

## **“Concepts of Labor Turnover: A Technical Primer for Executives”**

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Despite knowing that low turnover is good, senior executives are often confounded by high labor turnover. Lowering turnover is a huge competitive advantage, saving HR resources, hiring costs, training costs, and increasing productivity. Executives can learn invaluable information from tracking turnover, and can use that information to make meaningful decisions to hire and retain good employees and recapture costs and productivity. Management, however, needs to understand what kinds of turnover measures can be most helpful to them so that they can take meaningful action. This technical white paper explains the various types of turnover that TalenTeck considers important, and what executives may be missing in traditional measures.

Labor turnover is a multi-faceted concept. Most executives think about annual Employee Turnover in their decision-making. This type of turnover reflects the historical quit or termination rate, aggregated for all existing employees (or in a division or subsidiary), over a particular period, typically one month, one quarter, or one-year. Yet, there are more relevant, fundamental concepts of labor turnover than Employee Turnover.

Labor economists and experts in Human Capital theory use two other concepts that furnish greater insight into the impact of labor turnover: New Hire Turnover and Seat Turnover. New Hire Turnover reflects the fraction of new hires that quit within the first year after hire. Seat Turnover reflects the replacement rate of new hires needed to keep a particular job slot filled over a period of time.

New Hire Turnover, Seat Turnover, and the more general Employee Turnover, are all related, but the relationship between them is not linear. For starters, the metrics are different. New Hire and Employee Turnover track individuals, and are expressed as percentages that always fall between 0% and 100% -- since individuals leave a company (typically) only once. New Hire and Employee Turnover also relate directly to how well a company is selecting and retaining its employees and how much productivity they get from the employee, since they both measure the quit rates of individuals. When these rates go up, productivity goes down. TalenTeck views revising hiring and retention processes as levers to change it.

On the other hand, Seat Turnover, as a metric, tracks the job slot only – not an individual employee. Seat Turnover can often exceed 100% because some job slots turnover more than once during a period. Seat Turnover also relates directly to the costs of maintaining a particular seat, since the factors that would keep a job slot filled are typically financial – actual hard costs of recruiting, hiring, and training new people to fill it. There is no measurement of individuals in this percentage, per se. For this reason, TalenTeck views Seat Turnover as the most relevant for assessing the cost impact of turnover.<sup>1</sup>

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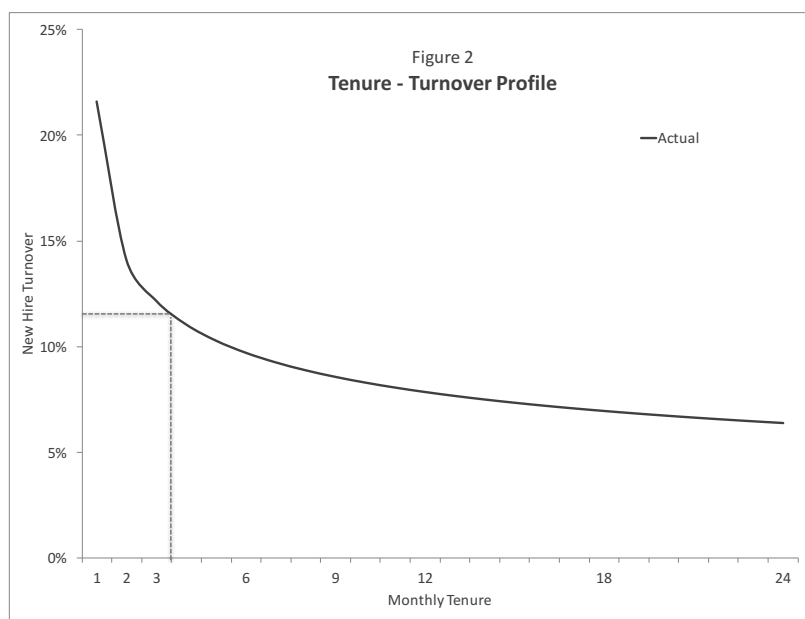
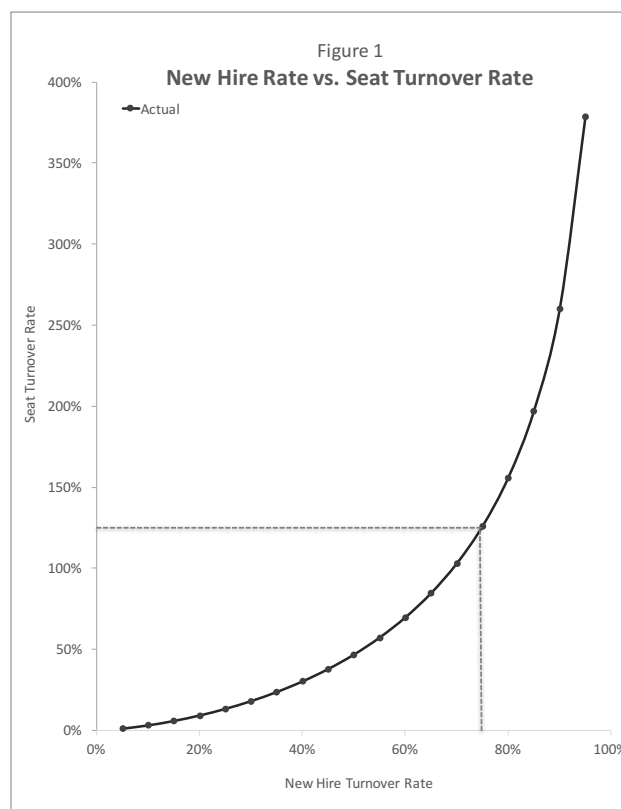
<sup>1</sup> To assess the financial impact, further information about hiring costs and training costs, which relate to cost savings, need to be specified. In addition, the learning curve (the rate at which employees become proficient at their jobs) is required to assess top-line gains due to productivity gains. These financial impacts are discussed in detail in other TALENTECK LLC White Papers.



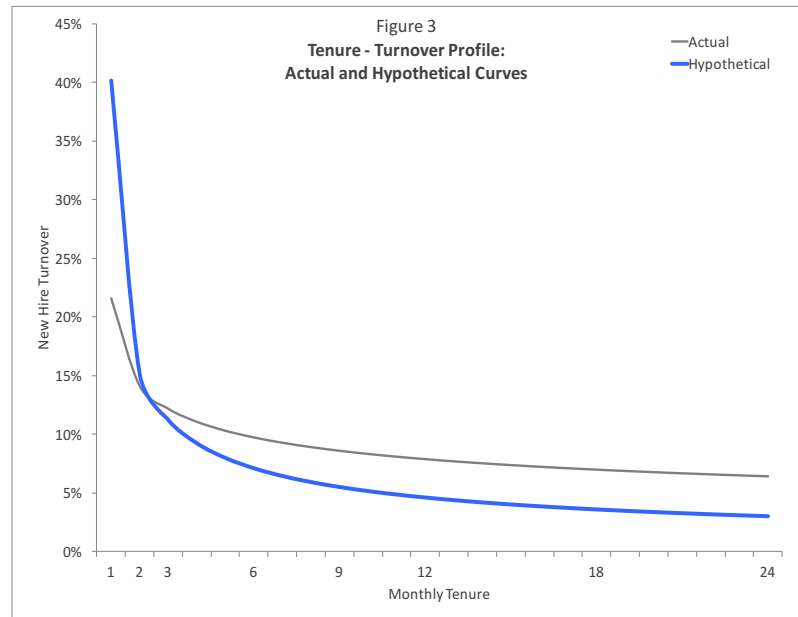
Our case-study company helps demonstrate how Seat Turnover and New Hire Turnover connect. The following two charts explain *how* they relate, and *why*. In Figure 1 at right the curve shows the results of actual new hire turnover rates (x-axis), plotted against actual seat turnover rates (y-axis). The average New Hire Turnover rate for this particular company is 75%, which corresponds to a Seat Turnover rate of 126%. The 75% new hire turnover rate says that for every 100 new hires, 75 of those individuals quit within one year; but the seat turnover rate says that to fill 100 job slots, executives need to hire 126 new people annually, since many of the new hires quit within a year – and so do their replacements.

What links these two turnover concepts is **when**, exactly, employees quit the company. Labor economists call the time distribution of quits the Tenure-Turnover Profile, and it represents the unique internal dynamics of employee turnover at a company. It delivers insight into whether a new hire leaves early in their careers at the firm, late in their careers, or in the middle. For example, the fact that 75% of new hires quit within a year could be compatible with most of them quitting very early in their careers at the firm, or closer to the one-year mark. Without a true understanding of the pattern, executives don't really know which time distribution is occurring. And, exactly **when** the employee quits is the event that determines the Seat Turnover rate, and the cost outcomes of hiring and training.

A tenure-turnover profile is typically negatively sloped, as shown in Figure 2. This graph plots the specific tenure-turnover profile from our case-study company, based on the hire and termination dates of the new hires. The curve is the actual Tenure-Turnover Profile, *i.e.*, the real distribution of quits over time which connects the observed 75% New Hire Turnover Rate to the 126% Seat Turnover Rate in the previous graph. The actual distribution of quits shows a steep decline in the first 3 months, and a gentler decline between 3 months and 2 years:



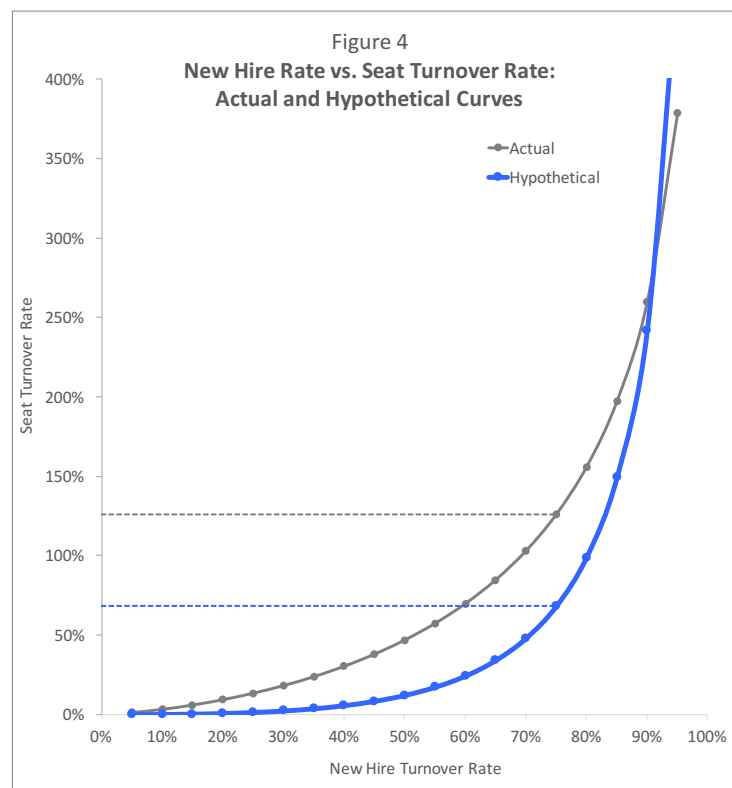
- Within the first 30 days, 22% of new hires separate;
- Among those who make it past the first 30-days, another 14% separate within the next 30-days;
- For all those who make it past the first 60-days, another 12% separate within the next 30-days (which is 30-day turnover rate shown by the dotted lines at the 3-month tenure mark and 12% turnover mark).
- The turnover rate continues to decline at a slower pace thereafter, reaching 8% by 1-year and 6% by 2-years.



Once the tenure-turnover profile is determined, then it is indeed possible to describe the entire relationship between New Hire Turnover and Seat Turnover, as depicted by the entire curve of the first graph.

The pattern of the estimated tenure-turnover profiles allows us to predict how changes in the New Hire Turnover rate will change the Seat Turnover Rate. For example, back in Figure 1 you can see how a reduction in new hire turnover to 60% (three points down the curve) corresponds to a substantial decrease in seat turnover rate, from 126% to 68%; and how a higher new turnover rate of 80% (one point up the curve) would imply a much bigger increase in seat turnover, from 126% to 156%. The key insight: If executives don't understand their company's particular tenure-turnover profile, the new hire turnover rate / seat turnover relationship will be inaccurate.

To illustrate this key insight, consider an alternative tenure-turnover profile. In Figure 3 above, a second curve (shown in grey) is a hypothetical distribution of quits that shows a very different profile than the actual tenure-turnover distribution (same curve from Figure 2, shown in black). The hypothetical curve depicts an initially steeper negative slope over the first 4-months of tenure, and a gentler decline thereafter. In the hypothetical curve, employees are more likely to quit earlier than in the actual



distribution.

While both tenure-turnover profile curves represent an average 75% new hire turnover rate, they each correspond to dramatically different seat turnover rates. For instance, looking at the alternative new hire vs. seat turnover graph in Figure 4, the hypothetical curve corresponds to seat turnover rate of 68%, an almost 50% reduction compared to the actual seat turnover rate of 126%. In the real world, the difference between a 68% seat turnover rate and a 126% seat turnover rate is a big dollar amount: the cost of having to hire 68 employees to fill 100 seats is going to be dramatically lower than the cost of hiring 126 employees to fill 100 seats. Therefore, executives clearly should care about reducing the Seat Turnover since the financial implications are likely to be huge.

The take-away is that most executives don't make distinctions in their company's turnover. The standard Employee Turnover measure ignores the complexity of turnover and can lead executives to make serious organizational errors. Each tenure-turnover profile is different based on the industry, occupation, region, and most especially the individual company. Unless executives look at when turnover is occurring, and how it impacts seat turnover, executives are likely to get the labor turnover story wrong.

To find out more about your company's labor turnover, contact us at [www.talenteck.com](http://www.talenteck.com)

