



Plan Management Navigator

Analytics for Health Plan Administration

January 2011

SUMMARY OF DECISIONS OF LOW COST BLUE CROSS AND BLUE SHIELD PLANS

Background and Methodology

The decisions of low cost Plans differ from those made by higher cost ones. This analysis examines the differences for the Blue Cross and Blue Shield Plans that participated in the *Sherlock Expense Evaluation Report (SEER)* in 2010.

For this analysis, the term “low cost” refers to the performance of health plans for the functional areas which make up approximately 75% of total administrative costs. These costs exclude the functional area of Medical Management and the functional area cluster of Sales and Marketing. The purpose of excluding Medical Management is that when effective, it drives down health benefit costs. Health benefits are identifiably discrete from administration and medical management may have benefits spanning years. Similarly, effective Sales and Marketing expenses often affect growth in subsequent years due, for example, to seasonal patterns. Therefore, it is of more value to focus on the remaining expenses that have an immediate impact on the operations of a health plan because their effect is largely confined to current period activities and each function’s performance principally affecting only those other remaining activities.

To simplify, the expenses of the remaining activities incurred during a health plan year can be thought of as more or less self-contained, and reflect their complementary roles during that period. We call these “tactical” administrative expenses for the purposes of this analysis. We acknowledge that, for Information Systems in particular, this segmentation is subject to criticism. We also recognize that the architecture of expenses is

Continued on Page 2

NEW BENCHMARKING CALCULATOR AVAILABLE ON WEBSITE

We have created a benchmarking calculator as a quick and easy way for your health plan or TPA to compare its administrative expenses to those of its peers. The benchmarking calculator is available at www.sherlockco.com/calculator. It is in test form but we think it is in pretty good shape.

The first step is to enter the average members for each product of your plan. Then, by selecting the universe of peer plans you wish to be compared to (either in total or by individual product), an expected PMPM administrative expense value will be calculated. If you wish, you can enter your plan’s total annualized administrative expenses and your values will be compared to the expected PMPM value.

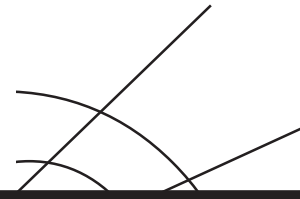
Continued on Page 6

NEW SEER UNIVERSES BEING FORMED

The challenging operating environment for health plans has convinced many managers that effective management of operating costs is central to their plans’ long-term success. The weak economy is placing great pressure on commercial enrollment, creating the risk that administrative expenses could be a source of negative operating leverage.

An additional challenge health plans face is health care reform. Under reform, the administrative expenses of health plans serving the commercial market are subject to the indirect limitations of the minimum medical loss ratios. The health care reform also will have some members using “exchanges” which are expected to create additional price pressures in the affected portions of the commercial market. For plans offering Medicare Advan-

Continued on Page 6



Summary of Decisions: *From Page 1*

established over multiple years. These tactical expenses are incurred in ways that largely reflect, in that period, completely and exhaustively, those management decisions affecting a health plan's business processes.

To identify the decisions that lead to low costs, we divided the universe of Blue Cross and Blue Shield ("BCBS") Plans into a low cost group, comprised of approximately 25% of the universe, and all other plans in that universe. The low cost group was determined based on relative performance after our comparisons eliminated the effect of product mix differences. We did not adjust for any cost of living differences since health insurance operating functions are not geographically confined.

Overall Cost Savings

Overall, low cost Blue Cross Blue Shield Plans have tactical administrative expenses that are \$5.75 PMPM, or 30%, lower than their higher cost counterparts. In the low cost Plans, the staffing ratio was significantly lower than the high cost Plans and accounted for the vast majority of the cost savings. Non-labor costs (supplies, depreciation and other operating expenses) had the second greatest influence on the low costs. By contrast, staffing costs per FTE were *higher*, and actually offset the overall cost savings for these Plans.

When examining the activities that were the sources of variances, the cluster of functional areas called Account and Membership Administration explained 71% of the favorable variance of the low cost Plans. The expenses that make up this cluster are responsible for the majority of reported overall tactical costs of health plans. The component of costs overwhelmingly responsible for this favorable variance was a generally low staffing ratio. Low non-labor costs also contributed but per FTE staffing costs were higher.

The functional area most responsible for the superior performance of the Account and Membership Administration cluster is Information Systems, which explained the vast majority of this variance. Again, a low staffing ratio contributed the most to the low costs of Information Systems, followed by low non-labor costs. Staffing costs per FTE were also low. Information Systems for low cost Plans is more likely to be outsourced than the high cost Plans. This could create some softness in the relative importance of the various drivers but if so we think that the potential for "play" in the numbers would be minor. After all, both the total costs per FTE and the staffing ratio are low.

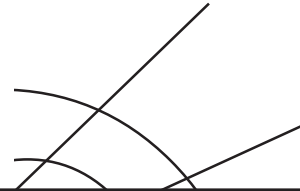
Another functional area that significantly contributed to the favorable variance of Account and Membership Administration was Claim and Encounter Capture and Adjudication. This area is more closely linked with Information Systems than any other functional area. Almost one-third of Information Systems activity was in support of this function among the BCBS Plans reporting Information Systems allocated by supported function. A low staffing ratio was the driver of low costs here, while both non-labor costs and staffing cost per FTE were high. These low costs also mean that IS costs were unlikely to be low due to misclassification between functions.

Customer Service and Enrollment functions also had low costs, even lower than Claims when expressed as a percent difference. Both functions have lower staffing ratios and higher staffing costs per FTE. Non-labor costs per FTE were also lower.

The cluster of Corporate Services comprises nearly one-third of the tactical expenses. The functions in this cluster include Finance and Accounting, Actuarial, Corporate Services function and Corporate Executive and Governance. For this cluster, a low staffing ratio was

Continued on Page 3





Summary of Decisions: *From Page 2*

responsible about three-quarters of the favorable variance. Low non-labor costs were responsible for most of the remaining favorable variance.

Many of the scalable functions are found in the Corporate Services cluster. However, the median size of the low cost Plans was 630,000 members, compared with 760,000 members for their higher cost peers. This indicates that economies of scale do not cause Plans' superior performance.

Low Corporate Services *functional* area costs greatly influence the overall difference with the higher cost Plans. The primary driver of low costs in this area was a low staffing ratio, and staffing costs per FTE were slightly lower. Non-labor costs per FTE were higher than those of the high cost Plans.

The functional area of Provider Network Management and Services had a moderately favorable impact on the overall tactical variance. Again, the vast majority of this cost savings came from a low staffing ratio. Non-labor costs per FTE were slightly lower, yet staffing costs per FTE offset this area's low costs.

The Choices Low Cost Plans Make in Tactical Expenses

Low cost Plans make decisions that differ from their higher cost peers. Hallmarks of these decisions include levels and distributions of expenses between functions, the levels and distribution of staff between functions, the levels of compensation and distribution between functions and the distribution between functions and levels of non-labor expenses.

Cost Variances. Among the low cost Plans, Actuarial represented the greatest *percent*

favorable variance enjoyed by the low cost Plans, followed by Information Systems. However, the low cost Plans did not spend more on one function and reduce costs in others. Rather, they maintained low costs *across the board*, but some functions were lower than others.

Components of Cost Variance. The leading *sources* of the overall favorable variance were the functional areas of Information Systems and Corporate Services. This was followed by the functional areas of Customer Services and Enrollment.

Staffing Ratio Variances. Low staffing ratios were primarily responsible for the difference between the low cost and other Plans. Actuarial had the greatest variance from their peers for low cost plans, followed by Customer Services. By contrast, Corporate Executive and Governance displayed an *unfavorable* variance compared to the high cost Plans.

Components of Staffing Ratio Variances. As noted earlier, the staffing ratios of low cost Plans are significantly lower than those for their high cost peers. The most important source of this difference is in the functional area of Information Systems, followed by Customer Services. Claims was also an important contributor.

Staffing Cost Variance. As noted before, staffing costs per FTE as a whole *offset* the favorable performance of low cost health plans. But some areas such as Actuarial, Corporate Executive and Governance and Finance and Accounting were lower than the high cost Plans. Staffing costs per FTE were notably higher, however, in the functional areas of Claims, Customer Services, Enrollment and Provider Network Management and Services.

Continued on Page 4





Summary of Decisions: *From Page 3*

Components of per Employee Staffing Cost Variance. Of the total staffing costs unfavorable variance (that is, *higher* per FTE costs), Claims comprised the greatest portion of it, followed by Customer Services. Information Systems, on the other hand, offset the unfavorable variance the most, followed by Corporate Executive and Governance.

Non-Labor Cost Variance. As stated before, non-labor costs were the second most important driver of performance for the lowest costs Plans. In variance from the other Plans, the functional area of Finance and Accounting had the greatest percent advantage in these costs, followed by Corporate Executive and Governance and Information Systems. Actuarial, Claims and Corporate Services, however, offset favorable variance.

Components of Non-Labor Cost Variance. As a percent of the overall favorable variance of non-labor costs, the functional area of Information Systems was the greatest contributor, followed by Corporate Executive and Governance. Claims offset favorable variance the most, followed by Corporate Services.

The fact that non-labor costs for Claim and Encounter Capture and Adjudication are higher and non-labor costs for Information Systems are lower than the other Plans raises the possibility that classification differences explain some of this. However, the results indicate that when the non-labor costs differences for these two functional areas are combined, the net effect is that non-labor costs are still significantly low, suggesting that classification differences would be unlikely to have been the most important contributor, even assuming it occurred.

Strategic Expenditures of Low Cost Plans

As noted above, certain expenses, especially Sales and Marketing and Medical Management, have returns that may be realized over a longer period of time. In addition, Medical Management expenses may yield lower health care costs. For this analysis, we call these “strategic activities.” We have considered these expenses separately and, in this analysis, assumed that health plans with low costs in the tactical functions are also likely to make insightful decisions regarding strategic functions as well. Interestingly like the tactical expenses, the costs in strategic expenses are also lower overall.

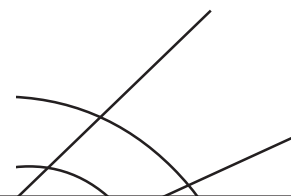
For the low cost Blue Cross Blue Shield Plans, the Sales and Marketing functional area cluster had expenses somewhat lower than the other Plans, but the drivers of these costs are much different than other clusters. The favorable variance is almost exclusively due to low non-labor costs per FTE (non-labor costs for this cluster include broker Commissions and Advertising). Staffing costs per FTE were slightly lower, but the staffing ratio was high.

The most important source of lower costs is in Advertising and Promotion. This area’s costs are lower primarily due to a low staffing ratio, followed by low non-labor and staffing costs.

By contrast to the low costs of internal Sales, external broker Commissions are relatively high compared to the other Plans. The combination of low internal marketing and sales expenses combined with higher Commissions suggests that the low cost Plans favor an external distribution system, rather than an internal one.

Continued on Page 5





Summary of Decisions: *From Page 4*

It is notable that these low cost Plans grew at a rate that was slightly faster than their higher cost peers. This is true even when adjusting for the mix of products offered by the low cost group.

The firms with the lowest costs in the tactical areas also have low costs in Medical Management. The costs in this functional area comprised the majority of the total favorable variance in strategic costs. Staffing ratios are low and are the primary driver of the total favorable variance in costs. Non-labor costs were slightly lower, while staffing costs were slightly higher than the high cost Plans.

The median health benefit ratio for the low cost Plans was higher than that of the Plans with higher administrative costs. This was also the case when adjusting for the mix of products offered by the low cost Blue Plans.

Conclusion

This analysis identifies the hallmarks of the choices that low cost Blue Cross Blue Shield plans make. It is free of product mix bias, and the data has been thoroughly scrubbed.

A few conclusions are especially important. While the expense savings are concentrated in Information Systems, Corporate Services and Customer Services, they are found in tactical functions across the board. This is suggestive of an overall management commitment and a culture of conservative spending throughout the organization.


Also, low costs have little to do with staffing costs per FTE. In fact, compensation per employee is higher among the low cost plans. Rather, they are mostly the result of lower staffing ratios and non-labor costs. This mix of drivers is suggestive of thoughtful attention to the processes of executing health plan transactions.

Factors such as membership growth and scale seem to have little to do with achieving low costs. Low cost Plans actually had smaller average membership than their higher cost peers and had only slightly higher membership growth.

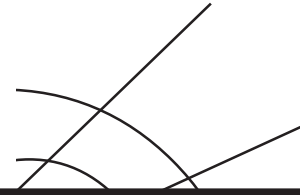
Low cost Blue Cross Blue Shield Plans do, however, tend to outsource more than their higher cost peers. We found that both Information Systems and Claim Encounter Capture and Adjudication for low cost Plans had a higher percentage of outsourced staffing costs. In the Sales and Marketing cluster, we see that low cost Plans have higher broker commissions and lower internal sales costs, suggesting that they favor an external distribution system.

This analysis is not an operational blueprint, however. This analysis contains no recommendations on what information system to buy, what proportion of claims should be autoadjudicated or the appropriate mix of manual versus automated customer service inquiries to shoot for.

The premise of this and our other benchmarking efforts is that the heads of the various functional areas are experts on how to improve their operations and that they are committed to doing so. We also recognize that aggressive cost management requires that managers make difficult decisions. In short, our benchmarks are intended to serve as catalysts to the actions that managers may already see as necessary on an intuitive level and also provide a broad-brush description of what those operational targets must look like. Those managers are likely experts in executing the goals implied in this analysis.

Additional information is available to users of the Blue Cross and Blue Shield edition of the Sherlock Expense Evaluation Report. 





New Benchmarking Calculator: *From Page 1*

The data used to calculate the benchmark value is drawn from the various *Plan Management Navigators* for Blue Cross and Blue Shield Plans, Independent/Provider-Sponsored Plans, Medicare and Medicaid-Oriented Plans, as well as for TPAs. Administrative expenses include those of Pharmacy and Mental Health management but exclude miscellaneous business taxes such as premium taxes. This data is, in turn, selected from various *SEER* benchmarking studies.

We hope this calculator will prove to be a helpful starting point in the analysis of your health plan administrative expenses. It won't tell you why your plan performs as it does, it won't tell you what factors contributed to its performance, and it compares your results only to averages. Still, this calculator is a way to begin and, in the current environment, getting a jump on administrative expense management is prudent. ♦

New SEER Universes: *From Page 1*

tage, administrative costs will be subject to pressures of their own. This product will ultimately be subject to MLR minimums but rate increases will be especially meager in the intermediate term. For plans offering Medicaid, weak state budgets will place continuing pressure on plans' Medicaid operations.

Benchmarking helps firms determine whether they are operating at best practice for costs and, if not, what functional areas provide the highest return on management's efforts in improvement. If improving your plan's performance is on your company's agenda for 2011, we invite you to consider participation in Sherlock Company's benchmarking surveys.

New SEER Universes: *From Previous Column*

We have a very strong network of Plans.

Fifty-eight Plans serving more than 43 million insured Americans participated in our benchmarking studies in 2010. Our universes consist of Blue Cross Blue Shield Plans, Independent/Provider-Sponsored Plans, Medicare Plans, Medicaid Plans and Third Party Administrator Plans.

We have unparalleled experience. Now completing our thirteenth survey, we have 454 health benefit years of experience. Our data definitions, metrics, "scrubbing" procedures and analysis methods are well-developed. Our experience means our benchmarks achieve a high degree of insight for your efforts.

Our benchmarks are generally accepted.

Including licensees, health plans serving more than one-half of all insured Americans are current users of our benchmarks. They are also relied upon for advocacy and health policy purposes.

We are structurally sound. Reliability is enhanced by its voluntary participation, freedom from conflicts of interest and incentives against the "tragedy of the commons." In other words, our benchmarks are an inexpensive unbiased complement to any consulting services for administrative cost management.

If your plan would like to consider participation, we invite you to give us a call at 215-628-2289 or email us at sherlock@sherlockco.com. We will launch the surveys beginning in March 2011 to reflect 2010 calendar year results. ♦

Continued Next Column

