

TRUE MASTER PLAN

True Master Plan (TMP) is a managed care company that provides and finances health care services for employees of DigiTech Media, Inc. Approximately 5,000 employees at DigiTech Media are currently enrolled in TMP's health insurance plan. The number of enrollees has increased over the past year as DigiTech Media continued to expand its workforce, and more and more DigiTech Media employees have elected to receive this benefit.

DigiTech Media currently pays TMP the full cost of health insurance for its employees. This insurance provides comprehensive coverage for inpatient and outpatient hospital care, surgical services, physician office visits, and other services (e.g., x-rays). The only cost to employees is a \$15 copayment for each physician office visit.

Frank Glen is the Director of Strategic Planning and Forecasting at True Master Plan. His key function is to direct the overall development and analysis of all strategic financial planning initiatives relating to TMP's managed care programs. His staff is involved in many activities, including preparing periodic reports of the costs incurred under the DigiTech Media account. Every time a DigiTech Media employee uses health care services, information about the type of service and the relevant costs are recorded in a database. Mr. Glen recently directed his staff to perform a financial analysis of the current utilization and costs incurred under the DigiTech Media account.

Bad News

Jane Paul personally delivered her summary of utilization on the DigiTech Media account to Mr. Glen (See Exhibit 1). The data, he noted, indicated a sharp increase in number of physician office visits over the past month. He remarked, "The DigiTech Media employees' use of outpatient physician services has been going up for the past six months. What's going on?" He asked Ms. Paul to provide him with the enrollment numbers to see if the increase in utilization of physician services was primarily due to the change in the number of employees enrolled in the health plan. "No problem," she replied. "I have already put the last six months' weekly statistics into a spreadsheet."

Mr. Glen was concerned about TMP's profitability. Last year, TMP negotiated with DigiTech Media to charge a fixed premium of \$250 per employee per month. The total premium revenue is allocated as follows: 55% to hospital and surgical services, 30% to physician visits, and 15% for other services, administration, and profit. These allocations are used to establish budgets in the different departments at TMP. The DigiTech Media contract would expire next month, at which time TMP would need to renegotiate the terms of its contract with DigiTech Media. Mr. Glen feared that TMP would have to request a sharp rate increase to remain profitable. TMP's monthly cost of administering the health plan was fixed, but the increases in the use of health care services were eroding TMP's profits. He suspected that other health plans were planning to increase premiums by 5-10 percent, which was reasonable given the recent statistics on national health expenditures. A report from 2004, the most recent he could find, indicated that total national health expenditures rose 7.9 percent from 2003 to 2004 -- over three times the rate of inflation.

Mr. Glen called in the rest of his staff to assist him in devising a strategy for renegotiating the DigiTech Media account. "If possible, I would like to figure out how we can continue providing this service for the rate we established last year. I'm afraid if we attempt to increase the per member premium, DigiTech Media will contract with another health insurer. What other options do we have?"

Neil Gordon, who works in Membership Marketing, reported that he recently conducted a survey of cost control mechanisms used by other health plans. His analysis revealed that TMP's competitors are increasing their use of these mechanisms, which include copayments, waiting periods, preauthorization requirements, and exclusions on certain health care services.

“One of the problems, in my opinion, is that the DigiTech Media employees have nearly full coverage for all their health care services,” remarked Gordon. “The DigiTech Media employees should pay some part of their health care services out-of-pocket, so that they share an incentive to stay healthy. TMP only charges a \$15 copayment, but many other health insurance plans require that enrollees pay \$20 – 25 for each physician office visit. A higher copayment will help us reduce the use of physician services.” He showed them the results from a national study that showed a significant relationship between the amount of a copayment and the number of visits to a physician (See Exhibit 3), and recommended that Mr. Glen consider implementing a larger copayment for each physician visit when the contract with DigiTech Media is renegotiated.

Rose Garcia, who works in Provider Relations, disagreed. “I don’t think a higher copayment is going to reduce the level of physician visits. The demand for health care services is a derived demand because it depends on the demand for good health. People don’t necessarily *want* to visit their physician, but they often *have to* in order to stay healthy. If we want to cut our costs, we will have to figure out how to pay the health care providers less.” TMP currently pays for health care services on a fee-for-service basis. Most of the area hospitals and physicians “participate” in TMP’s health insurance plan. When DigiTech Media employees obtain health care services from participating health care providers, the providers are reimbursed for their costs directly by TMP. Several factors have increased health care costs over time, including the growing availability of medical technology, such as magnetic resonance imaging (MRI), and increased medical malpractice litigation.

Ms. Garcia suggested that Mr. Glen consider negotiating with physicians to lower the costs of the services provided. “I’ve heard that some managed care plans have cut deals with physicians to lower their charges by 10-25 percent,” she said. “Physicians have accepted these deals because if they don’t, they could be cut out of the health insurance plan and they could lose all their patients.” Mr. Gordon conceded that this might be possible, but expressed his concern that if participating physicians accepted a lower amount per visit, they might reduce the quality of care they provide to TMP’s members.

Mr. Glen dismissed his staff. Eager to resolve this issue, he phoned your consulting company for assistance. TMP’s executives would need a full report of the current situation and evaluation of his staff’s suggestions to either (a) increase the copayment, or (b) implement a reduction in charges for physician office visits.

Required:

Prepare a report of TMP’s current financial situation and include an evaluation of the two options for controlling costs on the DigiTech Media account. Use the guidelines for writing a report on the course web site.

You may wish to review the following LDC Concepts: Microeconomics 3 and 5, SOM 1, 4, and 7.

Exhibit 1
Monthly Report of Health Care Utilization
 Total Costs Incurred - DigiTech Media, Inc.

Category of Service	July 2006	August 2006
Hospital Services- Inpatient	203,425	212,250
Hospital Services – Outpatient	182,440	180,700
Surgical Services	101,250	103,400
Physician Office Visits	337,900	391,450
Administrative Expenses	90,000	90,000
TOTAL	915,015	977,800

Number of members, July 31, 2006: 4129
 Number of members, August 31, 2006: 4137

Exhibit 2
Data file has been provided on the course website.

Exhibit 3
Sample Means for Annual Use of Health Care Services

Copayment Level	Physician Visits Per Capita
\$10	6.3
\$15	6.0
\$20	5.7
\$25	5.4
\$30	5.1
\$35	4.8

Source: "Demand for Health Care Services at Different Copayment Levels: Results Based on a National Study of Health Insurance Enrollees"