



Absenteeism

The Bottom-Line Killer

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Absenteeism: Why Should You Be Concerned?

- Unscheduled absenteeism is a chronic problem for U.S. employers, conservatively costing \$3,600 per hourly employee per year, and \$2,650 per salaried employee per year¹
- The majority of employers have limited ability to accurately and regularly track how much absenteeism is reducing their bottom line earnings
- Absence management systems track absenteeism, manage absence policies and work schedules, and control overtime, allowing management to recoup lost earnings
- Reducing absenteeism will also help employers better meet production and service demands without requiring an increase in headcount
- A company of 5,000 hourly employees has the potential to reduce costs by over \$7.9 million per year, or 3.2% of total payroll

Absenteeism has a material effect on the bottom line of most companies, yet few managers really understand the magnitude of the problem at their company. The unscheduled absenteeism rate in the U.S. hourly workforce is approximately 9%¹; almost one in ten workers is absent when he or she should be at work. There are considerable direct and indirect costs associated with absenteeism.

Not only should managers be motivated to reduce absenteeism because of the excess costs, but without absence tracking tools, employers cannot adequately estimate their accrued liabilities, potentially creating an issue that impacts the financial certifications required by the Sarbanes Oxley Act. Because an accurate portrayal of accrued paid time off (PTO) is needed, there is a considerable incentive for senior financial managers to learn more about what absenteeism really means for their companies.

Surely even absenteeism that results in a 1% increase in payroll costs, an inability to meet demand, or an unknown PTO liability would be of prime concern to any manager. Why is there such little focus on absenteeism, compared to other costs—healthcare for example? Perhaps because healthcare is a unique line item in a company's budget, as compared to absenteeism, which rarely appears in any reports that corporate managers see on a regular basis. And, health care costs are usually reported

¹ CIRCADIAN's *Shiftwork Practices 2005*

to management by external providers who maintain the data on more reliable systems than those used internally to track absenteeism or other workforce-related costs. Equally, even amongst the largest companies, there is rarely a corporate manager who oversees the costs associated with absenteeism so therefore it goes unnoticed.

What is Absenteeism?

The excess costs arise from a variety of absence types that all cause disruption to the business, make it difficult to deploy the workforce, and have a profound effect on productivity, profit margins, and employee morale.

- **Scheduled absences** consist of vacation or personal time, whether part of a PTO plan or separate
 - Excess costs arise when time is taken but not reported, or taken when it hasn't been earned
 - The average employee takes 3 days of unreported PTO annually²
 - Seventy-three percent of CFOs surveyed did not know their company's PTO liability²
 - When calculated, 82% felt the liability was significantly higher than anticipated²
- **Unscheduled absences** include sick days, disability, FMLA, and Workers' Compensation leave
 - Again, costs arise when time is taken but not reported, taken when it hasn't been earned, and, sometimes the employee is simply not entitled to the type of leave granted
 - Improving employee health can, at most, only reduce absenteeism by one-third, as two-thirds of absenteeism is associated with non-sickness (personal reasons, feeling of entitlement, family issues)³
- **Partial shift absences** include arriving at work late, leaving early, or taking longer breaks or lunches than allowed
 - The direct impact is reduced or delayed production, or customers not being serviced
 - Research shows that the average payroll inflation cost due to partial shift absence is 0.72%⁴

² AppMail report

³ This is true for both hourly employees (based on the anonymous responses of 2000 workers, CIRCADIAN data), and the US workforce as a whole (CCH Incorporated, *Unscheduled Absence Survey 2004*)

In the average hourly workplace, typical unscheduled absenteeism rates range from 5% to 10% (i.e. at any given time 5% to 10% of the workforce is missing from work). The rate varies by industry. Emergency services and healthcare, both known for their stressful working conditions and high rates of overtime, also have the highest rates of absenteeism (Figure 1). Reported absence within the whole of the U.S. workforce is considerably lower (2.1%)⁵, but this may reflect the difficulty in measuring absence for salaried employees.

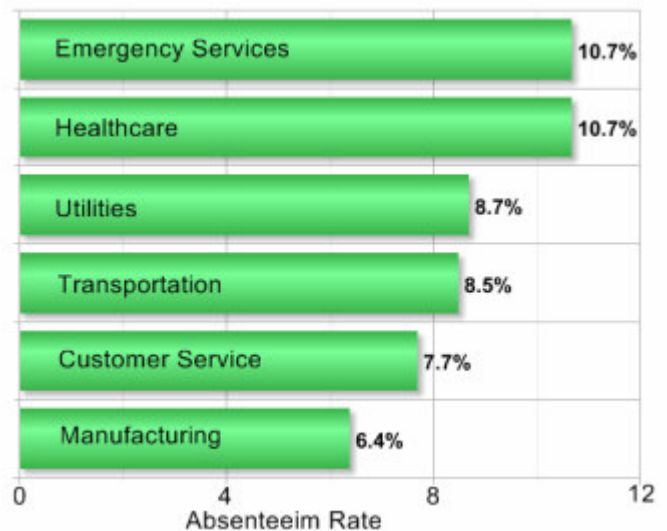


Figure 1. Absenteeism rates by industry. CIRCADIAN's *Shiftwork Practices 2005*.

What Is The Outcome of Excess Absenteeism?

Organizations handle unscheduled absences in a number of ways. In some cases employees are simply not replaced, resulting in lost productivity. In other cases, organizations maintain excess staff, utilize overtime, or substitute with agency workers. In any case, unscheduled absences are very disruptive to the business and result in increased indirect costs of absenteeism. Provided below are examples of how excess absenteeism may be manifested as costs:

- **Lost productivity:** The organization runs too lean and production or service requirements are not met:

The employer was using a five-day schedule, but demand was such that employees were asked to come in on the weekend on a regular basis. The employees disliked working so many consecutive days with no time off, which led to very high absence rates. The shortages of employees resulted in demand not being met, and customers were dissatisfied.

⁴ Nucleus Research, Inc.

⁵ CCH incorporated. *2004 Unscheduled Absence Survey*

- **High-cost replacement workers:** The organization has to replace missing workers with other employees or contractors, and pay overtime or higher rates. Overtime levels are 28% higher in facilities with high absenteeism than in facilities with low absenteeism:

The organization had high levels of absenteeism, coupled with a collective bargaining agreement that provided bonus pay on top of federal requirements. This caused payroll costs to be almost 50% higher than necessary if absenteeism and overtime were better managed.

- **Excess staffing:** Headcount is higher than necessary in order to cover unplanned absences:

The employer routinely increased headcount by 13% on weekends to cope with extra absenteeism on a Saturday and Sunday.

What Are The Direct Costs of Absenteeism?

For a manager to comprehend the potential costs of absenteeism to the company, the direct cost per employee is provided below. Because the result is different for hourly and salaried employees, each is considered separately.

Hourly Employees

Let's assume that the average hourly employee:

- Is absent for 9% of the time scheduled (average for hourly workers in 2004) ¹
- Is paid for half of the time absent as PTO (4.5% equates to 2 ¼ weeks of PTO)
- Receives \$19 per hour (average for hourly workers across all industries) ¹

Assume that the employee, when absent, must be covered by a replacement employee, working at an effective payroll rate of 150% (absent employee paid as well) for 4.5% of the time, and at an effective pay rate of 50% for the other 4.5% (absent employee not paid), but that there are *no other* indirect costs (manager time, lost capacity, etc.). In this conservative scenario:

- A full-time employee, working 2,100 hours a year (50 weeks of 42 hours a week) costs his or her company \$3,591 per year
- For a company of 5,000 employees this equates to almost \$18 million per year

This scenario assumes that the absent employee utilizes PTO for half of the time absent. If there are PTO abuses, and the employee is paid for the full 9% of time when he or she is absent, the cost is \$5,387 per year, an increase of \$1,800 per year per employee, or \$9 million per year for a company of 5,000 employees.

Salaried Employees

It is less usual for a salaried employee to be replaced when absent. Instead, the demands of customers (internal or external) are not met and depending on the employee's position in the company, the ability to create revenue may be affected. Compared to hourly workers, salaried workers are just as likely to take unreported PTO as time clocks and formal absenteeism accounting are less prevalent in the typical office environment than on the facility floor.

Calculating the cost of absenteeism is more difficult in the salaried population because data concerning actual hours absent are unavailable, but let's assume the following about the average salaried worker:

- Earns \$45,000 per year with a benefits package worth 30% of salary
- Allowing for overhead, profits, etc. this employee must generate \$162,000 in revenue⁶
- When absent, he or she directly affects the revenue generated

If the average salaried worker takes 3 days per year as unearned paid time off (1.2% of total work days, based on 50 weeks at 5 days per week), the impact to the business is 1.2% x \$162,000, or \$1,950 per year. Adding the PTO payroll liability of 1.2% x annual wage and benefits, equals an additional \$702 per year, resulting in a total direct cost of \$2,652 per salaried employee per year. For the salaried employee this value represents potential savings because ensuring PTO compliance would effectively reduce these costs to zero.⁷

The costs presented here are conservative as they reflect only direct costs. Table 1 shows how the costs may vary for companies with different pay structures, size, and ratio of hourly to salaried workers. Excess absenteeism can also lead to increased health care costs, greater safety issues and accidents, higher turnover, and poor morale. Therefore, total potential savings that could be achieved by reducing absenteeism and eliminating PTO abuse are significantly higher.

⁶ CFO Magazine estimates that 36% of revenue per employee is salary and benefits cost

⁷ There could also be significant cost savings by reducing excess absenteeism taken as part of recorded PTO

Total Number of Employees	Absenteeism Cost			Approximate % of total payroll
	1,000	5,000	10,000	
90% hourly workers paid \$10 per hour, 10% salaried, paid \$45,000 annually	\$ 1,966,200	\$ 9,831,000	\$ 19,662,000	7.4%
90% hourly - paid \$20, 10% salaried - paid \$60,000	\$ 3,755,600	\$ 18,778,000	\$ 37,556,000	7.5%
50% hourly - paid \$10, 50% salaried - paid \$45,000	\$ 2,271,000	\$ 11,355,000	\$ 22,710,000	6.3%
50% hourly paid - \$20, 50% salaried - paid \$60,000	\$ 3,658,000	\$ 18,290,000	\$ 36,580,000	6.5%
10% hourly paid - \$10, 90% salaried - paid \$45,000	\$ 2,575,800	\$ 12,879,000	\$ 25,758,000	5.7%
10% hourly - paid \$20, 90% salaried - paid \$60,000	\$ 3,560,400	\$ 17,802,000	\$ 35,604,000	5.7%

Table 1. Direct absenteeism costs for a range of sample organization sizes

What Are The Indirect Costs of Absenteeism?

A large component of total absenteeism costs stem from a variety of indirect causes. Excess absenteeism is associated with many different aspects of the business, including the following:⁸

- Higher turnover. Turnover is 7.8% per year in facilities with low to average absenteeism, and 10.6% in facilities with high absenteeism. Even recouping half of the 2.8% difference in turnover could save a company of 5,000 workers just under \$2 million per year
- Poor quality of goods or services (because of fatigue associated with excess overtime)
- Reduced ability to meet demand leading to dissatisfied customers
- Lower productivity - idle time is 4.1% in facilities with low or average absenteeism, and 7.7% in facilities with high absenteeism. If a company with 5,000 employees reduces idle time by half of the difference, approximately \$14 million could be added to total revenue (as a result of the improved productivity)
- Excess manager time (disciplining, terminating, finding replacement coverage)
- Safety issues (less-trained employees doing work, employees rushing work after arriving at work late). Absenteeism is 7.8% per year in facilities with few fatigue issues (tired employees lead to more frequent and severe accidents), and 8.9% in facilities with more fatigue problems

⁸ CIRCADIAN's *Shiftwork Practices 2005*

- Poor morale (other employees having to cover absence leads to resentment). Absenteeism is 7.5% per year in facilities with good morale, and 9.4% in facilities with poor morale
- Poorer health (if too much overtime is being used). Employees who work too many hours of overtime (which is associated with excess absenteeism) tend to get less sleep, and have a greater prevalence of cardiovascular and gastrointestinal disease, diabetes and musculoskeletal conditions
- Poor union relationships. Absenteeism is 7.4% per year in facilities with good union relationships, and 10.8% in facilities with poor relationships

How Can You Reduce the Costs of Absenteeism?

To achieve significant reductions in the excess costs associated with absence, the manager must reduce the rate of absenteeism, and the subsequent effect that absenteeism has on the business. The first step is accurately and efficiently tracking absenteeism rates and patterns on a regular basis. The majority of organizations do not have an automated means to track every instance of absence in one system and therefore lack the visibility necessary to address this business problem. Once the magnitude, patterns, and root causes of the problem are known, the manager can consider what steps need to be taken. These may include using sophisticated rules engines and process automation to consistently enforce absence policies, ensuring compliance with union, state, and federal rules, improving absence management technology, and increasing employee satisfaction with the workplace.

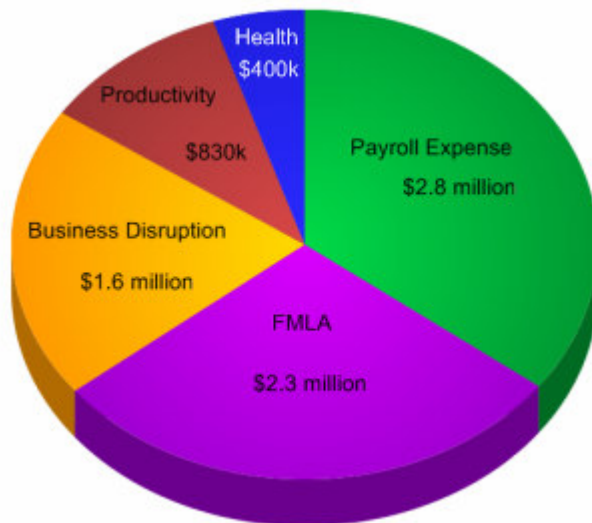


Figure 2. Potential cost savings relating to decreased absenteeism for a company of 5,000 employees

Clearly the opportunity to reduce absence exists within all companies. The first step is implementing absence management technology - Figure 2 demonstrates that an organization of 5,000 employees could save \$7.9 million, or 3.2% of total payroll. These conservative cost savings are found in five areas:

1. Reduced payroll expense

- Provide managers with regular, accurate reports of absenteeism, patterns over time, and root causes
- Reduce the incidence of non-reported PTO
- Reduce overtime costs by selecting employees to cover for absence based on their competence, training, and hours worked during the week

Opportunity for savings: Figure 3 shows that facilities that use specialized software to manage their day-to-day scheduling and to distribute overtime have significantly lower rates of absenteeism. A company of 5,000 hourly workers that decreases absenteeism by half of the 1.9% difference (9.6% vs. 7.7%) could save \$2.8 million per year.

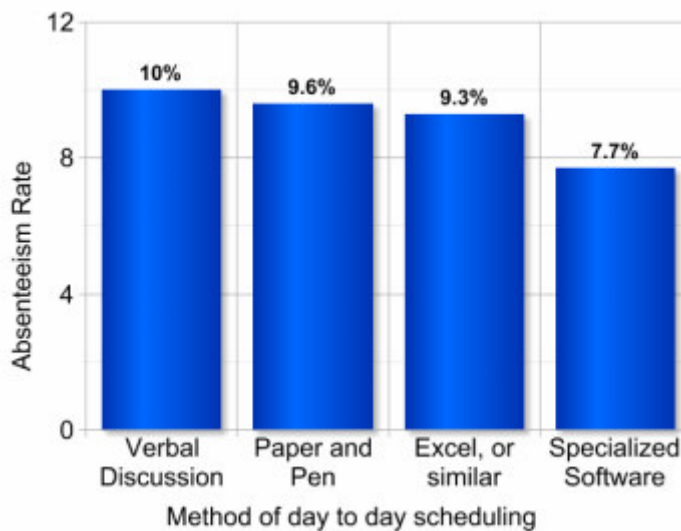


Figure 3. Absenteeism is lowest in facilities that use specialized software to manage day to day scheduling tasks. CIRCADIAN's *Shiftwork Practices 2005*

2. Improved productivity

- An improved forecast of workload leads to more predictable schedules, in turn resulting in more dedicated (and productive) employees
- Setting and enforcing appropriate overtime limits reduces employee burnout, and improves overall productivity
- With sophisticated rules engines and workflow, absence policies are enforced consistently and administrative burdens are reduced
- Reduction in partial shift absences directly affect productivity rates

Opportunity for savings: The average payroll increment due to partial shift absence is 0.72%.⁴, This is approximately equivalent to 1 in 5 employees having a 12-minute partial shift absence per 8-hour day. This lost time results in total facility productivity dropping by a small, but very significant, amount. If the average partial shift absence could be reduced to 6 minutes, a facility of 5,000 employees could save \$830,000 per year (from a total potential of \$1.66 million). Figure 4 shows how excess payroll costs increase as the minutes per day missed by 1 in 5 employees increases.

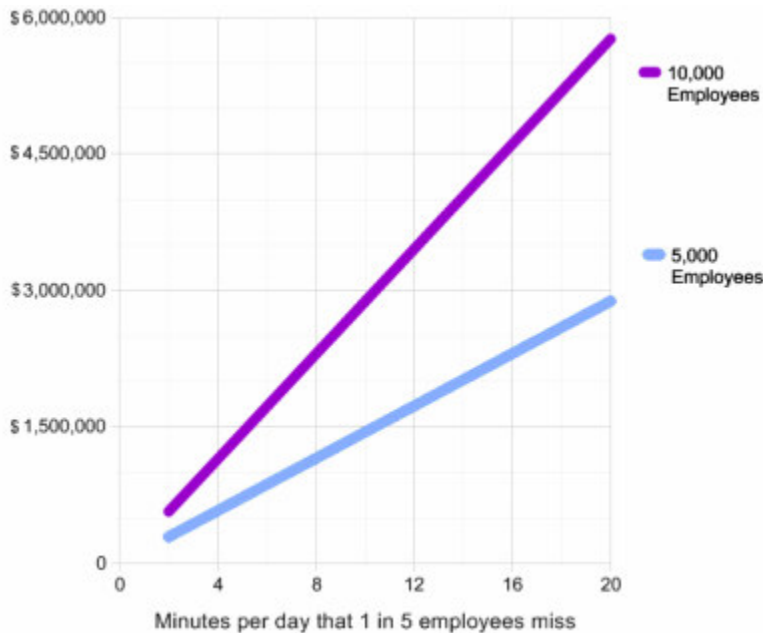


Figure 4. Excess payroll costs for 5,000 and 10,000 employee organizations when 1 in 5 employees have partial shift absences.

3. Reduced compliance risk

- Failing to manage absence of employees on disability or Family and Medical Leave (FMLA) can lead to excess payroll cost as replacement workers need to be found
- Without detailed absence accounting methods, employees may be taking more time than allowed, or even be taking leave when not eligible
- Without absence management software to enforce eligibility, employers may err on the side of caution, and award FMLA leave or disability leave when employees are actually not entitled to it

Opportunity for savings: Employee use of FMLA has grown considerably in recent years, with more employees taking leave, a higher use for chronic (repeated) illness, and in smaller increments of time. For 50% of FMLA absence, the employer has no advance notice of leave, further increasing costs. These changes in FMLA use have resulted in spiraling costs for

employers, estimated to be a direct cost of \$21 billion per year for companies in the U.S.⁹ The costs are associated with lost productivity, finding replacement workers, and continuance of benefits to absent employees. Workforce management software can help ensure compliance and efficiently schedule the most qualified and available replacement workers at minimal cost. Equally, software can highlight potential abuse (e.g. increased absence on Mondays and Fridays, or around major holidays). The total cost of FMLA leave is approximately 0.4% of the total U.S. payroll. By reducing this cost by just one quarter to 0.3% of payroll, a company with 5,000 employees could save \$2.3 million per year.

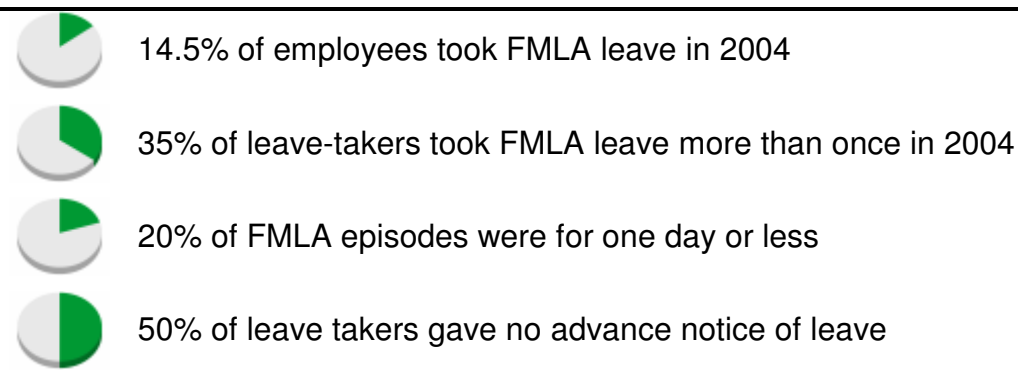


Figure 5. Reasons for managers to monitor FMLA usage. Employment Policy Foundation, *The Cost and Characteristics of Family and Medical Leave, 2004*

4. Decreased disruption to the business

- Reducing absenteeism helps organizations better meet production and service demands without increased headcount
- Managers spend considerable amounts of time dealing with the excess absenteeism
- Employee self scheduling tools enable employees to indicate their availability and schedule preferences thus contributing to reduced absenteeism
- Employee self service options such as online leave of absence requests and shift swapping engages workers and improves their satisfaction and productivity levels
- Enforcement of disciplinary attendance policies reduces favoritism and resulting employee grievances
- Comprehensive workforce management systems track absence in the same system as other HR metrics, providing visibility to managers so they can take corrective actions

Opportunity for savings: In facilities where employees select the schedule pattern, the absenteeism rate is 8.3% compared to 9.4% when a schedule is mandated without employee input (Figure 3). In a company of 5,000 employees, even half of the 1.1% difference in

⁹ Employment Policy Foundation. *The Cost and Characteristics of Family and Medical Leave, 2004*

absenteeism resulting from an employee-selected schedule could save over \$1.6 million. There are many types of schedules that are possible in any work environment and these must be tailored to fit both the business requirements, and the needs of the employees.

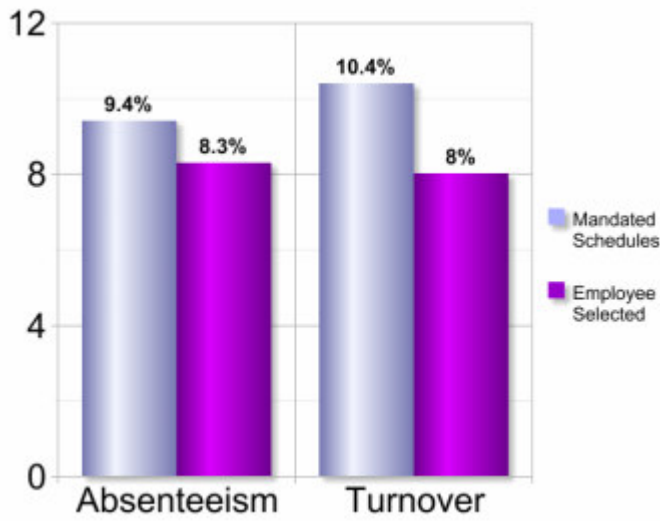


Figure 6. Allowing employees to select the schedule pattern reduces absenteeism and turnover. CIRCADIAN's *Shiftwork Practices 2005*

5. Better management of health benefit costs

- Excess overtime due to high absenteeism and poor staff scheduling leads to poor employee health (less overtime, improved disease management, health risk assessments, employee education, and EAP programs can help improve health and reduce absenteeism)
- There is an association between working over 55 hours per week and a three-fold likelihood of cardiac issues, and a four times greater chance of diabetes
- According to CIRCADIAN's *Health in Extended Hours Operations* study, hourly workers also have other increased healthcare risks, e.g. gastrointestinal disorders, musculoskeletal problems, and sleep disorders

Opportunity for savings: The average rate of overtime in an hourly facility is 16%. However, it is well recognized that overtime is not evenly distributed, and it is not uncommon for 20% of employees to be working 60% of the available overtime. This subgroup of employees is regularly working in excess of 55 hours per week. Assume that the percentage of employees working 55 hours or more is reduced from 20% to 15% as a result of better managing overtime with advanced scheduling tools. If a company of 5,000 employees just focused on reducing diabetes and cardiovascular rates in their employee population as a result of excess overtime, healthcare costs could be reduced by approximately \$400,000.

Conclusion

The first step in reducing costs is to use an automated absence management solution to identify the absence rate and the cause of the excess. From there managers can reduce the direct and indirect costs and gain significant benefits including improved production capacity and better customer satisfaction -- without increasing payroll.

About CIRCADIAN

Circadian Technologies, Inc. (CIRCADIAN) is the leading international research and consulting firm assisting companies with extended hours operations to:

- Improve company profits by increasing productivity and reducing the increased costs, risks, and liabilities of human factors inherent in extended hours operations
- Maximize opportunities for growth by educating managers and employees about how they can improve their performance, health, safety, and quality of life

Extended hours operations encompass all work environments with irregular schedules, night and evening shifts, or extended hours (typically outside the hours of 7 a.m. to 7 p.m.). Circadian's unique value-added research, information services, and consulting programs for operations, financial, legal, and human resource managers create win-win solutions for client management and employees alike. More than half of the *Fortune 1000* firms have benefited from working with Circadian's specialists in operations management, human resources, physiology, psychology, industrial engineering, ergonomics, biology, and sleep disorders. Circadian has worked in all extended hours business environments across most industries.

Nearly one in five employees, or approximately 24 million Americans, regularly work full-time or part-time night or weekend shifts, according to the U.S. Bureau of Labor Statistics. Half of the Americans working extended hours work in blue-collar and half in white-collar occupations. In the 21st century, employees supporting the 24/7 economy by working in extended hours operations include, among others:

- Manufacturing, utilities, and industrial process "shiftworkers"
- Logistics professionals and warehouse operators
- Pilots, flight attendants, train conductors, and other transportation employees
- Information technology and other extended hours professionals
- Construction industry workers
- Service sector call center and retail, hotel, and restaurant employees
- Nurses, doctors, fire, police, and other medical and emergency response personnel