Calculating the “Real” Cost of Employee Turnover

It’s a well-known fact that the loss of an employee can cause dramatic consequences for an organization. Before determining the steps to decrease employee turnover, the type of turnover must be understood. The types of turnover are managed; initiated by the organization and unmanaged; meaning, the turnover organizations can influence, but don’t. What many organizations don’t know is that the cost to lose a high performing employee can be ½ to 1 times their salary. To help reduce unmanaged employee turnover, we advise you begin by calculating the cost of turnover, understand why turnover occurs and learn ways to increase employee engagement and reduce unmanaged turnover.
The Cost of Employee Turnover

We’re all familiar with the expression, “you don’t miss someone until they’re gone.” While this sentiment is typically associated with personal relationships, the same can be said of companies for their top employees.

It’s not just a matter of missing the camaraderie of a valued team member; it’s a bottom line issue as well. Employee turnover takes a toll on morale, productivity levels, and customer satisfaction. For this reason, employee retention is an increasing priority for corporations around the globe, specifically with high performing team members.

The goal of any business, large or small, is to make a healthy profit that can be paid to shareholders or reinvested for growth. An important element of profit generation is the ability to control and minimize cost. Very extensive, yet often unrealized, the cost associated with employee turnover is an aspect of cost management that many business owners or companies fail to proactively control.

Employee turnover costs depend on labor markets in which you are competing. When the market is loose, for instance, it is relatively easy to find and train new employees quickly and at moderate costs. In contrast, in a more competitive market where labor and skills might be somewhat scarce, recruitment is generally more costly, and open positions may be vacant longer, resulting in higher loss of productivity and profitability. This is especially true when you are losing top talent to competitors or when customers have developed relationships with individual employees. Although market and labor conditions are indeed a factor, broad estimates put the cost of turnover in the U.S. at more than $150 billion annually.

In many cases, the financial impact of turnover is severe, both in terms of increased recruiting fees and downtime associated with the on-boarding of new hires. When top talent leaves, they are not just leaving holes in a workforce that negatively impact employee morale and productivity, they are taking with them knowledge and skills that provide a competitive advantage in your marketplace. Their departure causes a harsh ripple effect on both direct and indirect costs in an organization.
What is Employee Turnover?

Before we explore the costs associated with employee turnover, let’s step back for a moment to define it. We work with our clients to define employee turnover in several ways: managed, unmanaged, controllable, and uncontrollable. Here is a quick look at the differences.

**Managed employee turnover** is, as the term implies, when employees leave the organization and it is initiated by the organization. Managed employee turnover can range from mass layoffs to a specific employee being asked to leave. This type of turnover also includes someone that has resigned because they were on a performance management plan with a strong probability it would lead to termination. This is often referred to as involuntary turnover.

As a leader in employee retention, we wholeheartedly agree that some turnover in an organization is necessary. Some people are simply not a good fit for the organization in terms of performance; some can’t seem to get to work on time or violate company policy. They need to go.

On the contrary, **unmanaged employee turnover** occurs when someone leaves who the organization would like to keep. Voluntary employee turnover is another common description for this type of attrition - that is, the employee leaves the organization under their own steam.

This distinction leads to the further delineation of controllable versus uncontrollable employee turnover. For example, when someone leaves the organization, and it is someone that the organization would like to keep (i.e. highly trained, productive), he/she may be leaving for reasons outside the control of the organization. Examples of **uncontrollable employee turnover** include spouse relocation, returning to school or joining the armed forces. Although the organization would prefer the person to stay, uncontrollable turnover occurs when there is little that can be done to prevent them from leaving.

Conversely, **controllable employee turnover** occurs when a desirable employee leaves the organization for reasons that were under the control of the organization. Unmanaged, controllable employee turnover is the type of turnover that we help organizations not only identify, but also provides recommendations to reduce. Some of the causes of unmanaged, controllable employee turnover can easily be identified and resolved by improving communication, enriching job duties to be more interesting, developing leaders, increasing flexibility in work processes, etc.
What are the Direct Costs of Employee Turnover?

Unmanaged, controllable employee turnover has a significant monetary cost to organizations, as well as a significant impact on other key functions within the organization. To provide some scope of the costs typically experienced by organizations, we embarked on a study about employee engagement and retention challenges (with over 650 organizations participating from a range of industries), analyzing causes, costs, and consequences impacted by employee turnover. In this study, we asked organizations to report their estimated direct financial cost of losing a single front-line employee or leader. Direct costs include some of the more obvious expenses such as filling the vacancy (e.g., recruiting, interviewing, selection testing), training costs for replacements, equipment and tools, uniforms, and similar expenses.

For front-line employees, organizations indicated that the direct cost for replacement ranges from $500 to more than $20,000, with the median cost ranging from $5,500 to $7,500 per frontline employee. When asked about the direct cost of replacing a manager, most organizations indicated $20,000 or more per manager.

What are the Indirect Costs of Employee Turnover?

Of the two categories of cost that are associated with employee turnover, direct costs are typically the costs that leaders focus on because they are visible. Yet of equal importance and very often neglected, are the hidden or indirect costs. These costs are represented by lost productivity; the financial value of time that is used to find and hire the replacement employee and the negative impact on colleagues and customers when a valuable employee leaves an organization.

According to Robert Morgan, president of Spherion’s Human Capital Consulting Group, a world leader in the measurement of human capital, several noted experts believe that 70% of the country’s wealth today is in human capital as opposed to physical capital. “In a knowledge economy, the primary profit lever is people and therefore companies must take seriously their responsibility to manage this asset,” says Morgan.

To help reduce employee turnover, we advise you to view your employees as resources, not expenditures. As further evidence on how employee turnover affects organizations, we asked organizations to indicate their top five factors impacted by turnover. “Morale and Culture” ranks as the highest factor among all organizations and the Best in Class.
Top 5 Factors Impacted by Employee Turnover and Lack of Engagement

To estimate productivity levels, there are several formulas out there; some are based on thresholds such as an employee being 25% productive for the first month, 50% productive after two months, and so on. Naturally, for more senior-level positions or those requiring longer periods of time to develop full productivity, the costs will be higher.

One of the simpler formulas proposes that the cost of lost productivity is at a minimum of 50% of a person’s compensation and benefits cost for each week the position is vacant, even if there are people performing the work. Factors to consider are the “cost” of the knowledge of skills - and customer relationships - of the person walking out the door, missed deadlines due to disrupted work flow, the morale of the team members who must pick up the work or who might grieve the emotional loss of a respected colleague.

In our annual Workplace America report, we asked organizations to estimate the indirect cost of losing a single front line employee or manager. Although indirect costs are often difficult to quantify, they are often the most damaging to organizational viability. Consider the indirect impact on profitability when employee morale drops, customer service wanes, and sales are lost because relationships between employees are broken. Organizational knowledge leaves, and there are not enough employees to meet market demands. For almost a third of employers in our study indirect turnover costs average more than $20,000.
Why Don’t More Companies See the Critical Need to Measure Employee Turnover Costs?

There are a variety of reasons companies do not see the critical need to measure employee turnover costs, all of which cost companies in expertise and dollars. Some large company leaders, for example, believe that employee turnover is “an HR problem.” True, Human Resource employees need to serve as partners in reducing employee turnover cost; however, this is a strategic issue requiring top management’s attention and actions.

In other cases we uncovered, costs associated with employee turnover are either discounted as “part of doing business” or they are grossly underestimated and therefore register as less of a concern. A final reason why more companies don’t view employee turnover as a costly problem is because costs are not reported to top management. If leaders aren’t made aware of turnover costs, they can’t take appropriate action.

Do Organizations know their Cost of Attrition?

![Direct Cost Chart](image1)

![Indirect Cost Chart](image2)

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Workplace America 2019
Digging Deeper

When we consider the top business areas influenced by employee turnover, we quickly realize that none of these factors are isolated. Instead, these factors have wide reaching impacts on many other aspects of the organization. Take lower employee morale as an example. Lower employee morale can directly affect productivity, quality, and the customer experience. We also know that low employee morale perpetuates even more turnover as employees begin to look for greener grass. As can be seen, employee turnover does not just affect a single area - its effects can spread unnoticed throughout many areas of the organization, ultimately impacting the bottom line.

Some factors to be calculated in the cost of employee turnover are a combination of direct and indirect costs. Take recruiting costs as an example. An internal recruiter has to take the time to understand the position requirements, develop and implement a sourcing strategy, review candidates’ backgrounds, prepare for interviews, review resumes, schedule and conduct interviews, prepare candidate assessments, conduct reference checks, etc.

HR experts suggest this time (indirect costs) can range from anywhere from 30 to 100 hours. And don’t forget the time for managers and employees involved in the selection process and any internal candidates that will be away from their jobs during the interviewing process. Then we must factor in direct costs such as drug tests, background checks, and pre-employment tests for each candidate.

Training is another example of “blended” costs. Beyond the cost of new hire training, a company has invested in the person who is leaving, the cost of orientation, and job- specific training in terms of the new person’s time salary and the cost of the person who conducts the training must be factored in. We also need to include the direct costs of training materials such as workbooks, folders, identification cards, technology and/or space required to deliver the training, etc.

Lastly, let’s not forget to include the new hire costs outside of training such as laptops, telephone hook-ups, credit card accounts, mobile phones, business cards, and so on! As you can see, the costs and impact associated with an employee who leaves a company can be quite significant.
So What is Employee Turnover Really Costing Companies?

While employee turnover is one of the largest costs in all different types of organizations, it’s also one of the most unknown costs. Companies routinely record and report costs such as wages and benefits, Workman’s Compensation Insurance, utilities, materials, and space, yet research indicates that few companies have a consistent commitment or process for measuring and reporting the cost of employee turnover.

Most organizations simply track their basic employee turnover rates on a month by month or year by year basis by applying this common formula:

\[
\left( \frac{\text{Total number of leavers over period}}{\text{Average total number employed over period}} \right) \times 100
\]

More complex approaches to employee turnover costing give a more accurate and invariably higher estimate of total costs. Several well-regarded studies have begun estimating the true cost of losing an employee. For example, SHRM, the Society for Human Resource Management, estimated that it costs $3,500.00 to replace one $8.00 per hour employee when all costs were considered. SHRM’s estimate was the lowest of 17 nationally respected organizations who calculate this cost!

A generally accepted principle is that the cost of replacing an individual contributor is estimated at one-half to one times their annual compensation. For a leader, it’s double that, one to two times the annual compensation and benefits per individual position.

In the case of an individual contributor, to calculate employee turnover cost, use 50% to 100% of an employee’s annual salary.

Let’s apply this on the conservative end of this range. Assume the average salary of employees in a given company is $50,000 per year. Given that the cost of employee turnover is 50% of salary, the cost of one employee leaving equates to a $25,000 loss for a company. Applying these numbers to a company of 5,000 employees with a 10% annual rate of employee turnover, the cost of turnover is $12.5 million! A company of 10,000 employees with the same turnover rate doubles the costs to $25 million! What retention-focused leader wouldn’t want to add $25 million to their bottom line?

Although useful, recognize that general “rule of thumb” estimates can be misleading since direct and indirect costs vary greatly in a diverse and complex workforce. Actual turnover costs are usually much higher than we think they are!
Our Solutions

We recommend monitoring employee retention statistics, turnover costs and causes, as well as best practices of other local employers on a monthly basis. To identify that a problem exists, a company will need to rely on company comparisons. Benchmarks will allow you to not only determine how many similar companies are doing better, but will define criteria for improvement.

Our Strategies for Being on Top of Employee Turnover Costs:

- Know how employee turnover rates are determined.
- Monitor your employee turnover rates.
- Calculate the costs associated with employee turnover and socialize them within your organization to get agreement.
- Monitor retention practices of other local employers.
- Research best practices.
- Communicate team retention issues and employee turnover costs to senior leadership.

We know that determining the cost of employee turnover can feel a bit challenging; therefore we would like to invite you to access our website at www.TalentKeepers.com/tcc and use our online Turnover Cost Calculator to determine the direct and indirect cost per job title. This quick and effective tool will breakdown key items and show you how to calculate the actual costs for positions within your organization. Gaining access to this data is a powerful way to increase awareness and commitment to reducing turnover in your organization.

Furthermore, if you would like to benchmark your data with other industry-like positions, please contact us at solutions@talentkeepers.com or call 407.660.6041 x124 for assistance. One of our talent management experts can help you decipher your key data inputs and help you feel more confident with communicating your employee turnover cost to Senior Leadership.

We have helped thousands of leaders improve skills with their teams through our blended-learning leadership training programs. Retention Monitor and Retention Expert are two of a series of leadership training programs that will help your leaders better understand the cost, causes, and consequences of employee turnover and share best practices to keep leaders forward-thinking with regards to employee retention.
Conclusion

Future organizational success depends on effective human capital management, and this begins with identifying, analyzing, and evaluating data about a company's human resource assets and then measuring them against best practices for similar companies.

Companies that fail to see the importance of measuring the cost of employee turnover — especially the price of losing high-performing talent— is allowing dollars to slip away instead of adding them to their bottom line. The time to measure is now. Waiting until there's a crisis limits options to prevent or correct employee turnover causes.

Please direct questions, comments, and press inquiries to solutions@talentkeepers.com, please access our website at www.TalentKeepers.com or call 407.660.6041.

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Talent Management Solutions

We are celebrating 20 years of providing award-winning employee engagement and retention solutions to help companies around the globe increase their performance. We’re a recognized leader in innovative onboarding tools, employee engagement surveys that drive growth and accountability, HRCI and SHRM certified training for HR professionals, unique eLearning leadership programs, teambuilding tools and much more. Twice we have won HR Executive Magazine’s Product of the Year award. Re-energize your efforts and expect more from your engagement and retention partner. Contact us today at solutions@talentkeepers.com.

Leadership Training Programs
All of our training and development programs are built around critical competencies and designed to give leaders the skills they need to be increasingly effective in their careers. Leaders learn talents including Trust Builder, Flexibility Expert, Talent Developer & Coach and High Performance Builder in a total, blended learning approach including e-learning modules, reinforcement workshops and off-line practice activities.

Employee Engagement Solutions
Retaining and actively engaging high-performing employees builds strength in an organization’s culture and improves overall performance. We offer several tools proven to increase commitment and positively impact engagement and productivity.

Surveys/Assessments
Our surveys and assessments can help you measure and report the impact of critical factors that contribute to engagement and the degree of influence those factors have on employees’ decisions to join, stay or leave your organization.

For details on our Talent Management Solutions or to get more information on TalentKeepers’ full range of products and services:

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