

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

Please see our invitation to participate in the 2020 Sherlock Benchmarking Study on Page 6.

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 2018, 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 reflecting their 2018 results. We expect to revise this mid-year 2020 reflecting 2019 year public company information compared to 2019 Blue Cross Blue Shield benchmark values.

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

Results

As shown in Figure 1 the results do not definitively demonstrate low costs among public companies. Five of the publicly-traded plans have higher administrative expenses as a percent of premium than would be expected. Also five of the plans have lower administrative expenses PMPM than would be expected.

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

Company	Calculated	Expected	PMPM	PMPM	Pct. Difference	Calculated	Expected	Pct Point Difference	Pct Difference
	Administrative PMPM Expense	Administrative PMPM Expense				Administrative Percent	Administrative Percent		
Anthem, Inc	\$35.14	\$41.19	-\$6.06	-14.7%	9.8%	10.0%	-0.1%	-1.3%	
Centene Corporation	\$48.47	\$49.75	-\$1.28	-2.6%	11.7%	9.5%	3.5%	36.9%	
Cigna Corporation	\$44.39	\$38.74	\$5.64	14.6%	11.1%	9.8%	1.3%	13.4%	
Humana Inc.	\$52.33	\$59.61	-\$7.28	-12.2%	12.1%	11.8%	0.2%	2.1%	
Molina Healthcare, Inc.	\$31.23	\$47.20	-\$15.97	-33.8%	7.9%	9.5%	-1.5%	-16.2%	
UnitedHealth Group Incorporated	\$54.45	\$48.62	\$5.84	12.0%	13.8%	10.8%	3.0%	28.0%	
WellCare Health Plans, Inc.	\$34.98	\$54.11	-\$19.14	-35.4%	9.8%	9.7%	0.1%	0.7%	

In considering public company differences from the Blue Cross Blue Shield universe values, their 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. To overcome this, we adjust the Blue Cross Blue Shield Universe to match the product mix of each public company. Note that, because of each organization's reporting, results are qualified as discussed below.

How Are Public 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 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.

We used only individual public company information to calculate their cost ratios. If costs included something other than comprehensive products, we mention 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 public company 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 2019. 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 \$16.09 and for ASO they were \$0.09. They were \$14.81 for Medicare and \$4.91 for Medicaid. Median Blue Cross Blue Shield percent of premium values for premium taxes for Commercial Insured were 4.44%. They were 1.92% for Medicare and 1.10% 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.

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 overstating PMPM administrative expenses. Using average BCBS data to back out the effects of these products, the administrative expense and percent of premium would have been lower excluding Dental and Part D. Administration of Vision is not included in *Sherlock Benchmarks*.

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 would be slightly higher.

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 and as a percent of premium would have 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. WellCare was recently acquired by Centene in January of 2020.

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.

PULSE In-depth Analysis

This *Navigator* is a summary of a more in-depth analysis of publicly traded firms available exclusively to subscribers to our *PULSE* newsletter and participants in the *Sherlock Benchmarks*. The annual subscription to *PULSE* is available for \$395. Its greater detail includes:

- Analyses of each function, including P-Values and slope values.
- More detail concerning our methodology, including the mix-adjustment.
- Analyses of universes of Blue Cross Blue Shield plans, Independent / Provider -Sponsored plans and a universe of combined organizations.
- The application of the economies of scale results in the case of a doubling of the size of a plan in that universe.
- Process for the more general application of the results to all sizes of business combinations and internal growth.

Additional information on the newsletter and subscriptions are found at sherlockco.com/pulse/.

Sherlock Benchmarks: Participation and Licensing

Both this *Navigator* and the *PULSE* analysis rely on the results of the 2019 *Sherlock Benchmarks* for universes of Blue Cross Blue Shield Plans, our 22nd annual study. Survey materials were distributed in February 2019, collected in April, validated in May and published beginning in June. All data is for the 2018 calendar year and has been carefully validated both by us and by the plans themselves. Collectively, the 33 plans collectively served 47 million Americans. The range of membership was over 350,000 to more than 10 million among Blue Plans and about 65,000 to 2 million among IPS plans.

We are now conducting our 23rd annual Benchmarking Study for health plans. This study will reflect 2019 calendar year results and will be conducted on the same calendar as last year. We welcome Blue Cross Blue Shield Plans, Independent / Provider - Sponsored plans, Medicaid plans, Medicare plans and other plans. Please reach out to us if participation is of interest.

In addition, for those that cannot participate, licensing is available. Please see sherlockco.com/sherlock-benchmarks/ for additional information on the *Sherlock Benchmarks*.

Contact

Please do not hesitate to contact us with questions concerning this analysis, *PULSE*, the *Sherlock Benchmarks* on which it is based or your interest in participating in the 2020 *Sherlock Benchmarking Study*. We can be reached at sherlock@sherlockco.com or (215) 628-2289.