Employee Engagement Financial Impacts in Organizations

Fernando Garcia Flores

Central Michigan University

Reviewer: Dr. James Loughran

This MSA 602 paper is in partial fulfillment of the requirements for MSA698 Directed Administrative Portfolio
Executive Summary

The Society for Human Resource Management (SHRM) sustains that 75 percent of employees are actively seeking a new job, meaning the employees have a low engagement with their jobs. This statistic is an alarming situation for all organizations, as employee turnover costs could reach levels between 50 percent up to 200 percent of the former employee's salary. These costs are very high because when an employee leaves the organization, there are several activities that are needed to replace the employee, like recruiting, advertisement, temporary assistance, onboarding, and training. High turnover rates have a big negative impact on budgets and financial results for any organization (Cloutier, Felusiak, Hill & Pemberton-Jones, 2015).

The literature and conclusions included in this paper confirm that employee turnover costs could represent a heavy financial burden to any organization. In global organizations like Continental AG that are affected by high employee turnover rates, it is possible to do a quick cost-benefit analysis to justify the implementation of the necessary strategies to improve employee engagement, such as training, mentoring, educational assistance, additional work perks, and flexible schedule programs. Some additional benefits for the employees do not need high investments and can be implemented quickly. Any increase in employee engagement will help to lower turnover costs, reduce absenteeism, and increase profitability for the organization.

Researchers have found that organizations with highly engaged employees achieved a growth of 28 percent on their earnings-per-share (EPS) compared with low-engagement organizations that only showed an 11.2 percent rate. This benefit for the organization as a result of higher employee's performance when they are engaged in their work (Fisher, 2017).
Table of Contents

Introduction..................................................................................................................5

Do Ethics Pay? ..............................................................................................................6

Cost-Benefit Analysis and Return on Investment (ROI) ..............................................7

Literature Review .....................................................................................................9

Employee Turnover Costs .........................................................................................9

Employee Engagement Strategies - Costs and Benefits ..............................................10

Conclusions and Recommendations ........................................................................13

References ..................................................................................................................14
**LIST OF FIGURES**

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Continental AG 2017 turnover by age and gender in percentage</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>ROI &amp; HCROI calculation Model</td>
<td>8</td>
</tr>
</tbody>
</table>
Employee Engagement Financial Impacts in Organizations

Employee engagement is one of the main strategies organizations can use to address the impact of employee turnover. Researchers have found that the expenses for the organization related with employee turnover are in average $13,996 per employee. The high costs associated with employee turnover include recruiting, hiring, and training cost, for this reason, organizations pay close attention to employee turnover rates as these costs negatively impact the profit and performance of the organization (Alatawi, 2017).

The researcher concentration is general administration and employee engagement is one of the most important areas for managers and HR practitioners because it has a direct relationship with the performance and profitability of the organization. Improving employee engagement helps the organization to minimize the impact of employee turnover. Depending on the salary of the employee that is leaving, the turnover costs could go from 25 percent up to 500 percent of the employee’s annual salary.

The researcher of this paper sustains that companies like Continental AG need to improve the strategies to monitor and improve employee engagement. The literature included in this paper sustains that organizations can obtain more benefits when they have a high engagement workforce and the turnover rates are reduced. Some engagement strategies might require additional resources, but the necessary investments required to improve employee engagement are minimum in comparison with the potential benefit organizations could gain.

The Impact on employee turnover at Continental AG is an area of improvement the company has already identified as part of the sustainability report 2017. This report stated that the fluctuation rate for Continental AG worldwide is 5.7 percent at the end of 2017, unfortunately, the turnover increased by 1 percent compared to the previous year. Figure 1 below
shows the turnover rates distribution by age and gender. The total number of employees as of December 31st, 2017 was 235,473 and they helped the company to reach 44 billion Euros in sales (Continental Corporation, 2017).

![Figure 1 Continental AG 2017 turnover by age and gender in percentage](image)

Taken from 2017 Sustainability Report and UN Global Compact Communication on Progress (p. 29) by Continental Corporation, 2017.

In 2017, Continental AG invested an average of 350 Euros per full-time employee on external training, around 75 million Euro total. This amount excludes internal training sessions. As an additional benefit, Continental AG developed a continuous improvement program that encourages all employees to submit ideas to improve their own working environment. This commitment to the organization is rewarded with bonuses. The ideas submitted by employees supported the organization to achieved savings of around 152 million Euros (Continental Corporation, 2017).

**Do Ethics Pay?**

The ethical outlook and performance of the organization are commonly included in the corporate governance, in the corporate social responsibility (CSR) or in the sustainability report.
The corporate governance provides standardization and transparency for all business operations, which in consequence creates sustainable value for the organization and defines the foundation for the proper communication between shareholders and the leaders in the organization. Corporate social responsibility determines how the business is conducted beyond its primary objective of profitability and incorporates the concept of social environment and the community. Sustainability report includes all the detail social and economic figures relevant to all programs that have a positive impact on the community (Goel, 2017).

Corporate social responsibility (CSR) has become an important aspect for organizations. These activities are focused to enhance social benefits partially beyond the economic interest from the organization. Customer loyalty shows a tendency to be stronger with organizations that incorporate CSR activities. Some of the non-financial benefits from CRS practices include to gain recognition from the community, retain loyalty from customers, minimize labor-related litigation problems and promote higher employee morale through positive trust and ethical corporate environment (Cho & Lee, 2017).

Ethical practices involving the stakeholders can bring a competitive advantage for the organization as this fosters a positive relationship with the external community and within the individuals inside the organization. Researchers also found that corporate governance has a significant positive relationship with corporate performance indicators like Return on Capital (ROC) and Return on Assets (ROA), and provides a better risk-return trade-off for external investors (Goel, 2017).

Cost-Benefit Analysis and Return on Investment (ROI)

The process to compare benefits (gains) and costs (losses) as a result of a potential action, investment or decision is known as Cost Benefit Analysis (CBA). The key performance indicator
that comes out from the cash flow over time of net gains and losses is expressed in the form of the Economic Net Present Value (ENPV) and the Benefit Cost Ratio (BCR). When the ENPV result is positive and the BCR result is greater than one, this project is preferred over the other alternatives. CBA is a decision-making tool that provides important financial insight on the economic viability of the project (Sumana & Hegde, 2014).

In organizations, ROI (return on investment) is the financial indicator to calculate the profit of a business and the efficiency of an investment. Introducing ROI into Human Resources (HR) provides a method to evaluate which investments are necessary for the organization to generate a consistent return, and this metric is known as Human Capital Return on Investment (HCROI). Considering that ROI is a ratio of the net benefits to costs expressed as a percentage, HCROI can be calculated in a similar way as defined in Figure 2 below. This ratio focus on the value employees creates for the organization (Niculescu, 2016).

Figure 2. ROI & HCROI calculation Model

\[
\text{ROI} = \left( \frac{\text{(Monetary Benefits} - \text{Costs})}{\text{Costs}} \right) \times 100
\]

\[
\text{HCROI} = \frac{\text{Revenue} - (\text{Expenses} - \text{Pay and Benefits})}{\text{Pay and Benefits}}
\]

Taken from The critically of connecting people to financial results – An ROI calculation model for Romanian FSOs (p. 123) by Niculescu, 2016.
Literature Review

In today's global environment, social media plays an important role to extend to employee's attractive lucrative job offers from the external job market. When individuals are contacted by external sources it is very easy to persuade individuals to "hop jobs" for better opportunities outside their current organization. This represents a threat to all organizations because they are not only facing the problem to lose a person, but the organization will actually incur in several costs related with the process to replace the person that is leaving. Besides to the costs of hiring and training the new person, organizations will also be impacted by the additional resources required to train the new person and by the loss of productivity and corporate morale. In average, voluntary turnover could cost almost four to five times more than the annual salary of the employee to the organization (Bihani & Dalal, 2014).

Employee Turnover Costs

In some cases, the turnover costs for organizations are up to 250 percent of the annual salary of the employee that is leaving. On other conservative cases, the turnover costs are at least 30 percent of the employee's annual salary. In any case, these quantities can sum up very quick for organizations and they could reach frightening levels, depending on the annual number of employees that leave the workplace. In terms of absolute numbers, according to the Bureau of Labor Statistics, in 2007, the average costs to replace an employee was $13,996 USD, but these costs are only related to the hiring process (Nolan, 2015).

Researchers have found that the main costs associated with turnover include the costs of replacing the employee, the costs related with the separation of the employee, the time the position remains open, the recruiting costs, the interviewing costs, the onboarding costs, and the training costs of the new employee. All these costs are estimated to represent between 50 and
100 percent of an employee's yearly salary. However, depending on the salary grade of the person that is leaving, the turnover costs can vary between 1.5 and 2.5 times the annual salary of the employee that is leaving. Turnover costs can significantly impact the results and performance of the company, for this reason, organizations are very interested to increase the engagement and commitment of their employees (Schlechter, Thompson & Bussin, 2015).

**Employee Engagement Strategies - Costs and Benefits**

In a recent case study conducted in one organization, the results sustained that perks at work go hand-in-hand with employee benefits, and they have a positive relationship to improve engagement and retention of employees, especially millennials. The study was conducted at Enova International Inc. This company integrated into their building a relaxation area for the employees, including massage chairs and exercise balls. They also implemented free breakfasts, snacks, and beverages, offered a low-cost provider for dry cleaning services, and offered free yoga classes. Enova International improved their employee engagement level of almost 80 percent (Nolan, 2015).

Mentoring programs can be a cost-effective methodology to increase employee engagement in the organizations as researchers have found that in most cases mentors do not receive any financial remuneration and they mentored on top of their regular job responsibilities. Mentoring is an opportunity for employees to enhance existing skills and it could even potentially develop new ones. Group mentoring is another technique that can be used to increase employee engagement. This methodology eliminates the concern to have too few mentors, having multiple mentors provides a broader networking for the mentees, and it also provides a wider knowledge to the participants as many areas are involved in the group (Harris, Cheng & Gorley, 2014).
Educational assistance is a benefit that organizations can provide to employees to improve employee engagement. The investment required for this benefit is less compared to the costs organizations incur with employee turnover. For example, the turnover costs for a company could be equivalent to an employee’s salary of six to nine months, these costs include recruitment, hiring, and training of the replacement. Considering an employee’s salary of $60,000, the organization could spend up to $45,000. In contrast, the expenses for the same organization to provide educational assistance could vary from online degrees which cost around $43,000, or coding boot camp credentials which cost around $11,000, or some other personal certifications like time management that costs around $555. All these educational programs could boost employee's performance by about 20 percent (Carlson & Finkelstein, 2017).

Work-life balance is one of the best strategies to improve employee engagement, and flexible work is one of the most common methods used by organizations to address work-life balance for the employees. Federal law requires agencies to allow telework to the maximum extent as long as it does not affect the performance of the employees. Telework programs have many advantages for organizations such as a potentially positive effect on building costs, it reduces the carbon footprint of federal workers and it reduces the commuting time for employees. Research and consulting firm Global Workplace Analytics sustain that two to two and a half days per week of telework from all government employees could save $6 to $12 billion a year in space costs from the taxpayers (Denison et al, 2014).

Organizations can also increase apprenticeship and internship programs to a large extent defined by the cost-benefit ratio of such investment compared to the associated costs using full time or outsource employees. The costs related to apprenticeships normally include apprentice's wages, some training costs, recruitment costs, infrastructure costs, and office supplies. However,
the benefits for the organization is in relation with the productive time the apprentice provided to
the organization in comparison with the costs that would have incurred if the activity was done
by a full-time employee. The productive time can be calculated by multiplying the time required
to complete the activity times the wages of the employee. Another benefit of apprenticeships is
that normally organizations hire the apprentices at the end of school, so organization also benefit
of the low recruiting costs and they have the certainty that the new hire will require less training
to perform the work (Muehlemann & Wolter, 2014).

Some of the benefits organizations can offer to employees do not have a high financial
impact on the budget of the organization. Lazlo Bock, vice president of People Operations at
Google, sustains that the benefits Google provides to its employees as listed in Table 1, are not a
heavy burden for the company, and many of those are even free of costs, as providers are
offering their products and services free of charge to the company, and at a very competitive
costs for their employees (Moore, 2015).

Table 1 Cost of Perks at work – Example from Google

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Costs for Google</th>
<th>Costs to Employee</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bring ATMs</td>
<td>No Costs</td>
<td>No Cost</td>
<td>Higher Efficiency</td>
</tr>
<tr>
<td>Bikes around campus</td>
<td>Low</td>
<td>No Cost</td>
<td>Higher Efficiency &amp; Employee well being</td>
</tr>
<tr>
<td>Mobile Car Wash</td>
<td>No Costs</td>
<td>Low</td>
<td>Higher Efficiency</td>
</tr>
<tr>
<td>Dry Cleaning</td>
<td>No Costs</td>
<td>Low</td>
<td>Higher Efficiency</td>
</tr>
<tr>
<td>Haircuts and Salons</td>
<td>No Costs</td>
<td>Low</td>
<td>Higher Efficiency</td>
</tr>
<tr>
<td>Massage Chairs</td>
<td>Low</td>
<td>No Costs</td>
<td>Employee well-being</td>
</tr>
<tr>
<td>Massage</td>
<td>Medium</td>
<td>No Costs</td>
<td>Employee well-being</td>
</tr>
<tr>
<td>Culture Clubs</td>
<td>Low</td>
<td>No Costs</td>
<td>Community</td>
</tr>
<tr>
<td>Free Food</td>
<td>High</td>
<td>No Costs</td>
<td>Community, employee well-being, innovation</td>
</tr>
<tr>
<td>Employee Shuttle Service</td>
<td>High</td>
<td>No Costs</td>
<td>Higher Efficiency, community</td>
</tr>
</tbody>
</table>

Taken from Work Rules! Insights from inside Google that will transform how you live
and lead (p. 274) by Bock, 2015.
Conclusions and Recommendations

Employee turnover is a very important factor due to the high financial impact that it could represent for organizations. For example, considering the information from Continental AG that has a turnover rate of 5.7 percent, this ratio means that this organization has a fluctuation of 13,422 employees per year worldwide. Based on the literature included in this paper, the average costs of employee turnover is $13,996 per employee, so the total financial impact for Continental AG could reach as much as $187 million per year. For this reason, the following recommendations are applicable to Continental AG and for any other organization that needs to improve employee engagement to reduce employee turnover.

Recommendation 1

The literature included in this paper sustains that there are several low costs strategies that organizations can implement almost immediately to boost employee engagement such as implementing mentoring programs, increasing the number of apprenticeships in the organization, and allowing external vendors to provide their services, products, and discounts to employees at their own costs. Another strategy that is relatively easy to implement is a flexible work schedule as long as it does not interfere with the operations of the organization.

Recommendation 2

The researcher sustains that the cost-benefit analysis of strategies that help to reduce employee turnover, in most cases it will justify the necessary resources to convince the organization to invest in these strategies. Employee engagement strategies such as educational assistance programs, increase the amount of training per employee, subsidized or provide free meals to employees, and provide shuttle services, are some of the strategies that can be incorporated in the cost-benefit analysis for their implementation in organizations.
References


