

Indirect Loss Costs Cause Financial Drain

By: Anthony Tellers

Indirect Loss Costs are a reality in a business, and they result in continuous financial leakage to a company's bottom-line.

Sir Isaac Newton changed our understanding of the universe by proposing his Three Laws of Motion. By applying his Third Law of Motion, Mr. Newton's insight can help change our understanding of the hidden costs that are buried in the financial statement of a business. Essentially, the Third Law of Motion says that forces always come in pairs – for every action, there is an equal and opposite reaction. Neither force can exist without the other. The same can be said for a cost or expense that appears on an Income Statement. For every Direct Cost, there is an equal Indirect Cost.



A business that has employees, manufactures a product, or operates a fleet of vehicles has a myriad of direct costs that result from accidents. A *vehicle accident* generates direct costs – the cost to repair the vehicle, or the cost to tow the vehicle to a repair site. An *employee injury* generates direct costs – medical bills, or rehabilitation expenses. A *product malfunction* generates direct cost – repair expenses or parts replacement. To be sure, these direct costs are immediately offset by claim payments from the company's insurance carrier.

However, as Isaac Newton illustrated with his Third Law of Motion, every action has an equal and opposite reaction. Or, in financial language, every Direct Cost appearing on a financial statement has an equal Indirect Cost. A *vehicle accident* creates lost productivity, lost employee time, schedule delays, and rental costs. An *employee injury* leads to additional administrative time spent in investigations, retraining replacement employees, increased payroll costs, and lower morale. A *failed product* causes legal and investigative time, damage to brand image, and extra shipping costs. These indirect costs are usually not a separate line item in a financial statement. Still, these costs are there, lurking behind every accident or injury. All of these indirect costs are outside of the traditional insurance exposures but seriously impact a company's risk. This means that Indirect Costs are usually uninsured and therefore unrecoverable.

The Occupational Safety and Health Administration (OSHA), among others, has been publishing studies and statistics for years on the Indirect Cost phenomenon. Depending upon the industry, the ratio of Direct Loss Costs to Indirect Loss Costs can vary from 1:1 to as high as 20:1. This is staggering – at a 1:1 ratio, a \$5,000 vehicle claim



or workers compensation injury that is paid for by insurance can have an Indirect Cost of an additional, uninsured \$5,000. At a 10:1 ratio, this Indirect Cost becomes \$50,000. Now, these ratios are debatable and can vary based on industry, type of loss and more, but even if the ratio is .5:1, these Indirect Loss Costs are still draining your bottom-line. The point is that they exist, and until such time as they are recognized and accepted, efforts can't be made and resources deployed to limit and eliminate them.

A business is then faced with these sobering realities. Newton's Third Law of Motion is a fact. So to, it is a fact that Direct Loss Costs are immediately accompanied by Indirect Loss Costs. These Indirect Loss Costs are only recoverable through increased revenue. Is it more realistic to boost revenue to pay for these Indirect Loss Costs or take serious steps to reduce and control accidents and injuries?

Below are some examples of Indirect Loss Costs. Are any of these hiding in your company financial statement?

- Loss of productivity – work stoppage, rescheduling and more
- Increased wage costs for non-injured workers and overtime
- Loss of use of equipment or property – uninsured damages
- Increased administrative costs – accident investigation time
- Legal costs – litigation
- Lost employee time at work
- Clean-up and sanitation
- Downtime
- Needed outsourcing and subcontracting per onsite injury or damage
- Lost clients
- Lost sales
- Cost to hire and train replacements
- Management time
- Supervisor time
- Government agency costs
- Fines or penalties
- Increased transportation costs
- Missed or cancelled meetings

*It is a fact that
Direct Loss Costs
are immediately
accompanied by
Indirect Loss
Costs.*

The Bowermaster brokerage firm specializes in identifying and attacking these Indirect Loss Costs. Even though these costs are outside the usual insurance coverage, reducing these hidden expenditures helps our clients reduce their total cost of risk. This, in turn, begins to achieve the ultimate goal of increasing our client's ownership valuation. Certainly, Isaac Newton did not have this in mind when developing his Laws of Motion. But being able to utilize and adapt the wisdom of others has always been an indicator of true intelligence and a component of great success. Understanding and eliminating Indirect Loss Costs puts your enterprise on the path to rebuilding its financial performance. Contact us and let our team help you.