

## **Cost of Retaining Key Employees Is Less Than the Cost of Replacing Them**

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Would you add a 50% bonus to a manager's salary just to keep the manager on staff for another year? That may seem like a costly way to retain employees - and it is - but it is the type of drastic measure increasingly being taken in today's low unemployment environment.

The reason employers are taking such steps is that, while retention programs are costly, replacement of key employees is even more costly. Add up search fees, relocation expenses, hiring bonuses and other hard expenses, and the cost of replacing an employee earning \$75,000 a year typically reaches \$60,000 to \$150,000. Factor in lost productivity and the increased pressure on other employees and the cost can be much higher. Consider the cost, too, of a key employee joining a competitor.

According to a recent Coopers & Lybrand study, the number of employers offering retention bonuses has tripled since 1995, from 14% to 43%. The most common bonus was 10% of annual salary for nonexempt employees and 50% for managers. Flat-dollar bonuses ranged from \$1,000 for non-exempt staff to \$40,000 for senior management. Approximately 70% of respondents said the bonuses were effective in holding employees for the desired time periods.

### ***Developing a Retention Program***

Retention programs should be simple and focused, and should have a clear time frame that relates to program objectives. Review the program periodically and extend it if necessary.

While each company's retention program needs to be tailored to its objectives, all programs should follow seven key steps:

- 1. Identify critical employees.** Identify individuals who are important to the success of the business. Identify those whose continued employment is at risk and determine the potential impact on the company if they were to leave. It is important to identify both critical jobs and critical people. It may also be appropriate to establish tiers of participation, based on employees' positions, marketplace dynamics, current competencies and potential contributions.

2. **Set conditions for bonuses.** In most cases, employees are rewarded simply for remaining employed by the company. If they quit or are fired, they forfeit any further bonuses. Some employers add performance objectives and may require employees to sign non-compete or non-disclosure agreements. It is important to protect the company's investment, but without creating barriers to participation.
3. **Determine appropriate pay outs.** Pay outs typically range from 10% to 50% of salary, although we've seen pay outs as high as 300% of salary. The greater the employee's critical impact on the business, the higher the number should be. Also factor in company needs, the competitive marketplace and other programs the company offers. Dollars can be offset by opportunities for meaningful work, future earnings potential, and other recognition opportunities.
4. **Determine how to pay the award.** A cash bonus at the end of a retention period is the standard approach, but the award may also be in the form of company stock or stock options. Equity awards are valuable if there is significant growth potential, a dividend stream or symbolic value in the stock. Consider the tax consequences if stock is granted. The organization can also use special trips; gifts, such as personal computers, or opportunities for personal time. The value of the reward to the employee must exceed the cost to the company.
5. **Establish qualifiers or modifiers.** For some companies, retaining employees through a specific date is important. This applies to people working on Year 2000 computer system conversions, employees of acquired companies, or those completing new product development projects. If the organization can depend on the employee's performance, time retention is the key issue. In other cases, performance is key, and the award is modified based on pre-determined milestones. Be careful to design any restrictions to encourage desired performance.
6. **Determine the impact on other programs.** If an employee already participates in special incentive plans or receives annual merit reviews, what is the impact of participating in the retention program? In most cases, retention programs supplement performance pay programs. Substituting retention programs for performance programs may backfire by creating employee resentment.
7. **Identify other options.** Money is, of course, not the only factor for motivating employees to stay put. Companies with low turnover typically encourage high levels of involvement, are highly flexible, create numerous reward opportunities, and are responsive to employees' personal needs.

Other options that can help include:

- Providing flexible work hours;
- Using special projects to motivate employees;
- Reassigning employees to meaningful, rewarding assignments;
- Creating mentoring programs;
- Supporting training that contributes to employees' ability to add value to the company.

The challenge is to develop a retention strategy that is consistent with the firm's operating values and is meaningful to key employees. Companies that succeed will not only save the costs of replacing key employees, but will gain a competitive advantage - they will have a cohesive, involved and fulfilled workforce.

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