



## GROWTH IN MEDICAID PLANS' CORE ADMINISTRATIVE COSTS DECLINES IN 2008

### Summary

Core per member administrative costs trends decreased from 8.2% in 2007 to -1.4% in 2008, on an as-reported basis. Adjusting to eliminate the effects of changes in product mix, the rate of cost increase also declined, to a 1.4% increase versus a 4.2% increase last year. Including marketing costs, per member per month administrative expenses declined by 2.8%, as-reported, and 12.7% on a constant-mix basis.

Per member declines in Account and Membership Administration costs were chiefly responsible for the declines in growth. Marketing costs also declined. For the universe of Medicaid plans submitting 2008 data, core administrative expenses comprised 7.4% of premium equivalents compared with 8.1% for plans submitting data in 2007.

The core administrative expenses of Medicaid plans participating in our performance benchmarking study was \$21.69 per member per month (PMPM), and with marketing costs included, total costs were \$27.51. These costs varied by product: Medicaid SNP cost \$116.71 PMPM while the commercial ASO costs were \$15.08 PMPM. Medicaid HMO products had administrative expenses of \$20.13 PMPM.

In 2008, the commercial ASO administrative expenses were 6.5% of premium equivalents, the lowest ratio for comprehensive products in this universe. Medicaid Child Buy-in, at 21.1%, was the highest percent of premium. Medicaid HMO was 8.6% of premiums.

All attributes cited in this article exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. Pharmacy and

Mental Health administrative costs are included in total administrative cost calculations but not in individual functional area clusters. Core functions are comprised of all administrative costs except marketing-related costs. These results are excerpted from the Medicaid edition of the 2009 *Sherlock Expense Evaluation Report*, comprising 2008 data.

### Background on Medicaid

According to the Centers for Medicare and Medicaid Services (CMS), as of June 2008 the total Medicaid population was 47.1 million people of which approximately 21.1 million, or 45% were served through either Commercial MCOs or Medicaid only MCOs. There may be an increasing tendency for Medicaid programs to focus on managed care. Using CMS's broader definition of managed care, managed care enrollment has increased fairly steadily from 55.6% in 1999 to 70.9% in 2008.

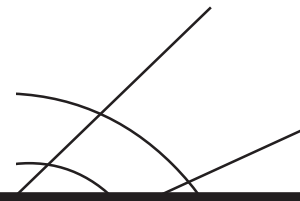
### Membership Trends and Mix Changes

Our benchmarks comprised the results of 1.7 million of Medicaid managed care members, not including 175,000 child or family buy-in members. Total members served by these plans, including Medicare and commercial, totaled 3.2 million members.

The eleven plans participating in our benchmarking study had relatively rapid growth. From June 2007 to June 2008, the total Medicaid population increased by 2.6% and the Medicaid managed care population increased by 13.5%, according to CMS. Average Medicaid members served by these plans increased by

**Figure 1. Medicaid Benchmark Summary**  
Medicaid Costs by Functional Area Cluster, 2008 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Provider & Medical Management	\$4.59	\$7.47	\$5.55	31.1%
Account & Mem. Administration	6.15	9.19	6.51	32.5%
Corporate Services	5.04	7.65	5.94	31.9%
Subtotal: Core Functions	\$18.21	\$22.83	\$21.69	16.9%
Marketing	1.03	8.43	5.23	83.9%
Total	\$23.61	\$30.56	\$27.51	22.1%



16.0% in 2008 and overall membership increased by 14.3% in the same period.

For plans that participated in our benchmarks in both years, the average proportion of commercial members decreased by 2.6 percentage points to 14.0% of the total. Medicare Advantage products increased by 0.4 percentage points to 2.9%. While Medicaid HMO increased by 1.4 percentage points to 74.2%, Medicaid including Child and Family Buy-in increased by 2.2 percentage points to 83.1%, on average.

### Administrative Costs and Trends

For convenience of analysis, we group various functional areas into clusters, and standardize for size by expressing expenses on a per member basis. These clusters consist of Provider & Medical Management, Account & Membership Administration, Corporate Services and Marketing. Note that Marketing costs are excluded from the Core Functions. Since states vary in their policies surrounding marketing of Medicaid products, we consider their costs separately. Values for 2008 and rates of change for these clusters and overall are shown in Figures 1 and 2. Appendix A provides values for all plans participating in 2008, and is comprised of 2007 data.

**Core Functions** costs declined by 1.4% (compared with a growth of 8.2% last year) to \$21.69 PMPM. (All rates of change hold constant the universe of participants.) While Provider & Medical Management and Corporate Services grew by 8.5% and 10.6%, respectively, Account & Membership Administration declined by 5.1% PMPM. On a constant mix basis, total core expenses increased by 1.4% compared with 4.2% last year, PMPM. Account & Membership Administration declined by 4.2% PMPM, while Provider & Medical Management and Corporate Services grew by 7.1% and 3.0% respectively.

### Calculation of Mix-Adjusted Rates of Expense Growth

To make the most useful comparisons administrative expenses between years, it is illuminating to eliminate the effects of product mix differences. This is beneficial both between organizations with different product mixes and also between periods. Accordingly, in comparing expenses between periods, we hold constant the product mix between the two years.

To do this, since Medicaid plans report to us by product, we reweight their expenses so that the product mix existing in the prior period is the same as in the current one. We then recalculate the rates of change based on these reweighted estimates.

**Medical and Provider Management** grew by 8.5% (down from 9.1% last year) to \$5.55 PMPM. While Provider Network Management and Services declined, the Medical Management / Quality Assurance / Wellness functional area grew rapidly.

On a constant mix basis Medical Management / Quality Assurance / Wellness growth was even more impressive. It comprised more than one-half of the increase in core administrative expenses, and was solely responsible for the growth in this cluster. By contrast, Provider Network Management and Services costs were unchanged, holding the universe's product mix constant versus 2007.

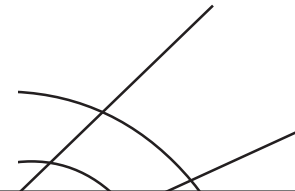
On a constant-mix basis, Provider and Medical Management increased by 7.1%. The costs of Medical and Provider Management at the 25<sup>th</sup> percentile was \$4.59 PMPM and \$7.47 PMPM at the 75<sup>th</sup> percentile.

**Account and Membership Administration** cost decreased to \$6.51, down by 5.1% from last year. In 2007, the rate of growth, on an as-reported basis, was 15.3%. The value at the 25<sup>th</sup> percentile was \$6.51

**Figure 2. Medicaid Benchmark Summary**  
Medicaid Percent Change in Costs by Functional Area Cluster

	2007 Data		2008 Data	
	Pct. Chg.	Pct. Chg. Mix-Adjusted	Pct. Chg.	Pct. Chg., Mix-Adjusted
Provider & Medical Management	9.1%	0.6%	8.5%	7.1%
Account & Mem. Administration	15.3%	7.9%	-5.1%	-4.2%
Corporate Services	4.5%	3.9%	10.6%	3.0%
Subtotal: Core Functions	8.2%	4.2%	-1.4%	1.4%
Marketing	6.0%	3.5%	-21.5%	-9.3%
Total	7.2%	3.8%	-2.8%	-12.7%





PMPM, while the costs at the 75<sup>th</sup> percentile were \$9.19 PMPM.

The function with the greatest decline was Claim and Encounter Capture and Adjudication. Information Systems costs also declined, though at a slower rate. By contrast Enrollment and Customer Services costs increased.

On a constant mix basis, the Account and Membership Adjudication cluster decreased by 4.2%, lower than the 7.9% increase for 2007. Declines in Claim and Encounter Capture and Adjudication and, to a lesser extent, Information Systems were responsible for this decline.

**Corporate Services costs** increased by 10.6%, compared with 4.5% in 2007. These costs include such support areas as Finance and Accounting, Actuarial, Corporate Services (like Facilities, Legal, Printing and Mailroom and OPEB), Corporate Executive / Governance and Association Dues and License / Filing Fees. Corporate Executive / Governance costs showed rapid growth.

On a constant mix basis, costs increased by 3.0%, compared with 3.9% in 2007. Corporate Executive / Governance increased on this basis. Actuarial decreased at a double-digit rate. Corporate Services also declined. Total costs for this cluster were \$5.94 PMPM in 2008, while the 25<sup>th</sup> percentile value was \$5.04 PMPM and the value at the 75<sup>th</sup> percentile was \$7.65 PMPM.

**Marketing expenses**, as noted above, are not included with our core functions since marketing activities of Medicaid plans are governed by differing state laws. Marketing costs were \$5.23 and declined by 21.5% PMPM, down from growth of 6.0% in 2007. Internal Sales and Marketing, followed by external broker Commissions were the reasons for this decline. Rating and Underwriting and Advertising and Promotion each increased. Product Development / Market Research costs surged in 2008. The 75<sup>th</sup> percentile value for this cluster was \$8.43 and the 25<sup>th</sup> percentile value was \$1.03 PMPM.

Holding the product mix constant, Marketing expenses also declined, by 9.3%, compared with growth of 3.5% last year. On a constant-mix basis, internal Sales and Marketing growth comprise most of the decline in this cluster's costs, followed by a decline in external broker Commissions. On a constant mix basis, Rating and Underwriting grew, but Product Development / Market Research costs grew strongly in 2008. Advertising and Promotion decreased.

**Total Costs** were \$27.51 PMPM, down by 2.8% in 2008. The rate of cost decline is amplified by the decline in the non-core Marketing cluster. The 25<sup>th</sup> percentile value was \$23.61 PMPM and the value at the 75<sup>th</sup> percentile was \$30.56 PMPM. On a constant mix basis, PMPM costs fell by 12.7%.

## *Accounting for Costs as a Percent of Premium Equivalents*

Notwithstanding its important drawbacks, health plans and others often express administrative costs as a percent of premiums. As shown in Figure 3, core administrative expenses were 7.4% of premium equivalents for comprehensive products sold by Medicaid plans, and 8.8% including Marketing expenses. (Please note that each median value and median of totals are calculated individually. Since medians are the value at which 50% of the distribution is higher and 50% is lower, the sum of the medians will not equal the total. Similarly, the sum of the percentiles will not equal their totals either.)

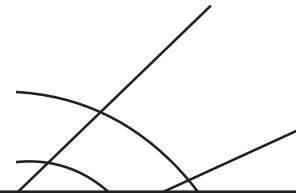
The 25<sup>th</sup> percentile value for core administrative expenses was 6.1% of premiums and equivalents and the value at the 75<sup>th</sup> percentile was 9.5%. Comparing these results to those in Appendix B, core administrative expenses were 70 basis points lower as a percent of premium equivalents. The sharp decrease in Account and Membership Administration costs appears responsible for this decline in core administrative costs relative to premium.

The value at the 25<sup>th</sup> percentile for Provider and Medical Management was 1.8% of premium equivalents, while the 2.5% of premium equivalents represented the 75<sup>th</sup> percentile. The median value, at 2.3% was 20 basis points higher than the 2.1% posted last year.

The costs of Account and Membership Administration were 2.5% of premium equivalents, 80 basis lower than the 3.3% reported last year. The value at the 25<sup>th</sup> percentile was 2.2% of premium equivalents and 3.8% of premium equivalents at the 75<sup>th</sup> percentile.

The median proportion of premium equivalents attributable to Corporate Services was 2.3%, 10 basis points lower than last year's value of 2.4%. Twenty-five percent of plans had values below 2.1% of premium equivalents or above 3.1% of premium equivalents in 2008.





**Figure 3. Medicaid Benchmark Summary**  
 Medicaid Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2008 Data  
 Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Provider & Medical Management	1.8%	2.5%	2.3%	29.0%
Account & Mem. Administration	2.2%	3.8%	2.5%	49.9%
Corporate Services	2.1%	3.1%	2.3%	34.5%
Subtotal: Core Functions	6.1%	9.5%	7.4%	31.5%
Marketing	0.5%	2.9%	1.8%	75.6%
Total	8.3%	11.4%	8.8%	26.4%

Including marketing costs, the 25<sup>th</sup> percentile value of total administrative expenses was 8.3%, while the 75<sup>th</sup> percentile value was 11.4%. The median value, at 8.8%, was 50 basis points lower than reported last year.

Marketing costs comprised 1.8% of premium equivalents, with the 25<sup>th</sup> percentile value at 0.5% and the value at the 75<sup>th</sup> percentile was 2.9%. The comparable median percent in 2007 was 1.5% or 30 basis points lower than for 2008.

#### Calculation of Premium Equivalents

Administrative services relationships comprise a relatively small part of the business mix of Medicaid plans. On average, they comprise 9.3% of members and most plans in our survey do not serve this market at all. Nevertheless, to the extent such relationships exist, they play havoc with the intuition that administrative costs, when expressed as a percent, are a proportion of the premium dollar. That is because, under ASO relationships, employers are only billed for the administrative services that they provide rather than for the cost of care, which is borne by the self-insured groups.

Our solution to this is to express expenses as a percent of premium equivalents. Since each of the plans submits the health care expenses for the self-insured groups (which they know since they process the groups' self-insured claims), by adding this amount to the administrative service fees actually billed, we are able to estimate the premium equivalents of the ASO arrangements.

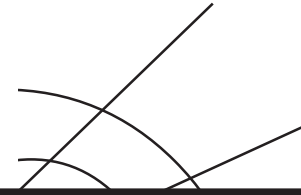
Note that, as with premiums, fees charged to ASO clients reflect a profit assumption. Therefore, to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to directly compare costs with the insured business.

#### Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by over forty functional areas. Overall, the resources employed in these products are reflected in administrative expenses that differ quite sharply between the various products. Our participants normally have quite robust activity-based costing systems to facilitate this. For example, suppose commercial HMO products have 40% of the claims volume as Medicare Advantage products; commercial products administrative expenses will be accordingly lower. Similarly, ASO products have lower overall costs than their insured counterparts since ASO arrangements are normally provided only to larger groups that tend to be less costly to market to.

These differences are manifest in their overall cost differences. The most expensive product offered by Medicaid plans is their Medicare SNP product at \$116.71 PMPM. Medicare Advantage followed, at \$94.74. The least expensive comprehensive product offered by these health plans was the ASO product at \$15.08 PMPM. This is shown in Figure 4. Medicare Part D was \$16.17. Total Medicaid administrative expenses were \$20.13.

As shown in Figure 5, on a percent of premium basis, the ranking of administrative expenses by product is different. The ASO product remained among the low cost on a percent basis but it was followed by Medicare SNP and Medicare Advantage. Medicaid HMO was 8.6% of premium equivalents. The high cost products, calculated on a percent of premium equivalent basis, were generally those sold to those less than 65 years of age. Medicaid Child Buy-in had the highest ratio, followed by Medicaid Family Buy-in and then the commercial products.



**Figure 4. Medicaid Benchmark Summary**

Medicaid Costs by Product, 2008 Data

*Per Member Per Month*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
HMO	\$27.46	\$31.21	\$29.97	23.5%
POS	24.52	32.12	28.32	38.0%
Indemnity & PPO	32.92	45.79	40.99	33.5%
Total Comm. Ins.	27.19	34.82	31.57	24.9%
ASO	11.78	18.52	15.08	32.8%
Total Commercial	22.85	30.17	26.45	20.5%
Medicare Advantage	79.93	96.06	94.74	28.8%
Medicare SNP	116.05	144.98	116.71	24.4%
Medicare Total	95.07	129.53	101.66	31.0%
Medicaid HMO	18.99	26.71	20.13	21.3%
Medicaid Child Buy-In	16.98	30.96	17.46	86.8%
Medicaid Family Buy-In	28.20	30.99	29.59	13.3%
Medicaid Total	19.37	26.71	24.08	20.3%
Comprehensive Total	\$23.61	\$30.56	\$27.51	22.1%
Medicare Part D	\$16.17	\$16.17	\$16.17	NM

Sponsored (IPS) plans which are smaller than Blue Cross Blue Shield (Blue) Plans.

Despite the overall similarity, the costs are lower for the Medicaid plans, followed by the Independent / Provider-Sponsored plans and then the Blue Cross Blue Shield Plans. We suspect that specialization may have a value in Medicaid in that it can facilitate administrative simplicity. Since most of the plans, regardless of universe, operate in only one state, their Medicaid product options may be quite limited, especially as compared with commercial products. A firm focused on Medicaid may well require a less complex information system than would be necessary in the commercial world.

**Figure 5. Medicaid Benchmark Summary**

Medicaid Costs by Product, 2008 Data

*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
HMO	8.6%	10.4%	9.4%	17.2%
POS	7.9%	10.4%	9.2%	38.6%
Indemnity & PPO	11.2%	15.4%	14.0%	32.1%
Total Comm. Ins.	9.0%	11.4%	10.5%	17.2%
ASO	6.0%	7.3%	6.5%	29.5%
Total Commercial	8.1%	10.4%	9.1%	19.6%
Medicare Advantage	7.4%	11.0%	8.0%	29.3%
Medicare SNP	6.4%	9.9%	7.9%	42.8%
Medicare Total	7.4%	11.7%	9.5%	32.9%
Medicaid HMO	7.5%	11.2%	8.6%	31.0%
Medicaid Child Buy-In	16.3%	30.2%	21.1%	54.7%
Medicaid Family Buy-In	12.5%	13.4%	13.0%	9.7%
Medicaid Total	7.5%	12.1%	8.8%	30.8%
Comprehensive Total	8.3%	11.4%	8.8%	26.4%
Medicare Part D	7.0%	7.0%	7.0%	NM

Accordingly, Medicaid plans have much lower Claim and Encounter Capture and Adjudication and much lower Information Systems costs PMPM than their Blue and Independent / Provider-Sponsored peers in their offerings of Medicaid products. We believe that it is most common to operate all insurance products on the same information systems platform so it may be that the higher costs of commercial products are shared with their Medicaid product.

Some of this is offset by higher costs in Provider and Medical Management. Medicaid-focused plans spend more on Provider

Network Management and Services than Blue and IPS, though scale may be a factor. Medicaid focused plans spend more on Medical Management than their Blue counterparts for this product.

On the other hand, the Corporate Services cluster tends to be higher cost for Medicaid plans. For instance, Finance and Accounting and the Corporate Services functional area, which tend to be scalable,

## Comparisons Across Universes

Health plans in other Sherlock Company benchmark universes also offer Medicaid products. Figure 6 compares their core costs. It is notable that while there are significant scale differences between the various plans, the core costs are relatively similar. Medicaid plans are smaller than Independent / Provider-



have higher PMPM costs. Similarly, Corporate Executive / Governance costs are also higher, PMPM.

## Background on This Universe and SEER

The peer group in this analysis consisted of eleven Medicaid plans, which together served 3.2 million members. On average 66.5% of the premiums and fees of these plans came from Medicaid products. The median membership in this universe was 230,000 members.

Costs comparisons are based on the results for plans that participated in each of the comparison years. PMPM and percent values are for all plans that reported this year. We employed median values throughout this process as the best measure of central tendency.

Overall, our benchmarks in 2009 (containing 2008 data) comprise the experience of approximately 397 health plan years. We also have universes of Independent / Provider-Sponsored Plans, Larger Health Plans, Blue Cross Blue Shield Plans and Medicare Plans. The results of the Independent / Provider-Sponsored Plans, and Blue Cross Blue Shield Plans may be found on our web site.

**Figure 6. Medicaid Benchmark Summary**

Medicaid Characteristics by Universe, 2008 Data

	Medicaid	Indep. / Prov. Sponsored	BCBS	Combined Universes*
<b>Core Costs PMPM</b>				
25th PCTL	\$16.19	\$17.07	\$17.57	\$16.38
Median	17.43	18.13	19.49	17.78
75th PCTL	\$21.98	\$23.75	\$20.32	\$21.93
σ/ Mean	21.1%	23.0%	15.1%	20.2%
<b>Core Costs as a Percent of Premiums</b>				
25th PCTL	6.2%	6.1%	6.8%	6.5%
Median	7.0%	11.1%	8.1%	8.4%
75th PCTL	9.6%	12.2%	8.6%	11.2%
σ/ Mean	29.7%	34.0%	24.6%	29.8%
<b>Total Costs PMPM</b>				
25th PCTL	\$18.99	\$19.78	\$19.97	\$19.20
Median	20.13	22.06	20.67	20.97
75th PCTL	\$26.71	\$28.75	\$23.12	\$25.63
σ/ Mean	21.3%	20.6%	15.2%	19.7%
<b>Total Costs as a Percent of Premiums</b>				
25th PCTL	7.5%	7.5%	7.6%	7.7%
Median	8.6%	12.5%	8.6%	9.9%
75th PCTL	11.2%	14.1%	9.9%	13.1%
σ/ Mean	31.0%	35.2%	25.9%	31.3%
Plans Offering Medicaid	11	9	3	20
Medicaid Members	1,650,830	475,734	162,753	1,929,443
Total Compr. Members	3,220,387	5,696,061	31,270,195	38,643,019

\* Three firms included in two universes, are excluded from combined figures.

**Appendix A. Medicaid Benchmark Summary**

Medicaid Costs by Functional Area Cluster, 2007 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Provider & Medical Management	\$4.73	\$6.70	\$6.19	25.5%
Account & Mem. Administration	7.07	9.34	7.72	30.2%
Corporate Services	4.63	7.29	5.73	39.4%
Subtotal: Core Functions	\$17.99	\$21.76	\$20.77	18.5%
Marketing	1.89	7.16	2.98	80.5%
Total	\$22.10	\$27.39	\$24.30	27.9%

**Appendix B. Medicaid Benchmark Summary**

Medicaid Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2007 Data

Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Provider & Medical Management	1.9%	2.7%	2.1%	28.3%
Account & Mem. Administration	2.2%	4.1%	3.3%	53.6%
Corporate Services	1.9%	2.6%	2.4%	51.3%
Subtotal: Core Functions	5.7%	9.7%	8.1%	38.4%
Marketing	0.8%	1.7%	1.5%	48.2%
Total	8.0%	11.5%	9.3%	28.2%