CHAPTER - IV

A THEORETICAL OVERVIEW OF ATTRITION

4.1 EMPLOYEE ATTRITION

Human capital is the real asset for any organization, and this makes the HR role as an important in recruiting, managing, and retaining the best. The HR department has a clear role in this process and determines the success tempo of any organization. An urgent priority for most of the organizations is to have an innovative and competent HR pool; sound in HR management practices with strong business knowledge (Chiamsiri S; Bulusu SD; Agarwal M, 2005).

The success or failure of an organization is largely dependent on the caliber of the people working therein. Companies have an extra ordinary flair to recruit and retain highly capable employees. these companies are described as “Talent Magnets”. The employees of choice for highly talented people. Such companies realize that the key to attracting and retaining quality employees is not merely compensation and benefit package but other non-pecuniary factors. They attract and retain competent employees by satisfying the key human needs that influence performance and loyalty. They satisfy these needs by leading and managing these skilled employees appropriately.

Without positive and creative contributions from people, organizations cannot progress and prosper. Companies have realized that
competitive advantage resides mostly in people and that finding and keeping good managers and employees is a strategic necessity (Kristen B Donahue, 2006). The concept of employer-of-choice has intensified in the last decade. Employees want to work for the best employers. Becoming an employer–of–choice often involves the issue of acquiring the best talent for the organization, motivating employees to improve performance, keeping them satisfied and loyal and developing employees so that they can grow and contribute skills, and ultimately employee retention forces place (Jack Philips; Adele O Connell, 2008).

Employees are the internal customers of the organizations and the ability to satisfy their needs reflect the HR philosophy of the company. The key to marketing and customer service success lies in fulfilling the customer’s need. Similarly, competing in the labour market requires understanding of the employees’ needs and development of HR retention strategies to recruit and retain the best talent and motivate them to contribute their best to the organizations.

4.1.1 Definition of Employee Attrition

Attrition, in Human Resource terminology, refers to the phenomenon of the employees leaving the company. It is usually measured with a metric called attrition rate, which simply measures the number of employees moving out of the company (voluntary resigning or laid off by the company). It is also referred as churn rate or turnover.
Attrition can be calculated as follows:

\[
\text{Attrition (Per Month) \%} = \frac{\text{Number of Separations in the given month}}{\text{Average head count in the given month}} \times 100
\]

High attrition is a cause of concern for a company as it presents a cost to the company. The company loses on the amount it spent to recruit and select these employees and to train them for their respective jobs. The company may also have to spend additional money to fill the vacancies left open by these employees. Software companies, in the recent past, have experienced high attrition rates of over 30%.

Attrition can also be used to refer to customer attrition which is the number of customers that a company has lost in a given period of time. Attrition, in general, refers to loss or decrease in number of personnel, material etc.

### 4.1.2 Logic of Employee Attrition

Employee Attrition (also known as labor turnover or wastage) is the rate at which people leave an organization. The term ‘natural wastage’ is also used to describe the employee attrition.

According to Wayne F Cascio and John W Boudreau (2008), decisions affecting the acquisition of new employees (that is, selection decisions) require consideration of the quantity, quality, and cost of those acquisitions. Likewise, decisions affecting the separation of employees (that is, layoffs, retirements, employee turnover) require consideration of the quantity, quality, and cost to produce the separations. Figure No.1.8 shows the diagrammatic presentation of the logic of Employee Attrition.
Figure No.4.1 Logic of Employee Attrition

Decisions affecting employee attrition reflect three basic parameters:

i. The quantity of movers

ii. The quality of movers (that is, the strategic value of their performance)

iii. The costs incurred to produce the movement (that is, the costs of acquisitions or separations)

The important points to remember are that the results of decisions that affect acquisitions or separations are expressed through quantity, quality, and cost. Secondly, the consequences of these decisions often depend on the interaction between the effects of acquisitions and separations. In each

period, two processes can change work force value: Employees are added, and employees are separated. As time goes on, these same two processes continue, with the beginning work force value in the new time period being the ending work force value from the last time period.

4.2 CLASSIFICATION OF EMPLOYEE ATTRITION

Wayne F Cascio and John W Boudreau (2008) introduced two popular ways of classifying employee attrition as voluntary attrition versus involuntary and functional attrition versus dysfunctional attrition. Following gives the description of the two types:

A. Voluntary versus Involuntary Attrition: Employee attrition may be voluntary on the part of the employee (for example, resignation) or involuntary (for example, requested resignation, permanent layoff, retirement, death). Voluntary reasons for leaving such as another job that offers more responsibility, returning to school full time, or improved salary and benefits are more controllable than involuntary reasons, such as employee death, chronic illness, or spouse transfer. Most organizations focus on the incidence of voluntary employee attrition precisely because it is more controllable than involuntary attrition. They are also interested in calculating the costs of voluntary attrition, because when these costs are known, an organization can begin to focus attention on reducing them, particularly where such costs have significant strategic effects.

B. Functional Attrition versus Dysfunctional Attrition: Employee Attrition can be categorized into functional attrition and dysfunctional attrition. Having categorized employee attrition as voluntary, many
organizations take the next logical step; namely, to determine the extent to which the voluntary attrition is functional /dysfunctional for the organization. Employee attrition is functional to the extent that the employee’s departure produces increased value for the organization. It is dysfunctional to the extent that the employee’s departure produces reduced value for the organization.

**Figure No. 4.2 : Performance and replaceability of employees who leave organization**

<table>
<thead>
<tr>
<th>Performance</th>
<th>Replaceability</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Easy</td>
</tr>
<tr>
<td>Low</td>
<td>Difficult</td>
</tr>
<tr>
<td>Functional turnover</td>
<td>Dysfunctional turnover</td>
</tr>
</tbody>
</table>

**Source:** Wayne F. Cascio and John W. Boudreau (2008)

High performers who are difficult to replace represent dysfunctional attrition, and low performers who are easy to replace represent functional attrition. Figure 4.2 gives the diagrammatic presentation of Performance and replaceability of employees who leave. From the Figure, it is clear that employee attrition is functional when the resulting difference in work force value is positive, and high enough to offset the cost of transacting the attrition. Employee attrition is dysfunctional when the resulting difference in
work force value is negative, or the positive change in work force value doesn’t offset the costs.

On the flip side, the loss of hard-working, value-adding contributors is usually not good for the organization. Such high performers often have a deep reservoir of firm-specific knowledge and unique and valuable personal characteristics, such as technical and interpersonal skills. It is unlikely that a new employee would have all of these characteristics, and very likely that he or she would take a long time to develop them. Thus, voluntary attrition among these individuals, and replacing them with others, is very likely to reduce the value of the work force and to produce costs associated with their separation and replacement. Voluntary attrition is even more dysfunctional, however, when it occurs in talent pools that are pivotal to an organization’s ability to be successful.

4.3 NEGATIVE IMPACT OF ATTRITION ON THE ORGANIZATION

The impact of employee attrition can be disruptive and costly. The CIPD Survey (2009) of recruitment, retention and employee attrition found that the average rate of attrition in the United Kingdom was 15.7 per cent. The negative impacts of employee attrition as described through the factors given by Jack. J. Philips, Adele. O. Connell (2008) is listed below:

1. High Financial Cost
2. Survival as an Issue
3. Exit Problems and Issues
4. Productivity Losses and Workflow Interruptions
5. Service Quality
6. Loss of Expertise
7. Loss of Business Expertise
8. Administrative Problems
9. Disruption of Social and Communication Networks
10. Job Satisfaction of Remaining Employees
11. Lost Image of the Organization

The impact of the above 11 factors are discussed as follows:

4.3.1 **High Financial Cost:** Employee attrition/turnover have a huge economic impact on the organization, both in direct and indirect costs. Translating, attrition into numbers that executives understand is essential because they need to appreciate the true costs. Sometimes the cost impact alone causes it to become a critical strategic issue. The performance of companies has been inhibited by high turnover rates.

4.3.2 **Survival as an Issue:** In a tight labor market where the success of the company depends on employees with critical skills, recruiting and retaining the appropriate talent can determine the success or failure of the organization.

4.3.3 **Exit Problems and Issues:** With increased litigation at the workplace, many organizations spend significant time and resources addressing the issues of disgruntled and departing employees. Some individuals find the need to involve the legal system, leaving the organization with the challenge of facing an even bigger problem. Even employees who leave voluntarily can cost the company time and money.
4.3.4 **Productivity Losses and Workflow Interruptions:** In most attrition situations, a person who exits abruptly leaves a productivity gap. This void not only causes problems for the specific job performed by the departing employee, but also for others on the same team and within the flow of work.

4.3.5 **Service Quality:** With so much emphasis on providing excellent service to external and internal customers, high attrition has a tremendous negative impact on the quality of customer service. Attrition of front-line employees is often regarded as the most serious threat to providing excellent external customer service.

4.3.6 **Loss of Expertise:** In the case of knowledge industries, a departing employee may have the critical skills needed for working with specific software, completing a step in an important process, or carrying out a task for a project. Sometimes an entire product line may suffer because of a departure.

4.3.7 **Loss of Business Expertise:** Attrition may result in a shortage of staff for a project or leave the remaining staff unprepared to take advantage of a new business opportunity. Existing projects or contracts may be lost or late because a key player is no longer available.

4.3.8 **Administrative Problems:** In most organizations, attrition creates a burdensome amount of administrative effort, not only in additional paper work, but also in time spent confronting and addressing attrition-related issues. This takes precious time away from more important, productive responsibilities.
4.3.9 Disruption of Social and Communication Networks: Every organization has an informal network. Attrition disrupts the communication and socialization patterns critical to the maintenance of teamwork and a productive work environment.

4.3.10 Job Satisfaction of Remaining Employees: The disruptive nature of attrition is amplified when other employees are forced to assume the workload of departing colleagues or address problems associated with the departure. Remaining team members can be distracted by their concern and curiosity about why employees are leaving.

4.3.11. Lost Image of the Organization: High employee attrition creates negative image of a company with a revolving door. Once this image has been established in the job marketplace, it is difficult to change, especially in the recruiting channels.

4.4 COMPUTATION OF EMPLOYEE ATTRITION

Organizations need a practical procedure for measuring and analyzing the costs of employee turnover, especially because the costs of hiring, training, and developing employees are now viewed as investments that must be evaluated just like other corporate resources.

4.4.1 Significance of computation: Wayne F Cascio and John W Boudreau (2008) studied the significance of computation of employee attrition and found that data on attrition is one of the basic metrics that can be used in human capital management and the evaluation of HRM effectiveness. Conceptually, annual employee turnover is computed by adding up the monthly turnover for a 12-month period. Monthly turnover is calculated as
the number of employee separations during the month divided by the average number of active employees during the same month.

Typically, organizations compute attrition rates by business unit, division, diversity category, or tenure with the company. Then they attempt to benchmark those turnover rates against other organizations to gauge whether their rates are higher, lower, or roughly the same as those of competitors or their own industries. When it comes to employee attrition, however, it is not always the case that “lower is better.” In the extreme, if employee attrition is zero, the organization may have employees who are of such low quality that they don’t have alternatives, or the organization may be losing the benefit of the new ideas that outsiders might contribute.

4.4.2 General Method:

Generally, the rate of attrition/turnover in percentage over any period can be calculated by the following formula:

\[
\text{Rate of attrition/turnover} = \frac{\text{Number of attrition / turnover incidents per period}}{\text{Average work force size}} \times 100
\]

The attrition rates are inversely related to unemployment rates (local, regional, national). That is, when unemployment is high, employees tend to remain with their current employers because there are limited opportunities elsewhere. On the other hand, when unemployment is low, employment opportunities are more plentiful, and thus, employee attrition tends to increase.
4.5 MEASUREMENT METHODS OF ATTRITION

Michael Armstrong (2010) developed three measurement methods of employee attrition which are described as given below:

4.5.1 Crude Employee Attrition Rate (BIM Index)

Crude Employee Attrition rate is the number of employees leaving over a period as a percentage of the average number employed over the period. This is the most common method in practice and it is easy to calculate and understand, and can be used readily for benchmarking.

Here attrition is expressed in terms of percentage of the number of people employed.

\[
\text{Number of leavers in a period} \times 100 = \% \text{ attrition / turnover} \\
\frac{\text{Average number of people employed in the period}}{X 100} = \% \text{ attrition / turnover}
\]

This is normally quoted as an annual rate and may be used to measure attrition per organization, department or group of employees. The advantage of this index is that it can alert HR planners to unusually high percentages of the workforce leaving compared with the HR plan, or with the industry average.

The disadvantage of this index is that it does not indicate who is leaving the department or organization: even a high turnover rate may not reflect any real instability if the core of experienced staff consistently remains.
4.5.2 Labor Stability Index:

This is the second method of measuring employee attrition which focuses mainly on stability. Here, eliminate short-term employees from the analysis, thus obtaining a better picture of the significant movements in the workforce. The Labor Stability Index value is calculated using the following formula:

\[
\text{Number of employees with one or more years’ service} \times 100\% = \% \text{ of stability} \\
\text{Number of employees employed at the beginning of the year}
\]

Particularly in times of rapid expansion, organizations should keep an eye on stability, as a meaningful measure. The purpose is similar to the survival index and it provides a simple, if rather limited, basis for measurement.

4.5.3 Survival Rate:

The labor stability index ignores new starts during the year and does not consider service, which may be added to the measurement via length of service analysis, survival rate analysis. Here, the organization calculates the proportion of employees who are engaged within a certain period who are still with the firm after various periods of time. There may be a survival rate of 70% after two years, for example, but only 50% in the third year. It is a good indication of the effectiveness of recruitment procedures as well as, typically, the high proportion of people who leave after relatively short periods of service. It can therefore highlight where the action is required.
4.6 THE COST OF EMPLOYEE ATTRITION

Employee attrition can represent a substantial cost of doing business. It is necessary to measure employee attrition and calculate its costs in order to forecast future losses for planning purposes and to identify the reasons that people leave the organization.

Unfortunately many organizations are unaware of the actual cost of attrition. Unless this cost is known, management may be unaware of the financial implications of attrition rates, especially among pivotal talent pools. Management also may be unaware of the need for action to prevent controllable turnover, and may not develop a basis for choosing among alternative programs designed to reduce attrition.

4.6.1 Key Cost Components: According to Wayne F Cascio and John W Boudreau, (2008), the general procedure for identifying and measuring attrition costs is founded on the premise that in measuring attrition, the organization must consider three major, separate cost categories: separation costs, replacement costs, and training costs. The cost of attrition should also include the economic value of lost business.

The key cost elements, that apply to total attrition costs include costs involved in conducting exit interviews (S1), costs linked to administrative functions related to termination (S2), separation pay(S3), and unemployment tax (S4), if applicable.

The key cost components to be considered in the calculation of Total employee attrition cost are listed as follows:

i. Cost involved in conducting Exit interviews (S1)
ii. Costs linked to administrative functions related to termination, such as deletion of the exiting employee from payroll, employment, and benefits files (S2).

iii. Separation pay as per Organizational policy decisions (S3).

iv. Unemployment tax calculated as per appropriate Government rules and legislation if applicable (S4).

By taking into consideration, the above cost components namely S1, S2, S3 and S4, the Total Attrition Cost is computed using the following formula:

\[ \text{Total Employee Attrition Cost} (ST) = S1 + S2 + S3 + S4 \]

### 4.6.2 Indirect Cost Components in attrition

While calculating cost of attrition the following components also must be considered for in depth understanding of the attrition problem.

#### 4.6.3 Replacement costs:
Replacement costs are incurred by an organization when it replaces a terminated employee. There are eight categories of replacement costs and they are listed below as:

a) Communication of job availability
b) Pre-employment administrative functions.
c) Entrance interviews
d) Testing
e) Staff meetings
f) Travel/moving expenses
g) Post-employment acquisition and dissemination of information.
h) Employment medical exams.
Training Costs: In all organizations, replaced employees must be oriented and trained to a standard level of competence before assuming their regular duties. This often involves considerable expense to an organization.

The overall cost of the training program depends on the cost of two major components: costs associated with trainers and costs associated with trainees. The cost of the on-the-job training must also be determined for all replacement employees hired during the period, for it is an important element of training costs.

The Cost of Lost Productivity and Lost Business: The cost of decreased productivity due to employee attrition must include the decline in the productivity of an employee prior to termination or the decrease in productivity of a work group of which the terminating employee was a member.

Seven additional cost elements included here are:

i. The cost of additional overtime to cover the vacancy.
ii. The cost of additional temporary help.
iii. Wages and benefits saved due to the vacancy (these are subtracted from the overall tally of turnover costs).
iv. The cost of reduced productivity while the new employee is learning the job.
v. The cost of lost productive time due to low morale of remaining employees.
vi. The cost of lost customers, sales, and profits due to the departure.
vii. Cost of additional (related) employee departures (If one additional employee leaves, the cost equals the total per-person cost of turnover.)
4.7 POTENTIAL ADVANTAGES OF EMPLOYEE ATTRITION

There are many useful, potential advantages of employee attrition. They can be stated as given below:

1. Opportunities to inject ‘new blood’ into the organization: new people bringing new ideas on outlooks, new skills and experience in different situations that enable them to grow and become enthusiastic about the work.

2. Balance in the age structure of the workforce. Absence of labor turnover would create an increasingly aged workforce, often accomplished by an increasing wage/salary cost.

3. The ability to cope with labour surpluses, in some grades of job, without having to make redundancies.

4. The creation of opportunities for promotion and succession which offers an important incentive to more junior employees (Jack. J. Philips, Adele. O. Connell, 2008).

Opportunities to learn and grow are powerful motivations to inspire talented workforce. The generous benefits packages and competitive salaries attract and retain talented employees. Addressing the fundamental human needs to satisfy the inner drive and a sense of professional pride in one’s abilities are the key drivers that motivate the star performers in an organization.