



EMPLOYEE SELECTION

THE FIVE SIDES OF ROI



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INTRODUCTION

How do you measure the return on investment (ROI) of an employee selection process? This is one of the most common questions that we are asked by our clients, and in turn, one that is asked of HR professionals by their executives. Based on our experience, our own research, and the research of many others, we feel that there is not a single answer to the question. In fact, we contend that there are five key factors directly related to the ROI of the selection process.

The purpose of this article is to describe those five areas and help establish a way of evaluating the true value of an improved selection process. In short, the true ROI of a selection process can be evaluated in relation to the following areas:

1. Increased Productivity and Quality
2. Reduced Turnover and Absenteeism
3. Reduced Risk of Legal Challenges
4. Reduced Risk of Aberrant Behaviors
5. Improved Resource Utilization

1. INCREASED PRODUCTIVITY AND QUALITY

This is the most common way of thinking about ROI. It answers the core question: Do the people you hire with this system perform better on the job?

Most of the utility calculations used by Industrial Psychologists are directed at this part of the ROI equation. We know that the more accurate a selection process is, the higher the probability of hiring better employees. The accuracy of a test or selection process is referred to as its validity and is measured in terms of the correlation between the scores on the test and actual job performance.

It is important to note that differences in accuracy are associated with a multiplicative increase in predictive accuracy as opposed to a simple linear increase. This means that a test which correlates .50 with performance is actually 64% more predictive than a test that correlates .30 (25% vs. 9% in terms of predictive accuracy) even though the first correlation coefficients are only 40% larger than the second.

Therefore, when you compare two different selection systems or tests, small differences in validity add up to large differences in your ability to select good employees.

Related to this, research has shown that one standard deviation in job performance is worth at least 40% of an individual's total compensation. For sales and executive positions, that number is much higher.

Thus, on a job that pays \$50,000 per year, a person performing at the 75th percentile is worth at least \$20,000 more to the organization on a yearly basis than someone performing at the 50th percentile. Why? Consider that better people tend to pick things up faster, work better with other people, make fewer mistakes, provide better service to their customers, sell more and, in general, produce more output. This is important because if better people didn't perform better on the job and result in some type of increased productivity, then hiring better people wouldn't matter. The research is clear and supports what most of us already know, namely, that it does make a difference.

When you put these two pieces of information together, you find that having a more accurate selection process helps you hire better quality employees, who in turn are more productive and valuable to the organization. To wrap up this piece of the puzzle, there is a commonly used formula in the field of Industrial/Organizational Psychology that evaluates the ROI for the increase in productivity and quality based on factors such as the salary of the employees and the correlation between performance on the job and the test.

Using that formula, we find that if you were able to increase the accuracy of your selection process from a correlation of .20 to .40, which is approximately what you would achieve by switching from an unstructured interview to a structured one, for a position that pays \$50,000, you would receive increased productivity of at least \$2,000 per year for every person you hire.

As we will see, there are many other factors that affect the total ROI an organization can receive from improving its selection process. However, looking at it from just this single perspective indicates that there is substantial value in improving the process.

2. INCREASED PRODUCTIVITY AND QUALITY

There is no doubt that turnover occurs for many reasons. Improving the selection process will not completely eliminate turnover. However, a significant portion of early tenure turnover can be attributed to poor job fit, which can be affected by an improved selection process. A process that aggressively focuses on screening for motivational fit and on identifying individuals with a higher risk of turnover can reduce turnover anywhere from 5% to 60%.

Turnover of productive and valued employees is something that adversely affects all organizations. For most organizations, early tenure turnover, or turnover within the first 12 months, is the most frustrating. Jobs differ in their ramp-up period, or the time it takes for a new person to get up to speed and perform the job at an acceptable and competent level. This ramp-up period can be as little as a few weeks for entry-level positions to several years for higher level, professional positions. This doesn't mean, however, that after four weeks, or six months or even two years that the person knows everything there is to know about the job and can't improve. It simply means that they've learned enough, gained enough relevant experience and acquired the appropriate skills to perform the job at an acceptable level.

The true cost of turnover needs to account for factors such as:

- a. Formal and informal training
- b. Reduced productivity during the ramp-up period
- c. Costs associated with recruitment and selection
- d. Disruption and reduced productivity associated with having the position open

More importantly, the costs associated with the first three factors need to be doubled because you will incur them again once the person leaves. The true cost of turnover is difficult to quantify because no one ever writes a check or allocates a line in their budget called "turnover." Nonetheless, the costs are real and affect both productivity and profitability.

3. REDUCED RISK OF LEGAL CHALLENGES

Simply put, having a well designed, well documented, and job-related hiring process is the single best way to avoid - or at least deter - costly lawsuits brought against your organization related to the hiring process. PSI has developed and implemented selection and assessment solutions to help organizations identify, select, and develop top talent. From entry-level to professional and executive, we provide innovative solutions for our clients across all industries, including manufacturing, healthcare, safety, and customer service. In addition, we've conducted more than 200 empirical validation studies to evaluate the quality of our systems and we continue to remain active in applied, professional research. PSI has also participated in a number of legal reviews by corporate attorneys, independent law firms, the Equal Employment Opportunity Commission (EEOC), and the Office of Federal Contract Control Programs (OFCCP). Selection and assessment systems developed by PSI have consistently met the standards and scrutiny of these reviews. By maintaining the highest standards in the industry and applying our expertise in employee assessment technology, we have become a trusted partner for selecting and developing great people.

Creating a legally defensible selection process is consistent in all ways with achieving the other goals discussed in this article. It helps organizations hire people who are more productive, make fewer mistakes, stay with the company longer and cause fewer accidents. It also saves millions of dollars in legal fees.

No company we work with actually wants to go to court to defend their selection process. Instead, they want a process that will stand up to any initial claims and be so ironclad that a lengthy defense is not necessary. It's hard to put a dollar figure to such increased protection, just as it's hard to justify insurance for something that may never happen. It's reasonable to assume, however, that if your organization hires people in large numbers, you are at risk for a lawsuit, and even the smallest lawsuit costs money to defend. If you can reduce the risk of a lawsuit occurring, as well as significantly reduce the amount of time required to defend one, then you'll find that the investment you make to develop an accurate and fair system is well worth it.

4. REDUCED RISK OF ABERRANT BEHAVIORS

Some employees engage in activities unacceptable to employers. These are often called aberrant behaviors. They involve things such as safety violations, workforce violence, drug use, theft, and fraudulent workers' compensation claims. These types of behaviors tend to follow the 80/20 rule, in that 80% of all problems are created by 20% of employees. In reality, it's probably closer to 90/10. There are a number of tools available that accurately flag high-risk individuals. It's not that there is a single trait that characterizes people who engage in these activities, however, there are patterns of behavior and definable profiles that tend to be associated with these types of individuals.

The problem of workforce violence, theft, and other aberrant behaviors is not as unusual as one might think. It's important to ensure that your selection process is designed to help you reduce the risk of hiring high-risk employees.

5. IMPROVED RESOURCE UTILIZATION

How much time do your managers spend interviewing job candidates?

It is important that managers be involved in the hiring process, but bringing them in too early unnecessarily wastes their time.

One of the goals we set for the organizations we work with is that for entry-level positions, managers should be able to make job offers to 65% of the candidates they interview. For higher level positions, the percentage drops somewhat. Does this mean that we recommend that our clients lower their standards and hire almost everyone with whom they talk? On the contrary, we recommend raising the standards by doing a better job of screening candidates before they ever get to the hiring manager.

As an example, we recently worked with a large manufacturing firm that received almost 70,000 applications for approximately 2,000 positions. These candidates were systematically screened using very accurate, job-related assessments before they ever talked with a hiring manager. Managers were able to make offers to over 70% of the people they interviewed. That means they were able to spend more time working with their teams, training, developing, and leading the people who work for them.

When you look at your selection process, make sure to take into account the amount of time spent in the screening process and the level of those involved at each phase. Your higher-level, more highly compensated resources should be used sparingly and only at the end of the process. If they have to interview too many people in order to find the right candidate, your selection process is not as efficient as it should be.

PUTTING IT ALL TOGETHER

Anytime you evaluate the true value or ROI of a selection process, it's important to look at it from different angles. When you compare the cost of one approach versus another, it's critical that you look at the key outputs of the system and not simply the cost. A system that helps you improve legal defensibility is probably worth significantly more than one that doesn't. A system that helps hire productive employees, but doesn't help reduce a turnover problem isn't worth as much as one that does both.