Correlation of Morale, Productivity and Profit in Organizations

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Abstract

This study examined whether the level of employee morale has a direct relationship to productivity and profit. Several studies indicated that low morale causes low productivity but have not indicated decreased profit as a result. There is also research that revealed high-level job performance results and high employee commitment and not the other way around. This research attempts to discover if morale, productivity and profit are related. The study was based on a sample of employees in five Engineering organizations. The employees were surveyed about whether their job performance was affected by individual morale within the organization. If so, how they perceived their productivity levels would fluctuate as determined by four levels of morale. The results revealed a direct relationship between job performance and morale. When morale is low, productivity is low and in turn, profits may be affected.

Introduction

Interest in the effect of morale on productivity has increased over the years as companies begin to realize that the bottom line may not just be profit, but the value of keeping employees happy. The literature focused on the types of distractions that can lower morale such as lack of certainty about jobs and failure of the employees to buy in to the mission statement and goals (Bennet, et al, 2004; Goodrich, 2004; Lynch, et al, 1999). Research also focused on the different ways to improve morale, but very little research actually showed the affect of morale on profit based on the fact that productivity is a function of morale. Employee wellness is indicated as the underlying factor in morale and that internal and external environments affect morale. For example, financial concerns of employees outside of work can affect productivity. Research also revealed that worker stress results in lower productivity such as absences, tardiness, leaving early, mistakes, and lack of concentration. A survey was conducted of 1000 employees that had household incomes of $25K or more. The findings showed that 43% of those below 45 years of age said financial worries sometimes affected their job performance and 60% desired financial planning assistance. This study also concluded that absenteeism increased with financial problems (Williams, et al., 1996). Other research indicated that employee morale can affect the bottom line due to poor customer service from an unhappy employee. The Service profit chain incorporated employees into the profit process (Bailey and Dandrade, 1995). Employees often become the front line when marketing your business. Unhappy employees can make for unhappy customers and in this age of intense competition, customer loyalty is a great financial value that must be maintained in the long run to grow profits. (Voges, 2003)

Morale is the key to developing and fully capturing human potential and channeling this energy toward productivity. Morale is a key factor of employee motivation and is defined as the state of the spirits of a person or group as exhibited by confidence, cheerfulness, discipline, and willingness to perform assigned tasks. The performance of these tasks is directly related to productivity which in turn is directly related to profit.

Theory Development and Hypothesis

The literature suggested that in order to understand whether good morale leverages productivity, a company must first be able to measure morale. (Bennet, et al. 2004) Research revealed the following measurement tools.

1. Job satisfaction survey provides qualitative data on what a person thinks of the organization. This survey can ask questions such as:
    a. Does my supervisor listen to my concerns?
    b. Do I have the training I need?
    c. Am I proud of the organization
2. Suggestion boxes
3. Employee interviews

The feel of the individual and the company is measurable; however, employees must feel confident that they will not be retaliated against for being honest.

Hypothesis 1: Employee productivity will decrease if the employee morale level drops.

A Business Week survey (YEAR) revealed that 42 percent of employees when unhappy are more likely to be distracted, less productive, and more likely to seek other employment. There is often dialectic between morale and productivity. Research from (Voges, 2003) suggested that as one goes up, the other goes up. Morale is an important characteristic of a company but can it necessarily affect productivity in a company ultimately increasing the bottom line. From a business perspective, a positive office morale leads to increased productivity and less missed time from work because people enjoy coming in, enjoy the people they work with, and enjoy the challenges of the job. It also leads to great customer service. All are benefits for management and employees both (Voges, 2003).

Hypothesis 2: Employee morale affects profit through increased expenses, lower productivity, or decreased customer satisfaction

Consider how much it costs to hire and train a new employee and how many hours of lost productivity there are because the staff has low energy, how much it costs the company for a lost customer because an employee had a negative attitude during interaction. How much can a company lose because of lack of employee cooperation and team spirit?

The literature suggests that "happy hands are busy hands" (Business Research Lab, 2003) suggesting that high morale can decrease employee turnover. Obviously, keeping employees happy is one way to decrease turn over. Poor morale can be costly to an organization. Employee turnover is very costly. In one company used in sample, it costs approximately $45,000 when replacing an employee just for recruitment fees, relocation fees and travel. When several employees must be replaced this can impact SG&A expenses. Research revealed that there is a definite link between the intention of people to stay at their place of employment and reward and recognition. The correlation between the length of time people stay with their current employers and the recognition given for work that is well done is 27% which is a positive and statistically significant relationship. This correlation is higher than that statistic based on monetary rewards and the intention to stay. (Business Research Lab, 2003)

In addition to expenses incurred to hire a new employee to replace an unhappy one that left the company, there is also a learning curve that the replacement employee may experience. Training costs may be incurred in order to get the incumbent up to speed on organizational activities. During this learning time, productivity is low which can ultimately cause schedule slips and possibly loss of revenue while he or she learns and adapts to the new position. Plus, the productivity level of the new employee may not be the same as the current employee. William Rothwell, a professor of work force education and development at Pennsylvania State University Park campus is quoted as saying "Morale does affect the bottom line in turnover. Happy employees are more likely to stay on, saving a company the cost of training new workers who initially may not be productive" (Business Research Lab, 2003)

Customer Satisfaction can be affected by morale. Consider Southwest Airlines, a company rating high in morale. This company is ranked # 1 in fewest customer complaints and is included in Fortune Magazines' top five Best companies to work for. Southwest's senior public relations editor, Ed Stewart explains that their belief is if you take care of employees, they'll take care of customers and your shareholders will be very happy at the end of the day (Goodrich, 2002). To determine the relationship between employee satisfaction which provides for morale and customer satisfaction, research was done at Digital Equipment Corporation. A model was created to show the relationship of employee satisfaction in the profit chain. An equation was used to set up the model. Employee Satisfaction + Customer Satisfaction = Sustained Profitability. In other words, profit is a function of employee satisfaction.

This equation suggests that employee morale could not only increase profits but may actually be a must in order to sustain profits. That is why it is important to create a nurturing environment where everyone is pulling in the same direction and peoples' contributions are valued as important. Employees buy into the mission statement and customer satisfaction goes up. Companies must allow employees to reflect upon the ways that they implement the values in the mission statement and in their daily work (Bennet et al., 2004)

The employee environment is very important and morale must be maintained. Researchers revealed that 69 % of workers experienced condescending behavior and that these workers would be more likely to make derogatory comments about their company to others. This could affect customer base ultimately preventing customer loyalty and possible loss of profits (Voges, 2003). This survey also suggested that 40% slowed down so that deadlines were not met, and 43% were rude to a customer or client. The research explains that while there are many studies that investigate and correlate customer satisfaction with profit, not many studies are done incorporating the employee satisfaction into the profit formula. Digital Equipment Corp became interested in this factor and in turn did an internal study of customer satisfaction, employee satisfaction, and operating measures. The research described that the success of Banc One, Southwest Airlines, and Taco Bell are due in part to the understanding they have about the correlation between putting employees and customers first. They explain that this new paradigm of understanding requires new ways of managing and measuring success. They focus on the impact of employee satisfaction, loyalty, productivity, and on the value of products and services delivered. By so doing, managers can build customer satisfaction and loyalty, thus assessing the impact on profitability and growth. This is all based on the premise that the lifetime value of a loyal customer can be astronomical, especially when referrals are added to the economics of customer retention and repeat purchases of related products.

The service-profit chain (Figure 1) establishes the relationships between profitability, customer loyalty and employee satisfaction, and loyalty and productivity. Profit and growth are stimulated by customer loyalty. Loyalty is a direct result of customer satisfaction. Satisfaction is influenced by value of services provided to customers. Value is created by satisfied loyal and productive employees. The satisfaction comes from high quality support services and policies that enable employees to deliver results to customers (Bailey and Dandrade, 1995).

Figure 1: The Service-Profit Chain

A study was done in seven MCI customer service centers that found clear relationships between employees perception of quality of MCI service and employee satisfaction and then linked this satisfaction to customer satisfaction (Bailey and Dandrade, 1995). The importance of customer loyalty is supported by psychologist's theory that two major principles helped to determine how individuals develop commitment, information and behavior. The example provided is described as when we hear an opinion from someone we trust about a particular service, we are more likely to act on that information by trying that service. The employee is the front line of sales to an organization's customers. Keeping them happy is important. The research and data below is based on the employee being part of the profit model.

Methodology

Sample and Procedures

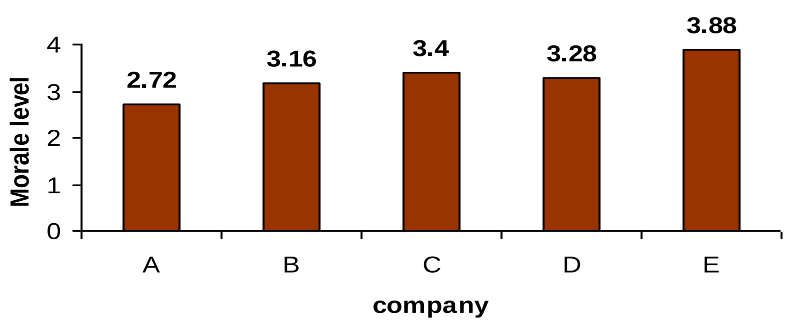
This research used a multiple respondent survey approach. Five Engineering companies were surveyed and 25 people from each company were asked a series of questions about morale in the work place. In the first part of the survey, respondents were asked to rate current morale in their respective companies. All 25 ratings in each company were tabulated and an average morale score was determined for each company. Table 1 shows averages and standard deviation.

Table 1: Average Morale Scores from Sample and Standard Deviation

Company	A	B	C	D	E
Average morale score	2.72	3.16	3.4	3.28	3.88
Standard Deviation	0.7	0.9	0.9	0.8	0.3

The average score per company is plotted in Figure 2.

Figure 2: Comparison of Average Morale Rating in 5 Companies



In order to test hypothesis 1, respondents were given four levels of morale: (1) *Best*, (2) *Good*, (3) *Fair*, and (4) *Worst* and were asked to rate perceived individual productivity levels at each stage in order to determine what relationship productivity has to morale levels. The findings revealed that 24.8% of respondents indicated that there was no relationship between morale and productivity and indicated that their job performance was 100% all the time. In contrast, 75.2% of respondents indicated that morale did affect job performance.

Respondents were then asked to quantify using the following numerical rate: 1=10% for *Worst* through 10=100% for *Best* what they felt their productivity level would be at each stage of morale from *Best* to *Worst*. The data extrapolated is graphed in Figure 2.

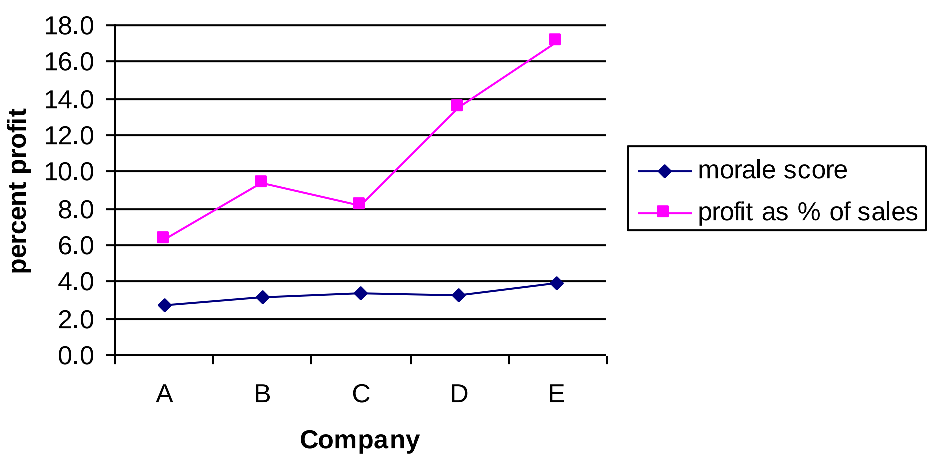
In order to test hypothesis 2, the average morale score provided by each company was compared to the current profit as a percentage of sales based on last reporting period of financials in each company (Table 2).

Table 2: Profit in 5 Companies as compared to Average Employee Morale Rating

Company	A	B	C	D	E
morale score	2.7	3.2	3.4	3.3	3.9
profit as % of sales	6.3	9.4	8.2	13.5	17.1

In order to determine a relationship between the two sets of data the results were plotted in Figure 3. The covariance of the sample is 1.59.

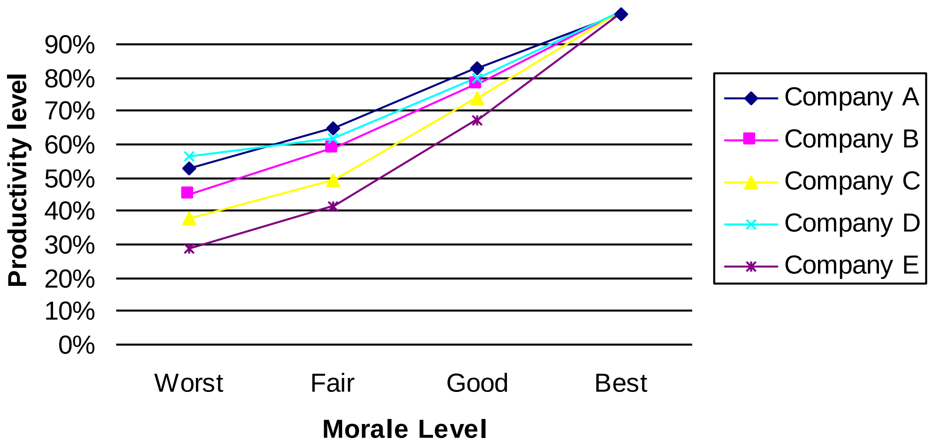
Figure 3: Correlation of Productivity and Profit



Discussion and Implications

Hypothesis 1 suggested productivity is affected by morale. Of the 25 respondents in each company, each person rated his or her own perceived productivity level based on the different morale levels. As seen in Figure 4, when morale dropped one level the rate of productivity dropped 24%, dropping 2 levels decreased productivity by a total of 45% and with a poor level of morale, employees could possibly lose 56% of their productivity. This could be devastating for a company.

Figure 4: Average Perceived Drop in Productivity Based on Morale Level



Hypothesis 2 suggested low morale affected profit by increasing expenses, decreasing productivity or decreasing customer satisfaction. The chart of companies' profit levels as a percent of sales vs. employee perspective morale level indicate a possible relationship between morale and profit. There were limitations to this research. This research used engineering companies which provide services. Many other industries will need to be examined. Better parameters for identifying which bracket (1-4) *Best*, *Good*, *Fair*, and *Worst* could be provided for the respondent to better ascertain which category his/her company fits into.

Conclusion

Based on the respondents in the morale surveys, it is clear that there is a definite perceived difference in performance based on the employees' satisfaction in the company. Measuring productivity and morale levels can be difficult. But it is likely that determining how morale affects productivity is best answered by the employees themselves because they are the driving factor in productivity levels and can best describe these levels during fluctuations in morale levels. Determining fluctuations in productivity are difficult in engineering organizations and only the employees know their personal effort levels and how they change based on morale. There is difficulty in linking morale directly to profit because there are more factors driving profit levels than just the productivity of employees. The data provided to address Hypothesis 2 is in its earliest stages and more research should be performed in order to provide a more conclusive answer.

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