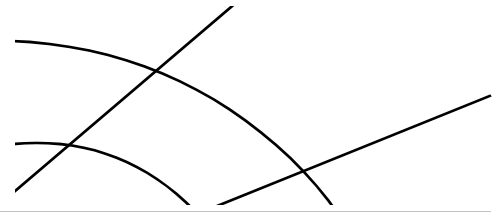




# Plan Management Navigator



Analytics for Health Plan Administration

June 2005

## SEER PUBLICATION DATES ANNOUNCED

This year's performance benchmarking process is well along and publication is expected shortly. The products reflect improvements such as strengthened medical management and information systems metrics, stronger definitions to promote comparability and others stemming from eight consecutive years of experience. Forty-seven plans, including most Blue Cross Blue Shield Plans, participated in this year's studies. In aggregate, these plans serve one in every four insured Americans. We expect that the various editions should be available as follows:

	<b>Volume I</b> <b>Financial Metrics</b>	<b>Volume II</b> <b>Operational Metrics</b>
Blue Cross Blue Shield	Late June	Mid July
Provider-Sponsored	Mid July	Late July
Larger Plan	Mid July	Late July
Medicaid	Late July	Mid August

We have not yet determined a date for the Medicare edition since it depends on the data supplied across universes. We are exploring the possibilities of specialized editions, such as those focused on a particular geographic area.

## EARLY RESULTS SUGGEST EFFECTIVE ADMINISTRATIVE COST MANAGEMENT

Based on preliminary findings from our Blue Cross Blue Shield universe, administrative expenses fell in 2004 versus 2003. Over all, PMPM administrative costs declined by 2.9%, however declines in account and membership administration and medical and provider management was 3.7% and 3.6%, respectively. By product, the PMPM costs trends in the commercial products ranged from (2.6%) for indemnity and PPO ASO to 4.5% for commercial HMO. The overall decline appears in part due to a change in the mix of products in favor of those that are less administratively complex.

The preliminary results are only suggestive but the theme of effective administrative cost management is consistent with other information from the Blue Cross Blue Shield Plans themselves and from the Blue Cross Blue Shield Association's aggregated data. However, we urge caution in using this information since the data is itself preliminary and the preliminary results include the addition of

several plans with relatively low costs. We expect to update these conclusions in late June. For additional details on administrative costs and other metrics of Blue Cross Blue Shield performance and capital costs, please consult the June edition of *PULSE*, and *SEER* when published.

## FROM BENCHMARKING TO ACTION STEPS

Benchmarking should serve to guide improved performance of the health plan. While a strong benchmarking process may well produce valuable feedback for all functional areas and product offerings, the usefulness of the analytical process is enhanced if the "low hanging fruit" can be readily identified and improvements implemented.

In this analysis, based on the *Sherlock Expense Evaluation Report* for 2004, we trace one plan's sources of variance in its administrative expenses from product mix to the underlying costs of a functional area within a product. We heavily rely on Pareto charts<sup>1</sup> to illustrate these successive drill-downs. Pareto charts are designed to focus management's attention on those aspects of the business that comprise 80% the sources of performance variances.

### Effect of Product Mix

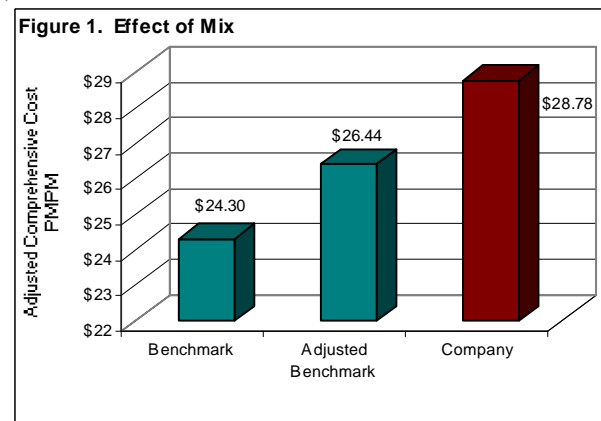
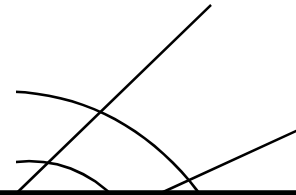


Figure 1 illustrates that this particular company has higher costs than its universe of other comparable health plans. At \$28.78, its costs per member per month are \$4.48 higher than the benchmark of \$24.30.<sup>2</sup> This is a strong statement regarding the performance of this plan. But how strong a statement is warranted?

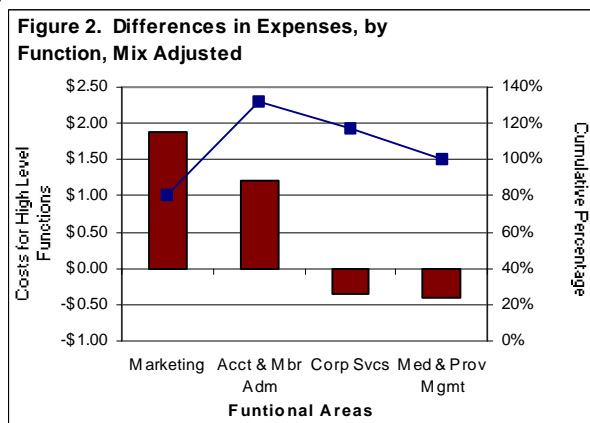


A health plan's administrative expenses may not be perfectly comparable to other ostensibly similar firms if its product mix is different. A plan that provides only ASO products will have lower per member per month (PMPM) expenses than a comparable firm with mainly insured business. Similarly, a high mix of Medicare could push the PMPM costs upwards. The solution is to adjust the benchmark to reflect the mix offered by the company.

This particular company has fewer indemnity and PPO ASO members and greater indemnity and PPO insured members than its peers. Accordingly, the difference is less than indicated using the raw benchmark since the mix-adjusted benchmark is \$26.44, \$2.13 higher than the unadjusted benchmark. While this reduces the variance from the benchmark, this plan is still \$2.34 per member per month higher than the benchmark, assuming an identical product mix.

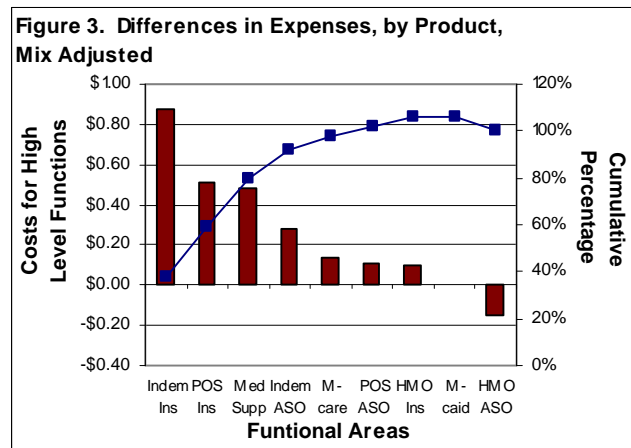
### Sources of Variance: Functional Areas

Figure 2 shows the sources of the variances by the main groups of functional areas, totaling \$2.34, PMPM. (In this section and following, the variances are weighted by the company's product mix to capture their impact on total variance to the product mix-adjusted benchmark. This also captures the relative importance of the variance in the context of the health plan as a whole.) The company's marketing costs were \$1.89 higher than the benchmark, accounting for 80.5% of the total variance. Account and membership administration was higher by \$1.21, accounting for 51.6% of the variance. Favorable variances in Medical and Provider Management of \$0.40 and Corporate Services of \$0.35, comprise a negative 32.0% of the variance from the total mix-adjusted benchmark. While account and membership administration is high, marketing appears to be the most fruitful area to focus management's cost saving efforts.



### Sources of Variance: Product Areas

We can also isolate the products in which the variances occurred. These also total \$2.34 PMPM, again on a product-weight adjusted basis. As shown in Figure 3, costs for all of the products exceeded the benchmark, except for the Medicaid product and the HMO product sold on an ASO basis. Weighted by the product mix, indemnity and PPO insured, POS insured and Medicare supplemental together comprise \$1.87 in PMPM variances or 80% of the total. Indemnity and PPO Insured represented the lion's share of the variance, at 37.5% of the total \$2.34 variance, or \$0.88 PMPM. The implication of this analysis is the insured indemnity and PPO represents the highest return on management's cost-saving efforts.

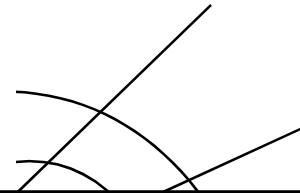


### Sources of Absolute Difference

Rather than focusing on the mix-weighted variances, one could instead address products in which the absolute variances were greatest. Absolute performance differences for the different products are shown in Figure 4, and they would appear to offer a different set of priorities. For instance, POS Insured has a PMPM variance of almost \$14.00 while Medicare and Medicare Supplemental have variances in excess of \$5.00 PMPM.

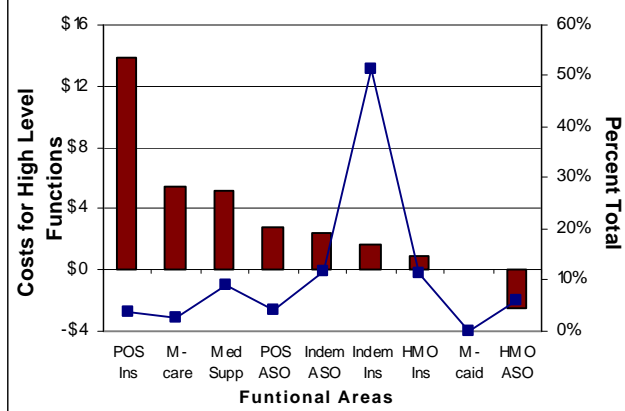
The blue line highlights the weakness of focusing on absolute variances, without considering their relative contribution to the firm as a whole. While POS insured and Medicare present the greatest variances, they represent only 3.7% and 2.5% of the whole business respectively. On the other hand, the indemnity and PPO insured product, which has only a \$1.71 variance, also comprises 51.4% of the plan's business, or fourteen times the size of the POS insured product. Accordingly, the approach used in the previous sections, weighting the variances to capture the relative contribution to the total,





is a better method for prioritizing initiatives. Please note that, in this chart, the blue line represents each product's share in the mix rather than the cumulative value in the Pareto charts.

**Figure 4. Absolute Differences, by Product**

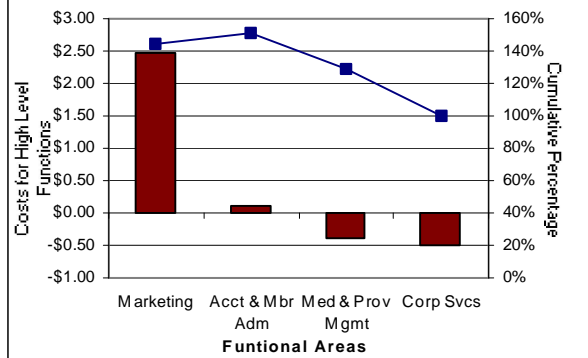


### Functions Within the Indemnity and PPO Insured Product

Returning to the priorities based on the weight of the importance of the product in the company's overall portfolio, recall that the insured indemnity and PPO product had the highest variance of \$0.88, or 37.5% of the total of \$2.34. But what functional areas supporting this product should be targeted for special scrutiny? A Pareto chart can help prioritize these variances as well.

On an absolute basis, the total variance in the insured indemnity and PPO product was \$1.71. Figure 5 illustrates that marketing costs are far and away the most important source of variance, comprising \$2.46, or

**Figure 5. Ind. PPO Insured, Differences by Function**

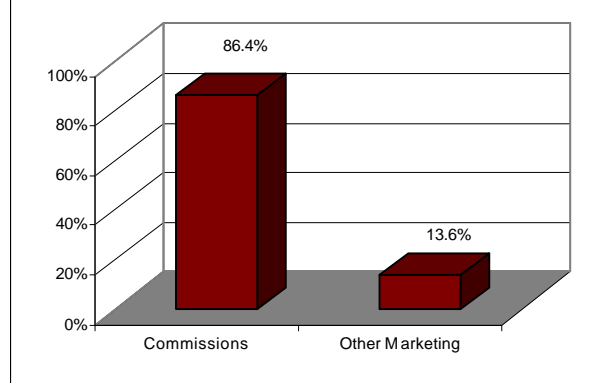


144.1% of the total variance. Account and membership administration also had a \$0.12 unfavorable variance while medical and provider management and services and corporate services had a favorable variance of \$0.38 and \$0.50, respectively. As with the company as a whole, the marketing expenses in the indemnity and PPO insured product seem to be a prime target for heightened scrutiny.

### Sources of Variances within Indemnity and PPO Insured Marketing

Within marketing, the key opportunity for savings may be commissions because \$2.13 of the \$2.46 difference, or 86.4%, stems from such payments. This is shown in Figure 6. Notwithstanding the attractiveness of focusing on commissions for indemnity and PPO, it also probably reflects market conditions.

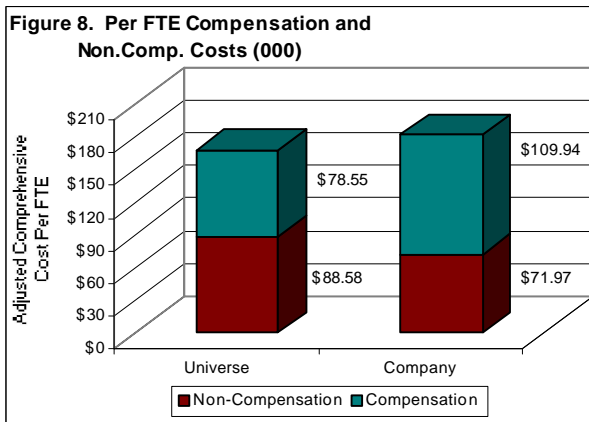
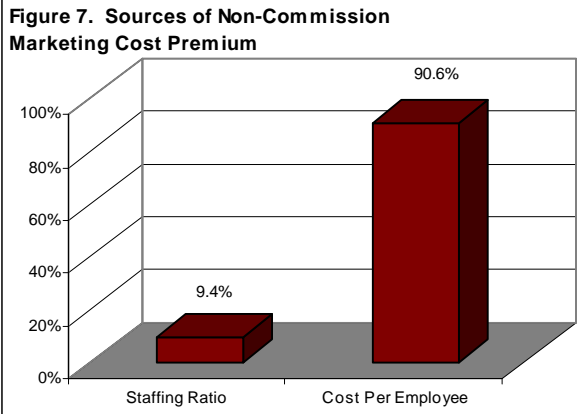
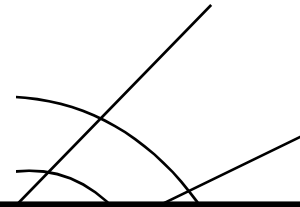
**Figure 6. Sources of Marketing Cost Premium**



While much smaller, the remaining \$0.33 difference can also be addressed. Marketing may be deconstructed by individual sub-functions and through consideration of factors of staffing and total costs per employee<sup>3</sup>. Costs per employee can be further divided into staffing and other costs. As shown in Figure 7, costs per employee is the dominant factor in these costs: While staffing, at 2.21 employees per 10,000 members, is only 0.9% greater than the mean of 2.19, costs per employee, at \$181,900 is 8.8% higher than the benchmark of \$167,123.

Figure 8 shows that the source of these high costs are compensation costs as opposed to other costs of marketing. Compensation per employee is \$109,935, 40.0% higher than the benchmark of 78,546, whereas non-compensation costs at \$71,965 are 18.8% lower than the benchmark of \$88,578.





Further elaboration of this analysis is beyond the scope of this article, but a close look indicates that the source of the high staffing costs are subcategories of sales and marketing and product development / market research. Sales and marketing staffing is lower than the benchmark, however compensation costs per employee are 44.6% higher. In product development / market research, both staffing levels and staffing costs are very high.

## Conclusion

So what action steps should be considered for this company? First, it is clear that the company has room for improvement, even when the effect of its mix of higher cost products is considered. It is also clear that the indemnity and PPO insured product has costs that run higher than average, and that marketing costs are a target of opportunity for the company as a whole.

Within the indemnity and PPO insured product, marketing costs represent the lion's share of the unfavorable variance. Commission costs for this product are rela-

tively high, however non-commission marketing costs are also high as well. A close look at marketing for indemnity and PPO insured indicates that these high costs mainly result from high per employee costs as opposed to the staffing ratio, and high staffing costs are especially notable.

In short, for this health plan, we think that the greatest opportunity for cost savings for this plan is found in marketing indemnity and PPO insured products, specifically the control of the per employee compensation. We think that this is an approach that can usefully be applied in all health plans seeking operational performance improvement.

## Footnotes

<sup>1</sup> Pareto charts are commonly used in quality improvement because they highlight the few vital areas in which improvements can provide the greatest payoff. They reflect the observation that 80% of the impact of the problem will show up in 20% of the causes. The left axis, relating to the bars on the charts, generally represent the values of variances while the right axis represents the cumulative impact of the variances. Figure 3 resembles the classic form of these charts. However, the superior performance of this company makes the curve slope downward on the right side.

<sup>2</sup> For successive drill-downs to tie to one another, values of central tendency have to logically relate to each other. Arithmetic means have that quality. However, generally when we report the mean for a performance metric in a particular product area, it is the mean only for plans that reported the underlying data and we do not include plans without the products in the calculation. On the other hand the totals for the plans included their entire portfolio, effectively giving a "0" weighting to products not offered. Since each plan may offer different products the sum of the average costs for all products will not equal the total.

In order to tie the product means to the Comprehensive Total mean, we first adjusted mean membership so that it was the average for all plans, including those that did not respond. We then calculated the average of the means of each product, weighted by adjusted mean membership.

<sup>3</sup> Our survey captures staffing in aggregate, not by product. Because we costs are reported by product, we can make reasonable inferences about the likely staffing ratios for commercial products. The mix of costs, that is, compensation and non-compensation, is reported by the respondents and are assumed to be the same across products.

