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There Are Significant Business Costs to Replacing Employees

Workplace policies that improve employee retention can help companies reduce their employee turnover costs.

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The cost of employee turnover for businesses is high, regardless of the level of wages being paid to the departing or incoming employees. Workplace policies that improve employee retention can help companies reduce their turnover costs. (AP/ Mike Groll)

This issue brief contains a correction.

A table describing the 31 case studies and their key findings is available in the PDF version of this brief.

Implementing workplace policies that benefit workers and help boost employee retention is not simply a “nice” thing for businesses to do for their employees.

Maintaining a stable workforce by reducing employee turnover through better benefits and flexible workplace policies also makes good business sense, as it can result in significant cost savings to employers.

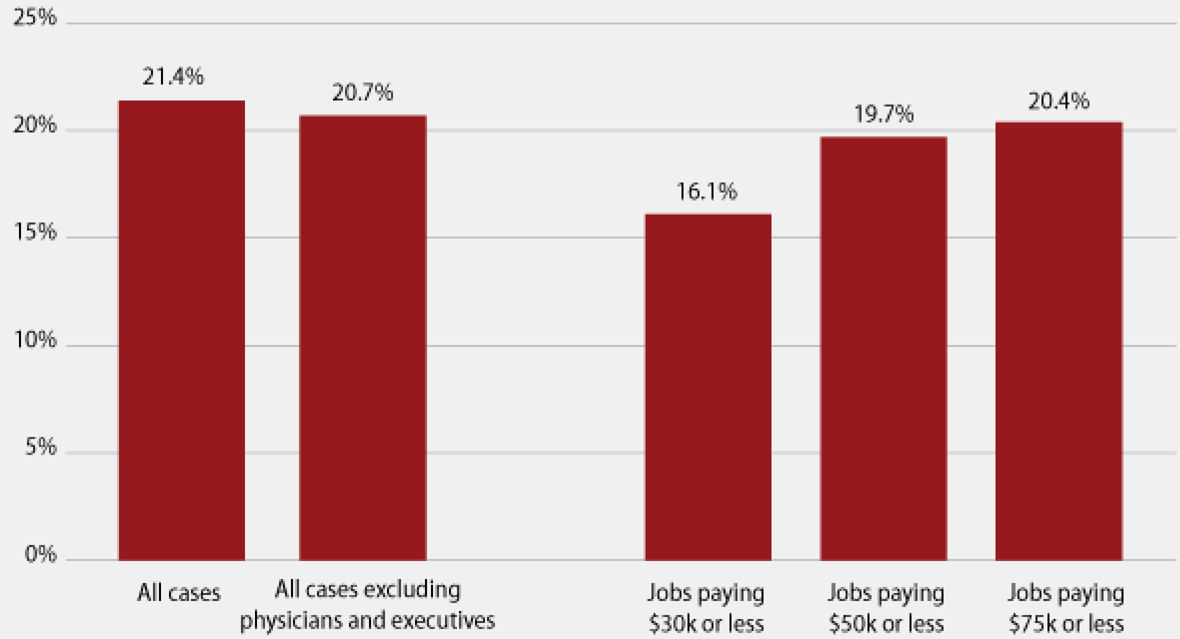
Thirty case studies taken from the 11 most-relevant research papers on the costs of employee turnover demonstrate that it costs businesses about one-fifth of a worker's salary to replace that worker. For businesses that experience high levels of turnover, this can add up to represent significant costs that can potentially be avoided by implementing workplace flexibility and earned sick days at little or no cost at all.

Indeed, it is costly to replace workers because of the productivity losses when someone leaves a job, the costs of hiring and training a new employee, and the slower productivity until the new employee gets up to speed in their new job. Our analysis reviews 30 case studies in 11 research papers published between 1992 and 2007 that provide estimates of the cost of turnover, finding that businesses spend about one-fifth of an employee's annual salary to replace that worker. (see Figure 1)

FIGURE 1

Replacing employees is costly for companies' bottom line

The cost of turnover is remarkably consistent across jobs at different pay levels, except the very highest-paid jobs, 1992 to 2007



Source: Authors' analysis of 30 case studies on the cost of turnover from 1992 to 2007

Specifically, the economic studies we examined reveal a number of patterns about the cost of turnover:

- For all positions except executives and physicians—jobs that require very specific skills—across the remaining 27 case studies, the typical (median) cost of turnover was 21 percent of an employee's annual salary.
- For workers earning less than $50,000 annually—which covers three-quarters of all workers in the United States—the 22 case studies show a typical cost of turnover of 20 percent of salary, the same as across positions earning $75,000 a year or less, which includes 9 in 10 U.S. workers.
- Among positions earning $30,000 or less, which includes more than half of all U.S. workers, the cost of replacing an employee is slightly less than among positions earning less than $75,000 annually. The typical cost of turnover for positions earning less than $30,000 annually is 16 percent of an employee's annual salary.

Jobs that are very complex and that require higher levels of education and specialized training tend to have even higher turnover costs. In one study, economist Eileen Appelbaum and sociologist Ruth Milkman find that executive positions, which are well-compensated and likely have stringent educational credential requirements, have higher turnover costs than jobs with low educational requirements. Very highly paid jobs and those at the senior or executive levels tend to have disproportionately high turnover costs as a percentage of salary (up to 213 percent), which skews the data upwards.

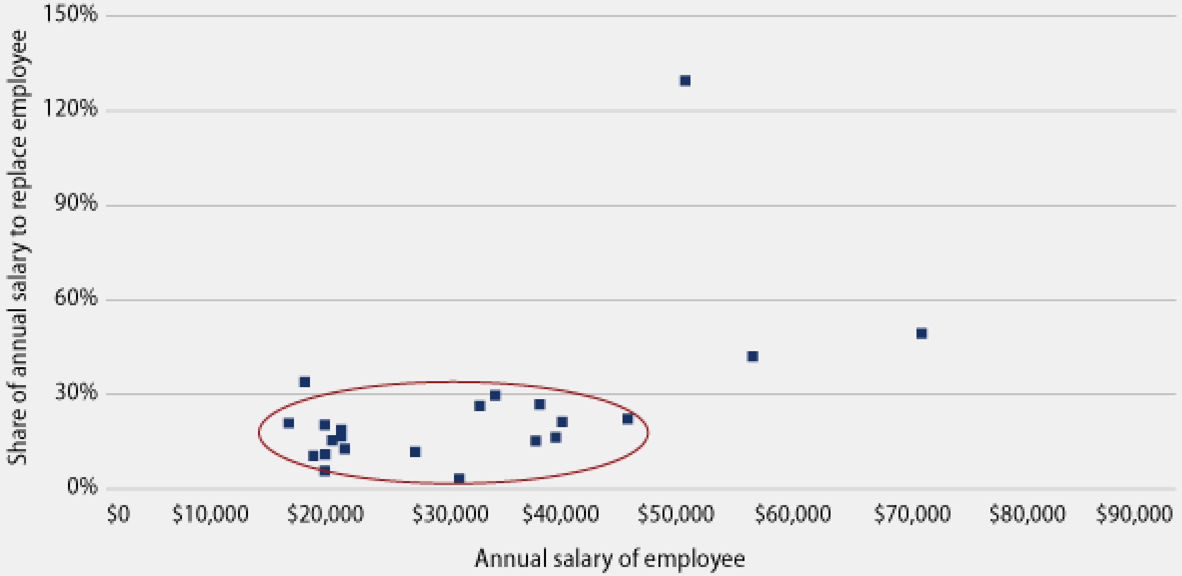
Because some jobs have very high costs of turnover and others are less significant, there is a wide range of estimates across all types of employment. Above, we reported the "typical" cost of turnover using the median among the case studies. This means that half of the case studies had a cost above what is "typical" and half had a cost below. The estimates of the cost of turnover in the 30 case studies analyzed here range from 5.8 percent up to 213 percent, depending on the job and employee skills. But the estimates are clustered around the "typical" (median) values. Looking only at estimates of the cost of turnover for workers earning, on average, $75,000 per year or less, 17 case studies find a cost of turnover in the range of 10 percent to 30 percent. (see Figure 2)

The cost of turnover is an important economic issue because about one-fifth of workers voluntarily leave their job each year and an additional one-sixth are fired or otherwise let go involuntarily. While workers who were laid off might not be replaced at all, for other kinds of workplace exits it doesn't matter whether an employee left a firm voluntarily or whether they were fired—the reality is that it will cost the firm to replace that employee. In the long-term, even if a firm saves money by firing an employee who has stolen or has very low

FIGURE 2

Across jobs, the cost of replacing an employee is clustered between 10 percent and 30 percent of an employee's annual salary

Range of estimates of the cost of turnover from 30 case studies spanning 1992 to 2007



Source: Authors' analysis of 30 case studies on the cost of turnover from 1992 to 2007

productivity, in the short-term the firm must address the costs of replacing that worker with one who will perform the job better than the one fired.

The Great Recession sharply increased the share of workers involuntarily leaving their jobs. At its peak in early 2009, the share of the total labor force subject to what the Bureau of Labor Statistics calls "layoffs and discharges"—but what those affected might refer to as "getting canned"—was 2 percent, up from 1.2 percent in 2006, before the recession began. As unemployment remained high, the recession and subsequent recovery reduced the number of workers who voluntarily left a job. In 2011, 23.6 million workers—or 17.9 percent of the total workforce—quit their jobs, down from 22.6 percent of the workforce in 2006. Due to the collapse of the housing bubble and the ensuing economic recession, workers employed in construction especially experienced spikes in unemployment and increased turnover rates. (see Figure 3)

job losses by industry

High quit rates are often due to workplace policies. The Bureau of Labor Statistics data show that the accommodations—including hotels and motels—and food-services industries have the highest voluntary quit rate, with 37 percent of employees reporting that they quit their jobs in 2011, nearly twice as many as left their jobs involuntarily. These are jobs that tend to pay low wages and often have little in the way of workplace benefits or policies to help workers address conflicts between work and family.

Researchers find that high rates of turnover could be lowered through changes in workplace policies. Harvard Business School professor Zeynep Ton recently wrote in Harvard Business Review:

> **Highly successful retail chains … have demonstrated that … bad jobs are not a cost-driven necessity but a choice. And they have proven that the key to breaking the trade-off is a combination of investment in the workforce and operational practices that benefit employees, customers, and the company … I believe that the model these retailers have created can be applied in other service organizations …** [such as] **hospitals, restaurants, banks, and hotels.**

Conclusion

This brief documents that the cost of employee turnover for businesses is high, regardless of the level of wages being paid to the departing or incoming employees. Companies typically pay about one-fifth of an employee's salary to replace that employee. While it costs businesses more to replace their very-highest-paid employees, the costs for most employers remains significant and does become less significant for those with low earnings.

Workplace policies that improve employee retention can help companies reduce their turnover costs. Family-friendly policies such as paid family leave and workplace flexibility help retain valuable employees who need help balancing work and family. For example, research has found that access to any form of parental leave makes women more likely to return to work after giving birth. Moreover, by 2050 up to 20 percent of Americans will be older than age 65, and improved leave policies would allow workers to provide the care their elderly parents may need without having to sacrifice their livelihoods.

Appendix

The analysis presented in figures 1 and 2 is based on a thorough review of academic studies on the costs of employee turnover between 1992 and 2012. We found 11 published papers that provide empirical analysis of the cost of the turnover with detailed information on their methodology. Most of the research focused on a specific occupation within an industry, which meant that the 11 research papers provided 31 separate case studies. We then pooled these case studies to evaluate the typical cost of turnover across firms as a share of an employee's annual salary.

The research papers examined a variety of turnover costs, but they can be broken down into two main categories—direct and indirect, which vary depending on the specifics of the job. Both direct and indirect costs will vary within and across firms in terms of skills and training needs for a particular job. There will also be differences in the cost to replace an employee based on the industry, the region, and general economic conditions, as it may cost more to recruit employees to a remote location or if the unemployment rate is very low.

In the late 1990s, for example, when the U.S. economy was close to full employment, there was a great deal of media coverage about how employers were scrambling to fill positions. One story from the Associated Press was simply titled "Fewer workers mean more picky applicants" and detailed the creative ways employers would try and attract employees. The article highlighted one employer, an apparel maker, who offered eight paid days of vacation for each friend an employee recruited to the company.

The first type of cost is direct costs. This category includes:

- Separation costs such as exit interviews, severance pay, and higher unemployment taxes
- The cost to temporarily cover an employee's duties such as overtime for other staff or temporary staffing

- Replacement costs such as advertising, search and agency fees, screening applicants, including physicals or drug testing, interviewing and selecting candidates, background verification, employment testing, hiring bonuses, and applicant travel and relocation costs
- Training costs such as orientation, classroom training, certifications, on-the-job training, uniforms, and informational literature

The second category of turnover costs to businesses is indirect costs. This includes:

- Lost productivity for the departing employee who may spend their last days on the job writing exit memos or with reduced morale
- Lost productivity due to the need to hire temporary employees
- Coping with a vacancy or giving additional work to other employees
- Costs incurred as the new employee learns his or her job, including reduced quality, errors, and waste
- Reduced morale
- Lost clients and lost institutional knowledge

While direct costs may be easy to measure, by their very nature indirect costs may be hidden and difficult to ascertain. Because of this, out of the 11 research papers that we looked at, only 2 included indirect costs.

A table describing the 31 case studies and their key findings is available in the PDF version of this brief.

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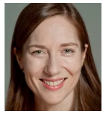

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