



The Financial Cost of Conflict in Organizations

BY MICHAEL LAZAN



ABOUT MICHAEL LAZAN

Michael Lazan, senior vice president of The Arbinger Institute, leads the delivery of Arbinger's programs in Europe and with multinational corporations globally. With more than 20 years of management experience, Michael brings tremendous practical experience to Arbinger's work with organizational clients.

Prior to joining Arbinger, Michael served in the White House under President Reagan, and subsequently held a number of key management positions in the United States and internationally with Procter and Gamble, Pillsbury, and Reckitt-Benckiser.

Michael earned a B.A. from Columbia University, an M.A. from the Johns Hopkins University School of Advanced International Studies, and an MBA from the Wharton School of the University of Pennsylvania.

Almost anyone who's ever worked in a company has witnessed organizational conflicts of some kind and quickly realized that these conflicts damage the work environment. It's clear to all that even relatively minor conflicts are damaging and lead to workplace issues such as office politics, miscommunication, and employee frustration. These minor conflicts also often lead to more significant conflicts, such as poor teamwork, poor decision-making, and undesirable employee turnover, which result in major damage to the workplace.

We usually accept these conflicts—and the damage that they cause—as a given in corporate life. In addition, we usually invest little in trying to prevent these conflicts because we tend to view them as inevitable and assume that the damage that they cause is cosmetic. But what if you could quantify the damage that these conflicts cause to your company in financial terms? And what if you were to determine that conflicts were a very expensive problem? Might that cause you to take them more seriously and invest resources in trying to prevent them? Probably...but only if you were convinced that there was a way to actually do so. This article will attempt to help you quantify the cost of conflict in your company and help you determine what it is costing you.

QUANTIFIABLE SYMPTOMS OF CONFLICT

Some symptoms of conflict are more difficult to quantify than others, but we can put price tags on just about all of them, albeit with varying degrees of precision. Dan Dana, an American mediator, has come up with a useful way of doing so that forms the basis for the ideas below.*

WASTED TIME

One of the most obvious side effects of organizational conflict is wasted time. Conflicts devour employee time through a whole host of time-consuming activities

beyond merely the time that the conflicting parties invest in the basic conflict itself. There is the time that parties waste on thinking about the conflict, the time they waste (both their own time and the time of others) complaining to anyone who will listen—such as their bosses, colleagues, or subordinates—about the other party, the time they waste figuring out how to subvert the other party, the time that others waste in cleaning up the resultant messes, the time that more senior managers waste in trying to bring the warring parties together, and the list goes on. Since “time is money,” it shouldn’t be too difficult to put a cost on all of this wasted time. We’ll use a hypothetical conflict in order to illustrate how to calculate it, as well as other costs caused by conflicts.

We first need to count the number of people involved in the conflict and then calculate the average cost to the company of these employees (fully-loaded to include not only salary, but all benefits). Next we’ll need to determine how many months (or years) the conflict continued and then estimate the percentage of the employees’ time that was wasted on the conflict (remembering to include the time wasted on ancillary activities such as those noted in the previous paragraph).

With these four pieces of data, we can now easily determine the cost of the conflict. Let’s say that six of these employees, who cost \$100,000/year on average (including benefits and other employer costs, such as Social Security payments), were involved in a conflict that lasted all year and consumed 10% of their time. If that were the case, this single conflict directly cost the company \$60,000 in wasted employee time alone ($6 \times \$100,000 \times .10 = \$60,000$).

LOWER RETURN ON INVESTMENT IN LABOR

However, that lost time actually has a greater impact given that the return on investment in labor is (or at least should be) greater than the cost of labor. Dana estimates that the ROI of labor ranges between 150-500%. Even if we take the lowest end of that range, then the lost ROI on labor caused by the conflict above would be \$90,000 ($150\% \times \$60,000 = \$90,000$).

POOR DECISION-MAKING

Poor decisions are another very costly side effect of organizational conflicts, though more difficult to quantify. That conflicts contribute to poor decision-making is obvious in the event that multiple people sharing decision-making responsibility are in conflict. In such a case, the decision

will ultimately be decided based on the balance of power among the conflicting parties and not on an objective evaluation of the company’s best interests. However, conflicts contribute to poor decision-making even if there is only one person making the decision. That’s because the decision-maker must rely on others for information. If the information-providers are in conflict with each other and/or with the decision-maker, then the information that they provide will likely be distorted and result in a poor decision.

Given the large number of issues faced by decision-makers, the wide variety of potential decisions for each issue, and the virtual impossibility of knowing how a different decision would have altered the outcome, there is no way to reliably calculate the cost of the poor decision-making caused by a conflict. However, it is possible to make an estimate. Dana cites statistics claiming that the average financial impact of a manager’s decisions equals 75-200% of his or her annual salary. We’ll conservatively assume that our sample conflict caused only one of the six employees to make just one terrible decision, costing 75% of that employee’s annual salary. With these assumptions, the conflict would cost the company \$75,000 due to poor decision-making ($1 \times \$100,000 \times .75 = \$75,000$).

Though difficult to quantify, the cost of poor decision-making as a result of conflict represents major costs to organizational performance.

EMPLOYEE ATTRITION

Organizational conflicts also invariably lead employees to leave a company. We can quantify this side effect of a conflict by determining the cost of losing an employee, the number of employees who leave, and the impact of the conflict on the departure of those employees. While there is little question that an employee’s departure has a significant cost, estimates of how to determine that cost range from 150%-700% of an employee’s annual salary. For the purposes of our example, we’ll conservatively use 150% and further assume that only one of the employees involved in the conflict left the company. The cost of losing that employee—assuming that he earns the average annual salary of \$100,000 cited above—would therefore be \$150,000 ($\$100,000 \times 1.5 = \$150,000$). Of course, that

employee's departure was probably not solely the result of the conflict, so we'll need to estimate the extent to which the conflict prompted him to leave. In this example we'll estimate that the conflict was one of five equal factors that prompted this employee's departure, meaning that the conflict cost \$30,000 in employee attrition ($20\% \times \$150,000 = \$30,000$).

ADDING IT ALL TOGETHER

Depending on their nature, scope, and duration, organizational conflicts can and do lead to other significant costs including restructuring, employee sabotage or theft, and lost productivity resulting from employee absence or reduced motivation. We'll ignore those costs for the purposes of our hypothetical conflict.

Even if we ignore these costs and use the very conservative assumptions above, our sample conflict is still quite costly. Adding up all of the elements above, this single conflict would cost the company \$255,000. Our hypothetical

company, like most companies, probably suffers from more than just a single conflict. If we were to calculate the costs for all of those conflicts and add them up, we'd see that the overall costs are staggering. These costs would certainly be high enough for us to take conflict seriously and decide to invest in combating it—if only there were a way to do so effectively. Fortunately, there is a proven method of working that helps prevent conflicts from arising and allows them to be resolved when they do. This is what we at Arbinger do. From labor management disputes on a large scale, to interpersonal conflicts between members of a team, Arbinger's unique methodology for diagnosing the underlying causes of conflict and our proven ways to transform those conflicts into healthy and productive working relationships has been proven with hundred of clients over the last 35 years.

*See <http://www.mediationworks.com/dmi/toolbox.htm> for a full discussion of these calculations by Daniel Dana.