

The Economic Impact of Employee Behaviors on Organizational Performance

Wayne F. Cascio

Consider a recent quote from the *Wall Street Journal*: "It's no longer about what you own or build; success is hinged to the resources and talent you can access."¹ Unfortunately, recent statistics indicate that American workplaces are not doing a very good job of managing the talent they currently have. Thus:

- Only 14 percent of American workers say they are very satisfied with their jobs.
- Twenty-five percent say they "are just showing up to collect a paycheck."²
- From January 2004, to January 2005, 24 percent of American workers voluntarily quit their jobs, a 13 percent rise since the previous year. That figure varies widely by industry, though, with relatively low rates in manufacturing and transportation (roughly 15 percent), and relatively high rates in leisure and hospitality, retail, and construction industries (ranging from about 25-45 percent).³ To appreciate what that means for an individual firm, consider the number of people Wal-Mart employed at the end of 2004—1,600,000 people.⁴ Its annual employee turnover rate is 44 percent—close to the retail industry average.⁵ Each year, therefore, Wal-Mart must recruit, hire, and train more than 700,000 new employees just to replace those who left.
- Women now outnumber men in managerial and professional jobs, yet many leave even blue-chip employers because they do not feel valued, their companies do not offer flexible-employment policies, or their work is not intellectually challenging. Rather than leave the workforce, most resurface at companies that offer more progressive policies.⁶

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- The fully loaded cost of replacing a worker who leaves (separation, replacement, and training costs), depending on the level of the job, varies from 1.5 to 2.5 times the annual salary paid for that job.⁷ Historically, for example, in 1914, when the prevailing wage was \$2.34 per day, Henry Ford offered his assembly-line workers \$5 per day. Why? Because a turnover of 370 percent meant hiring almost 50,000 people a year just to maintain a workforce of 14,000!⁸

In fact, the behavior of employees has important effects on the operating expenses of organizations in both the private and public sectors of our economy. These effects are not widely known, or even, in some cases, appreciated by employers, but they are, nonetheless, very real.

Financial Impacts of Employee Behavior

Costco Versus Sam's Club: A Tale of Two Employment Strategies⁹

In 2004, Costco employed 68,000 workers, one-fifth of whom are unionized, while Wal-Mart's Sam's Club employed 102,000. In terms of wages alone, a Costco employee earned, on average, \$33,218 (\$15.97 per hour). The average Sam's Club employee earned \$23,962 (\$11.52 per hour). If a Costco employee quits voluntarily, the fully loaded cost to replace him or her is about \$49,827 (1.5 times annual salary). If a Sam's Club employee leaves, the cost is \$35,943.

At first glance it may look as if the low-wage strategy at Sam's Club yields greater savings in turnover. But wait! Employee turnover at the end of the first year of employment is only 6 percent per year at Costco (4,080 employees), while it is 21 percent a year at Sam's Club (21,420 employees). The total cost to Costco is therefore $\$49,827 \times 4,080 = \$203,290,000$, while the total cost to Sam's Club is $\$35,943 \times 21,420 = \$769,900,000$. Costco's opportunity savings (costs not incurred) thus exceed \$566 million *per year*! Of course, the overall costs and numbers of employees who leave at Sam's Club is higher, because it employs more people to begin with. Averaged over the total number of employees at each firm, however, the per-employee cost at Costco is about \$300, while that at Sam's Club is about \$755. High employee-turnover rates are expensive any way you look at it.

Wages are not the only distinguishing characteristic between the two retailers. At Costco, 82 percent of employees are covered by the company's health care insurance plan, with the company paying an average of \$5,735 per worker. Sam's Club covers 47 percent of its workers, at an average annual outlay of \$3,500. Fully 91 percent of Costco's employees are covered by retirement plans, with the company contributing an average of \$1,330 per employee, versus 64 percent of employees at Sam's Club, with the company contributing an average of \$747 per employee.

In return for all of its generosity, Costco gets one of the most loyal and productive workforces in all of retailing. While Sam's Club's 102,000 employees generated some \$35 billion in sales in 2003, Costco generated \$34 billion with

one-third fewer employees. As a result, Costco generated \$13,647 in its United States operating profit per hourly employee, compared to \$11,039 at Sam's Club. Labor and overhead costs at Costco were 9.8 percent of sales, versus an estimated 17 percent of sales at Sam's Club. By comparison, it was 24 percent at Target Stores. Costco's motivated employees also sell more: \$795 of sales per square foot, versus only \$516 at Sam's Club, and \$411 at BJ's Wholesale Club, its other primary club rival.

These figures illustrate nicely the common fallacy that labor rates equal labor costs. Costco's hourly labor rates are almost 40 percent higher than those at Sam's Club (\$15.97 versus \$11.52), but when employee productivity is considered (sales per employee), Costco's labor costs are significantly lower (9.8 percent vs. 17 percent). As Costco CEO James Sinegal put it: "Paying your employees well is not only the right thing to do, but it makes for good business."

To make its high-wage strategy pay off, however, Costco is constantly looking for ways to increase efficiency, such as by repackaging goods into bulk items to reduce labor, speed up Costco's just-in-time inventory and distribution system, and boost sales per square foot. Nor have rivals been able to match Costco's innovative packaging or merchandising mix. Costco was the first wholesale club to offer fresh meat, pharmacies, and photo labs.

Defenders of Wal-Mart's low-wage strategy focus on the undeniable benefits its low prices bring to consumers. But the broader question is this: Which model of competition will predominate in the United States? While shareholders may do just as well with either strategy over the long run, it is important to note that the cheap-labor model is costly in many ways. It can lead to poverty and related social problems and transfer costs to other companies and taxpayers, who indirectly pay the health care costs of all the workers not insured by their frugal employers.

Wayne F. Cascio is US Bank Term Professor of Management at the University of Colorado at Denver and Health Sciences Center.
<Wayne.Cascio@cudenver.edu>

If a large number of employers adopted the same low-wage strategy, their policies would certainly reduce the wages of U.S. workers, along with their standards of living. Such a low-wage strategy also would crimp consumer spending and constrict economic growth. Costco's strategy, in contrast, shows that with innovative ideas and a productive workforce, consumers, workers, and shareholders all can benefit.

Financial Payoffs from Employee Retention

The flip side of employee turnover is employee retention. It is a major issue for employers as varied as Farmers Insurance Group, S.C. Johnson, and Walt Disney World, especially as labor markets tighten. To illustrate the effect of improved employee retention on the bottom line, and on a company's stock price, let us consider SYSCO Corporation of Houston, Texas. SYSCO is the number one food service marketer and distributor in North America. In 2004, its revenues exceeded \$29 billion, it employed almost 48,000 people, and it served 420,000 customers with approximately 300,000 different products. SYSCO is composed of 147 operating companies, each of which serves a geographic area.

Approximately 75 percent of SYSCO's operating costs are people-related, at an annual cost of roughly \$3 billion. Its marketing associates alone number about 10,000. Imagine the financial impact on the company if it improved its retention rate among marketing associates from 70 percent to 80 percent. Using a conservative estimate of the cost of employee turnover of \$50,000 per marketing associate, SYSCO found that a 10 percent improvement in retention resulted in more than \$70 million of savings *per year*. Since 1998, SYSCO has increased its marketing associates' retention rate from 70 percent to 82 percent.

Next consider delivery associates, who are very critical to SYSCO's success because they know the customers and are the people whom the customers rely on to get their groceries to them on time and in good condition. To do that, the company needs to have the same person delivering groceries to the same customer on a regular basis. SYSCO was able to increase the retention rate of its delivery associates from about 65 percent in 1998 to 85 percent in 2004 (a 31 percent improvement). Human resource (HR) professionals found the training and hiring loss for a delivery associate to be about \$35,000. That 20 percent improvement represents almost another \$50 million in annual savings. For SYSCO investors, every \$5 million represents a penny per share, so the improved retention of delivery associates alone represents about 10 cents per share.¹⁰ In 2004, SYSCO reported a 39 percent return on the average shareholders' equity.¹¹

How did SYSCO produce such impressive results in employee retention? Among other things, it began to measure characteristics of the work environment on a regular basis, and then it helped operating companies with low ratings to improve. More specifically, employees of each operating company periodically complete a "work climate survey" that assesses seven dimensions related to employee satisfaction. These are leadership support, front-line supervisor, rewards, quality of work life, engagement, diversity, and customer focus.

Through statistical analysis, the company was able to demonstrate that operating companies with highly satisfied employees delivered systematically better results in terms of improved customer loyalty, higher pretax operating income, lower operating costs, and improved retention of drivers, marketing associates, and night-warehouse employees. Then it developed a "best-practices" database, so, for example, an operating company in Atlanta that might be experiencing high turnover among marketing associates could learn from an operating company in Dallas that might be a leader in retaining marketing associates.

SYSCO's experience is typical of many contemporary organizations, in that more and more of its asset value rests in its human capital. To prosper and grow, organizations need to be able to retain current employees and to attract a steady supply of new ones. To accomplish both of those objectives, they need to develop an employer brand that attracts the right kind of applicants.

So we have shown that the financial impact of employee retention is significant. At a broader level, however, at least some employers might ask, "Why should we worry about retention?" One reason is that supply/demand imbalances in many types of jobs are building. A recent report from the Society

for Human Resource Management estimates that by 2012, the U.S. economy will experience a 33 percent shortfall of degreed candidates—approximately six million graduates fewer than expected to fill new jobs and to replace retirees. Beyond that, consider these survey results:

- Only 9 percent of organizations rate their retention efforts as highly successful.
- Despite company rhetoric to the contrary, only 35 percent of U.S. workers truly believe that their performance has a significant impact on their pay increases.
- Fully 55 percent of employees think of quitting or plan to quit within a year.¹²

As if these results were not alarming enough, consider the impending exodus from the full-time workforce of baby boomers, along with their experience and know-how. To be sure, the majority of baby boomers say they want to continue to work, at least part-time,¹³ yet there are solid reasons why every employer should be looking for ways to increase retention now.

The Financial Impact of Employee Absenteeism and Presenteeism

From a business standpoint, absenteeism is “any failure of an employee to report for or to remain at work as scheduled, regardless of reason.”¹⁴ The term “as scheduled” is very significant, for it automatically excludes vacations, holidays, jury duty, and the like. It also eliminates the problem of determining whether an absence is “excusable” or not. Medically verified illness is a good example. From a business perspective, the employee is absent and is simply not available to perform his or her job; that absence will cost money. How much money? In 2003, the cost of unscheduled absences in U.S. workplaces was about \$800 *per employee per year*.¹⁵ For every 100 employees, that is \$80,000.

Surprisingly, the leading causes of absenteeism are family-related issues (e.g., lack of childcare alternatives, eldercare responsibilities).¹⁶ Personal illness, the reason one might expect to be the main justification for calling in sick, is actually true only in about one in five cases. Other causes are personal needs (about one in five cases), stress (about one in six cases), and entitlement mentality (about one in six cases).

It is also important to note that for some organizations, or business units, absenteeism may be a non-issue. Specifically, if employees can vary their work time to fit their personal schedules, if they need not “report” to a central location, and if they are accountable only in terms of results, then the concept of “absenteeism” may not have meaning. Many teleworkers fit this category.

On the other hand, workers who come to work sick, when they should stay home instead, cost their employers an average of \$255 per year in reduced productivity due to “presenteeism.” Presenteeism refers to slack productivity from ailing workers.¹⁷ It often results from employees showing up but working at sub-par levels due to chronic ailments.¹⁸ For example, the estimated productivity loss associated with depression is 6.4 percent. It is 4.9 percent for arthritis,

and 3.2 percent for obesity. In the aggregate, economists estimate that presenteeism costs U.S. businesses \$180 billion annually.

Linking Unhealthy Lifestyles to Health Care Costs

A four-year study of 15,000 Ceridian Corporation employees showed dramatic relationships between employees' health habits and their insurance-claim costs. For example, people whose weekly exercise was equivalent to climbing fewer than five flights of stairs or walking less than half a mile spent 114 percent more on health claims than those who climbed at least 15 flights of stairs or walked 1.5 miles weekly. Health care costs for obese workers were 11 percent higher than those for thin ones, and workers who routinely failed to use seat belts spent 54 percent more days in the hospital than those who usually buckled up.

Finally, people who smoked an average of one or more packs of cigarettes a day had 118 percent higher medical expenses than nonsmokers.¹⁹ Rockford Products Corp., which makes metal parts used in items from Caterpillar earth-movers to yo-yos, combed through 15 years of records and found that 31 out of 32 workers who had heart attacks or required major heart surgery—including two who keeled over in the factory—were smokers.²⁰ Results like these may form the basis for incentive programs to both improve workers' health habits and reduce employees' contributions to health insurance costs or increase their benefits.

A recent analysis revealed that for an individual employee a healthier lifestyle could mean a personal saving of as much as \$7,868 *per year*.²¹ Here is how.

- *Stop smoking.* A pack-a-day smoker could save \$1,460 per year in cigarette costs, plus \$1,623 per year in excess medical costs relative to nonsmokers, according to the Centers for Disease Control and Prevention.
- *Lose weight.* On average, an obese person spends \$900 more per year in medical expenses than a person of normal weight. In addition, regular-size clothing is 10 to 15 percent cheaper than "plus-size" or "big and tall" clothes. This accounts for an estimated additional savings of \$200 per year.
- *Drink no-fat, no-frills coffee.* A five-cup-a-week drinker will save \$520 per year (and more than 300 calories per serving) by drinking basic black, brewed coffee instead of caramel Frappuccino blended coffee with whipped cream served at a coffee shop.
- *Requalify for life insurance.* Healthy people pay lower premiums. For example, a 45-year old with healthy levels of blood pressure, weight, and cholesterol will pay \$770 per year for a \$500,000, 20-year term life insurance policy through The Hartford. A less healthy, nonsmoking counterpart will pay \$1,385. Smokers who quit will see their \$3,735 annual premiums drop by 63 percent.

- *Use employer incentives.* For example, Blue Shield of California pays \$200 to members who successfully complete a 35-week online program that includes exercise, nutrition, stress-management, and smoking-cessation support.

Of course, savings for individual employees also translate into savings for companies. Yet there is much that companies themselves can do to encourage healthier lifestyles among employees, from educating employees about health- risk factors, to serving healthier food in company cafeterias and vending machines, to instituting work/life programs to reduce stress levels among employees.²² How much can employers expect to gain from these efforts? Johnson & Johnson Health Management, Inc., which sells wellness programs to companies, estimates that fully 15 to 25 percent of corporate health care costs stem from employees' unhealthy lifestyles.²³

In light of these potential savings, some companies preempt excess health care costs by imposing additional charges or by not hiring those with unhealthy lifestyles in the first place. For example, Rockford Products imposes a \$50 per month fee on employees who smoke, are obese, or suffer from hypertension.²⁴ Turner Broadcasting will not hire smokers. Multi-Developers will not hire anyone who engages in what the company views as high-risk activities: skydiving, piloting a private aircraft, mountain climbing, or motorcycling.

Federal civil rights laws generally do not protect individuals against "lifestyle discrimination" because smokers and skydivers are not named as protected classes. However, more than half of all states prohibit termination for various types of off-duty conduct (e.g., use of tobacco products). There is no right or wrong answer here. Perhaps the best advice is for each company to develop its own policy in a manner that is consistent with its values.

Why should employers worry about what their employees do? To put that issue into perspective, consider that from 1999-2004 the average increase in health insurance premiums among U.S. employers was 32 percent. In 2004, employers paid an average of 79 percent of those health care premiums.²⁵ Over time, costs like these make companies less competitive in global markets, as the U.S. auto industry illustrates. Until it modified its plans in late 2005, General Motors spent about \$1,784 per vehicle just for retiree pension and health care costs, compared with less than \$200 per vehicle for Toyota. Together, GM, Chrysler, and Ford have 524,000 hourly worker retirees. Toyota has 49.²⁶ (Toyota has not had U.S. facilities long enough to build a sizable number of retirees.) Without those costs the American companies could cut prices or offer better cars, either of which would make them far more competitive with Toyota.

The Financial Impact of Employee Attitudes

Employee turnover or employee retention are by no means the only areas where enlightened human resource management policies can pay off. As just one example, consider an in-depth study conducted by the Gallup Organization, the Princeton, New Jersey-based polling and research firm.²⁷ Gallup identified 12 worker beliefs (measures of employee satisfaction/engagement) that play

the biggest role in triggering a profitable, productive workplace. Its multiyear study was based on an analysis of data from more than 100,000 employees in 12 industries. A subsequent meta-analysis (quantitative cumulation of research results across studies) included data from almost 8,000 business units in 36 companies.²⁸

Analysis showed a consistent, reliable relationship between the 12 beliefs and outcomes, such as profits, productivity, employee retention, and customer loyalty. For example, work groups that have these positive attitudes are 50 percent more likely to achieve customer loyalty and 44 percent more likely to produce above-average profitability.

At the level of the business unit, those in the top quartile on employee engagement had, on average, \$80,000 to \$120,000 higher monthly revenues or sales than those in the bottom quartile. Even an \$80,000 difference per month per business unit translates into \$960,000 per year per business unit. Harter et al. concluded that the causal order runs from employee attitudes to organizational performance, although they recognized that the relationship might also be reciprocal in nature.²⁹

Gallup analyzed employee data to determine how well the respondents' organizations support the 12 employee statements. Organizations whose support of the statements ranked in the top 25 percent averaged 24 percent higher profitability, 29 percent higher revenue, and 10 percent lower employee turnover than those that scored lowest on the statements. Here are the 12 basic belief statements that underlie the most important worker attitudes:

- I know what is expected of me at work.
- I have the materials and equipment I need to do my work right.
- At work I have the opportunity to do what I do best every day.
- In the last seven days, I have received recognition or praise for doing good work.
- My supervisor, or someone at work, seems to care about me as a person.
- There is someone at work who encourages my development.
- In the last six months, someone at work has talked to me about my progress.
- At work, my opinions seem to count.
- The mission/purpose of my company makes me feel my job is important.
- My fellow employees are committed to doing quality work.
- I have a best friend at work.
- This last year I have had opportunities at work to learn and grow.

The good news about these beliefs is that all 12 of them can be coaxed forth with sound management techniques, and both managers and team members can really do something about them. Unlike pay issues, which most managers and workers have no control over, every individual team member can do something to help create these beliefs.

For instance, consider belief number four ("In the last seven days I have received recognition or praise for doing good work"). Although it requires long-term commitment, managers can deliver on this, at very little cost. Belief number seven ("In the last six months someone at work has talked to me about my progress") is even less time-consuming.

Interestingly, researchers found significant variances among work groups or operating units within the same company. This implies, paradoxically, that while we tend to celebrate great companies, in reality there are only great managers, for it is on the front line that the hard work of building a stronger workplace gets done.

The Benefits Associated with Wise Management of People

Economic Benefits of Training and Development Programs

We use the terms training and development interchangeably. Training consists of planned programs designed to improve performance at the individual, group, and/or organizational levels. Improved performance, in turn, implies that there have been measurable changes in knowledge, skills, attitudes, and/or social behavior. Such changes may be evaluated at the level of the individual (e.g., reactions to the training, demonstrated new knowledge or skills, changes in behavior), at the level of a team (e.g., improved ability to function effectively in a collective effort), or at the level of the organization, in terms of the overall return on investment of a training and development program. For the present purposes, we shall focus on the latter. To illustrate such returns, let us consider the approach taken by one company.

A large, U.S.-based multinational firm conducted a four-year investigation of the economic benefits of its corporate/managerial and sales/technical-training functions.³⁰ The study is noteworthy, for it adopted a strategic focus by comparing the payoffs from different types of training in order to assist decision makers in allocating training budgets and specifying the types of employees to be trained.

Project History

The CEO, a former research scientist, requested a report on the economic impact of training. He indicated that training should be evaluated experimentally, and it should be aligned strategically with the business goals of the organization to determine whether or not it is a worthwhile investment for the company. Thus the impetus for this large-scale study came from the top of the organization.

Methodological Issues

For the training to have value, skills must be generalized to the job (that is, exhibited on the job), and such transfer must be maintained for some period of time. To address the issue of transfer, the measure of effectiveness of

all training programs was the change in behavioral performance on the job. Performance was assessed by means of a survey completed by each trainee's supervisor (for most courses), peers (for Hazardous Energy Control), or subordinates (for Team Building) before and after training.

Because in this study it was not possible to measure the duration of the effects of the training, decision makers assumed that the effects (and economic utility) were maintained without reduction or growth for precisely one year. In addition, the researchers calculated *break-even values*, which indicate the length of time the observed effect would need to be maintained in order to recover the cost of the training program.

Training Programs Evaluated

A sample of 18 high-use or high-cost courses was selected based on the recommendation of the training departments throughout the organization. Managerial training courses were defined as courses developed for individuals with managerial or supervisory duties. Sales training courses were defined as programs designed to enhance the performance of sales representatives. Technical training courses (e.g., Hazardous Energy Control, In-House Time Management) were defined as courses not specifically designed for sales or supervisory personnel.

Of the 18 programs, eight evaluation studies used a control-group design in which training was provided to one group and not provided to a second group that was similar to the trained group in terms of relevant characteristics. In the remaining ten training programs, the performance of the trained group alone was evaluated before and after the training program.

Results

Overall there were 18 programs, assuming a normal or bell-shaped distribution of performance on the job, the average improvement in performance was about 17 percent. However, for technical/sales training it was higher (about 22 percent), and for managerial training it was lower (about 11 percent). Thus training in general was effective.

The average return on investment (ROI) was 45 percent for the managerial training programs, and 418 percent for the sales/technical training programs. However, one inexpensive time management program developed in-house had an ROI of nearly 2,000 percent! When the economic benefits of that program are removed, the overall average ROI of the remaining training programs was 84 percent, and the ROI of sales/technical training was 156 percent.

Time to Break-Even Values

There was considerable variability in these values. Break-even periods ranged from a few weeks (e.g., time management, written communications) to several years (e.g., supervisory skills, leadership skills). Several programs were found to have little positive or even slightly negative effects and thus would never yield a financial gain.

A Note of Caution

Despite the overall positive effects and economic benefits of the training, there were some exceptions. The important lesson to be learned is that it is necessary to evaluate each training program separately before drawing conclusions about the overall impact of training. It would be simplistic to claim either that "training is a good investment" or that "training is a waste of time and money."

Make or Buy?

A key issue in any company's decision making with respect to human capital is whether to "make" competent employees through training or to "buy" the skill sets the organization needs (paying a premium to do so, thereby increasing compensation costs) by selecting individuals who can be productive almost immediately. Given a choice between selection and training, the best strategy is to choose selection. Selection of high-caliber employees will enable these individuals to learn more and to learn faster from subsequent training programs than will the selection of lower-caliber employees. Of course, labor market conditions can eliminate such choices. If the supply of labor is tight, then organizations have only one option: to select the highest-caliber employees they can, and then to train them in skills that they specifically require.

General Estimates of Training Effectiveness

Meta-analytic methods (quantitative cumulations of research results across studies) have also been used to reach more general conclusions on the effectiveness of different kinds of training, both management and non-management training. Results show that the particular training method used, the skill or task trained, and the choice of training evaluation criteria (e.g., trainee reactions, measures of learning, on-the-job changes in behavior, or bottom-line results) all relate to the observed effectiveness of training programs.

However, consider some overall results for an individual whose pre-training performance is right at the mean (fiftieth percentile). The results of one large-scale meta-analysis of training's effects (397 independent studies from 162 sources and thousands of subjects) revealed an improvement in performance of about 20 percent for that individual regardless of the training-evaluation criterion used.³¹

Such studies are valuable, because they allow managers to rely on cumulative knowledge of the expected payoffs of proposed training programs. Indeed, a "menu" of such expected payoffs will allow managers and HR professionals to estimate expected economic benefits to their organizations *before* the decision is made to allocate resources to such programs.

Economic Benefits of Valid Employee Staffing Programs

The most important characteristic of any procedure used as a basis for an employment decision, such as hiring or promotion, is validity. Validity refers to the job-relatedness of a measure—shown, for example, by assessing the strength of the relationship between scores from the measure (such as a written test or

an interview) and some indicator or rating of actual job performance (such as supervisory ratings, dollar volume of sales). A correlation coefficient, whose value may vary between -1 and $+1$, typically provides a statistical index of the strength of that overall relationship. In employment contexts, the validities of staffing procedures typically vary between about .20 and .50. Such validities yield high economic payoffs to firms when the firms can be selective in choosing whom to hire or promote, when the percentage of successful hires is not extremely high already, and when the cost of a mistake—selecting or promoting the wrong person—is high.

A large body of research has shown that the economic gains in productivity that are associated with the use of valid staffing procedures far outweigh the cost of those procedures.³² This means that people who score high (low) on such procedures also tend to do well (poorly) on their jobs. High scores suggest a close “fit” between individual capabilities and organizational needs, while low scores suggest a poor fit. By hiring or promoting those who score high on valid measures of performance (and rejecting those who score poorly) productivity, quality of work life, and the bottom line all stand to gain. Thus a study of firms in the service and financial industries reported correlations ranging from .71 to .86 between the use of progressive staffing practices (e.g., validation studies, use of structured interviews, biographical data, and mental ability tests) and measures of organizational performance over a five-year period (annual profit, profit growth, sales growth, and overall performance).³³

At a broader level, many firms have adopted so-called high-performance work practices that include the use of valid staffing procedures, as well as practices such as the following:

- organizational cultures that emphasize team orientation and respect for people,
- employee involvement in decision making,
- compensation linked to firm or worker performance, and
- substantial investments in training and development.

Numerous studies have found that such practices can have an economically significant effect on the market value of the firm.³⁴ For example, a large-scale study of 702 publicly traded firms analyzed the financial impact of HR systems that incorporate such high-performance work practices. Each firm received a score based on its use of these practices. Results indicated that an improvement of one standard deviation in the HR system (movement from the fiftieth percentile to the eighty-fourth percentile of scores) was associated with an increase in shareholder wealth of \$41,000 per employee—about a 14 percent market-value premium.³⁵

Policy Implications for Employers

Thus far we have examined several areas where the behavior of employees has significant economic implications for employers. They are: the impact on

employee turnover and productivity of high- versus low-wage employment strategies; the costs of absenteeism, presenteeism, and unhealthy lifestyles; and the financial payoffs associated with improving employee retention, developing positive employee attitudes, implementing well-designed training and development programs, and using valid staffing procedures. As we have seen, the implementation of progressive management practices has the potential to reduce operating costs and to increase considerably organizational performance and productivity. Such practices also have positive economic and psychological benefits for employees, families, and communities.

What should employers do to begin to reap these benefits for their organizations and for those who work in them? At the outset it is important to recognize that in 2005, fewer than 20 percent of U.S. workers were employed in manufacturing, the lowest level since 1850. We live in the information economy, and in it, as noted, the most important assets are not buildings and equipment; they are human assets—the kind that walk out the door every night at five o'clock (or later). Shareholders do not own those assets. To attract and retain them, the challenge is to create a culture that makes the best among them want to stay.

Enhancing Employee Retention

In general, what drives retention? What do workers want? A 2005 study by Gantz Wiley Research found that across all generations, the top five drivers are opportunities for career development, a sense of confidence about the future of their current employers, feelings of accomplishment, the amount of joy at work, and employment security.³⁶ Table 1 lists some specific actions that employers can take to address these concerns.

In terms of best practices, firms that excel in employee retention seem to do three other things well:

- Each is a company that people want to work for. Management inspires commitment to a clear vision and definite objectives, or as Bill Gates recently noted, "It's important to work at a place where you are connected to a dream."
- They get new employees off to a great start, beginning with proactive management of the first 90 days (orientation and socialization). They recognize that most employee turnover occurs early in the employment relationship, and so they provide the kind of information, support, and tools that employees need to do their jobs well. They never stop communicating how each employee's work is vital to the organization's success, and they ensure that each new employee has a performance agreement. That agreement clearly identifies expectations, time frames for performance, and the standards that will be used to measure performance.
- They provide regular coaching and rewards to sustain commitment. To do that, they proactively manage the performance agreement, they recognize results regularly, and they give employees the tools they need to take charge of their own careers.³⁷

TABLE I. Some Steps Employers Can Take to Enhance Employee Retention

Career-Development Opportunity	• Provide mentoring, access to information, informal and formal learning programs, up-to-date training • Provide career-advancement opportunities
Confidence in Future	• Communicate the business condition (quarterly or semi-annually)
Feelings of Accomplishment	• Listen to employee ideas (e.g., through one-on-ones) • Provide recognition
Amount of Joy	• Use humor to retain employees • Make work fun
Employment Security	• Provide a challenging but supportive environment • Involve employees in decisions that affect them • Recognize that pay is important but not more so than other practices

Controlling Absenteeism and Presenteeism

What can organizations do to control or reduce absenteeism? A comprehensive review of research findings in this area revealed that absence-control systems can neutralize some forms of absence behavior, but at the same time they may catalyze others.³⁸ For example, research shows that punishments, or stricter enforcement of penalties for one type of absence, tend to instigate other forms of missing work. This is not to suggest, however, that absence-control policies should be lenient. Lenient policies convey a relaxed norm about absenteeism, and research evidence clearly indicates that those norms can promote absence-taking.

A first step is to assess the problem correctly so that the organization knows where to apply control mechanisms. Organization-wide absenteeism-control methods (such as rewards for good attendance, progressive discipline for absenteeism, daily attendance records) may be somewhat successful, but they may not be effective in dealing with specific individuals or work groups that have excessively high absenteeism rates. Special methods (such as flexible work schedules, job redesign, and improved safety measures) may be necessary for them. It is the careful analysis of detailed absenteeism research data that can facilitate the identification of these problems and suggest possible remedies.³⁹

With regard to presenteeism, companies such as Comerica Bank, Dow Chemical, and J.P. Morgan Chase are among those that have put programs in place to help employees avoid or treat seasonal or chronic health conditions, or at least to stay productive in spite of them.⁴⁰ To ensure employee privacy, for example, Comerica Bank used a third party to survey its employees and found that about 40 percent of them said they suffered from irritable bowel syndrome (IBS), which can involve abdominal discomfort, bloating, or diarrhea. Extrapolating from that, the company estimated its annual cost of lost productivity to be

at least \$8 million a year. Comerica now provides written materials for its employees about IBS and has sponsored physician seminars to educate workers about how to recognize and deal with it through their living habits, diet, and possible medications.

Changing Unhealthy Lifestyles

At first glance, it might appear that changing employees' unhealthy lifestyles is a win-win for employers and employees. Perhaps, but beware of violating the Americans with Disabilities Act (ADA)! Employers violate the ADA if they *require* employees to submit to wellness initiatives, such as health-risk appraisals (questionnaires about one's health history and current lifestyle) and assessments (physical and biomedical tests that screen for specific health conditions). This is so because the ADA forbids employers from conducting mandatory medical exams once an employee is hired, unless the inquiry is "job-related and consistent with business necessity."

Employers also must be careful when tying financial incentives or disincentives (such as cash bonuses or reduced health insurance contributions) to test results. The employer can offer an incentive only upon verification that the employee went for the test. The incentive cannot be tied to the test results.⁴¹

Educational wellness programs that encourage people to sign up for tests and instruct them on how to improve their lifestyles do not violate the ADA. Here are four steps that employers might take to promote healthier lifestyles among employees:

- Educate employees about health-risk factors—life habits or body characteristics that may increase the chances of developing a serious illness. For heart disease (the leading cause of death), some of these risk factors are high blood pressure, cigarette smoking, high cholesterol levels, diabetes, a sedentary lifestyle, and obesity. Some factors, such as smoking, physical inactivity, stress, and poor nutrition, are associated with many diseases.
- Identify the health-risk factors that each employee faces.
- Help employees eliminate or reduce these risks through healthier lifestyles and habits.
- Help employees maintain their new, healthier lifestyles through self-monitoring and evaluation, work/life programs, and healthy food alternatives in vending machines and cafeterias at the workplace.

Unfortunately, evidence indicates that employees who are most at risk are often the most difficult to induce to change their lifestyles, though monetary incentives often make it attractive and in their best interest. Here is an example.

At Johnson & Johnson, employees get \$500 discounts on their insurance premiums if they agree to have their blood pressure, cholesterol, and body fat checked and fill out detailed health-risk questionnaires. Among the more than 150 questions, there are questions such as "Do you drive within the speed limit?" "How often do you eat fried foods?" "Do you exercise regularly, and if not, why not?"

Workers found to be at high risk of having health problems receive letters urging them to join a diet and exercise program. Those who refuse lose the \$500 discount. Before the discount was offered, only 40 percent of the company's 35,000 U.S. employees completed the health assessments. After the discount was offered, more than 96 percent did.⁴²

Conclusions

As we have seen, the behavior of individual workers has important financial consequences for organizational performance and productivity, as well as for employees themselves. We have examined just a few of the many possible areas where the control of costs associated with employee behaviors (e.g., turnover, absenteeism, presenteeism, unhealthy lifestyles) and the benefits associated with wise management of employees (promotion of positive employee attitudes, training and development programs targeted to strategic challenges, use of valid staffing practices for hiring and promotion) can increase productivity and decrease operating expenses. These are things employers can do now. Comprehensive audits of human resource policies at all levels of employees and managers may well reveal opportunities for even greater gains.

Some employers may choose to accept high employee turnover, to externalize some of their health care costs by offering little or no health care or pension coverage to their employees, and to downsize their employee populations indiscriminately. There are, however, alternative approaches. Xilinx, Inc., is an example of one of them.⁴³

Based in San Jose, California, Xilinx is a semiconductor company known as the world's leading supplier of programmable logic solutions. With approximately 2,600 employees, Xilinx's annual revenues exceeded one billion dollars for the last several years. When the semiconductor and other high-technology sectors experienced a significant downturn in 2001, a downturn that was global in its reach and effects, Xilinx's revenues plummeted 50 percent in six months. How quickly things change! Just the year before, the company had hired over 1,000 people to keep pace with the better than 50 percent per year growth rate from the previous two years.

During this difficult time, teams at Xilinx convened regularly. There were two recurring themes during those meetings: one was that the teams did not want to continue to lose money, and the other, that Xilinx should not mortgage its future with short-term actions. The company's strategy was to reduce expenses, maintain productivity, and emerge as a stronger organization. The seasoned semiconductor executives at Xilinx were well aware of the cyclical nature of the industry, and they were confident that it would eventually rebound as it had done in past cycles. They believed strongly that the intellectual capital at Xilinx would enable it to maintain its innovation edge, and they were not about to undercut that source of competitive advantage. Xilinx president and CEO Wim Roelandts was fond of saying, "De-motivated engineers do not create breakthrough products."

The company implemented a complete shutdown for two weeks. In addition, focus groups of employees developed a menu of options for taking multi-tiered pay cuts, from 20 percent for senior executives all the way down to zero percent for the lowest-level employees. Managers agreed to hold mid-term performance reviews of all employees, to provide stock options to 85 percent of the employee population, and to send very clear messages regarding the need for performance improvement to the bottom 15 percent of the employee population. The company also offered voluntary resignation and retirement programs, as well as sabbatical leaves to employees. All of this was in marked contrast to what competitors were doing—massive layoffs of their employees.

The following quarter, which was the first quarter of 2002, the company's business improved significantly. Xilinx restored employees' pay halfway through the quarter, and although it could not pay its typical profit-sharing bonus to all employees, it did award each employee a one-time "recognition bonus" for weathering the storm with the company.

Two years later, results at the company clearly justified its management approach during the economic downturn. Prior to the downturn in its core business, Xilinx's worldwide market share was 30 percent. By the second quarter of 2003 it was 51 percent. At the same time, the company's revenues exceeded that of all three of its major competitors combined! Xilinx brought more products to market on time than at any other period in its corporate history.

Looking to the future, the Xilinx management team is more financially savvy regarding the management of company expenses, and it is also more disciplined in its management of poor performers within the organization. Shareholders understand the value of maintaining committed people after the 21 percent market-share boost. Employees are proud to tell others that they work for Xilinx, one of the few companies to have emerged from the economic downturn without a layoff. Finally, the downturn focused the company on its driving principles: First, put a programmable logic device in every piece of electronic equipment, and second, set a new standard for how to manage a high-technology company.

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