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The Total Financial Impact of Employee Absences

Survey Highlights

October 2008

Introduction

The full cost of employee absences is very significant, amounting to 36% of payroll, according to the results of this survey. The cost of absence is often misunderstood, seen as unmeasurable, or dismissed as a negligible amount. While most other expenses for an organization, including most benefit programs, have clearly defined costs, employee absence is an area that is often not carefully tracked or even when it is, does not easily reveal its full costs. In a simplistic view, absences are sometimes seen as having no extra costs, since they are largely included in payroll expenses. But most managers know that absences do affect an organization's customer service, staffing, and attainment of production and other business objectives. Otherwise, there would be no need to try to manage them.

Absences have three areas of financial impact:

- **Direct costs** for the benefits or wages paid to employees while absent,
- **Indirect costs** for lost productivity or the replacement worker expenses to "cover" absences and minimize loss of productivity, and
- **Administrative expenses**, whether due to internal staffing and overhead, or to vendor services.

Many employers, surveys, and other types of studies have identified the direct costs of certain types of absences, such as vacations, holidays, and disability benefits. The 2007 Mercer/Marsh *Survey on Health, Productivity, and Absence Management Programs* found that the direct costs of absence totaled 14.2% of payroll, including 10.2% for vacations and holidays (scheduled or planned time off) and 4.0% for sick, disability, and workers' compensation benefits. This new survey is perhaps the first large-scale initiative to attempt to identify the total costs, including the indirect financial impact of absences, in terms of the class of employee (exempts, nonexempt salaried, nonexempt hourly, and union hourly) and the type of absence (incidental unplanned, planned, and extended).

About the Survey

This survey was sponsored by Kronos® Incorporated and conducted online in the summer of 2008. A total of 455 organizations responded from all major industry segments, sizes, and regions through out the United States. Theses organizations averaged 5,022 benefits-eligible US employees.

Defining Terms

In the survey and throughout the report we use several terms that may mean different things to different people. Here is how we defined the following terms:

Employee Classes

Exempt employees: employees classified according to the Department of Labor rules as generally having supervisory or professional responsibilities and not required to be paid at overtime rates for working longer hours.

Nonexempt salaried employees: those subject to overtime pay requirements but typically paid a weekly or biweekly salary and often found in administrative roles.

Nonunion hourly employees: those paid an hourly wage and subject to overtime pay requirements.

Union hourly employees: working under a collective bargaining agreement and also subject to overtime pay requirements.

Types of Absence

Unplanned incidental absences: absence of five work days or less, such as casual sick days, where the occurrence was not known and approved ahead of time by the employee's supervisor.

Planned absences: short or moderate duration absences such as vacations and holidays, where the supervisor knows about and has likely approved the absence in advance.

Extended absences: absences lasting beyond one week, often unplanned, and generally due to a disability and/or qualifying as a leave under the federal Family and Medical Leave Act (FMLA) or a state equivalent.

Unplanned incidental and extended absences, or *absenteeism:* the combination of two of the above categories, representing the kind of "lost time" that employers try to minimize or at least manage carefully.

Direct and Indirect Costs

Direct costs: the pay or benefit provided to an employee for time not worked. For example, this may be "salary continuation" for vacation or a short-term disability, or a separate benefit paid by a disability carrier.

Indirect costs: these costs represent the real impact to the organization as a result of the absence. There are two main components:

- *Replacement labor expenses*: the costs for employers to have other individuals do the work that an absent employee is unable to do. Replacement worker costs are hard-dollar expenses, representing added pay and benefits for extra staffing, or costs for overtime, temporary labor, and outside contractors.

- *Net lost productivity value:* a soft-dollar measure of potential lost revenue to the extent that the work is not fully “covered” by replacement labor. In other words, if fewer widgets are produced, fewer customers are served, or fewer sales are completed, potential revenue is lost. We conservatively estimated this value to equal the salary and benefits/other HR costs as a percentage of payroll for the percentage of work not fully covered by replacements or by exempt employees working longer hours. In reality, a for-profit employer’s lost productivity value could be much higher, since the work needs to cover not only employee expenses but other business costs as well, plus a return or profit on the work performed.

Total costs: the sum of direct and indirect costs, with the indirect “netting out,” or being offset by the employee’s salary, since the direct costs replace salary. For example, if sick pay is counted as a direct cost, then it should not also be counted as a payroll expense during the time the employee is absent — the employee does not receive two incomes. In other words, if the direct payments are counted as sick pay costs, then the additional increment is only the “net indirect costs” (total indirect costs, less the payroll offset amount). But the following is a simplified example for one day of a disability benefit at 75% of pay, assuming a daily salary of $200:

A.	Direct cost (@ 75% of pay):	$150
B.	Payroll offset:	$200
C.	Replacement worker cost (assuming pay plus overtime):	$300
D.	Final total costs (A – B + C):	$250
E.	Net indirect cost (C – B):	$100
F.	Ratio of total to direct costs (D / A):	1.67

Administrative costs: additional costs an employer bears for internal staff, software, office space and equipment — or for an outside organization — to administer absence benefits (tracking, review, approvals, processing, case management, clinical support, etc.). While not normally included in indirect costs, these are clearly additional expenses associated with employee absenteeism for all organizations.

Payroll for purposes of this survey means “base payroll,” which is the total annual salaries and wages paid for benefits-eligible U.S. employees, excluding such items as overtime pay, bonuses, commissions, benefits, and other fringes.

Key Findings

The survey yielded several important and interesting findings:

- **The total costs of all major absence categories, including direct and indirect costs, average 36% of base payroll.** These costs range from 25% for exempt employees, to 36% for nonexempt salaried, 39% for nonunion hourly, and 49% for union hourly.

- **The average total costs of incidental unplanned absences amount to 6.0% of payroll, and those for extended absences average are 3.2% of payroll.** The combined total costs for incidental and extended absences — the kinds of absences employers try to minimize — add up to 9.2% of payroll. This figure is more than half the cost of healthcare, measured at 15.4% percentage of payroll in Mercer's 2007 *National Survey of Employer-Sponsored Health Plans*. Employers tend to focus their energies on controlling healthcare costs, since the dollars are easily measured, but this new survey suggests that large opportunities exist for managing absences, if employers could reasonably quantify them.

- **The total costs for planned absences, such as vacations and holidays, average 26.6% of base payroll.**

- **Incidental unplanned absences result in the highest net loss of productivity per day** (i.e., work that is missed or postponed by not being covered by others): 21%, versus 15% for planned absences and 17% for extended absences.

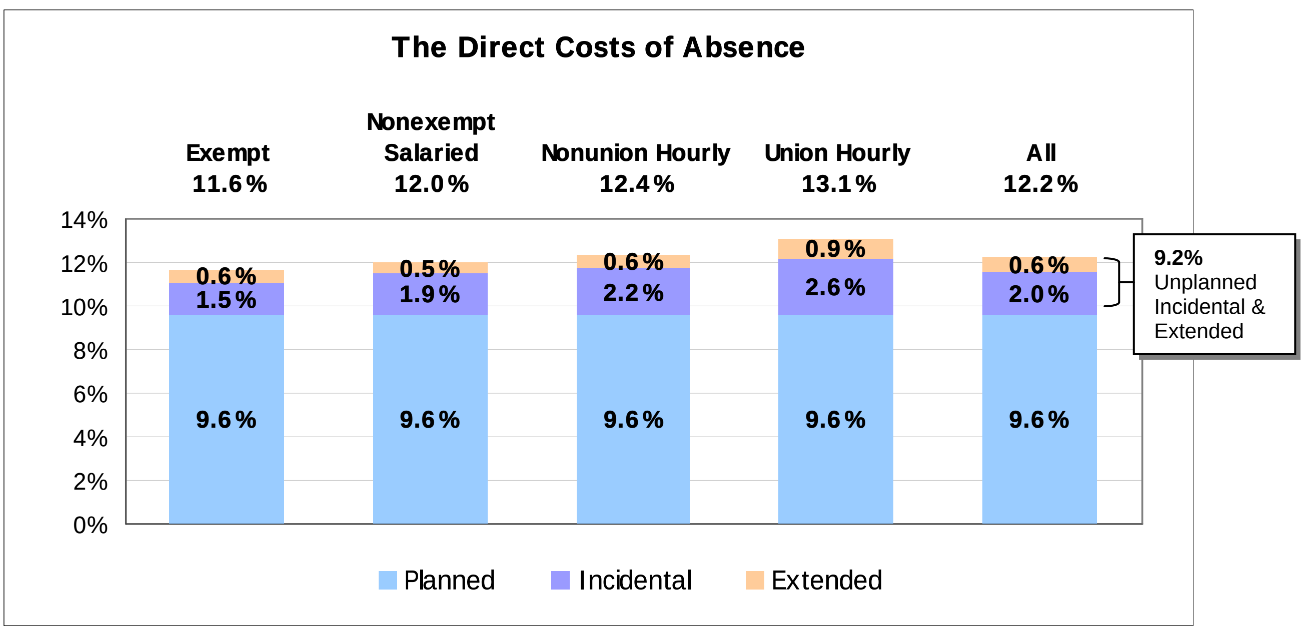
- **To help manage incidental unplanned absences, 36% of participants have PTO banks** that combine vacation and incidental sick days for nonunion hourly workers, and 35% have them for exempt employees. By contrast, only 29% have PTOs for nonexempt salaried and 28% for union hourly. Fourteen percent provide no paid time off for incidental absences for nonunion hourly workers and 8% provide none for their union hourly.

- **The number of incidental unplanned absence days per employee per year averaged 5.3 days across all employee classes,** and ranged from 3.8 for exempts, to 4.9 for nonexempt salaried, to 5.6 for nonunion hourly, and 6.7 for union hourly.

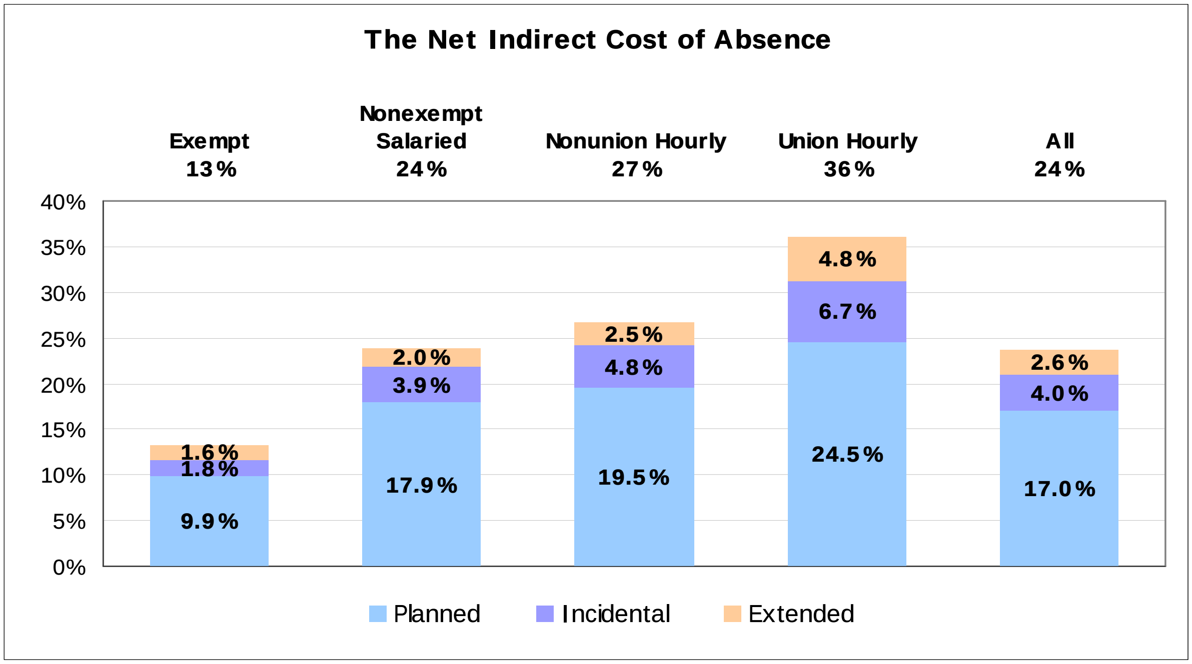
The Full Cost of Absence

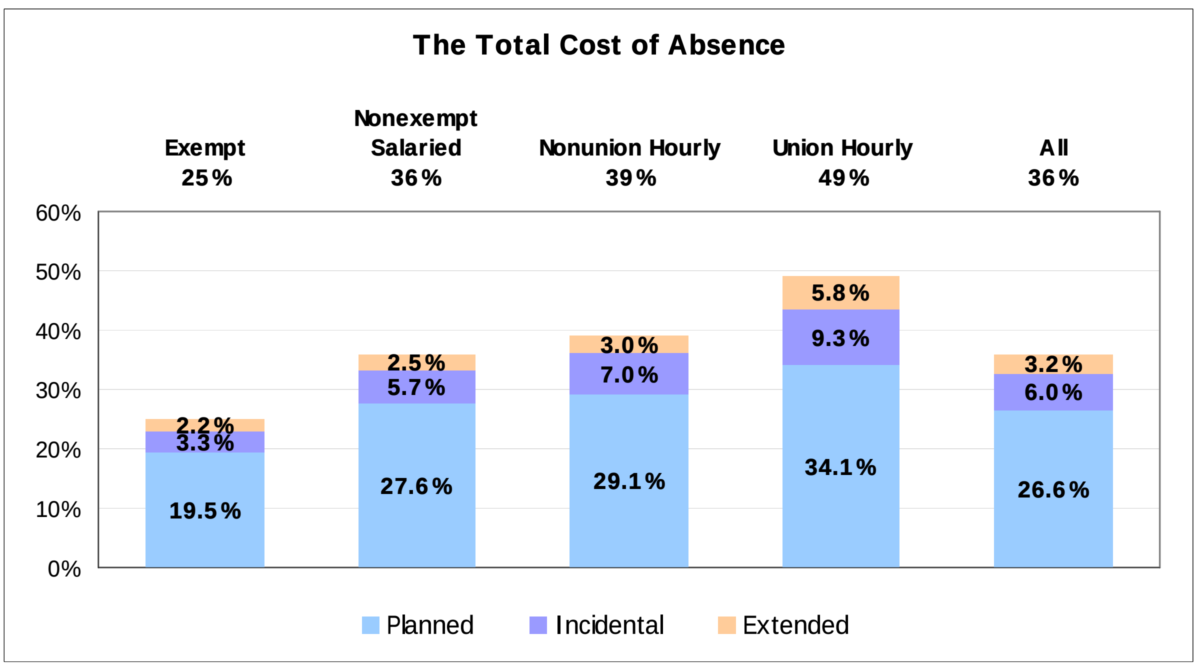
If senior executives look only at the direct cost of absence, the amount may not cause much concern. But if they could also see the indirect costs, the total would be much more likely to get their attention. For example, while the direct costs of incidental unplanned absences equaled 2.0% of base payroll, the total costs (including the indirect costs of replacement labor) were three times higher: 6% of payroll. The costs of both incidental and extended absences (short-term disabilities and unpaid FMLA leaves) amounted to 2.6% of base payroll in direct costs but 9.2% in total costs.

The total costs of planned absences are 26.6% of base payroll, 2.8 times their direct costs of 9.6% of payroll. But the total costs of extended absences (3.2% of payroll) are over five times their direct cost (0.6% of payroll). The high ratio of total costs to direct costs for this type of absence occurs because the denominator, the direct costs, are proportionally lower than for other type of absence. When an employee takes an incidental sick day or a vacation day, he or she normally receives full salary. But extended absences may be unpaid (such as some FMLA-qualified leaves) and absences paid through a short-term disability plan typically have a benefit that is less than full salary. So if the total costs are $400 per day of absence and the employee takes a sick day with full pay of $200 a day, the ratio of total to direct costs is 2 to 1. But if the employee is receives 60% of pay while on disability, the ratio is higher: 3.33 to 1 ($400 / $120).



The direct costs of the three major leave categories in this survey totaled to 12.2% of payroll. This figure is similar to the 14.2% of payroll for direct costs that was identified in the 2007 Mercer/Marsh *Survey on Health, Productivity and Absence Management Programs.* That survey also included costs for long-term disability benefits and workers' compensation programs. But the significant finding in this survey is that when 9.2% total costs for unplanned incidental and extended absences are added to the 26.6% total costs of planned absences, the overall total cost is 35.8% (rounded to 36%) of payroll, about three times the direct costs for the same plans.





The total costs for exempt employees relative to their direct costs are less than for other employee classes. But they are still nearly double the direct costs for planned absences and unplanned incidental absences. Exempt employees do make up an average of 44% of their work from an unplanned incidental absence and 45% of their work from a planned absence by working longer hours before or after the absence (or sometimes even during the absence). But because of their absence's impact on co-worker productivity and the greater need for their supervisors to cover for them, their indirect costs are still high.

The total costs as a percentage of payroll for all three categories of absence vary by class of employee: ranging upward from exempt employees (25.0%) to nonexempt salaried (35.8%), to nonunion hourly (39.1%), and to union hourly (49.2%).

Conclusions

There is no question that employees need and deserve sufficient time for planned absences and that they will inevitably need to take unplanned incidental and extended absences. But to the extent the latter — absenteeism — gets out of control, employers' ability to accomplish their objectives is thwarted and their costs of doing business increase. Employers who understand the full financial and other consequences of absence are better positioned to adopt the tools and processes needed to manage them.

Employers have been in the midst of scrutinizing and attempting to reduce healthcare costs for years, while not paying as much attention to absence costs. Mercer's 2007 *National Survey of Employer-Sponsored Health Plans* puts the cost of active employee healthcare benefits at 15.4% of payroll, a figure that has been steadily climbing over many years. But as learned in this survey, the full cost of absence totals 35.8% of payroll, including 9.2% for unplanned incidental and extended absences. For an employer with 1,000 employees whose annual salaries average $50,000, 36% of payroll equals $18,000,000. The portion of this due to unplanned incidental and extended absences (9% of payroll) equals $4,500,000 per year. Clearly, it is time for employers to turn their attention to addressing absenteeism as a way to help control overall operating expenses in the future.

Consider the following example:

XYZ Company with…

Number of employees:	1,000	
Average annual salary per employee:	$50,000	
Annual payroll:	$50 million	

Total cost of absences*

Planned:	$13.5 million	27% of payroll
Unplanned and extended:	$ 4.5 million	9% of payroll
Total	**$18.0 million**	**36% of payroll**

**Rounded to whole percentages*

Addressing absences requires attention to three key areas:

1. Plan design and policies, such as benefit level and attendance policies.
2. Absence management and administration:
   - Streamlined processes
   - Centralized recordkeeping across all locations of the enterprise, accessible by managers and supervisors, and HR, payroll, and other staff
   - Careful monitoring of absences and consistent enforcement of policies
   - Reviewing of data and trends for issues
   - Planning for return to work, and
   - Disability and workers' compensation vendor performance management
3. Tackling the underlying causes, which can be health-related, tied to other outside circumstances, or affected by employees' commitment to their managers and the organization (the workplace "culture").

Identifying the problems and opportunities in each of these areas is essential to achieving success. Employers tend to focus on the first area, then the second, and often not at all the last area, since the time and financial investments increase with each one. However, a more complete understanding of and attempt to estimate the full costs of absences can help improve the case for a significant investment by identifying a potentially much larger return. In fact, knowing that the combined total cost for employee healthcare and unplanned incidental and extended absences amounts to almost 25% of payroll, should further spur employers' efforts around health, productivity, and absence management.

About Kronos Incorporated

Kronos Incorporated empowers organizations around the world to effectively manage their workforce. At Kronos, we are experts who are solely focused on delivering software and services that enable organizations to reduce costs, increase productivity, improve employee satisfaction, and ultimately enhance the level of service they provide. Kronos serves customers in more than 60 countries through its network of offices, subsidiaries, and distributors. Widely recognized as a market and thought leader in managing the workforce, Kronos has unrivaled reach with more than 30 million people using a Kronos solution every day. Learn more about the Kronos Absence Management solution at www.kronos.com.

About Mercer

Mercer is a leading global provider of consulting, outsourcing and investment services. Mercer works with clients to solve their most complex benefit and human capital issues, designing and helping manage health, retirement and other benefits. It is a leader in benefit outsourcing. Mercer's investment services include investment consulting and multi-manager investment management. Mercer's 18,000 employees are based in more than 40 countries. The company is a wholly owned subsidiary of Marsh & McLennan Companies, Inc., which lists its stock (ticker symbol: MMC) on the New York, Chicago and London stock exchanges. For more information, visit www.mercer.com.

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