

Plan Management Navigator

Analytics for Health Plan Administration



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SUMMARY OF SHERLOCK SCALE STUDY FOR HEALTH PLANS: THEY EXIST BUT SHOULD NOT BE OVERSTATED

Economies of scale are broadly thought to impact the cost structures of health plans. If significant scale economies exist, then new entrants are highly risky and a persuasive policy argument may be made in support of a single payer health insurance system.

Sherlock Company performed an analysis of the economies of scale of Blue Cross Blue Shield plans. The details of the study are published in *Plan Management Navigator's* sister publication *PULSE*. This edition of *Plan Management Navigator* summarizes the key conclusions.

1. Of the total administrative costs of health plans, only ten functions, totaling 17.8% of all administrative expenses were subject to economies of scale. Functions displaying economies of scale included Provider Contracting, Information Systems Application Maintenance and Audit, among others.

2. While these scalable areas had a P-Value of 10% or less, there were additional factors other than scale that explained cost differences between the Plans. The function with the greatest R² was Audit with an R² of 48.8%.

3. The effect of scale on costs that were significantly affected was not precipitous. A doubling of the size of the health plan would lead to scalable administrative costs equal to 85.8% of their pre-doubling per member cost value.

4. The modest slope of the scale line (85.8%) combined with the modest proportion of scale expenses subject to scale effects (17.8%) means that the overall effect of scale is modest: a health plan with administrative expenses of \$30.00 PMPM could expect to have administrative expenses of \$29.24, a savings of \$0.76 PMPM, if it doubles in size and the advantages of scale are fully realized. An advantage of this magnitude would be more significant from a corporate finance than a market perspective.

5. Product mix increasingly distinguishes the otherwise very similar Blue Cross Blue Shield Plans. Recalculating to eliminate the effect of product mix differences, *every* function identified as scalable without eliminating the effect of product mix, was confirmed as scalable after the effect of the mix adjustment. In addition, Case Management, which is sensitive to product mix, especially Medicare, is identified as scalable in this analysis.

6. This year's scale study, when compared to last years, is consistent with the theory that the costs to adapt the Affordable Care Act were higher for smaller plans. Thus, the percent of costs subject to economies of scales were greater and such functions as Information Systems Application Maintenance and Actuarial were scalable this year but not last.

Economies of scale is measured as a decline in costs associated with an increase in size. Our universe of Blue Cross Blue Shield Plans, comprised of 19 relatively similar organizations, was the universe employed in this analysis. Their size ranged from somewhat lower than 236,000 to somewhat higher than 3.7 million members.

The detailed study is included with *PULSE*. Subscriptions costs \$375.00. The statistical summaries of the data employed to perform these analyses are available as the *2014 Sherlock Expense Evaluation Report – Blue Cross Blue Shield Edition*. Please contact us at sherlock@sherlockco.com or 215-628-2289 if either is of interest.

