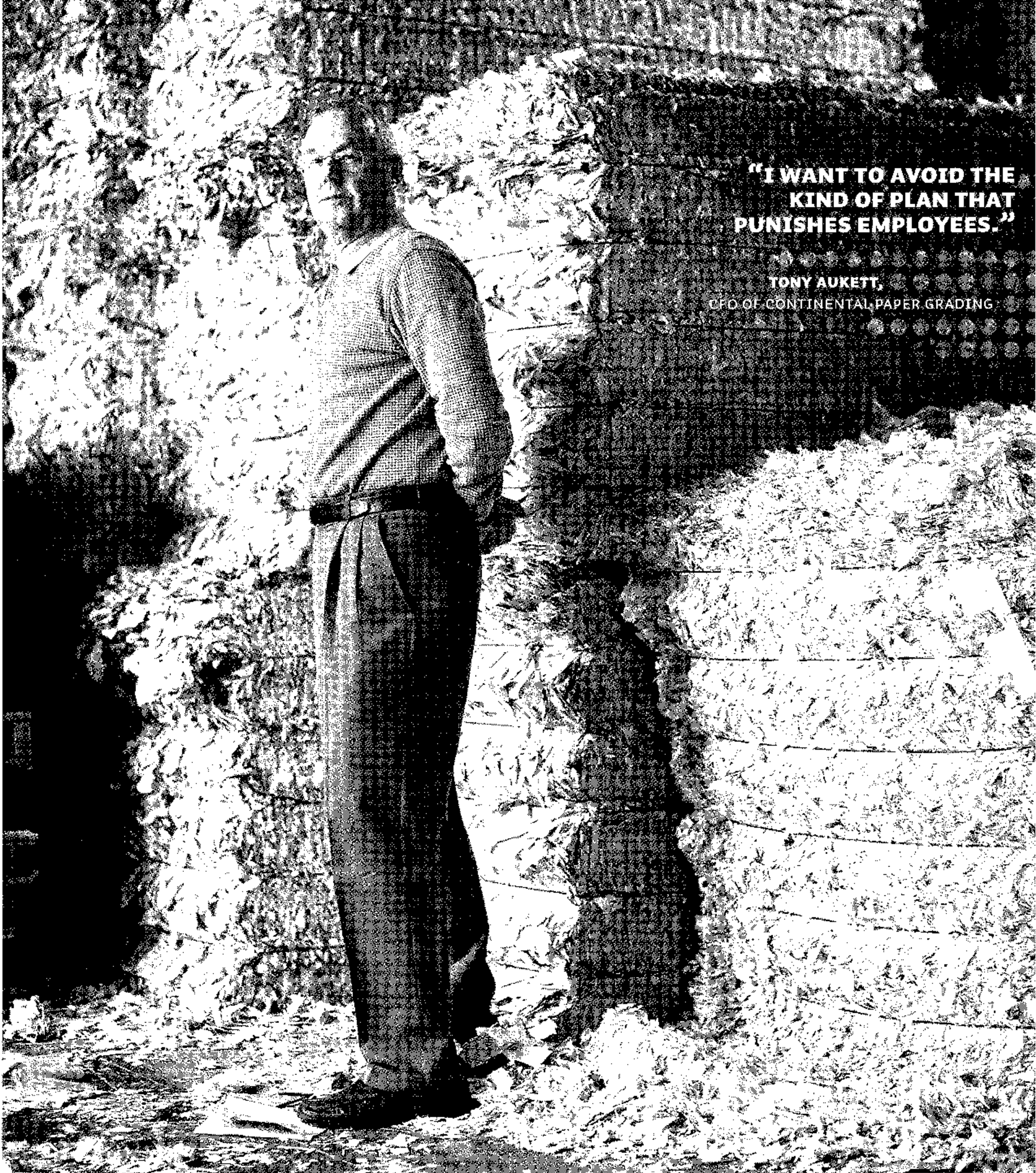
RISING HEALTH-CARE PREMIUMS HAVE COMPANIES SHIFTING COSTS, PUSHING "WELLNESS," AND [illegible] PUNISHING UNHEALTHY BEHAVIOR

BY JOSH HYATT

PROGNOSIS: NEGATIVE

ILLUSTRATION BY TAVIS COBURN



Bob Stefko

CFO at Continental Paper Grading, a broker of waste paper. "We value them and we want them to stay." By December, he had identified a plan that fits those requirements and cuts the company's annual health-care spend by as much as 18 percent. But Aukett knows the situation will become more challenging. "This is probably a good stop-gap," he says. "But I am very aware of what is coming down the pike, and as much as I want to avoid it, we may not have any choice."

What Aukett would like to avoid, but may not be able to, is what one CFO calls the "penalty box" approach to health coverage. In recent years companies have discovered that they can reduce health-care costs by offering incentives for employees to take better care of themselves. The practice has become so widespread that companies such as Virgin HealthMiles, which is part of Sir Richard Branson's Virgin Group, now offer a service that helps businesses measure employee fitness and come up with creative rewards for those who achieve specific exercise goals.

The problem with the rewarding-the-good approach has been that participation starts to drop off unless management keeps sweetening the pot—which, at some point, dangerously dilutes the return on investment. As a result, "some employers think they have gotten all they can get out of giving people incentives," says Jerry Ripperger, national practice leader of consumer health for The Principal Financial Group. "To reach the next level, they need to try an-

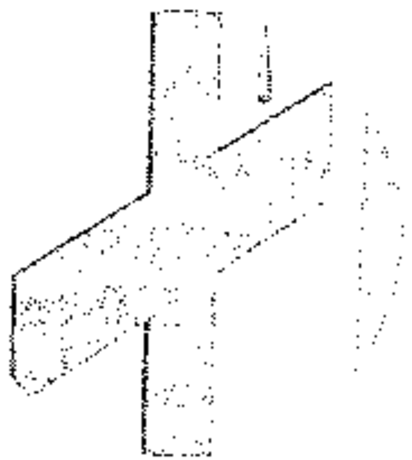
other approach." That means good-bye carrot, hello stick: employees who do not make an effort to quit smoking, lose weight, or otherwise reduce their health risks pay for their decisions—often literally, through higher premiums.

A renewed sense of urgency regarding health-care costs is taking hold because such costs are expected to grow at an average 6.7 percent annual rate between now and 2017 (after rising 6.1 percent in 2007), according to the Centers for Medicare and Medicaid Services. As companies struggling with the dismal economy terminate 401(k) matches—not to mention employees—and take a host of other cost-cutting steps, CFOs are likely to take a harder look at health plans.

In a survey of 320 finance executives conducted late last year by CFO Research Services, more than 40 percent said they intend to reduce the company's contribution to benefits in 2009. A staggering 82 percent expect to control costs by changing their health-care plans. In just one example of the kind of trade-offs finance chiefs are weighing, Guy Anthony, CFO of Quellan, a maker of specialized semiconductor chips, says that because the company had been fairly conservative on salary increases, it could afford to absorb the 8 percent increase in health-care costs. "We didn't make a precise calculus, but we kept the health-care number in front of us when we did our calculations," says Anthony. "We decided not to create angst by changing how much of the premium employees pay."

But containing that angst will require trickier trade-offs in the years ahead. If government estimates are on target, health-care spending will nearly double by 2017, leaping from $2.4 trillion in 2008 to $4.3 trillion. Companies won't be able to easily absorb that increase. Nor will they simply be able to pass it on to workers using the time-honored tradition of raising deductibles and co-pays. The average family premium has already risen by 78 percent between 2001 and 2007, according to the Kaiser Family Foundation. At SAP America, the North American division of the German software giant, the 8,000 employees saw their premiums rise yet again in 2008. "We've asked employees to pick up a greater share of the cost over the past five years," says CFO Mark White, adding that this year, "I'd like to have the employees not paying any more."

For some companies, the only way to avoid passing on the sizable cost increases to employees will be to rethink the very nature of their health plans. "Employers are going to be bearing down on costs like never before," says Phil Litos, president of The Bostonian Group, a benefits-consulting firm. "They may be looking at significant reductions in revenue and restricted access to capital. If that's the case, then they're going to have to take a hatchet to their benefit plans. The question is, How draconian will they get?"



40 PERCENT OF CFOs SURVEYED SAID THEY INTEND TO REDUCE THEIR COMPANY'S CONTRIBUTION TO BENEFITS THIS YEAR. A STAGGERING 82 PERCENT EXPECT TO CONTROL COSTS BY CHANGING THEIR HEALTH-CARE PLANS.

MINOR CUTS

SMALL CHANGES TO COMPANY HEALTH-CARE PLANS MAY FORESTALL MAJOR SURGERY.

DON'T YANK DENTAL COVERAGE—not yet anyway.

In the private sector, health-care costs have been declining since 2003. But now that they are heading north again, employers may be tempted to do something drastic. Private-plan premiums rose about 8 percent last year, but are projected to increase 9 percent this year. And though many companies may not realize it, they are in a position to absorb more of that increase than they have so far.

Employees will certainly be grateful. Almost a quarter of workers, who pay an average of $3,354 annually for a family plan, identify paying for health care as "a serious problem," according to the Kaiser Foundation Employer Health Benefits 2008 Annual Survey. Ed Kaplan, national health practice leader for The Segal Co., advises executives to probe for cost savings by giving the plans a thorough examination. What behaviors does the plan encourage—or even reward? Here's a clue: if the company cafeteria still specializes in meatball subs, then somebody hasn't gotten the message. More commonly, you'll find employees who are encouraged to take $20 pills that mask, say, hypertension symptoms, rather than addressing the underlying causes of high blood pressure through a wellness program.

To trim costs—and keep the employee deductible from rising more than about 2 percent—Kaplan advises CFOs to consider the following moves:

* Negotiate a multiyear contract with vendors, in return for a discount on administrative costs.
  Cut: 0.5 percent of plan costs

* Switch from brand-name to generic prescriptions.
  Cut: 1 percent of plan costs

* Raise ER co-pay.
  Cut: 1 percent of plan costs

* Enforce eligibility rules.
  Cut: 5 percent of plan costs —J.H.

HEALTH-PLAN ACTIVISM

In a 2007 study, Towers Perrin found that companies that aggressively manage their benefit programs and try new approaches can cut their per-employee spending by about $1,500. Actively managed plans with teeth (not to be confused with dental coverage) are already gaining traction among large employers, and smaller ones are starting to take notice, Ripperger reports. "These plans hold employees accountable," says Blaine Bos, a partner at consulting firm Mercer. How so? "By creating a link between healthy behavior and coverage," as Ripperger puts it.

That link can take many forms. Three years ago, Douglas Machine, which makes packaging equipment for the food and beverage industry, began to reimburse workers for joining a health club—as long as the club could provide documentation showing that the employee actually appeared there four times a week.

Companies that have established medical-spending accounts (health savings accounts, or HSAs) for their employees as part of a broader shift to consumer-directed care may use them to influence behavior. HSAs allow employees to sock away pretax dollars that they can spend on health-related services. Because employers can also contribute to the accounts—a fact that employees welcome, given that the average deductible for a consumer-driven plan is more than $1,000—companies can use the size of their subsidy as leverage. An employer that wants every worker to fill out a health-risk questionnaire, for example, may entice them to do so by offering to beef up the accounts of those who cooperate. Combined with claims information, the answers are used to construct a robust portrait of the employee's health (or lack thereof).

Those who comply with the recommendations that come out of that process—joining a weight-loss program, for example—will receive a $750 contribution. Those who answer the questions but refuse to change their now-documented bad habits will receive just a $250 subsidy. (Those whose habits are already demonstrably healthy would get the full $750.)

A NUDGE TOO FAR?

In addition to obliging employees to participate in wellness programs, many finance chiefs are examining their plans in painstaking detail in an effort to wring out costs. Douglas Machine CFO Tom Wosepka says that he spent "a lot of time" studying the company's plan, and the company was able to keep medical-cost increases for its 550-employees to just 5 percent this year. One change: employees who undergo gastric-bypass surgery will no longer have that cost, which usually runs between $20,000 and $25,000, covered by their medical insurance. Working with an outside health-care consultant, Wosepka concluded that the stomach-shrinking procedure often causes complications and rarely produces long-lasting benefits.

Perhaps the most surprising finding to emerge from Wosepka's ongoing analysis with the health-care consul-

ON-SITE CLINICS CAN HELP COMPANIES SEE A WHOPPING 50 PERCENT REDUCTION IN THE COST OF OFFICE VISITS.

SITES FOR SORE EYES (AMONG OTHER SYMPTOMS)

WHY ON-SITE CLINICS MAY BE ONE CURE FOR RISING COSTS.

CLINICS THAT TREAT EMployees on-site are breaking out all over. One-third of *Fortune* 500 companies have already built them and more are in the works.

Two trends have converged to create this rash of interest. First, health-care costs show no sign of dropping, making a long-term investment worth reconsidering. Second, a fast-growing group of vendors who will build, manage, and help finance such clinics has emerged. These firms typically work on contracts that run for three to five years, costing anywhere from $250,000 to $500,000. The turnkey-clinic industry even attracted a big player last year. In May, Walgreen, the country's largest drugstore chain, acquired two operators of worksite clinics, CHD Meridian Health Care and Whole Health Management.

Still, most CFOs aren't going to budget to acquire on-site clinics until "they are convinced that these save money—and can see it in detail," says David Beech, a health-care consultant specializing in on-site clinics, who estimates that savings can amount to more than 8 percent a year. Among the savings: a projected 2 to 5 percent rise in worker productivity, a 25 percent reduction in urgent-care services, a 35 percent drop in self-referred specialist visits, a 3 percent decrease in short-stay in-patient admissions, and a whopping 50 percent reduction in the cost of office visits. —J.H.

tant was that spouses, not children, tend to be the most expensive family members to insure. As a result, the company changed the structure of its health-insurance offerings so that any employee who wants a spouse covered must opt for the family plan, which carries a higher premium than the company's former "single-plus-one" category. For the most part, however, Wosepka says Douglas would rather give its employees a nudge than a shove, which is why the company offers incentives for exercising, smoking cessation, and flu shots. "We'd rather use the carrot to help people be good health consumers and make healthy choices," he says.

Some CFOs contend that certain measures that tie the cost of premiums to employees' lifestyle choices spread a dark tarp of suspicion and mistrust over the company. "That would be very inconsistent with our values," says Ken Rader, finance chief at adhesives maker Bostik. "It would create a lot of negative impressions. When you start doing that, you erode the bond of trust between employer and employee."

COMPANIES HAVE "REACHED A POINT WHERE THEY FEEL THEY ARE NOT GETTING THROUGH TO THEIR EMPLOYEES AND ALL THEY WANT TO SAY IS, 'DO THIS, OR YOU WILL PAY.'" THE PRINCIPAL FINANCIAL GROUP'S JERRY RIPPERGER

SAP America's White thinks such an approach can send a counterproductive message: "We hire the best and the brightest professionals and we expect them to excel," he explains. "We treat our people according to our values."

RESTRAINT ORDERED

Lest employees feel that any and all health-care savings will come at their expense, it's worth noting that finance executives are scrutinizing every other link in the health-care chain as well. Some are searching for savings by reining in coverage (see "Minor Cuts," page 61). Others are aggressively monitoring their vendors and conducting audits to see whether insurers are administering their plans appropriately. About 10 percent of every premium consists of administrative costs—all the support services involved in paying out claims—which employers can try to control by signing multiple-year deals with their carriers.

It has become increasingly common, for instance, for employers to conduct an eligibility audit to make sure that everyone who is carried is actually entitled to coverage. Companies generally alert employees about six months ahead of time so that they can track down any documentation they might need to stay enrolled. By updating that information, companies may find family members who have divorced, dependents who exceed the age requirements for full-time-student status, or domestic partners who have no paperwork to back up their claim of a civil union. "People bend the rules," says Edward Kaplan, national health practice leader at The Segal Co. In this climate, more companies are bending them back.

Kaplan says that a number of his clients also conduct claims audits every year, making sure that the insurer is requiring the right co-pays and deductibles, for instance, and checking for any administrative errors. "It's usually not fraud, just computer or implementation mix-ups," Kaplan notes. As for serious medical errors—avoidable mistakes that should not happen, otherwise known as "never events"—they can now become the hospital's financial burden, rather than costing patients and their insurers. As of October, Medicare identified eight such events (such as wrong-side surgeries) for which it would no longer provide reimbursement.

Within the plan itself, employers can tease out savings by tinkering with areas that don't affect most employees—raising the ER co-pay from $25 to $50, for instance, or doubling the out-of-pocket maximum (which affects only those who have catastrophic claims) to $5,000. In consultation with their pharmacy benefit managers, companies may also want to push employees to substitute generics for brand-name drugs. The generic version of stomach-soothing Protonix, for example, has recently hit the market and costs about one-fifth as much as the name brand.

Most companies will settle for whatever "innovation around the edges" they can apply to cut health-care costs, according to Kaplan. Others go to extremes, setting up their own health-care facilities (see "Sites for Sore Eyes," facing page). Ripperger says he is no longer surprised when an executive suggests that employees who don't see fit to get fit—as the company defines it—simply pay for their own health insurance. "They've reached a point where they feel they are not getting through to their employees and all they want to say is, 'Do this, or you will pay,'" says Ripperger. "These are people who are frustrated by the whole situation."

There is plenty of frustration to go around, of course, as employees come to regard the constant increase in their contributions, combined with scaled-back services and other measures, as tantamount to a pay cut, and in some cases one that leaves their health or bank accounts vulnerable to catastrophe. It's no wonder that the whole subject brings the temperatures of both employees and employers to a boil. If they need to cool down—hey, that's what the gym is for. CFO

JOSH HYATT (JOSHHYATT@CFO.COM) IS A CONTRIBUTING EDITOR AT *CFO*.