Capturing Turnover Costs

*In-depth analysis of your organization’s turnover may help gain support for HR strategies.*

Tracking turnover costs has become increasingly important in the current tight labor market. Getting to the bottom of what causes turnover and how much it hurts a company's bottom line helps HR hone the recruiting process and find ways to improve the work environment to hike retention.

"You're bleeding because you can't get enough people, or you're bleeding because you can't keep them. You have to fix something, though," says Susan Burleigh, SPHR, senior associate of the U.S. flexible staffing service at Eli Lilly & Co. in Indianapolis, and a member of the Society for Human Resource Management (SHRM) Employment Committee.

Quantifying turnover will help garner upper management support for HR strategies. "In the past, HR was not as credible when it said, 'Here's what I feel,' or 'Here's what I think.' You ought to be able to back up any good business decision with data and figures."

Turnover analysis tends "to become a rallying point" to help HR determine if it's spending money on activities that promote retention, says Michael O'Malley, a consultant with William M. Mercer Inc. in New York and author of *Creating Commitment* (John Wiley & Sons, 2000). Along with providing concrete information about turnover expenses, the process helps align decision makers with the company's goals and gives HR measurements it can re-examine after it has implemented changes. Uncovering the costs of turnover can be a real wake-up call, as it was for Walter Kalinowski, executive director of HR at El Paso-based Petro Stopping Centers LP, a company with truck plazas at 53 locations.

"Historically, the company was profitable and could get new people easily. Then we hit a wall," says Kalinowski. "We were hiring 200 to 300 employees per pay period. It was out of control, and we were starting to have trouble finding people." After hiring a consultant, he discovered that turnover was costing his company millions of dollars.

Examing Turnover

Formulas vary, but a simple turnover rate equals a company's total number of "separations" - both voluntary and involuntary divided by its total number of employees. Most companies exclude cyclical layoffs, permanent reductions-in-force and cutbacks due to mergers. They also factor out temporary or contract employees in their turnover formulas. Further more, some also may omit unavoidable turnover due to death, illness or a spouse's relocation.

Beyond that, the challenge for HR is to capture all the costs, so that strategies can be aligned with true expenses. O'Malley suggests using categories such as pre- turnover, separation, vacancy, recruiting and new-hire processing to help guide the search for pertinent expenses.

Pre-turnover, for instance, may include costs that result from the employee's slower work pace and increased absenteeism. O'Malley also points out that involuntary turnovers often incur a grievance process, which can be time-consuming for everyone concerned. Actual separation can incur severance pay, unemployment costs or litigation fees.

Vacancy costs will include lost opportunities in sales and service, as well as expenses such as overtime pay for employees who pick up the slack.
Recruiting and new-hire processing includes the direct cost of advertisement and promotional materials, referral bonuses, relocation expenses, sign-on bonuses, background checks, etc. Added to that are wages of employees who recruit, process paperwork, conduct interviews and tours, give tests, train and conduct orientation, along with the wages of support staff who hook up computers and phones, process identification badges and so on.

Many HR staffs have already captured some of these figures in assessing their company's cost per hire, but that is only one component of turnover expense.

Using Industry Estimates

Industry associations and surveys may provide a benchmark to base individual turnover costs; For example, the Bureau of National Affairs Inc.'s March 2000 Bulletin to Management shows that the national rate of turnover averaged 1.2 percent of employers' workforces per month last year.

The Saratoga Institute believes that an average turnover figure for companies is one times the cost of the employee's salary and benefits; however, it can vary widely depending on the industry. Saratoga's 1999 Human Resource Financial Report shows that turnover, and therefore the costs of turnover, are much higher for the retail industry.

Specific industry groups can usually calculate average costs or devise formulas with reasonable accuracy. The Washington, D.C.-based American Hotel & Motel Association's 1997 U.S. Full-Service Deluxe & Luxury Hotel Benchmarking Study used well-known industry figures of $2,500 for direct and $1,600 for indirect turnover costs per departing employee to calculate the average turnover cost of a hotel at $631,400. Similarly, the Coca-Cola Retailing Research Council (CCRC), a grocery industry service group in Atlanta, offers a simplified method of calculating turnover costs, which is based on the average hourly wage for the focus job.

William M. Mercer's 1998 FAX Facts Survey on Employee Turnover shows that 55 percent of companies surveyed estimated the cost of turnover at $10,000 per person or less, but 10 percent calculated it at more than $40,000 per person. A 1998 retention study by Manchester Consulting also indicates that for any number of factors-including company revenue and number of employees-turnover costs are most likely to fall within the range of $1,000 to $10,000 per employee.

In addition to industry trade organizations, Burleigh suggests referring to consulting firms and large surveys, which companies can purchase or participate in for the benchmarks of a specific industry. Also, local chambers of commerce often provide similar data for their areas. Global companies may want to be aware of benchmarks in various geographic areas, she adds.

"You don't have to reinvent the wheel, either," Burleigh contends. "One of the benefits of being an SHRM member is your access to [its] white papers and the Information Center. You can find a lot of data there and can use these research items to be credible with your CEO."

Doing the Analysis

Warren L. Culpepper, CEO of Culpepper and Associates Inc., a company specializing in information technology (IT) business issues in Alpharetta, Ga., contends that formulas and "rules of thumb" are good to get attention. They say, "Wow, we'd better take this seriously." But, he says, sticking with averages isn't all that useful.
To get more specific, experts suggest that HR begin the process of individual analysis by dividing costs into two categories—soft and hard. Soft costs are difficult to quantify because they don't show up as a direct payment or out-of-pocket expense; yet, research indicates that real monetary pain lies here. CCRRC recently studied turnover costs in supermarkets and found that industry-wide, "hard" (or direct) turnover costs totaled $813 million, while "soft" opportunity costs—change-making errors, paperwork mistakes, damaging products, etc.—added another $4.9 billion.

Burleigh says that companies need to add in their soft costs to get an accurate picture of the financial impact of turnover. "What are you losing in projects or work not being completed?" she asks. "How is morale affected by overtime or additional work that employees must take on? How much revenue have you lost from jobs you can't bid on?"

"As people leave, you lose what's in their brain. Especially at high levels or where policies and procedures aren't written, you lose everything they know, down to the status of their project." Burleigh says senior executives understand "brain drain" because of their experience with succession planning, but HR may need to push for a good knowledge management plan as well.

One way to calculate soft costs is to look at trends. "HR can compare absenteeism or tardiness to earlier levels or track a decrease in productivity and output," says Burleigh. Another trend to consider is increased use of your employee assistance program (EAP), which could indicate higher employee stress.

Much of this analysis can be done through automation, says Burleigh. For example, overtime wages can be tracked to see how turnover affects the amount of hours the remaining staff works. Also, HR can create a standardized exit process that includes an exit interview survey tool. HR can ask questions about the reason for leaving, the employee's length of assignment, whether they were looking for something out of the job that they weren't getting and any other questions that may be helpful to stem turnover. These survey answers could then be tracked in a database.

But, Burleigh warns, the process has to be continuous. "You may not have a lot of time to be thoughtful—you'll get behind the curve very quickly."

Lost opportunities also can hit the bottom line hard. "The productivity of a sales rep selling very sophisticated products like software continues to rise for as long as three years," explains Culpepper. "If you're losing an experienced salesperson, you may hire someone else who is experienced but not in your company." Culpepper estimates that the loss of a good sales route equals one times the annual quota for that person, rather than the person's salary.

"In IT sales, you also have follow-up sales," Culpepper adds. "So, if you didn't make the initial sale because of a vacancy or inexperience, you also lose the opportunity to make follow-up sales." All of these factors should be considered when calculating turnover costs.

Mistakes, incomplete or sloppy work, lower customer service and lost productivity for supervisors and co-workers will certainly cost the company something in direct profit potential and voluntary separations may transfer customers, energy and good ideas to your competition. The CCRRC study, for instance, found that "the impact of lost customers could add from 34 percent to 119 percent to the direct and opportunity costs of supermarket employee turnover, depending on the job type involved."

Most experts believe that turnover costs rise as the level of the job and its complexity increases. John Sullivan, chief talent officer at Agilent Technologies in Palo Alto, Calif., says that turnover costs
of $200,000 per departing employee are the norm, and $250,000 are not unusual for software engineers a high-knowledge occupation. "One firm I work with just calculated the cost of an engineer vacancy in lost revenue at $7,000 per day," he adds.

**Using the Information**

Kalinowski discovered that the per employee turnover cost was $3,500, which translated to $1 million for a turnover rate of 10 percent. "That $1 million got everyone's attention," he says, and it gave everyone the incentive to look closely at what they were doing.

"One of the things we found out was that the type of people we got from walk-ins and newspaper ads turned over two-and-a-half times higher than referrals from employees," says Kalinowski. "Along with other measures, we redesigned our referral program and changed part of our interview so we could identify loners and people who don't know how to work as a team." Kalinowski says that the company's cost of recruiting has probably increased because he's taking more time—but turnover has dropped from 168 percent to 103 percent a year.

If you're making a case to senior management, the first thing to do is to document how the problem affects business strategies, advises O'Malley. For example, if your company differentiates itself through customer service and you have 100 percent turnover, you can't support that strategy. O'Malley also urges HR to enlist the help of operating managers and reach agreement on determining the problem and the solutions. "You need an executive team with one voice."

Although Burleigh says that one of HR's strengths is being on the front line with employees, "HR needs to come in with the figures, too."

*By Carla Joinson, HR Magazine, July 2000*