

Workplace Possibilities<sup>SM</sup>

# PRODUCTIVITY INSIGHT #2

## Health-Related Lost Productivity: The Full Cost Of Absence

Workplace Possibilities, by The Standard

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Standard Insurance Company





## Introduction To Productivity Loss

Traditionally, absence and disability management programs have been marketed with claims of increasing the productivity of the employer's workforce. The challenge is how to translate these programs and services into *specific* employer productivity gains. How does productivity get "lost"? How can this loss be quantified? How much can a provider's program reduce the productivity loss?

This *Insight* explores the productivity loss caused by employees who are away from work for medical reasons (absence and disability). Future *Insights* will address the productivity loss caused by employees at work with medical conditions, i.e., presenteeism. Collectively, they're known as Health-Related Lost Productivity (HRLP).

## Indirect Costs Have A Direct Impact

The costs of absence and disability may be perceived as inconsequential compared to the costs of employer-sponsored health plans. A primary reason for this view was that most providers and employers did not consider the indirect costs of absence and disability, but only measured the direct costs of related programs, including the following:

- Sick leave
- Salary continuation
- Paid time off banks
- Short term disability (insured, self insured, self insured/self administered)
- Long term disability
- Leave of absence (includes Family Medical Leave)
- Extended illness banks

## Research And Surveys On The Cost Of Absence And Disability

A study by researchers at Cornell University estimated that the total cost of absence in teamwork environments averaged 1.3 times the wages/salary of the absent employee.<sup>1</sup>

In 2008 and again in 2010, the workforce management company Kronos and employee benefits consulting firm Mercer published survey reports entitled "The Total Financial Impact of Employee Absences."<sup>2</sup> These studies estimated the full cost of absence and disability at approximately nine percent of payroll. Compare that to a 2010 Mercer survey<sup>3</sup> that estimated the cost of employer-sponsored health plans at 13.6 percent of payroll. Comparing those two figures shows the full cost of absence amounts to 66 percent of the cost of health care plans.

1 "Measuring the effects of work loss on productivity with team production," Sean Nicholson, Mark V. Pauly, Daniel Polsky, Claire Sharda, Helena Szrek and Marc L. Berger, Health Economics, Feb. 2006, Article first published online: 30 SEP 2005 | DOI: 10.1002/hec.1052.

2 Kronos/Mercer, The Total Financial Impact of Employee Absences, 2008, 2010.

3 Mercer Survey Report on Employer Sponsored Health Plans, 2010.

The purpose of this *Productivity Insight* – the second in a series – is to help human resource professionals, brokers and consultants develop a better understanding of how programs for managing absence and disability in the workplace affect workforce productivity.

The full cost of absence averages close to nine percent of payroll.<sup>4</sup>

At last, the cost of absence and disability were no longer seen as inconsequential.

The Kronos/Mercer survey postulated three types of absence:

- **Incidental absences:** under five days in duration, e.g., calling in sick, vehicle problems on the way to work, etc.
- **Extended disability absences:** five days or longer in duration, taken for medical reasons, often involving job protection programs like Family Medical Leave (FMLA)
- **Planned absences:** holidays and vacations (not included in the total cost of absence and disability as described in this paper).

The survey then defined two types of costs:

- **Direct costs:** These include income replacement payments given to an absent employee by the employer (as in sick leave, salary continuation, etc.) or by a disability carrier (as in STD). Direct costs are often tracked by the employer or carrier.
- **Indirect costs:** These comprise the other consequences of employee absences and include:
  - Lost productivity
  - Overtime
  - Temporary staffing
  - Working slow
  - Replacement training
  - Late deliveries
  - Customer dissatisfaction
  - Variable product quality

These indirect costs can be significant but are difficult to track. However, they represent the major costs and impacts of absence, and are quite different for each employer.

<sup>4</sup> Kronos/Mercer, The Total Financial Impact of Employee Absences, 2008, 2010.

## How Does Productivity Get Lost Through Employee Absence?

The Kronos/Mercer survey found that among non-exempt employees, the work must usually continue even if an employee is absent, and this is where the production loss occurs. The employees left behind to do the work are 21-29 percent less efficient and they are 15-44 percent more expensive than the absent employee.<sup>5</sup> Potential reasons for these high productivity losses include:

- Less efficient replacement workers – due to less knowledge of the absent employee’s job, or fatigue related to overtime
- More expensive replacement employees – due to overtime pay, temporary contract workers, or higher-paid employees such as supervisors doing the work

Given these findings, let us see how they play out for a prototype employer’s gross profit when a non-exempt employee is away on an extended disability absence.

### Higher Cost And Lower Productivity = Lost Profit

Jane At Work	Salary Cost	Value Of Goods Produced	Gross Profit
	\$100	\$200	50%

Jane Absent	Replacement Worker Cost	Value Of Goods Produced	Gross Profit
Extended disability absence	\$115	\$158 (21% production loss)	27%
Extended disability absence	\$144	\$158 (21% production loss)	9%

### Profits When “Jane” Is At Work

In the example shown, when Jane is at work, she produces \$200 worth of goods and is paid \$100 for each day worked. The employer’s gross profit is 50 percent.

### Productivity Costs When “Jane” Is Absent

When Jane is away on an extended disability absence (five days or longer), the estimated productivity loss that ensues, caused by others doing her work, is 21 percent, and the individuals doing the work cost from \$115 - \$144 per day. Consequently, the employer’s gross profit from that day’s work may drop to 27 percent or even lower to nine percent. The loss is due to the indirect costs of Jane’s absence, and a major component of that is **lost productivity**.

### The Solution?

Reduce the duration of Jane’s extended disability absence, which will lower both direct and indirect costs and protect the employer’s gross profit.

Replacement workers are 21-29 percent less efficient and they are 15-44 percent more expensive than the absent employee.<sup>5</sup>

<sup>5</sup> “Survey on the Total Financial Impact of Employee Absence,” Kronos/Mercer, 2010.

The Standard's Workplace Possibilities program is a unique, proactive approach to helping employers reduce absence and disability-related costs.

## Reducing Productivity Losses Through Workplace Possibilities<sup>SM</sup>

One solution to address Health-Related Lost Productivity is The Standard's Workplace Possibilities program, a unique, proactive approach to helping employers prevent and manage employee absence and disability. A Workplace Possibilities on-site consultant helps to connect employees with their health management programs and identifies opportunities to keep at-risk employees on the job or return them to work faster. In doing so, the program delivers rapid and measurable reductions in absence- and disability-related costs.

In 2011, Workplace Possibilities reduced extended disability absences for 81 employers by an average of 39 days for every employee the program helped return to work (RTW).

In total, the program saved employers \$4.7 million in direct costs. Most of these savings were related to extended disability. As we have discussed, the direct costs do not represent the total costs as identified by Kronos/Mercer. Their survey found that the ratio between direct costs and total costs of extended disability absences is 1:4.7.

Using that ratio, the calculation for the total employer cost savings generated by Workplace Possibilities for extended disability absences is estimated at:

$$4.7 \times \$4,700,000 = \$22,090,000$$

In other words, when we calculate the total cost savings generated by Workplace Possibilities in 2011, it amounts to an estimated \$22.09 million for 81 employers.

## 2011 Workplace Possibilities Program Results<sup>6</sup>

Workplace Possibilities Program	2011
Total groups with Workplace Possibilities	81
Total employees covered by Workplace Possibilities	412,000
Average reduction in lost time per employee that participated in the program	39 days
Total RTW benefit cost savings	\$4.7 million
Total employees assisted with services	RTW: 2,022 SAW: 845

<sup>6</sup> As of December 31, 2011, based on internal data developed by Standard Insurance Company.

## Case Study: A Medical Equipment Distributor

One example of Workplace Possibilities in action is the case study of a national medical equipment distributor with over 500 branches nationwide. The company had no strategic process to manage absence/disability. The chart shown here highlights key issues and results.

Challenge
Inadequate communications
Managers required employees to RTW at 100%
Employees were terminated after 12 weeks of FMLA if unable to RTW at 100 percent
Results
Workplace Possibilities helped develop a transitional RTW program with timely communications
In first 9 months, <b>114</b> employees successfully returned to work through transitional duty program
Reduction of <b>3,597</b> absence and disability days
<b>\$311,116</b> in short term disability benefit direct cost savings
Overall <b>38% reduction</b> in expected disability duration

It is time for employers and their brokers and consultants to begin focusing on the cost of absence in addition to the cost of health care.

## Addressing Absence Costs – A Real Opportunity

To summarize, we began by examining the cost of absence, which adds up to 66 percent of the cost of employer-sponsored health care.<sup>7</sup> Now that we've explored some of the interconnected ways absence affects productivity, it's easy to understand why it's difficult for employers to measure and track their indirect and total costs.

But if brokers and consultants inquire as to how their clients experience overtime, replacement worker and other indirect costs, they will find employers only too willing to talk about them and their beliefs that these costs are real, if not easily measureable.

It is time for employers and their brokers and consultants to begin focusing on the cost of absence in addition to the cost of health care. The rewards may be substantial and be reflected in productivity gains in the workplace, as well as a healthier bottom line.

<sup>7</sup> Kronos/Mercer, The Total Financial Impact of Employee Absences, 2008, 2010.



## About The Workplace Possibilities Program

The Workplace Possibilities program is a unique, proactive approach to helping employers prevent and manage employee absence and disability. A Workplace Possibilities consultant helps to connect employees with their health management programs and identifies opportunities to keep at-risk employees on the job or return to work faster. In doing so, the program delivers rapid and measurable reductions in absence- and disability-related costs. For tips and tools HR professionals can use to help re-imagine the way they manage absence and disability, visit [www.workplacepossibilities.com](http://www.workplacepossibilities.com).

## About The Standard

The Standard is a leading provider of financial products and services, including group and Individual Disability Insurance, group Life, AD&D, Dental and Vision insurance, retirement plans products and services, individual annuities and investment advice. For more information about The Standard, visit [www.standard.com](http://www.standard.com).

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