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## **HOW EMPLOYEES' SATISFACTION AFFECTS QUALITY AND PROFITABILITY IN SERVICE INDUSTRY. A CASE OF MALAYSIAN MAJOR SHOPPING CENTERS**

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### **Abstract**

How human resources can effect on the organization's operation have not been fully addressed so far. In operation management (OM) literature the significance of employees' attitudes in organizations such as satisfaction, loyalty, and commitment and how these attitudes could affect the organizations' performance, has not been explored in-depth (Boudreau, 2004; Boudreau, Hopp, McClain, & Thomas, 2003)

Employees are often deemed to be the first line in the service organizations, and they create the perception that customers take against the firms' services. Employees' satisfaction is the mediator between what a firm makes available for customers and how employees in that particular firm deliver the service. But the relationship between organizational strategies and employees attitudes needs to be further investigated, since few attempts have been done so far in this area (Hartline & Ferrell, 1996; Hartline, Maxham III, & McKee, 2000; Singh & Sirdeshmukh, 2000) This study focused on high contact service industries in Malaysia by examining 112 service shops in major shopping centers in Malaysia. By using structural equation modeling (SEM) this study found that the relationship between employee

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satisfaction and customer satisfaction is partially mediated by service quality, and customer satisfaction will lead to higher profitability in firms.

Keywords: Employee satisfaction; Customer satisfaction; Service quality; Firm profitability

Topic Groups: Production and operations management

## 1 INTRODUCTION

In this competitive and globalized era, every organization is looking to find ways to bring more values to the services it renders, and improves the quality of its services. Priority is given to the operational processes in profitable ways, which convey values to customers and fulfill what they expect (Frei, 1999; Yee, Yeung, & Cheng, 2008). Firms try to enhance their service quality and their operational efficiency in order to attract more customers to increase their profit share. In this matter more attention has been given to how firms design, manage and optimize their quality to bring more profit (Frei, 1999; Saccania, Johanssonb, & Perona, 2007; Yee, et al., 2008). But how their human resources such as their employees through their satisfaction, loyalty, and commitment can be companion in the task of increasing profit has not been fully addressed. In the high-contact service firms, employees are the people who are directly in touch with customers, and how they might respond to customers' wants, desires, and expectations is very important whether bring more value and profit to the firms or make customers to run away and may never come back.

It has been showed that satisfied employees are considered to be loyal and have great impact on service quality, which, as a consequence, bring satisfied and loyal customers that make more profit to the firms (Yee, Yeung, & Edwin Cheng, 2010). Many companies observe employee satisfaction behavior and employ programs to augment satisfaction and loyalty of the employees (Matzler & Renzl, 2007).

The nature of the service industry shows no doubt that employee satisfaction is vital in this industry (Lam, Zhang, & Baum, 2001), then it seems very much worthwhile for firms to be cautious to any behavior and signs regarding employee satisfaction. It has been shown by some researchers that there is a positive relationship between employee satisfaction and customer satisfaction (Koys, 2003; Wangenheim, Evanschitzky, & Wunderlich, 2007b), there is a relationship between low productivity and low job satisfaction (Appelbaum, et al., 2005), employee satisfaction is positively related to customers' satisfaction, while customers' satisfaction affects firm profitability (Bettencourt & Brown, 1997; Yee, et al., 2008), and both productivity and consumer satisfaction are positively associated to profitability (He, Chan, & Wu, 2007).

Since the study of employees in the service industry has been proven to be important based on what we mentioned above, this paper examines the relationship between employee satisfaction and customer satisfaction, and how this satisfaction from employees and customers can influence the firms' profitability. This paper practically examined the effects and consequences of employee satisfaction in the firms' service quality and their profitability by investigating 112 service shops in Malaysia by using structural equation modeling development.

## 2 THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

Organizations are competing in a century that is full of rapid changes, globalization issues, and information technology booms, along with the increased number of service industries around the world. All of the above issues have made companies and their owners to become interested to find out where they can be more benefited from. It has been determined and demonstrated that one of the ways is increasing customers' satisfaction and retention. Antecedents and consequences of customers' satisfaction have become important matters that have made organizations to invest a lot of attentions and interests (Snipes, Oswald, LaTour, & Armenakis, 2005). It is worthwhile to study where customers' satisfaction comes from, and where it affects.

One of such antecedents to customers' satisfaction has been found to be employee satisfaction (Christina & Gursoy, 2009; Kenneth, Donthu, & Kennett, 2000; Tornow & Wiley, 1991; Wangenheim, et al., 2007b; Yee, et al., 2008; Yee, et al., 2010). Employee satisfaction has been an issue for social research for at least two decades since it is regarded as an important factor that can enhance companies' performance and productivity (Christina & Gursoy, 2009; Matzler & Renzl, 2007). (Locke, 1976), (Wanous & Lawler, 1972), and (O'Reilly, Chatman, & Caldwell, 1991) all defined job satisfaction as a auspicious stance or satisfying emotional state that results from a person's job experience or a fit between a person and an organization. Employees' or their job satisfaction have been defined in many different ways as well, like the one that defined it as a positive affective state that is resulted from the judgment of all facets of a working relationship among employees (Cheng, Lai, & Wu, 2010; Geyskens, Steenkamp, & Kumar, 1999). (Theo, 2004) defined employee satisfaction as the degree to which the working environment meets the wants, desires and needs of a particular employee.

Several studies have found where the employee satisfaction affects. When employees become satisfied with their jobs and their working environment, they are more likely to be attached to their organizations and less likely to leave there; and more likely to render quality services (in service industry) for their organizations, which these high quality services will bring more customers' satisfaction (Bettencourt & Brown, 1997; Christina & Gursoy, 2009; Steven & Lam, 2008; Yee, et al., 2008; Yee, et al., 2010). A lower level of intention to turn over by employees is rooted on the fact that satisfied employees recognize better benefits when they stay in their respective organizations, and consequently show higher level of loyalty to their organizations (Barrow, 1990; Guimaraes, 1997; Jun, Cai, & Shin, 2006; C. Lee & Way, 2010; Porter & Steers, 1973; Schlesinger & Zornitsky, 1991; Testa, 2001).

Many other studies conducted around the world also indicate that employee satisfaction has a positive and significant relationship with employees' loyalty to their organizations, and has a negative relationship with their intention to leave (Brown & Peterson, 1993; Griffeth, Hom, & Gaertner, 2000; Hom & Kinicki, 2001; Martensen & Gronholdt, 2001).

On the other hand (Schlesinger, 1982) found that satisfied employees provide better services than dissatisfied employees. Since service products require a great deal of human interference, it is vital for organizations that maintain and meet their employee's expectations, while it has been demonstrated that employees who experience job satisfaction will be more productive in their respective jobs (C. Lee & Way, 2010; McNeese-Smith, 1997; Rafaeli, 1989; Spinelli & Canavos, 2000).

Based on what we mentioned above the first proposition of this study is hypothesized as follow:

### **Hypothesis 1**

H0: Employee satisfaction is not positively related to service quality.

H1: Employee satisfaction is positively related to service quality.

Among many studies done in the area of employee-customer satisfaction, one of the popular conceptualization is the service-profit chain (Heskett, Jones, Loveman, Sasser, & Schlesinger, 1994; Heskett, Sasser, & Schlesinger, 1997), which embraces several relationships between employee satisfaction, customer loyalty and company performance; and this is the reason why organizations are looking for the way to enhance their employees' satisfaction and loyalty (Matzler & Renzl, 2007).

(Heskett, et al., 1994) proposed the service profit chain idea that underscores the significance of employee characteristics to convey high levels of service quality to satisfy customers, and in turn increase organizations performance. On the other hand satisfied employees who become loyal to their organizations enhance the quality of the services, bring more innovative and productive ideas, which in turn bring satisfied customers to organizations (Edvinsson, 1999; Matzler & Renzl, 2007; Sveiby, 1997; Yee, et al., 2010). Maintaining quality employees seems an ideal way to preserve a dense reputation and create a loyal customer base (Keane, 1996; C. Lee & Way, 2010).

Based on the above mentioned explanation and on the findings that service quality has been found positively related to customers' satisfaction (Christina & Gursoy, 2009; Heskett, et al., 1994; Heskett, et al., 1997; Steven & Lam, 2008; Yee, et al., 2010); the second proposition of this study is hypothesized as follow:

### **Hypothesis 2**

H0: Service quality does not mediate the relationship between employee satisfaction and customer satisfaction.

H1: Service quality mediates the relationship between employee satisfaction and customer satisfaction.

Employee satisfaction has been found to be influential on customers' satisfaction (direct or indirect), and customers' satisfaction has been found to be positively related to financial performance (Chi & Gursoy, 2009; Christina & Gursoy, 2009; Isaiah & Obeng, 2000; G. Lee, Magnini, & Kim, 2011).

Other scholars also found that employee satisfaction is directly related to customer loyalty, which in turn brings profitability to organizations (Fay, 1994; Iaffaldano & Muchinsky, 1985; C. Lee & Way, 2010).

Several other studies have found the positive and significant relationship between employee satisfaction, customer satisfaction, and firms' profitability (Bernhardt, Donthu, & Kennett, 2000; Bettencourt & Brown, 1997; Christina & Gursoy, 2009; Harter, Schmidt, & Hayes, 2002; Koys, 2003; Steven & Lam, 2008; Tornow & Wiley, 1991; Wangenheim, Evanschitzky, & Wunderlich, 2007a; Yee, et al., 2008).

Employee satisfaction in organization, especially service industry has been demonstrated to be influential on customer satisfaction (Christina & Gursoy, 2009; Kenneth, et al., 2000; Tornow & Wiley, 1991; Wangenheim, et al., 2007a; Yee, et al., 2008), and then the third proposition of the study is hypothesized as follow:

### **Hypothesis 3**

H0: Employee satisfaction is not positively related to customer satisfaction.

H1: Employee satisfaction is positively related to customer satisfaction.

On the other hand, customer satisfaction has been found to be significantly related to firms' profitability in several studies (Bettencourt & Brown, 1997; He, et al., 2007; Yee, et al., 2008; Yee, et al., 2010), then the fourth proposition of this study is hypothesized as follow:

### **Hypothesis 4**

H0: Customer satisfaction is not positively related to firms' profitability.

H1: Customer satisfaction is positively related to firms' profitability.

## **3 METHODOLOGY**

### **3.1 Sampling and data collection procedures**

In this paper, we try to concentrate on those industries that are in high contact with their customers through the services they offered in Malaysia. We identified big shopping centers and randomly chose 6 major shopping centers (e.g., KLCC, Midvale). We focused of those shops that have 2 to 5 service employees. By service employee, we mean those employees who are responsible to offer services (e.g., beauty shops), or sell products to customers.

In order to collect data properly, the authors hired some local bachelor students and asked them to go to those identified major shopping centers in different areas to distribute the questionnaires. Two types of questionnaires were asked to distribute, one among the people who are in charge of shops, and the other among employees. For every one questionnaire for the shop managers, two questionnaires were distributed to employees. Some shop managers avoid participating in the survey, indicating that they cannot disclose their financial information, this matter made the authors to go by person to some shops and asked them again to participate by explaining that their financial information would be confidential and used only as a source.

Distributors visited around 200 shops in 3 months period. Total of 402 questionnaires obtained, 134 from shop managers and 268 from employees. We dropped 22 shops due to either missing information or incomplete questionnaire from shop managers or employees. Then, 112 sets of questionnaires from 402 participants were used to analyze (Table 1).

Table 1: Sampled shops

Service	Number of shops
Fashion retailing	25
Beauty salons	22
Skin care products and salons	21
Optical	10
Travel agency	8
Body massage shops	11
Jewelry	6
Others	9
Total	112

### 3.2 Variable measurements

For measuring employee satisfaction, customer satisfaction, service quality, and financial profitability this study adopted the questionnaires that (Yee, et al., 2008) developed and validated. In order to measure the employee satisfaction, four questions were chosen from Job Satisfaction Index (Smith, Kendall, & Hulin, 1969). Each item in this questionnaire was rated using seven-point Likert-Scale ranging from 1= "totally disagree" to 7= "totally agree". For measuring service quality, five questions were chosen based on the five dimensions of SERVQUAL (Parasuraman, Berry, & Zeithaml, 1991; Parasuraman, Zeithaml, & Berry, 1988) that are considered to be the most relevant to the service sectors in which this study focuses. Each item in this questionnaire was rated using seven-point Likert-Scale ranging from 1= "totally disagree" to 7= "totally agree".

To measure customer satisfaction four questions were developed related to feature performance, which impels satisfaction, including enquiry service, price, customer service in transactions, and service handling of dissatisfaction (Gustafsson, Johnson, & Roos, 2005; Heskett, et al., 1997; Oliver, 1997).

For measuring firm profitability, return on assets (ROA), return on sales (ROS), return on investment (ROI), and overall profitability were chosen as indicators. These measurements of profitability have been shown to be consistent with previous studies (Yee, et al., 2008). We asked the shop managers to assess their profitability relative to their respective industry norms. Each item in this questionnaire was rated using seven-point Likert-Scale ranging from 1= "much lower" to 7= "much higher".

### 3.3 Reliability test

Reliability of this study verified by Cronbach's Alpha, which is a popular method for measuring reliability. For any research at its early stage, a reliability score or alpha that is 0.60 or above is sufficient (Nunnally, 1978). As shown in table 2, the reliability score of all constructs were measured to be greater than 0.60.

Table 2: Reliability coefficient test

Scales	Number of items	Alpha	Mean	SD
Employee satisfaction	4	.850	5.5000	.87536
Customer satisfaction	4	.636	5.5290	.74340
Service quality	5	.620	5.0464	.59744
Firm profitability	4	.874	5.2299	.82346

(Yee, et al., 2008) verified the validity of the instrument used in this study by doing exploratory factor analysis (EFA) and confirmatory factor analysis (CFA).

#### 4 DATA ANALYSIS AND RESULTS

We applied structural equations modeling (SEM) to examine the proposed model. SEM is used to conduct the data analysis for testing the research hypotheses. SEM is a feasible statistical tool to examine the hypothesized factor structure for all variables. SEM also examines measurement error and provides path coefficients for both direct and indirect effects of structural hypotheses. In this study analysis of moment structure (AMOS) was used.

Table 3 shows the result of fit statistics for our model. The overall fit of our structural model was good, chi-square =293.144 degree of freedom=115, chi-square/degree of freedom=2.549, RMSEA=0.083, CFI=0.920, GFI=0.964. All the four hypothetical relationship were supported at the significance level of  $p=0.05$ .

Table 3: Goodness of fit indices of model

Goodness of fit measure	Criteria	Model
Chi-square of estimated model	-----	293.144
Degree of freedom	-----	115
Chi-square/degree of freedom	$\leq 3.0$	2.549
Goodness of fit index (GFI)	$\geq 0.90$	0.964
Root mean square (RMSE)	$\leq 0.10$	0.083
Comparative fit index (CFI)	$\geq 0.90$	0.920

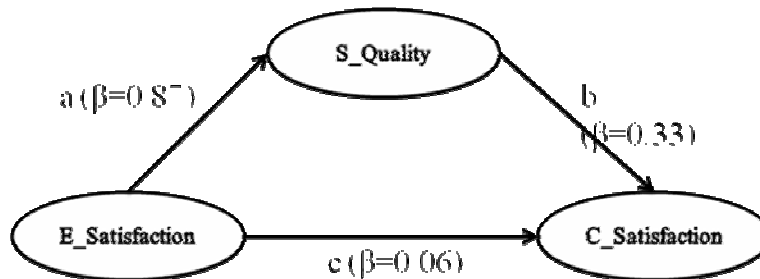
In order to test hypotheses 1, 2, and 3, the following steps were taken: (figure 1)

Step 1: We conducted a simple regression analysis with employee satisfaction predicting customer satisfaction to test the significance of path "c" alone ( $\beta=0.06$ ).

Step 2: We conducted a simple regression analysis with employee satisfaction predicting service quality to test the significance of path "a" alone ( $\beta=0.87$ ).

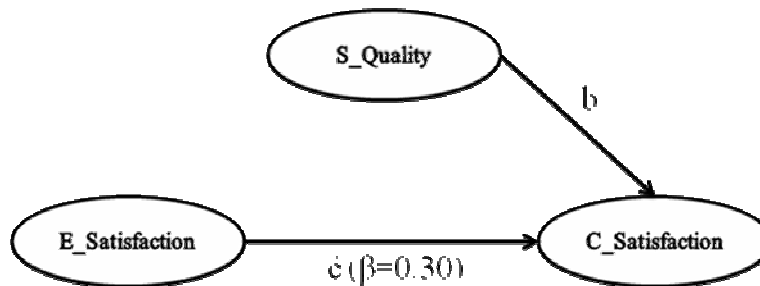
Step 3: We conducted a simple regression analysis with service quality predicting customer satisfaction to test the significance of path "b" alone ( $\beta=0.33$ ).

Figure 1: Path analysis for step 1, 2, and 3.



Step 4: We conducted a multiple regression analysis with employee satisfaction and service quality predicting customer satisfaction to test "c" ( $\beta=0.30$ ).

Figure 2: Path analysis for step 4.

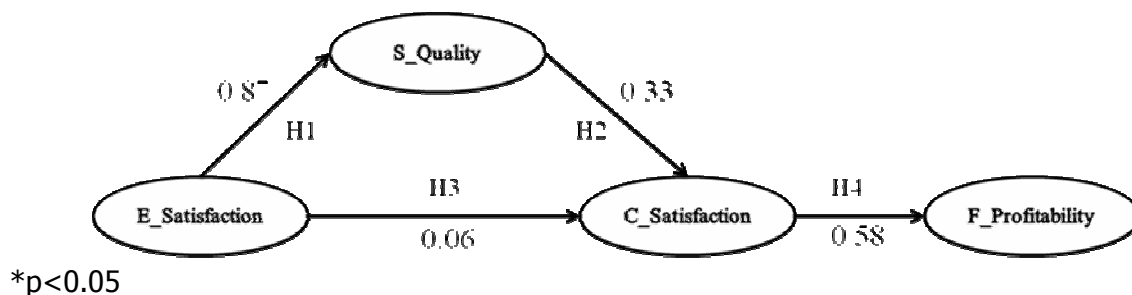


A, b, c, and  $\acute{c}$  are standardized regression coefficients, which all measured to be significant indicating that service quality is a partial mediation between employee satisfaction and customer satisfaction. The first three hypotheses were supported by these findings.

We conducted a simple regression between customer satisfaction and firm profitability ( $\beta=0.58$ ), supporting the fourth hypothesis

The theoretical and hypothesized model is shown in figure 3.

Figure 3: Hypothesized model:





## 5 DISCUSSION AND CONCLUSION

We developed and examined the relationship between employee satisfaction, service quality, customer satisfaction, and firm profitability. The findings of this study support that employee satisfaction is very important to enhance the quality of services that rendered to the customers in any given company, and is crucial to the firms' profitability. The results support that employee satisfaction leads to customer satisfaction through high service quality, and eventually the satisfaction from customers will lead to higher profitability. By this study we provided evidence that support the basic relationship between employee satisfaction, service quality, customer satisfaction, and firm profitability. These findings support the previous studies' findings (Yee, et al., 2008).

As in the study of Yee, et al. (2008), which supports the conceptual framework of the balance scorecard (Kaplan & Norton, 1996) proposing that employee morale and growth, internal business process, customer satisfaction, and financial measures are considered as four balanced quadrants that make the strategic initiatives of an organization; this study also provided evidence that support a right balance between those four perceptions as essential factors in small scale service industries that their employees are in high contact with their customers.

There always have been concerns among managers about which of the employee or customer satisfaction is more important for higher profitability in firm; by doing this study we practically demonstrated that for any firm in high contact service industries the employee satisfaction is more crucial in order for a firm to be more profitable. This study showed that higher satisfaction among employees brings high quality services to customers making them more satisfied with these high quality services, which in turn increase the firm profitability. We here argued that for any service industry companies in Malaysia, employee satisfaction plays an important role for companies' profitability by showing that the relationship between employee satisfaction and customer satisfaction is partially mediated by service quality, and customer satisfaction is in significant relationship with firm profitability. Conclusively, employee satisfaction should be attended more carefully since it is an important factor to bring customer satisfaction and profitability.

## 6 LIMITATION

Limitations, like any other studies, were unavoidable in this study as well. One would be that some managers were not willing to participate since they consider the profitability section in questionnaire as information revelation. Some times during conducting this research we faced non responding managers that we needed to deal with them by going in person and explaining that their information is confident and that the financial information of theirs were not required in detail; some agreed to participate, and others not. In this study in order to measure customer satisfaction we rather asked employees and managers to participate in this measurement since it seemed to us that asking customers to participate would create many inconsistencies in our work. This study only focused on high contact service industries in Malaysia, which makes this study non-generalizable to those low contact services.

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