Plan Management Navigator

Analytics for Health Plan Administration

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Please see our invitation to participate in the 2020 Sherlock Benchmarks on Page 9.

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 22nd annual *Sherlock Benchmarks* and 18th 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 the 2019 edition of the *Sherlock Benchmarks* reflecting year-ended 2018 financials. Corresponding figure numbers, found at the end of the text, are shown in parentheses.

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 upon 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 longer-term 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 also 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 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

PMPM Tactical expenses were 32% lower for Best-in-Class plans with a mean of $20.13 compared to $29.58 for the Peer plans.[1] The low Staffing Ratio was the overwhelming driver in low Tactical costs. Non-Labor Costs per FTE and Staffing Costs per FTE also contributed to overall low Tactical costs.[2]

It generally appears that Best-in-Class plans operate in a culture of conservative administrative expenses as *every* functional area was lower than the Peer plans.

The overwhelming contributor among functions to superior performance was low costs in Information Systems and it was responsible for about 33% of the Tactical difference.

The Corporate Services *Function*, Claim and Encounter Capture and Adjudication, and Corporate Executive and Governance functions followed in contribution to low Tactical costs. These three functions composed 39% of the difference between Best-in-Class and Peer plans.

Greater detail is available to participants and licensees of the 2019 *Sherlock Benchmarks* for IPS plans. Please contact us if licensing is of interest.

Possible Extraneous Characteristics

To focus on these key expense factors, we identified five characteristics that the two sets of plans display. These characteristics may or may not affect costs.

Scale. Economies of scale could have played a role. The median membership size for Best-in-Class plans was 775,000 versus 325,000 for the Peers, over 2 times larger. Based on Sherlock's Scale Study for IPS plans, approximately 28% of administrative expenses are subject to economies of scale. These subject-to-scale expenses have a BCG slope of 87%. In other words, if you double the size of a health plan operating at $51.99 (Total PMPM costs for Peer Plans), costs would be expected to fall by about $1.93.

Cost of Living. There was possibly an effect of local costs of living though the results are ambiguous. The mean wage index for Best-in-Class plans was 5% lower at 1.001 versus 1.054 for Peer plans. The average wage index for all IPS plans was 1.040. The median wage index, however, was *higher* for Best-in-Class plans at 1.041 versus 0.972 for Peer plans. The median for all IPS plans was 1.035. (We employ the Hospital Wage Index used by CMS).

[1] Costs are standardized for member months (i.e., PMPM) even if not stated.
[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. For example, outsourced staffing is included in the Staffing Ratios reported in these analyses.

Importantly, Tactical Staffing Costs per FTE for the Best-in-Class plans was lower. The wage index, it should be recognized, may exaggerate the actual wage differences 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. Also, outsourcing can affect these comparisons as discussed below.

Propensity to Outsource. Propensity to Outsource. Peer plans tended to outsource slightly more than the Best-in-Class plans. The mean percent of FTEs outsourced was 11% for Best-in-Class versus 13% for Peer plans. The median percent was 13% for Best-in-Class versus 15% for Peer plans.

One of the functions that is most often outsourced, Information Systems, was outsourced by Best-in-Class plans at a mean rate of 15% and a median rate of 28%. In comparison, Peer plans outsourced an average of 17% of IS FTEs and a median of 23%.

Low Cost Product Mix. Mix can make a difference since product costs can differ. The Best-in-Class plans had fewer low-cost ASO and low cost Medicaid members. On an as-reported basis, such plans would be expected to have higher costs. 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.

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

	Commercial Insured	Commercial ASO	Commercial Total	Medicare Total	Medicaid Total	Medicare Supplement	Comp. Total
Best-in-Class	57%	20%	77%	9%	14%	0%	100%
Peer Plans	42%	25%	67%	13%	18%	2%	100%

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 57% 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 this cluster was lower was Information Systems. Its costs comprised 58% of the low-cost variance in this cluster and 33% of low Tactical costs. Claim and Encounter Capture and Adjudication contributed 12% to overall low Tactical costs and 22% of the cluster's low costs. Since the degree of automation can cause where certain activities are reflected, it is interesting that both IS and Claims are lower. Enrollment / Membership / Billing and Customer Services contributed 6% and 5%, respectively, to overall low Tactical costs.

Information Systems. This function's costs were 29% lower for the Best-in-Class plans contributing 33% to overall low Tactical costs. The Staffing Ratio was the primary driver for this function's low cost, which was lower by 22%. Non-Labor Costs per FTE was also lower by 22%, while Staffing Costs per FTE was higher by 6%.

The sub-function, Applications Acquisition and Development, contributed the most to overall low IS expenses. Best-in-Class plans' costs were 49% lower primarily due to a Staffing Ratio that was lower than the Peers by 35%. Non-Labor Costs per FTE was lower by 42%, while Staffing Costs per FTE was higher for Best-in-Class plans by 1%.

Corporate Services *Function.* (This word is italicized to distinguish it from the more encompassing cluster of the same name.) Best-in-Class plans reported expenses that were 36% lower than Peer plans and composed 19% of overall low Tactical costs. This function's low costs were overwhelmingly driven by a Staffing Ratio that was 40% lower for Best-in-Class plans. Staffing Costs per FTE was lower by 1% for Best-in-Class plans, while Non-Labor Costs per FTE was higher by 12%.

There were 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 equal or lower in favor of Best-in-Class plans except in Imaging and Printing and Mailroom. Facilities expenses were the same for both sets of plans.

Claim and Encounter Capture and Adjudication. Best-in-Class plans' Claims costs were 35% lower and contributed 12% to overall low Tactical costs. The Staffing Ratio was 26% lower for Best-in-Class plans, while Non-Labor Costs per FTE was lower by 32%. Staffing Costs per FTE was slightly higher for Best-in-Class plans, by 1%.

Best-in-Class plans' Other Claims costs were lower by 34% mainly on a Staffing Ratio that was 31% lower. Non-Labor Costs per FTE was lower by 11%, while Staffing Costs per FTE was lower by 1%. Note, Other Claims represents the majority of costs in this functional area with activities primarily focused on the manual processes involved in claims adjudication. COB and Subrogation was also lower, due to a lower Staffing Ratio.

Corporate Executive and Governance. Best-in-Class plans were lower in this function by 52% and contributed 8% to overall low Tactical costs. The Staffing Ratio was the central driver, lower for Best-in-Class plans by 45%. Staffing Costs per FTE was lower by 25%, but Non-Labor Costs per FTE was higher for Best-in-Class plans, by 25%.

Strategic Expenses were Also Lower

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 by 32% for Best-in-Class plans. This cluster's low costs were driven entirely by a low Staffing Ratio, which was lower by 49%. Non-Labor Costs per FTE was higher by 48%, while Staffing Costs per FTE was higher by 4%.

Best-in-Class plans' Sales and Marketing outsourced an average of 3% and a median of 6% of its FTEs. This compares to Peer plans outsourcing an average of 2% and a median of 9% of its Sales and Marketing FTEs.

Best-in-Class plans held a cost advantage in every Sales and Marketing functional area. Sales was the most important contributing function, lower by 55% for Best-in-Class plans. The Staffing Ratio was 59% lower, while both Non-Labor Costs per FTE and Staffing Costs per FTE were higher, by 39% and 4%, respectively. The largest driver in low Sales expenses was the Account Services sub-function. Best-in-Class plans were lower by 63%, explainable entirely by a 65% lower Staffing Ratio.

External Broker Commissions followed in importance and was lower by 25% in favor of Best-in-Class plans. Note, the *Sherlock Benchmarks* includes external Broker Commissions within Non-Labor expenses. There are no Staffing Costs in this function.

Marketing expenses were lower by 35% for Best-in-Class plans mainly on a Staffing Ratio that was 26% lower. Non-Labor Costs per FTE and Staffing Costs per FTE were also lower by 14% and 10%, respectively.

Rating and Underwriting costs were 23% lower for Best-in-Class plans primarily due to Non-Labor Costs per FTE that was 51% lower. Staffing Costs per FTE was 7% lower, while the Staffing Ratio was 2% *higher* for Best-in-Class plans.

Advertising and Promotion expenses were lower by 13%. Non-Labor Costs per FTE represented the majority of this function's low variance, lower by 33%. Staffing Costs per FTE was lower by 12%, but the Staffing Ratio was higher by 24%.

Low costs of Sales and Marketing did not impact growth, evidently. Comprehensive membership for the Best-in-Class plans increased by a median rate of 3%, compared with a median *decline* of 1% for Peer plans. At the product-mix of the Best-in-Class plans, the Peer plans median membership declined at a rate of 1%.

Best-in-Class plans had lower Medical Management costs by 22% entirely on a Staffing Ratio that was lower by 30%. Non-Labor Costs per FTE was 54% higher, while Staffing Costs per FTE was 2% greater.

All nine sub-functions except for Pre-Certification and Health and Wellness were lower cost than the Peer plans. Best-in-Class plans outsourced an average of 1% and a median of 3% of their Medical Management FTEs compared to Peer plans at an average of 5% and a median of 8%.

Suggestive of the possibility of an ROI on Medical Management, Peer plans experienced a slightly *higher* gross profit margin at a median of 13% versus 12% for Best-in-Class plans for *insured products*. (Insured products include Commercial Insured, Medicare Supplement, Medicare and Medicaid). At the mix of Best-in-Class plans, however, margins for Peer plans were 11%. (Gross profit margins are premiums less health benefits divided by premiums.)

Per Member gross profits for *insured products* were also higher in the Peer plans. On a PMPM basis, *insured* gross profits were $50 PMPM for the Best-in-Class plans and $72 for the Peer plans. At the mix of the lower-cost plans, the Peer plans' PMPM gross profits were $57. (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 88%, compared to 87% for the Peer plans. However, at the product mix of the Best-in-Class plans, the Peer plans had a median health benefit ratio of 89%.

Our Approach

Each of the plans included in this analysis differs in many key characteristics. 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 nineteen plans, or approximately 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 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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INVITATION TO PARTICIPATE IN THE 2020 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.

With cumulative participation of 858 health plan years, health plans serving more than 180 million insured Americans are licensed users of the *Sherlock Benchmarks* since June 2017. While all of the universe panels, described below, are still open, our earliest panel is Blue Cross Blue Shield Plans. Of the 34 U.S.-based Blue Cross Blue Shield primary licensees, eighteen serving 42 million people have committed to participate in the 2020 edition of the *Sherlock Benchmarks* for Blue Cross Blue Shield Plans.

The *Sherlock Benchmarks* have been called the "Gold Standard" by leading health care consultants. Besides **Blue Cross Blue Shield** Plans, our universes include **Independent / Provider – Sponsored** Health Plans, **Medicare** and **Medicaid** plans. All are still under development.

Report publication begins in late June but varies by universe. 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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