Employee turnover costs in IT Industry- A Critical Analysis

Ayodhyaram Gurazada[1] and Prof. (Dr.) G.Tulasi Rao[2]

1. Sr. Program Manager, Verizon Data Services, Hyderabad
2. Professor and Head, Dept. of Commerce and Management Studies
Dean –CDC, Dr.B.R.Ambedkar University, Srikakulam, Andhra Pradesh

Abstract: Employee turnover is an integral part of corporate life. But many organisations consider the cost associated with it as cost of doing business but does not look into how it would impact their bottom line. This paper tries to find the cost associated with employee turnover. Organisations can devise their retention strategies based on it. This paper intends to observe the costs associated with an employee turnover and also propose a hypothesis to arrive the individual employee turnover costs.

Keywords*:* IT/ITES companies, financial penalty, $/Rs value, employee turnover.

Introduction

Employee turnover is an integral part of running business and is inevitable in any kind of industry. But this issue has reached epidemic levels in IT/ITES companies in India in the recent past. Excessive turnover often engenders far reaching consequences and, at the extreme, may lead to jeopardy of the organizations objectives (Abbasi and Hollman, 2000). For organizations to reach their competitive advantage, they are dependent on their key resources. Employee turnover in some cases have far reaching consequences like hampering organizations growth and will impact big time in reaching its objectives. In many cases losing valuable resources, read real critical employees, may hamper the deliverables and can impact the services provided to the clients.

Indian IT outsourcing business might very much be impacted due to employee turnover. Employee turnover is not an internal issue to the organizations alone, anymore! It is in fact creating insomnia to the overseas clients of Indian IT companies who outsource their work to them. It is quite but natural for the projects to get delayed, if any of key resources working on the projects quit the organization mid way. Now a day's clients are no longer willing to accept excuses for project delays on account of employee turnover, nor or they willing to bear the additional financial burden due to delayed delivery. In this context, clients are now introducing "retention clauses" in their contracts with the organizations they are outsourcing their work to. This will make organizations, responsible for retaining their key resources/teams working on client's projects, failing which they could attract a financial penalty. The clients are increasingly trying to take cover under this clause- as the employee turnover can break the entire delivery schedule. In the above context it is even more important for the IT organizations to pay special attention and focus on developing strategies that would help employee retention. But in the midst of all this, as employee turnover and hiring of new employees go hand in hand, many organizations fail to observe or care for the latent cost associated with employee turnover**.**

Employee Turnover Costs

Studies by American Management Association report that the employee turnover costs can range between 25 to 250% of annual salary of the exiting employee. In line with the above study we can safely conclude that the replacement costs will be huge and at the higher end of the cost range if the employee leaving the organization happens to be a manager, sr. Executive or a highly successful sales person.

There are numerous variables that contribute to the turnover cost. Some of them are hard to quantify in terms of a $/Rs value. Some are hard to pinpoint. For example it is very difficult to quantify the cost of lost customers and contacts, cost of lost knowledge etc in the context of an employee turnover.

But some of the most important factors that need to be discussed are as below:

1) Advertising costs for the new position.
2) The preliminary costs associated with evaluating and work on the job requirements.
3) The cost to review candidates, conduct interviews to choose the right candidate.
4) Referral bonus, Agency fee etc, if any.
5) Sign on bonus, relocation costs etc, if any.
6) Background screening costs and mandatory pre joining medical costs.
7) Excess salary paid to the new joiner to do the job of the person leaving.
8) Lost productivity during the transition.
9) Period the position is vacant for.
10) Cost of training new employees.

Though there were numerous studies done on identifying the cost of employee turnover in the past, it is difficult to identify the cost associated with an individual employee leaving the organization. Considering that, we propose the below formula which we feel can be used to significantly zero in on the individual's cost of turnover.

Cost of an employee turnover = (Cost of Hiring the New Employee + Cost of Training New Employee + Cost of Lost Productivity + Cost of the New Employee) – Cost of the Employee Leaving.

Cost of Employee Turnover Index = (Cost of an employee turnover/Cost of Employee Leaving)*100

Let us examine these factors up close!

Cost of Hiring the New Employee

As soon as an employee resigns from his position, the search for his replacement is on. The costs associated with advertising for the new position, the cost of recruiter working in identifying the right fit to the position are part of these costs. Also part of this cost is the referral bonus or the Agency fee that need to be paid for referring the right replacement. On top of it, the organization might have to pay relocation costs, sign on bonus etc if the same are negotiated by the employee to join the organization. Once the right replacement is identified, the cost of background screening by the 3rd party vendors is to be added to the list. The mandatory medical screening before the employee joins the organization is also part of this cost. After incurring all these costs and the offer is made- there is every possibility the prospective joiner can turn down the offer in the last minute for a better opportunity. In such a situation the costs incurred till such period are sunk and the process has to begin again adding up the costs.

Cost of Training the New Employee

New employees need to understand and align themselves to the organizations code of conduct and their policies. They need to imbibe the organizational culture to be part of the team and the overall organization itself. In this process, every organization will have its new employees take mandatory courses that would cost to the organization. All new employees of the organization invariably need to go through the induction program as part of HR policies. The cost associated with it, classroom trainer, manuals, materials etc are all part of the training the new employee. In addition to the above the value of the time spent by the co-workers in imparting the knowledge about the work, client etc to the new joiner can also be considered as the cost of training a new employee.

Cost of Lost Productivity

This is one of the hard to quantify costs in determining the cost of employee turnover. Let us consider that all employees of the organization are 100% productive. It is obvious that the employee serving the notice period might not necessarily be 100% productive during the said period. In most such cases employees bide their time for the exit. Till such time the replacement is hired, the co-workers of the employee exiting need to perform some of his duties that might impact their own deliverables and productivity. As and when the replacement is hired he or she cannot hit the ground running from the very moment they join the organization. There would be a learning curve and would take some time for them to ramp it up. During that period the new joiner cannot be 100% productive. But all said and done- it is very difficult to quantify the above mentioned costs. So how do we arrive at the cost of lost productivity? To circumvent this issue, we suggest that the cost associated with the period the position is vacant can be considered as cost of lost productivity. For example, if the cost of employee per month, leaving the organization is Rs50,000/- and the position happens to be vacant for 2 months from the time he exits to the time his replacement joins the organization- the cost of lost productivity would be Rs 100,000/-.

Cost of New Employee

Compensation could be one of the major drivers for employee turnover. To attract talent to replace the employee leaving, the organizations in most cases end up paying more salary to the new employee than the person leaving them. The straight CTC value of the new employee is considered as the cost of new employee.

Cost of Employee Leaving

The straight CTC value of the employee leaving the organization is considered as the cost of the employee leaving.

Let's do the Math!

Assumptions

1) Lets make some generic assumptions based on which we can compute the cost of employee turnover. Let's assume that the cost of hiring a New Employee is fixed at Rs.1,00,000/-. The recruiting costs including the advertising costs, referral bonus, agency fee, sign on bonus, background verification, medical examination, relocation costs etc all fall under this cost and we pegged it at Rs1,00,000/- per employee.

2) Cost of training the new employee is assumed to be Rs.10,000/-. The time spent by the co-workers in ramping up the new employee on the learning curve, the induction costs, the mandatory training courses to be taken etc all fall under this category.

3) The cost of lost productivity is calculated considered to be the cost of the employee leaving the organization for the period that position is vacant before his/her replacement joins. For example, if the position created by the employee's exit is vacant for 1 month from the time he leaves the organization, the cost of lost productivity is considered to be the CTC per month of the employee who quit the organization.

Based on the above assumptions- let's consider various scenarios and arrive at the cost of employee turnover.

Scenario 1

Consider a scenario where the replacement of the employee leaving the organization joins the day he/she is leaving , at the same CTC as that of the employee leaving, say Rs.6,00,000/-. This is a best case scenario- which is idealistic and rarely happens. Let's try to observe the cost of employee turnover based on the assumptions we made.

Cost of turnover =

1,00,000+10,000+0+6,00,000-6,00,000

= 7,60,000-6,00,000 = 1,60,000/-

The Cost employee turnover index in this rare to happen scenario is 27%.

Scenario 2

Consider a scenario where the above assumptions holds good and the position happens to be vacant for a month before the replacement joins the organization. Also, the CTC of the new joiner is 10% more than the leaving employee.

The cost of employee turnover =
1,00,000+10,000+50,000+6,60,000-6,00,000

= 8,20,000-6,00,000 = 2,20,000

The cost of employee turnover index in this case happens to be 37%

Scenario 3

Consider a scenario where the above assumptions holds good and the position happens to be vacant for 2 months before the replacement joins the organization. Also, the CTC of the new joiner is 20% more than the leaving employee.

The cost of employee turnover =
1,00,000+10,000+100,000+7,20,000-6,00,000

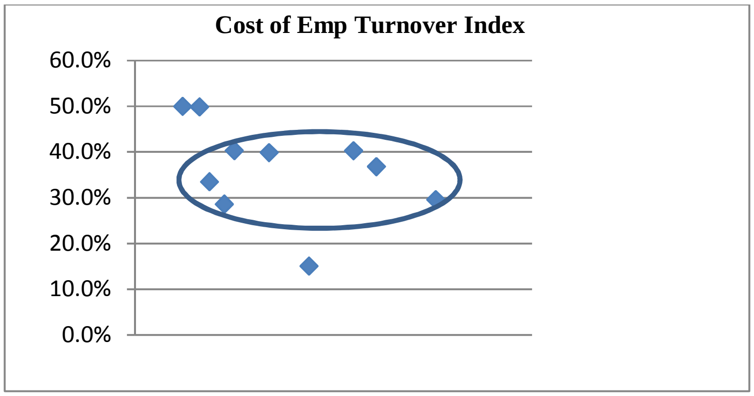
= 9,30,000-6,00,000 = 3,30,000/-.

The cost of employee turnover index in this case happens to be 55%

Just considering these scenarios we can observe that the cost of employee turnover vary between 27% to 55 %.

Case Study

To check the veracity of the above hypothesis, the authors studied the data of the last 10 replacements of Ranklin Solutions to identify their respective cost of turnover. RANKLIN Solutions Limited, incorporated in the year 1996 isheadquartered in Hyderabad, India. They provideIT solutions totheir clients and are extensively into Custom Software Development, Professional Consulting Services, Development of custom IT solutions especially in e-commerce, banking, pharmaceutical & life sciences, retail, financial, Insurance and healthcare sectors.



Source: Ranklin's Employee turnover details for the latest 10 replacements in 2013

Conclusion

Based on the above hypothesis the HR teams of organizations can arrive at the individual cost of the employee turnover based on the real data. Considering that the cost of turnover for the 3 scenarios we considered ranges from 27% to 55%, the same could considerably increase if the training costs gets increased and the cost of hiring increases as well. From the study made on Ranklin it is observed that their cost of employee turnover index is between 30 to 40%. This is in line with the assumptions made. If the HR teams can crunch these numbers across their organizations by computing the cost of overall employee turnover- the number could be staggering!

It is desirable for organizations to have certain amount of turnover to bring in fresh ideas and perspectives, in dealing with issues. Hence some level of turnover is required for the organization to be progressive and not to get stagnated. In that context to some extent cost of employee turnover can be considered as cost to do business. It is inevitable. But the organizations should realize excessive cost of employee turnover and should try to retain their key employees. Organizations should develop sound employee retention strategies to retain their key employees not only to reduce their cost of employee turnover but also to achieve its competitive advantage.

References:

Cost of Employee Turnoverby William G. Bliss

There Are Significant Business Costs to Replacing Employees By Heather Boushey and Sarah Jane Glynn

How much does it cost companies to lose employees? By SUZANNE LUCAS / MONEYWATCH/ November 21, 2012

Abbasi.S &Hollman. K. Turnover: The real bottom-line, Public Personnel Management, Volume: 29 Issue: 3, 2000, Page: 333

Porter, Lyman W.; Steers, Richard M. Organizational, work, and personal factors in employee turnover and absenteeism, Psychological Bulletin, Vol 80(2), Aug 1978

McBey K, Karakowsky L, Examining sources of influence on employee turnover in the part-time work context, Leadership Organization Dev. J. 21 (3), 2000, pp:136-144.

LEWIS, Robert .E. and HECKMAN Robert J. Talent management: a critical review, Human

Resource Management Review, Vol.16, No. 2 June 2006, p139-154.

Peter Cappelli , Talent management for the twenty-first century, Harvard Business Review. Vol 86, No 3, March 2008. Pp 76-81

Narendra M Agrawal, Mohan Thite, Human resource issues, challenges and strategies in the Indian software industry, International Journal of Human Resources Development and Management, 2003