The Cost of a Bad Hire
and

Alternative Strategies for Recruiting Leadership Talent

BattaliaWinston

A NEW STUDY REVEALS 95% OF COMPANIES ADMIT TO RECRUITING THE WRONG PEOPLE EACH YEAR, ACCORDING TO **FAST COMPANY MAGAZINE. THE ARTICLE IN FAST COMPANY** GOES ON TO SAY TODAY THE COST OF A BAD HIRE IS MUCH LESS OF A RECRUITMENT METRIC AND MUCH MORE OF A BUSINESS METRIC.

While it is true there are too many variables to come up with a set dollar figure for the loss of any one employee, according to a study by SHRM (Society of Human Resources Management), the cost for a poor hiring decision could be up to five times the amount of a poor hire's annual compensation. CareerBuilder's CEO said, "When you add up missed sales opportunities, strained client and employee relations, potential legal issues and the resources to hire and train candidates, the cost can be considerably more. "The higher the person's position, the more impact they have on the bottom line and the longer their tenure, the greater the direct and indirect cost will be to the company". The article in Fast Company Magazine found that "bad fit" hires have an impact on four distinct parts of their companies:

- ***Productivity***
- ***Retention***
- ***Performance***
- ***Culture***

The Talent Advisor put percentages on these factors:

- ***Lost productivity 39%***
- ***Negative effects on employee morale 33%***
- ***Negative impact on clients 19%***
- ***Fewer sales 11%***
- ***Legal issues 9%***

Here are some data points from other sources:

Human Resources IQ surveyed several sources including: The Harvard Business Review and Human Resources Recruiting & Selection firms. Here are some statistics they found:

> - *U.S Department of Labor estimates that the average cost of a bad hiring decision can equal 30% of the individuals first year potential earnings. (US Dept. of Labor 2003)*
> - *27% of US employers surveyed said that just one bad hire cost their company more than $50,000. (CareerBuilder's survey of 6,000 hiring managers and HR professionals worldwide 2013)*
> - *Replacing supervisory & managerial personnel can cost from 50%, to several hundred percent, of a person's salary. (Society of HR Management 2008)*
> - *General rule of thumb:*
>   - *The higher the position, or higher the salary, the higher the cost of a mistake.*
>   - *The longer the ill-placed employee has worked at the organization, the higher the cost.*
>   - *The more training required, the higher the cost.*

What are the direct costs related to a bad hire?

- *The time & resources used to hire the person*
  - *Outlining the specification for the position*
  - *Writing & placing an ad*
  - *Handling calls*
  - *Receiving and organizing resumes*
  - *Reviewing resumes*
  - *Arranging interviews*
  - *Conducting first interviews*
  - *Developing short list*
  - *Arranging second interviews*
  - *Conducting second interviews*
  - *Reference checking*
  - *Negotiating & extending offer*
  - *Sending reject letters*
- *Salary & benefits for the time the employee is on board*
- *Training*

Indirect costs that are difficult to measure related to a bad hiring decision include:

> - *Productivity losses.*
> - *Lost customers.*
> - *Unemployment compensation.*
> - *Legal fees.*
> - *According to a New York Times article there are other hidden costs of a bad hire:*
>   - *The hit to your unemployment tax rate: business owners know when the state pays out claims to a company's former employees that company's unemployment tax rate goes up. The problem is you are not going to get a bill for a hiring mistake. Instead the costs will be hidden in an unemployment rate that goes up for the next three years, in wasted time that could have gone into other more productive things, and customers who get a bad product or service. It could easily cost $40,000 in extra unemployment insurance by itself. It could easily be $200,000 if the person cost the company a customer.*

Here's a simple example using only the direct costs associated with a bad hiring decision for an executive with a base compensation of $200,000 plus a 35% annual bonus.

> - *Annual Salary & bonus = $270,000.*
> - *Benefits paid by the company during employment (life insurance, healthcare, etc.) could be 50% of the executive annual compensation or $135,000 per year.*
> - *Severance package: the norm is generally a minimum of 6 month's salary = $100,000.*
> - *The person is terminated after 18 months.*
> - *Total direct cost for an executive who stayed in that position for 18 months = $600,000 (salary, benefits + severance).*
> - *Factoring in the hidden cost of productivity, potential lost customers or business and negative effects on employees and customers, the cost of a poor or bad hire could be easily be in the millions.*

Alternative Recruitment Strategies-the pros and cons

According to Workforce 2020, 42% of executives believe their companies growth plans are slowed by the lack of access to the right leadership. The global business landscape and ever-changing nature of work are placing additional pressures on companies to invest in their leaders.

Yet research shows that leadership is not what it should be, and those efforts to identify and develop future leaders are far from adequate, or as Workforce 2020 calls it, a "Leadership Cliff". It is imperative that companies address the leadership gaps that threaten to derail their business plans.

How do companies go about attracting and retaining talent? For our purpose this discussion is focused on leadership talent, versus individual contributors. Leadership talent is defined as individuals who directly impact a company's bottom line. Traditionally, companies have relied on one or more of the following to attract leadership talent; word of mouth, networking within one's circle of personal and professional contacts, advertising and the use of third-party recruiting firms. Since a company's future is directly dependent on the success of their hiring and retention strategies, we thought it would be worthwhile to discuss the risks associated with each of these recruitment strategies.

Let's categorize these recruiting strategies into two major categories: high risk and moderate to low risk. Personal referrals, networking one's personal and professional contacts and advertisements all have one thing in common. Each carries a high risk of making a poor hiring decision. There are a number of factors of why these are high risk:

- ***Little or no planning on what background skills & experiences are needed to take your company forward.***

- ***Focus is generally on replacing the current person, without regard for the skills and experiences needed to improve the position.***

    - ***Only accessing individuals in your immediate network.***
    - ***Generally limited to those individuals actively in the job market.***
    - ***Generally hiring the best of what's available.***

We are not saying these strategies will not produce a successful hire, but there is a far greater risk of recruiting the position again in 18 months to three years. Whether that happens or not, there is a greater risk your company has not hired the leader that will move the company forward, thus you have lost valuable time and opportunities to grow your business.

Third party recruiting firms are broken into two categories: those that are paid once you hire a candidate (contingency firms) they present and those that are paid for their time, usually as a set retainer and not contingent on hiring a person.

Recruiting firms that are paid only when you hire a candidate are generally better than personal networking and advertisements and do potentially lower your risk of making a poor hire. Aside from the upside of greater coverage, there is access to non-job seekers, third party screening and assistance in the hiring process. These firms have some downsides that do not necessarily make them the best choice for key leadership positions. Here is why:

- *Since these firms work on commission paid only when you hire one of their candidates, their motivation is to earn a fee. This usually translates into more resumes and greater work for your internal staff.*

- *They spend limited time learning about your position and the skills & experiences needed in the position in question.*

- *They do not work exclusively on your behalf and will present a candidate to multiple companies.*

- *Staff has limited industry and search experience.*

- *Generally, they present their inventory, versus extensive outreach into the market.*

- *This business model is based on placing candidates, versus solving leadership problems.*

- *Generally, these firms are best suited to work on low impact positions, where there are greater margins for errors and limited negative impact to the business.*

The second type of third party recruiting firm is what is commonly referred to in the industry as a “retainer firm”. These firms offer the best opportunity to successfully hire key leadership talent, with minimal risk. They are also the most expensive. These firms work on a predetermined fee, usually one third of the successful candidate’s first year compensation. Their fee is generally paid over the first 3-4 months of the search process, plus expenses for candidate and consultant travel. There are a number of reasons retainer firms offer the best option to lower your risk of making a bad hire. Here are some of the factors that make using a retainer firm the best option for high impact leadership positions:

- ***They act exclusively on your company’s behalf to recruit a specific position.***
- ***They’re usually staffed with consultants who have extensive industry and search experience.***
- ***They meet with your leadership team to develop a thorough and detailed description of the position, including the short & long-term goals and objectives.***
- ***They create, along with your leadership team, the search strategy: what will be the focus of the search (industry, geography etc.) and who they will target.***
- ***They have an extensive outreach process to include; the target companies, industry contacts, professional associations.***
- ***There is a rigorous selection process to get to a short list of potential candidates, usually not more than 3-4 fully vetted candidates.***
- ***They conduct thorough referencing and provide guidance on the structure of the offer package.***

In summary, you can’t eliminate the possibility of a bad hiring decision, but you can with thorough planning, and using the appropriate resources, minimize that possibility.
