Plan Management Navigator
Analytics for Health Plan Administration

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Please see invitation to participate in the 2016 Sherlock Benchmarking Study on Page 8.

Comparing "Best-in-Class" Independent / Provider - Sponsored Plans Against Their Peers

In this issue of *Plan Management Navigator*, we provide a summary of our analysis on "Best-in-Class" plans versus their Peers. Our analysis is based on the 13th annual Independent / Provider – Sponsored Sherlock Benchmarks. 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 2014.

We recognize that the long-term preferred objective is cost that are optimal for their strategic objective. But the Best-in-Class 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, such as quality, membership growth or low health care costs.

The focus of much of this analysis is "Tactical" costs, that is, costs other than Sales and Marketing and Medical Management (which we consider "Strategic" expenses). Those areas have costs most readily associated with strategic objectives such as growing the business and reducing health care costs. The plans reported costs segmented by product and function, as shown in Figure 1. In making this exclusion, 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.

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.

Figure 1. Best-in-Class 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
- 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

Best-in-Class plans' Tactical PMPM costs were 38% lower than their Peers. A low Staffing Ratio was the main driver in low costs, with Best-in-Class plans lower by 33% and comprising 84% of the difference. Best-in-Class plans also operated with lower Staffing Costs per FTE, but Non-Labor Costs per FTE were high, by 10%.[1]

It appears that Best-in-Class plans operate in a culture of conservative administrative expenses since every functional area was lower than the Peers. The main contributor among functions to superior performance was low costs in Information Systems and it was responsible for 43% of the overall low Tactical costs. The Corporate Services function and Claims function were also significant drivers in low costs. These three functions together comprised 70% of the difference between Best-in-Class and Peer plans.

Select Characteristics of the Two Sets of Plans

Scale. If scale played a role it was modest. The median values for the two sets were 448,000 and 328,000, respectively. The mean membership size for Best-in-Class plans was 406,000 versus 467,000 for the Peer plans. Size did not determine ranking though since two of the five Best-in-Class plans were significantly smaller than the median size of the Peer plans.

Operating in Low Wage Areas. There was an effect of local costs of living but it was modest. Staffing Costs comprised 25% of the cost advantage for Best-in-Class plans. The average wage index for Best-in-Class plans was about 9% lower than the Peer plans. (We employ the Hospital Wage Index used by CMS). Staffing Costs per FTE were lower by approximately 20%, meaning that Staffing Costs per FTE were lower than indicated by the relative wage index.

The wage index, it should be recognized, may actually exaggerate the actual 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 plans' headquarters' cities, the more advantageous remote service centers would be.

Propensity to Outsource. Outsourcing was associated with high costs in the Peer plans. The mean percent of FTEs outsourced was 8% among the Best-in-Class plans compared to 19% among the Peer plans.

[1] All of the factor ratios used in the analyses that follow this section, e.g., 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 those analyses.

Low Cost Product Mix. By reweighting, as we describe in the Our Approach section at the end of this issue, our analysis eliminated the effect of any product mix differences between the groups of plans. A plan focused on ASO products will have lower per member costs than one focused on Medicare Advantage irrespective of its efficiency so it is important to make this adjustment to reported costs. The product mixes of the plans were in fact different so that reweighting to eliminate the effects of product mix was an important step. The different product mixes can be seen in Figure 2.

Activities that Made a Difference

The Account and Membership Administration Cluster, which includes functions central to health plan operations, contributed 58% to the Best-in-Class plans' low Tactical costs. The PMPM expenses for this cluster were 36% lower for Best-in-Class plans. The functions included in the Account and Membership Administration Cluster includes Enrollment/Membership/Billing, Claim and Encounter Capture and Adjudication, Customer Services and Information Systems.

In the Account and Membership Administration cluster as a whole, Non-Labor expenses per FTE were 24% higher, but the Staffing Ratio was lower by 36%. Staffing Costs per FTE were 20% lower.

Notably, if the Staffing Ratio in the Best-in-Class group was the same as the Peers, and if the Staffing Costs remained the same, the Non-Labor Costs per FTE would be 37% of the Peers. That means that the low Staffing Ratios are not likely to be artifacts of flawed reporting stemming from outsourcing or expense classification. The low Staffing Ratio suggests that it is superior processes that are responsible for superior performance. Put conversely, productivity is simply greater for the Best-in-Class organizations.

All four functions for Best-in-Class plans were lower than the Peers. Information Systems was chiefly responsible, comprising 73% of low costs for the cluster and 43% of overall low Tactical costs. Claims followed contributing 17% to the cluster's low costs and 10% to overall low Tactical costs. Both Customer Services and Enrollment comprised about 3% of overall Tactical costs and approximately 5% of low Account and Membership Administration cluster costs. Lower Staffing Ratio and Staffing Costs per FTE for Best-in-Class plans was present for all four functions.

Figure 2. Best-in-Class Health Plans

Product Mix Comparisons

	Commercial Insured	Commercial ASO	Commercial Total	Medicare Total	Medicaid Total	Comprehensive Total
Best-in-Class	46%	27%	73%	8%	17%	100%
Peer Plans	55%	19%	74%	11%	13%	100%

*Medicare Supplemental is not shown.

Information Systems. Costs for Best-in-Class plans were 40% lower than the Peer plans. Staffing Ratios were 56% lower, while Staffing Costs per FTE were also lower. Non-Labor Costs per FTE, however, was much higher for the Best-in-Class plans.

The sub-function, Operations and Support was 57% lower in favor of Best-in-Class plans and contributed over half of the low cost variance in Information Systems. A Staffing Ratio that was 66% lower for Best-in-Class plans was the central driver, while Staffing Costs per FTE was also lower. Applications Acquisition and Development contributed 26% to low Information Systems expenses with Best-in-Class plans holding a 36% cost advantage. Applications Maintenance contributed 17% to low IS costs and IT Security Administration and Enforcement was only marginally lower for Best-in-Class plans.

Corporate Services Function. This function comprised 17% of the overall low Tactical cost variance. A Staffing Ratio that was 35% less than the Peer plans drove low costs in this function with Staffing Costs per FTE also lower. Peer plans were 6% lower for this function's Non-Labor Costs per FTE.

There were five subcategories within this functional area: Human Resources, Legal, Facilities, Imaging and Other. All were relatively low cost for the Best-in-Class plans. In almost every subcategory, a low Staffing Ratio was by far the factor most responsible for the low costs. For the Other Corporate Services sub-function, Non-Labor Costs per FTE and Staffing Costs per FTE contributed similarly to low costs, while the Staffing Ratio was slightly higher for the Best-in-Class plans.

Claim and Encounter Capture and Adjudication. This function's costs were lower primarily on a low Staffing Ratio. This is significant in light of the low Information Systems costs noted previously since it is within the realm of possibility that the same activities in two organizations may be reflected differently in different organizations, either through the unlikely case of reporting error or differing degrees of auto-adjudication.

Both sub-functions, Coordination of Benefits and Subrogation, and Other Claim and Encounter Capture and Adjudication, were lower and a low Staffing Ratio was a central factor.

Provider Network Management and Services. This function contributed 7% to overall low Tactical costs because of a Staffing Ratio that was 30% lower for the Best-in-Class plans and Staffing Costs per FTE that was 9% lower. Non-Labor Costs, however, were higher.

The Other Provider Network Management and Services sub-function contributed over half of the function's low costs and the Best-in-Class plans had costs 51% lower than its Peers. (This sub-function contains activities such as orientation, on-going education with new and existing providers, and maintaining relationships with providers.) A low Staffing Ratio was key, while Non-Labor Costs per FTE and Staffing Costs per FTE were also lower. Provider Contracting and Provider Relations Services contributed 26% and 19%, respectively, to the function's low costs.

Corporate Executive and Governance. Best-in-Class plans reported PMPM expenses that were lower by 54%. Staffing Ratios were lower by 72% for the Best-in-Class plans. Compensation and Non-Labor Costs were higher. Recall that scale appeared to play little difference in plan cost performance.

Strategic Expenses

Reflecting a culture of conservative administration, Best-in-Class plans also have lower costs in the Strategic areas as a whole (comprised of Sales and Marketing and Medical Management). Including Strategic Expenses, the Best-in-Class plans had costs that were lower by 26%.

Sales and Marketing Cluster costs were *higher* for the Best-in-Class plans by 4% entirely due to their 34% higher Non-Labor Costs per FTE. The Best-in-Class plans reported that a median of 8% of their Sales and Marketing staff is outsourced, compared with a median of 3% for the Peer plans. The Best-in-Class plans appeared to favor a broker-driven, rather than internal, distribution system.

Broker Commission, which we classify as entirely Non-Labor, were higher for the Best-in-Class plans by 50%. This explained most of the higher costs variance in the Sales and Marketing cluster.

Rating and Underwriting costs were 9% higher for the Best-in-Class plans due to much higher Non-Labor Costs per FTE. Staffing Costs per FTE were also higher, while the Staffing Ratio was lower by 17% for Best-in-Class plans. Peer plans had much lower costs than the Best-in-Class plans for the sub-function HCC Expenses, by 28%. Best-in-Class plans outsourced a median of 59% of their FTEs for HCC compared to Peer plans at a median of 17%. Best-in-Class plans had lower expenses in the Other Rating and Underwriting sub-function, by 9%.

Marketing costs were lower by 35% for Best-in-Class plans with low Staffing Ratio being the sole driver. The Other Marketing and Product Development and Market Research sub-functions contributed to low Marketing costs. Both sub-functions had lower Staffing Ratios and Staffing Costs per FTE. Conversely, the Member and Group Communication sub-function was high entirely due to Non-Labor Costs per FTE.

Sales expenses were lower by 20% for Best-in-Class plans mainly on a Staffing Ratio that was 21% lower. Staffing Costs per FTE was lower by 8%, but Non-Labor Costs per FTE was higher by 45%. Both the Account Services and Other Sales sub-functions contributed to the function's low costs and were lower by 29% and 28%, respectively. The sub-function, Internal Commissions, was higher by 14%. Similarly to *external* Broker Commissions, we classify Internal Commissions as entirely Non-Labor.

Advertising and Promotion costs were 25% lower for the Best-in-Class plans primarily on low Staffing Ratio and low Staffing Costs per FTE. Both of the Advertising and Promotion sub-functions, Media and Advertising and Charitable Contributions, were lower by 25% and 28%, respectively.

Best-in-Class plans' higher Sales and Marketing costs illustrate a potential trade-off in the rate of membership growth. Total product membership for the Best-in-Class plans grew by a median value of 10%, compared with a median of 3% for their Peer plans. More meaningfully, the Peer plans, when weighted at the product-mix of the Best-in Class plans, posted an increase of 1%, growing slower than the Best-in-Class plans.

Medical Management was lower for Best-in-Class plans, by 38%. Low Non-Labor Costs per FTE was mainly responsible, while Staffing Costs per FTE and Staffing Ratio was also lower. (Both sets of plans outsourced at similar levels, each at a median of 7%.)

Most sub-functions were lower for the Best-in-Class plans except for Pre-Certification, Disease Management, and Nurse-Based Counseling. In instances where sub-function costs were higher for the Best-in-Class plans, its Staffing Ratio was also high.

It is possible that lower expenses in Medical Management by the Best-in-Class plans resulted in lower gross profits, that is, premiums less health benefits. As with Sales and Marketing, low profits and low Medical Management costs may illustrate a potential trade-off of low costs of administrative expenses on other attributes of health plan performance.

Gross profit margins were lower for the Best-in-Class plans. Gross profit margins for *Insured* products had a median of 11% for the Best-in-Class plans and 12% for the Peer plans. At the mix of the Best-in-Class plans, the Peer plans had a gross profit margin of 14%.

Gross profits themselves are also higher in the Peer plans. On a PMPM basis, *Insured* gross profits were $39 for the Best-in-Class plans and $50 for the Peer plans. At the mix of the low-cost plans, the Peer plans' gross profits were $46 PMPM.

Similarly, it is notable that the median *insured* health benefit ratio for the Best-in-Class plans was 89%, compared to 88% for the Peer plans. At the product mix of the Best-in-Class plans, the Peer plans had a health benefit ratio of 86%.

Similarities of Best-in-Class IPS and Blue Plans

Earlier we published a study similar to this in our previous *Plan Management Navigator* based on Blue Cross Blue Shield Plans. There were many similarities between the two universes in the characteristics of Best-in-Class plans. In both cases the key factor for superior performance in low Tactical Costs was a low Staffing Ratio. Compensation was also a factor in low Tactical costs, but less so in Best-in-Class Blue Plans. Non-Labor Costs per FTE was higher for Best-in-Class plans in both universes. While low cost IPS plans held an advantage in every functional area over their peers, low cost Blue Plans had higher costs in one function, Claims. It appeared that scale either had little to no effect in either sets of plans, while there was a modest benefit of low local costs of living for both sets of Best-in-Class plans. As previously mentioned, lower cost plans in both universes outsource less than their higher cost peers.

Our Approach

Each of the plans analyzed in the course of this study differs from its peers in many key characteristics. So to compare them we employed a composite approach to summarize the characteristics of the low cost, Best-in-Class health plans. We summarize the steps below.

1. We identify the Best-in-Class Plans by comparing each plan's costs to its universe. We then selected the lowest cost plans that comprise 25% of the total Independent / Provider – Sponsored universe. 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 are those with the smallest differences from reweighted universe values. Five 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 comprise 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 directly employed in each of the composites.

3. The Costs per Member per Month used in each of the two 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 weightings were then summed to arrive at a total for each function. The sum of the function costs yielded a total Tactical cost value. The Tactical costs plus the Strategic costs equaled the total costs. To assure comparability between the Best-in-Class and Peer plans, we employed the product mix for the Best-in-Class plans for both sets of plans.

4. The plans supplied detailed staffing information to us, including total staff by function. We used this information to estimate Staffing Ratios for each function in the two composites to eliminate the effect of product mix differences. We first calculated 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 adjust for the fact that the Staffing Ratios are presented in 10,000 members rather than per member.

Would Your Health Plan Like to Participate in the 2016 Sherlock Benchmarking Study?

Our highly valid, well-populated Benchmarks provide an unbiased ranking and help prioritize activities that will have the greatest impact on improving your health plan's overall operating performance. Now that most provisions, including the MLR limitations, of the Affordable Care Act have been implemented, participation by your health plan may be an appropriate and necessary response to the strong incentives to cost efficiency.

We believe that many of your peers have concluded that participation is timely. The overwhelming proportion of health plans participating last year are participating this year, and we have added several plans. Please link to www.sherlockco.com/seer/peers.shtml for what last year's participation looked like.

We will meet to finalize the content of the survey in February, distribute the survey forms in March, collect the completed surveys in May and publish beginning in late June or early July. Participation entails efforts on your part since useful outputs require relatively granular inputs. 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.