The Leadership-Profit Chain

A year-long study, including a literature review of hundreds of studies from 1980 through 2005, reveals some profound connections between leadership effectiveness, employee passion, customer devotion, and organizational vitality.

Defining the Importance of Leadership Capacity

It's no secret that leadership capacity is critical to organizational success, but little research has been compiled about the long-term impact of leadership on organizational productivity and profitability. In response, Blanchard® embarked on a study to answer some important questions about leadership and its role in supporting the overall success of an organization. The study focused on four questions:

- What role does leadership capacity play in driving organizational vitality?
- What specifically can leaders do to increase organizational performance?
- What are the connections between leadership capacity, customer devotion, and employee passion?
- How are customer devotion and employee passion linked to organizational vitality?

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Organizing the Data

Initially, the literature review revealed a multitude of definitions, terms, metrics, and points of view that needed to be organized.

The first step was to organize the data by issue and by hard and soft measures. Hard measures are objective, quantifiable numbers, behaviors, and measures. Soft measures are subjective perceptions gathered from survey data.

The second step, based on our initial findings, was to categorize leadership into two areas: strategic leadership and operational leadership practices. Since five critical elements were identified through the research, the third step was to define the elements to be quantified, measured, and linked.

The fourth step was to create a framework and model based on the relationships and connections of the five elements and their impact on one another.

Defining the Elements

The five elements that were consistently present in the research—employee passion, customer devotion, strategic leadership, operational leadership, and organizational vitality—are defined below. The terms were created to incorporate a broader range of information for our elements rather than simply using previously defined terms such as organizational success, leadership, employee engagement, and customer loyalty.

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Strategic Leadership

Strategic leadership defines the imperatives for everyone in the organization. It is the "what" that provides the key relationships and metrics needed to ensure that all units follow the same strategy. Strategies must then identify the criteria that are the key determinants of behavior. Examples of strategic leadership include vision, culture, and the declaration of strategic imperatives.

Operational Leadership

Operational leadership practices provide the "how" in the organization. They enable departments and employees to understand how they specifically contribute to organizational success. They are the procedures and policies that clarify how each unit will achieve the overall strategy.

Employee Work Passion

Employee passion results from the employee's positive experience and overall satisfaction with the organization and its policies, procedures, products, and management practices. Hard measures of employee passion include retention, absenteeism, tenure, and productivity. Soft measures include employee perceptions of fairness, justice, and trust.

Customer Devotion

Customer devotion occurs as a result of positive experiences with the organization's products and services, policies, procedures, and personnel. Hard measures of customer devotion include customer retention, length of the customer relationship, number of transactions, average transaction size, and referrals of new clients. Soft measures include survey-based perceptions of satisfaction on themes related to quality, value, customer service, product expectations, and overall customer satisfaction.

Organizational Vitality

Organizational vitality is a company's economic stability over time as well as the degree to which it is successful in the eyes of its customers, employees, and shareholders. Hard measures of organizational vitality include contract retention, revenue retention, stock price, profits, revenue growth, venture capital, and operating costs. Soft measures include perceptions of public trust, employee commitment, and employee intent to stay.

Research Findings

Earlier research has shown that there is a Service-Profit Chain, a Value-Profit Chain, and an Employee–Customer-Profit Chain. Blanchard® research indicates that there is also a Leadership-Profit Chain. The data clearly show that strategic leadership as well as organizational leadership capacity are critical to overall organizational success.

In addition, leadership impacts customer loyalty and devotion as it does employee engagement and passion. We found throughout the literature that leaders will often attempt to influence organizational vitality through overhead control and fiscal measures, which has been proven to be ineffective over the long term. Many leaders believe that they can impact organizational vitality by tinkering with the process and policies directly governing the use of economic resources rather than educating, empowering, and supporting employees' wise use of resources. Thus we determined that the key variable that drives long-term sustainability and organizational profitability is a combination of strategic and operational leadership actions that drive employee passion and customer devotion.

Leadership-Profit Chain

Truths

- Effective strategic leadership indirectly predicts organizational vitality.
- Effective operational leadership directly predicts positive employee passion.
- Positive employee passion directly predicts customer devotion.
- Employee passion directly predicts organizational vitality.
- Customer devotion directly predicts organizational vitality.
- One of the strongest indicators of employee commitment is commitment to the organization.
- There are many factors that cause lack of retention, but relationship with a boss is not the number-one driving factor.

Myths

- Organizational vitality directly predicts customer devotion.
- Organizational vitality directly predicts employee passion.
- The number-one reason that people leave their jobs is based on their relationship with their manager.

Strategic leadership is a critical building block for setting the tone and direction for a service-quality culture. As practices cascade throughout the operation, they reflect and reinforce the implementation of this culture. Our research indicates that, fundamentally, effective leadership is linked to the integrity of the triangle (i.e., to both strategic and operational leadership), as this is the area of primary importance.

Employees who perceive that leadership practices emphasize quality, customer service, and employee development tend to be more satisfied with their jobs and the organization overall. As a result, customers are more satisfied and will maintain a long-term relationship with the company. Whether employees are supported and enabled to manifest value for the customer ultimately depends on leadership.

Our findings support several connections and the overall framework of the model that we developed to illustrate these connections. Our theory is that the employee–customer relationship is dependent on the strategic and operational leadership demonstrated within the organization. As a result, leadership is the crux of the Leadership-Profit Chain. The integrity and effectiveness of leadership and management practices is an indirect driver of organizational success. The maximum impact on an organization's bottom line can be expected when both strategic leadership and organizational management practices are aligned, thus supporting a purpose that is visible to customers and employees alike.

Making the Connections in the Leadership-Profit Chain

The integrity of the Leadership-Profit Chain lies in the inner triangle. The effective interconnection of strategic leadership, operational leadership, employee passion, and customer devotion is as critical to organizational success as the organization's supply chain. While the Leadership-Profit Chain is an integral model, there is a beginning, middle, and end to the chain. If there is a lack of integrity at any point in the chain, organizational productivity and profitability may be jeopardized.

Strategic Leadership and Operational Leadership Directly Predict Employee Passion

Strategic leadership is critical to organizational vitality, but it is an indirect connection. Senior leadership messages, while critical, must be supported by and executed through operational leadership practices in order for employees to understand where they are going in relation to the vision, to buy into the culture and what the company stands for, and to understand how to connect their work to the strategic imperatives. Without the connection between strategic leadership and operational management practices, a gap occurs, thus causing a break in the chain. When this happens, initiatives are either inconsistent or never executed at all.

Of greater importance are the operational leadership practices that support the strategic leadership messages and initiatives, as they create an environment where employees and customers can have a positive experience with the company. Effective and aligned operational leadership practices allow employees to be passionate about their work and the company and to be in a position to influence customer devotion.

Because of our findings, our belief is that the number-one reason people leave an organization is not based on their relationship with their manager, although the relationship employees share with their manager directly affects their engagement and their satisfaction with their job and the company. There was overwhelming evidence to support our findings that many employees will stay with a good company even while complaining about a bad boss based on the perception that they could transfer to a better job within the company. Thus, in regard to employee turnover, employee commitment to the organization is more important than job satisfaction, which includes satisfaction with the manager.

Employees are looking for a sense of fairness and justice in the organization and in the relationships they have with their managers and coworkers. Employees who are subjected to inequity and to unethical or unfair behavior feel unsafe in the work environment, which directly impacts their level of passion for and treatment of the customer. Conversely, employees who perceive that organizational resources are in place to support them are more engaged in their work.

Furthermore, our research shows that employees need to perceive that they and the customer are being treated fairly and justly by leadership and the organization as a whole. In fact, the research showed that the number-one reason employees leave an organization is that they perceive that justness and fairness are not present in the organization. Finally, our research indicates that both initiative-based and general management practices are essential for employee passion, as they directly contribute to individuals getting their jobs done, serving the customer, and creating a quality product.

Employee Passion Directly Predicts Customer Devotion and Organizational Vitality

A direct positive correlation between employee passion and customer devotion has been documented in the literature through both hard and soft measures. In fact, the most powerful connection we found in the research was the link between employee passion and customer devotion. When employees are passionate about what they do, clear about roles and goals, and perceive that the organization is fair and just in its treatment of coworkers and customers, the impact on their desire to serve the customer is tremendous. Employees who lack passion take it out on the customer. Studies clearly link employee job and company satisfaction to customer satisfaction. In other words, the way that leaders treat employees is the way that employees will treat the customers.

Customer Devotion Directly Predicts Organizational Vitality

Customer devotion is a powerful driver of organizational success. It costs six to seven times more to gain a new customer than to retain an existing one. Customers care about the service they receive from a company and the experience they have with the product, policies, and procedures of a company. They do not care how profitable or successful the company is unless it influences the product, service, or experience. Further, Blanchard research suggests that the Service-Profit Chain is defined by

> The number-one reason that employees leave an organization is their perception that justness and fairness are not present in the organization.

leadership. Leaders of exemplary service companies emphasize the importance of each employee and customer, and they maintain a culture that is centered on service to customers and employees.

Operational Leadership Directly Predicts Customer Devotion

Operational leadership and management practices such as sharing information, providing training, and rewarding and recognizing excellence are positively related to satisfaction with service quality. These dimensions are related in that the underlying component is information: that is, seeking information from other employees and/or customers (e.g., how service could be improved), conveying information as it pertains to training, and sharing information with employees in the form of recognition and rewards. The findings support the notion that management practices, as they relate to climate, have a positive effect on customer service. Results confirm significant relationships between various climate indicators. Information seeking, training, and rewards and recognition proved to have the strongest relationship to customer satisfaction. Likewise, the research findings provide further support for the relationship between training and customer satisfaction as it pertains to delivering service. Additionally, divisions of an organization that invest in training on delivery of service experience a higher rate of customer satisfaction.

Conclusion

Creating an organization that is successful and effective is an inside-out proposition. The quality of the culture, the quality of management practices, and the alignment of these practices to key strategic initiatives rest with leadership.

Leaders who hold people accountable and ensure effective, productive behaviors in their people can be the most effective influencers and drivers of organizational results. Equally important is a leader's ability to affect the mood, attitude, and engagement of employees and the culture of the organization overall through a specific chain of events that are implicitly linked.

The key to organizational vitality is creating an environment that allows employees to win and be passionate about what they do. By taking care of employees, leaders establish an environment in which the employees take care of the customers at a level that causes the customer to want to return year after year. When managers focus their attention and emphasis only on organizational indicators of vitality such as profit, they have their eye on the scoreboard and not on the ball. Profit is a byproduct of serving the customer, which can be achieved only by serving the employee.

About the Researchers

Dr. Drea Zigarmi is a highly respected and experienced management consultant, best-selling author, and founding associate for Blanchard®. Drea is the director of Blanchard's Employee Work Passion research team and co-developed the Employee Work Passion Assessment (EWPA). Drea is coauthor of *Leadership and the One Minute Manager®*, the third book in Ken Blanchard's best-selling One Minute Manager Library, and various chapters in *Leading at a Higher Level*. In addition, he has coauthored *The Leader Within*, *Achieve Leadership Genius*, and *The Team Leader's Idea-A-Day Guide*. Drea has coauthored numerous Blanchard products, including the widely used SLII®, DiSC, and Optimal Motivation™ programs. Drea received a bachelor's degree in biology from Norwich University and a master's degree in humanistic education and doctorate in education, administration, and organizational studies from the University of Massachusetts, Amherst.

Scott Blanchard is president of Blanchard. Scott cofounded one of the first coaching companies in 1999—today's Blanchard Coaching Services (BCS). Later, with the goal of democratizing corporate coaching, he cocreated the first coaching management system to enhance the delivery of coaching at scale. To date, BCS has provided the highest caliber of coaching to hundreds of companies and more than ten thousand clients worldwide. Scott also devoted ten years to software development, creating a learning content management system in partnership with CD2™ Learning. He is coauthor of *Leverage Your Best, Ditch the Rest* and *Leading at a Higher Level* as well as Blanchard's training programs Coaching Essentials® and Blanchard Management Essentials®. Scott holds a bachelor's degree in hotel administration and hospitality from Cornell University and a master's degree in organizational development from American University.

Dr. Vicki Essary is an industrial-organizational psychologist with demonstrated results in program evaluation and training and development. In her former role as director of assessments for Blanchard, she oversaw the strategic development and implementation of the assessment center. She is skilled in all aspects of the evaluation process, from research design to validation and reporting, and has worked extensively in the field of organizational development. Vicki holds a bachelor's degree in psychology from San Diego State University and a master's in organizational behavior and doctorate in industrial-organizational psychology from Alliant International University (formerly the California School of Professional Psychology).

Dobie Houson is a founding partner of The Employee Work Passion Company. A member of Blanchard's Employee Work Passion research team since 2006, Dobie was involved in developing the Employee Work Passion Assessment from its inception. Formerly the director of marketing research at Blanchard for more than three decades, Dobie is an experienced researcher with a demonstrated history of working in the management consulting industry with a focus on executive development, coaching, executive coaching, team building, and facilitation. Dobie holds a bachelor's degree in communication and media studies from California State University, Chico.

Blanchard® is a global leader in leadership development, consulting, and coaching. For more than 40 years, Blanchard has partnered with organizations to maximize individual achievement and organizational performance—bringing measurable progress and true transformation. Blanchard's SLII® is the global leadership model of choice, powering inspired leaders for more than 10,000 organizations worldwide. Blanchard also offers a suite of award-winning solutions through flexible delivery modalities to meet the specific needs of clients and learners.

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