More Than You Think: The Cost of Employee Turnover

8 min read

The effects of the Great Resignation have left many companies in the lurch with productivity stymied while they struggle to fill open positions and smooth out operations while they function short-handed.

Key Takeaways

- **Recognizing the Significant Cost of Turnover:** Turnover costs are substantial, and this is especially true for small businesses because most of their employees run on tribal knowledge – when a member of the tribe leaves, so, too, does the knowledge..
- **Even More Costs: The Effects of Turnover on Clients:** Losing just ONE client worth $30,000 can push the total turnover cost to more than 200% of the original staff member's salary!
- **Improve Employee Engagement to Reduce Turnover Rates:** Before you know it, you are paying more than half of the missing employee's annual salary in direct, out-of-pocket costs to replace that mid-level staff person...

With an average of just under 4 million workers leaving their jobs each month in 2021, the U.S. suffered its highest annual turnover rates ever.[1] According to the U.S. Bureau of Labor and Statistics, employee separations rates have not shown significant improvement since.[2]

High employee turnover rates do not create productivity jams and frustration for business leaders, but they also lead to skyrocketing direct and indirect costs which can quickly shrink a company's profit margins, lead to cash flow shortages, and even damage the business's ability to consistently provide high-quality service to its customers resulting in future losses, too.

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Recognizing the Significant Cost of Turnover

No matter which way you slice it, profits are heavily impacted when an employee leaves for a variety of reasons. Although the expense does not have its own line on your income statement, the cost of turnover should not be ignored. Turnover costs are substantial, and this is especially true for small businesses because most of their employees run on tribal knowledge – when a member of the tribe leaves, so, too, does the knowledge.

The absorbed costs involved to recruit, hire, train, and bring the replacement up to speed are often overlooked overhead expenses. These directly reduce the business’s gross profit, translating to money coming right out of the owner’s pocket. Unfortunately, turnover is a big expense of doing business. According to the U.S. Small Business Administration, the cost to replace an employee goes up with the employee’s rank in the company.

For instance, replacing an entry-level, non-skilled employee costs up to 50% of the employee’s annual salary. Whereas, when replacing a supervisor’s position, the turnover cost could soar up to 150% of the annual salary.

Let’s look at examples of direct and indirect costs when a 40-person company suddenly loses a top performer earning a $60,000 salary. Then, we’ll provide tips on how you can help retain employees and reduce turnover

How Much Does Turnover Cost?

Direct Costs of Turnover

For an employee with a **$60,000** salary, there are many of the costs you’d expect with them leaving. These include:

- When businesses need to replace a billable worker in a hurry, most use a recruiter, who charges **20-30%** of the new hire’s first-year salary. If we’re conservative, and go with **20%** of a **$60,000** salary, that’s a $12,000 hit to the bottom line. Ouch. [3]
- According to the University of Pennsylvania, external hires demand **18-20%** more in salary than internal hires. If we split the difference and use **16%**, that’s **$10,000** more in salary expense (And we’re not even counting the cascading effect when coworkers find out about that higher pay level.) [4]

- You also have to pay PTO as the person walks out the door. Following our previous example, one week of PTO is valued at **$1,750.** [2]
- There's also the cost of recruitment. An ad in Monster and CareerBuilder, plus paying for the time of the employee placing the ads, is going to run around **$1,000.** And if you do ANY employment testing or screening, you can add a few hundred more dollars to the tab.
- There's also the labor cost of employees who are diverted from their main job duties to write recruitment ads, update job descriptions, review resumes, and interview candidates. This cost is often forgotten. If 3 managers spend 90 minutes each on interviews, the cost of their time could be more than **$3,000**. That doesn't include the opportunity cost of the lost billable time for those managers.
- The remaining employees may incur overtime to pick up the slack of the lost worker. If you have a highly compensated staff, you may even have tax restarts (when an employer has to restart paying taxes mid-tax year despite their contributions to date for Social Security and unemployment).

Add it all up and before you know it, you are paying more than half of the missing employee's annual salary in direct, out-of-pocket costs to replace that mid-level staff person. You up the ante, even more, when you add indirect costs to the turnover turmoil.

This doesn't even account for indirect costs, which we'll go into next:

Indirect Costs of Turnover

- Typically, it takes **8-12 weeks** to replace a knowledge worker, and then another month or two before the replacement gets to full productivity mode. Let's say that the employee who left generated **$100,000** in revenue. For every 3 months that work doesn't get done, the company incurs **$25,000** in lost income and profits!
- A smart CEO will put the best people in charge of training a new hire, which takes the most valuable people out of production. That decision impacts 3 people: the trainer, their manager, and the trainee. During the new hire's first 3 months, those hidden labor costs can quickly add up to tens of thousands of dollars.
- Not only do you need to make the new person feel welcome, but you also need to make sure the other staff members don't leave – which means more one-on-one meetings, lunches with the boss, and happy hours after work. You need to lift office morale because losing a work friend is akin to a family member moving away.

Now for the total turnover hit: combine the direct and indirect costs and factor in the lost revenue opportunities, and the cost of turnover ends up being **150% of the employee's full-year salary ($90,000)!**

Even More Costs: The Effects of Turnover on Clients

Wait – there's more! If you lose just one client due to the turnover, the costs grow exponentially. It's an undeniable fact: people buy from people. When an employee leaves, clients often reassess if they should move their business elsewhere.

Losing just ONE client worth $30,000 can push the total turnover cost to more than 200% of the original staff member's salary!

Now that we've got your full attention, how can you lower your turnover costs? You must implement a human capital strategy to reward and retain your employees.

Tracking & Preventing Turnover in the Future

While turnover is a normal part of business, and will always happen, there are things you can do to control turnover rates from skyrocketing.

To learn how to prevent turnover in your company and improve retention rates, you must first examine numbers and data to further understand what your turnover is – in order to take steps to address it. But how do you keep track of your turnover, you might ask?

You measure the employee turnover rate, which is:

> The number of employees who had an unplanned termination from the company divided by the total number of employees in the company.

We take planned terminations out of this calculation because removing people who don't fit the culture or are actively disengaged and hurting the business should be removed. You don't want those decisions to be deferred because it skews this important metric.

The business in the graph below has lowered its turnover rate through its efforts to recruit staff that fit the culture and have the behaviors that will be successful. Since 80% of all terminations are the result of bad hires, you can see how greatly focusing on culture improved their ability to retain their workers.

Improve Employee Engagement to Reduce Turnover Rates

Low employee engagement has been shown to increase turnover rates. A study from Gallup that looked at almost 24,000 businesses found that the businesses with the lowest employee engagement experienced turnover rates that were 31-51% higher than companies with better engagement [3].

Applying the following tips to your workplace can keep your employees more engaged and your turnover rates low:

- Consider a mentoring program in your office. A Columbia University study shows students who were mentored had “a lesser chance of dropping out than students who were not mentored.” The very same can be said about employees who feel like you’re invested in their ongoing success.
- Encourage communication. An employee leaving will naturally cause curiosity and inner office gossip. Being transparent will avoid wild stories or misconceptions cropping up around the workplace and contribute to a happier environment.
- Provide an actionable path for upward growth and momentum. This is especially important for the new generation of workers, as many will prioritize career opportunities over a higher salary. In other words, simply paying someone more isn’t going to be an instant fix if there are culture or other internal issues that are causing unhappiness
- Design a human capital strategy and/or culture matrix for new hires, so you don’t churn based on an unrealistic workload or an employee’s inability to adjust to your company. This will help establish clear lines as to who will work best alongside existing workers and set the precedent to fill the void the employee left.

At the end of the day, people want to know you care. You can take actionable steps by measuring employee turnover and implementing some of the above points to mitigate the effects, and the financial impact it can have on your business.