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Costs of employee turnover

Employee turnover costs more than most people realise, because there are a lot of indirect costs that tend to be overlooked as they are hard to quantify. However, there are many reasons why HR practitioners should attempt to make precise calculations of the cost of turnover. This article discusses the use of a simple turnover cost calculator.

What costs do you need to calculate?

The global management consulting firm Caliper publishes a turnover cost calculator tool on its website. The following is based on that tool.

Daily basis

Caliper recommends calculating turnover costs on a daily basis. It is then simple to calculate overall cost by multiplying daily cost by the number of days that the particular cost is incurred.

Direct costs

First step is to calculate the employee's daily remuneration cost, as that figure also forms the basis for many other calculations.

Remuneration = base wage/salary + value of employee benefits (eg superannuation contributions, vehicle use, employer-supplied amenities/facilities such as mobile phones and laptops) + value of on-costs (eg workers compensation premiums, leave loadings).

Value of benefits and on-costs is estimated at 30% of base pay. To calculate a daily cost, assume 220 working days per year (based on 52 weeks x 5 days, minus 20 days annual leave, 10 days public holidays and 10 days sick/carer's leave). So daily cost = annual cost divided by 220.

Other direct costs include:

- costs of advertising the vacancy
- fees paid to recruitment agencies
- fees paid to consultants for conducting tests, checking references, pre-employment medicals, etc
- termination payout amounts, such as pro rata long service leave and pay in lieu of notice

Indirect costs

Loss of productivity from other employees filling in for vacant position

Where other employees perform part of the vacant job as well as their own jobs, use an estimate of one-third of each employee's total daily recruitment cost, multiplied by the number of days they continue to fill in.

In-house hiring costs

Calculate the following:

- daily total remuneration rate of employees involved in recruitment/screening/selection processes, eg HR/recruitment staff; line managers; administrative staff who make appointments, prepare and place advertisements, liaise with consultants, etc
- the amount of work time each of the above spends on the process
- the amount of work time spent on screening applications and processing rejections

- the amount of time spent attending interviews and debriefing afterwards (include the time of each interview panel member)
- the amount of time spent verifying CV contents (eg qualifications), checking references, conducting tests, etc

Training/induction costs

Calculate the following:

- daily total remuneration rate of employees involved in training and induction processes, eg trainers, line managers, 'buddies'
- the amount of work time each of the above spends on the process
- cost of training/induction resources and facilities, on a per employee basis

Termination administration costs

These costs may include pay officers' time to process termination pay, exit interviewer's time, time required for employee and line manager to complete paperwork, return and check employer's property (such as security tags, vehicles, tools, uniforms, sales resources, etc) plus miscellaneous administrative tasks such as closing off computer access.

Loss of productivity in early stages of employment

New employees normally take some time before they become sufficiently familiar with their jobs to achieve 100% productivity. The time period varies according to the job content and employee, but Caliper suggests using an estimate of 50% productivity until the required standard is reached. Therefore, estimate the number of days required to reach 100% productivity and multiply this by 50% of the employee's daily total remuneration rate. Some estimates will be quantifiable (eg changes in production or sales figures), but many will not.

Loss of productivity in final stages of employment

This is harder to estimate, but the productivity of many (but not all) employees deteriorates while they are serving out their notice period. For example, many are preoccupied with making new arrangements relating to a new job, and some attempt to 'square the account' if they have untaken sick leave or rostered days off owing to them.

There will also be time taken with exit interviews, farewell parties, etc. To calculate this cost, you could attempt to estimate percentage loss of productivity based on your observations of past employees who resigned, and multiply the percentage by the employee's daily total remuneration rate. Again, some estimates will be quantifiable (eg changes in production or sales figures), but many will not.

Offset: unpaid costs while job vacant

On the other hand, there will be some offsetting cost savings while the vacancy remains unfilled. From the above costs you should deduct the employee's daily total remuneration cost multiplied by the number of days the job remains vacant.

Summary: calculating total cost

The total cost of turnover of one employee is as follows:

Total direct costs

\+ Loss of productivity from other employees filling in for vacant position
\+ In-house hiring costs
\+ Termination administrative costs
\+ Training/induction costs

+ Loss of productivity in early stages of employment
+ Loss of productivity in final stages of employment

LESS Unpaid costs while job vacant

= Total cost of employee turnover

Tell ’em the price!

Why bother making the calculation when it’s obviously a complicated process to do it properly? Many managers are shocked to discover the true cost of employee turnover. Some sources estimate that the cost of replacing a salaried and professionally qualified employee is equivalent to a year’s salary or more. Other studies suggest that a typical rate of voluntary turnover (resignations) for organisations is about 10% per year (ie excluding dismissals and redundancies).

Consider the following sample calculation. A business with 500 employees can expect to have 50 resignations per year. Latest Average Weekly Earnings (AWE) figures issued by the Australian Bureau of Statistics (for November 2015) record AWE for full-time employees of $1,499.30. Adding 30% to this for the cost of employee benefits and on-costs amounts to $449.79, giving a total cost of $1,949.09.

Assuming turnover cost to be a year’s total remuneration for each employee, total annual cost of turnover for this business is $1,949.09 x 52 weeks x 50 employees. That’s a total of $5,067,634 per year. So a retention strategy that was able to reduce employee resignations from 10% to 5% per year would save this business over $2.5 million per year, less the costs of implementing the strategy.

Anyone still think retention strategies are a waste of time and resources?

If you do the appropriate calculations for your own organisation, they will be useful for the following purposes:

- For line managers and senior managers who tend to be blasé about people management and turnover, producing dollar figures may shock them into putting more effort into trying to retain employees.
- When doing cost/benefit analysis of HR strategies, such as retention strategies or work/life balance initiatives, data on turnover costs will help support the business case for implementing the strategies. If you can demonstrate that a strategy will reduce turnover, you can put a dollar figure on the potential benefits, so that decision-makers can evaluate the strategy compared to alternative uses of organisation funds, eg marketing campaigns, investing in new technology.
- Closer to home, if you can demonstrate financial benefits from HR strategies, your own position is enhanced!

Be conservative, not deadly accurate

It is important to note that some of the above calculations will be difficult and based on obscure assumptions. For example, 'percentage loss of productivity' will be hard to quantify, and not cost-effective to measure precisely.

The best approach is to make very conservative estimates of these costs. Point out to your audience that you are being conservative because it is difficult to be precise, but in the interests of accuracy you must include each relevant factor. That should give your case greater credibility, plus the opportunity to imply that the real cost (or real saving) is actually greater than what you have calculated.