

Driving the bottom line: improving retention

Organizations that overlook the proven advantages of detailed and frequent measurement around the cost of retaining, and **losing** valuable employees—especially high performance talent—are allowing dollars to slip away instead of adding them to the bottom line.

It's a shame, but people often value something only after it's gone. In the case of retaining employees, it's not just a matter of valuing the employee but a bottom line issue that may be the difference between hitting or missing Wall Street expectations. Saratoga believes that the “war for talent” has shifted from a battle of acquisition to one of retention. While we recognize that turnover of low performers may well be good for an organization, Saratoga sees more and more companies asking themselves, “how do I keep the right people?”

The turnover issue has long belonged to the realm of the HR department. However, in the ultra-competitive world in which we live, turnover needs to be managed by both HR and the line and may well be the difference between achieving short-term goals or missing them. Some of the costs of turnover include:

- Lost productivity during a vacancy
- Diminished productivity of the team and managers who are covering for a vacant position
- Diminished productivity of the team and managers who are training the new hire
- Increased labor costs due to overtime or contractors needs
- Hiring and onboarding costs
- More difficult to quantify impacts may include decreased customer satisfaction, increased future turnover and loss of institutional knowledge.



Combined, these turnover-related costs represented more than 12% of pre-tax income for the average company. For companies at the high end of the spectrum, at the 75th percentile, turnover costs are equivalent to nearly 40% of earnings!

Companies that are lagging their competitors have dug themselves into a deep financial hole. As data from Saratoga's 2006/2007 Human Capital Effectiveness Report demonstrate, there is a significant difference between the top quartile and bottom quartile voluntary turnover. In most industries, bottom quartile performers experience twice the amount of separations than top quartile performers. Given the cost of turnover, companies that work to address their retention problems can make a dramatic impact to the bottom line.



Voluntary Separation Rate			
Industry	Bottom Quartile	Top Quartile	Difference
Public Sector	4.5%	11.7%	160%
Engineering/Manufacturing	5.7%	12.7%	123%
Services	8.4%	18.4%	119%
IT & Electronics	7.3%	15.0%	105%
Pharmaceutical	6.2%	12.6%	103%
Other Finance	10.7%	21.4%	100%
Telecommunications	7.6%	14.9%	96%
Utilities	3.6%	6.7%	86%
Insurance	8.0%	13.5%	69%
Banking	16.4%	25.5%	55%
Healthcare	9.1%	13.6%	49%

Saratoga believes that HR departments need to present leadership with a business case for reducing turnover. This business case must include pinpointing turnover “hotspots” in the organization, quantifying the financial impact of turnover by business unit, job class, and performance ranking, and determining actions the company can take to reduce it.

Saratoga believes that the business case to reduce turnover covers three phases:

- 1 Identifying the Scope of the Problem
- 2 Quantifying the Business Impact
- 3 Determining Actions with Impact

A description of each of the phases appears below.

Identifying the scope of the problem

Most companies have turnover reports that show how turnover has been trended over a period of time— and this is a start. To better understand turnover, organizations will need to rely on more than an aggregate analysis. Organizations need to dissect it from a number of different vantage points.

- What types of employees are leaving? Losing high performers is far more damaging than average performers, and losing low performers may be seen as a good thing. What might appear to be an acceptable amount of turnover may mushroom into a significant issue if those employees that are leaving are the key performers.
- What does turnover look like by tenure? Losing employees in their first year of service may suggest issues with the staffing or on-boarding process. Losing employees between three and ten years may represent a compensation or career development issue. Losing employees after ten years may represent a leadership issue.

Unfortunately, driving bottom line improvement through retention is not the obvious solution that most HR professionals might believe. Managing and optimizing the workforce investment is not part of classical business management, consequently line managers and executives are frequently not aware of the opportunity. An unenlightened reaction to the opportunity to drive bottom line results through retention might be “Turnover’s not a problem. It’s the same as it’s always been;” or “What does turnover cost? It can’t be more than a couple hundred dollars to rehire people, right?”



- Were the employees in pivotal positions? By pivotal positions we mean segments of the workforce that are expected to create value and determine the success of the company. Clearly, turnover with employees in pivotal roles is more concern than others. Employees in call center or retail environments tend to turn over more – though if these are pivotal positions, this still may be concerning.

Moreover, to identify that a problem exists, a company will likely also need to rely on benchmarks and peer comparisons. Benchmarks will allow the company to not only determine how many similar companies are doing better, but will define some criteria for improvement.

Quantifying the impact

While it is important to recognize how your turnover compares to others, and when and who is leaving, unless HR is able to translate turnover into a business impact (i.e. money), HR will not be as successful in its business case. Without this translation, excessive turnover can be dismissed as having little financial impact, and not become a high priority.

While there is no single correct answer to the question of “how much does turnover cost, there is one wrong answer – \$0. Without developing internal consensus, HR departments are accepting an answer of \$0.

In Saratoga’s opinion, the process of determining a cost of turnover is more about developing consensus internally than about the impact of turnover rather than creating a “perfect” formula. Having a formula (such as 1.5 times the salary of Exempt employees + 0.5 times Nonexempt

employees) means little if the formula has no credibility. Convincing line management or executives on the impact of turnover requires itemization of that impact and the detail to support the final opinion (e.g., how much productivity does the organization assume they lose for a high vs. a low performer). At the end of the day a formula that is accepted by the organization as correct should be the goal, even if the formula is filled with “wild guesses and assumptions.”

Once a formula has been developed, it can be converted into a rule of thumb (e.g. each average performing employee we lost costs \$50,000. Each high performing employee costs \$125,000). Different than metrics, this rule of thumb calculation does not need to be reassessed on a monthly or quarterly basis and does not require a benchmark comparison. When presenting cost of turnover results Saratoga believes it is most interesting to present numbers in absolute value (e.g., Turnover of our call center employees is costing our organization \$55 million).

Determining proper actions with impact

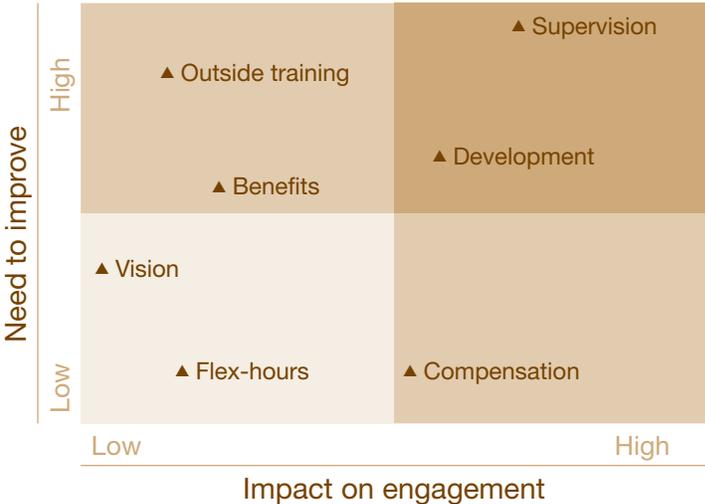
Once turnover has been identified as an issue and the impact has been quantified, it is critical to determine the actions that can reduce turnover and those that will have the greatest impact. This should be done for each level of employees including pivotal employees, high performers, average performers, and low performers. While metrics quantify effort in dollars, time, ratios, and percentages, employee survey data measures the human response to the working environment. Most employee surveys are good at identifying sources of dissatisfaction that management may address, correct, or eliminate.



The problem with the way many surveys are constructed and analyzed is that they do not determine the drivers of behavior. Some employees can be very dissatisfied and stay; others satisfied and quit. For example, right after a change to the benefits co-payment, employees may be very dissatisfied, but turnover is not likely to change. Companies need to statistically analyze and prioritize those issues that are driving employees to stay and leave and take appropriate action.

For example, let's look at two sources of dissatisfaction on a typical engagement survey. If we assume pivotal employees are dissatisfied with their supervisor communication and outside training, management may have a difficult time prioritizing between these two. Once we correlate these sources of dissatisfaction with the likelihood of staying we may learn that outside training has less impact on staying than supervisors do. In this case, the organization would want to focus retention efforts on supervisor communication training.

Saratoga believes that by approaching the issue of turnover from these three angles, companies can have a comprehensive understanding of the causes of turnover and the ammunition they need to convince executives and managers of the value of prioritizing investment. Individually, these three steps identify that an issue exists, translates the issue into a business value and identifies the actions that will have an impact. The three ingredients create a recipe for financial improvement and help define the impact that HR can make to the business.



Saratoga, a service offering of PricewaterhouseCoopers, teams with executives and HR departments to identify, quantify, and track the results of people initiatives in terms of dollars gained—or lost—due to the actions of managers and work teams. For more than 30 years, Saratoga has stood at the forefront of defining and optimizing talent and the workforce investment and has helped thousands of clients define the return on investment in HR.

To learn more about Saratoga, please visit our website: www.pwc.com/saratoga or call us at 866 727-2864.