

Perspectives

The Leadership-Profit Chain

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, The Ken Blanchard Companies® 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?

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.

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 include objective, quantifiable numbers, behaviors, and measures. Soft measures include 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 we found present repeatedly 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 universe of information for our elements rather than simply using previously defined terms such as organizational success, leadership, employee engagement, and customer loyalty.

DEFINITIONS

Strategic Leadership—vision, culture, strategic imperatives

Operational Leadership—management practices that drive procedures, policies, behaviors

Employee Passion—commitment, job satisfaction, perceived fairness

Customer Devotion—positive experience with product and services as well as company policies, procedures, and personnel

Organizational Vitality—the degree to which an organization is successful

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 organization success. They are the procedures and policies that clarify how each unit will achieve the overall strategy.

Employee Passion

Employee passion results from the employee’s positive experience and overall satisfaction with the organization, 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 perceived quality, value, customer service, product expectations, and overall customer satisfaction.

Organizational Vitality

Organizational vitality is the degree to which an organization is successful in the eyes of its customers, employees, and shareholders, as well as its economic stability over time. 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 shows that strategic leadership as well as organizational leadership capacity are critical to overall organizational success.

In addition, leadership impacts customer loyalty and devotion as well as employee engagement and passion. We found throughout the literature that, often, leaders 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 organization profitability is a combination of strategic and operational leadership actions that drive employee passion and customer devotion.

Strategic leadership is a critical building block for setting the tone and direction for a service-quality culture. Operational practices, cascading down, 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 dependant 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 both customers and employees alike.

The Leadership-Profit Chain



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.

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

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

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 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 both being treated fairly and justly by leadership and the organization as a whole. In fact, the research showed that *the number one reason that employees leave an organization is when 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 connection 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 customer.

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

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

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 could service 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 service delivery training 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 rests 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 only be achieved by serving the employee.

About the Researchers

Scott Blanchard, Executive Vice President of Client Delivery for The Ken Blanchard Companies, is an unforgettable motivational speaker, accomplished corporate trainer, and passionate champion of corporate coaching. Part owner of The Ken Blanchard Companies, Scott is also the cofounder of Coaching.com, a Web-enabled corporate coaching and personal development service. As a Senior Consulting Partner for more than six years, Scott led major training interventions at numerous *Fortune* 500 companies. In 2004, he coauthored *Leverage Your Best, Ditch the Rest* with Madeleine Homan. Scott is also a certified facilitator and trainer for the Myers-Briggs Type Indicator®, a well-known temperament assessment tool. Scott was educated at Cornell University and received his master's degree in organizational development from American University in Washington, DC.

Dr. Vicki Essary is an Industrial-Organizational Psychologist with demonstrated results in program evaluation and training and development. She is the Director of Assessments for The Ken Blanchard Companies and oversees 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, a master's in organizational behavior and a doctorate in industrial-organizational psychology from Alliant International University (formerly the California School of Professional Psychology).

Dr. Drea Zigarmi is a highly respected and experienced management consultant, best-selling author, and speaker for The Ken Blanchard Companies. Drea is coauthor of *Leadership and the One Minute Manager*®, the third book in Ken Blanchard's best-selling One Minute Manager Library, and codeveloper of a number of The Ken Blanchard Companies' products, including Situational Leadership® II the widely used Leader Behavior Analysis instruments. Drea received a bachelor's degree in biology from Norwich University, and a master's degree in humanistic education and a doctorate in education, administration, and organizational studies from the University of Massachusetts, Amherst.

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About The Ken Blanchard Companies®

The Ken Blanchard Companies® is a global leader in workplace learning, productivity, performance, and leadership effectiveness that is best known for its Situational Leadership® II program—the most widely taught leadership model in the world. Because of its ability to help people excel as self-leaders and as leaders of others, SLII® is embraced by *Fortune* 500 companies as well as mid-to small-size businesses, governments, and educational and non-profit organizations. Many Blanchard® programs for teams, customer loyalty, change management, and leadership effectiveness blend the use of assessments with instructor-led and online learning. Using best practices based on the company's continual research, Blanchard's world-class trainers and coaches support people in making the shift from learning to doing and drive organizational and behavioral change into all levels of organizations. To learn more, visit www.kenblanchard.com.

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