Plan Management Navigator
Analytics for Health Plan Administration

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Please see invitation to participate in the 2017 edition of the Sherlock Benchmarks on Page 9.

How do Best-in-Class Independent / Provider-Sponsored Plans Achieve It?

In this issue of *Plan Management Navigator*, we provide a summary of our analysis on "Best-in-Class" plans versus their Peers. Our analysis is based on the 13th annual Independent /Provider-Sponsored *Sherlock Benchmarks*. For these purposes, we define "Best-in-Class" plans as among the 25th percentile in lowest cost. Others are referred to as "Peer" plans. All results are from 2015.

Notwithstanding our referring to low cost plans as Best-in-Class, we recognize that the long-term preferred objective are costs that are optimal for strategic objectives. But the focus on low costs places the burden of proof on functions that are relatively high to justify their costs through other objective metrics of superior performance. Put a different way, the focus on low costs is the basis for which an ROI can be calculated.

The focus of much of this analysis is "Tactical" costs, that is, costs other than Sales and Marketing and Medical Management. Those "Strategic" areas have costs most readily associated with strategic objectives such as growing the business and reducing health care costs.

This analysis highlights the role of careful management in superior health plan operational performance. To perform the analysis, we endeavor to quantify and even eliminate the effect of factors largely beyond management control. We then isolate and measure the specific contributing factors that are more likely to be under the control of the management team. In making these exclusions, we are recognizing that these strategic expenses have impacts outside of current period administrative costs. We do, however, address these functional areas separately towards the end of this issue.

Figure 1. Best-in-Class Independent / Provider-Sponsored Health Plans
Functions in Tactical and Strategic Expenses

Tactical Expenses:
Provider Network Management and Services

Account and Membership Administration Cluster
- Enrollment / Membership / Billing
- Customer Services
- Claim and Encounter Capture and Adjudication
- Information Systems

Corporate Services Cluster
-Finance and Accounting
-Actuarial
-Corporate Services Function
-Corporate Executive and Governance
-Assocation Dues and License / Filing Fees

Strategic Expenses:
Sales and Marketing Cluster
- Rating and Underwriting
- Marketing
- Sales
- Broker Commissions
- Advertising and Promotion

Medical Management / Quality Assurance / Wellness

Conclusions

Best-in-Class plans' Tactical PMPM costs were 42% lower than their Peers. A low Staffing Ratio was the overwhelmingly most important factor in low Tactical Costs, with Best-in-Class plans holding a 33% advantage and comprising 73% of the difference. Moreover, in every major functional area, Best-in-Class plans operated with lower Staffing ratios. Staffing Costs per FTE were lower by 19%, and Non-Labor Costs per FTE were lower by 6%.

It appears that Best-in-Class plans operate in a culture of conservative administrative expenses since all of the major Tactical functional areas were lower than the Peers. The overwhelming contributor among functions to superior performance was low costs in Information Systems and it was responsible for 40% of the difference. The Corporate Services function and Claims functions were also low. These three functions comprised 70% of the difference between the two sets of plans.

When we observe costs that differ between the Best-in-Class and Peer plans, these are standardized for member months (i.e., PMPM) even if not stated.

Accounting for Extraneous Factors

To hone to the most manageable factors, we address five factors that are either extraneous to reducing true operational costs or cannot be readily managed over the short or intermediate term.

Scale. If scale played a role it was modest. The mean membership size for Best-in-Class plans was 580,000 versus 500,000 for the Peer plans. The median values for the two sets were 640,000 and 330,000, respectively. Size did not determine ranking though since two of the five Best-in-Class plans were significantly smaller than the median size of the Peer plans.

Operating in Low Wage Areas. There was an effect of local costs of living but it was modest. The mean wage index was 0.914 among the Best-in-Class plans and 1.048 among the Peer plans, 13% lower (We employ the Hospital Wage Index used by CMS). Importantly, Staffing Costs per FTE for the Best-in-Class plans were lower by 19%, meaning that Staffing Costs per FTE were lower than indicated by the relative wage index. In any event, the proportion of the Best-in-Class cost advantage that can be attributed to Staffing Costs per FTE is 21%.

[1].When we observe costs that differ between the Best-in-Class and Peer Plans, these are standardized for member months (i.e., PMPM) even if not stated.

Propensity to Outsource. Outsourcing was associated with high costs in the Peer plans. The mean percent of FTEs outsourced was 12% among the Best-in-Class plans and 16% among the Peer plans. The median percent of FTEs outsourced was 7% among the Best-in-Class plans and 15% among the Peer plans.

Information Systems is generally among the functions most often outsourced, at a mean of 25% for all Independent / Provider-Sponsored plans. The mean percent of FTEs outsourced was 17% among the Best-in-Class plans and 27% among the Peer plans. The median percent of Information Systems FTEs outsourced was 12% among the Best-in-Class plans and 27% among the Peer plans. The Information Systems costs for Best-in-Class plans was the most important factor in their lower costs.

Low-Cost Product Mix. By reweighting, as we describe in the section Our Approach, the analysis presented here eliminates the effect of any product mix differences between the groups of plans. A plan focused on ASO products will have lower per member costs than one focused on Medicare Advantage irrespective of its efficiency. Since the Best-in-Class plans were less focused on commercial products and much more focused on the less expensive Medicaid HMO, reweighting to eliminate the effects of product mix was an important step. The different product mixes can be seen below.

Forgoing "Strategic 'Investments.'" A Best-in-Class Plan's declining to spend on Medical Management and the Sales and Marketing functions could not contribute to the superior performance measured here since these activities are excluded from the central part of this analysis. In making this exclusion, we are recognizing that these "strategic" expenses have impacts outside of current period administrative costs. We do address these functional areas separately towards the end of this analysis.

Figure 2. Best-in-Class Independent / Provider-Sponsored Health Plans
Product Mix Comparisons*

	Commercial Insured	Commercial ASO	Commercial Total	Medicare Total	Medicaid Total	Comprehensive Total
Best-in-Class	46%	17%	63%	15%	21%	100%
Peer Plans	51%	20%	71%	14%	12%	100%

**Medicare Supplement is not shown.*

[2]Unless otherwise noted, all of the factor ratios referred to in this analysis, i.e., Staffing Ratios, Staffing Costs per FTE and Non-Labor Costs per FTE, are adjusted to treat outsourced activities as in-sourced. In other words, outsourced staffing is included in the Staffing Ratios reported in these analyses.

Activities that Made a Difference

Because all of the functions in Best-in-Class plans were lower than their Peers, Best-in-Class plans appeared to operate in a culture of conservative administrative costs. However, a few of the functions were especially important in the plans' achieving superior performance. We will address them in order of their importance.

The **Account and Membership Administration cluster** of functions comprised 63% of the difference between the Best-in-Class plans and their Peers. Account and Membership Administration is comprised of the core operating activities of Enrollment/Membership/Billing, Claim and Encounter Capture and Adjudication, Customer Services and Information Systems.

The most important reason why costs in this cluster of functions were lower was Information Systems. Its costs comprised 63% of the low-cost variance in this cluster and 40% of low tactical costs. Claim and Encounter Capture and Adjudication contributed 13% to overall low tactical costs. Customer Services and Enrollment contributed 6% and 5%, respectively, to overall low tactical costs.

In the Account and Membership Administration cluster as a whole, the Staffing Ratio was lower by 32%, while Staffing Costs per FTE and Non-Labor Costs per FTE were also lower by 20% and 8%, respectively.

Information Systems. This function's costs were 42% lower in the Best-in-Class plans. The Staffing Ratio was 49% lower and contributed the most to low-cost variance. Staffing Costs per FTE were low by 18%, while Non-Labor Costs per FTE were high by 39%.

The Information Systems sub-function, Applications Acquisition and Development, contributed the most to low Information Systems, at 51% of the low-cost comparison for the function. The Staffing Ratio was the main driver in low Application Acquisition and Development expenses, at 45% lower. This was closely followed by low Non-Labor Costs per FTE at 41% lower. Staffing Costs per FTE were 19% lower.

Claim and Encounter Capture and Adjudication. Best-in-Class plans reported lower expenses than Peer plans by 45%. A low Staffing Ratio was responsible for 91% of these lower costs. Staffing Costs per FTE were 10% lower, while Non-Labor Costs per FTE were 8% higher.

The sum of Information Systems and Claims, closely linked activities, was lower for the Best-in-Class plans by 43%.

Corporate Services *Function.* (This word is italicized to distinguish it from the more encompassing cluster of the same name.) This function comprised 18% of the overall low tactical costs variance. Low Corporate Services Function costs were overwhelmingly driven by a low Staffing Ratio, at 48% lower. Non-Labor Costs per FTE was lower by 20% in favor of the Best-in-Class plans, while Staffing Costs per FTE were lower by 22%.

There are nine sub-functions within this functional area: Human Resources, Legal, Facilities, Audit, Purchasing, Imaging, Printing and Mailroom, Risk Management and Other. All sub-functions were lower for the Best-in-Class plans except for Audit and Printing and Mailroom. The latter was more than double the costs of the Peer plans.

This function, along with many of the sub-functions, appear to be subject to economies of scale. Please see the December 2016 *Plan Management Navigator* and December 2016 *PULSE* for a complete analysis of economies of scale for health insurance.

Provider Network Management and Services. Best-in-Class plans reported lower Provider Network Management and Services expenses by 39%. The Staffing Ratio was almost half that of the Peer plans, while Staffing Costs per FTE was 12% lower. Non-Labor Cost per FTE were more than three times that of the Peer plans.

All Provider Network Management and Services sub-functions were lower in favor of Best-in-Class plans. A low Staffing Ratio was the key to lower costs for all three sub-functions.

The Provider Relations Services sub-function contributed 36% to the low functional area cost and 3% to overall low tactical costs. It was 38% lower for Best-in-Class plans. A Staffing Ratio that was 31% lower was the chief driver. Staffing Costs per FTE were also lower, yet Non-Labor Costs per FTE were 16% higher for the Best-in-Class plans.

Customer Services. Customer Services contributed 6% to overall low tactical costs. Low Staffing Costs per FTE contributed 52% toward this function's low-cost variance, while a low Staffing Ratio contributed 41% toward the low costs. Low Non-Labor Costs per FTE made up the rest.

Strategic Expenses were Also Lower

Possibly reflecting a culture of conservative administration, Best-in-Class plans also had lower costs in the Strategic areas of Sales and Marketing and Medical Management, but not as low as the tactical costs. The Strategic Expenses decreased the Best-in-Class plans' cost advantage from 42% lower to 34% lower.

The Sales and Marketing Cluster of expenses was lower for Best-in-Class plans by 13%. Best-in-Class cost advantage was primarily due to a low Staffing Ratio, which was lower by 25%. Staffing Costs per FTE were 18% lower, but Non-Labor Costs per FTE were 32% higher for Best-in-Class plans.

Best-in-Class plans' Sales and Marketing outsourced an average of 9% and a median of 6% of FTEs. This compares to Peer plans who also outsourced an average of 9% and a median of 4% of FTEs.

Best-in-Class plans held a cost advantage in most Sales and Marketing functional areas. Its most important advantage was in Sales, which was 48% lower than the Peer plans. This is the function that houses internal sales reps and account services. The Staffing Ratio was 45% lower for this function, while Staffing Costs per FTE were 18% lower. Non-Labor Costs per FTE were 71% higher than the Peer plans.

Marketing expenses were lower by 32%. The sub-function Other Marketing comprised the largest source of low Marketing costs with Best-in-Class plans having costs that were 59% lower than Peer plans. The Staffing Ratio was the overwhelming driver in this sub-function's low costs.

Rating and Underwriting costs were 38% lower for Best-in-Class plans due mainly to a low Staffing Ratio. Staffing Costs were also low, yet Non-Labor Costs per FTE were 51% higher for Best-in-Class plans. Both Rating and Underwriting sub-functions were lower for the Best-in-Class plans and a low Staffing Ratio was the main reason.

While Sales costs were low, External Broker Commissions were 9% higher for the Best-in-Class plans. In the Sherlock Benchmark classifications, external Broker Commissions are entirely Non-Labor expenses.

Advertising and Promotion costs were also 34% higher for Best-in-Class plans mostly due to higher Non-Labor Costs per FTE. Media and Advertising sub-function contributed the vast majority of these higher costs. Charitable Contributions were also higher by 23% for Best-in-Class plans.

Low costs of Sales and Marketing did not impact growth, evidently. Total product membership for the Best-in-Class plans grew by a median value of 11.3%, compared with a median growth of 1.9% for their Peer plans. At the product-mix of the Best-in-Class plans, the Peer plans had membership growth of 1.2%.

Best-in-Class plans had lower Medical Management costs by 36%, with a low Staffing Ratio as the central driver. This is in contrast to Blue Cross Blue Shield Plans, whose Best-in-Class Plans had higher Medical Management costs. Staffing Costs per FTE, as well as Non-Labor Costs per FTE, were also low. All sub-functions except for Disease Management and Nurse Information Line were lower cost than the Peer plans. (Best-in-Class plans outsourced an average of 11% and a median of 3% of their Medical Management FTEs compared to Peer plans at an average of 11% and also 11% for the median.)

Peer plans experienced higher gross profit margins at a median of 12.3% versus 10.2% for Best-in-Class plans for insured products. (Insured products include Commercial Insured, Medicare Supplement, Medicare and Medicaid). Peer plans had even higher margins when reweighted at the mix of Best-in-Class plans, at 13.2%. (Gross profit margins are premiums less health benefits divided by premiums.)

Gross profits for insured products were also higher in the Peer plans. On a PMPM basis, insured gross profits were $40 PMPM for the Best-in-Class plans and $58 for the Peer plans. At the mix of the lower-cost plans, the Peer plans' PMPM gross profits were $63. (Gross profits are premiums less health benefits.)

Similarly, it is notable that the median insured health benefit ratio for the Best-in-Class plans was 90%, compared to 88% for the Peer plans. At the product mix of the Best-in-Class plans, the Peer plans had a median health benefit ratio of 87%.

There may be a unifying theme in these results although we do not explore them further in this study. It appears that the Best-in-Class plans achieved their growth not through aggressive Sales and Marketing efforts but through low prices. They enabled this strategy by keeping all administrative expenses low, including Sales and Marketing. This resulted in higher Health Benefit Ratios and lower Gross Margins, while enabling faster membership growth.

Our Approach

Each of the plans studied during this study differs in many key characteristics. So, to compare them we employed a composite approach to summarize the characteristics of the low cost, Best-in-Class plans and Peer plans to which they are compared. We summarize the steps below.

1. We identify the Best-in-Class plans by comparing each plan's costs to its universe. We selected the lowest cost plans that comprise 25% of the total Independent / Provider-Sponsored universe. To do so, and to eliminate the potentially distorting effect of product mix differences on the cost comparisons, we reweight the costs of the universe to match the mix of each plan. Thus, the lowest cost plans were those with the smallest differences from Plan-reweighted universe values. Five of the plans, or 25%, were called "Best-in-Class" and the others were called "Peers."

2. Best-in-Class and Peer plans were compared as composites of the plans that comprise them. That is, the central tendencies of the two sets of plans were compared with each other. The median cost drivers of Staffing Costs per FTE and Non-Labor Costs per FTE for each cluster, function and sub-function of the two sets were employed in establishing two factors underlying the differences between each of the composites.

3. The Costs per Member per Month used in each of the composites employed the mean values for each function and product for its respective composite set of plans. To develop the total function values for each composite, we multiplied the mean product mix for the Best-in-Class plans times each of the mean cost values for each function. These weightings were then summed to arrive at a total for each function. The sum of the function costs yielded a total Tactical cost value. The Tactical costs plus the identically calculated Strategic costs equaled the total costs. To assure comparability between the Best-in-Class and Peer plans, we employed the product mix for the Best-in-Class plans as weights for both sets of plans.

4. Staffing Ratios for each function, the third factor in function variances, were estimated so as to eliminate the effect of product mix differences and to overcome the fact that health plans generally don't segment their staff by product. To make this estimate, we first calculate Total Costs per FTE as the sum of the median per FTE Staffing and Non-Labor Costs. Then we divided the PMPM costs for each function by the Total Costs per FTE. This value is then multiplied by 120,000 to convert annual values to monthly ones, and to adjust for the fact that the Staffing Ratios are presented as per 10,000 members rather than per member.

5. The percent of total variance by the Best-in-Class plans is calculated through a series of simulations and interpolations. Since costs Per Member Per Month is the product of Total Costs per FTE and the Staffing Ratio, each factor is held constant to assess the dollar impact of its opposite. The two resulting values are interpolated. The same procedure is employed on the per FTE Costs of Staffing and Non-Labor, given the calculation of the contribution of Total Costs per FTE.

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WOULD YOUR HEALTH PLAN LIKE TO PARTICIPATE IN THE 2017 SHERLOCK BENCHMARKING STUDY?

The highly valid, well-populated Sherlock Benchmarks provide an unbiased ranking and helps prioritize cost management activities to have the greatest impact on improving your health plan's overall operating performance. The combination of the current environment of the Affordable Care Act along with the distinct possibility of changes in law and regulation may make participation by your health plan an appropriate and necessary response to the strong incentives to cost efficiency.

Many of your peers have concluded that participation is timely. The overwhelming proportion of health plans participating last year are participating this year, and we have added several plans. Please see this link to the Selected Characteristics chart for what last year's participation looked like.

While the calendar varies by universe, broadly speaking we will meet to finalize the content of the survey in late February, distribute the survey forms in March, collect the completed surveys in May and publish beginning in late June or early July. Participation entails notable efforts on your part since useful outputs require relatively granular inputs. However, the cost is relatively modest.

Please reach out to Douglas Sherlock at sherlock@sherlockco.com or 215-628-2289 if you are interested. You will be among good company.

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