



DECISIONS OF LOW COST INDEPENDENT/PROVIDER-SPONSORED PLANS IN 2011

Independent / Provider-Sponsored (“IPS”) Plans play a central role in local health care markets and health care reform may increase their prominence. They typically enjoy strong brand recognition, often through the association with a health system, hospital or physician group. In their historic choice of product offerings and through their culture they have tended to focus on managed care products. They are also typically not-for-profit organizations.

Under health care reform, these organizations may become increasingly numerous through the auspices of the creation of Consumer Oriented and Operated Plans, or “CO-OPs.” Eligible organizations must be organized to operate as not-for-profit and may include small business coalitions, physician and hospital providers and associations, agricultural organizations, unions, and community-based sponsors. Of the 24 funded start-up health plans, six are at least associated with health providers or insurers, and they have received more than one-half billion in funding. Thus, IPS plans may be a suitable model for the most successful of the CO-OPs.

This analysis is derived from data collected from the 18 Independent/Provider-Sponsored plans participating in *Sherlock Expense Evaluation Report* in 2012. We believe that there are approximately 80-90 provider-sponsored plans. However, we have reason to believe that our participants may be atypical or even elite. Their average size of 372,000 is far larger than most provider-sponsored plans, so they have overcome whatever cost disadvantages associated with start-ups. In addition, these organizations typically approach \$2 billion in annual revenues so, to the degree that they are owned by providers, they could not be considered to be primarily their distribution system. The fact that they complete the survey form indicates a commitment to measurement, a prerequisite to management.

Independent / Provider-Sponsored plans that operate with low costs make expense decisions that differ from firms that operate at higher costs. This analysis summarizes the hallmarks of those decisions.

The most important reason for their superior performance stems from staffing ratios that

are remarkably low. This ratio incorporates outsourced as well as full-time employees. Low costs in Account and Membership Administration were a central factor in this, and low Information Systems costs were the largest contributor to overall low costs.

This analysis corresponds with a similar one published in the December 2012 Navigator. While the business mix differences between the universes limit comparability, it is notable that staffing ratio differences are similarly important to the relative performance of the low cost plans.

Overall Cost Savings

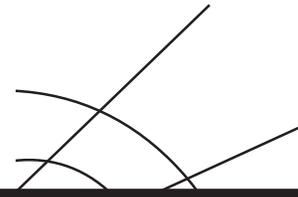
Overall, low cost Independent/Provider-Sponsored plans had tactical administrative expenses that were \$8.58 PMPM, or 40%, lower than their higher cost counterparts. Tactical expenses exclude Marketing and Medical Management, as developed in the box on Page 2. In the low cost plans, the staffing ratio was significantly lower than the high cost plans and accounted for 78% of the overall cost savings. Non-Labor Costs (supplies, depreciation and other operating expenses) per FTE were also lower by approximately 18% and were the next most important factor. Staffing Costs per FTE were 5% lower and accounted for 6% of the overall cost savings.

The low staffing costs per FTE may be understood in the context of the wage levels in the markets of the low cost plans. They averaged 92% of the average of the high cost plans.

Notably, low cost plans are able to improve their relative performance. As a group, the five low cost plans kept their increase in PMPM tactical administrative costs to 2.1% while their higher cost peers increased by 3.0%. One plan

Figure 1. Plan Management Navigator
Sources of Total Variances, Mix-Adjusted

	Non-Labor Costs per FTE	Staffing Costs Per FTE	Total Costs Per FTE	FTEs Per 10K Mbrs.	Costs PMPM
<i>Lowest Five Plans</i>	\$53,219	\$77,415	\$130,634	11.70	\$12.74
<i>Other Plans</i>	\$64,950	\$81,308	\$146,258	17.49	\$21.32
Dollar Variance	(\$11,731)	(\$3,893)	(\$15,624)	(5.79)	(\$8.58)
Percent Variance	-18.1%	-4.8%	-10.7%	-33.1%	-40.3%
Percent of Total Variance	16.6%	5.5%	22.1%	77.9%	100.0%
PMPM Dollar Variance	(\$1.43)	(\$0.47)	(\$1.90)	(\$6.68)	(\$8.58)
<i>Source of As-Reported Data:</i>	<i>Volume II.A, Page 312</i>	<i>Volume II.A, Page 290</i>		<i>Volume II.A, Page 274</i>	<i>Volume I, Page 126</i>



even posted a decline in tactical costs. These trends hold constant universe and the business mix of these plans between the two measurement years.

When examining the specific activities that were the sources of savings, the cluster of functional areas called Account and Membership Administration explained 62%. The expenses that make up this cluster were responsible for the majority of reported overall tactical costs of health plans. In this cluster of functions, a low staffing ratio explained 84% of the superior cost performance. Staffing Costs per FTE, as well as Non-Labor Costs per FTE, were below their respective medians as well.

Information Systems was the functional area responsible for the vast majority of the superior performance of the Account and Membership Administration cluster. This function was also the most important reason for lower total tactical costs. A low staffing ratio was the most important contributor to low IS costs. Both Non-Labor and Staffing Costs per FTE were lower than their respective medians. In 2011, Information Systems functions for low cost plans are less likely to be outsourced than the high cost plans.

The other three functions in this cluster, Enrollment, Customer Services and Claim and Encounter Capture and Adjudication were also low. Enrollment costs were lower by 25% and Customer Services costs were lower by 40%. Claim and Encounter Capture and Adjudication costs were also lower by 40%. In 2011, Claim and Encounter Capture and Adjudication expenses were also less likely to be outsourced than the high cost firms.

The fact that all four of these functions are low is important for two reasons. First, since the operations are all part of the same array of processes, the organizations as a whole are operating at low costs rather than shifting activities between functions. Moreover, were any activities incorrectly classified, for example between information systems and claims (and our reporting conventions contain strong assurances that this is not the case), that all these functions are low means that whatever blurring that exists does not change the underlying conclusion.

Among the three functions of Enrollment, Customer Services and Claim and Encounter Capture and Adjudication, all had lower staffing ratios and lower staffing costs per FTE. Enrollment Non-Labor Costs per FTE were higher than the low cost plans, but they were lower for Customer Services and Claims.

The cluster of Corporate Services comprised 33% of the low cost plans' tactical expenses. The functions in this cluster include Finance and Accounting, Actuarial, Corporate Services function and Corporate Executive and Governance. For this cluster, a low staffing ratio was responsible for the overwhelming proportion of the low costs. Staffing costs were also low, while non-labor costs were high.

Many of the scalable functions are found in the Corporate Services cluster. The median size of the low cost plans was 500,000 members, compared with 250,000 members

Background and Methodology

For this analysis, the term "low cost" refers to the performance of five Independent/Provider-Sponsored plans for the functional areas which make up approximately 50% of total administrative costs. These costs *exclude* the functional area of Medical Management and the cluster of Sales and Marketing, which we call "strategic."

The purpose of excluding Medical Management is that when effective, it drives down health benefit costs. Health benefits are identifiably discrete from administration and medical management may have benefits spanning years. Similarly, effective Sales and Marketing expenses often affect growth in subsequent years. This analysis focuses on the remaining expenses that have an immediate impact on the operations of a health plan. Their effect is largely confined to current period activities and each function's performance principally affects only those other remaining activities.

We call these remaining expenses "tactical" for the purposes of this analysis. We acknowledge that, for Information Systems in particular, this segmentation is subject to criticism. We also recognize that the architecture of expenses is established over multiple years. These tactical expenses are incurred, however, in ways that largely reflect those management decisions affecting a health plan's business processes in that period.

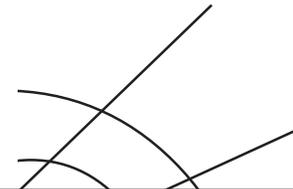
To identify the decisions that lead to low costs, we divided the universe of Independent/Provider-Sponsored plans into a low cost group, comprised of approximately 25% of the universe, and all other plans in that universe. Five of the 18 plans were selected for the low cost group. The low cost group was determined based on relative performance, after our comparisons eliminated the effect of product mix differences. We did not adjust for any cost of living differences since health insurance operating functions are not geographically confined, though we did note the average wage index.

We sometimes use the term "superior performance" as a synonym for low cost. This should not be construed as meaning that low costs are necessarily optimal. However, we do not have any evidence that low costs in these tactical areas lead to suboptimal performance in other aspects of their operations.

among their higher cost peers. This suggests that scale may play an important role here.

The Corporate Services *function* is comprised of the sub-functions of Human Resources, Legal and Facilities, and others. This function was responsible for 18% of the low costs in tactical expenses as a whole and 58% of the low costs in the cluster. Like the cluster of the same name, a low staffing ratio was responsible for most of the low





costs. Staffing costs per FTE were also low and non-labor costs were high.

Corporate Executive and Governance contributed 7% to the overall low costs, with staffing ratio comprising most of the advantage. While Staffing Costs per FTE were 13% higher than the median, Non-Labor Costs per FTE were 91% below the median.

The functional area of Provider Network Management and Services contributed only 6% to overall tactical low costs. Most of the cost savings came from low Staffing Costs per FTE and low Non-Labor Costs per FTE. The Staffing Ratio was also low.

The Choices Low Cost Plans Make in Tactical Expenses

Low cost plans make decisions that differ from their higher cost peers. Hallmarks of these decisions include levels and distributions of expenses between functions, the levels and distribution of staff between functions, the levels of compensation and its distribution between functions and the distribution between functions and levels of non-labor expenses.

Cost Variances. Among the low cost plans, Corporate Executive and Governance represented the greatest percent of low cost variance enjoyed by the low cost plans, followed by Information Systems and Actuarial. Low cost plans maintained low costs in all functions except Association Dues and License/Filing Fees.

Components of Cost Variance. The leading sources of overall low costs were the functional areas of Information Systems and Corporate Services. This was followed by the functional areas of Claim and Encounter Capture and Adjudication and Corporate Executive and Governance.

Staffing Ratio Variances. Low staffing ratios were primarily responsible for the difference between the low cost and other plans. In terms of functional areas, Finance and Accounting for low cost plans had the greatest variance from their high cost peers, followed by Actuarial.

Components of Staffing Ratio Variances. As noted earlier, the staffing ratios of low cost Plans were significantly lower than those for their high cost peers. The most important source of this difference was in the functional area of Claim and Encounter Capture and Adjudication followed by Information Systems.

Staffing Cost Variance. Staffing costs also contributed to the performance of low cost health plans. Provider Network Management and Services and Customer Services costs were especially low. However, staffing costs were higher in Corporate Executive and Governance and Actuarial.

Components of per Employee Staffing Cost Variance. Of the total staffing low costs, Information Systems

comprised the majority of it followed by Provider Network Management and Services. Actuarial and Corporate Executive and Governance staffing costs were higher, on the other hand, slightly offsetting the overall low costs.

Non-Labor Cost Variance. Low Non-Labor Costs per FTE were the second-most important factor in overall low costs. Corporate Executive and Governance and Provider Network Management and Services were especially low. Finance and Accounting, on the other hand, had very high Non-Labor Costs per FTE. The Corporate Services function and Enrollment also had high costs.

Components of Non-Labor Cost Variance. The functional area of Information Systems was the greatest component of low Non-Labor Costs per FTE, followed by Corporate Executive and Governance. Finance and Accounting was the greatest offset to low costs, followed by the Corporate Services function and then Enrollment.

Strategic Expenditures of Low Cost Plans

As noted above, certain expenses, especially Sales and Marketing and Medical Management, have returns that may be realized over a longer period of time. In addition, Medical Management expenses may yield lower health care costs. For this analysis, we call these strategic activities. Therefore, we have considered these expenses separately and, in this analysis, assumed that health plans with low costs in the tactical functions are also likely to make insightful decisions regarding strategic functions as well. Unlike the tactical expenses, however, the strategic expenses were higher overall.

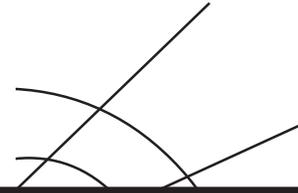
For the low cost Independent/Provider-Sponsored plans, the Sales and Marketing functional area cluster had expenses higher than the other plans. Although Staffing Ratios for this cluster were low, Non-Labor Costs per FTE were high. Non-labor costs for this cluster include broker Commissions and Advertising.

It is notable that these low cost plans' membership grew at higher rate as compared with their higher cost peers. This is amplified for the higher cost peers when the product mixes were matched.

The major source of higher costs was in external broker Commissions. No staffing was associated with this activity and all costs were considered non-labor for our purposes.

Internal Sales costs, however, were low. The staffing ratio was 13% lower than average, while Non-Labor Costs per FTE were 32% lower. Staffing Costs per FTE were slightly above the other peer plans. That Commissions expenses were high and Sales costs were low suggests that low cost plans favored external distribution.





Advertising and Promotion costs were slightly high, chiefly due to high Non-Labor Costs per FTE. The Staffing Ratio was about average, while Staffing Costs were slightly high.

Marketing expenses were lower, while Rating and Underwriting expenses were higher. Marketing costs were lower notwithstanding higher Non-Labor Costs per FTE and Staffing Costs per FTE. The Staffing Ratio was low for this function. Rating and Underwriting costs were higher mainly due to a high Staffing Ratio. Non-Labor Costs per FTE were high, while Staffing Costs per FTE were low.

The firms with the lowest costs in the tactical areas also had low costs in Medical Management. While the Staffing Ratio was slightly high, Non-Labor Costs per FTE and Staffing Costs per FTE were both high.

The median health benefit ratio for the low cost plans was higher than that of the plans with higher administrative costs. This was also true when adjusting for the mix of products offered by the low cost plans, though the difference diminished.

Conclusion

This analysis identifies the hallmarks of the choices that low cost Independent/Provider-Sponsored plans make. It is free of product mix bias, and the data has been thoroughly scrubbed.

A few conclusions may be drawn. While the expense savings were concentrated in Information Systems, Corporate Services and Claim Encounter Capture and Adjudication, they were found in all tactical functions except Association Dues and License/Filing Fees. This is suggestive of an overall management commitment and a culture of conservative spending throughout the organization.

Also, low costs were mostly the result of lower staffing ratios. Non-Labor Costs per FTE and compensation per employee were also lower, but their contribution was relatively modest. This mix of drivers was suggestive of thoughtful attention to the *processes* of executing health plan transactions.

Among low cost plans' "strategic" expenses, both Sales and Marketing costs were actually higher than their higher cost peers, while Medical Management costs were lower.

It is possible that low administrative costs came at a cost. Health Benefit Ratios were higher for the low cost plans. On the other hand, enrollment growth was more rapid for the low cost plans.

Economies of scale may have benefited the low cost plans, which typically had greater numbers of members. We

believe that this may have been especially important in the Corporate Services cluster.

Low cost plans tended to outsource less Information Systems staff than their peers, which was also the case for Claim Encounter Capture and Adjudication staff.

This analysis is not intended as an operational blueprint. It contains no recommendations on what information system to buy, what proportion of claims should be autoadjudicated or the appropriate mix of manual versus automated customer service inquiries to shoot for.

The premises of this and our other Sherlock benchmarking efforts from which this analysis is drawn is that the heads of the various functional areas of the health plans are experts on how to improve their operations and are committed to doing so. We also recognize that aggressive cost management requires that managers make difficult decisions. In other words, our benchmarks are intended to serve as catalysts to the actions that managers may already see as necessary on an intuitive level and also provide a broad-brush description of what those operational targets must look like. Those managers are likely experts in executing the goals implied in this analysis.

There many reasons why health plans are taking a heightened interest in managing their administrative costs. First, health care reform under the PPACA creates pressures on operating activities. They include the effects of the rebate rules of MLR regulations, the more intense competition fostered by state and federally administered exchanges and the possible migration of employers to self-insured products to avoid PPACA regulations, which increases the visibility of administrative costs. Secondly, the weak employment environment pressures membership, forcing rationalization of operating costs.

Sherlock Company is the leading provider of actionable benchmarks for health insurers. Now beginning its 16th consecutive year, Sherlock benchmarks are used by most Blue Cross Blue Shield plans, and most of the health plan board members of AHIP.

Additional information is available to users of the Independent/Provider-Sponsored edition of the Sherlock Expense Evaluation Report.

