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Seven Key Performance Indicators:

Managing Workers' Compensation Risk for Bigger Profits

By Stephen B. Paulin, CIC

Businesses today are putting more emphasis on improving risk management than ever before. This is due in large part to increased regulation, emerging exposures such as cyber liability and supply chain interruption, as well as the associated escalation in financial consequences. According to a 2014 Price Waterhouse Coopers (PwC) global survey of approximately 2,000 business executives and risk managers worldwide, 75 percent are investing resources to create a more risk-aware company culture, with one in four identifying fragmented risk data as the largest capacity gap.

Over the next 18 months, 82 percent of the respondents plan to develop an in-depth process to continually identify and monitor risk, a trend corroborated by the Risk Management Society's *Excellence in Risk Management XI* survey. Though 90 percent of C-suite respondents said risk management impacts business strategy, only 25 percent feel their companies use risk management to its fullest ability. Key areas in which the use of data and analytics can be improved, include risk identification, quantification and mitigation.

Implications for Worker's Compensation

Workers' Compensation is the one property and casualty coverage where a business can exert the most control to reduce claims and cost. Many middle-market businesses fail to identify important key performance indicators (KPIs) to help them understand, analyze, track and measure process improvements that reduce claims, maximize ROI and increase profitability. Specific areas that should be examined include:

- Where is the organization in relation to the report's findings and claim analysis abilities?
- Is the business using current methodologies to evaluate, analyze, track and measure the performance of your workers' compensation program?
- Is the business aware of the cost of a workplace injury beyond what is shown on a loss run?
- What does the business have available for comparing results with other California businesses in the industry, or across the country?
- Is the business using this information to grade the broker's performance in managing those costs as effectively as possible?

What gets measured gets improved - the more effective the measure, the more dynamic the opportunity to obtain the desired results. An ideal system of best practices includes seven specific key performance indicators incorporating a unique combination of analytics and metrics that a management team must not only know but also implement and monitor to achieve the full potential of its workers' compensation program. Forward-thinking businesses are capturing and using relevant data in new ways to develop innovative metrics and operate more effectively. With more precise information in hand, managers can better evaluate, track and measure outcomes to make quicker, more informed decisions. The results extend beyond simply solving a workers' compensation problem. From a more global perspective, the ability to prevent and mitigate workplace injuries has far-reaching benefits to support an organization's strategy to maintain or improve its competitive position. The rewards include the ability to reduce costs, enhance employee health and wellness, foster a safer work environment, improve productivity, create a better risk profile and add more profit to its bottom line.

The Seven Key Performance Indicators

1) Lowest Possible Modification: The Experience Modification Rate (EMR) is an important baseline and benchmarking factor for internal use, and as a comparison to competitors. A business' Lowest Possible Modification (LPM) is the value the experience modification would be if the business had no work-related injuries during the applicable experience rating period. Think of it as the perfect score. This will be different for every business. So, knowing the LPM is essential.

The gap between the EMR and LPM is a controllable cost and has many implications. Aside from what the numbers themselves represent, it measures the degree of inefficiency in an organization's ability to manage the expense side of their business. Within this context it points to:

- The level of understanding management has regarding operations.
- The amount of energy a company is willing to devote to peak performance.
- The knowledge of the service providers, i.e. insurance broker, and the effectiveness of the support received.

Once the gap is exposed and the implications are understood, the LPM becomes the focal point from which a consistent and sustainable plan can be conceived and executed to close that gap. If the broker has not provided the business with the LPM, it's likely no one is examining the important gap between the businesses EMR and LPM to improve its risk efficiency.

2) Claim Incidence Rate and Cost Rate: Effectively managing a workers' compensation program begins with identifying the sequential events within the business process that lead to employee injuries. Understanding the underlying proximate cause(s) is essential to interpreting and interrupting that sequence. A businesses Claim Incidence Rate/Cost Rate are extremely important numbers in the risk- management equation and specifically for this analysis. The Claim Incidence Rate/Cost Rates are a measure of the cost of production or operation that carry over into subsequent years and represent the slippage between intention and the combination of design and effort (process). The first measures the frequency (number) of claims, and the second accounts for claim dollars, expressed as a cost per some significant internal measure of production or expense.

Loss runs are useful reports to draw information but lack the capacity to provide necessary details for exposing patterns and trends and setting baselines and benchmarks from which the appropriate processes can be designed. Because both claims and premiums have too many variables causing them to change over time, the antiquated loss ratio (Claims $ / Premium) is a poor data set to establish a reliable and consistent measure for diagnosing and solving potential problems. Therefore, it is important to use the right denominator in the Incidence Rate/Cost Rate formula – one that is subject to minimal variation. This precise measure delivers consistently reliable numbers correlating past performance with current events and allows for higher confidence in predicting future outcomes. Often a current internal KPI is best. Examples of a precise measure range from, units of electricity to tons of dough (used by a bread manufacturer), or patient bed days (healthcare) and even raw material expenses.

In spite of the huge amount of premium, exposure, and claim data produced by the workers' compensation industry, many businesses complain about the lack of actionable information available to make informed, real-time decisions. It is more beneficial, therefore, to cross-reference, analyze and correlate multiple sources of information—both internal and external—in order to make educated decisions.

3) Industry Comparison: A competitor's experience modification provides a business with valuable but limited information. There is a way, however, to compare the Claim Incidence Rate with the industry average, specific to state and also nationally. It's a great benchmarking tool to determine how the business' operation is performing. By underperforming, a business relinquishes advantages to the competition. Similar to the LPM, this comparison provides a specific metric to gauge results and a target to aim for to close the gap.

4) Indirect Cost of Claims: Dr. Edward Deming, who gained world renown for introducing and instructing Japanese manufacturing CEOs about Total Quality Management, lists at number five of his Seven Deadly Diseases of Management, "Running Your Business on Visible Numbers." He cautions that using only obvious and visible numbers with little or no consideration of figures that are unknown, can lead to uninformed, costly actions. This certainly has workers' compensation implications, particularly when determining the total cost of a claim. Little attention is given to the indirect cost of a work comp claim, also referred to as secondary costs. Depending on the industry and claim size, that amount can range from one to two times the medical, lost time, disability and associated expenses shown on your loss run. This links to a study of direct and indirect workplace injury costs (http://ergoweb.com/liberty-mutual-releases-workplace-injury-and-cost-data/), which affect a wide range of areas in the business, such as:

- Damaged equipment and materials.
- Lost productivity due to time spent responding to and investigating the cause and outcome.
- Overtime associated with covering for an employee, who is now unable to fulfill his or her responsibilities in the production process.
- Time spent on claims management and litigation.
- Possible time spent searching for, interviewing and training a new replacement employee (and the statistically established likelihood that a new employee is more likely to be injured at work than an experienced worker).
- Three years of elevated insurance costs, as the injury is included in the experience rating formula.

There is no specific line item for the various hidden costs associated with a claim, but they do show up as lost profit. Like a slow leaking pipe tucked away in the recesses of a building that goes unnoticed, indirect costs of claims represent leakage in a financial statement.

Consider the effect of $250,000 in claims, and the associated indirect costs at 1X (an additional $250,000). Now, take a business' Net Profit Margin (say 10%) and divide it by $250,000 to get the additional sales required to fund this uninsured cost. $250,000 /.10 = $2,500,000. How many units of product would the company need to sell in order to cover this unrecorded cost? Is it easier to increase the company's sales by $2,500,000 or perhaps undertake a program to minimize workers' compensation claims?

5) Loss Prevention & Control Program Audit & Rating: Business owners face the common struggle to identify and control the drivers of workers' compensation expense. In the absence of quality analytics and metrics, intuition often becomes the default mechanism to determine a course of action. However, without the necessary experience, skills and resources, intuition often results in solving the wrong problem.

Even with the right KPIs and capabilities, a plan still needs to be properly executed. To ensure success, it is imperative to assess an organization's internal loss prevention and control program in conjunction with other stakeholders, i.e. insurer and medical provider. Examples of areas to review include:

- Management's commitment and awareness.
- Return-to-work/transitional duty.
- Communication.
- Performance goals.
- Medical cost containment.
- Training initiatives.

Quantitative measures, such as claim incident and cost data abound. However, proper consideration is rarely given to measuring and scoring the quality of a risk management program.

Audit tools are available to assess workers' compensation practices and procedures, recommend improvements and receive the targeted materials, expertise and training to implement cost-saving improvements. A report generates a score to measure the initiatives mentioned above that are relative to best practices, and pinpoints which areas are in the most need of improvement and will yield the greatest savings in the quickest amount of time.

Once the rating is established, resources to improve the program are put into place, including:

- Claims benchmarking to determine the cost of current practices and forecast the benefits of improvements.
- Access to training programs and collateral material to educate the team about specific prevention measures.
- Processes to track and measure progress.

6) Health of Your Workforce: Today's workforce is suffering from lifestyle-related illnesses such as obesity, diabetes and other chronic diseases. Employer awareness continues to rise and studies present compelling evidence correlating a healthier workforce to a reduction in the number and cost of workers' compensation injuries.

Approximately 50 percent of Americans have at least one chronic health condition. High-risk individuals are nearly three times more likely to file a workers' compensation claim. This population accounts for 85 percent of workers' compensation costs, and have medical expenses that are significantly higher per year than low-risk individual's injuries. These conditions contribute to a significant loss in productivity for any organization.

Population Health Management Programs (wellness plans) offer a comprehensive solution to minimizing workers' contributions to loss in productivity in a formalized and integrated manner.

This begins with an employee Health Risk Assessment. The results are aggregated to reveal where the workforce is at risk for lifestyle-related illnesses, with both current conditions and those with indicators for susceptibility. With this insight and baseline factors, one can implement a tailored population health management program to improve employee well-being, increase productivity and reduce workers' compensation costs.

7) Broker Compensation: Similar to other operating areas in a business, broker's compensation is an investment and should be known and open to measure. Compensation is an important component of the value proposition. Yet, brokers loath to let clients know how much commission they are being paid by the insurance company and surprisingly, clients don't ask. If clients are unaware of how much the broker is being paid for his/her workers' compensation services, how can they effectively measure his/her performance? Isn't it a critical part of formulating the ROI to assess the broker's contribution to improve outcomes and close the gap on the Lowest Possible Modification?

Often, a disproportionate balance favoring the broker exists in situations where the experience modification continues to rise over several years, developing a win–lose relationship with the client. As the renewal premiums increase, so does the broker compensation. Yet, the broker has not been able to bring a solution. Hence, this calls into question the value of the services rendered.

Using Meaningful Analytics

Despite the growing challenges associated with capability gaps and technology changes, companies are making progress at maintaining and building their risk management competencies. PwC's survey respondents reported being the least satisfied with their abilities around risk forecasting and scenario analysis as well as building up the risk function and resources. In a world of inherent risk, where yesterday's methods of addressing workers' compensation costs continually prove to be ineffective, it is more important than ever to explore and learn new risk management perspectives.

There exists an increasing focus by a small group of forward-thinking professionals toward using more meaningful analytics and metrics to identify savings opportunities, formulate action plans and measure the impact of change. What gets measured gets improved - the more effective the measure, the more dynamic the opportunity to obtain the desired results.

Knowing and employing these numbers gives organizations an advantage. The aggregated savings and additional benefits obtained far exceed any potential year-over-year reduction in the renewal premium. These measures not only provide transparency but also serve as a barometer to measure the organization's own performance, as well as the broker's overall ability and willingness to be accountable for achieving the desired results.

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