



## TenStep Supplemental Paper

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### Turnover Cost Calculations

Most people know that losing an employee is expensive to a company, but people often are unsure of exactly what the cost is. Based on past company records, it's a lot more than you think! Most financial statements provide little analytical data regarding turnover because most companies do not realize the amount of indirect investment made when an employee leaves.

An analysis of the costs and causes of employee turnover can lead to a reduction in these expenses and thereby have a positive impact on profits.

Before making an analysis of the costs and causes of employee turnover, addressing a few of these concerns might help.

- What is the employee turnover rate in your organization / department? What should it be?
- What does it cost to hire a new employee? How long does that new employee take to start performing in tune the company's expectations?
- How much money are you losing when an employee leaves? How much can be saved?
- What are your costs in terms of legal exposure, taxes, and opportunity costs?
- What impact does employee turnover have on customer satisfaction and repeat and referral business?

Cost incurred on employee turnover is the most wasteful expenditure in any organization. To implement the most appropriate turnover reduction strategies, management needs to identify the cause for turnover.

Turnover can be categorized as voluntary and involuntary.

- **Voluntary.** Voluntary turnover occurs when an employee leaves the organization by his or her own choice due to various reasons. These may include poor job feedback, job dissatisfaction, performance problems and lack of career advancements.
- **Involuntary.** This type of turnover occurs when an employee is discharged or terminated.

Management can easily identify the reasons for employee separation from the company by reviewing exit interviews.

Cost of turnover, if calculated, helps companies review their retention policies more objectively. However, there are many tangible and intangible components involved in the calculation of these costs.

When computing the cost of turnover, the cost of vacancy, cost of hire and opportunity costs need to be computed.



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### Cost of Vacancy

The Cost of Vacancy includes hampered product development and lost productivity, which can be computed using the following:

- Impact on teams
- Increased stress among existing employees due to overwork
- Increased effort and time from management necessary to juggle day-to-day activities
- Customer impacts
- Loss of competitive advantage
- Lower performance by new hires
- Loss of productive time by new hires
- A "break in the dike" of one vacancy might cause the whole team to leave
- Many new hires might have to be replaced within 6 months, essentially stretching the length of the vacancy

### Cost of Hire

The cost of hire includes the following components:

- Hire against anticipated rate of hiring need
- Time to fill
- Quality of hiring
- Priority of hiring to priority of need
- Immediate hiring need vs. strategic hiring plan
- Training and assimilation costs

The following intangibles need to be considered:

- Are you hiring the same type of people this year as in the previous one?
- Are these hires at the same level?
- Is the market strong or weak?
- Are you looking for people with generic or industry-specific skills?
- How urgent is the need to hire?
- How successful was last year's recruitment program?

### The computation formula

**Separation Costs.** Cost of the exit interviewer's time + cost of a terminating employee's time + cost of administrative functions related to termination + separation pay = Total



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**Vacancy cost.** Cost of additional overtime + cost of additional temporary help (optional) - wages and benefits saved due to the vacancy = Total

**Replacement cost.** Cost of attracting applicants + cost of preliminary interviews + cost of testing + cost of travel expenses + pre-employment administrative expenses + cost of medical examination + cost of acquisition and dissemination of information = Total

**Training costs.** Cost of company literature + formal training costs + informal training costs = Total

**Performance differential.** Cost of the differential in performance costs / benefits (this can be either positive or negative)

**Total turnover costs per employee.** Separation cost + replacement cost +/- vacancy cost + training cost +/- performance differential.

The performance differential quotient calculates in financial terms the difference in productivity between the replacements and replaced. Separation, replacement and training are all net costs of a new hire. The vacancy cost and the performance differential quotient can either be savings or a cost. For example, if overtime costs are less than the replaced employee's overtime earnings, a vacancy savings occurs. Similarly, if the new employee's performance surpasses the predecessor, a net performance benefit results.

Only tangible costs are included, while the intangible costs are often more than the quantifiable costs. A few intangible costs are: uncompensated increased workloads, stress and tension, declining employee morale and decreased productivity. These costs are real, yet difficult, if not impossible, to compute.

### Summary

Using this method of costing, fact-based decisions can be made for adopting retention strategies. If a retention strategy helps to retain 10 employees and the turnover cost is less than the cost incurred on retention, then the HR manager needs to consider the intangibles before abandoning it.