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BEST-IN-CLASS INDEPENDENT / PROVIDER-SPONSORED PLANS

This is our analysis of "Best-in-Class" Independent / Provider – Sponsored (IPS) plans versus their Peers. Our analysis is based on the 21st annual Sherlock Benchmarks and 16th edition of the IPS study. 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 2017.

Notwithstanding our referring to low cost plans as Best-in-Class, we recognize that the maximizing long-term objective are costs that are optimal for its 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 the Sales and Marketing cluster and Medical Management function. 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.

Decisions of Best-in-Class Health Plans

Functions in Tactical and Strategic Expenses

Tactical Expenses:

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

Medical and Provider Management Cluster
- Provider Network Management and Services

Strategic Expenses:

Sales and Marketing Cluster
- Rating and Underwriting
- Marketing
- Sales
- Broker Commissions
- Advertising and Promotion

Medical and Provider Management Cluster
- Medical Mgmt. / Q.A. / Wellness

Conclusions

Median PMPM Tactical expenses were 40% lower for Best-in-Class plans compared to the Peer plans[1]. A low Staffing Ratio was the main driver in low Tactical costs for Best-in-Class plans, an advantage of 34% and comprising 81% of the difference. Every functional area for Best-in-Class plans operated at a lower Staffing Ratio.

Staffing Costs per FTE were 11% lower in favor of Best-in-Class plans and contributed 13% to low Tactical costs. Non-Labor Costs per FTE were lower for Best-in-Class plans, a difference of 8% comprising 7% of low tactical expenses.

It appears that Best-in-Class plans operate in a culture of conservative administrative expenses since all functional areas were lower than the Peer plans. The overwhelming contributor among functions to superior performance was low costs in Information Systems and it was responsible for 40% of the difference. Other notable low cost functions include the Corporate Services function and Customer Services function. These three functions composed 74% of the difference between the two sets of plans.

Accounting for Extraneous Factors

To hone to the most manageable factors, we consider five characteristics 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 552,000 versus 545,000 for the Peer plans, about 1% smaller. The median values for the two sets were 639,000 and 272,000, respectively. The standard deviations of the two sets are about 536,000 for the peer plans and about 302,000 for the Best-in-Class plans, together showing overlap between the sets.

Cost of Living. There was likely not an effect of local costs of living due to a minimal difference in the wage index. The mean wage index was .9900 among the Best-in-Class plans and .9902 among the Peer plans, .02% lower (We employ the Hospital Wage Index used by CMS). Meanwhile, mean wage index for all plans was .9900.

The wage index, it should be recognized, can exaggerate the actual wage differences experienced by the wage environment actually facing the health plans. The wage index is applied based on the city where the plan is headquartered. Presumably, the higher the wage levels in the headquarters' cities, the more advantageous remote service centers can be.

[1] Costs are standardized for member months (i.e., PMPM) even if not stated.

Propensity to Outsource. Outsourcing was associated with higher costs in the Peer plans. The mean percent of FTEs outsourced was 11% among the Best-in-Class plans and 16% among the Peer plans. The median percent of FTEs outsourced was 10% among the Best-in-Class plans and 12% among the Peer plans[2].

Information Systems is generally among the functions most often outsourced, at a mean of 22% for all Independent / Provider-Sponsored plans. The mean percent of FTEs outsourced was 15% among the Best-in-Class plans and 24% among the Peer plans. The median percent of Information Systems FTEs outsourced was 5% among the Best-in-Class plans and 14% among the Peer plans. The Information Systems costs for Best-in-Class plans was the most important factor in their lower costs.

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.

Low-Cost Product Mix. Mix can make a difference since product costs can differ. The Best-in-Class plans had more low cost Medicaid, but fewer low cost ASO members. However, by reweighting to equalize the mixes, as we describe in the section Our Approach, the analysis presented here eliminates the effect of any product mix differences between the sets of plans. The different product mixes can be seen below. These are mean values.

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 "investments" are excluded from the central part of this analysis. In making this exclusion, we are recognizing that these "strategic" expenses generate benefits in future periods. We do address these activities separately towards the end of this analysis.

	Commercial Insured	Commercial ASO	Commercial Total	Medicare Total	Medicaid Total	Comprehensive Total
Best-in-Class	47%	21%	69%	11%	18%	100%
Peer Plans	49%	24%	73%	11%	13%	100%

[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 tactical 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 59% of the difference between the Best-in-Class plans and their Peers. Account and Membership Administration is comprised of the central health plan 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 were 67% of the low-cost variance in this cluster and 40% of low tactical costs. Customer Services contributed 9% to overall low tactical costs and 16% of the cluster's low costs. The sum of Information Systems and Customer Services, was lower for the Best-in-Class plans by 49%. Claim and Encounter Capture and Enrollment contributed 8% and 2%, respectively, to overall low tactical costs.

In the Account and Membership Administration cluster as a whole, the Staffing Ratio was the most important driver, responsible for 84% of the variance, and was lower by 34%. Non-Labor Costs per FTE and Staffing Costs per FTE were lower than the peer plans by 3% and 11%, respectively.

Information Systems. This function's costs were 44% lower for the Best-in-Class plans with the Staffing Ratio being the primary factor for this function's low cost, lower by 40%. Non-Labor Costs per FTE were lower by 11% and Staffing Costs per FTE were greater by 0.7%.

The sub-function, Applications Acquisition and Development, contributed the most to overall low Information Systems expenses. Best-in-Class plans were 72% lower in this sub-function's costs with a low Staffing Ratio a chief driver. The Staffing Ratio was 69% lower in favor of the Best-in-Class plans, while Non-Labor Costs per FTE were lower by 17%. Staffing Costs per FTE were lower by 7%.

Corporate Services Function. Best-in-Class plans posted 54% lower expenses compared to Peer plans and composed 25% of overall low tactical costs. This function's low costs were chiefly due to a low Staffing Ratio at 63% lower in favor of Best-in-Class plans. Staffing Costs per FTE were lower by 5%. Non-Labor Costs per FTE, however, were higher for Best-in-Class plans by 50%.

There were nine sub-functions within this functional area: Human Resources, Legal, Facilities, Audit, Purchasing, Imaging, Printing and Mailroom, Risk Management and Other Corporate Services. All sub-functions were lower for the Best-in-Class plans.

Customer Services Function. Best-in-Class plans had 43% lower costs than Peer plans. The Staffing Ratio was the primary driver, 43% lower than Peers. Staffing Costs per FTE were slightly lower but Non-Labor Costs per FTE were 15% higher than Peer plans. The Member Services sub-function was 43% lower cost than Peer plans.

Claim and Encounter Capture and Adjudication. Best-in-Class plans reported expenses that were lower than Peer plans by 29% and contributed 8% to overall low tactical expenses. Staffing Ratio for Best-in-Class plans was 45% lower. Non-Labor Costs per FTE were 105% higher than Peer plans, and Staffing Costs per FTE was 3% higher.

Provider Network Management and Services. This function contributed 8% to overall low tactical costs and were lower for Best-in-Class plans by 36%. Staffing Costs per FTE and Staffing Ratio were the overwhelming drivers for this function and were lower by 22% and 17%, respectively. Non-Labor Costs per FTE was 25% lower for Best-in-Class plans.

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

Of the sub-functions, Provider Contracting contributed the most to overall low tactical costs, at 4%. PMPM expenses were 46% lower for Best-in-Class plans with a Staffing Ratio lower by 40% the sole driver. Non-Labor Costs per FTE were lower for Best-in-Class plans by 8%. Staffing Costs per FTE were lower for Best-in-Class plans by 11%.

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 the Sales and Marketing cluster and the Medical Management function.

The Sales and Marketing Cluster of expenses was lower for Best-in-Class plans by 11%. Best-in-Class cost advantage was primarily due to a low Staffing Ratio, which was lower by 34%. Staffing Costs per FTE were slightly higher, but Non-Labor Costs per FTE were significantly higher by 49% for Best-in-Class plans.

Best-in-Class plans' Sales and Marketing outsourced an average of 7% and a median of 3% of its FTEs. This compares to Peer plans who also outsourced an average of 12% and a median of 9% of FTEs.

Best-in-Class plans held a cost advantage in the majority of functions in the Sales and Marketing cluster. Its most important advantage was in Rating and Underwriting, which was 53% lower than the Peer plans. The Staffing Ratio was 57% lower for this function, while Staffing Costs per FTE were 3% higher. Non-Labor Costs per FTE were 28% higher than the Peer plans.

Sales expenses were lower by 38%. Non-Labor Costs per FTE and the Staffing Ratio were the central drivers of lower costs by 33% and 30% respectively. Staffing Costs per FTE were 6% lower.

Marketing costs were 19% lower for Best-in-Class plans explainable entirely by a low Staffing Ratio. Non-Labor Costs per FTE were also low, but Staffing Costs were 6% higher for Best-in-Class plans.

By contrast, External Broker Commissions were 29% 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 lower by 60% for Best-in-Class plans. The Staffing Ratio for Best-in-Class plans was 59% lower than peers. Non-Labor costs per FTE were 5% lower, however Staffing Costs per FTE were 21% higher.

Low costs of Sales and Marketing did not impact growth, evidently. Comprehensive membership for the Best-in-Class plans grew by a median value of 1%, compared with a median decline of 4% for Peer plans. At the product-mix of the Best-in-Class plans, the Peer plans posted a median membership decline of 3%.

Best-in-Class plans had lower Medical Management costs by 21%, with a low Staffing Ratio as the primary driver. Staffing Costs per FTE, were slightly higher, while Non-Labor Costs per FTE, were 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 10% and a median of 4% of their Medical Management FTEs compared to Peer plans at an average of 14% and a median of 10%.)

Suggestive of the possibility of an ROI on Medical Management, Best-in-Class plans experienced higher gross profit margins than Peer plans at Best-in-Class product mix. Best-in-Class plans had profit margins at a median of 9% and Peer plans at Best-in-Class product mix of 7%. Profit margins for Peer plans was 11%. (Gross profit margins are premiums less health benefits divided by premiums.)

Gross profits for *insured products* themselves were higher in the Peer plans. On a PMPM basis, *insured* gross profits were $53 PMPM for the Peer plans and $40 for the Best-in-Class plans. At the mix of the lower-cost plans, the Peer plans' PMPM gross profits were lower at $35 PMPM. (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 91%, compared to 89% for the Peer plans.

Our Approach

Each of the plans included in this analysis 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 constitute 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 compose 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 the 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 weights were then summed to arrive at a total for each function. The sum of the function costs yielded a total cost value. 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 were estimated so as to eliminate the effect of product mix differences and to overcome the fact that health plans generally do not 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 in 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.

Contact

This look at the characteristics of Best-in-Class plans has the virtue of being systematic and controlled for data quality and comparability. While the results are relatively objective and strongly emphasize the quantitative, the process is complex. We hope that you will feel free to address any questions to:

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