain the sustainable competitiveness of many service organizations. The model attributes a service organization's financial and market performance to its relationships with its customers and employees. According to the service profit chain, internal service quality serves the foundation of the model and it ignites a chain effect leading to an organization's growth and profitability in the end. The purpose of this study is to provide an ad hoc analysis of two key elements of the service profit chain. Specifically, this research explores the direct linkage between performance in growth and profitability and quality of work life, which is a proxy for internal service quality in the service profit chain model. The performances of companies with a reputation of high quality of work life were contrasted to a control group of S&P 500 companies using COMPUSTAT data.

Key words: performance, profitability, quality of work life, internal service quality

Introduction

The effects of many human resource development factors on business performance have been widely reported in business research literature in recent years. In service industries, where services are often characterized by an encounter between service providers and customers, the quality and capability of the service providers have a direct, significant effect on the service delivery process and customer satisfaction. The initial interaction, having a great influence on how customers evaluate the service quality, has been better known as the "moment of truth" as customers start to form their opinion and expectation of the service delivery experience (Normann, 1984). This brief encounter can be critical in achieving a reputation for superior quality and repeated business.

The connection between workforce competence and customer service quality is conceptually strong since most service delivery or tasks are often performed by an organization's employees. After years of organizational restructuring and work re-engineering, management comes to recognize that a productive workforce is increasingly important to attain sustainable competitive advantages for business organizations on a global basis (Bohl *et al.*, 1996). For example, using data from the retail banking futures project, Roth and Jackson (1995) empirically found that service quality is directly linked with business performance. As the composition of workforce continues to change, companies offering better benefits and supportive working environments are expected to gain leverage in hiring and retaining valuable people.

Service profit chain is a well-received concept to explain the sustainable competitiveness of many service organizations. This has been thoroughly explained in Heskett *et al.* (1994, 1997).

In essence, the service profit chain proposes that growth and profitability are derived from loyal customers who are satisfied with the perceived value of the service.

Service value is created by satisfied, committed, productive employees because they enjoy the quality of work life (QWL) provided by the service organization.

Implying causal effects between each link, Heskett *et al.* (1997) proposed that QWL, which is measured by the feelings that employees have toward their jobs, colleagues, and companies, would ignite a chain effect leading to an organization's growth and profitability in the end.

Research applies an *ad hoc* test for the service profit chain by comparing the differences of four growth and profitability measures between companies with a reputation of QWL and a control group of companies. While this approach will not provide any statistical evidence to validate each individual linkage within the service profit chain, it does indicate whether QWL is a significant factor in determining any difference of growth and profitability in a wide spectrum of service industries. Thus, this research primarily targets a relatively high level of abstraction in an effort to gain more understanding about this subject matter.

Previous research on service profit chain

Heskett *et al.* (1994) proposed a service profit chain model that attributes a service organization's performance to its relationships with its customers and employees. They substantiated their proposed model with many field studies of service organizations. The service profit chain has unified a large body of prior research studies, trying to link its individual components together as follows.

The relationship between QWL and growth and profitability

The basic objectives of an effective QWL program are improved working conditions (mainly from an employee's perspective) and greater organizational effectiveness (mainly from an employer's perspective). Positive results of QWL have been supported by a number of previous studies, including reduced absenteeism, lower turnover, and improved job satisfaction (Havlovic, 1991; Cohen *et al.*, 1997; King and Ehrhard, 1997). Not only does QWL contribute to a company's ability to recruit quality people, but it also enhances a company's competitiveness. Common beliefs support the contention that QWL will positively nurture a more flexible, loyal, and motivated workforce, which is essential in determining the company's competitiveness (Allan and Loseby, 1993; Meyer and Cooke, 1993; Bassi and Vanburen, 1997). Other studies also found positive associations between progressive human resource management practices, such as training and staffing selectivity, and common firm performance measures (Huselid, 1995; Delaney and Huselid, 1996). Employee satisfaction is essential to implementing high-performance or high-commitment work systems (Osterman, 1995), which often lead to high financial and market performance. Roth (1993) empirically found statistically significant correlations between a measure of QWL and business performance (in terms of market performance, stakeholder value, and business sustainability) as well as differentiating competitive capabilities (in terms of service quality, delivery, employee knowledge, flexibility, and technological leadership).

Swanson (1998) reviewed and updated recent financial analysis research on human resource development, which generally supports a positive relationship between human resources practices and business performance. Increased growth and profitability would provide additional financial resources for management to reinvest in employees, thereby further enhancing QWL. Because of the generally accepted "good work equals high performance" assumption (Schurman, 1998), employee satisfaction is always an important management goal in job design and human resource policies. However, studies of direct relationships between job satisfaction and productivity have not always been consistent (Page and Wiseman, 1993; Davidson and Worrell, 1990). Given the important managerial implications of the links between worker satisfaction and business performance, more longitudinal or comparative analyses are needed to validate and unify this area of research. This study proposes the following hypotheses:

H1: QWL companies have a higher sales growth than the control group companies.

H2: QWL companies have a higher asset growth than the control group companies.

H3: QWL companies have a higher ROA growth than the control group companies.

H4: QWL companies have a higher profit margin than the control group companies.

Methodology

One approach to a comprehensive study of the service profit chain is to evaluate the statistical significance of each linkage in the model. Such an approach requires extensive resources and efforts to survey many service companies, which are beyond the scope of this study. Instead, an *ad hoc* approach was employed to test if QWL is indeed a significant factor for a company's growth and profitability. This approach facilitates an indirect evaluation of the service profit chain model with its first and last elements (that is, the internal service quality and growth and profitability elements as shown in Figure 1.) Many prior studies also tested the indirect effect of some of the elements in the model without involving every element as presented in the service profit chain. For example, Hallowell (1996) studied the linkages between customer satisfaction and customer loyalty and between customer loyalty and profitability. In addition, several studies in a special issue of the journal *Human Resource Planning* in 1991 reported findings supporting the idea that employee satisfaction is linked to customer satisfaction. These studies have been across a wide variety of service industries, such as banking, truck rental, retailing, and consulting, and thus have a high degree of generalization.

This research evaluated the performances, in terms of growth and profitability, based on a sample of QWL and S&P 500 companies. After eliminating all privately held companies (for a lack of published financial information) and all manufacturing or industrial companies based on their primary SIC, only 29 QWL companies remained for the purpose of this study. The control group consisted of 208 service companies selected from the list of S&P 500 using their SIC codes as a guide. To ensure there was a proper comparison of these two groups of companies, a statistical test was first performed on their latest sales figures. The test found no evidence of any bias of business size ($p = 0.9036$).

All financial data used in this study were extracted from COMPUSTAT (updated in June 1999), a widely used, reliable financial database for financial analysts and academic researchers. Growth was defined by five-year trends on two measures: sales growth (SG) and asset growth (AG). Profitability was defined by the five-year growth rate of return on assets (ROA) and the five-year average profit margin (PM). All trend data represented the log linear growth rates for SG, AG, and ROA data over the prior five fiscal years. To this end, this study compared the performance of the QWL companies and a control group of companies with independent two-sample t-tests.

Comparative analysis is a commonly used research methodology to explore the effect of unique characteristics of subjects. In particular, the independent two-sample t-test procedure has been used in studying QWL and related topics with secondary sources of data. For example, Allan and Loseby (1993) investigated the effect of no lay-off policies on corporate financial performance by comparing companies that practice job security and companies that do not. Likewise, Golembiewski and Sun (1989) used a large panel of QWL evaluative studies to test the difference of QWL applications in public and business sectors. Lau and May (1998) also used a similar technique to compare the financial performance between the QWL companies in 1994 and the S&P 100 companies.

Results and analysis

The first two research hypotheses tested whether the QWL companies have a higher growth rate, measured by the five-year trends of sales growth (*H1*) and asset growth (*H2*), than that of the S&P 500 companies. Analysis of the data revealed that higher sales growth ($p = 0.00058$) and assets growth ($p = 0.0313$) for QWL companies are all supported (see Table I). The results indicated that QWL companies indeed enjoy higher growth rates than those of S&P 500 companies, and their differences are statistically significant. On average, QWL service companies have an average sales growth rate of 23.1 percent, while the control group companies have only 14.5 percent, suggesting that QWL companies are growing almost 60 percent faster than average S&P 500 companies.

The next two research hypotheses tested whether the QWL companies have a higher profitability, measured by the five-year trends of ROA (*H3*) and the profit margin (*H4*), than the S&P 500 companies. The analysis yielded mixed results. On the one hand, the result showed that QWL companies are more profitable than S&P 500 companies in terms of the ROA growth rate ($p = 0.0005$). On average, QWL companies enjoyed 7.9 percent growth per year for their ROA while the control group companies had only a 3.7 percent growth, suggesting that profitability of the QWL companies, in terms of asset utilization, is growing more than twice as much as that of control group companies. On the other hand, although QWL companies still managed to have a higher average profit margin than their counterparts, the difference was not statistically significant (p = 0.1977). On this account, the QWL companies have an average profit margin of 41.9 percent, compared to the control group companies, 37.4 percent.

Conclusion

A large body of prior research supports the service profit chain concept. We used an *ad hoc* approach to study two key elements of the service profit chain model, namely QWL and performance. The study showed that service organizations that emphasized QWL for their employees tended to have better sales growth, asset growth, and return on asset growth over a five-year period when contrasted to other S&P 500 firms. While this research did not differentiate among firms regarding their average profitability, it is generally recognized that profitability suffers from accounting distortions and is generally not a useful measure for cross-industry comparisons (Davidson and Worrell, 1990). This is clearly an area for future research. Nonetheless, the observed performance growth relationships with QWL are consistent with the service profit chain model's expectation of "increased employee loyalty" and "share of wallet." The findings here imply that the creation of strategies that strengthen the human resources components of the service operations can have a positive chain effect on the service organization's financial performance.

Management and resource strategies aimed predominantly at financial goals such as being profitable (typified by US companies) can operate in conjunction with providing a secure and satisfactory workplace for employees. Companies need not sacrifice profitability in order to provide for their employees. A win-win situation is not only feasible but also highly desirable. Satisfied employees are often easier to manage than dissatisfied employees. A company's effort to provide more employee security, benefits, and incentives to boost employee morale can result in important bottom line financial improvement that will benefit all stakeholders, notably the investors and customers. As evidenced by many years of corporate restructuring efforts, improved financial performance is not necessarily achieved by directly reducing labor costs. Rather, increased financial performance is linked to sound human resource practices that effectively increase the extent and degree of employee satisfaction.

Figure 1*Concepted linkages of the service profit chain model*

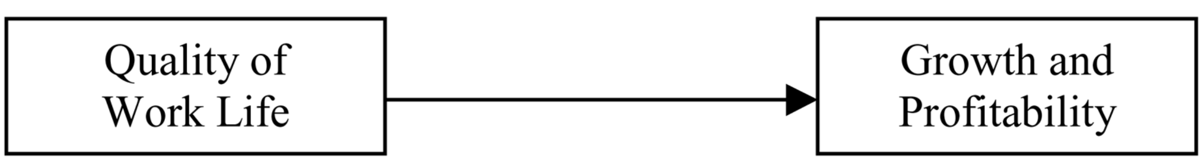

Figure 2 *An ad hoc service profit chain model*

Test subject	Research hypothesis	Group 1 QWL firms (n = 29)(%)	Group 2 S&P 500 firms (n = 208)(%)	P-value (%)
SG: sales growth	*H1*: μ_1(SG) > μ_2(SG)	23.2	14.5	0.0058
AG: asset growth	*H2*: μ_1(AG) > μ_2(AG)	22.9	15.9	0.0313
ROA: return on asset growth	*H3*: μ_1(ROA) > μ_2(ROA)	7.9	3.7	0.0001
PM: average profit margin	*H4*: μ_1(PM) > μ_2(PM)	41.9	37.4	0.1977

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