

# 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 BLUE CROSS BLUE SHIELD PLANS

This is our analysis of “Best-in-Class” Blue Cross Blue Shield (Blue) Plans versus their Blue Peers. Our analysis is based on the 21<sup>st</sup> annual edition of the Blue study. For these purposes, we define “Best-in-Class” Plans as among the 25th percentile in lowest cost. Other Blues are referred to as “Peer” Plans. All results are from the 2019 edition of the *Sherlock Benchmarks* reflecting year-ended 2018 financials.

Notwithstanding our referring to low cost Plans as Best-in-Class, we recognize that the maximizing long-term objectives are achieving 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 benefit 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 Blue Cross Blue Shield 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
- Association 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

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## Conclusions

PMPM Tactical expenses were 35% lower for Best-in-Class Plans with a mean of \$20.13 compared to \$30.75 for the Peer Plans.<sup>1</sup> Every factor driving PMPM cost variance contributed to the superior performance. Lower Non-Labor Costs per FTE (e.g., those in Information Systems and Facilities) was the most important driver to low Tactical costs for Best-in-Class Plans.

It generally appears that Best-in-Class Plans operate in a culture of conservative administrative expenses as nearly 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 44% of the Tactical difference.

Other notable low cost functions include Claims, Corporate Services *Function*, and Corporate Executive and Governance. These three functions composed 46% of the difference between the two sets of Plans.

## Possible Extraneous Characteristics

To focus on these key expense factors, we identified, five characteristics that the two sets of Blue Plans also 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 over 2 times *larger* than Peer Plans. Based on preliminary results of Sherlock's Scale Study, only 40.7% of administrative expenses are subject to economies of scale. These subject-to-scale expenses have a BCG slope of 83.3%. In other words, if you double the size of a health plan operating at \$46.45 (Total PMPM costs for Peer Plans), costs would be expected to fall by \$3.16. *Note that we will be publishing our analyses of Economies of Scale in the coming weeks.*

**Cost of Living.** There was possibly an effect of local costs of living. The mean wage index was 0.875 among the Best-in-Class Plans and 0.993 among the Peer Plans, 12% lower (We employ the Hospital Wage Index used by CMS). The mean wage index for all Plans was 0.959.

Importantly, Staffing Costs per FTE for the Best-in-Class Plans was lower by 10%, meaning that Staffing Costs per FTE was higher than indicated by the relative wage index. In any event, the contribution of the Best-in-Class cost advantage to Staffing Costs per FTE is 13%. Local costs of living can, in principle, be affected through management decisions of where service centers are located.

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<sup>1</sup> Costs are standardized for member months (i.e., PMPM) even if not stated.

The wage index, it should be recognized, may actually exaggerate the actual wage differences 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. Also, outsourcing can affect these comparisons as discussed below.

**Propensity to Outsource.** The mean percent of FTEs outsourced was 15% among the Best-in-Class Plans and 13% among the Peer Plans. The median percent of FTEs outsourced was 11% among the Best-in-Class Plans, the same as the Peer Plans.<sup>2</sup>

Information Systems is, among the functions, most often outsourced. The mean percent of FTEs outsourced was 15% among the Best-in-Class Plans and 25% among the Peer Plans. Information Systems for Best-in-Class Plans cost less than those in Peer Plans.

**Low Cost Product Mix.** Mix can make a difference since product costs can differ. The Best-in-Class Plans had more low cost ASO and Medicaid 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 in Figure 2 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 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. Strategic expenses were in fact lower, a conclusion we do address towards the end of this analysis.

**Figure 2. Best-in-Class Blue Cross Blue Shield Health Plans**  
Product-Mix Comparisons

	Commercial Insured	Commercial ASO	Commercial Total	Medicare Total	Medicaid Total	Medicare Supplement	FEP	Comp. Total
Best-in-Class	24%	53%	78%	7%	8%	5%	3%	100%
Peer Plans	37%	45%	82%	3%	0%	7%	9%	100%

<sup>2</sup> 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.

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## *Activities that Made a Difference*

Because almost 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 were responsible for 73% of the difference between the Best-in-Class Plans and their Peers. This cluster represented two-thirds of the Tactical costs. Account and Membership is comprised of the central health plan activities of Enrollment / Membership / Billing, Claim and Encounter Capture and Adjudication, Customer Services, and Information Systems.

The overwhelming driver in low costs for this cluster was Information Systems, comprising 44% of overall low Tactical costs and 60% of the cluster's low costs. The Claim and Encounter Capture and Adjudication functional area also had lower costs and contributed 25% to overall low Tactical costs and 34% to low Account and Membership Administration cluster. Meanwhile, Customer Services was 12% lower for Best-in-Class Plans contributing 3% to low Tactical costs and Enrollment/Membership/Billing was lower by 14% and comprised 2% of low Tactical costs.

**Information Systems.** This function was 39% lower for the Best-in-Class Plans primarily due to low Non-Labor Costs per FTE, by 41%. The Staffing Ratio was lower by 17% for Best-in-Class Plans, while Staffing Costs per FTE was lower by 10%.

All Information Systems sub-functions were lower for Best-in-Class Plans with Applications Acquisition and Development contributing most of the low Information Systems costs. Best-in-Class Plans were lower in this sub-function by 66% driven by a Staffing Ratio that was lower by 49%. Best-in-Class Plans' Non-Labor Costs per FTE in this sub-function was lower by 46%, while Staffing Costs per FTE was lower by 9%.

**Claim and Encounter Capture and Adjudication.** The second most important driver in low Tactical costs contributing 25%; Claims costs were lower for Best-in-Class Plans by 44%. Staffing Ratio was the overwhelming driver in low Claims costs for Best-in-Class Plans, lower by 49%. Staffing Costs per FTE was slightly lower by 1%, while Non-Labor Costs per FTE was higher for Best-in-Class Plans, by 21%.

BlueCard Home and Custom Par Fees was the only Claims sub-functions to be higher for Best-in-Class Plans, by 18%. Conversely, the most significant driver in low Claims was the Other Claims sub-function. Note, Other Claims represents the majority of costs in this functional area with activities primarily focused on the non-autoadjudicated claims processes. Best-in-Class Plans were lower by 59% driven by a Staffing Ratio that was lower by 52%. Non-Labor Costs per FTE also contributed, lower by 41%.

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**Corporate Services Function.** (The word "Function" is italicized to distinguish it from the more encompassing cluster of the same name.) Best-in-Class Plans had expenses that were lower by 30% and contributed 13% to overall low Tactical costs. A Staffing Ratio that was lower by 19% for Best-in-Class Plans was the main driver in this function's low cost. Non-Labor Costs per FTE was lower by 20%, while Staffing Costs per FTE was lower by 6%.

This function consists of sub-functions of Facilities, OPEB, Audit, Purchasing, Imaging, Printing and Mailroom, Risk Management and Other. The Best-in-Class Plans reported lower costs in all sub-functions except in OPEB, Imaging, and Printing and Mailroom.

### *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 for the Best-in-Class Plans by 24%. The key driver in the cluster's low costs was Non-Labor Costs per FTE, lower by 18%. The Staffing Ratio was lower by 12%, while Staffing Costs per FTE was lower by 3%.

Best-in-Class Plans outsourced an average and median of 20% of its Sales and Marketing FTEs. This compares to Peer Plans outsourcing an average of 7% and a median of 4% of Sales and Marketing FTEs.

Except for Rating and Underwriting, all Sales and Marketing functional areas were lower for Best-in-Class Plans. Marketing expenses were lower for Best-in-Class Plans by 60% and contributed 42% to low Sales and Marketing cluster costs. A Staffing Ratio that was lower by 60% for Best-in-Class Plans was central, while Non-Labor Costs per FTE and Staffing Costs per FTE were higher. The largest contributor to low Marketing expenses was Product Development and Marketing Research, lower by 85%. The low costs of this sub-function were chiefly driven by a low Staffing Ratio.

External Broker Commissions were 17% lower for Best-in-Class Plans. Note, the *Sherlock Benchmarks* reflects external Broker Commissions as Non-Labor expenses. There are no Staffing Costs in this function.

Advertising and Promotion costs were lower by 44% entirely on a low Staffing Ratio. Charitable Contributions were lower by 76% and composed most of the low Advertising and Promotion costs. Media and Advertising costs were also lower, by 28%.

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The Sales functional area was 12% lower for Best-in-Class Plans with a 16% lower Staffing Ratio central to low costs. Non-Labor Costs per FTE was slightly lower by 1%, while Staffing Costs per FTE was higher by 8%. The Account Services sub-function was key to low Sales costs with Best-in-Class Plans lower by 17%, mainly on a low Staffing Ratio.

Rating and Underwriting for Best-in-Class Plans was *higher* by 7%. The sub-function Other Rating and Underwriting (the activity most commonly thought of as Rating and Underwriting) was the chief driver in higher functional area expenses. The Staffing Ratio was higher by 51% and Non-Labor Costs per FTE were higher by 12%. Staffing Costs per FTE, however, was lower by 6%.

Low costs of Sales and Marketing did not impact growth, evidently. Comprehensive membership for both Best-in-Class and Peer Plans increased at a median rate of 1%. At the product-mix of the Best-in-Class Plans, the Peer Plans posted a median membership *decrease* of 3%.

Medical Management expenses were 25% lower for Best-in-Class Plans. A Staffing Ratio that was 12% lower was key. All nine sub-functions were lower in favor of Best-in-Class Plans with Quality Components being the most important source of low Medical Management expenses. Best-in-Class Plans outsourced an average of 26% and a median of 27% of their Medical Management FTEs. In comparison, Peer Plans outsourced an average of 9% and a median of 8%.

Suggestive of the possibility of an ROI on Medical Management, Peer Plans experienced *higher* gross profit margins at a median of 18% versus 15% for Best-in-Class Plans for *insured products*. (Insured products include Commercial Insured, Medicare Supplement, FEP, Medicare, and Medicaid). Peer Plans' margins were 17% when reweighted at the mix of Best-in-Class Plans. (Gross profit margins are premiums less health benefits, all divided by premiums.)

Gross profits Per Member Per Month for *insured products* were lower for the Peer Plans. On a PMPM basis, *insured* gross profits were \$78 PMPM for the Best-in-Class Plans and \$73 for the Peer Plans. At the mix of the lower-cost Plans, the Peer Plans' PMPM gross profits were still lower at \$71. (Gross profits are premiums less health benefits.) This is a modest difference especially when local costs of living factors are considered.

The median *insured* health benefit ratio for the Best-in-Class Plans was 84%, compared to 82% for the Peer Plans. At the product mix of the Best-in-Class Plans, the Peer Plans had a median health benefit ratio of 83%.

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## *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 Blue Cross Blue Shield universe. To do so, and to eliminate the potentially distorting effect of 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. Four of the Plans, 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.

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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. Of the 34 U.S.-based Blue Cross Blue Shield primary licensees, fourteen serving 37 million people, participated in the 2019 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 which 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](mailto:sherlock@sherlockco.com) or 215-628-2289 if you are interested. *You will be among good company.*

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