

Are Health Insurance Premiums Higher for Small* Firms?

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* Definitions of "small" firms vary from study to study and are noted in figures.

INTRODUCTION

Small firms are much less likely than large firms to offer health insurance coverage. Analysts point to higher costs of coverage as one reason for the lower offer rate. To address this, policymakers have developed a range of strategies to bring small firm health coverage costs more in line with the costs faced by larger firms. But are small firm costs really higher, and if they are, what are the reasons?

FIGURE 1. Average Annual Premiums for Single and Family Coverage, by Firm Size, 2001

	Single Coverage	Family Coverage
Small Firms (3-199 workers)	\$ 2,735	\$ 6,902
Large Firms (≥200 workers)	\$ 2,610	\$ 7,124

THE SYNTHESIS PROJECT

NEW INSIGHTS FROM RESEARCH RESULTS

Available data show that small and large firms pay similar health insurance premiums on average, but this simple comparison is misleading.

DO SMALL FIRMS PAY HIGHER PREMIUMS THAN LARGE FIRMS?

- ▶ Small and large firms paid similar average premiums in 2001. Small firm premiums were somewhat higher for single coverage but were lower for family coverage (FIGURE 1).
- ▶ However, these simple comparisons are misleading as:
 - The data omit the one-third of small firms that did not offer coverage and may have faced higher premiums (FIGURE 2).
 - Small firms typically offer less generous benefits, but the premium data do not take this into account.
 - Averages disguise the greater variability of premiums among small firms, which is largely due to medical underwriting.
- ▶ Recently, small firms have experienced larger premium increases than large firms, which may translate into a wider gap in premiums (FIGURE 3). In response, some small firms may drop coverage, reduce their benefits, or shift more costs to workers.

FIGURE 2. Percentage of Firms Not Offering Health Benefits, 2001

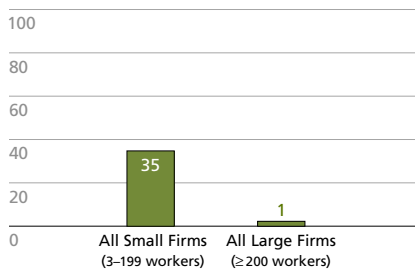
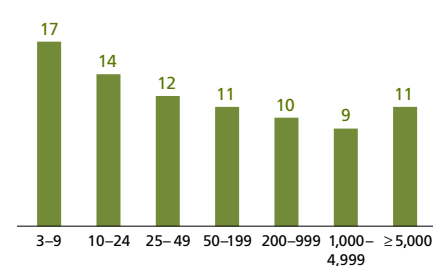


FIGURE 3. Annual Percent Increase in Premiums, by Firm Size (number of workers), 2001



DISCUSSION

There are several logical reasons to expect that small firms do indeed face higher health insurance costs. These reasons include: higher administrative costs; state benefit mandates; greater likelihood of dropping and adding coverage; more employee turnover; and firm failure.

Widely cited estimates show that administrative cost burdens are more than three times as high for small firms than large firms. However, those findings should be treated cautiously as they are dated and are based on actuarial estimates, not on survey data. One reason for the higher administrative costs is the greater effort (per covered person) needed to sell coverage to small firms.

Available evidence, mostly from the 1990s before many of today's mandates were enacted, suggests that benefit mandates are not a major contributor to higher premiums for small firms. The best study of benefit mandates, which indirectly measured their impact on costs by examining changes in coverage rates, found that, in aggregate, benefit mandates decreased coverage by less than two percent.

Purchasing pools have been advanced as a strategy to lower health insurance costs for small firms by creating greater economies of scale. To date, these pools have not succeeded in lowering costs, perhaps because they remain quite small. However, even if cooperatives achieved the size of large firms, they currently operate in a very different regulatory environment. Small group market rules, which limit risk selection and stabilize the small group market, reduce premium variation and thus restrict the extent to which cooperatives can achieve lower premiums.

Several factors, including higher administrative costs, contribute to higher premiums for small firms.

WHAT FACTORS MIGHT LEAD TO HIGHER PREMIUMS FOR SMALL FIRMS?

- ▶ Higher administrative costs contribute to greater health care costs for small firms, although the available estimates are old and the differences are probably overstated (FIGURE 4).
- ▶ Several characteristics of small firms increase health insurance costs by making risk pools more unstable and raising the administrative burden for insurers.
 - Small firms are more likely to drop or add coverage (FIGURE 5).
 - Small firms are more likely to go out of business (FIGURE 6).
 - Worker turnover is higher in small firms.
- ▶ According to available (though limited) evidence, state mandates to cover certain benefits do not contribute substantially to higher costs for small firms. Existing benefit mandates have had only a small impact on cost.

FIGURE 4. Administrative Costs as a Percent of Incurred Claims, by Firm Size (number of workers), 1988

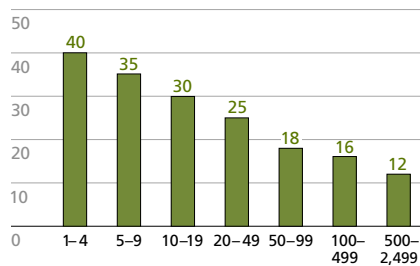


FIGURE 5. Percentage of Firms Dropping or Adding Coverage in Last Two Years, by Firm Size (number of workers), 1997

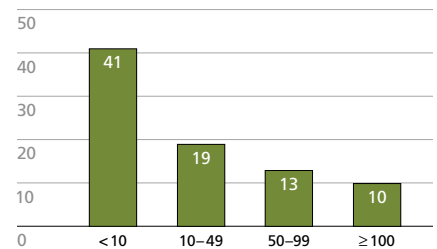


FIGURE 6. Four-year Failure Rate of Firms* (percent), by Firm Size, 1982-1986



* Excludes firms with payroll less than \$2,500.

Implications for Policymakers

CONCLUSIONS

Small and large firms that offer coverage have similar premiums (FIGURE 1). However, this comparison does not take the following into account:

- Benefit packages for small firms are less generous.
- Just over one-third of small firms do not offer insurance (FIGURE 2).
- Small firms experience greater premium variation due to medical underwriting.

Small firms probably pay more than large firms for the same benefit package due to higher administrative costs and more unstable risk pools (FIGURES 4–6). Cycling in and out of the market, employee turnover, and firm failure are contributors.

Small high-wage firms are about as likely to offer coverage as large firms. By contrast, small low-wage firms are much less likely to provide health coverage (QUICK FACTS, P.3). When small firms do offer health insurance, their eligibility, take-up, and coverage rates are similar to large firms (FIGURE 7).

High premiums are the primary reason small employers do not offer coverage (FIGURE 8). To date, interventions to lower costs for small firms have not been very effective:

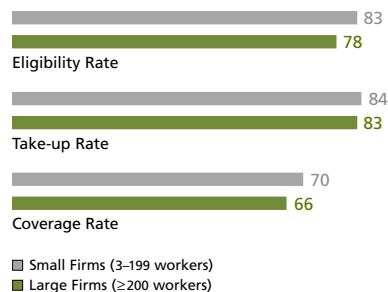
- Reducing state benefit mandates does not appreciably reduce the cost of insurance for small firms. However, the best estimates of the impact of mandates are from 1994, and more recent information is needed.
- Purchasing pools have not greatly reduced costs for small firms, but they are not yet large enough to evaluate their potential impact.

QUICK FACTS

Small firms are less likely than large firms to offer health insurance; 65 percent of small firms (3–199 workers) offered coverage in 2001, compared with 99 percent of large firms (≥200 workers). But eligibility, take-up, and coverage rates are similar among workers in firms that offer coverage, regardless of firm size (FIGURE 7).

Small firms with high average wages have offer rates that are similar to large firms. Only one third of small low-wage firms (average wage < \$7.00 an hour) offered coverage in 1996, compared with 85 percent of small high-wage firms (average wage > \$15.00 an hour). (REFERENCE 1)

FIGURE 7. Eligibility, Take-up, and Coverage Rates of Workers (percent) for Firms Offering Coverage, by Firm Size, 2001



POLICY IMPLICATIONS

Policymakers wishing to increase small firm offer rates might consider interventions that:

Offer subsidies targeted to small low-wage firms.

Reduce administrative costs for small firms.

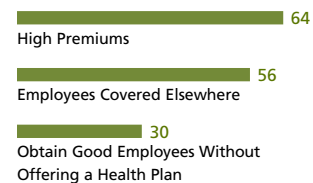
Reduce or offset factors that can increase premiums for small firms such as:

- Premium variability due to medical underwriting.
- Cycling in and out of the insurance market.
- Employee turnover and firm failure.

QUICK FACT

Small firms most frequently cite high premiums as a reason for not offering health insurance.

FIGURE 8. “Very Important” Reasons Cited by Small Firms (3–199 workers) for Not Offering Coverage (percent citing each), 2001



REFERENCES

FIGURES 1–3. Henry J. Kaiser Family Foundation and Health Research and Educational Trust. 2001. *Employer Health Benefits, 2001 Survey, 2001*. (Hereafter: KFF/HRET, *2001 Annual Survey*.)

FIGURE 4. Committee on Education and Labor (Serial No.100-EE), Committee on Energy and Commerce (Serial No.100-CC), and Special Committee on Aging (Serial No.100-P). *Cost and Effects of Extending Health Insurance Coverage*. Committee Print: Congressional Research Service, Library of Congress. October 1988.

FIGURE 5. S. Long, et al. *Trends in Offering Employer-Sponsored Coverage*. Data Bulletin No.15: Center for Studying Health System Change. 1998.

FIGURE 6. Nichols, et al. *Small Employers: Their Diversity and Health Insurance*. The Urban Institute. 1997.

FIGURES 7–8. KFF/HRET, *2001 Annual Survey*.

REFERENCE 1. B. Schone. Agency for Healthcare Research and Quality, personal communication, June 21, 2002.

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