The Role of Payroll in Employee Retention

How accurate, efficient payroll can help curb costly turnover

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Introduction

As we emerge from the worst of the COVID-19 pandemic, the U.S. job market is the strongest it's been in decades, presenting great opportunities for employees and major headaches for employers. The current 11.2 million job openings (July 2022) are approximately 50% above the pre-pandemic record high and equate to nearly 1.9 available jobs for every person who is seeking employment.[i] Even as fears of recession persist, the labor market continues to be robust with widespread job increases across all sectors of the economy.[ii]

At the same time, voluntary exits continue to ramp up as workers seek better career opportunities, higher pay, increased flexibility, and improved work-life balance. These conditions have employers scrambling to hire new employees and persuade current workers to stick around.

With the cost of turnover estimated to be one third to two times the employee's annual salary,[iii] it's not surprising that employee retention has become a top priority for employers.

The Link Between Payroll and Employee Retention

While lack of career development, job workload/stress, and corporate culture are the top preventable reasons why people left their jobs in 2021[iv], employers need to consider all aspects of the employee experience to arrive at an effective retention strategy. **Payroll is one of the factors worth examining — especially in the current economic climate.**

What does payroll have to do with employee retention?

Short answer: plenty. During the summer of 2022, the U.S. consumer inflation rate reached 40-year high.[v] Prices for gas, groceries, and other essentials have risen significantly, making it difficult for many people to make ends meet. These are concerning trends given that approximately 64% of Americans are living paycheck to paycheck.[vi] Even more alarming, this squeeze is not limited to those with low incomes. Forty-eight percent of Americans making more than $100,000 are living paycheck to paycheck.[vii]

In light of these realities, payroll errors can have a substantial impact on an employee’s personal finances, especially given that the cycle time to resolve a payroll error ranges from two to 10 business days.[viii] Research shows that, depending on company size, best-performing organizations take two to four days (maximum) to resolve a payroll error, while the lowest performers take at least five to 10 days to do so.[ix] That’s a long time to wait for employees who are under financial stress and have bills due, potentially forcing them to incur overdraft or late fees or resort to high-interest loans.

The bottom line is that getting payroll right is essential for supporting employees’ financial wellbeing and reducing unnecessary stress. Accurate, on-time payroll is an important, yet often overlooked, component of the employee experience that can help foster a culture of trust and transparency that makes employees feel valued and want to stick around.

Payroll Complexity = More Room for Error

While accurate pay is key to employee satisfaction, it's not always easy to avoid errors as payroll becomes increasingly complex. Payroll calculations and tax obligations can vary widely by geography and federal, state, and local regulations continue to evolve. As a result, businesses with limited HR and payroll staff dedicate considerable time, energy, and effort keeping pace with tax and payroll complexities — leaving less time to focus on more strategic initiatives.

What factors are making an impact on modern payroll?

Developments in recent years have further contributed to payroll complexity, upping the ante for employers looking to retain top talent and stay compliant.

1. Remote and Hybrid Work Models
2. Increased Reliance on Overtime
3. Misclassification of workers

Did you know?

The U.S. remains in the top 40% of countries for payroll complexity globally.[x]

Remote and Hybrid Work Models

As more employers embrace remote or hybrid work models, ensuring accurate pay and ongoing compliance is growing more complicated. Dedicated payroll functionality that supports multi-state, multi-jurisdiction, and multi-rate environments provides an advantage for employers that are trying to manage:

- Workers deployed across state and city lines
- Temporary assignments in other locations
- Stipends, allowances, and other travel expenses
- Employees moving to different geographic areas

Companies are typically subject to taxes based on where employees perform their work, while employees are generally subject to taxes based on where they reside. Employers must pay the correct withholding tax in the right jurisdiction to ensure pay accuracy and regulatory compliance. Ultimately, withheld taxes (or lack thereof) will come back to haunt the employee when completing the federal and state 1040 at year-end. The employee will be responsible for any uncollected/unwithheld income taxes, potentially adding to already elevated levels of financial stress and leading to frustration and disengagement.

With the shift to a remote-first work model during the COVID-19 pandemic, some employees have failed to report their relocation to their employer — an oversight that can have significant tax implications. The onus is on employers to update the workforce on changing remote-work policies and the actions required by employees to ensure tax compliance.

Increased Reliance on Overtime

To deal with persistent labor shortages, many employers are relying on existing workers to stay late, come in early, and pick up extra shifts, which can lead to even more employee burnout and increased employer overtime costs.

Standard overtime pay is easy to calculate, but things get more complicated when it comes to blended overtime, the pay an employee who works at two or more pay rates receives for working more than 40 hours in a seven-day period. Using modern payroll technology that automatically calculates blended overtime not only ensures that employees receive the accurate pay they expect, but it also helps employers avoid costly overpayments and simplify compliance with U.S. Department of Labor (DOL) wage and hour laws.

Policies & Paychecks

With the U.S. government making payroll-related policy changes to mitigate the short-term impact of inflation, employers need to be vigilant. Staying on top of these changes is imperative to avoid IRS penalties and ensure employees receive all of the compensation they're owed. For example, the Internal Revenue Service (IRS) recently increased the standard mileage reimbursement rate for business travel to 62.5 cents per mile for July through December 2022 — up four cents from the rate effective at the start of the year.[xi]

By working with a payroll provider that proactively monitors regulatory changes, employers are better able to remain on the right side of compliance — and in the good graces of employees.

Liability is an important consideration, too. If two employees are working the same hours at similar pay rates, but one employee is consistently overpaid due to human error or system miscalculation, this exposes the employer to liability. In addition, it could open the door to employee grievances over discriminatory practices related to pay inequality.

Labor shortages may also require employers to ask their workers to work different shifts to ensure adequate coverage. Studies have shown that up to 92% of companies pay shift differentials to hourly employees, and 36% pay shift differentials to salaried employees.[xii] In addition to Fair Labor Standards Act (FLSA) rules around premium pay, some collective bargaining agreements stipulate payment of shift differentials or premiums to employees who work overnight and other less desirable shifts. These pay premiums not only help ensure fair worker compensation, but they can also serve as an effective tool for retaining quality employees.[xiii]

Without the ability to accurately calculate shift differentials, employers risk making payroll errors that degrade the employee experience and may lead to costly fines. Each year, scores of employers face litigation over unpaid wages resulting from errors in overtime calculations involving shift differentials. When shift differentials are paid separately from the employee's regular earnings, employers must factor them into the calculation of the regular rate of pay for overtime purposes and calculate overtime premiums using the proper formula. To further complicate matters, some states, including California, have their own calculation requirements which must be continuously monitored and met.

Misclassification of workers

How an employer classifies an employee — nonexempt or exempt, independent contractor or employee — can significantly affect payroll by determining their eligibility for overtime. For example, the FLSA requires that all employees receive overtime pay for any hours worked over 40 hours per week, unless they are classified as exempt. Misclassifying a non-exempt employee can cause that employee to miss out on overtime earnings, while putting the employer at risk for FLSA-related violations.

Misclassifying a worker as an independent contractor rather than an employee can also lead to payroll errors stemming from failure to pay overtime wages for hours worked in excess of 40 per week. These errors can lead to employee grievances and costly litigation that can damage an employer's reputation. For example, in recent years the DOL recovered:

- $350,000 in back wages for 50 workers misclassified as independent contractors by a home health care service provider, resolving overtime violations uncovered during one of their investigations.[xiv]
- $139,068 in back wages and liquidated damages owed for 21 workers whose Houston employer, TSTAR Services Inc, misclassified them as independent contractors and failed to pay overtime wages.[xv]
- $5.3 million in penalties, damages, and back wages resulting from Walmart's misclassification of 4,500 managers and coordinators as exempt from the Fair Labor Standards Act's overtime provisions.[xvi]

The Social Dilemma

A negative payroll experience not only leads to disgruntled employees, but it can also damage an employer's brand. In today's digital world, unfavorable comments from employees can quickly spread across social media platforms or company review sites such as Glassdoor and Indeed, where other employees and potential job candidates can see them. When this happens, it doesn't take long for workforce morale to suffer and an employer's hard-earned reputation to take a hit.

Trust lost is not easily regained, so taking steps to ensure a flawless payroll process is crucial for attracting quality talent, retaining valuable employees, and protecting the employer's brand.

Leveraging Earned Wage Access to Drive Retention

Keeping pace with evolving employee expectations is vitally important for optimizing retention. Today's workers increasingly expect financial wellness benefits that help them manage day-to-day finances, withstand unplanned expenses, and plan and save for the future. These benefits include financial education, retirement planning, debt counseling, savings support, and even digital apps with budgeting tools and one-on-one coaching — all of which can help reduce employees' money-related stress and anxiety.

Why are employees embracing financial wellness programs? According to a recent study:

- 35% of individuals fall short on an expense between pay periods
- 75% report major impacts on life and wellbeing as a result of financial shortfalls.[xvii]
- Another survey revealed only 39% of Americans can afford a $1,000 unexpected expense.[xviii]

Did you know? 1 in 5 workers say they cannot make it from paycheck to paycheck.[xxii]

As more employees demand financial wellness programs, employers are starting to view payroll as a benefit, offering earned wage access (EWA) products — also known as on-demand pay. EWA enables workers to access wages already earned and owed before the traditional two- or four-week pay cycle, giving them greater control over their finances. In most cases, third-party EWA providers work with the employer, the employee, or both parties to enable on-demand pay — often through integration with the employer's payroll system.

The overwhelming majority of employees think on-demand pay is an attractive benefit. In an EY survey, 80% of respondents indicated they would use a form of on-demand pay for reasons that range from emergencies to budgeting and saving.[xxiii] Another study found the option to be particularly appealing to Millennial and Gen Z workers[xxiv] who have grown up with on-demand access to everything from information to entertainment.

Even more important, EWA is considered an effective retention tool. New research showed that:

- 72% of respondents would feel more valued and appreciated
- 69% would stay longer with their company

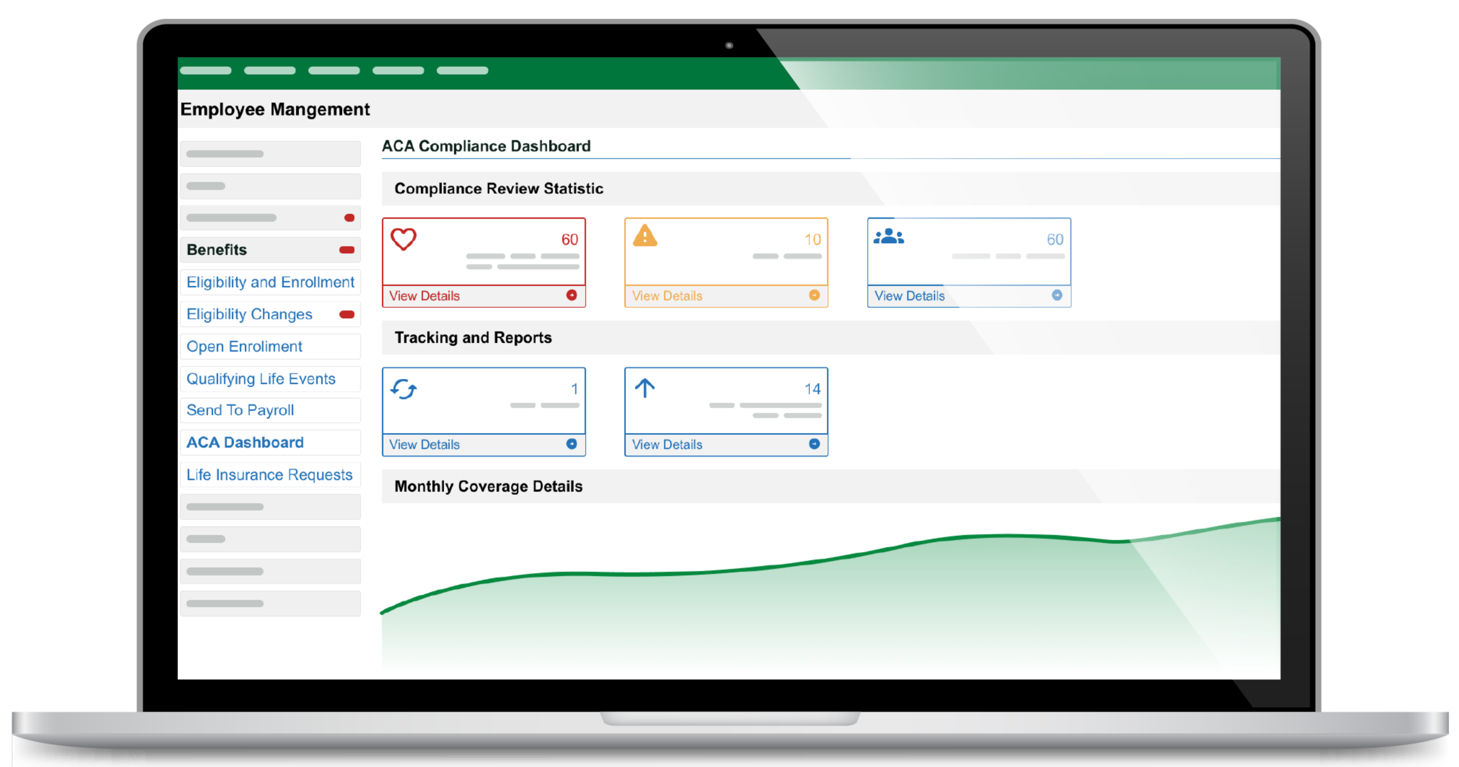
if their employer offered immediate access to a portion of their earned pay after every day's work at no cost.[xxv]

Given employee demand, it's likely that an increasing number of employers will offer EWA as an employee benefit. Those that do will need to make sure their payroll system can handle all associated integrations and complexities, such as tax and benefit deductions, as well as reconciliation via payroll deductions or bank account debits.

Conclusion

The ongoing labor shortage clearly gives employees the upper hand, putting employers at higher risk of losing top talent. With plentiful job opportunities available to workers, employers need to deliver a stellar employee experience that is built on trust and makes people feel valued. After all, happy, engaged employees are far more likely to stay with their current employer and bring their best to work every day.

Payroll errors are a surefire way to erode employee trust, fuel dissatisfaction, and increase turnover. Therefore, accurate, on-time payroll, and rapid resolution of any errors that may occur, must be a fundamental component of an effective employee retention strategy.



Investing in modern payroll technology that can handle complex calculations and withholdings, monitor policy changes, update compliance rules, and integrate with EWA solutions, is a smart move for employers looking to retain top talent and maintain a competitive edge.

Take the next step toward better payroll

Explore how modern, real-time payroll solutions from Greenshades can simplify complex payroll calculations and earnings management to ensure the accurate, on-time pay employees expect.

Check out our ebook "The Core of Comprehensive Payroll & HR" to learn more. For more immediate information, request a demo, or contact a sales representative at 888.255.3815 or sales@greenshades.com.

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