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Business Valuation Guide for Mergers and Acquisitions a Simple Insurance Question

By Robert E. Underdown, AIC, ARM

How would you like to have a simple way to judge the overall health of a company that you are examining?

It is a known fact that happy, healthy employees do not have workers' compensation claims or on-the-job injuries.

Here is how

The way to tell the general health of any company is to obtain the Experience Modification Factor (E-Mod or EXP MOD) for the past five years. This is represented as a number, most often between .5 to 2.0.

Background

The insurance industry has developed a system to reward workers compensation policyholders who have a better than average loss experience. For those entities that qualify, based on the minimum premium requirements, the experience rating plan is mandatory. The heart of the plan is the E-Mod, which is a number developed by a complex formula including premiums, claims cost, and exposure types.

For the majority of states, the number is promulgated annually for each workers compensation policyholder in the US by the National Council on Compensation Insurance, Inc. (NCCI). For non-participating states, the same data is developed by a state agency. Essentially, workers compensation E-Mod calculations operate under the law of large numbers, because the experience of a given class is a combination of a large number of homogeneous exposure units.

Workers compensation insurance is based on a premium charge for each \$100 of payroll in each different category of employee or class code. For instance, in a typical company there may be clerical, administrative, outside sales, etc. class codes for employees. The total workers compensation premium for a specific policy is the sum of the total of the premium for each class code, subject to some modifications.

Summary

The average E-Mod for any class is 1.0. If the E-Mod is 2.0 for a specific company, they have incurred twice the losses of the average for their group, and your question should be why. If a company has an E-Mod of 0.5, they are 50 percent better than the average company in their business and are operating a very efficient company.

Reviewing the E-Mod for the past five years will give you a very good picture of how the company has been operating. To illustrate, often an insurance broker will ask for the recent E-Mod calculations when quoting other lines of coverage, because they know the E-Mod presents a good picture of a company's overall health.

I have experienced the results in both extremes. The most notable was when a company I was with announced the closing of a small office, and four of the six employees suddenly had on-the-job injuries. This was obviously a management or human resources issue that manifested as a workers compensation issue.

Alternatively, I have seen divisions within companies where the on-the-job injuries were very rare because of the tone set by the manager of the division or section. When a manager is a true leader, the employees are treated well and respond accordingly. One look at the statistics for a company and it is evident who the best managers are.

The very best way to create an effective work environment and reduce the expense of on-the-job injuries is when top corporate management sets the tone and makes efficiency (safety) a part of the corporate culture.

If you have any questions, review the page of a company's workers compensation insurance policy that shows the premium calculation. Look for the line labeled Experience Modification Factor (E-Mod or EXP MOD), that is your key.

Robert E. Underdown, AIC, ARM, is a nationwide insurance consultant based in Scottsdale, Arizona. He serves corporations in the area of risk management and the legal community as an expert witness in insurance litigation. Mr. Underdown is an expert in agent/broker; insurance company and TPA standards of care and bad faith claims. In addition, he provides trust-owned life insurance audits and portfolio management services for individuals, trustees and other financial professionals. Find out more at www.Insurance-Expert.com or call (480) 216-1364.