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Risk Management and Safety, Do We Speak the Same Language?

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Introduction

For nearly twenty years now, I have worked in the safety field, training and educating my employers, clients, and coworkers on the need to speak the language of "business management" and not just the language of "safety."

The following provides an overview of why and provides what I hope is some useful information to help the reader improve how his/her organization evaluates safety performance and the "value" the organization is deriving from what we as safety professionals do every day.

There is a reason why safety professionals concentrate their efforts on talking "safety speak." It is primarily because doing so enables us to compare our performance to that of our peer group or Standard Industrial Classification (SIC) code or the more currently reference be to North American Industrial Classification System (NAICS) code. That works fine when we are at an ASSE function, talking to peers, and working with industry groups. But, the "safety" statistics that we provide mean absolutely nothing to senior management, middle management, and the guy on the floor in most organizations. If you think I am wrong, ask them at your next plant or facility meeting. An example question you could pose to the group is, "What is our frequency rate and what does that mean?" I would be willing to bet that about half of the folks in the room may know what your frequency rate is because safety folks proudly post it all over their facilities as a badge of honor if we are below the national average for our class. However, very few will actually know what the number means. In my opinion, safety professionals have done a fine job of advising others what our frequency rate is but have not followed through on the more important task of educating others as to how that number is derived and what it ultimately means to an organization.

How can we be a better steward?

First and foremost we have to learn to speak the language of management. Doing so will enable us to better communicate exactly what improved safety performance means to an organization –

at all levels – including plant or facility staff and senior management. Cost and money is universally understood. Almost everyone in the United States understands the value of a dollar and what can be purchased with that dollar. For organizations in the insurance business, we relate to insurance and the cost of deductibles or retentions as the total cost of risk. Total cost of risk is how much an organization spends in premium to buy an insurance policy and pay for retained losses, (deductable or retention), plus any fees charged by the broker or wholesaler to get the policy. In addition, yet often not considered, is the soft cost impact due to losses. Studies confirm these costs are anywhere from 3 to 7 times the amount of the loss. With that being said, there are two types of insurance buyers. An economic buyer is a person that buys the insurance, usually from a broker and administers the program for the company. Risk managers or CFO's, in most large organizations, are the economic buyer. The user buyer is the person that uses the insurance program, but does not actually buy it. These are usually safety folks, claims folks, or fleet managers within an organization. These folks play a very vital role in the organization, but very seldom know why.

Why is "Cost of Risk" important to safety folks?

The cost of risk for most organization is between two to four percent of a company's revenue. It is the third most expensive part of doing business in most organizations. Personnel and raw materials are usually the top two. Two common approaches to purchasing coverage are the guaranteed cost insurance programs where a policy is purchased and the carrier pays all the claims from the very first dollar or the company will buy an insurance policy where they retain some of the risk. In this latter scenario, the organization will pay all the claims cost within the retention level. Actuarial analysis helps determine what best fits an organization's appetite for risk and helps keep the company from "trading dollars" with the insurance carrier. Smaller premium and larger retentions or deductibles work well for proactive safety organizations. Consider this, when you got your first car most of us purchased auto insurance with a two hundred and fifty to five hundred dollar deductible, if we had full coverage. As we got into the "real world" and our income rose, it was easier to put more at risk, so to speak. Many of my friends and I are very safe drivers and purchase insurance with deductibles as high as two thousand dollars. We would rather have lower premiums every year and assume the risk for any accidents with the resulting deductibles paid out of our own pocket. The commercial workers' compensation, general liability and auto liability insurance programs for corporations work the same way. Why would you pay large premiums if you have a safe environment for your employees? The safer your company, the more the risk manager or economic buyer is willing to put at risk. Planning is everything when it comes to higher risk retention levels. You do not want to have an incident and not have the funds available to pay the claim. To provide for this contingency, most companies will post a letter of credit which ties up available capital that could be used in other areas of the organization.

I have a client that pays nearly two million dollars in premium for a workers compensation policy and they retain the first $500,000 of each and every claim. That means that they could ultimately pay a half a million dollars of each and every workers' compensation claim that they have within their company. There is no stop loss. If they have 50 claims that max out their retention, they could potentially pay out $25,000,000 in losses before the insurance program would pay the first dollar. You can see how important the safety department is in an organization with a high retention level like this. As an organization, they drive safety in the same manner as productivity

and quality. They continuously improve processes and drive culture change in all aspects of the organization, not just safety. This company gets people involved, and speaks a common language relative to safety and cost of risk that everyone understands…the language of money. How much does safety really cost? How would not being safe when doing your job affect the overall well-being of the company? Just like the cost associated with quality and production, well managed companies track safety cost as well as the benefits of having a safe environment and keeping the qualified people involved in the safety process. Most of the employees at this particular client can tell you how much it cost to produce a product and how much workers' compensation cost per item produced. They communicate the information in financial terms. Safety personnel need to communicate our information in the same manner to the risk manager or economic insurance buyer. By communicating "safety" performance in this manner, we are connecting performance of the safety program in a manner he/she will understand, and more important, making that person capable of using our information to make informed decisions. An example of such decisions might be determining the acceptable risk retention level for the organization. If safety professionals communicate the success, or need for improvement, in the company's safety process in this manner, the economic buyer can combine this information with actuarial modeling and the company's financial health to make important decisions.

When things go bad

Being involved in the broker side of the business, I have seen organizations move from a guaranteed cost program to a very high retention program even though their loss history did not support that change. In one example, after changing to a high retention, the following two years were awful for the risk management and safety groups. The individuals in both departments and their staff received poor reviews because losses increased, and therefore the company's "total cost of risk" more than doubled from the previous guaranteed cost premium. The company almost went out of business. Don't make that same mistake. Be prepared with a strong safety culture and a good track record before moving to a high retention program.

What is the language?

Senior management and the risk management department understand:

ROI - Return on Investment is a performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. From a safety standpoint you have to prove to management that the expenditures you want to undertake are going to have a positive return…there is a value to the organization. If there is no value to the organization or other investments offer a higher rate of return, there will be no money for your project.

EPS - Earnings per Share are the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Exercise caution describing the project's impact on EPS unless you are expecting really huge returns on your safety efforts because very large companies have a substantial amount of outstanding stock and a million dollars in savings may be far less than one cent per share of stock.

Revenue growth is an increase of a company's sales when compared to a previous quarter or year revenue performance. The current quarter's sales figure can be compared on a year-over-year basis or sequentially. A great tool for comparing WC, AL, and GL performance is Cost per Unit of Revenue. An ideal situation would be for revenue to increase and the WC, AL and GL cost to decrease. If your revenue increases and the WC, AL, and GL cost decrease, your overall cost of risk will be declining also.

Insurance cost per item produced is a great tool for comparing your workers' compensation, general liability, and/or auto liability claim cost to the products that are produced by your organization. It is a great tool to show senior management that claims cost are coming down or going up as a Rate in relation to the products that are made.

Workers' comp cost as a percentage of payroll is a relationship that many risk managers use to determine if they are best in class, average for their class, or a below average for their class. Risk managers that I have dealt with like this because it tells them what percentage of their payroll is used to pay claims.

All of these are more useful for a risk manager or economic insurance buyer and are in a language that they understand…money. Would you not agree that any of the above forms of reporting are better that recordable rate, frequency rate, or severity rate? Most risk managers or economic buyers do not understand the calculation, why we multiply by a constant of 200,000 and what the resulting number really means to an organization. Incident rates tell us about the lack of safety and do not tell the risk manager anything about the cost of accidents. Can you have a high frequency rate and low loss dollars? Yes. You can use any of the examples noted and the risk manager is going to understand the concepts and the cost associated with the losses at your company. The risk management staff will have a better understanding of your goals and objective and the direction of the safety process.

Additional tools

Benchmarking is a very important tool to any organization. As safety professionals we tend to benchmark using total recordable rate, lost work day rate, first aid rate, near miss rate, labor hour per doctor visit rate, or other rates that are based on man hours worked. These are good ways to measure and I am not telling you to stop measuring that way. Is it possible to have a high recordable rate with low workers' comp cost? The answer is yes. Compensability and recordability are two totally different things. I have had clients that have had a very high recordable rate and lower workers' compensation cost associated with those claims. An additional measurement tool that can be used is to benchmark your losses by using the Risk and Insurance Management Society benchmarking tools. Benchmark your WC, GL, and AL cost per $1000 of revenue. This will give your organization a better understanding of whether your safety efforts are paying off and whether they are getting better as an organization. These additional loss-forecasting tools are beneficial for management because they help in determining cash flow needed to finance a risk. Some examples include:

- Posting of LOC's to pay claims under the retentions
- Should the company increase or decrease retentions?

Impact of Accidents on profits

If your company's profit margin is:

Accident Cost	1%	2%	5%	10%	20%
$1,000	$100,000	$50,000	$20,000	$10,000	$5,000
$5,000	$500,000	$250,000	$100,000	$50,000	$25,000
$10,000	$1,000,000	$500,000	$200,000	$100,000	$50,000
$25,000	$2,500,000	$1,250,000	$500,000	$250,000	$125,000
$100,000	$10,000,000	$500,000$	$2,000,000	$1,000,000	$500,000

This table illustrates the financial impact of on-the-job accidents. An accident that carries direct cost of $1,000 is not "paid for" until a company with a 1% profit margin sells $100,000 worth of goods.

Accident impact on losses

"Do Nothing" Model

Assume Base Year with Developed Total Incurred of $1,000,000 – 200 Claims

Five Year Cumulative "Do Nothing" Cost

$5,666,410 (Assuming 4.2% Annual Inflation)

5% Year Over Year Reduction in Frequency

Five Year Cumulative Total = $4,850,525

Five Year Savings = **$815,885**

At 5% Net Profit Margin **$16,317,706** in Revenue Required to Generate Same Financial Benefit

5% Year Over Year Reduction in Frequency <u>and</u> Severity

Five Year Cumulative Total = $4,174,006

Five Year Savings = **$1,492,404**

At 5% Net Profit Margin **$29,848,075** in Revenue Required to Generate Same Financial Benefit

Take this information to your economic buyer or senior leadership and tell them you need money for a new safety initiative that will affect frequency and severity and see if they will be able to do the math. This is about as easy as it is going to get.

Summary

Educate yourself in the risk management terminology and use that terminology to convey your safety message to the risk manager or insurance economic buyer. Remember that most risk management departments have a seat at the boardroom table. Conveying your message to them in a format that they can use might help you get noticed by the organization. The risk management and safety goals are one and the same. Reducing frequency and severity allows the risk management department to make strategic decisions that could impact the future of the organization. By driving down retained losses and the overall cost of risk, the risk management department will be allowed to increase retentions and therefore free up capital that would have been used for insurance. That capital can then be used to expand operations, buy equipment, hire more employees, or even give you a raise or bonus for a job well done! Convey your organization's safety statistics in a format that management and the employees on the floor will understand. Everyone understands the value of the dollar or the product that you manufacture. Telling your story in way that people understand will get them involved and make they feel like they are part of the process, and the information and statistics will make sense to them. This understanding and buy-in will help to drive continuous improvement and ownership. Employees will understand how they affect the organization.

Work with your risk manger. If you do not know who they are, find out. If your company has cross training or mentoring programs, try getting into the risk management department. Find out how the insurance program is set up. Information is power, and the more you know the more you can tailor your safety efforts to complement and support the risk management objectives. Remember that frequency rates and severity rates are important to an organization, but more important is what the true cost of accidents are to an organization. With management talk their language…MONEY.