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Small Business Research Summary

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# The Relationship Between Employee Turnover and Employee Compensation in Small Business

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This study explores the relationship between employee turnover and firm size as it relates to compensation using the National Longitudinal Survey of Youth (NLSY). The purpose of this study is to examine whether employee turnover differences between small and large firms are the result of differences in wages and benefits or of some form of self-selection where employees of small businesses are simply more prone to high turnover rates than those in larger firms.

## Overall Findings

Employees of large establishments stay in their jobs longer than employees of small establishments. Offering benefits improves employee retention. When a firm offers benefits, it decreases the probability of an employee's leaving in a given year by 26.2 percent and increases the probability of staying an additional year by 13.9 percent.

The earnings results based on the relationship between establishment size and earnings show that firm size has a positive impact on earnings for service and manufacturing occupations. These findings coincide with those of past literature showing an earnings difference based on firm size.

## Highlights

The probability of turnover increases by about 3 percent for each additional year of age, and married individuals are 22 percent more likely to leave their jobs than otherwise identical single workers. The effect of tenure is especially large; each additional year of tenure at the present job reduces the probability of turnover by 81 percent. Yet, the tenure results demonstrate that over half of the observed differences in tenure among employees at small and large establishments may be attributable to other factors besides establishment size.

The earnings results based on the relationship between establishment size and earnings demonstrate that for professional occupations, establishment size still seems to have no effect on earnings. However, this is not the case for other occupations. The study shows that other factors, including educational attainment, unionized workplace, and marital status, explain the observed tenure differences. The findings on tenure duration confirm that employees of larger firms are more likely to remain with their employers than employees of small firms. In essence the size of the firm has a positive impact on tenure, all other things being equal.

## Scope and Methodology

Data from the National Longitudinal Survey of Youth (NLSY) were used for the current analysis. The Bureau of Labor Statistics of the U.S. Department of Labor directs the NLSY, which gathers detailed information on demographics, labor market activity, job characteristics, and other significant life events of men and women. The survey subjects were interviewed annually from 1979 to 1994, and they are still interviewed biannually. The data have some limitations that affect the analysis. For example, the firm-level data on industry, ownership, location, and firm size are reported by employees and must be considered an estimate at best. Also, significant gaps in some of the variables (e.g., benefit categories) prevent granular exploration.

This report was developed under a contract with the Small Business Administration, Office of Advocacy, and contains information and analysis that was reviewed and edited by officials of the Office of Advocacy. However, the final conclusions of the report do not necessarily reflect the views of the Office of Advocacy.

The first stage uses basic logit regressions and hazard models to determine the stay/leave decision and the effect of the variables on job duration. The second stage estimates earnings using the ordinary least squares method, with firm size, demographic, and compensation as explanatory variables.

This report was peer reviewed consistent with the Office of Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at **advocacy@sba.gov** or (202) 205-6533.

## Ordering Information

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