

The Business Case for Managing Health and Productivity

Results from IBI's Full-Cost Benchmarking Program



Research by the Integrated Benefits Institute

June 2004



This report reflects the results of the Integrated Benefits Institute's Full-Cost Benchmarking Study for participants' health- and absence-related benefits programs in 2002. Participants in 11 industry groups report aggregate data on short-term disability, long-term disability, group health, workers' compensation, incidental absence and family and medical leave programs. In addition, companies report on demographic and benefits plan characteristics and key business metrics.

IBI's participant reports are unique in several ways. IBI calculates and reports the lost productivity that results from absence so that participants can target and report their full ROI from health and productivity interventions. In addition to out-of-pocket payments by benefit program, IBI shows results across programs to help detect cost shifting. IBI also reports company results in terms of key business metrics important to senior management to assist in getting their attention and approval for program improvements. Finally, IBI compares results across industry groups and against best-in-group performers to demonstrate what is "left on the table" by those that don't perform as well.

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The **Integrated Benefits Institute** is a national, non-profit organization supported by employers, consultants, insurers, healthcare providers, disease management firms, third-party administrators, pharmaceutical companies, behavioral health providers and others having an interest in health and productivity management through integrating employee benefits.

To best serve the needs of employers and employees, IBI identifies and analyzes health and productivity issues as they cut across traditional benefits programs of group health, workers' compensation, and non-occupational lost time. IBI's programs include research, an integrated benefits educational forum and Full-Cost benchmarking to monitor benefits down and across programs and up to bottom-line business effects.

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Results from IBI's Full-Cost Benchmarking Program

Principal Findings

- **Full Costs of absence are more than four times total medical payments** for employers in IBI's Full-Cost Study when the productivity lost from absence is added to wage replacement payments. When *only* payments are considered, however, group health averages 63% of total payments.
- **Two-thirds of the Full Costs of benefits in the study are in the two programs that frequently are unmanaged** for employers: incidental absence and short-term disability.
- **Full Costs of health- and absence-related benefits amount to 129% of net income and 30% of payroll** for study participants.
- **Absence-related costs alone amount to 76% of net income when Full Costs are considered**, including lost productivity from absence and wage replacement benefits.
- **On average, employers leave an equivalent of 85% of net income on the table in excess benefits costs** compared to companies with best-in-group performance in industry comparison groups.



Background

The Squeeze Is On

Trimmed corporate budgets and constrained income statements are putting benefits and risk managers under the gun to cut their costs or otherwise prove their value to the corporate bottom line. With medical costs soaring, workers' compensation costs growing apace and the general health of American workers declining, the squeeze is on. The situation demands creative solutions, especially when cost shifting to employees is near the bottom of CFOs' preferred benefits management and delivery strategies.¹

Health and productivity management initiatives can help meet these stubborn cost drivers. But benefits managers need senior management buy-in to fund such investments in human capital. Approval will be slow in coming, however, if employers don't know their current, Full Costs of absence, lost productivity and health; don't know how those costs compare to others in their industry; and can't assess the magnitude of those differences.

IBI's recent release to participants of its 2002 benefit year Full-Cost Benchmarking Study results provides much of the necessary information and tools they need to:

- Assess their true costs of health, disability and absence-related benefits, including lost productivity from absence
- Put those costs into context across benefits programs
- Compare their costs to those of industry peers
- Express the benefits burden on the key business indicators important to senior management
- Quantify the benefits-delivery business disadvantage they suffer compared to employers providing best-in-industry-group performance

¹ *On the Brink of Change: How CFOs View Investments in Health and Productivity*, Integrated Benefits Institute, December 2002. www.ibiweb.org/publications/research/33

Who Are They?

IBI's Full-Cost Study summarizes these comparisons for the 88 employer participants that together had:

- \$1.26 trillion in total operating revenue
- \$190 billion in payroll
- 3.3 million full-time equivalent employees (FTEs)
- Net income for profitable companies: \$67 billion
- Net loss for unprofitable companies: (\$91 billion)

Payments Versus Full Costs

The Traditional View

Most benefits administrators still tend to view costs in their programs as out-of-pocket payments alone. Group health payments—shown here without dependent coverage costs—predominate. Although most probably recognize the existence of lost productivity resulting from employee absence—inefficiencies in production, overstaffing, missed contracts or decreased worker morale—they likely view such costs as unquantifiable or buried somewhere in corporate good will.

This narrow view of benefits costs focuses on group health as the principal benefit cost-driver. Such a view channels corporate resources and concern into reducing medical costs, often causing medical treatment to be viewed as a cost to be minimized instead of being treated as an investment in employee health.

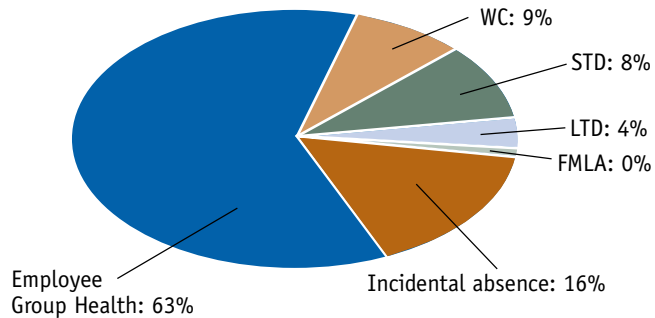
Quantifying Lost Productivity

What's worse, a traditional view causes employers to ignore the principal benefits cost driver: lost productivity from absence. Over the past five years, IBI has learned that many of these hidden costs from lost productivity can be quantified and are likely to have a significant impact on a company's operating income.

Employers use a variety of means to respond to employee absence, with some approaches doing a better job to minimize lost productivity than others. Employers can keep excess staff on hand to fill in for absent workers. If employers were able to replace every absent worker with a substitute worker from excess staff, study results show that the cost would amount to \$2,929 per FTE as shown in Column A. Such costs include wages, benefits and training new workers. This would be the least expensive method of dealing with absence, but is highly unlikely, since employers can't know which employees will

Traditional View: Paid Benefits

(2002 Benefits Data)

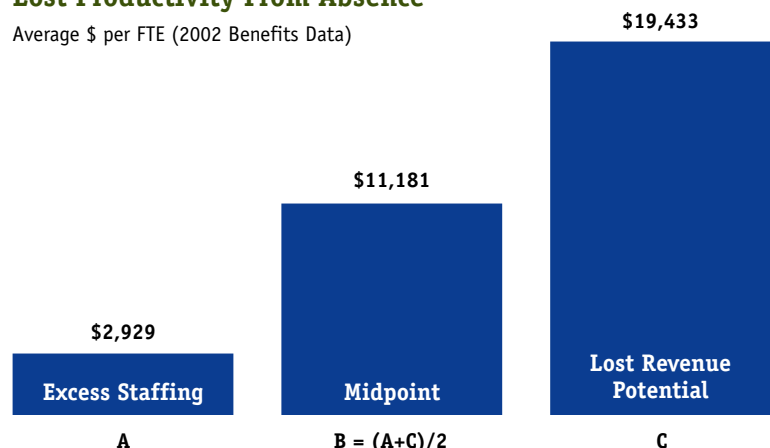


be absent on any given day and can't have only the right number of substitute workers available that are a perfect match.

The most expensive option is the impact that not replacing an absent worker would have on the company's revenue stream—shown in Column C. On average, such a strategy costs \$19,433 per FTE. This, clearly, is the least palatable option and will be avoided by most employers, where possible. An example of an industry that used this strategy might be one like the telecommunications industry in the late 1990s, where replacement workers aren't easily available and all current workers are at capacity. When workers were absent, calls were likely not to get answered and sales were lost.

Lost Productivity From Absence

Average \$ per FTE (2002 Benefits Data)



Realistically, most employers use a variety of responses to manage effects of absence. Larger employers may have some replacement workers available for jobs where absence is common or that employ enough workers so that an employer can predict a base absence rate. Employers may “create” replacement workers through paying a premium for temporary workers or paying overtime to current employees where possible. Sometimes they won’t get as much product out the door, either because they don’t fill the missing positions or because of inefficiencies from using poorly-trained or fatigued workers. IBI takes into account this mix of potential responses by showing for its lost-productivity measure the midpoint between the two extremes (Column B) for a cost for this study of \$11,181 per FTE. Employers that know their own strategies in responding to absence can adjust that estimate up or down.

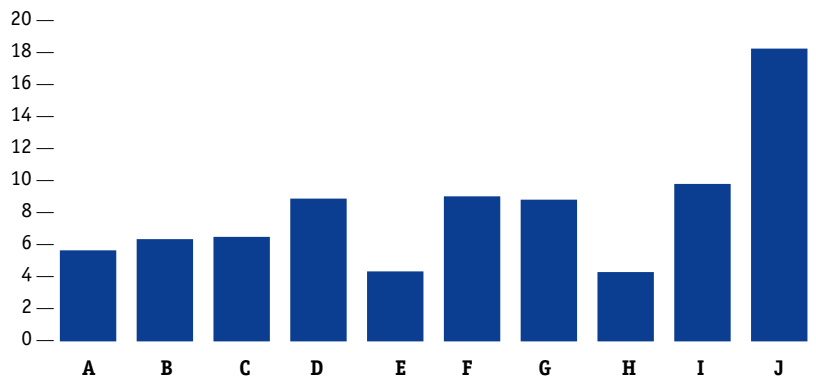
Leveraging Human Capital

An important determinant of relative lost productivity from absence for each company is the extent to which employers are able to leverage their human capital to produce revenue. Some companies produce far more revenue per worker than others, even in the same industry. Actual results within a single IBI benchmarking industry group are shown at the top of the right column, represented by Companies A through J. The Human Capital Leverage Ratio on the vertical axis represents each company’s gross revenue divided by its cost of human capital (wages and benefits). The value of human capital in revenue-producing power for company J, for example, is more than four times that of company H.

What causes such a variance within a single industry? Poor short-term revenue performance or regional differences in human capital costs can determine some of the difference. As to other effects, we can only guess. One employer may invest more in equipment or technology that makes human

Leveraging Human Capital

Human Capital Leverage Ratio of 10 companies (A–J) within a common industry group



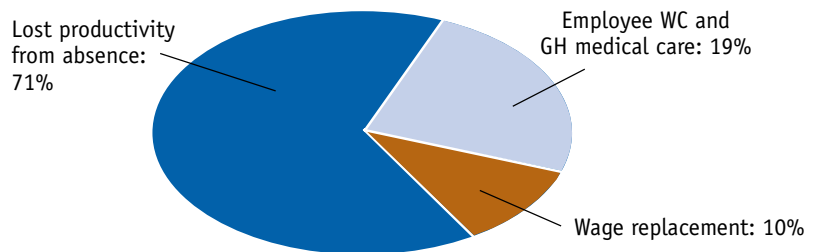
operators more productive. Some employers may train or retain highly skilled workers that simply do a better, more efficient job with less waste. Relative health has an effect, with less absence meaning fewer workers required in the workforce, or more productivity while at work due to less interference from poor health (presenteeism). In any event, an employer with highly leveraged workers is likely to try to replace an absent worker, but it may be more difficult to find similarly-skilled replacement workers.

Full Cost of Benefits

When we add this calculation of lost productivity to out-of-pocket benefits payments, the proportions of employee costs represented by medical payments and absence-related costs looks much different than the traditional view.

Full Costs of Employee Benefits

(2002 Benefits Data)



Employee medical costs amount to only 19% of the Full-Cost pie, even when we add workers' compensation medical payments. The impact of the Full Costs of absence on total costs is more than eight times the impact of wage-replacement payments alone. Even when we consider dependent medical costs, total medical costs amounts to only 30% of Full Costs.

Considering Full Costs in corporate decision-making should substantially enhance senior management's willingness to invest in the health of the workforce. For example, an investment in reducing absence that produces an ROI of 2:1 in wage replacement cost savings alone represents an ROI of 16:1 when the Full Cost implications of reducing absence are considered.

Full Costs by Program

Most employers focus benefits management on the programs that produce the biggest costs. A review of out-of-pocket and lost-productivity costs on a program-by-program basis shows how different the dollar burden of Full Costs looks compared to a traditional view of out-of-pocket payments, alone.²

Incidental absence, commonly the least monitored and managed benefit that employers offer, represents the largest single program cost when viewed this way. Here, short-term disability (STD) is the second largest absence program, dwarfing the third largest, workers' compensation (WC), by a ratio of almost 5:1, in part because WC costs include medical costs, permanent partial disability and other components that don't reflect lost productivity because they aren't absence-based in nature.

A key advantage to Full-Cost benchmarking is that by examining results across programs, employers can better understand that if they squeeze eligibility in one program, the costs may pop out elsewhere. Fighting marginal claims for work-related conditions, for example, may force employees to file for benefits in relatively unmanaged STD and receive group health medical treatment that doesn't promote effective return to work. Similarly, trying to control group health medical costs by increasing deductibles or employee co-payments may lower medical costs but also may cause workers to forego treatment with a resulting increase in disability duration and even severity.³

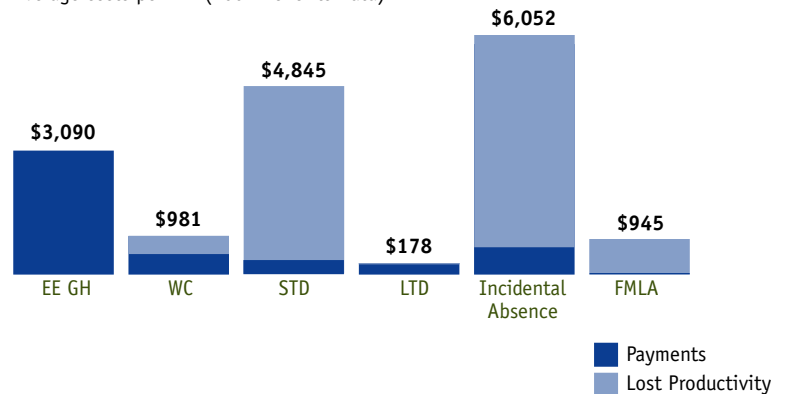
Quantifying the Full Costs of incidental absence by including lost productivity highlights for employers the importance of dealing with incidental absence as an important benefits cost driver. Though incidental absence may be difficult to manage as it occurs, employers that identify it as a problem can shift resources to prevention, wellness and disease management to curb the incidence of incidental absence. Interventions as simple as free flu shots at the workplace could make a difference.

² Note that IBI's Full-Cost Study doesn't capture absence days for long-term disability, since at that point most employers will have had to replace that worker.

³ *Linking Medical Care to Productivity: Considering a New Employer Healthcare Strategy*, Integrated Benefits Institute, February 2001. <www.ibiweb.org/publications/research/15/>

Full Costs by Program

Average costs per FTE (2002 Benefits Data)



Business Impact of Full Costs

Full Costs and the Bottom Line

CFOs in an IBI survey⁴ said that the top financial measures they use to measure business performance are cash flow and revenue growth, which rank about the same for CFOs, followed by earnings growth and operating profit growth. If benefits managers want the CFO's attention, they should demonstrate benefits-delivery results in similar business terms.

When we analyzed the Full-Cost burden of health, disability and absence in the context of several business metrics, we found, on average, that the cost of benefits related to employee health during the study period *substantially exceeds* net income for participating companies. Using net income as a baseline denominator during this period of economic downturn may not be the best measure, with short-term results varying widely by company depending on their fiscal health. Two relatively stable benchmarks, payroll and gross revenue, still demonstrate in CFO terms the substantial burden that the Full Costs of health-related benefits place on operations.

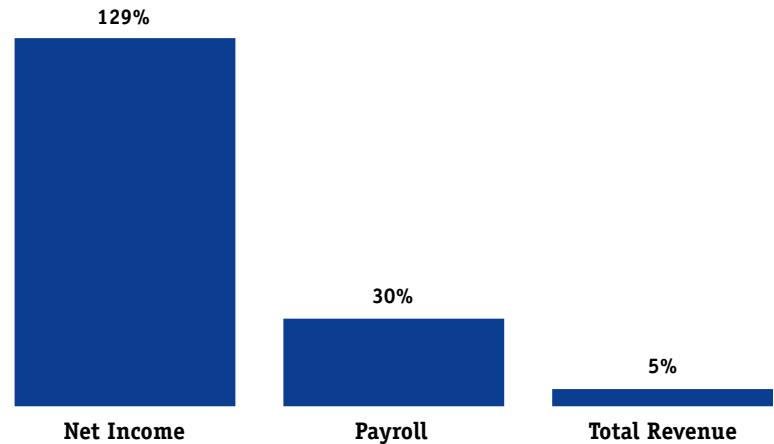
Absence Effects

A substantial proportion of that cost burden, however, comes from medical benefits that shouldn't be viewed just as a cost to be minimized. When properly focused, medical benefits can be an important investment in the health and productivity of the workforce.

As a result, we calculated a more limited view of the benefits burden, looking only at the Full Costs of disability and absence, which employers should try to prevent, where unnecessary. We found that absence-related Full Costs place a huge burden on CFOs' key performance indicators, averaging 76% of net income and 21% of payroll for participating companies.

Impact of Full Costs of Benefits

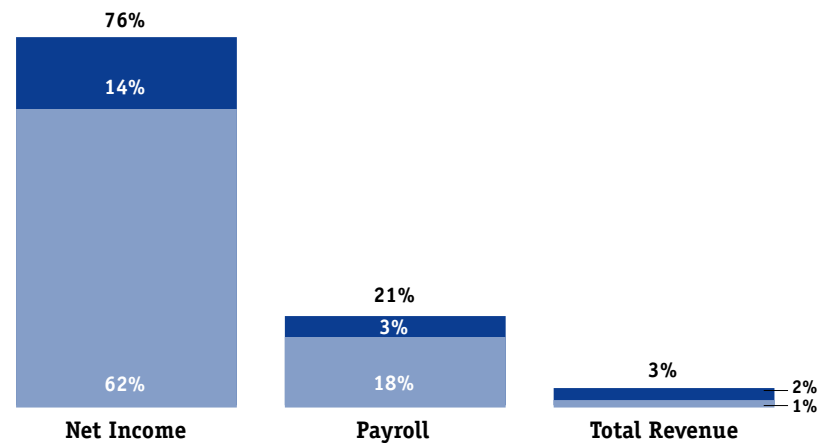
Including Employee and Dependent Group Health (2002 Benefit Data)



⁴ *On the Brink of Change: How CFOs View Investments in Health and Productivity*, Integrated Benefits Institute, December 2002. <www.ibiweb.org/publications/research/33>

Impact of Absence on Operations

(2002 Benefit Data)



■ Wage Replacement Payments
 ■ Lost Productivity from absence

What's Being Left On the Table?

What Are Possible Opportunities?

Not all absence can be avoided or managed effectively. Normal pregnancy, for example, typically isn't a "managed" condition. In addition, some companies will have better results than others for reasons that shouldn't or can't be changed easily, like worker demographics or structural factors like industry or collectively-bargained plan designs.

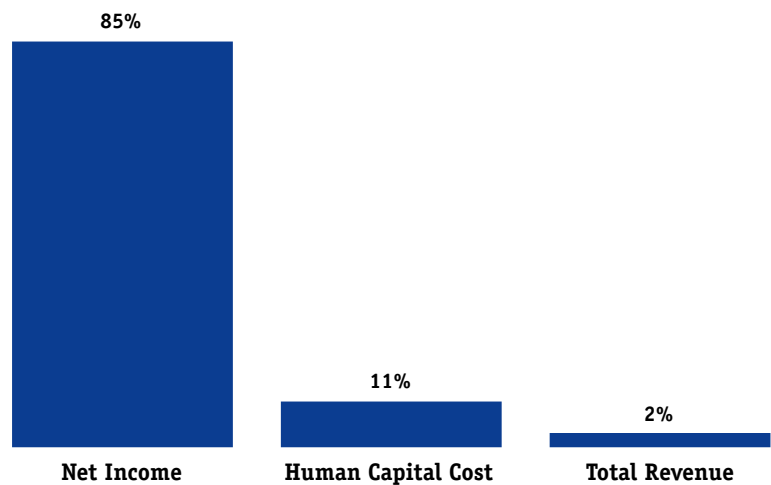
IBI identifies many of these factors in participants' Full-Cost Study reports as context for individual results. Nonetheless, such differences play out in business advantage and disadvantage, affecting the bottom line. In the future, Full-Cost Study reports also will compare the amount the participant "leaves on the table" compared to best-in-group company performance for the industry comparison group. For each employer, we quantify those excess costs in terms of Full Costs per FTE times the number of employees in proportion to the key business measures.

The numbers are significant for aggregate average results. We average individual company results across all participants to get an overall measure for what employers are leaving on the table by not being best in their industry group in medical, absence, disability and lost productivity costs. We express those dollars in terms of the operating business metrics important to the CFO. On average, employers leave on the table an equivalent of 85% of net profits or 11% of human capital costs (comprising payroll plus benefits).

This is not to say that achieving best-in-group results would be possible for all employers given structural or demographic differences or without cost. It also is important to understand that best-in-group does not mean "best practice." Best-in-group is simply the best overall result by one of the companies that participates in each IBI industry comparison group. Even the best-in-group performer probably could improve performance by adopting best-practice health and productivity management techniques.

On average, employers leave on the table an equivalent of 85% of net profits or 11% of human capital costs (comprising payroll plus benefits).

Average Cost of *Not* Being Best in Group



Conclusions

Employers can approach a business case for health and productivity management using IBI's Full-Cost study in several ways. First, they can participate in the study itself and gather their own benefits and financial data in their own industry group. They then can use the results to show senior management the benefits burden on their own financial results and the opportunities that may come from investing in benefits delivery improvements.

Second, they can use the numbers in this report to estimate a range of costs for their own company. Employers may find that the sheer magnitude of *average* Full-Cost results is enough to provoke senior management approval for the initial steps in a health and productivity management initiative. Steps can be taken to adjust average results by a company's own strategy for responding to absence.

In an additional step, companies that don't benchmark themselves may access aggregate results for their own industry by working with a benefits partner that is an IBI supplier member (see www.ibiweb.org/membership/members.php) and that has access to IBI's aggregate industry reports. Benefits managers then can go to senior management with average aggregate numbers that are even better focused for their own operations and human-capital leverage performance.

However employers proceed, their chances of getting senior management approval for their proposed benefits improvements will be enhanced by appreciating the Full-Cost burden of their benefits programs, seeing how they compare with their peers, knowing how the benefits burden impacts their company's financial performance and understanding the opportunities for improving their own programs based on actual results for other companies in their industry.

For information on participating in IBI's Full-Cost Benchmarking Study or in the National Business Group on Health's EMPAQ benchmarking program that focuses on program-by-program payments performance, please contact IBI's president, Dr. Thomas Parry, at (415) 222-7282 or e-mail him at tparry@ibiweb.org.

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For membership information, please contact us through one of the channels below. IBI can provide you with invaluable information, work with you to benchmark your benefits programs and offer communication opportunities to keep you in tune with the latest changes in this rapidly evolving arena.

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