

# **The Eight Major Mistakes Employers Make When Workers' Compensation Rates Go Down**

*By  
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Throughout much of the country declining Workers' Compensation rates are music to employers' ears. After all, that seems like long-awaited good news, particularly since Workers' Compensation is more often than not viewed as a necessity and a significant cost of doing business.

Yet, looking at Workers' Compensation as a business necessity or a commodity is a major fallacy. Although most employers fail to recognize it, *Workers' Compensation is a core business practice and a means for improving the bottom line.*

Rather than diverting attention and finances during periods of lower Workers' Compensation rates to other business priorities, employers can benefit by taking steps to guarantee long-term savings. Here are eight mistakes employers should avoid so they can achieve long-term Workers' Compensation savings.

## **1. Confusing lower premium rates with cost reductions**

Many employers are often surprised to learn that a reduction in rates does not always mean a reduction in costs. Let's begin with a basic understanding of what determines the cost of Workers' Compensation insurance. Unlike other insurance, Workers' Compensation functions like a credit line to finance the costs of injuries. As such, rates alone do not determine the *overall* cost. An Experience Modification Factor (Mod) tailors the cost of insurance to the individual loss performance of an employer. A Workers' Compensation premium is calculated by this formula: Rate x \$100 Payroll x Experience Modifier.

The Mod calculation is complex, but in general, an employer is compared with similar employers in the same industry classification and if past losses are lower than average, a credit rating reduces the premium. Conversely, if past losses are higher than average, a debit rating can actually increase costs in spite of lower rates.

## **2. Becoming complacent**

Declining rates act as blinders for many employers. With lower prices it's easy to shift focus away from injury management and cost containment to other more pressing business matters.

While increased attention to safety led to a decline in the number of workplace accidents, which resulted in fewer claims and lower rates, claim frequency is only one part of the equation. The other part, claim cost including indemnity (lost wages) and medical care, continues to rise.

In many industries where there are tight labor markets, wage gains are expected to trend higher, suggesting further increases in indemnity severity. At the same time, medical care costs have marched relentlessly upward since the mid 1990's.

Even more disturbing is the fact that the growth in Workers' Compensation medical costs has been much steeper than in the health care industry as a whole, indicating that it is not only medical inflation but a mix of services and over-utilization that are driving up costs.

If claims remain open and injury costs escalate, reserves (estimate of ultimate cost of injury) rise and adversely affect the employer's Experience Modification Factor, thus increasing costs. Employers need to understand what is impacting medical costs and measure key metrics such as cost per claim trends adjusted for diagnosis and severity.

## **3. Focusing on direct costs only**

Ask a businessperson how much they spend on Workers' Compensation and almost all will respond with the price of the premium. Yet, the direct costs of Workers' Compensation often represent only 20–30% of the overall injury expenses.

Indirect costs, including overtime, temporary labor, increased training, supervisor time, production delays, unhappy customers, increased stress, and property or equipment damage represent several times the direct cost of the injury. A *2002 Safety Index* report by Liberty Mutual tallied the direct cost of workplace injuries at \$40.1 billion. The total financial impact of both direct and indirect costs was estimated to be as much as \$240 billion.

*Injury costs— both direct and indirect—will have a much greater impact on an employers' overall costs than rate decreases.*

#### **4. Thinking that rates will stay low**

Historically, the Workers' Compensation price cycle has repeated in a predictable pattern – rates decline, insurance is purchased for a lower price, employers shift focus away from Workers' Compensation, claim costs do not fall in relationship to reduced rates and employers' Mod increases, legislative reforms erode or become ineffective, insurance company profits diminish and rates increase.

During a declining rate cycle, the plan expects that if rates go down, so should injury costs. If employers do not manage injury effectively and claims do not go down, the employers' Mod will go up. *When rates rise again, the increased Mod will wipe out any savings garnered during the declining rate cycle.*

#### **5. Viewing Workers' Compensation as an expense**

Employers should recognize that Workers' Compensation is more than a necessary expense; it is a controllable aspect of business that if managed properly will have a measurable and positive return on investment (ROI).

In *ROI Selling*, authors Michael Nick and Kurt Koenig note three measures of ROI: "Return on investment occurs when a company realizes an increase in revenue, a reduction in cost, or an avoidance of cost."

Viewing Workers' Compensation as an ongoing process and not an expense can accomplish all three. When injuries do occur, employers can increase their revenues by getting employees back to work quickly and reduce their costs by managing the injury effectively. By recognizing that Workers' Compensation begins at the date of hire, employers can avoid costs by hiring the right people.

#### **6. Separating Workers' Compensation from Employee Retention**

Retaining skilled employees is one of the most difficult challenges facing businesses today. Turnover is extremely costly. According to estimates it is anywhere from 50% to 150% of an employee's annual salary.

If a work-related injury is not managed properly it can result in the unnecessary loss of a skilled, trained employee. The longer employees are away from the job, the less likely they are to return. Statistics show that if employees are not back to work within 12 weeks, they only have a 50% chance of ever returning.

The fundamental reason for most lost time is not medical necessity but the non-medical decision-making and lack of a process that occurs after an employee is injured. The workplace response is key—studies show that employees’ satisfaction with their employer’s response has a much larger impact on employment stability than does their satisfaction with health care itself. *Being guided by a plan that focuses on communication and return to work will be far more effective than declining rates in both reducing Workers’ Compensation costs and improving productivity.*

### **7. Devaluing your relationship with the insurance company or agency**

In a time of declining rates and new competition, there is a tendency to shop for the lowest price. The insurance industry is not immune to the old adage, “you get what you pay for.” Chasing the lowest rate can result in poor service or having to deal with an insurance company’s unstable finances. In every “soft market” cycle, insurance companies have gone bankrupt and been unable to pay claims. It is critical for employers to investigate the insurer’s stability as well as its long-term commitment to the Workers’ Compensation market to mitigate the possibility of a financial failure.

Furthermore, selecting an agent and carrier with an excellent understanding of Workers’ Compensation is very important. The added benefits of improved hiring practices; medical relationships and comprehensive injury management services will reduce both the number of claims and the costs of claims resulting in a lower Mod. *Unlike declining rates, a reduced Mod is a guaranteed way to drive down costs over the long-term.*

### **8. Measuring the wrong thing**

John Tukey, Ph.D., the prominent statistician, said, “When the right thing can only be measured poorly, it tends to cause the wrong thing to be measured well. And, it is often much worse to have a good measurement of the wrong thing, especially when it is so often the case that the wrong thing will, in fact, be used as an indicator of the right thing, than to have a poor measure of the right thing.”

When Workers’ Compensation is treated as a commodity, the decision is reduced to the lowest possible common denominator – price. This shortsighted approach is equivalent to expecting gourmet food on a fast food budget. If employers are not measuring the true financial impact of work-related injuries, they cannot effectively

manage them.

Viewing Workers' Compensation as a core business practice of comprehensive risk management, the focus shifts from price to tangible metrics that are driving claims costs. With this information, employers can address the underlying circumstances and conditions that are pushing up work-related injury costs and measure the value of their actions.

The declining rate period provides an opportunity and a challenge for employers. The opportunity is to use the "found" money to implement practices that will improve their company and profits – better hiring, injury management and improved education and training. The one constant that separates employers from their competitors is their workforce. The challenge is to protect it.

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