

How to Calculate Your ROI on Background Screening

The True Cost and Financial Rewards



Introduction

IS THERE VALUE?

The sheer number of employers using background screening as a final step in the recruiting process demonstrates the perceived importance of this best practice, with more than 86% of companies performing checks¹. Given that so many companies include background screening in their HR process, some value is obviously being derived. But how much? Employers – both those who screen and those who don't – would be wise to know how much a background screening program is actually worth.

WHAT TO CONSIDER WHEN CALCULATING RETURN

Most successful businesses track the financial impact of their expenses and investments to ensure that monies spent produce an appropriate rate of return. Human capital is often the largest expense on the balance sheet, accounting for close to 100% of expense in industries such as staffing. It's also one of the most valuable assets – although the actual value can be harder to quantify.

Employers turn to tools like background screening to ensure they select the right assets to add to their teams. Effective background screening programs can help to improve employee retention, reduce the risk of workplace violence and minimize occupational fraud and theft. Unfortunately, these benefits are also often difficult to quantify. So when Human Resources is asked to justify the expense, how do they come up with a real number? Few people doubt that background screening

is valuable, but just how valuable? Does it save employers hundreds, thousands, perhaps even millions of dollars?

In this paper, we'll outline the key metrics that HR teams should consider when determining the value of background screening. We'll also share a simple formula for calculating a return on the investment, including:

- 1 The rate and costs of employee turnover**
- 2 The potential cost of violent employees**
- 3 The financial impact of employee fraud and theft**

Leveraging more than 35 years of knowledge and experience in background screening with enterprise and small businesses worldwide, SterlingBackcheck is well-positioned to shed some light on the financial impact of background screening on employers and to help quantify the benefits of this investment.

¹Society of Human Resource Management, The Use of Criminal Background Checks in Hiring Decisions, 2012

Risks and Costs by the Numbers

100-250% The average estimated cost of employee turnover per position, as a percentage of salary plus benefits

572,000 The number of violent but not fatal incidents against employees while on the job since 1999 in the U.S.

1 in 5 The share of violent workplace crimes committed by current or former employees

**\$3.5
TRILLION**

**THE ESTIMATED
ANNUAL COST OF
OCCUPATIONAL
FRAUD WORLDWIDE**

THE REVOLVING DOOR: EMPLOYEE TURNOVER

Turnover is the rate at which employees leave an organization, either voluntarily or involuntarily, resulting in an opening that the employer must replace. There are a number of theories surrounding the true cost of turnover; however, most estimates fall between 100% and 250% of an employee's annual salary plus benefits. This figure varies from employer to employer based on factors such as location, industry, employer policies and the type of position. For example, management-level or highly specialized positions often require more hiring and training resources to get the replacement up to an acceptable level of performance, thus increasing the turnover cost.

FACTORS IN CALCULATING TURNOVER COSTS INCLUDE:

- + Off-boarding the departing employee
- + Finding and training a replacement
- + Transition and opportunity costs
- + Long-term disruption of the talent pipeline²

Some turnover costs are easily measured, such as advertising for a replacement or the payment of wages during training. There are also turnover costs that are more difficult to measure such as loss of productivity, loss of institutional knowledge and decreased customer satisfaction³.

Average Turnover by Industry

INDUSTRY	AVERAGE ANNUAL TURNOVER
Services - accommodation, food and drinking places	35%
Arts, entertainment and recreation	27%
Retail/wholesale trade	22%
All industries	15%
High-tech	11%
Government/public - state/local	9%
Association - professional/trade	8%
Utilities	8%

SOURCE: SHRM HUMAN CAPITAL BENCHMARKING DATABASE (2011)

Background screening can impact turnover rates by identifying applicants with criminal records, resume discrepancies, past drug use or credit problems (when relevant to the position). By determining which data points are most meaningful for building a stable and optimized workforce, companies can hire the best candidates. When employees are capable of performing their jobs, are engaged in their companies, and are surrounded by likeminded professionals, they are more likely to be satisfied and remain with their employers. Though there are many ways of improving employee retention rates, the first step is ensuring the right person is hired for the right position.

²Society of Human Resource Management, Measuring and Mitigating the Cost of Employee Turnover, 2012

³PricewaterhouseCoopers Saratoga, Driving the Bottom Line: Improving Retention, 2006

GRIM STATS: WORKPLACE VIOLENCE

According to the U.S. Department of Justice's National Crime Victimization Survey (NCVS), approximately 572,000 non-fatal violent crimes – including rape, sexual assault, robbery and aggravated assault – were committed against individuals on the job⁴ in the U.S. in the past 15 years.

The survey also found that one in five violent crimes in the workplace was committed by current or former employees.

These bleak statistics should be enough to

convince any employer to take preventive measures to protect its teams.

Workplace violence may be the harshest consequence of a bad hire and its cost reaches far beyond litigation and turnover. A survey conducted by the Society for Human Resource Management asked participants which costs they incurred as a result of workplace violence. The chart below highlights the financial impact of workplace violence across a business.

Financial Impact of Workplace Violence

Management time/expense of being distracted from focusing on managing business operations	55%
Productivity loss (e.g., slower production)	37%
Staff replacement costs due to turnover caused by the incident	34%
Increased training expenses	31%
Increased security expenses	28%
Incident debriefing with affected employees	28%
Turnover-related expenses	27%
Increased communications cost (e.g., meetings, equipment)	27%
Increased legal expenses/higher utilization of legal staff	20%
Increased HR expenses	19%
Increased absenteeism	17%
Lawsuit-related expenses	15%
Temporary hiring costs	14%
Increased EAP/psychiatric services expenses	11%

Source: Society for Human Resource Management Survey Findings: Workplace Violence (February 29, 2012)

Employees who commit violence against other employees often have a violent criminal past or a history of abusive behavior in the workplace. A thorough criminal record check, verification of employment history and reference interviews with former supervisors can reveal potential risks and help employers protect their most valuable asset – their people.

⁴U.S. Department of Justice, Special Report Workplace Violence, 1993-2009, 2011

STICKY FINGERS: OCCUPATIONAL FRAUD AND THEFT

Employee fraud and theft is commonplace and most companies, regardless of size, encounter it to some degree. At its most extreme, it can take the form of corruption, asset misappropriation or financial statement fraud. Though many cases go undetected, the annual global cost of occupational fraud is estimated at more than \$3.5 trillion⁵. Occupational fraud and theft is a problem that knows no borders, affecting employers around the world, as evidenced in these regional estimates of total loss per instance⁶.

REGION	AVERAGE TOTAL LOSS PER FRAUD
Asia	\$1,500,000
Middle East	\$1,500,000
North America	\$1,200,000
Australia / New Zealand	\$1,100,000
Eastern Europe	\$1,000,000
Western Europe	\$900,000
Africa	\$900,000
South America	\$800,000
India	\$700,000

According to the Association of Certified Fraud Examiners⁷, in 81% of fraud cases reported in 2012 the perpetrator displayed red flags: 36% were living beyond their means and 27% were experiencing financial difficulties. Credit checks of prospective employees can find these red flags and expose patterns of financial recklessness and instability. However, employers must be cautious when using credit history to determine an applicant's suitability, and they can only do so when the applicant's credit history is relevant to the job role (e.g., the person will be handling cash or will be in a position of financial authority). Employers must also pay attention to local laws that may further restrict the use of credit history in the employment context. A few missed payments or sizeable debt should not necessarily be enough to prevent an applicant from gaining employment. The purpose of a credit check is to identify substantial issues with financial responsibility, such as an extensive history of collections, bad debt write-offs, bankruptcies or fraudulent banking.



Financial distress is not the only red flag that background checks can reveal. According to a report by KPMG⁸, 7% of employee fraudsters serve jail time for their crimes, 35% face criminal or civil proceedings, and 55% are dismissed from their jobs. Criminal record checks are effective for tracking down past criminal activity that is relevant to the position. In the United States, criminal record checks should be performed at the county, state and federal district levels to identify fraud convictions. White-collar fraud schemes can often cross state borders and end up in federal court, which makes it particularly important to perform federal district criminal court searches for executive-level positions and positions with

financial responsibility. In Canada and the United Kingdom, criminal record checks are comprehensive at the national level and reveal any past convictions for corrupt activity. The completeness and reliability of criminal record checks elsewhere varies by country so it is best to select an experienced background screening provider who is knowledgeable in global screening.

KPMG⁹ has also surveyed employers globally to determine how cases of occupational fraud and theft are handled. The results show that disciplinary action and enforcement action, including regulatory, legal and police intervention, are most common, while it is less common for civil recovery or voluntary resignation to occur.

REGION	DISCIPLINARY ACTION	ENFORCEMENT ACTION	CIVIL RECOVERY
North America	66%	63%	37%
South America	36%	36%	No Data
Asia	No Data	40%	No Data
Africa	51%	65%	No Data
Eastern Europe	33%	17%	2%
India	25%	25%	No Data
Middle East	29%	57%	43%
Western Europe	41%	42%	26%

Based on the survey conducted by KPMG, it is evident that disciplinary action is a frequent consequence for employee fraud and theft regardless of where the company is located. The screening tool best used to identify these red flags is an employment verification. Employment verifications gather factual information from former employers, including information about why the person left the company. If the applicant was dismissed for theft or fraudulent activity, an employment verification or reference check may provide some insight.

In order to reduce the risk of falling victim to employee fraud and theft, employers must take measures to prevent and recognize potential risks. Background screening can help employers spot red flags that would otherwise go unnoticed.

⁵ Association of Certified Fraud Examiners, Report to the Nations on Occupational Fraud and Abuse, 2012

⁶ KPMG, Who is the Typical Fraudster?, 2011

⁷ Association of Certified Fraud Examiners, Report to the Nations on Occupational Fraud and Abuse, 2012

⁸ KPMG, Global Profiles of the Fraudster, 2013

CALCULATING THE RETURN ON INVESTMENT

To calculate the financial contribution of background screening to your business, you should first determine which costs are relevant (i.e., turnover, workplace violence, occupational fraud). The real costs differ by company so you need to determine your specific costs.

LET'S LOOK AT A FICTITIOUS COMPANY, ALPHA INDUSTRIES

Alpha Industries has 5,000 employees and a turnover rate of 37.5%, which results in annual hires of 1,950 employees. The company grows by 4% each year, adding an estimated 200 more employees annually for a total of 2,150 new hires. It takes Alpha Industries approximately three weeks to fill a vacancy and employees generate an average of \$6,534.33 each in revenue per week. A bad hire,

which is considered to be an employee dismissed for theft, fraud or workplace violence, costs the company \$25,840, or 75% of the average salary. Approximately 2% of hires are dismissed for these activities. Hiring a new employee costs the company \$3,196 plus a background check, which costs \$65 on average. Alpha Industries screens two applicants per position. If the company avoids bad hires and reduces its turnover rate by 15%, here is what its return on investment will look like:

STEP 1: Calculate how much Alpha Industries will save by reducing its turnover by 15%:	Reduction of Turnover $\frac{(\text{Hires} \times \text{Turnover} \%) \times [(\text{Weeks to Replace} \times \text{Average Revenue per Employee}) + \text{Hiring Cost}] \times \text{Reduction in Turnover}}{}$ $= (2,150 \times 37.5\%) \times [(3 \times \$6,534.33) + \$3,196] \times 15\%$ $= 806.25 \times \$22,798.99 \times 15\%$ $= \mathbf{\$2,757,252.85}$
STEP 2: Calculate how much Alpha Industries spends on bad hires:	Cost of Bad Hires $\frac{\text{Hires} \times \text{Cost of a Bad Hire} \times \text{Percentage of Bad Hires}}{}$ $= 2,150 \times \$25,840 \times 2\%$ $= \mathbf{\$1,111,120.00}$
STEP 3: Calculate the savings achieved by implementing a background screening program:	Savings $\frac{\text{Savings} = \text{Reduction of Turnover} (\$2,757,252.85) + \text{Cost of Bad Hires} (\$1,111,120.00)}{}$ $\mathbf{\text{Savings} = \$3,868,372.85}$

CALCULATING THE RETURN ON INVESTMENT

STEP 4: Calculate the cost of the background screening program:	<h3>Cost of Background Screening</h3> <p>Hires x Background Screening Cost x Number of Applicants Screened per Position</p> <hr/> <p>= 2,150 x \$65 x 2 = \$279,500</p>
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STEP 5: Calculate the value of the screening program and the return on investment:	<h3>Value of Screening Program</h3> <p>(Savings - Cost of Background Screening)</p> <hr/> <p>= \$3,588,872.85 RETURN ON INVESTMENT = 1,284.03%</p>
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Each business is structured differently and has its own strengths, weaknesses and efficiencies. The data used in this example is based on industry averages; however, the formulas can be applied to any business to determine the accurate return on investment that will be gained by implementing a background screening program. The following statistics can be applied to calculate the return on investment for specific industries¹⁰.

INDUSTRY	AVERAGE ANNUAL TURNOVER	REVENUE PER FTE	COST PER HIRE
Services - accommodation, food and drinking places	35%	\$183,173	\$1,062
Arts, entertainment and recreation	27%	\$188,817	\$1,394
Retail/wholesale trade	22%	\$523,529	\$2,549
All industries	15%	\$339,785	\$3,196
High-tech	11%	\$207,763	\$3,357
Government/public - state/local	9%	\$204,594	\$2,293
Association - professional/trade	8%	\$294,582	\$5,582
Utilities	8%	\$413,086	\$3,936

SOURCE: SHRM HUMAN CAPITAL BENCHMARKING DATABASE (2011)

¹⁰ U.S. Department of Justice, Special Report Workplace Violence, 1993-2009, 2011

Conclusion

Implementing a background screening program makes financial sense when you consider the chain of events that can follow a bad or misinformed hire. The results of negligent hiring can be catastrophic and extremely costly for employers. This paper focused on turnover, workplace violence, and occupational fraud and theft, but there are many other positive effects of background screening that cannot be accurately measured, including but not limited to, improved customer satisfaction, better performance and reduced absenteeism due to an engaged workforce. The many benefits of background screening make it clear that it is an investment well worth making.

About SterlingBackcheck

SterlingBackcheck works with more than 20,000 customers world-wide to help them hire the best talent. We assist a range of organizations, from small local businesses to Fortune 100 companies. In fact, more than 25% of the Fortune 100 rely on SterlingBackcheck for their employment screening.

WANT MORE?

In addition to this report, SterlingBackcheck regularly publishes cutting-edge research and insight on the latest trends in human resources, talent management and hire processing.

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