

5 EXERCISE

Evaluating the Financial Impact of Human Resource Management Activities: Reduced Turnover Costs

I. OBJECTIVES

- A. To provide you with practice in analyzing data and drawing conclusions regarding managerial implications.
- B. To make you aware of the potential costs of controllable, dysfunctional turnover and its impact on net income or profit.
- C. To make you aware of the potential benefits of human resource management activities to an organization's "bottom line."

II. OUT-OF-CLASS PREPARATION TIME: 2 hours

III. IN-CLASS TIME SUGGESTED: 45 minutes

IV. PROCEDURES

Read the entire exercise, including the "Background" on the Charlotte Health System and the three exhibits. Using the data in the exhibits, do the calculations (on your own, prior to class) requested on Form 2. Then assemble groups of three to five students during the class period and discuss each of the questions. At the end of the class period, have a spokesperson for each group discuss the group's answers and rationale with the entire class.

BACKGROUND

The health care industry has undergone dramatic change and restructuring during the past decade. Mergers, consolidations, and downsizing were the norm as organizations struggled to provide more cost-effective, high-quality services demanded by managed-care organizations and corporate employers. A major response to these pressures has been the development of "integrated delivery systems" which typically combine multiple units of hospitals, physician practices, outpatient facilities, long-term care facilities, and insurance.

While the goal of these systems is to provide "seamless" care through internal referrals, a common medical record, common policies and procedures, etc., the reality has been somewhat less than a total success. Among the problems identified have been differences in values and incentives between the organizational units, lack of top management knowledge of some of the units acquired, and inability to "integrate" the different units clinically and managerially.

The Charlotte (North Carolina) Health System was developed from a base of a public hospital to which various delivery sites were added after Mr. Harry Majors became CEO 15 years ago. Since his arrival, Majors and his executive team have created the dominant health system in North Carolina. Despite this success, the system continues to be under pressure from employers and managed-care organizations to further reduce its costs and document both clinical quality and cost-effectiveness.

Almost four years ago, Majors and the board of directors decided that the time had come to "professionalize" the human resource function because the organizations they had purchased or aligned with were exhibiting varying degrees of sophistication and vastly different policies and procedures. Ms. Betty Williams was recruited from another health system as the new vice president for human resources. Williams came to her job after completion of an M.A. degree in human resources management from the University of Alabama and 16 years of experience in the

EXHIBIT 1.6 Human Resource Management Department Budget for Years 1 Through 4

Budget Cost	Department Budget Per Year			
	1	2	3	4
Salaries and Benefits	\$110,000	\$233,000	\$288,000	\$324,000
Equipment and Supplies	24,000	39,000	48,000	57,000
Communications	41,000	62,000	73,000	81,000
Totals	\$175,000	\$334,000	\$409,000	\$462,000

field. During the three years she has been at Charlotte Health System, she has hired three new HRM staff persons in recruitment, employee benefits, and compensation.

As the board has considered how to reduce the cost of service delivery in the system, the corporate office in general, and the human resources department in particular, have come under increased scrutiny. Williams has been told she needs to justify the additional budget allocation to her department over the past three years. Exhibit 1.6 shows her department's budget for Year 1 (the year prior to Williams's arrival) as well as the three years since her arrival. The board has calculated "extra" costs of the Human Resources Department over the past three years (using Year 1 as the base) to be \$680,000. The largest percentage cost increases were in salaries and benefits and equipment and supplies. Most of the latter increases were the result of upgrades in computer hardware and software.

The board has scheduled a meeting for next Monday. One of the agenda items is to examine the costs of the human resource management department with the possibility of a budget cut for next year. Williams has been asked to make a presentation to justify her budget and to show how expansion of her department has contributed to the system's bottom line. She has considered a number of changes she made which she believes have improved overall system performance. Among these were the development of system career ladders to increase employee retention, in-house management training programs to improve management competence, development of "model" staffing ratios to reduce employee stress and burnout, quarterly performance reviews to increase employee feedback, absenteeism incentive programs, and initiation of an annual employee survey to identify problem areas.

After some discussion with her staff, she has decided that it would be easier to document the benefits of increased employee retention. Exhibit 1.7 shows the decline in employee turnover from Year 1 to each of the three latest years.

EXHIBIT 1.7 Annual Turnover Rate by Category for Years 1 Through 4

Personnel Categories	Percent Turnover Per Year			
	1	2	3	4
Executive ($n = 127$)*	12.8	11.5	9.2	8.3
Physician ($n = 367$)	18.1	17.6	17.9	15.6
Other Professional ($n = 615$)	22.6	22.1	18.3	15.6
Non-Professional ($n = 804$)	29.0	26.3	27.1	24.3
Totals** ($n = 1913$)	23.8	22.3	21.3	18.8

* n is the average number of employees in each category over the four-year period.

**The weighted average turnover rate for all four categories for each of the four years.

EXHIBIT 1.8 *Average Costs of Turnover per Individual Over the Four-Year Period by Personnel Category*

Turnover Costs	All Categories ⁺ (n = 1913)	Personnel Category			
		Executive (n = 127)	Physician (n = 367)	Other Professional (n = 615)	Non-Professional (n = 804)
Separation Costs:					
Exit Interviews	50.73	62.50	73.00	51.00	38.50
Administrative Costs	119.27	127.00	132.50	116.00	114.50
Separation Pay	348.01	2,254.00	1,034.00	—	—
	518.01	2,633.00	1,239.50	167.00	153.00
Replacement Costs:					
Job Advertisements	1,346.49	1,805.00	2,416.50	1,127.50	953.00
Pre-Employment Administration	353.28	405.00	416.50	386.50	291.00
Entrance Interviews	324.86	486.00	724.50	284.00	148.00
Assessment Testing	271.69	382.50	695.00	214.50	105.00
Staff Time	249.00	417.50	522.00	212.00	126.00
Travel/Moving Expenses	293.68	1,215.50	1,110.50	—	—
Processing New Employees	87.50	87.50	87.50	87.50	87.50
Medical Examinations	175.00	175.00	175.00	175.00	175.00
	3,101.50	4,974.00	6,147.50	2,487.00	1,855.50
Training Costs					
Informational Literature	80.00	80.00	80.00	80.00	80.00
Formal Training	147.53	340.00	516.50	35.00	35.00
On-the-Job Training	68.15	—	—	212.00	159.50
	295.68	420.00	596.50	327.00	274.50
Reduced Productivity					
During Learning Period	<u>3,133.37</u>	<u>4,000.00</u>	<u>6,500.00</u>	<u>3,452.00</u>	<u>1,215.50</u>
Total	\$7,048.56	\$12,027.00	\$14,483.50	\$6,433.00	\$3,528.50
Total Excluding Productivity	\$3,915.19	\$7,837.50	\$7,983.50	\$2,981.00	\$2,313.00

⁺Weighted average

Williams and her staff have calculated the average cost of turnover per employee by personnel category and these calculations are shown in Exhibit 1.8. Most of these calculations can be documented from personnel records. The exception is the “reduced productivity during the learning period.” For these calculations, the staff calculated the average monthly productivity for a small sub-sample of the individuals who left and compared it to the average monthly productivity of those who replaced them during their first three months. They then calculated the dollar cost of this lost productivity for a one-year period.

Their assumption is that the lower productivity continues at the same level for a 12-month period and then disappears. More realistically, the lower productivity probably declines over time but continues for longer than a 12-month period. However, they feel their method of calculation is a good approximation of reality since their overestimation of the productivity loss is offset by the shorter time period of their calculations.

Exhibit 1.8 shows that the total cost for each individual who leaves the Charlotte Health System averages \$7,049, but this varies from a high of \$14,484 for physicians to a low of

\$3,644 for non-professional employees. These costs are divided into separation costs, replacement costs, training costs, and costs of reduced productivity (for the new employee) during the (assumed) one-year learning period.

QUESTIONS

1. Are the calculated benefits of reduced turnover sufficient to justify the \$680,000 in increased costs associated with the expansion of the human resource management department? Would your answer be the same if “reduced productivity during the learning period” was excluded from the analysis?
2. In addition to improved employee retention, what are some other areas of potential economic benefit to the organization from having a human resource department? What calculations would you do to prove such benefits?

FORM 2 Calculation of Benefits of Higher Employee Retention Using a Base of Year 1

Personal Category	Savings in Year			Total Savings
	2	3	4	
Executive				
Physician				
Other Professional				
Non-Professional				
All Categories				

Calculation of Savings or Loss:

1. Total Incremental Savings from Higher Employee Retention for all Personnel Categories for Years 2, 3, and 4.

2. Total Incremental Costs of the Human Resource Management Department Budget for Years 2, 3, and 4.

-\$680,000

Net Savings or Loss

Benefit/Cost Ratio (1) ÷ (2)
