

## PROGRESS IN SEER

At this stage in the 2006 benchmarking process, we have received approximately one-half of the Blue Cross Blue Shield Plan finance submissions so that we are on schedule for our late June, early July publication date. Other universes' submissions are staggered and therefore not yet due.

We have had unprecedented participation in our panelist Forum, which contributes to consistency in responses and comparability in results, with 109 members this year. Operational metrics in Medical Management (both activities and health care utilization) and Information Systems have been central to this year's discussions. The 220 page *Common Guidelines* for the survey submissions have facilitated the resolution of these issues.

*For those firms that are still considering benchmarking against our universes of more than 40 health plans, we have some solutions that may be of interest. Please contact us for further information.*

## WHY DID ADMINISTRATIVE EXPENSES FOR PROVIDER SPONSORED PLANS INCREASE LAST YEAR?

Total administrative costs per member per month (PMPM) of Provider Sponsored<sup>1</sup> health plans increased by a 1.9% in 2004. This article takes an in depth look at the causes for the increase by looking at specific Functions / Departments. As discussed further, marketing costs were central to the increase.

The data was extracted from the 2004 and 2005 *Sherlock Expense Evaluation Reports* for the years of 2003 and 2004, respectively. The

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## DASHBOARD SUMMARY FOR FEBRUARY

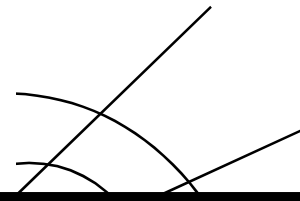
This month marks the beginning of the third year for the Sherlock Company *Health Plan Dashboard*. This is an important milestone in an analysis intended to complement our SEER performance benchmarks.

For the trailing three months ended February 28, 2006, the eleven health plans in our *Health Plan Dashboard* reported revenue growth of 6.1%, with ASO/ ASC growth of 9.8%, while managed care revenue decreased by 0.4%. Membership declined by 7.5% for managed care but increased by 32.2% in the indemnity business. Managed care and ASO had price increases of 8.3% and 13.1%, respectively, while indemnity posted an increase of 5.3%.

Health benefits ratios overall declined by 1.8 percentage points, but increased by 3.6 and 0.6 percentage points for indemnity and managed care lines, respectively. The number of scripts per person increased by 0.2 to 9.6 on an annualized basis. E/R visits per thousand members decreased by 27.0 to an annual rate of 248.5 per thousand and hospital days decreased by 2.1 days to 308.7 days per thousand.

The administrative expense to premium ratio increased by 0.5 percentage points to 9.4%. Claims volumes increased to 13.4 per member per year while inquiries per member decreased to 2.0 per member per year. Staffing ratios increased by 1.06 FTEs to 17.2.

*Please contact us regarding ordering or participation information.*



results were divided into four major functions, and then separated further into various sub-categories. The universe was comprised of ten Provider Sponsored plans that participated in both years. The four functions were Marketing, Medical & Provider Management, Account & Membership Administration, and Corporate Services.

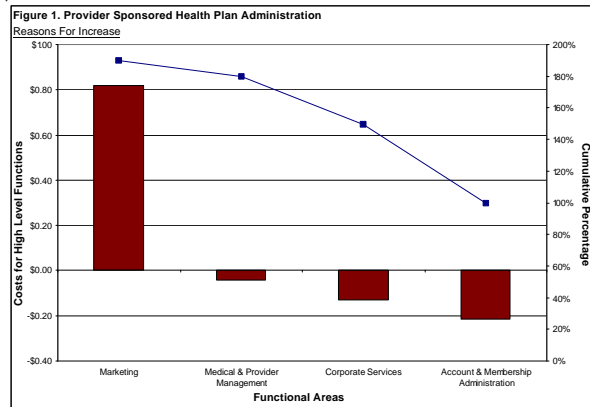
We employ Pareto Charts<sup>2</sup> to illustrate successive drill-downs into the causes of increases. Pareto Charts are designed to focus management's attention on aspects of business that comprise the greatest proportion of the sources of increase.

It should be noted that the Provider-Sponsored plans that are the subject of this analysis are firms that have made a significant and multi-year commitment to the management of administrative costs. Because of this unusual commitment, we do not know whether these results can be generalized to other independent health plans. *We are now completing our fourth annual analysis for this universe, which should be available in July.*

### Varying Contributors to Cost

As noted above, the total cost of administration increased by 1.9% PMPM in 2004. Figure 1 shows that the amount of increase totaled \$0.43 PMPM in 2004, and the functional areas contributed in various ways.

Marketing was the main driver for the increase, accounting for 190.0% of the total growth of administrative expenses. Together, declines in PMPM Medical & Provider Management, Corporate Services and Account & Membership Administration, helped to offset the increase, comprising *negative* 90.0% of the increase of the total PMPM cost.



### Account and Membership Administration Costs Decline

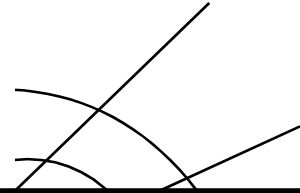
Account and Membership Administration is comprised of “back office” functional areas that are central to the transactions role of health insurance companies. This functional area is composed of Customer Service, Claim and Encounter Capture and Adjudication, Information System Expenditures and Enrollment/Membership/Billing.

Per member per month Account & Membership Administrative costs declined by 3.1% in 2004. Within this major category of expenses, each functional area posted a decline except for Claims.

Customer Service costs had an 11.3% PMPM decrease. This was especially important as it represents the greatest proportion of Account and Membership administration. Total Information System Expenditures underwent a 2.2% decrease, while Enrollment/Membership/Billing also experienced a reduction of 5.4%.

Claim and Encounter Capture and Adjudication was the only function to have an increase, a modest 2.4% PMPM. It somewhat offset the





general trend of decreases in this functional area group.

## *Corporate Services Also Decreased*

Corporate Services includes most of the scalable functions of health plans. That is, as membership grows these functions do not increase as rapidly. This functional area group consists of Finance and Accounting, Actuarial, Corporate Executive / Governance, Association Dues and License / Filing Fees, Miscellaneous Business Taxes and Corporate Services.

The PMPM cost of the major grouping, Corporate Services, declined by 2.0% during 2004. The subcategory Corporate Service, within the more global grouping of the same name, is comprised of HR, Facilities, Legal and Regulatory services. It declined by 15.1% PMPM. This function represents the largest proportion of Corporate Services. Actuarial costs also decreased by 14.5%.

Most functions increased but their proportion of the group's total costs were modest. Finance and Accounting costs increased 2.0%, as Miscellaneous Business Taxes grew by 22.4%. Association Dues and License/Filing Fees grew by 45.1% PMPM. The largest increase in this category was Corporate Executive/Governance cost, which increased by 70.4% for this period.

## *Medical and Provider Management Costs Decline*

Medical and Provider management and services is the among the most visible of the managed health care plan functions, and serves a role similar in plan performance and differentiation to that of professional management in investment companies. This function is

comprised of Provider Network Management and Services and Medical Management / Quality Assurance / Wellness.

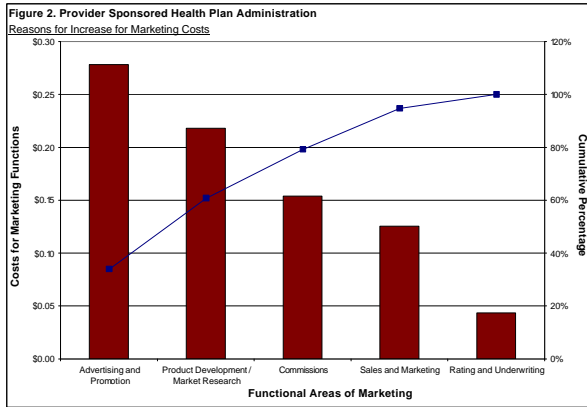
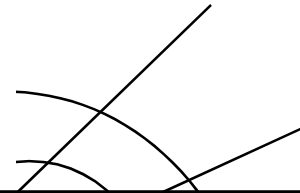
Medical & Provider Management experienced a 1.4% decrease in cost. Provider Network Management and Services, focusing on contracting and service to providers, experienced a 2.0% PMPM decrease, which accounts for a most of the total decrease in the category. The balance is explained by Medical Management/Quality Assurance/Wellness experienced a 1.0% PMPM reduction in cost 2004.

## *Marketing: The Main Reason for the Increase*

Marketing is complex in health plans because of the breadth of potential products and the varying requirements of customers. Functions we group together as Marketing include Advertising and Promotion, Product Development / Market Research, Sales and Marketing, Commissions and Rating and Underwriting. Overall, Marketing costs increased by 14.6% for an absolute increase of \$0.82 PMPM.

Figure 2 illustrates that Advertising and Promotion was the primary contributor to the growth of the Marketing expense in 2004 with an increase of 53.1% over last year. Product Development / Market Research also made a considerable jump with an increase of 117.6%. Sales and Marketing (mainly internal marketing efforts, supportive of, or alternative to, external distribution systems) also showed a significant contribution with an increase of 8.0%. Commissions were the next largest contributor to the growth by increasing by 4.9% in 2004. Rating and Underwriting had the least impact on the increase in Marketing expense, increasing 22.7% over the previous year.





## Conclusion

Marketing was a key priority for Provider Sponsored health plans in 2004, responsible for an absolute increase in PMPM administration of \$0.82, compared with a total increase of only \$0.43. There was particular emphasis on Advertising and Promotion and Product Development / Market Research.

One of the plans noted that, “We had done relatively little marketing in the past and purposefully stepped up our efforts and spending.” Because Provider-Sponsored health plans are often associated with leading hospitals or medical groups, which sometimes dominate their service areas, they enjoy a halo-effect and other advantages that has historically reduced their need to aggressively market their services.

Corporate Services, by contrast, posted a sharp decline in PMPM costs. Some of the more scalable areas had especially sharp declines, as membership increased by 4.5% on average. The decline in costs would have been even more precipitous if not for the sharp increase in such hard to control expenses as Miscellaneous Business Taxes and Association Dues and License/Filing Fees. Also, Corporate

Executive/Governance costs also surged: While these costs are modest in the context of each plan, we surmise that they may have earned by officers pursuant to their achievement of superior performance, a frequent accomplishment in this universe in 2004.

## Endnotes

<sup>1</sup> We use the term Provider Sponsored health plan generally to refer to health plans sponsored by providers of health care such as hospitals, physician groups and health systems. Also included in this group are a few plans whose relationships with providers are mere legacies. Notably, these plans have achieved a sufficient degree of strategic separation that their profit margins and operating metrics are normal for health plans. Because such strategic separation is crucial for long-term success, we consider these plans the “best and brightest” of the provider-sponsored plans.

<sup>2</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 common observation that 80% of the impact of the problem will show up in 20% of the causes. The left axis represents the cumulative impact of the differences. Figure 2 resembles the classic form of these charts.

