Plan Management Navigator

Administrative Expense Ratios of Publicly-Traded Companies

Healthcare Analysts

Douglas B. Sherlock, CFA
sherlock@sherlockco.com

Christopher E. de Garay
cgaray@sherlockco.com

Erin Ottolini
erin.ottolini@sherlockco.com

John Park, CFA
jpark@sherlockco.com

Andrew L. Sherlock
asherlock@sherlockco.com

(215) 628-2289

Background

Whether administrative expenses have significant economies of scale can have important corporate finance and market implications for health plans. Among the mosaic pieces of evidence on this matter are the ratios of large, publicly-traded companies. If there are economies of scale in health insurance administration, then they could be apparent among publicly-traded firms. After all, they are larger than most other health plans, often many times larger. So, relatively low PMPM costs and percents of premium ratios in such companies would demonstrate economies of scale.

Our analysis is focused on the principle business of health insurers: comprehensive products. "Comprehensive" products cover doctor and medical bills. Medicare Supplement is also included although it is a secondary payor to Medicare.

This analysis shows what we believe those ratios are for comprehensive products during 2017, derived solely from information supplied to investors. It then compares these values to those of the Blue Cross Blue Shield benchmark values published by Sherlock Company. We expect to revise this in coming months reflecting 2018 public company information: the first public company to report 2018 results will be UnitedHealth Group, on Tuesday January 15.

Estimating percent of premium and PMPM values for public companies is complex. Most of the companies offer products and services that are sometimes out of the health insurance business. Even if segment reporting is provided, it reflects each organizations' idea of its business model, which may include expenses other than comprehensive.

Figure 1. Public Company Administrative Expenses Compared with Sherlock Company Benchmarks

Administrative Expenses for Public Companies

Company	Calculated Administrative PMPM Expense	Expected Administrative PMPM Expense	PMPM Difference	PMPM Pct. Difference	Calculated Administrative Percent	Expected Administrative Percent	PCTL Difference	PCT Difference
Aetna Inc	$40.48	$35.69	$4.79	13.4%	10.3%	10.0%	0.3%	2.9%
Anthem, Inc	$31.79	$32.85	-$1.06	-3.2%	9.0%	9.5%	-0.5%	-4.9%
Centene Corporation	$44.88	$46.37	-$1.50	-3.2%	10.6%	9.2%	1.4%	15.1%
Cigna Corporation	$42.63	$30.70	$11.94	38.9%	10.7%	9.1%	1.7%	18.3%
Humana Inc.	$58.47	$56.96	$1.51	2.7%	10.8%	10.9%	-0.1%	-0.8%
Molina Healthcare, Inc.	$40.59	$43.87	-$3.28	-7.5%	9.0%	9.4%	-0.4%	-4.0%
UnitedHealth Group Incorporated	$46.77	$40.37	$6.40	15.9%	13.1%	11.1%	2.0%	18.4%
WellCare Health Plans, Inc.	$41.55	$51.60	-$10.05	-19.5%	10.1%	9.6%	0.5%	5.1%

Results

As shown in Figure 1, many of the publicly-traded plans have higher administrative expense ratios.

In considering differences from the mix-adjusted universe values, ones plan's results will not be strictly comparable to another. That is because the product mix of each company differs. For instance, a health plan with an especially high mix of Medicare Advantage could have higher PMPM favorable or unfavorable variances resulting solely from the higher levels of PMPM costs in that product.

Note that, because of each organization's reporting, results are qualified as discussed below.

How Are Company Ratios Calculated?

The public company ratios are calculated based on information found in the SEC forms 10-K and occasionally supplemental information supplied by those public companies. We rely especially heavily on segment reporting exhibits where available.

There are numerous calculations that are necessary to approximate comparability of publicly-traded companies with Blue Cross Blue Shield plans. Most of the calculations can be done directly and arithmetically. In a few cases, for instance in which products other than comprehensive health insurance are included in a health insurance segment, we apply identical ratios within the public company to back out the effect of their classification.

We used only individual public company information to calculate their cost ratios. If cost functions were calculated with something other than comprehensive products, we mentioned directionally the effect of this, below. An example of this is when company reports included stand-alone Part D with comprehensive products: this would tend to yield higher PMPM comprehensive costs since we exclude the associated membership from the denominator.

Once the ratios were calculated, we compared them to the ratios of Blue Cross Blue Shield plans, weighting the Blue Cross Blue Shield percent and PMPM ratios by the product mix of each of the public companies. In other words, we do not calculate the public company information by product line, rather we employ product cost information from Blue plans and reweight them for comparison with public company totals.

The Blue Cross Blue Shield values were published in the *Plan Management Navigator* for June 2018. The PMPMs are based on all members of comprehensive products. The administrative expense percents were calculated based only on insured products. We excluded ASO products from the percent calculations because, unlike the Blue Cross Blue Shield plans that participate in our Benchmarks, the medical expense information necessary to calculate premium equivalents is unavailable for the public companies. We have excluded Triple-S from this analysis because of the complexity of its product portfolio, and the cost of living of its service area.

Qualifications

The ratios shown in Figure 1 are estimates and have some important limitations. Some limitations are likely found in all companies and others are specific to individual plans.

Premium taxes, when we were able to identify them, were excluded from this analysis. They were not always evident so it is possible that some of the plans had these costs in our estimates of their PMPMs. Median Blue Cross Blue Shield PMPM values for Commercial Insured were $5.63 and for ASO they were $0.08. They were $1.00 for Medicare and $0.00 for Medicaid. Median Blue Cross Blue Shield percent of premium values for, premium taxes for Commercial Insured were 1.9%. They were 0.0% for Medicare and for Medicaid.

Many public companies report medical management expenses as health benefits. That is not the case with participants in our benchmarking studies, including Blue Cross Blue Shield plans. This is a relatively large functional area and can distort the administrative expense ratios.

Our approach compares on a product mix adjusted basis. Market segment adjustment could yield different results. We believe that the differences between the approaches are likely modest since the ASO/Insured mix can approximate Large/Small group mix.

The public companies differed from Sherlock Benchmarks in how they report product lines and business segments. Each public company was unique in its reporting that may have affected its PMPM and percents of premium ratios. We summarize them below.

Aetna Inc: Health Care segment products includes PBM, dental, behavioral health and vision. As measured here, its costs and revenues include those products, while membership excludes them. This has the effect of overestimating PMPM administrative expenses. Using average BCBS data to back out the effects of these products, the administrative expense PMPM decreased moderately.

Anthem Inc.: Health Care segment products include Dental, Vision and Part D. As measured here, its costs and revenues include those products, while membership excludes them. This has the effect of overestimating PMPM administrative expenses. Using average BCBS data to back out the effects of these products, the administrative expense PMPM decreased slightly.

Centene Corporation: The primary reporting segment for this company's comprehensive products is its Managed Care segment. Managed Care excludes Corrections and TRICARE and all revenues, expenses and members have been excluded from these ratios. Also, Centene includes its stand-alone Behavioral Health business in the Managed Care segment. As measured here, its costs therefore include those expenses, and its revenues include Behavioral Health revenues while its membership excludes those members. If we use Blue Cross Blue Shield norms for this product, the PMPM would be slightly lower, while the percent of premium are approximately equal.

CIGNA Corporation: Global Health Care products include international, Dental and Medicare Part D. As measured here, its costs and revenues include those products, while membership excludes them. This has the effect of overestimating PMPM administrative expenses. Using average BCBS data to back out the effects of these products, the administrative expense PMPM decreased moderately.

Humana Inc.: The primary reporting segments for this company's comprehensive products is its Retail and Group segments. The Group segment includes fully-insured commercial group, ASO and military services. The Retail segment includes products of Medicare Advantage, Medicaid, Medicare Supplement and Medicare Part D. As shown in Humana's figures, expenses include Part D, while membership and revenues exclude Part D. If we use Blue Cross Blue Shield norms for this product, the PMPM and percent of premium values would be lower. Note Humana discloses its revenues for Medicare Part D.

UnitedHealth Group Incorporated: This company reports its Medicare Part D with its UnitedHealthcare segment, in Medicare and Retirement. This segment is composed primarily of comprehensive products. As measured here, its costs therefore include those expenses, and its revenues include Part D revenues while its membership excludes those members. If we use Blue Cross Blue Shield norms for this product, the PMPM and percents of premium values would be somewhat lower.

WellCare Health Plans, Inc.: Comprehensive products for WellCare are entirely composed of the government sponsored products of Medicare Advantage, Medicaid, and Medicare Part D. As shown in WellCare's figures, administrative expenses include Part D, while membership and revenues exclude Part D. If we use Blue Cross Blue Shield norms for this product, the PMPM and percents of premium values would be lower. Note that WellCare discloses its revenues for Medicare Part D.

Implications

There is no definitive evidence from publicly available information that publicly-traded companies enjoy competitively overwhelming economies of scale in administrative expenses. In other words, what identifiable cost advantages can be estimated are not substantial enough to support a price advantage sufficient to stimulate switching.

The fact that many of these companies have higher ratios may not mean that they are less efficient. For instance, a health plan that reports costs that lead to high ratios may have low costs in Account and Membership Administration, offset by high costs in Sales and Marketing, enhancing its growth. We simply cannot know from the information supplied to investors.

On the other hand, companies with low ratios may well be more efficient, subject to the comparability issues noted above. The treatment of medical management is a particularly important one.

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