

Exchange

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Competition among health insurance companies

Evidence from the online HMO auctions

The election of President Barack Obama has created an opportunity to change healthcare policy in the United States. A critical part of his proposed agenda is the expansion of health insurance to the 45 million citizens without coverage.

With these new opportunities for change in healthcare, electronic medical records and information technology (IT)-enabled systematic reforms are playing critical roles in managing escalating costs and improving the quality and access of healthcare services. As IT becomes more widely adopted, one possible use could be the design of market mechanisms, such as electronic auctions for the procurement of health insurance. Our research highlights the potential of an online auction process that will enable competitive bidding for health insurance contracts.

Beginning in 1999, Internet-based auctions were conducted over a three-year period by Hewitt Associates LLC, a Chicago-based global management consulting and employee benefits delivery firm. Hewitt pre-screened competing health maintenance organizations (HMOs) and only the health plans that met certain minimum standards of quality were allowed to participate. Contracts from these auctions provided health insurance to employees of Fortune 500 companies in various markets across the U.S. By introducing a new online auction process, Hewitt's goal was to provide health plans with accurate data to generate more direct premium/price competition to reduce the costs for participating employers. The hope was that, by stimulating a more direct competition among plans in a fair and dynamic environment, results for the client would improve.

Each auction took place over the course of a week in a secured website administered by Hewitt. Participating plans were able to view all bids placed in the auction; however, company identities were not disclosed. Auctions were piloted for two months in 1999 with three employers and 50 plans participating. As a result, annual rates were reduced and the three employers found significant savings at a time when most were facing increases

significantly higher than the general rate of inflation. Following this successful pilot study, the auctions were launched nationwide in July 2000. Auctions were also conducted in 2001 but failed to generate cost savings for the employers, and were discontinued.

Open auctions are not a commonly used mechanism for selecting health insurance carriers. Online auctions introduced by Hewitt changed the information for bidders by providing them market information; they could see where they were (with rates, plan features, design, etc.) amongst their competitors. Using this information, health plans could make better local business decisions. Online auctions also automated the negotiations between the buyers and the suppliers, sped up the bidding process from a typical six weeks to a few hours, allowed more suppliers to participate and permitted bids to be submitted anytime from anywhere.

We analyzed 58 auctions conducted over a three-year period. More than 100 health plans in 53 U.S. markets competed to acquire contracts from employers who were buying insurance for over 50,000 employees.

Even though, at one time, auctions generated cost savings for the employers, the design had several shortcomings, which led to its discontinuation. Using the data from three years of Hewitt auctions, we examined the nature of competition among health insurance companies and analyzed shortcomings that led to the failure of online auctions. We analyzed 58 auctions conducted over a three-year period. More than 100 health plans in 53 U.S. markets competed to acquire contracts from employers who were buying insurance for over 50,000 employees.

From the Director

This is the third issue of *Exchange*, a publication featuring dialogue on medical industry research and application. The content is a summary of research from both academia and the medical industry, followed by commentary on the importance of the research and its application. Topics highlighted in *Exchange* will span all sectors of the medical industry and include commentary from leaders in the field as well as researchers from the University of Minnesota and other academic institutions.

This issue highlights research done by Carlson School Professor of Information & Decision Sciences Alok Gupta, graduate student Pallab Sanyal, and myself, on reducing healthcare procurement costs for employees by having HMOs compete in open online auctions. This unique study examines the contest between managed care providers in obtaining customers. Findings of this study could have significant policy implications for the design of brokered exchanges for insurance contracts.

*Professor Stephen Parente, director
Medical Industry Leadership Institute*

Participating sellers included the top 10 health plans in the country and buyers were all Fortune 500 firms. Our results led us to find several alternatives for developing sustainable avenues for automating the procurement of health insurance.

An important issue with the auctions is that they were unsustainable after three-years, in part, because of the less evident competition in the third year and the high transaction costs of Hewitt and insurers to operate the market. We have three suggested changes to help solve these problems.

1. The elements of insurance benefits design must be standardized to avoid paper and personal negotiations. This would greatly reduce the transaction costs charged by Hewitt, creating a more sustainable model.
2. Insurers that want to add benefits to the standardized design could do so with

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Commentary

by Simon Stevens, President, Global Health, UnitedHealth Group, &
Chairman, UnitedHealth Center for Health Reform



The paper provides an interesting review of a failed experiment a decade ago to procure health insurance coverage for several large employers through an online reverse auction process. With hindsight it is perhaps not overly surprising that the mechanism was unsuccessful, and there are some grounds for skepticism that in practice it could be successfully resurrected by employers, even with the modifications

the authors propose.

First, since many large employers now self-insure and hence pay directly for their employees' healthcare costs, the effectiveness with which their health insurer / benefits manager manages those employee medical costs will typically be more economically important than the price of those "ASO" management services per se. So the risk here is that an auction process focuses on the wrong variable.

Second, even in the case of fully-insured employers, there is a complex array of variables that an employer may wish to consider alongside price, including for example, responsive customer service, the breadth of provider networks or the likely effectiveness of programs to get employees back to work quickly or to improve workplace productivity, to name but a few. That helps explain why the authors report that even with an auction process, "much of the work remained as an exchange of paper contracts and bids, along with numerous in-person meetings, conference calls, and site visits." It also underlines why it was

probably a mistake to assume that sourcing employer-based health insurance might resemble the procurement auctions used for office supplies, flowers, and eye glasses (being some of the examples cited in the paper).

Third, strategies the authors propose to deal with these problems may create their own issues, and in practice could be hard to implement. While too much complexity clearly brings its own problems, over-standardization (or, as the authors propose, commodification) of insurance benefits may stop future innovation in health benefits—many of the plans that employers now most value were not invented in 2001, and could have been locked-out had competition been restricted to a subset of the options then prevalent in the market. There are some insights to be had here from Medicare Part D drug plans: given a choice, fewer than a fifth of seniors have now chosen the "standard" benefit design produced by Congress in 2003. Furthermore, attempting to define "core" and "non-core" only gets you so far—much of what differentiates competing health plans lies in the different methods embedded inside their "core" medical benefits to tackle cost and quality.

Having said all that, there are elements of the authors' proposals that could have application, perhaps in the individual insurance market, where an easily comparable essential benefits package may have particular value. Similarly, there may be ways of taking transaction costs out of individual insurance markets through "exchanges" or "connector" models. One thing is clear. As the nation debates how to move towards the goal of universal coverage and improved healthcare affordability, reforming insurance markets—alongside changes in the care delivery and wider health system—will have an important role.

HMO auctions, continued

an "à la carte" price design (additional benefits such as disease management for chronic conditions, etc.). This allows for greater transparency of pricing differences and could possibly increase competition.

3. Brokered prices must be allowed to remain the final price paid. Re-opening

the bidding process after it has closed raises transaction costs. The entire process should proceed electronically.

By implementing these changes, our study results conclude that a more sustainable mechanism could be put in place. As health insurance premiums continue to rise, IT-

enabled open auctions may be useful in generating stronger price competition and lower premium costs for employers and possibly, government agencies. Discovering new ways of using IT to create cost savings measures, such as online auctions, will play an important role in containing the soaring costs of healthcare in the U.S.