

# Plan Management Navigator

## *Analytics for Health Plan Administration*



Healthcare Analysts

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*Please see page 5 for our invitation to participate in the 2023 or license the 2022 Sherlock Benchmarks.*

## SUMMARY OF SHERLOCK COMPANY'S 2021 ECONOMIES OF SCALE IN HEALTH INSURANCE ANALYSIS

### *Conclusion*

Economies of scale of administrative expenses were significant for Blue Cross Blue Shield (Blue) and Independent / Provider - Sponsored (IPS) plans. Our analysis on a combined universe of the 16 Blue Plans and 15 IPS plans yielded insignificant results. Individual functions displayed economies of scale in each universe. This conclusion builds on another indicator of economies of scale was illustrated in the discussion of the Larger Plan edition, summarized in the Late October edition of *Navigator*. The source of the information used in these analyses is from the *Sherlock Benchmarks*, reflecting 2021 costs.

Each of the numerous functions that health plans operate vary in their apparent cost sensitivity to scale. Shown in Figure 1, functions composing a range of approximately 20% to 43% of health plan administrative expenses demonstrated economies of scale in 2021, the most recently available year. The scale slope is relatively modest so that a doubling of the size of the health plan will lead to those costs *subject to economies of scale* that are 79% to 91% of the pre-doubling PMPM costs. The proportion of the expenses subject to economies of scale, the functions subject to scale and their sensitivity to scale each varied by whether the set of plans analyzed was IPS plans, Blue Plans or the combination of both.

From a strategic perspective, this means that administrative and technical economies of scale are unlikely to create an overwhelming competitive advantage. For instance, suppose a health plan operated at \$55 PMPM. Using the Combined universe model shown in Figure 1, 35% or \$19.10 PMPM would be subject to economies of scale and, if the enterprise doubled in size, \$1.76 or 3.2% would be saved through pure scale advantages. While an additional \$1.76 PMPM would be welcomed by any CFO, the modest effect of scale implies that firms of modest scale can be on a similar competitive footing as their larger peers on administrative expenses.

### Figure 1. Economies of Scale Summary

Administrative Expenses Subject to Economies of Scale and BCG Slopes  
*BCBS, IPS, and Combined*

	Blue Cross Blue Shield Plans	Independent / Provider - Sponsored Plans	Combined Plans
Percent of Administrative Expenses Subject to Scale	42.7%	20.1%	34.7%
BCG Scale Slope of Functions Subject to Scale	85.9%	78.7%	90.8%

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That economies of scale are limited in the long term does not mean that cost stickiness cannot affect costs in ways that mimic the presence of fixed costs and economies of scale. It takes time for health plans to adapt to changing membership volumes. If membership declines, staffing remains until normal attrition and forced reductions occur. Growth has a similar effect in that managements may be conservative in building capacity given that growth projections are usually speculative.

### *Background*

While the largest costs for health plans are health benefits, not every benefit plan sponsor pays health plans to assume health benefit variance risk. For Blue Cross Blue Shield Plans, generally about 50% of members are fully-insured and, among Independent / Provider Sponsored plans, those ratios are commonly 70% or more. By contrast, 100% of all members and their sponsors pay health plans to assume responsibility for administrative activities of their health benefit programs.

For this reason, health plans are vitally interesting in managing their administrative costs. Understanding economies of scale can quantify the feasible parameters of such management and offer strategic insights for the enterprise.

The *Sherlock Benchmarks* provide a robust data set to evaluate economies of scale in health insurance. It is populated by a large sample, is from a single year, is uniquely granular, and is carefully validated.

Economies of scale occurs when per unit costs decline as volume of output increases. Because the “output” of a health plan is health coverage services to its members, volume is defined as member months. The costs that are the subject of this analysis are administrative, classified by function: examples include Claims Adjudication, Customer Services, Enrollment and so forth. The unit costs we use in this analysis are administrative costs expressed Per Member Per Month (PMPM). Volume is the number of members expressed as member months. Each plan in the study reported its costs segmented into approximately seventy functions and sub-functions, allowing each of the activities to be analyzed individually.

An analysis of economies of scale is complicated by the extraneous factor of differences in the product mixes between the health plans. Fortunately, each organization participating in the *Sherlock Benchmarks* reports all functional costs segmented by product, thereby allowing us to eliminate the effects of product mix differences. To some degree, the adjustment for product differences also mutes differences in demographics since senior products are segmented from those sold to working age people, which are in turn segmented from Medicaid populations. Within the Commercial products, since ASO products are segmented from Insured products so, to some degree, product-mix adjustments also adjust for group size as well.

So, put simply, we determine whether economies of scale exist by regressing mix-adjusted cost values in each function against member months. Suppose a regression yields a 0.1 p-value: it can be interpreted to mean “Assuming that there weren’t economies of scale, you’d obtain the observed difference or more in 10% of such studies due to random sampling error.” So the lower the p-value, the more reliable the results.

The BCG (Boston Consulting Group) Slope is an intuitive way of expressing the slope of scale: it is the percent of the pre-doubling unit costs that the activity will exhibit if the plan doubles in size.

Figure 2 summarizes all functions that were sensitive to scale, with p-values less than 0.1. A down arrow (↓) indicates that the function within the identified universe is subject to economies of scale. An up arrow (↑) indicates that the function is subject to diseconomies of scale in that universe. A null symbol (∅) indicates that the function is not subject to either economies of scale or diseconomies of scale in that universe but is in at least one other universe.

<b>Figure 2. Economies of Scale Summary</b>			
<u>Slopes of Significant Administrative Expense Economies of Scale</u>			
	Blue Cross Blue Shield Plans	Independent / Provider - Sponsored Plans	Combined Plans
2. Marketing	↓	∅	∅
(c) Other Marketing	↓	∅	∅
6. Provider Network Management and Services	∅	∅	↓
(b) Provider Contracting	↓	∅	↓
(1) Provider Configuration	∅	↓	↓
7. Medical Management / Quality Assurance / Wellness	∅	↓	∅
(d) Nurse Information Line	∅	∅	↓
(f) Quality Components	∅	↓	∅
8. Enrollment / Membership / Billing	↓	∅	∅
(a) Member Services	∅	∅	↑
(b) Printed Materials and Other	∅	↑	∅
10. Claim and Encounter Capture and Adjudication	∅	∅	↑
(d) Other Claim and Encounter Capture and Adjudication	∅	∅	↑
11. Information Systems Expenses	↓	∅	↓
(b) Applications Maintenance	↓	∅	↓
(1) Benefit Configuration	↓	∅	∅
(d) Security Administration and Enforcement	↓	∅	∅
12. Finance and Accounting	↓	∅	↓
(b) Other Finance and Accounting	↓	∅	↓
13. Actuarial	↓	∅	↓
14. Corporate Services Function	↓	∅	∅
(a) Human Resources	↓	∅	∅
(b) Legal	↓	∅	∅
(1) Compliance	↓	∅	↓
(4) Fraud, Waste & Abuse	↓	∅	∅
(5) All Other Legal	↓	∅	∅
(c) Facilities	∅	↓	↓
(e) Audit	↓	∅	∅
15. Corporate Executive & Governance	∅	↓	∅
<b>Subtotal Expenses</b>	↓	∅	∅
17. Miscellaneous Business Taxes	∅	∅	↓
<b>Total Expenses</b>	∅	↓	∅

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## *PULSE In-Depth Analysis*

This *Navigator* is a summary of an analysis available exclusively to subscribers to our *PULSE* newsletter and participants in the *Sherlock Benchmarks*. The annual subscription to *PULSE* is available for \$425. While the focus of *PULSE* is analyses of publicly traded health plans, it includes an insert with far greater detail including:

- Analyses of each of more than 70 functions (e.g., Information Systems, Actuarial, Finance, etc.), including p-values and slopes.
- More detail concerning our methodology, including the mix-adjustment.
- Analyses of three universes: Blue Cross Blue Shield plans, Independent / Provider - Sponsored plans and a universe combining all these organizations.
- An example showing the application of the economies of scale results in the case of a doubling of the size of a plan in that universe.
- A description and example of the process for the more general application of the results of business combinations and internal growth that would give rise to changes in health plan size.

Additional information on the *PULSE* newsletter and subscriptions are found here.  
<https://sherlockco.com/pulse/>

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## *Sherlock Benchmarks: Participation and Licensing*

Both this *Plan Management Navigator* and the *PULSE* analysis rely on the results of the 2022 *Sherlock Benchmarks* for universes of Blue Cross Blue Shield Plans and Independent/Provider-Sponsored health plans, our 25<sup>th</sup> annual study.

In this analysis, all data is for the 2021 calendar year and has been subject to careful validation both by us and by the plans themselves. Collectively, the 31 plans served about 60 million Americans in comprehensive products. The range of membership was from 178,000 to over six million among Blue Plans and about 215,000 to 1.6 million among IPS plans. In addition to the Blue Cross Blue Shield and Independent / Provider – Sponsored universes, we also have universes of Medicare, Medicaid, and Larger plans.

**Benchmarking Study for 2023.** Your health plan is invited to participate in the 2023 cycle based on 2022 results. We will send invitations out next week. *You will be among good company.*

**Licensing the Sherlock Benchmarks.** For those that cannot participate, licensing is available. Please see the following link <https://sherlockco.com/sherlock-benchmarks/> for additional information on the *Sherlock Benchmarks*. The Reports shown on that page are also the Reports received by the participants.

### *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 licensing the 2022 edition or participating in the 2023 *Sherlock Benchmarks*. We can be reached at [sherlock@sherlockco.com](mailto:sherlock@sherlockco.com) or (215) 628-2289.

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