Plan Management Navigator
Analytics for Health Plan Administration December 2012

Decisions of Low Cost Blue Cross and Blue Shield Plans in 2011

Blue Cross Blue Shield Plans operate under many parameters of the Blue Cross Blue Shield Association, but cost structure is not one of them. In fact, Blue Cross Blue Shield plans at the 25th percentile in costs operate at a 32% cost advantage to their higher cost peers.

This analysis summarizes the hallmarks of decisions of low cost Plans. The most important reason for their superior performance stems from staffing ratios that are remarkably low. Low costs in Account and Membership Administration were a central factor in this, and low Information Systems costs were the largest contributor to overall low costs.

This analysis is derived from data collected from the 24 Blue Cross Blue Shield Plans participating in *Sherlock Expense Evaluation Report* in 2012. These comprise 65% of all Plans based in the contiguous United States.

Overall Cost Savings

Overall, low cost Blue Cross Blue Shield Plans had tactical administrative expenses that were $6.51 PMPM, or 32%, 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 94% of the overall cost savings. Staffing costs per FTE were also lower by approximately 12% and were the next most important factor. However, non-labor costs (supplies, depreciation and other operating expenses) were higher for the low cost plans.

The low staffing costs per FTE may be understood in the context of the wage levels in the markets of the low cost plans. They averaged 90% of the average of the high cost Plans.

Notably, low cost Plans are able to improve their performance. Of the six low cost Plans, four achieved declines in their PMPM tactical costs in 2011. As a group, the six low cost Plans achieved a 3.8% decline in their PMPM costs. This decline holds constant the business mix of these Plans between the two measurement years.

When examining the specific activities that were the sources of savings, the cluster of functional areas called Account and Membership Administration explained 60%. The expenses that make up this cluster were responsible for the majority of reported overall tactical costs of health plans. In this cluster of functions, a low staffing ratio explained 89% of the superior cost performance. While per FTE staffing costs were lower, non-labor costs were higher.

The functional area responsible for the vast majority of the superior performance of the Account and Membership Administration cluster was Information Systems. This function was also the most important reason for lower tactical costs. A low staffing ratio was the most important contributor to low IS costs but low non-labor costs were nearly as important. Compensation levels were lower but their contribution was relatively minor. In 2011, Information Systems for low cost Plans was less likely to be outsourced than for the high cost Plans.

The other three functions in this cluster Enrollment, Customer Services and Claim and Encounter Capture and Adjudication were also low. Enrollment costs were lower by 36% and Customer Services costs were lower by 28%. Claim and Encounter Capture and Adjudication costs were lower by 6%. In 2011, Claim and Encounter Capture and Adjudication for low cost Plans was equal in its likelihood to be outsourced with the high cost Plans.

Figure 1. Plan Management Navigator
Sources of Total Variances, Mix-Adjusted

	Non-Labor Costs per FTE	Staffing Costs Per FTE	Total Costs Per FTE	FTEs Per 10K Mbrs.	Costs PMPM
Lowest Six Plans	*$67,977*	*$76,642*	*$144,619*	*11.41*	*$13.75*
Other Plans	$60,872	$87,278	$148,150	16.41	$20.26
Dollar Variance	$7,105	($10,636)	($3,531)	(5.00)	($6.51)
Percent Variance	11.7%	-12.2%	-2.4%	-30.5%	-32.1%
Percent of Total Variance	-12.6%	18.9%	6.3%	93.7%	100.0%
PMPM Dollar Variance	$0.82	($1.23)	($0.41)	($6.10)	($6.51)
Source of As-Reported Data:		*Volume II.A, Page 343*		*Volume II.A, Page 290*	*Volume I, Page 130*

The fact that all four of these functions are low is important for two reasons. First, since the operations are all part of the same array of processes, the organizations as a whole are functioning at low costs. Moreover, were any activities incorrectly classified, for example between Information Systems and Claims (and our reporting conventions contain strong assurances that this is not the case), that all these functions are low means that whatever blurring that exists does not change the underlying conclusion.

Among the three functions of Enrollment, Customer Services and Claim and Encounter Capture and Adjudication, all had lower staffing ratios of about 25% and lower staffing costs per FTE. Interestingly, Customer Services and Claims also had *higher* non-labor costs compared to their higher cost peers. Enrollment non-labor costs were lower however.

The cluster of Corporate Services comprised 33% of the low cost plans' 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 responsible for the overwhelming proportion of the low costs. Staffing costs were also low, while non-labor costs were high.

Many of the scalable functions are found in the Corporate Services cluster. The median size of the low cost Plans was 1.4 million members, compared with 700,000 members among their higher cost peers. Economies of scale may play a role here.

The Corporate Services *function* is comprised of the subfunctions Human Resources, Legal and Facilities, and others. This function was responsible for 19% of the low costs in tactical expenses as a whole and 56% of the low costs in the cluster. Like the cluster of the same name, a low staffing ratio was responsible for most of the low costs. Staffing costs per FTE were also low and non-labor costs were high.

Finance and Accounting contributed 6% to the overall low costs, with staffing ratio comprising most of the advantage. Both non-labor and staffing costs per FTE were also low.

The functional area of Provider Network Management and Services contributed only 6% to overall tactical low costs. All of the cost savings came from a low staffing ratio. By contrast, non-labor costs per FTE and staffing costs per FTE were higher.

Background and Methodology

For this analysis, the term "low cost" refers to the performance of six Blue Cross Blue Shield 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 cluster of Sales and Marketing, which we call "strategic." 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. This analysis focuses on the remaining expenses that have an immediate impact on the operations of a health plan. Their effect is largely confined to current period activities and each function's performance principally affects only those other remaining activities.

We call these remaining expenses "tactical" 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 established over multiple years. These tactical expenses are incurred, however, in ways that largely reflect those management decisions affecting a health plan's business processes in that period.

To identify the decisions that lead to low costs, we divided the universe of Blue Cross and Blue Shield Plans into a low cost group, comprised of approximately 25% of the universe, and all other Plans in that universe. Six of the 24 Plans were selected for the low cost group. 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, though we did note the average wage index.

We sometimes use the term "superior performance" as a synonym for low cost. This should not be construed as meaning that low costs are necessarily optimal. However, we do not have any evidence that low costs in these tactical areas lead to suboptimal performance in other aspects of their operations.

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 its distribution between functions and the distribution between functions and levels of non-labor expenses.

Cost Variances. Among the low cost Plans, Finance and Accounting represented the greatest percent low cost variance enjoyed by the low cost Plans, followed by Corporate Executive and Governance and Information Systems. One significant finding was that the low cost Plans did not spend more on one function and reduce costs in others. Rather, they maintained low costs in all functions, but some functions were relatively lower than others.

Components of Cost Variance. The leading sources of overall low costs were the functional areas of Information Systems and Corporate Services. This was followed by the functional areas of Corporate Executive and Governance and Provider Network Management and Services.

Staffing Ratio Variances. Low staffing ratios were primarily responsible for the difference between the low cost and other Plans. In terms of functional areas, Corporate Executive and Governance for low costs Plans had the greatest variance from their high cost peers, followed by Finance and Accounting.

Components of Staffing Ratio Variances. As noted earlier, the staffing ratios of low cost Plans were significantly lower than those for their high cost peers. The most important source of this difference was in the functional area of Claim and Encounter Capture and Adjudication followed by Information Systems.

Staffing Cost Variance per Employee. Staffing costs also contributed to the performance of low cost health plans. Corporate Executive and Governance and Information Systems costs were especially low. However, staffing costs were higher in Provider Network Management and Services and Actuarial.

Components of per Employee Staffing Cost Variance. Of the total staffing low costs, Information Systems comprised the plurality of it followed by Claim and Encounter Capture and Adjudication and Corporate Executive and Governance. Provider Network Management and Services and Actuarial staffing costs were higher, on the other hand, slightly offsetting the overall low costs.

Non-Labor Cost Variance. High non-labor costs offset overall low tactical costs, although some functions had low non-labor costs. The non-labor costs for Customer Services, Claim and Encounter Capture and Adjudication and Corporate Executive and Governance were especially high. It is possible that consulting costs related to health care reform were part of the high costs for Corporate Executive and Governance. By contrast, Actuarial and Information Systems costs were quite low.

Components of Non-Labor Cost Variance. The functional area of Information Systems was the greatest, nearly sole, offset to the overall high costs of non-labor costs. Claim and Encounter Capture and Adjudication was the largest contributor to high non-labor costs. Low cost plans were less likely to have outsourced IS at 17% compared with 28% for the other Plans.

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. Therefore, we have considered these expenses separately and, in this analysis, hypothesized that health plans with low costs in the tactical functions might make insightful decisions regarding strategic functions as well. Interestingly, like the tactical expenses, the strategic expenses were also lower overall.

For the low cost Blue Cross Blue Shield Plans, the Sales and Marketing functional area cluster had expenses lower than the other Plans. As with the tactical expenses, the low costs were primarily due to a low staffing ratio. But while staffing costs were low, non-labor costs were slightly high. Non-labor costs for this cluster include broker Commissions and Advertising.

Low cost Plans had an increase in average membership in 2011, while the high cost Plans had a decrease. This difference diminishes when the product mixes are matched.

The major source of lower costs was in external broker Commissions. No staffing was associated with

this activity and all costs were considered non-labor for our purposes.

Internal Sales costs were also low, the next most important contributor after Commissions to this cluster's low costs. The staffing ratio was much lower than average, while per FTE staffing costs were slightly low. By contrast, non-labor costs were high. That both Commissions and Sales costs were low suggests that the entire distribution system costs are low, not just the external one.

Advertising and Promotion costs were also low, chiefly due to a low staffing ratio and non-labor costs. Staffing costs per FTE were also low.

Marketing and Rating and Underwriting costs were also lower. Marketing costs were lower notwithstanding higher staffing and higher compensation levels. Non-labor costs were low for this function. Rating and Underwriting costs of low cost Plans were also lower with only non-labor costs being higher than their peers.

The firms with the lowest costs in the tactical areas also had low costs in Medical Management. Staffing ratios were low and was the sole driver of this function's low costs. Both non-labor costs and staffing costs were 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 true when adjusting for the mix of products offered by the low cost Blue Plans, though the difference diminished.

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 may be drawn. While the expense savings were concentrated in Information Systems, Corporate Services and Corporate Executive and Governance, they were found in all tactical functions. This is suggestive of an overall management commitment and a culture of conservative spending throughout the organization.

Also, low costs were mostly the result of lower staffing ratios. Compensation per employee was also lower, but its effect was relatively modest. This mix of drivers was suggestive of thoughtful attention to the *processes* of executing health plan transactions.

Among low cost Plans' "strategic" expenses, both Sales and Marketing and Medical Management costs were low.

It is possible that low administrative costs came at a cost. Health Benefit Ratios were unfavorable for the low cost Plans. Economies of scale may have benefited the low cost Plans in the Corporate Services cluster, which typically had greater numbers of members.

Low cost Blue Cross Blue Shield Plans were less likely to outsource for Information Systems but equally likely for Claim Encounter Capture and Adjudication.

This analysis is not intended as an operational blueprint. It 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 premises of this and our Sherlock benchmarking efforts from which this analysis is drawn is that the heads of the various functional areas of the health plans are experts on how to improve their operations and are committed to doing so. We also recognize that aggressive cost management requires that managers make difficult decisions. In other words, 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.

There many reasons why health plans are taking a heightened interest in managing their administrative costs. First, health care reform under the PPACA creates pressures on operating activities. They include the effects of the rebate rules of MLR regulations, the more intense competition fostered by state and federally administered exchanges and the possible migration of employers to self-insured products to avoid PPACA regulations, which increases the visibility of administrative costs. Secondly, the weak employment environment pressures membership, forcing rationalization of operating costs.

Sherlock Company is the leading provider of actionable benchmarks for health insurers. Now in its 15th consecutive year, Sherlock benchmarks are used by most Blue Cross Blue Shield plans, and most of the health plan board members of AHIP.

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