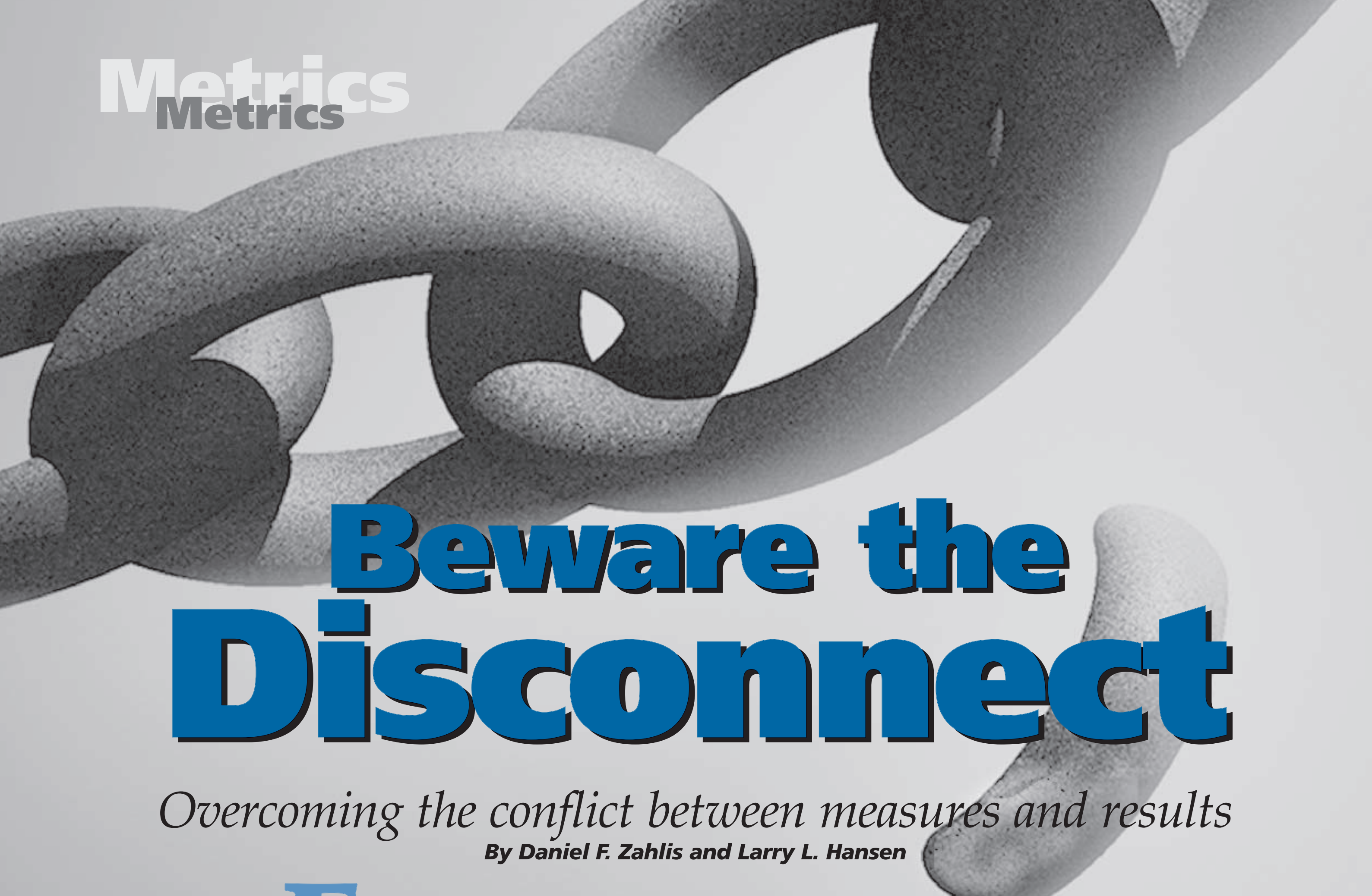

Beware the Disconnect

Overcoming the conflict between measures and results

By Daniel F. Zahlis and Larry L. Hansen

EXCITEMENT WAS IN THE AIR. People were giving each other thumbs-ups, high-fives and Tiger Woods power fists. "Yes! We did it!" was the collective refrain. Safety and health managers assembled from around the country had just heard the company president kickoff the annual SH&E conference with a review of 2004 statistics.

> Ladies and gentlemen, I am indeed proud to be here today. You are to be commended for your efforts, your persistence and your unwavering commitment to keeping an eye on the prize. Due to your great leadership, I am pleased to announce that our organization has achieved a level of safety performance never before attained in the history of this company. We have successfully reduced our incident rates for a fifth consecutive year and, in doing so, have driven our key safety metrics to their lowest levels ever. These accomplishments prove that we indeed have the best programs, the best practices and the best professionals in the business. I hope the remainder of your conference is productive, and I look forward to the opportunity of coming before you next year with even greater news. Thank you all.

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As break chatter subsided, the meeting chair called the group back into session and introduced the next senior manager on the agenda. The CFO took the podium and quickly changed the mood with this sobering message:

> Ladies and gentlemen, despite what you just heard, our workers' compensation program is hemorrhaging loss dollars, our accruals have tripled over the past three years and our loss triangulations are frightful. We must stop the bleeding . . . fast. What you are doing isn't working. It's not about rates, it's about dollars—loss dollars. Figure out what's wrong; figure out why; figure out a strategy; figure out effective measures; and start addressing the real challenge facing this organization—elimination of loss costs that are diverting revenue from reaching our bottom line.

The silence was palpable. This organization had just experienced the "disconnect."

In substance, this was the story recited by the corporate safety executive of a large international corporation during a recent seminar. When he finished, other participants confirmed his experience by reciting similar stories, experiences and frustrations.

One attendee spoke of the success her facility had achieved in attaining the lowest OSHA total incidence rate (TIR) in its history, a rate of 0.5—a number some would "die" for. But before the group could offer any commendation on the achievement, she suggested that is exactly what had occurred—the facility had sustained three fatalities that year. An example of the disconnect.

Another participant from the insurance and risk management industry (a "Big 3" brokerage) offered this insight: "Our clients pay us huge amounts of money to help explain and resolve the discrepancy between their OSHA rates (trending favorably) and their workers' compensation costs (skyrocketing), but there just aren't any good metrics." Another example of the disconnect.

Finally, the corporate safety manager of a large military contractor brought discussions to a conclusion by exclaiming, "What do they expect us to do about it?" Most definitely a sign of the disconnect.

In many organizations, workers' compensation costs continue to plague operations and pose a real threat to corporate profitability. The problems are the same, only now, the answers are different—and, therefore, so must be the strategies and measures used to combat them. SH&E professionals tasked with leading their organizations to higher levels of performance are finding that traditional strategies and prevailing metrics are no longer adequate. A disconnect is evident in safety. It is driven by what is measured (TIR as scorecard) and it is misaligned with what is wanted (cost reduction) in operations.

This disconnect (loss rates in conflict with costs) is not an anomaly, a temporary situation or a condition peculiar to an industry segment or unique geography. Consider the 2004 National Council on Compensation Insurance (NCCI) SOL Report analyzing the state of the line in workers' compensation. The report concludes, "Workers' compensation continues to stand out as a line in need of attention," yet further suggests that "not all is doom and gloom" (Mealey). In this regard, it cites the cumulative decline in claims frequency totaling a 39.7-percent reduction over the past 10 years (Mealey) as a positive development in the line. Although it would be hard to argue that workers' compensation is not in need of attention, the authors adamantly disagree that the continuing decline in claim frequency is a positive development. Instead, it is argued that the decline in frequency is the source of this disconnect.

Despite the 39.7-percent decrease in reported claim frequency (Figure 1), the NCCI report indicates that severe claim rates (fatal, permanent total and permanent partial) have remained relatively flat, while lower-severity claims (temporary total and medical-only) have been reduced significantly (Figure 2). The analysis further shows that the costs of both the medical and indemnity components of these claims continue to escalate dramatically (Figures 3 and 4) (Mealey).

Note the decline in medical-only claim frequency beginning in 1997 (Figure 2) and the steady rate of increase in claims costs depicted over the same period (Figures 3 and 4). These trends are not surprising. The escalation of costs in conjunction with a concurrent decline in frequency evidences the disconnect between reporting criteria and effective claims management practices. In the authors' experience, punitive enforcement (based on rates) encourages underreporting of less-severe injuries, which leads to buried truth and unmanaged exposures in the workplace. These exposures remain unresolved and ultimately manifest as incidents with higher severity and loss costs. It is the "pay me (a little) now or pay me a whole lot more later" dynamic in action.

During the past four decades, two management experts, W. Edwards Deming and Peter Drucker, have emphasized the critical importance of measuring and managing the right things as requisites for business success. These concepts are equally relevant to safety success as well. Deming identified "visual measures only" as one of the five deadly diseases of American management. He cautioned managers to be wary of the dangers of "managing by the numbers." Instead, Deming urged managers to seek profound knowledge (the reasons behind the statistics) by advising them that "numbers are numbers, numbers are not knowledge."

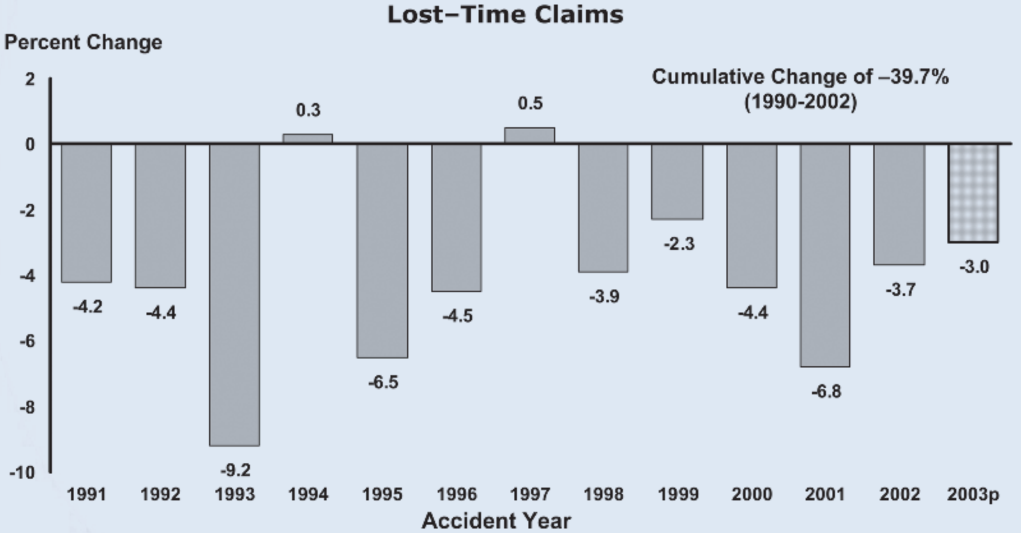
Peter Drucker further cautions American managers not to be misguided by a focus on the wrong numbers. His belief, contrary to that of many managers, is that a management's primary focus should not be on the bottom line, but rather on the critical "middle lines" of a business. He asserts, "The first duty of business is to survive, and the guiding principle of business economics is not the maximization of profit, it is the avoidance of loss" (Drucker).

Loss, also known as cost and expense, is that which a manager can do something about (manage) and by doing so, affect the bottom line. It does not matter how much revenue (top line) is generated in the business if these top dollars are diverted by loss

Abstract: *National data confirm significant reductions in incident rates and lost-time compensable injuries over the past 10 years. Yet, the average cost of medical and indemnity claims continue to escalate. Workers' compensation renewal premiums are increasing, and corporate accrual accounts to fund incurred losses are hemorrhaging in many organizations. This "disconnect" (measures in conflict with results) is pervasive, systemic and inherently fueled by the traditional measures employed to manage safety in the business process. This article examines the reality of this disconnect and discusses the disincentives traditional metrics create. Recommendations derived from actual experience are offered to reconnect effective safety (prevention) and loss (mitigation) practices and strategies.*

Figure 1

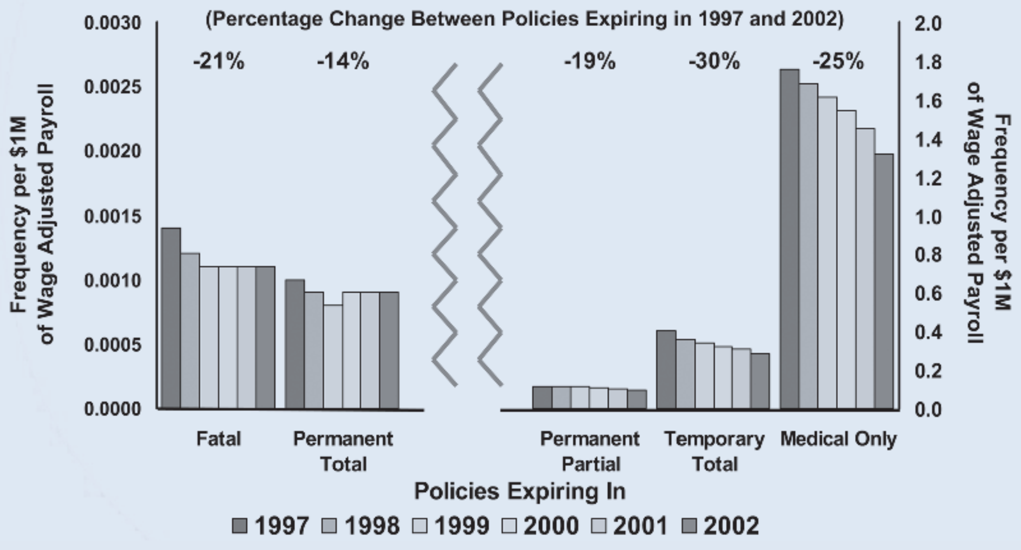
Workers' Compensation Claim Frequency Continues to Fall



Notes: 2003p: Preliminary based on data valued as of 12/31/2003.
1991-2002: Based on data through 12/31/2002, developed to ultimate.
Based on the states where NCCI provides ratemaking services.
Excludes the effects of deductible policies.

Figure 2

Claim Frequencies by Injury Type



Source: NCCI Unit Statistical Plan data

(middle lines) from reaching margin (the bottom line). SH&E (loss/cost) management is not the sole province of the SH&E manager; it is the shared obligation of every manager in an organization. The SH&E practitioner's challenge is to grow organizational ability to control loss/cost by strengthening line manager competency in measuring and managing the right things at all levels.

In "Delivering a 'One-Two' Combination to Flatten the Cost of L.O.S.S.," Hansen premised that accidents (alone) do not drive workers' compensation costs—claims do. If one does not effectively manage both the causes of accidents (things) via an effective safety program and the causes of claims (people) via effective pre- and post-injury management practices, all one continues to achieve are lower loss rates and skyrocketing loss costs (again, the disconnect) [Hansen(b)].

Most agree that the loss control function has two core components: pre-incident prevention (safety) and post-incident loss mitigation (claims). Unfortunately, companies often separate these responsibilities, placing them in human resources and finance. As a result, they end up with competing efforts and metrics—safety gauging success by OSHA rates and claims measuring success by claim cost.

One question begs: "Why does safety attach so strongly to OSHA incident rates while most every other organizational function accepts accountability based on cost metrics?" The answers are many, although none are very good. Following are 10 good reasons why SH&E continues to use poor measures.

Ten "Good" Reasons for "Poor" Measures

Incident rate metrics proliferate because:

- •regulators require them;
- •the SH&E profession tracks them;
- •industry groups compare them;
- •owners base huge contracts on them;
- •authors cite them;
- •rating bureaus use them;
- •executives believe them;
- •managers are rewarded based on them;
- •administrators can manipulate them;
- •using them is easier than performing.

In the authors' opinion, it is all about the ultimate "end game"—when forced to manage by the numbers, managers become highly adept at manipulating the numbers to reward their performance while true results and purpose fail (Hansen and Zahlis).

James Nash has made some notable contributions to this subject, including a November 2004 article, "Weyerhaeuser Fires Plant, Safety Managers for Recordkeeping Abuses," and a January 2005 online article titled, "OSHA Recordkeeping: Overcoming the Hurdles to Honesty." That article begins:

> OSHA recordable injury and illness rates are widely used to assess the effectiveness of workplace safety programs. Yet many observers say the recent five- and six-figure OSHA citations against Weyerhaeuser and General Motors for recordkeeping fraud may just be the tip of an underreporting iceberg affecting much of U.S. industry [Nash(a)].

The article cites corporate safety directors, a corporate medical director, a labor organization leader, safety consultants, a law firm specializing in OSHA compliance and the chief of OSHA's division of recordkeeping requirements. These sources agree that attaching positive and/or negative consequences to the reporting of work-related injuries is a harmful business practice. According to Joe Fortuna, M.D., of Delphi Corp., "I hear people saying, 'We have such a low OSHA recordable rate, but our workers' compensation costs keep going up. What's wrong with this picture?'" [Nash(a)]. Yet again, the disconnect.

Based on such comments, it would be easy to conclude that fewer OSHA log entries are occurring while these unreported OSHA recordables are being captured as compensables on insurance loss runs, thereby driving up costs. Yet, this is not the case as both Bureau of Labor Statistics and NCCI report fewer claims.

With 50 years of combined experience in the insurance and risk control industries, the authors concur with Nash's findings—fewer entries are reaching OSHA logs and insurance loss runs due to incentives and/or consequences that discourage frequency reporting. As a result, organizations (and rating bureaus and regulators) are deprived of enormous volumes of risk data (truth) in their operations. Reality suppressed ensures fewer opportunities for prevention and ultimately enables more severe and costly losses to manifest.

Methods known and observed to manipulate recordability include:

Figure 3

Rate of Change in Indemnity Claim Costs Has Accelerated Since 1995

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Excludes the effects of deductible policies.

Figure 4

Workers' Compensation Medical Claim Cost Trends Continue to Climb

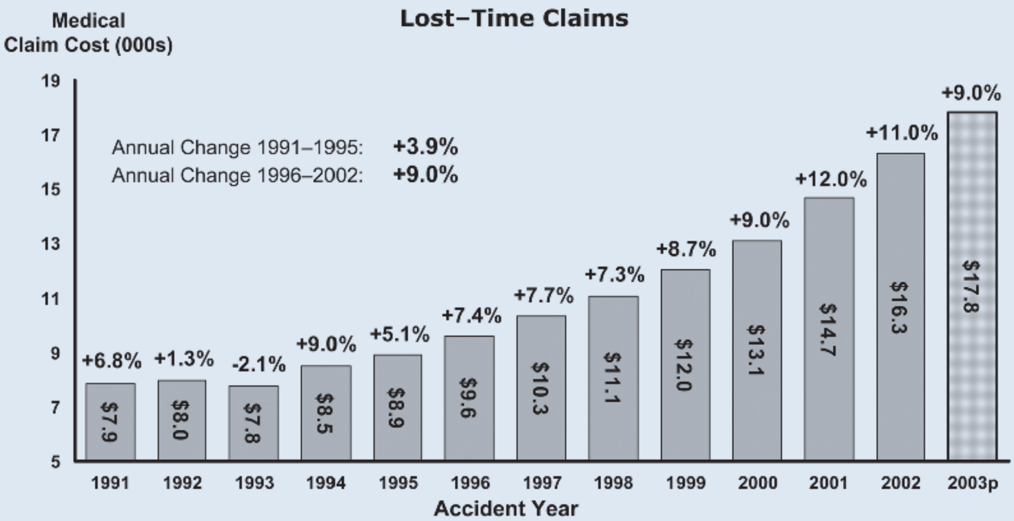

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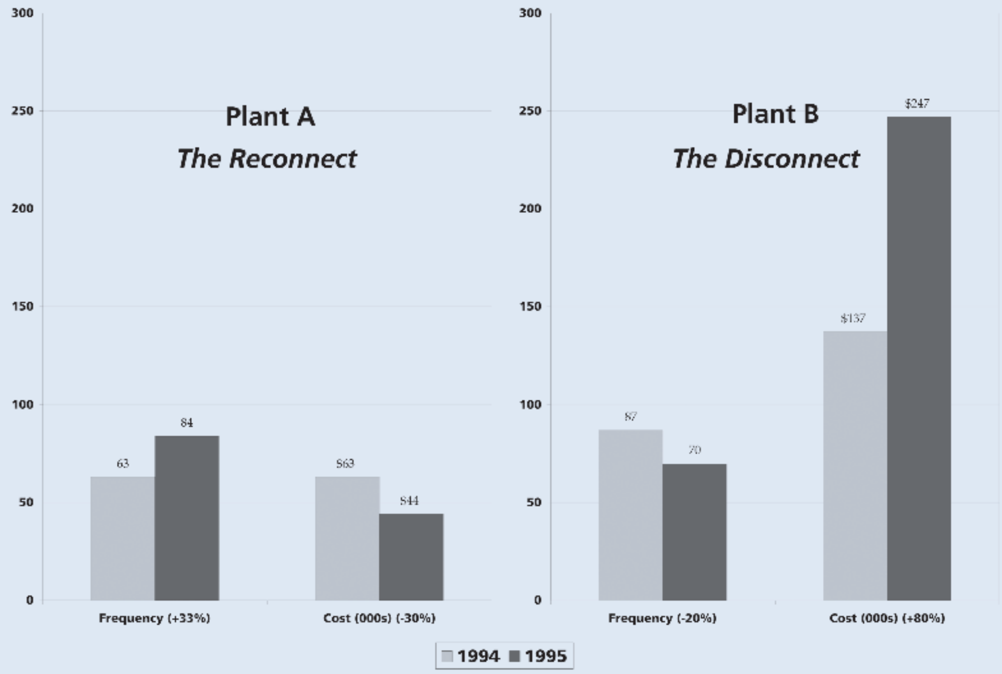
Figure 5

Performance Comparison



Source: Zahlis(a).

- hiring plant nurses to avoid medical treatment by physicians;
- influencing doctor prescriptions;
- charging employees late filing fees for reporting incidents after occurrence dates;
- using modified-duty programs designed to avoid lost-time classifications;
- reassigning injuries to prior incidents to avoid logging requirements;
- controlling employee choice of medical provider to retain control over treatments;
- using first-aid logs to capture injuries that often worsen because there is no early intervention.

Manipulating reporting to avoid recordability fuels employee resentment, which fuels human resources adversity (desire to get even). In turn, adversity fuels abuse (opportunity to get even), which fuels litigation, which exposes the company's funds to the legal system. Employees become conditioned to enter the workers' compensation system as incredulous claimants, more often becoming litigants. Litigation fuels cost.

OSHA recording criteria is not the only reason why claim costs are escalating. Ironically, insurance experience modification formulas also discourage reporting. Every injury reported has a direct financial impact on the employer via the multiyear punitive impact on the experience modification rate.

Time for New Thinking

The 1995 article, "Caution: Beware of OSHA Statistics" was based on actual industry experience that led to quantifiable and reproducible results, premised on the belief that an inverse relationship exists between incident rates and loss costs—that is, the higher the incident rate, the lower the cost incurred [Zahlis(a)].

The article shared the author's experience as a divisional risk manager hired by a large global food conglomerate to help an operating unit of a larger organization (Plant A). The plant was experiencing high workers' compensation costs and a higher-than-average OSHA recordable rate.

An initial assessment determined that Plant A employed no SH&E professionals and that its leadership had deemed safety to be a line responsibility with various program responsibilities distributed across many functions in the organization. It was easy to realize that Plant A had it right and had developed a healthy, well-integrated safety culture based on partnering. The challenge was to determine what was driving the high costs and recordable rates.

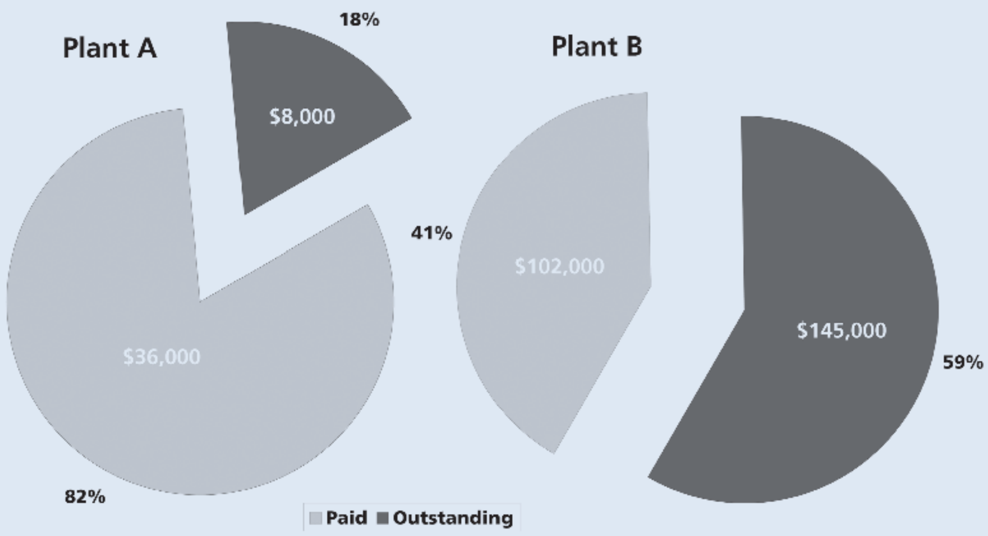
It was quickly recognized that the high costs were because of a lack of local management involvement in the claims administration process, along with underqualified personnel and disrespectful (disregard for claimant) practices by claim administrators. Claims for the California facility were administered at the corporation's Midwest headquarters. The solution was evident: Bring the locus of claims control to the local facility where management could be better informed, advocate on behalf of injured workers and insist on treatment that exceeded legal minimums in order to optimize medical improvement and regain employee trust. Efforts were initiated to achieve this.

As for the high OSHA recordable rate, review of injury logs revealed that the facility did not fully understand the criteria for recordability. This led to many unnecessary entries—which was actually good. Over the next few months, employees were trained to understand the process and myths of the workers' compensation system. They were openly advised of their rights and entitlements under workers' compensation, taught how money moves through the system, how claims costs grow through litigation and forensic medical opinions, and how high costs negatively impact the company. Employees were also taught the dangers of litigation (to the company, their relationships and their livelihood), and were introduced to free advocates offered by the state of California.

This process uncovered deep-seated employee resentment toward the company based on the incident rate measurement and incentive program imposed by the global parent. As the facility began to focus on real issues rather than statistics, and employees began to witness the advocacy of local management on their behalf within the workers' compensation system, they began to open up and

Figure 6

Claim Payments



Source: Zahlis(a).

identify numerous injuries (and injury-causing conditions) that had gone unreported due to pressure associated with the incident rate measure. The truth finally started to emerge—many injuries had been sustained, just not reported.

In response to this feedback, incentives tied to OSHA recordables and reports based on incident rates were discontinued. Employees were encouraged to report every incident and near-hit immediately. In fact, reporting was "incentivized." The more Plant A knew, the more those involved could preemptively manage risk.

The OSHA recordables and claims increased significantly, but another result also occurred—costs began to decrease. Plant A was managing a large book of low-severity claims; it was attacking the causes of injuries and was closing claims almost as quickly as they were filed. One year later, Plant A had achieved a 33-percent increase in reported frequency and a 30-percent reduction in costs—all in the volatile workers' compensation environment present in California.

A sister facility (Plant B) of the same business unit followed a more traditional approach. It had hired a safety coordinator, centralized program responsibilities under that person's supervision, and adhered to traditional practices and OSHA recordable rates. Plant B won a corporate safety award for those efforts and was rewarded with a plantwide celebration attended by corporate dignitaries. The facility met its goal of reducing its OSHA recordable rate by 20 percent. In the process, however, its loss costs increased 80 percent (Figure 5).

By the end of the year, not only had Plant A reduced loss cost by 33 percent, it had also closed 82 percent of claims compared to Plant B's 41 percent (Figure 6). Plant A had become the second-least-expensive facility in the company's global network, just behind a small facility in Idaho.

Reconnecting to High Performance

Given this, SH&E professionals need to work toward generating a body of preemptive risk knowledge about their organizations. They need to gather data through suggestions; feedback (reinforcing and constructive); hazard reports and abatement status; audit discrepancies and mitigation status and employee satisfaction surveys. Other relevant data include incident details such as nature, source, location, task at time of incident; employment practice complaints; incentives awarded (based on quantifiable actions); values threats; supervisor success in motivating more reporting of these metrics; and any other upstream data that guarantee safety success by aggressively predicting and preempting failure (cost).

Incentives and enforcement based on statistics should also be eliminated. When evaluating safe versus unsafe, consider equations that involve claim cost because such measurements are in sync with other business metrics and encourage increased reporting of incidents, proactive prevention activities and good claims management practices directed by local employee advocates. When looking for advocates, recruit employees who grew up in the area and know their coworkers and families personally.

For companies interested in reconnecting safety with cost control, the authors recommend the following steps in order:

1) Take back control of the claims management process. Insurance companies do not favor this so it will require assertive action. Companies may also need to explore the alternative risk financing market. This market consists of self-insurance, high-deductible programs, risk retention groups, captives and other risk financing plans that allow employers to have a more direct impact on the claims management process. The key is to maintain control over performance by retaining a contractual right to cancel services.

2) Locate the claims management administrator within the geographical jurisdiction where claims will be adjudicated. Identify third-party claims administration companies located within the surrounding community and work toward hiring one of these firms. Local administrators are more knowledgeable about the network of doctors, attorneys and service providers practicing in a given area and they can more effectively identify system abuses.

3) Require the company's insurance carrier or adjuster to learn about a company's plant, its employees and corporate values. Schedule regular site visits and invite injured workers to meet face-to-face with the adjusters. It is also important to remind the adjuster that employees will heavily influence their contract renewal by participating in an annual survey of the adjuster's performance.

4) Require adjusters to attend workers' compensation hearings rather than hire defense attorneys, unless absolutely necessary. Attorneys on both sides

Plant A was managing a large book of low-severity claims; it was attacking the causes of injuries and was closing claims almost as quickly as they were filed.

Fewer entries are reaching OSHA logs due to incentives and/or consequences that discourage frequency reporting. As a result, organizations are deprived of enormous volumes of risk data in their operations.

can add to problems and both benefit from prolonged disputes. Claims adjusters are knowledgeable of administrative rules and most hearings are simply casual conversations between the parties in a courthouse lunchroom. If possible, ride to the hearing in the same car as the injured worker.

5) Grant the power of advocacy and budget authority to the leaders closest to employees. Insurance companies come and go based on market conditions and rate fluctuations. A company's supervisors, team leaders and workforce will remain employed well after the workers' compensation claim and local managers have moved on. Granting authority to resolve claims to local supervision will enhance business continuity and eliminate the disruption (distrust) that is inherently associated with cyclical insurance adjusters and management.

6) Educate leaders on the importance of their advocacy—and the power of their trust-building behaviors. Train local leadership about the importance of trust in controlling medical costs and reducing litigation. Help local managers understand that the workers' compensation system is used effectively as a "push back" system and rising costs can be controlled by eliminating the desire to "push back."

7) Exceed workers' compensation mandates that lead to litigation (e.g., medical controls, benefit delays). Rather than require an injured worker to exceed a three-day waiting period to begin receiving indemnity benefits, start paying on day one and save days two, three and four.

8) Rather than require an employee to see the "company" doctor, allow him/her to see a doctor s/he trusts and work with that doctor to return the employee to work when it is in the employee's best interest—even if it costs a few days of indemnity payments to save thousands of dollars in forensic medical bills and attorney's fees.

9) Talk with workers honestly about their feelings toward OSHA recordkeeping. Hold town-hall-style meetings to let everyone express their concerns.

10) Eliminate measurements and incentives tied to OSHA rates. Eliminate all signs from the workplace that quote the number of hours worked without a lost-time accident. Be prepared to explain the increase that will occur once the process detailed here has begun. Based on the authors' experience, OSHA compliance officers generally understand when they observe high frequencies of low-severity events in conjunction with effective programs and a positive culture.

11) Develop an information system capable of capturing, tracking and trending large amounts of operational risk data and converting those data to knowledge, and knowledge to action. Distribute ownership of the system so that all levels of the organization can enter data directly and browse operational performance. It is amazing what people with differing perspectives can extract from the same set of data.

12) Share learned knowledge by posting risk discoveries, dialogues and activities of every functional type (e.g., safety, operations, quality, labor relations) in high-traffic areas. Never assign a functional title (e.g., safety report) to these postings. Keep the information timely and specific to local operations. The information should be an accurate and truthful reflection of what the culture already knows (e.g., 60 percent of inspection deficiencies are recorded by supervisor A; 80 percent of suggestions are submitted by employees of manager X; 72 percent of incentives are awarded to employees of manager Z).

13) Educate employees about the workers' compensation system, their entitlements, the company's approach and its perspective on the importance of reporting everything. Show employees how dollars flow through the system and how the "pie" grows when a claim is litigated. Show employees how their "slice" does not grow commensurate with the cost of the claim and ask employees to volunteer their experience. Invite employee advocates from the state to help educate employees. Illustrate how a high frequency of low-cost claims is the best approach to prevent more severe losses.

14) Conduct regular and frequent claims meetings. Meeting attendees should include the local employee advocate, the injured worker (at his/her option) and the claims adjuster. Do not invite anyone who benefits financially from the loss.

15) To achieve lower loss cost, measure what is needed—better management. Begin tracking average cost per "anything and everything" that needs to increase in order to achieve better results—more reporting (hazards, concerns, complaints, threats, incidents); more communication (postings, flyers, town-hall meetings); and more involvement (teams, suggestions, audits). At the very least, use average cost per incident reported (regardless of severity) because such a metric encourages cohesiveness between prevention and claims management.

Do you have the courage to pull the switch to reconnect safety (prevention) with claims management (cost reduction) and create a clear path to the higher ground of excellence? ■

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