



Retaining key employees:

TEACHING/RESEARCH NOTES

Synopsis of case

A manager wants to retain a high-performing employee who is relatively new to an organisation where the remuneration policy does not encourage “non-standard” payments. Another organisation has offered the employee an increased salary, which is tempting in her current financial circumstances. Can the manager find a way to retain her, and should the organisation develop a retention policy?

Introduction

The case study is intended as a tool for discussing strategies to retain key employees. This teaching note suggests ways in which the case study can be applied to relevant research literature on:

- The high cost of turnover
- Remuneration and retention
- Non-salary rewards
- Fairness
- Employee retention strategy.

Concepts for discussion

The case lends itself to discussion of the issues around the retention of key employees, from a number of perspectives. The fact that the employee is a single mother with small children, and is a recent recruit bringing new skills to an organisation that has relied largely on automatic increments, and therefore length of service, to reward staff performance, opens a number of discussion points.

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A more general point is that high employee turnover is costly for an organisation, both in financial terms and in human capital, so it is important to manage turnover rates, particularly of key employees. An employee retention strategy is essential.

There is opportunity for wide-ranging discussion about the range of factors that influence retention, including organisational culture, financial and non-financial rewards, and the psychological contract between employer and employee. This should refer to the fact that the relationship between salary levels, employee satisfaction and retention is complex.

Course audience

- Masters level students
- Mid-level and senior managers on executive programmes

Teaching objectives

1. To explore the managerial issues raised by the urgent need to retain a key staff member who has been offered a higher salary by another organisation.
2. To examine how an organisation might review its current retention policy and if necessary re-shape it to meet future needs.
3. To consider how any form of exceptional reward can be given in a way that is perceived as fair by other staff.

Immediate issues

1. How George might persuade his high-performing team member to reconsider the offer of another job with increased salary.
2. How he can ensure that other staff feel that his decision is fair.

Basic issues

1. What factors should an organisation consider in reviewing or establishing a retention policy?
2. How can an organisation incorporate the introduction of new staff with different skills into a traditional reward system?

Suggested student assignments

1. How should George weigh up the costs vs benefits of retaining Helen?
2. What opportunities might George explore to encourage Helen to stay? What are the implications for the organisation, that Helen's decision will be driven in part by external relativity?
3. How can non-financial rewards be matched with employee preferences?

4. How can George ensure that Helen's colleagues do not feel unfairly treated if he secures an exceptional salary increase for her?
5. What should the department consider when preparing a future retention strategy?

Research notes to assist in developing responses to student assignments

The high cost of turnover

An effective Human Resource Management (HRM) strategy can provide a competitive advantage for an organisation (Pfeffer 1998; Macky 2008). How an organisation rewards employees communicates its values and expectations. (Fay and Thompson 2001) and supports other elements of the HRM strategy, such as recruitment, performance management, and retention management (Macky 2008).

Managing retention is important to ensure human capital recruited and developed by an organisation is not lost. Sheridan (1992) showed the high cost of turnover, and that the cost increased with effectiveness of departing employees. Retention management is particularly important when there is strong demand for skills and experience (Williams and Sunderland 1999), and for retaining top-performers (Brannick 2001). Understandably then, employee turnover is considered an important metric by HRM specialists (Verma and Dewe 2008).

A range of factors affect retention. In a meta-analysis of 155 studies, Tett and Meyer (1993) showed strong correlation between employee retention and that employee's satisfaction in and commitment to an organisation. Sheridan (1992) showed that organisational culture affected retention rates and, similar to Chew and Chan (2008) concluded that "person-organisation fit" is important in retention. Other authors have shown that retention is affected by factors including pay and other benefits, interesting work, challenging work, recognition, promotion, training, mentoring, and work-life balance (Fay and Thompson 2001; Applebaum *et al* 2003; Boxall *et al* 2003; Marley-Wallace 2007; Chew and Chan 2008). Boxall *et al* (2003) noted that average tenure increases with age but there is no significant gender-related difference in average tenure.

Remuneration and retention

The role of pay and other extrinsic rewards in employment is the subject of much research. Armstrong and Murlis (2007) summarised motivational theories underpinning reward and concluded that money is important because it satisfies needs and is a tangible recognition of worth and self esteem.

While clear links between financial remuneration and retention have been demonstrated, the relationship is complex. Boxall *et al* (2003) found that, in New Zealand, nearly 50 percent of those surveyed had left a job for better pay, and 73 percent considered good pay a reason for staying with an employer. While pay is not the most important factor in retaining employees, it is an influence. Adequate pay may be a "threshold" factor, required to support other approaches.

Armstrong and Murlis (2007) considered financial reward more important in attracting new employees than retaining them. Milkovich (2001) suggested unsatisfactory financial reward is associated with increased turnover, however, the reverse does not always hold. Both Anon (2003) and Henderson (2003) reported that increased employee satisfaction resulting from a salary increase can rapidly diminish. Harris *et al* (2008) cautioned that paying too much could result in less satisfaction, due to feelings of guilt or discomfort. Similarly, Henderson (2003) reported the conclusion of Deci's work that paying for performance (an extrinsic motivation) can act as a demotivator for tasks with high intrinsic motivation, although Macky (2008) reported this conclusion could be discounted as false.

Factors other than the level of remuneration are important contributors to employee satisfaction. Miceli and Mulvey (2000) showed that satisfaction with a pay system, rather than pay levels, is associated with higher levels of organisational commitment and better "organisational citizenry". Many authors emphasise the need for financial reward systems to be well designed, for instance linking pay for performance to an organisation's goals and mission (e.g. Hale and Bailey 1998; Williams and Sunderland 1999; Macky 2008). Sweins *et al* (2009) also showed that increased knowledge about a pay system is associated with higher levels of pay satisfaction. Applebaum *et al* (2003) highlighted that risks should be carefully considered when changing an organisation's remuneration system.

Non-salary rewards

An extensive literature indicates both the potential importance of non-salary rewards in employee satisfaction and retention, and the complexity of using such rewards. The key message is that different groups of people and different individuals within groups value rewards in different ways. To be effective, non-salary rewards must be carefully tailored to the individual (Brannick 2001). For instance, Patel and Kleiner (1990) highlighted work-related factors of particular importance to working mothers.

A wide range of non-salary rewards and benefits is used for the strategic purpose of employee retention (Macky 2008). Macky (2008) categorises benefits as *direct* (salary or other financial benefits) and *indirect* (mandatory and voluntary benefits). Armstrong and Murlis (2007) categorise non-salary rewards as *financial* (similar to *direct* above), *non-financial* (e.g., recognition, responsibility, meaningful work, career opportunities, work-life balance) and *relational* (e.g., quality of leadership, and organisational values and behaviours).

Hytter (2007) concluded that the importance of different aspects of the work environment, such as remuneration, training and development, work-life balance, in a retention strategy varies greatly between different countries. Marley-Wallace (2007) identified work-life balance, training and career progression, mentoring, secondment, and culture as important factors for retaining accountants. Wilkinson (2008) suggested work-life balance is important to "genY" surveyors while Abbott and Psaltis (2008) reported that career opportunity, reputation, and remuneration (and not work-life balance) were most important to "genY" accountants.

The difficulty of determining the most effective combination of non-salary rewards for an individual has led to the "cafeteria" or "flexible benefits" approach in which

employees choose the components of their rewards package (Corner 1998; Macky 2008). This approach is captured well by the suggestion to employers, “[i]f you’re unsure what will motivate your employee, just ask!” (Giles 2004). Various authors (e.g., Henderson 2003; Armstrong and Murlis 2007; Macky 2008) emphasised the need for salary and non-salary elements of an individual’s reward package to be integrated and Macky (2008) suggested employees should know the value of the benefits they receive.

Macky (2008) also identified a number of factors relevant to the selection of reward types. These include the objectives and strategy of the firm, government taxation policies, and the life-cycle stage of the organisation. He suggested that, whereas start-up companies may emphasise rapid growth through use of low base salaries and larger at-risk financial incentives, large mature organisations in stable environments may reinforce stability through rewards structured around career paths.

As most government departments are mature organisations, the range of rewards available to employees in public sector agencies is usually more limited than in the private sector. For example, profit sharing, gain-sharing, and share ownership – all common in the private sector – are not available. Other than employer contributions to government superannuation, few non-salary financial rewards are commonly offered in the public sector.

Fairness

It is clear that satisfaction with rewards is based not just on the amount and type of the reward, but also the level of reward relative to others, and the process by which it is determined.

Milkovich *et al* (2001) observed that perceptions of fairness about reward levels vary between individuals. When determining fairness, employees compare their rewards with those received by others within the organisation (internal equity) and those in other organisations (external equity) (Macky 2008), and with their own expectations of reward (Bregm 2008). The latter includes expectations based on both the employee’s formal contract and the increasingly important “psychological contract” with the employer (Armstrong and Murlis 2007). Van Yperen *et al* (1996) observed that the psychological contract could also constrain an employee from leaving. Bloom (2004) observed that employees are concerned about the fairness of the pay system as a whole rather than their individual remuneration alone.

Perceptions of fairness are strongly influenced by the process used to determine rewards, including distribution of rewards being consistent with policies (Miceli *et al* 1991) and fairness of the evaluation process (Lau and Moser 2008) or “procedural justice” (Omar and Ogenyi 2006).

Of particular relevance to the case at hand, Cook (1997) suggested the practice of counter-bidding is unethical and that managers should unilaterally pay employees their “evaluated worth”. His warning that counter-bidding encourages other employees to seek alternative job offers to increase their salaries is an important caution to managers.

Employee retention strategy

The importance of retaining key employees suggests organisations should have a strategy to achieve this. While rewards will form a major part of the strategy, it should also address broader issues such as organisational culture and recruiting the right people to ensure person-organisation fit. It should also identify ways to lessen dependence on key employees by developing required competencies in other employees and, where possible, managing workload by focusing on core tasks to give greater freedom to increase employee rewards.

Macky (2008) suggested that, while remuneration-based incentive programmes must be designed specifically for an organisation, there are normative design issues, including involving employees in the design process. He refers to research showing employee involvement resulted in positive outcomes including higher employee satisfaction.

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