Loss Control Department

Technical Information Paper Series

Controlling Workers' Comp Costs:

Using Cost Allocations and Safety Incentives

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Controlling Workers' Comp Costs:
Using Cost Allocations and Safety Incentives

As with most things in life, a good safety program requires continuous commitment and maintenance. It is one thing to find a dedicated safety director to accept this on-going challenge, and still another to have the rest of management and the work force adopt a similar dedication to safety. Two ways to help create more enthusiasm and support for safety within an organization are through the *allocation of insurance costs*, and by establishing *safety incentives* at various levels.

Allocating Insurance Costs

Allocating insurance costs for each of a company's profit centers is a quick way to educate managers about the importance of controlling accidents. Under this plan, insurance expenses become a direct part of the managers' budget, as opposed to merely an obscure number handled only by the CFO at the end of the policy period. For single location businesses, the insurance expense can be spread across key departments. With larger multi-location businesses, it is also possible to devise a reasonable approach for allocating insurance premium charges.

The most equitable way to do this is to use a formula that includes loss exposures (e.g., number of employees, number of units sold, number of square feet of building space occupied, etc.), along with a fair way to factor in the individual accident experience for each location. This approach is illustrated in the table below, that depicts the ABC Corporation which has five plant locations.

Table 1 Allocating Insurance Premiums (ABC Corporation)

Loc.	Exposure Base (60%)			Accident Frequency (25%)			Accident Severity (15%)			Final Premium
	No. of Units	% of Base	Premium Load	No. of Claims	% of Base	Premium Load	Claim Dollars	% of Base	Premium Load	
1	64,000	42%	$126,000	30	43%	$53,750	$128,000	45%	$33,750	$213,500
2	40,000	26%	$78,000	17	24%	$30,000	$75,000	26%	$19,500	$127,500
3	20,000	13%	$39,000	12	17%	$21,250	$47,000	17%	$12,750	$73,000
4	15,000	10%	$30,000	7	10%	$12,500	$24,000	9%	$6,750	$49,250
5	14,000	9%	$27,000	4	6%	$7,500	$8,000	3%	$2,250	$36,750
TOTAL	**153,000**	**100%**	**$300,000**	**70**	**100%**	**$125,000**	**$282,000**	**100%**	**$75,000**	**$500,000**

Table 1 shows that the total insurance premium allocated for these five related plant locations is $500,000. Senior management at ABC Corporation uses three major factors to calculate the insurance premium allocations: (1) Exposure Base, (2) Accident Frequency, and (3) Accident Severity. ABC Corporation has also decided that in splitting up the total premium for the Corporation, 60% of the premium will be based on

the Exposure Base, 25% on Accident Frequency, and 15% on Accident Severity. This means that the total insurance premium of $500,000 would be divided initially as follows:

60% Exposure Base	x	$500,000 Premium	=	$300,000
25% Accident Frequency	x	$500,000 Premium	=	$125,000
15% Accident Severity	x	$500,000 Premium	=	$75,000

Once these three basic premium subgroups have been established, the next task is to calculate the appropriate premium allocations for each of the five plants. The first element used is the Exposure Base, which in this case factors in the total units sold for each of the five locations. This approach tends to level the playing field for the smaller locations which should have a correspondingly smaller risk factor than the larger operations. In the table above, Location #1 is the largest operation with 64,000 units sold annually. This sales volume represents 42% (64,000 units/153,000 units) of the total sales for the five locations combined. Using this approach then, location #1 would pay 42% of the premium set aside for the Exposure Rating (that is, 42% x $300,000 = $126,000).

For the second premium allocation factor, ABC Corporation has determined that the next 25% of the total premium should be spread across the five locations based on their accident frequency records. Out of the 70 total accidents for the Corporation, Location #1 has had 30 claims or 43% of the total frequency. For this reason, Location #1 will be assessed 43% of the $125,000 of premium that has been allocated for accident frequency (that is, 43% x $125,000 = $53,750).

Finally, ABC Corporation has decided that the remaining 15% of the total $500,000 premium will be charged back to each location based upon their accident expenses for the year. In this case, Location #1 has had 45% of the accident expenses for the Corporation ($128,000/$282,000), and will be charged with that portion of the $75,000 set aside for Accident Severity (45% X $75,000 = $33,750). To keep large shock claims from skewing the severity numbers, a company can use a predetermined limit per individual claim or set an aggregate total loss limit per location.

Safety Incentives

A second way to make job safety more of a daily focus for management and workers is through safety incentives. The most traditional approach with safety incentive plans has been to offer some form of recognition, prize, or monetary reward for groups or individuals who meet predetermined safety accomplishments (e.g., number of days without a lost time accident, a certain percentage reduction in vehicle accidents; etc.). Some companies have found it effective to use a series of progressive drawings where eligible participants can win bigger prizes as the contest period goes forward. Whichever form of incentive plan is selected, a company often experiences a high degree of worker motivation at the start of the program, and a diminishing return thereafter. Sometimes, too, employees begin to feel that they are *entitled* to certain safety incentives, and

subsequently experience negative attitudes if incentives are reduced or eliminated at a later date.

A newer form of safety incentive that is gaining in popularity has to do with individual bonuses based on performance. For department managers and supervisors, this may take the form of an end-of-the-year bonus based on how well their units did in controlling accidents. Since zero accidents is usually not a realistic goal, payouts may be based on reducing the frequency of accidents by an agreed upon percentage.

For example, the Warehouse Department of XYZ Company has been having problems with material handling strains. For the past three years, this Warehouse Department has averaged 12 strains annually. To encourage the manager of this Department to reduce these costly claims, management has implemented this safety bonus plan for the coming year:

Number of Strain Occurrences	Specified Bonus
12 or greater strains	No bonus payout
9-11 strains	1% of gross annual salary
6-8 strains	3% of gross annual salary
3-5 strains	5% of gross annual salary
< 3 strains	7% of gross annual salary

In addition to the bonuses paid to effective department managers and supervisors, some companies also build safety incentives into annual performance shares for all workers. Production workers who achieve specific quality and quantity quotas for production, while avoiding costly accidents or safety violations, can realize increased merit increases at the end of their performance period. Sales people who operate company vehicles can be eligible for safety payouts based on how well they avoid moving violations and vehicle accidents. When senior management of a company places great emphasis on job safety, and is willing to offer meaningful incentives to encourage safe performance, they can anticipate success with their safety program.

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