Transformational Leadership in The Hotel Industry: A New Look at The Service-Profit-Chain Concept

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Abstract

Employee engagement is essential to the Service-Profit-Chain concept as the factor to produce high quality service that would meet or exceed customer expectations. However, despite its suggested advantages, limited knowledge is known about what causes employee engagement. This study attempts to understand the Service-Profit-Chain concept more comprehensively, by encompassing transformational leadership as the preceding factor to employee engagement. It aimed to examine the role of transformational leadership in shaping employee engagement and service quality which lead to financial performance. The sample groups taken were among the star-rated hotels located in Surabaya, Indonesia. Each hotel was represented by three groups namely: hotel managers, staff, and hotel customers. The Partial Least Square-SEM method was applied to evaluate the proposed model. The results revealed that the effect of transformational leadership on financial performance is mediated by employee engagement. However, service quality cannot mediate the effect of transformational leadership on financial performance. It is interesting to note that Service-Profit-Chain has some limitations in practice, depending on the organization's strategy. This study is among a few attempts to contribute to a better understanding of the Service-Profit-Chain concept application, with transformational leadership as the factor preceding employee engagement specifically in the hotel industry. It founds that the application of Service-Profit-Chain concept in the hotels have some constraints related to the business strategy that hotels select to penetrate the market.

Keywords - Service-Profit-Chain, Balanced Scorecard, transformational leadership, employee engagement, service quality, financial performance.

1. Introduction

Financial performance is the primary dependent variable of interest for researchers in almost any area of management. The competitive demand for customers, inputs, and capital make financial performance important for organizations to survive and succeed. Consequently, it gained a central role as the goal of modern industrial activity. Measuring financial performance is important to evaluate the determined actions of organizations and managers, where organizations stand against their rivals, and how organizations develop and operate (Richard, et al., 2009).

Apart from financial performance, other important factors include human resources and operating systems. But since operating systems work only with the presence of human, it can be concluded that the most essential asset of an organization is its human resources (Hanushek,1997). Today, human resources issues are not only about staff attendance or other administrative issues, but more about motivational issues and satisfaction of needs, providing space for growth and creativity along with a safe and healthy environment with satisfying material needs of employees (Kavanagh et al., 1990). According to Kahn (1990), those psychological conditions affect employee's engagement at work.

One of the most-widely used theories explaining the link between an organization's employees and their connection to the overall financial performance is the Service-Profit-Chain (Heskett et al., 1994). It proposed that engaged employees, achieved internally through human resource management, can produce high quality service that will meet or exceed customer expectations, creating satisfied customers; satisfied customers would become loyal to the company, leading to improved financial performance through the effect of repurchase and good reputation (Myrden, 2013).

The Service-Profit-Chain concept always started with employee engagement. According to Saks (2006) and Slatten and Mehmetoglu (2011), although employee engagement has received many attentions because of its suggested advantage, limited knowledge is known about what causes it. The challenge creates the condition to achieve employee engagement, because organizations that get the conditions right will gain a competitive advantage that will be very difficult to be imitated. Therefore, there is a need of a research not only to study the advantage of employee engagement, but also the factor preceding employee engagement. (Saks, 2006; Slatten & Mehmetoglu, 2011).

Literature has shown that transformational leaders play an important role in stimulating employee engagement (Harter et al., 2002; Macey & Schneider, 2008) due to their ability to increase the fundamental motivation of their followers to reach the organization's goals (Richer & Vallerand, 1995). Transformational leaders stimulate the motives of their followers, which in turn would enhance their fundamental value of accomplishing goals, raising the level of satisfaction in participating in the leader's mission, raising the level of commitment to the leader's vision and raising their level of engagement (House & Shamir, 1993).

Parallel with, but also completing the Service-Profit-Chain, the Balanced Scorecard concept (Kaplan & Norton, 1992) also discussed the linkage between intangible assets and the creation of tangible assets. The value from intangible assets like human resources and organizational culture seldom have a direct impact on the organization's financial performance. Improvements in intangible assets affect the financial performance through cause-and-effect relationships involving some intermediate stages (Kaplan, 2010). When the Service-Profit-Chain starts with engaged employees, the Balanced Scorecard, under the Learning and Growth Perspective embraces leadership as one of the principal intangible assets.

In 2018, Indonesian government designates tourism as the leading sector in Indonesia (Badan Pusat Statistik Kabupaten Bolaang Mongondow, 2018), since it is one of the lead sectors contributing to the country's foreign exchange. In addition, it is projected to be Indonesia's largest foreign exchange producer in 2019 (Kementerian

Pariwisata Republik Indonesia, 2017). Bureau of Statistics East Java in their published report stated that the development of tourists visiting Indonesia, especially in East Java in the last three years continues to increase (Badan Pusat Statistik Provinsi Jawa Timur, 2018). Because of such an increase, the hotel industry has been highly affected. Starting in the year 2015, the number of hotels in East Java has increased significantly at 70.45% compared to the previous year and has stayed at the higher figure since then. This shows that investment in hotel businesses has been promising and of high interest especially in East Java. From the total number of accommodation businesses in East Java, 49% of them are located in Surabaya city (Badan Pusat Statistik Provinsi Jawa Timur, 2018). This means that the competition in hotel industry especially in Surabaya has been fierce because of the significant increase in the industry player. Therefore, hotels in Surabaya need to be alert on how they could stay on top of the competition.

Previous studies mentioned above (Myrden, 2013; Harter, Schmidt, & Keyes, 2003; Heskett, Jones, Loveman, Sasser, & Schlesinger, 1994; Schneider & Bowen, 1985; Harter, Schmidt, & Hayes, 2002), have shown that one way to achieve financial performance is by offering a high-quality service, which could be produced by engaged employees, which is highly affected by the leader. A study to provide evidence of these relationships is needed, in order to present new findings in how organizations can achieve good financial performance. In previous studies about Service-Profit-Chain, the concept mostly started with employee engagement (Saks, 2006; Slåtten & Mehmetoglu, 2011). Therefore, this study is anticipated to contribute for a better application of the Service-Profit-Chain concept, with transformational leadership as the factor preceding employee engagement. Based on the above stated background, this research is undertaken to study the relationships of transformational leadership, employee engagement, 15 service quality, and financial performance and their link to the Service-Profit-Chain and Balanced Scorecard concept, in hotel industry in Surabaya.

2. Literature Review and Hypothesis Development

2.1. Service-Profit-Chain

In the new economics of the service sector, the new success measurement calibrate the impact of employee engagement on the service quality delivered for building customer satisfaction and loyalty, and finally asses their impact on the financial performance (Heskett et al., 1994). As stated by Ennew (2015), The Service-Profit-Chain outlines a series of causal links on how internal management of employees impacts the service quality, then the customer satisfaction and ultimately the financial performance. The Service-Profit-Chain requires a special kind of leader who understand the importance of maintaining an organizational culture centered around employees and service to customers. Such leaders display willingness and ability to listen, spend ample time with employees and customers, while listening to employees' improvement suggestion. They care about their employees and seriously work on selecting, tracking, and recognizing them (Heskett et al., 1994). Those qualities are found in a transformational leader. According to Fitzgerald and Schutte (2010), transformational leaders lead by building relationship with employees, understanding their needs, and helping them develop. The simple logic underlying the Service-Profit-Chain is instinctive yet compelling – care for your employees, they will care for your customers, and those satisfied customers will deliver a good financial performance (Ennew, 2015; Schneider & Bowen, 1985).

2.2. Balanced Scorecard

The Balanced Scorecard allows managers to look at the organization from four vital perspectives; financial, customer, internal business process, and learning and growth perspectives. This scorecard includes financial measures that show the results of the actions already taken. And it completes the financial measures with the other three operational measures – customer, internal business process, and learning and growth – that are the drivers of the financial performance (Kaplan & Norton, 1992). This scorecard was never intended to replace financial measures, but to complete them (Kaplan & Norton, 2007). Most organizations' control systems are constructed around financial perspectives and targets, which have very little connection to the organization's progress in achieving long-term strategic objectives. The focus around short-term financial perspectives leaves a gap between the establishment of a strategy and its implementation. Using the Balanced Scorecard, organizations do not have to rely only on the short-term financial perspective. Organizations can now observe its short-term result from the three additional non-financial perspectives and evaluate its strategy in view of recent performance. Meeting only the short-term financial target should not be considered satisfactory when the other non-financial perspectives signify that the long-term strategy was not well implemented (Kaplan & Norton, 2007).

2.3. Transformational Leadership

Transformational leadership can be defined as the motivational leadership related to providing a clear corporate vision and inspiring employees to achieve that vision by building relationships with them, understanding their needs, and helping them reach their potential (Fitzgerald & Schutte, 2010). Leaders who implement transformational leadership focus on developing employee value systems, their level of motivation and morality with the development of their skills (Ismail et al., 2009). Transformational leadership acts as a bridge between leaders and followers to develop a clear understanding of the interests, values, and level of motivation of followers. This kind of relationship helps followers to achieve their goals, and it encourages followers to feel free to express ideas and be adaptive to new and better ways in a changing environment (Bass & Avolio, 1994). Bass (1985) based his theory of transformational leadership on the concept by Burns (1978), with several enhancement and modifications. One of the considerable modifications is on the behaviors that indicate transformational leadership. In the most recent and widely used version there are four dimensions of transformational leadership: idealized influence, inspirational motivation, individual consideration, and intellectual stimulation (Bass & Avolio, 1994).

2.4. Employee Engagement

Employee engagement was initially presented by Kahn (1990), who defined the construct as the harnessing of employees to their work. Maslach and Leiter (1997) stated that engagement is characterized by energy, attachment, and productivity. Engaged employees possess the energy and strong connection to their work and are confident about their ability to complete their job demands. The shared idea is the understanding that employee engagement is "a desirable condition, has an organizational purpose, and connotes involvement, commitment, passion, enthusiasm, focused effort and energy, so it has both attitudinal and behavioral components" (Macey & Schneider, 2008, p. 4). They stated that engagement is not a momentary and specific state, but more of a persistent and extensive affective and cognitive state not focused on any specific object, occurrence, individual, or behavior. Therefore, it is a positive, satisfying, work-related state of mind that can be characterized by the three dimensions: vigor, dedication, and absorption.

2.5. Service Quality

Grönroos (1988) stated that service quality can be determined by the difference between the actual service performance delivered, with the service performance that was expected. In other words, service quality can be defined as a general judgment about the overall excellence of the service performed (Parasuraman et al., 1988). Parasuraman et al. (1988) introduced the SERVQUAL model to measure service quality using five dimensions: reliability, responsiveness, assurance, empathy, and tangibility. SERVQUAL model has been widely applied in the hotel industry as a quality measurement (Yuan et al., 2005; Shaikh & Khan, 2011; Dedeoglu & Demirer, 2015). Service quality is conceptualized as the difference between the perceived and expected service (Zeithaml et al., 1996).

2.6. Financial Performance

Financial performance measurement can be used to measure the organization's success in managing and allocating their resources to generate profits (Devie et al., 2019), because financial performance measures demonstrate whether the formulated strategy, along with its implementation and execution, are contributing to the organization's financial return (Kaplan & Norton, 1992). Prieto and Revilla (2006) argue there are four perceptual measures to obtain a comprehensive view of the hotel's financial performance, namely: profitability, sales growth, work productivity, and cost reduction. The use of perceptual measures was found to be consistent with factual measures and also helped on the reluctance of hotel managers to provide factual financial performance measures.

2.7. Proposed Model and Hypotheses

Previous findings have revealed the significance of managers and their effect on employee engagement (Harter et al., 2002), because leaders manage many aspects that influence an employee's work experience (Bhatnagar, 2007). Other study found that although employees agree their company is a good place to work, only half agree that the company inspired them to do their best. The dissatisfaction area included distant and non-communicative leadership and lack of development opportunity (Towers-Perrin, 2003). This suggests the importance of leadership in determining employee engagement (Bakker et al., 2011).

Some researchers specifically suggested that transformational leaders play an important role in stimulating employee engagement (Harter et al., 2002; Macey & Schneider, 2008) because of their ability to increase the followers' fundamental motivation to reach the organization's goals (Richer & Vallerand, 1995). This will also raise the level of satisfaction in participating in the leader's mission, raising the level of commitment to the leader's vision and raising their level of engagement (House & Shamir, 1993).

Having engaged employees would offer many benefits to organization (Salanova et al., 2005). Engaged employees care about the organization's success and are motivated to give effort to help achieve it (Linsner, 2009). Employee engagement affects employee retention and customer loyalty (Harter, et al., 2010), which directly impact financial performance through customer's repeat orders and positive word-of-mouth (Myrden, 2013). Based on the foregoing discussion, the following hypotheses on transformational leadership, employee engagement, and financial performance were formulated as follows:

H_1: Transformational leadership has an effect on employee engagement.

H_2: Employee engagement has an effect on financial performance.

H_3: Employee engagement can mediate the relationship between transformational leadership and financial performance.

Employees represent the organization to its customers during service delivery; therefore, they are considered to have the main responsibility for the service quality received by customers (Lytle, Hom, & Mokwa, 1998). However, leaders have the ability to influence employees' attitudes and behaviors during service delivery. The leadership styles adopted by the leaders are the determinant of the service delivery process effectiveness, which results in better service quality provided (Zeithaml & Bitner, 1996). Othman et al. (2014) and Schalkwyk (2011) found a significant positive relationship of transformational leadership style and service quality in hotel industry. A high-quality service is crucial for any business but specifically for service-based businesses (Myrden, 2013). Parasuraman et al. (1985) pointed out that technique-oriented and price-competition based product are not the future trend, but service quality through interaction with customers to enhance their satisfaction will promote an organization's financial performance. The Service-Profit-Chain concept stated that when customers receive a high-quality service, it will bring many benefits to the organizations, which ultimately results in financial performance (Heskett et al., 1994). On this basis, the following hypotheses on transformational leadership, service quality, and financial performance were proposed as below:

H_4: Transformational leadership has an effect on service quality.

H_5: Service quality has an effect on financial performance.

H_6: Service quality can mediate the relationship between transformational leadership and financial performance.

Service quality is based not only on the tangible aspects, but also on the intangible aspects, such as employee's behavior, service efficiency, and attention to customers (Parasuraman et al., 1988). Therefore, the interaction of employees and customers is considered an important determinant of the actual service quality performed (Bitner, 1990; Gwinner et al., 1998). For a service organization, its employees are a significant resource because of their extensive interaction with customers (Myrden, 2013). The Service-Profit-Chain concept suggested that employees who are engaged are more likely to produce higher quality service. Because the organization care for its employee well, its employees will likely to care for its customers better (Schneider & Bowen, 1985). Based on this discussion, a hypothesis on employee engagement and service quality was drawn as follows:

H_7: Employee engagement has an effect on service quality.

Efficiency in resource utilization and enhancement of organization's financial performance are highly dependent on leadership style (Obiwuru et al., 2011). Effective leadership is a powerful source of management development and sustainable competitive advantage to achieve financial performance (Avolio, 1999; Lado et al., 1992; Rowe, 2001). Muterera (2012) found that both transactional and transformational leadership styles both had a positive effect on organization's financial performance. However, transformational leadership has a higher contribution to financial performance than transactional leadership does. Based on this conceptual framework, the following hypothesis on transformational leadership and financial performance was developed:

H_8: Transformational leadership has an effect on financial performance.

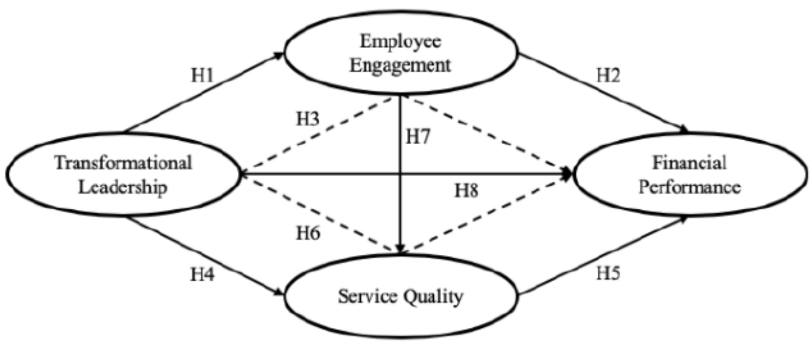

Figure 1. Proposed Research Model

3. Research Method

The population of this study was limited by the location and type of hotel, to only the star-rated hotels located in Surabaya. According to the report of Bureau of Statistics East Java, in 2017 there are 97 star-rated hotels located in Surabaya (BPS Provinsi Jawa Timur, 2018). Each hotel will be represented by three respondent categories: employee, customer, and manager respondents. Employees gave responses for transformational leadership and employee engagement variables while customers provided responses for service quality variable, and managers responded to financial performance variable. The employee respondents must be a full-time staff of the hotel, who has worked for at least one year in the hotel as a front liner. Customer respondents must have stayed in the hotel for at least one night. Manager respondents must be working for at least two years in the hotel. Under the convenience sampling method, only the hotels that return with responses within the given time period of two months will be included as sample. From all the 97 hotels reached, the researcher was able to explain about the study to 60 hotel managers and received 30 commitments to participate. Out of the 30 participating hotels, a total of 63 manager and 149 employee questionnaires were used for further analysis. To reach the customers, the researcher approached all friends, acquaintances, and all other people met during the research. There were 181 people who have stayed in one of the 30 participating hotels. Each hotel can be represented by more than one employees, customers, and managers. In case of multiple responses gathered for one hotel, the scores obtained from each of the respondent groups are averaged to get a sinlge outcome score for each measured variable for each hotel.

To assess the employees' perceptions of their manager's transformational leadership behaviors, items were taken from those used by Myrden (2013), which was developed by Podsakoff et al. (1996). The measure was applied in 12-items to capture the level of transformational leadership. To measure employee engagement, items were taken from those used by Myrden (2013), based on the 9-item day level version of UWES (Schaufeli et al., 2006). The 9-items measure is applied in this research to capture the level of employee engagement. To measure service quality, items were taken from those used by Myrden (2013), an adapted version of SERVQUAL by Parasuraman et al. (1988). The measure was applied in 10-items to capture service quality level. To measure financial performance, items were taken from those used by Prieto and Revilla (2006). The 4-items measure were used, to measure financial performance.

4. Results

Hotels with three-star rating have the highest proportion (40%) of the total sample, followed by hotels with four-star rating (30%), five-star rating (16.7%), and two-star rating with the lowest number (13.3%). There was no one-star rating hotel that participated. To examine the measurement model, this study evaluates the average variance extracted (AVE), outer loading, and composite reliability (CR). The convergent validity test reveals that the validity is fulfilled as AVE is higher than 0.5, and loadings are higher than 0.6 (Hair et al., 2014). This result satisfies the requirement of discriminant validity of the variables.

Table 1 Measurement Indicators

Variables and Indicators	Loading Factor	CR	AVE
Transformational Leadership		0.951	0.617
TL1	0.760		
TL2	0.735		
TL3	0.740		
TL4	0.844		

TL5	0.838		
TL6	0.800		
TL7	0.844		
TL8	0.774		
TL9	0.776		
TL10	0.731		
TL11	0.807		
TL12	0.766		
Employee Engagement		0.934	0.613
EE1	0.856		
EE2	0.800		
EE3	0.737		
EE4	0.764		
EE5	0.815		
EE6	0.797		
EE7	0.735		
EE8	0.739		
EE9	0.794		
Service Quality		0.948	0.623
SQ1	0.845		
SQ2	0.718		
SQ3	0.788		
SQ4	0.830		
SQ5	0.756		
SQ6	0.817		
SQ7	0.798		
SQ8	0.766		
SQ9	0.710		
SQ10	0.840		
SQ11	0.803		
Financial Performance		0.851	0.589
FP1	0.844		
FP2	0.712		
FP3	0.792		
FP4	0.716		

Coefficient of determination (R Square) assessed the model predictive accuracy. The R Square score represents the percentage of change in the dependent variable that is explained by the change in the independent variables. In other words, it is the combined effects of the independent variables on the dependent variables (Hair et al., 2014).

Table 2. R Square Result

	R Square
Employee Engagement	0.223
Service Quality	0.513
Financial Performance	0.488

Table 2 shows that transformational leadership can explain 22.3% of variance in employee engagement. The combined effects of transformational leadership and employee engagement can explain 51.3% of variance in service quality. Finally, the combined effects of transformational leadership, employee engagement, and service quality can explain 48.8% of variance in financial performance. In addition to coefficient of determination, the model can exhibit predictive relevance for each of the endogenous construct in which the Q^2 value must be more than zero. The value of Q^2 can be calculated using the following formula:

$$Q^2 = 1 - (1 - 0.223)\,(1 - 0.513)\,(1 - 0.488)$$
$$= 0{,}8062 = 81\%$$

From the result of the above calculation, the value of Q^2 is 0.8062, which means that the structural model can explain 81% of the phenomena variance. The remaining 19% is caused by other factors, which was not explored in this research.

Hypotheses Testing

The significance testing of the relationships between constructs was derived using the bootstrapping procedure. This was done to test the research hypotheses, resulting in path coefficients testing for the direct effects. Commonly used critical values for the significance testing of the hypothesized relationships are 1.65 (significance level = 10%), 1.96 (significance level = 5%), and 2.57 (significance level = 1%). The generally accepted significance level is 5%, while the 10% significance level is often accepted in the exploratory phase of a research. As for the P-value, it has to be less than 0.10 ($P < 0.10$), 0.05 ($P < 0.05$) and 0.001 ($P < 0.001$) for the effect to be significant at the level of confidence of 90%, 95% and 99%, respectively.

Table 3. Path Coefficient Results

Direct Effects			
	Original Sample (O)	**T Statistics**	**P Values**
Transformational Leadership → Employee Engagement	0.472	2.442	0.015
Employee Engagement → Financial Performance	0.664	2.950	0.003
Transformational Leadership → Service Quality	0.444	2.826	0.005
Service Quality → Financial Performance	-0.080	0.443	0.658
Employee Engagement → Service Quality	0.390	2.571	0.010
Transformational Leadership → Financial Performance	0.153	0.631	0.528
Indirect Effects			

	Original Sample (O)	T Statistics	P Values
Transformational Leadership → Employee Engagement → Financial Performance	0.314	2.010	0.097
Transformational Leadership → Service Quality → Financial Performance	-0.036	0.398	0.810

H_1 is accepted, meaning that transformational leadership has a significant positive effect on employee engagement in star-rated hotels in Surabaya. The hotels which applied transformational leadership will have an increased level of employee engagement. H_2 is accepted, indicating that employee engagement has a significant positive effect on financial performance in star-rated hotels in Surabaya. Hotels with higher level of employee engagement will have higher level of financial performance. Next, H_3 is also accepted, meaning that employee engagement can mediate the effect of transformational leadership on financial performance. Further, when the mediation effect is not included in the model, transformational leadership has no significant effect on financial performance. H_4 is accepted, confirming that transformational leadership has a significant positive effect on service quality in star-rated hotels in Surabaya. Hotels which applied transformational leadership will have an increased service quality performed. H_7 is also accepted, showing that employee engagement does affect the level of service quality in the star-rated hotels in Surabaya. Hotels with a higher level of employee engagement will deliver a higher level of service quality.

On the other side, there are three hypotheses rejected. First is H_5 meaning that service quality does not have a significant effect on financial performance of the star-rated hotels in Surabaya. The service quality performed by the hotels will not affect their financial performance. H_6 is also rejected, indicating that there was no evidence that service quality can mediate the relationship of transformational leadership and financial performance. Last is H_8 that is rejected, meaning that transformational leadership does not affect the financial performance of the star-rated hotels in Surabaya. Application of transformational leadership style by the hotels will not directly affect their financial performance.

5. Discussions

This study revealed that transformational leadership affects the level of employee engagement, which is consistent with previous researchers (Bezuidenhout & Schultz, 2013; Myrden, 2013; Evelyn & Hazel, 2015). In Service-Profit-Chain concept, special qualities in a leader are required to maintain an organizational culture centered around employees (Heskett et al., 1994), and those qualities can be found in transformational leaders (Fitzgerald & Schutte, 2010). This study also found that employee engagement affects the organization's financial performance, which is consistent with previous researchers (Harter et al., 2003; Xanthopoulou et al., 2009). It is because engaged employees, care more about the success of the organization and are willing to give effort to help achieve it (Linsner, 2009). The Service-Profit-Chain concept suggests that the satisfaction and loyalty of engaged workforce will ultimately generates improved financial performance (Pritchard & Silvestro, 2005).

In addition, the finding showed that transformational leadership style affects the level of service quality, which is consistent with previous researches (Othman et al., 2014; Schalkwyk, 2011). The types of leadership may influence employees' service attitudes and behaviors (Farrell, 2001). The Service-Profit-Chain concept started with internal service quality that refers to the ability of the organization to deliver the kind of support that will enable to produce high-quality service. The internal service quality includes job design, working environment, support systems, which are all tied closely to the leadership style (Ennew, 2015).

The result of this study found that service quality does not directly affect financial performance. This result is similar with previous research by Nair (2016) in a hotel setting, which found that service quality may not be the only determinant of financial performance. There are many factors that may affect the hotel's financial performance, such as marketing, branding, customer retention, and customer loyalty (Nair, 2016). The absence of a significant relationship between service quality and financial performance may indicate that the organizations are not focusing on providing high-quality services to draw the customers' attention (Goyit, 2015). In this present study, the majority of hotel customer sample group were those from three-star hotels, which might be more price-sensitive and take price above service quality as the main factor in choosing in which hotel to stay. Murasiranwa et al. (2010) stated that there were many aspects other than service quality that may affect the hotel's financial performance, including competition and staff turnover. The very intense industry competition has made all hotels of the same class look very similar. Therefore, aside from maintaining a good service quality, the hotels also need to have other innovative strategies and promotions to be different from the competitors.

The hotel industry is also known with high staff turnover, which is very costly, because they have to continually hire and train new team members which will increase costs that affect the hotel's financial performance (Murasiranwa et al., 2010). Staff turnover has serious cost implications, from both the tangible aspects (i.e. recruitment and training), to the intangible aspects (i.e. loss of skills and inefficiency) (Patiar & Wang, 2016).

Besides, with the path coefficient of -0.080 showing a negative relationship, there is a possibility that to serve a higher service quality to the customer, the hotel must incur additional costs that negatively affect financial performance. This is consistent with the argument of previous researcher (Ekinci et al., 2011), that when additional services are offered by the hotel, they will add to the hotel's costs, which consequently cut the hotel's profitability.

While service quality improvements create an opportunity to increase financial performance by the ability to charge a higher price and to generate customer loyalty, this may be counterproductive where the customer's price sensitivity is high. According to Ekinci et al. (2011), such a situation would have an adverse effect on the customer's demand which result in a lower company's profitability and financial performance (Ekinci et al., 2011).

According to Porter (1980), there are two generic strategies that could be chosen by companies in pursuing competitive advantage. The cost leadership strategy, which is effectively implemented when the organization designs, produces, and markets a comparable service more efficiently and at a more competitive price than its competitors. And the differentiation strategy which fulfills a unique customer need by tailoring the service, allowing organizations to charge a premium price to capture market share. The connection of the implementation of the two generic strategies with the Service-Profit-Chain concept is shown in the figure below.

Figure 2. Service-Profit-Chain and Strategy

As shown on Figure 2, the application of Service-Profit-Chain in the hotels have some constraints related to the applied strategy. When the hotel offers a higher quality service, some additional costs will need to be incurred, but at the same time it creates an opportunity to charge a higher price for hotels applying the differentiation strategy. However, for hotels applying the cost leadership strategy, there is a border line of the maximum price level they could possibly charge to the customer, and consequently they reach the maximum service quality level they could possibly provide without hurting the financial performance. When such hotels further increase their service quality level, they will consequently cut the hotels' profitability.

This study also found that employee engagement affects the service quality performed, which is consistent with previous researchers (Myrden, 2013; Salanova et al., 2005; Na-Nan et al., 2015). The Service-Profit-Chain concept stated that service quality can only be created by engaged workforce who are willing to give out high levels of effort on their work because they enjoy their quality of work life (Lau, 2000).

This study showed that transformational leadership does not directly affect financial performance. It was not significantly affected by transformational leadership possibly because financial performance is the lagging indicators of performance (i.e. financial results related to increase in revenue and decrease in cost). Which also relate to the concept of Balanced Scorecard (Kaplan & Norton, 1996), that the possible reason for the lack of significance is related to the effect of lag (financial) and lead (non-financial) performance indicators. In this research, even though transformational leadership does not have a significant direct effect on financial performance, it was found that transformational leadership style has a significant and positive impact on the leading non-financial performance indicators (i.e. employee engagement and service quality). There are sufficient research evidences from previous researchers that non-financial performance will eventually drive the financial performance (Bento et al., 2013; Evans, 2005; Maiga & Jacob, 2009). These cause and effect relationships are the secret to achieving financial performance of an organization (Patiar & Mia, 2015). Nevertheless, given that non-financial performance drives financial performance, the effect of transformational leadership on financial performance may exist indirectly through improvements of non-financial performance (Patiar & Wang, 2016). In this research, it is found that transformational leadership has a significant positive effect on financial performance with the mediating effect of employee engagement. Transformational leaders that encourage their followers to be innovative, creative, and to try something new (i.e. intellectual stimulation) (Avolio & Bass, 2004), consequently will need to give room for mistakes which can be unbeneficial for the financial performance. By giving room for mistakes, leaders can create feeling of safety at work for the followers which allow them to feel safe to challenge current methods and try new ways (Myrden, 2013). The instant reward and disciplines of transactional leadership style can bring an effect to short-term performance; but transformational leadership creates fundamental changes in the followers' beliefs and attitudes, which effect to the organization is long-term in nature (Cleveland et al., 2000). In Balanced Scorecard, financial perspective is seen as a short-term performance, while the other non-financial perspectives signify the implementation of long-term strategic objectives (Kaplan & Norton, 2007). Consistently it was found, that transformational leadership has a significant effect on the long-term non-financial performance (i.e. employee engagement & service quality), but not directly on the short-term financial performance. This indicates that transformational leadership will have an effect on the lagging indicator financial performance in a longer time frame (Cleveland et al., 2000), through the mediation of the leading indicator employee engagement (Patiar & Wang, 2016). In this research, the financial performance indicators measure only the short-term performance that includes profitability, sales growth, work productivity, and cost reduction. These measures might not be able to reflect and measure the long-term financial performance of the hotel.

6. Conclusion, Implications, and Further Research

Consistent with the underpinning theory of Service-Profit-Chain, this research found that the application of transformational leadership style has a significant and positive direct effect on employee engagement and service quality in the hotels. Further, employee engagement also has a significant and positive direct effect on service quality and financial performance of the hotels. Consistently, it was found that employee engagement can mediate the relationship between transformational leadership and financial performance. On the contrary, this research found that service quality has an insignificant and negative direct effect on financial performance, as well as transformational leadership that has an insignificant effect on financial performance. Consistently, it was found that service quality cannot mediate the relationship between transformational leadership and financial performance. Based on the results drawn, managers of the star-rated hotels in Surabaya need to be aware that the application of transformational leadership will bring a longer-term benefit, that may not be realized just yet. As the finding suggests that transformational leadership does not have a significant direct effect on financial performance. Nevertheless, by applying transformational leadership, the organization could build its long-term intangible human asset (i.e. employee engagement), which was found to be beneficial to financial performance in a longer time frame. In addition, the application of transformational leadership in the hotels has proven to have a significant positive effect on the delivery of a higher service quality to the customers. However, the research also found that service quality has an insignificant negative effect on financial performance, which may be linked to the attributes of the market in Surabaya that are still highly price-sensitive.

Despite this study's significant contributions, several limitations should be acknowledged. The context of this research was in a service-based, specifically the hotel industry. The attributes and characteristics of the market and customers may not be the same in a non-service-based industry or in other geographical areas. Another limitation was in the questionnaires measuring the hotel's financial performance. The questionnaire items have not specified the time frame of each of the financial performance items intended to be measured. This could result in different time frame perceptions of the manager respondents and therefore may affect their answers in measuring the financial performance.

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