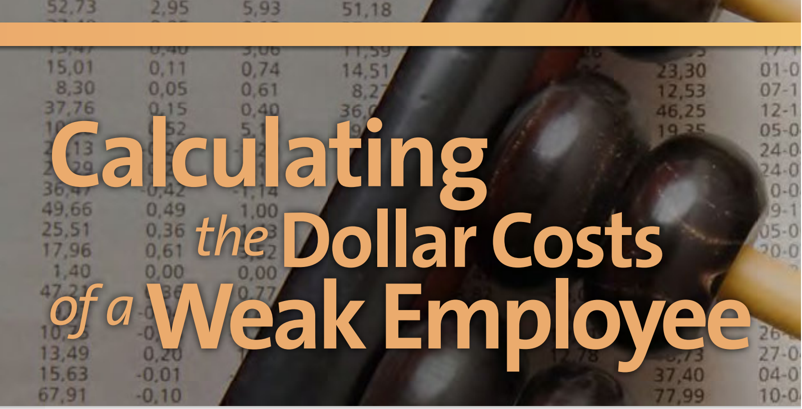


Calculating *the* Dollar Costs *of a* Weak Employee

Almost every manager, when asked, readily agrees that weak employees significantly underperform average employees. We certainly know from sports teams, where performance is easily measured, that there is a huge performance differential (often double or triple) between the below average, average, and top performers in the same position.

From a talent management perspective, if the performance differential between the average employee and the worst employee is small (less than 5%), it doesn't make much sense to spend a lot of money on performance management programs. However, when weak performers produce more than 33% below the average, it makes clear business sense to invest in great performance management and recruiting to fix or replace them.

And when your calculations reveal that employee actions can have a multimillion-dollar impact (in the negative direction as in the Edward Snowden NSA document leaking case, or in the positive direction as in the US Airways Sully Sullenberger safe landing on the US Hudson River), you quickly realize the need to quantify the dollar impact of these bottom- and top-performing employees.

Begin Working with the King of Metrics

Before you begin putting a dollar value on below-average employees, consult with the CFO's office (the king of metrics) to get them to partner with you throughout the calculation process. With their help, you not only avoid major calculation errors but also call on their credibility to avoid any future criticism from finance professionals. For similar reasons, including the COO's office is also a good idea.

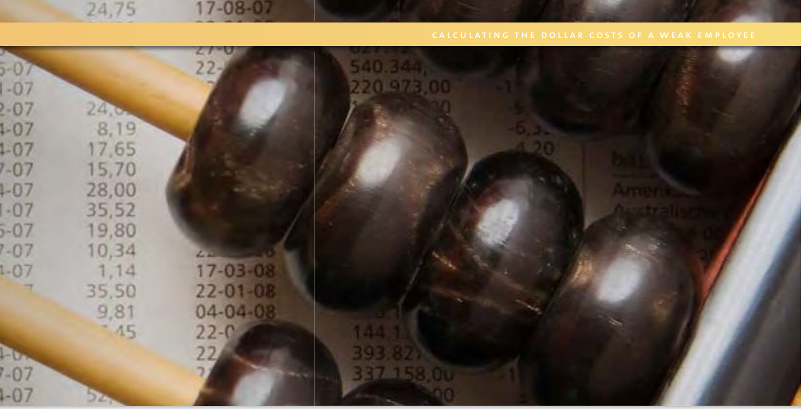
Follow These Six Calculation Steps

STEP 1: *Determine what an average employee is worth*

By definition, weak performers produce below-average results. Your first step is to determine the results that an average employee produces. The accepted method is to use the average revenue per employee (the total corporate revenue divided by the number of employees) as a baseline, which is a fair indicator of the worth produced by the average employee over one year. Even organizations that do not produce a profit can calculate their revenue per employee. For example, at Sears, the average revenue per employee is $138,200; an employee performing 10% above average produces an additional $13,820 in revenue each year; and a weak one performing 10% below average produce $13,820 less.

STEP 2: *Determine the weak performer differential between an average employee and a weak employee in the same job*

Your next step is to determine the percentage below that average output that a weak performer produces — the weak performer differential percentage. You may need to eventually calculate the weak performer differential percentage across several different jobs, but it's best to start with a job where performance is easily quantified.



A good place to start in most organizations is with salespeople because their performance, both volume and quality, is already closely measured. You simply rank the sales for all salespeople from the very best to the worst on a single "ranked from best to worst list". From that list, identify the salesperson who is in the middle and designate their sales number as the average sales amount. Then calculate what percentage below that amount the bottom salesperson on the list produces. Let's assume in this example that the weak performers sell 30% below average.

STEP 3: *Quantify the value of the "weak performer differential" percentage*

Continue on to the next step. If bottom performers produce 30% below the average, multiply that 30% by the average revenue per employee that you calculated earlier, say $138,200 as in the Sears example, which gives you an estimate of the cost of keeping a bad performer, in this case a negative $41,460 per year.

If you're not comfortable with just using the sales volume differential, you can do the same ranking and comparison for quality using the customer satisfaction scores of your salespeople. For example, if the customer service scores also vary 30% below, you can be pretty sure that your original sales performance differential percentages are accurate. If they vary, you can average the two percentages.

STEP 4: *Determine the weak performer differential for other jobs*

If you perform the same calculation for other jobs where on-the-job performance is already quantified (e.g., customer service, programmers, accountants, or any revenue-generating job), you can get a better idea of what the average performance percentage difference is for a number of jobs. On average, 40% of all jobs in a firm have their performance effectively quantified and reported, so those alone might be enough to use as a basis for establishing a credible company-wide performance differential percentage.

The performance differential definitely varies based on the job. Jobs that require creativity, adaptiveness, and innovation have a higher performance differential. The performance differential percentage between top and weak employees in easy-to-learn routine jobs will be much smaller than in jobs that require innovation, creativity, and continuous adaptation to new technologies and business challenges.

STEP 5: *Add other weak performer costs to the calculation*

You can add some additional cost factors based on the premise that weak employees cost more because they make serious errors, which average or top performers do not. These additional costs are always estimates based on the documented cost of damages of a few representative weak or bad employees.

- **Absenteeism:** Bad employees are absent more often, which either slows down the work or requires expensive temps.

- **Less revenue:** In revenue-generating jobs, weak performers generate significantly less revenue.
- **Interaction with customers:** In jobs where weak performers can damage customer relationships, the cost of the weak performer can multiply by two or three times.
- **Errors:** Weak performers make many more serious errors, which require expensive redoing.
- **Accidents:** Weak performers cause or create serious accidents, which increase insurance costs.
- **Theft:** Some have found that bad employees break the rules more often or even routinely steal.
- **Revealing trade secrets:** Bad employees may accidentally or purposely reveal valuable company secrets.
- **Negative team impact:** In addition to their individual bad performance, weak team members can negatively affect team recruiting, retention, innovation, quality, rewards, and speed.
- **Wasting management's time:** Weak performers take up an average of 17% of a manager's time.
- **Staying forever:** Because weak performers can't easily find another job, they may stay forever at your firm, multiplying the damage they are doing over decades.

If you find that weak performers have any of these additional negative impacts, add the estimated costs of the easy-to-estimate ones to your revenue-per-weak-employee calculation.

STEP 6:

Determine whether weak performers can be improved quickly and inexpensively

Once you complete your calculations, try to find out if weak performers can quickly turn around their performance after undergoing performance management, coaching, and training. Wait 6 to 12 months after applying an intervention and measure the employee's percentage improvement in performance. Unfortunately, the positive impact of performance management on weak performers is often small or even zero. Releasing them may be the best option.

The Normal Weak Performer Differential

Organizations with excellent talent management have a relatively low weak performer differential because weak performers self-select out or are proactively managed out. The majority of firms have a weak performer differential (i.e., the performance percentage difference between the average and the worst employee in a job family) resembling the following pattern. (I have converted the negative impacts to a percentage of the weak employee's annual salary.)

- Minimum weak employee performance differential: –33.3% of the average revenue per employee (–$46,060 each year in the Sears example) or 3/4 of their annual salary in dollars
- Typical weak employee performance differential: –100% of the average revenue per employee (–$138,200 each year in the Sears example) or 2 1/4 times their annual salary
- Exceptionally bad employee: –300% of the average revenue per employee, or 6 3/4 times their annual salary each year, until they make the single catastrophic mistake that finally gets them fired.

Final Thoughts

All organizations should know the value of their human assets, both well performing and weak performing. Since employees are our most important asset, it is surprising that few firms have taken the time to calculate the positive performance differential that is provided by top performers and the negative performance differential that the organization suffers because it keeps weak performers. There are more complicated formulae to consider (e.g., dollars spent on labour versus dollars of profit earned each year) but the best approach is one that is customized and found acceptable to your CFO and your executives. I hope my basic approach gives you a head start on this essential calculation.

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