Risk Insights

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Understanding Total Cost of Risk

Risk exists everywhere in business. One of the biggest mistakes that companies make is assuming that the cost of risk only involves their insurance premiums paid, retained losses and administrative costs. However, the total cost of risk encompasses much more than that.

While a risk management program can be an effective method for controlling risk, the resources used by the program may not be addressing all the risks faced by the business. One way to discover all of the risks facing your business—including the ones that might not be seen, considered or addressed in your risk management program—is to examine the total cost of risk (TCOR).

TCOR is the total cost of the items that businesses are responsible for, such as insurance premiums, retained losses in the form of deductibles and uninsured losses, indirect costs of claims and administrative costs, and other factors that can include the following:

- Transaction costs
- Loss of reputation
- Loss of market share
- Overtime
- Additional training
- Product loss
- Production decrease
- Claims reporting and investigation
- Fines

Over time, an idea of an organization's TCOR can provide a form of measurement for assessing how its risk-related costs are changing, relative to the overall growth rate of the business.

Why is Knowledge of TCOR Important?

If your business is only focusing on insurance premiums as your way of quantifying risk, you may be missing costs that you have more control over. For example, premiums may be the least controllable costs, as insurance rates are determined by outside forces such as weather-related events, the stock market, interest rates and the insurance marketplace.

Furthermore, the benefit of decreasing premiums is negated if an organization sees an increase in indirect costs of claims and administrative costs. True cost reduction is most impacted by lowering indirect costs, which can cost more than the actual claim itself. TCOR helps identify those costs.

How Does TCOR Work?

TCOR is measured per $1,000 of revenue. By measuring TCOR against revenue, you can measure the progress that your safety and risk management programs make in reducing internal costs throughout the years.

Benefits of Knowing Your TCOR

When business owners accurately measure TCOR, they tend to possess the motivation to invest into a more effective risk management effort, which can provide a significant rate of return. Many business owners use TCOR to realize the following benefits:

- Increased productivity, profitability and efficiency
- Reduced costs across the entire business, not just reduced insurance premiums
- A better idea of any inconsistencies in the organization's risk management approach

Tips for Utilizing TCOR

Consider the following tips when evaluating TCOR for your organization:

- Use a basic framework to break down costs into component categories such as insurance premiums, service provider costs, risk transfer costs and safety department expenses.
- Identify existing costs for each risk category, expressed as a percentage of overall company revenues.
- Establish targets for each category for future years.
- Remember that it's not just about premiums. TCOR also includes self-insured losses, internal administrative fees and outside vendor fees.
- Work on one area of TCOR at a time. This helps expose weaknesses in other areas of your risk management program and helps identify problem areas that need attention.
- Consider all components of TCOR proportionally, and examine how they're operating in conjunction with each other. If losses are low and premiums are high, there may be a need to reduce annual premiums and retain more predictable losses.
- Be patient. Don't expect immediate cost savings. Be prepared to invest in risk management tools that can deliver financial benefits over time.

Contact Winters-Oliver Insurance Agency for a TCOR evaluation and resources that can help you lower your TCOR and improve your bottom line.