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Risky Business: When Mom and Pop Buy Health Insurance for Their Employees

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ABSTRACT: The economics of small group insurance makes offering health benefits to employees a risky business. Surveys of employers from 1989 to 2003 reveal that more rapid premium increases are forcing small firms to impose higher cost-sharing. In 2003, premiums for small firms (3–199 workers) increased 15.5 percent, outpacing the 13.2 percent increase for large firms (200+ workers). From 2000 to 2003, deductibles among small firms increased 100 percent in PPO plans when employees use in-network providers and 131 percent when they use out-of-network providers; among large firms, deductibles in PPO plans increased 33 percent and 44 percent, respectively. And in 2003, 40.3 percent of employees in the smallest firms contributed 41 percent or more of the total family premium, compared with only 11.2 percent of employees in large firms. Clearly, fundamental change in the small employer market is necessary, including new options for helping small firms gain access to the advantages large firms have in purchasing health benefits.

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Lack of health insurance in America remains closely associated with the inadequacies of the small employer market. Of the roughly 44 million Americans without health insurance, over 80 percent come from working families. Nearly 50 percent of uninsured workers are either self-employed or work for firms with fewer than 25 employees.[1]

This issue brief has two objectives: 1) to characterize discrepancies between small and large employers in benefits received and cost of coverage (the value of health coverage); and 2) to examine whether small firms bear greater risk when they commit to providing coverage for their employees. In this context, low-risk coverage means that an employer purchasing health insurance for its employees this year can purchase a similar package next year

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at a nearly equivalent price. Both low value and high risk may deter small employers from offering coverage.

The data in this issue brief is derived from The Kaiser/HRET Survey of Employer-Sponsored Health Benefits, an annual survey of employer-based health plans. Specifically, we analyzed data from 1989, 1996, 2001, and 2003.[2]

FINDINGS

Benefits and Premiums in Small and Large Firms

From spring 2002 to spring 2003, health insurance premiums for the smallest firms (those with 3 to 24 workers) increased 15.8 percent and for all small firms (those with 3 to 199 workers) premiums increased 15.5 percent, outpacing the 13.2 percent increase for large firms (with 200 or more workers). Premiums for single and family coverage in smallest, small, and large firms were statistically equivalent (Table 1).

Although premiums were comparable among different-sized companies, the amount of the premium contributed by employees differed. Employees in the smallest firms contributed $20 a month less than employees in large firms for single coverage, but employees of the smallest firms who got family coverage contributed $51 more per month than those in large firms (Table 1). Looking at all small firms (not just the smallest), employees contributed $69 more per month for family coverage than employees in large firms. Small firms require smaller contributions for single coverage to encourage higher participation by eligible workers. When a low percentage of workers participates in the health plan, insurers become more fearful of adverse selection and accordingly raise their premiums.

These differing contribution patterns between small and large companies help explain why single coverage constitutes 54 percent of enrollment in small firms, but only 45 percent of coverage in large firms.

The 2003 data also show that premiums buy fewer benefits with higher cost-sharing in small firms. Employees in small firms pay substantially higher deductibles than workers in large firms. For example, compared to employees of large companies, workers in small firms enrolled in PPO plans must pay deductibles that are 100 percent higher when using in-network providers and 59 percent higher when using out-of-network providers.

Large firms also tend to offer broader coverage. For example, only 38 percent of workers in the smallest firms are offered dental insurance, compared to 87 percent of workers at large firms. Among all small firms, dental benefits are offered 57 percent of the time.

Table 1. Benefits and Premiums for Average Worker by Firm Size, 2003†

	Smallest Firms (3–24 Workers)	All Small Firms (3–199 Workers)	All Large Firms (200+ Workers)
Premium Change, 2002 to 2003	15.8%★	15.5%★	13.2%
Single Premium	$292	$286	$280
Family Premium	$728	$746	$761
Single Premium Contribution	$25★	$37	$45
Family Premium Contribution	$230★	$248★	$179
PPO Deductible—In Network	$433★	$419★	$209
PPO Deductible—Out of Network	$858★	$783★	$458
Prenatal Care Benefit Covered	93%	97%	100%
Dental Benefits	38%	57%	87%

† Figures are means.
★ T-tests indicate significant difference from All Large Firms at 0.05 level.
Source: Kaiser/HRET 2003 Survey of Employer-Sponsored Health Benefits.

Table 2. Premium Change by Firm Size by Year†

Premium Change	Smallest Firms (3–24 Workers)	All Small Firms (3–199 Workers)	All Large Firms (200+ Workers)
2003	15.8%★	15.5%★	13.2%
2002	14.7	13.2	12.5
2001	15.50★	12.49★	10.23
1996	3.14★	2.04★	0.51
1989	21.5★	20.9★	17.1

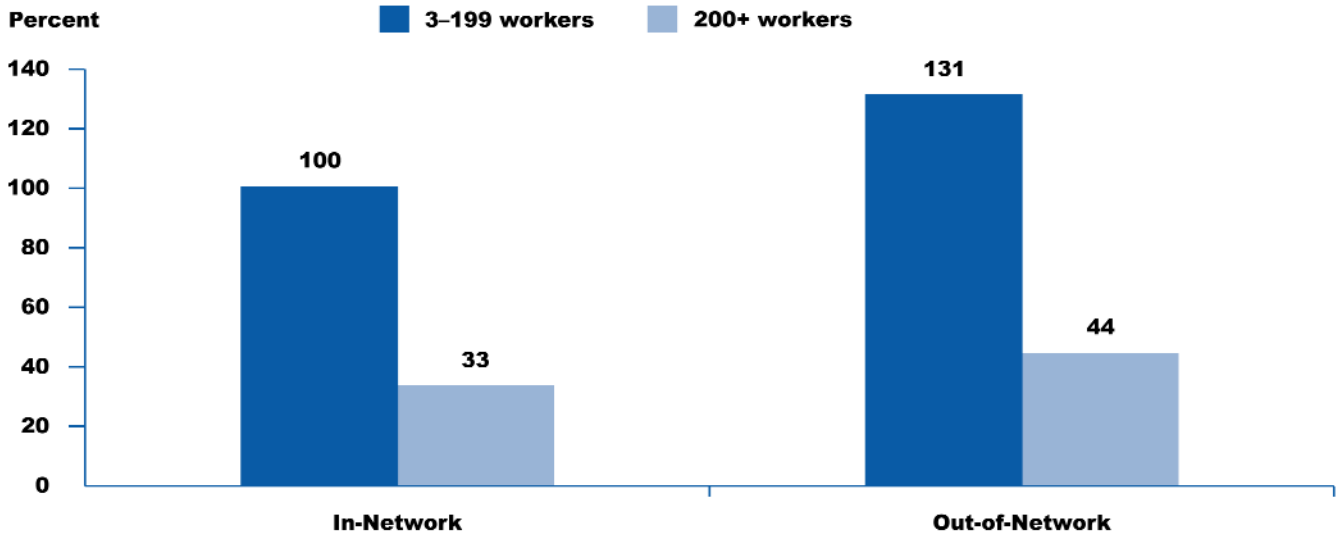
† Figures are means.
★ T-tests indicate significant difference from All Large Firms at 0.05 level.
Sources: Kaiser/HRET 2003 Survey of Employer-Sponsored Health Benefits; Kaiser/HRET 2002 Survey of Employer-Sponsored Health Benefits; Kaiser/HRET 2001 Survey of Employer-Sponsored Health Benefits; KPMG 1996 Employer Benefit Survey; Health Insurance Association of America 1989 Employer Benefit Survey.

Premium Increases Over Time

As shown in Table 2, small firms have consistently experienced greater annual increases in insurance premiums than large companies over the years from 1989 to 2003. During periods of rapid premium increases, small firms appear more subject to "buy-downs"—when an employer increases patient cost-sharing to reduce the premium increase. Figure 1 shows that among small firms during the period 2000 to 2003, deductibles increased 100 percent in PPO plans when employees use in-network providers and 131 percent when using out-of-network providers. Among large firms, deductibles in PPO plans increased 33 and 44 percent respectively when using in- and out-of-network providers.

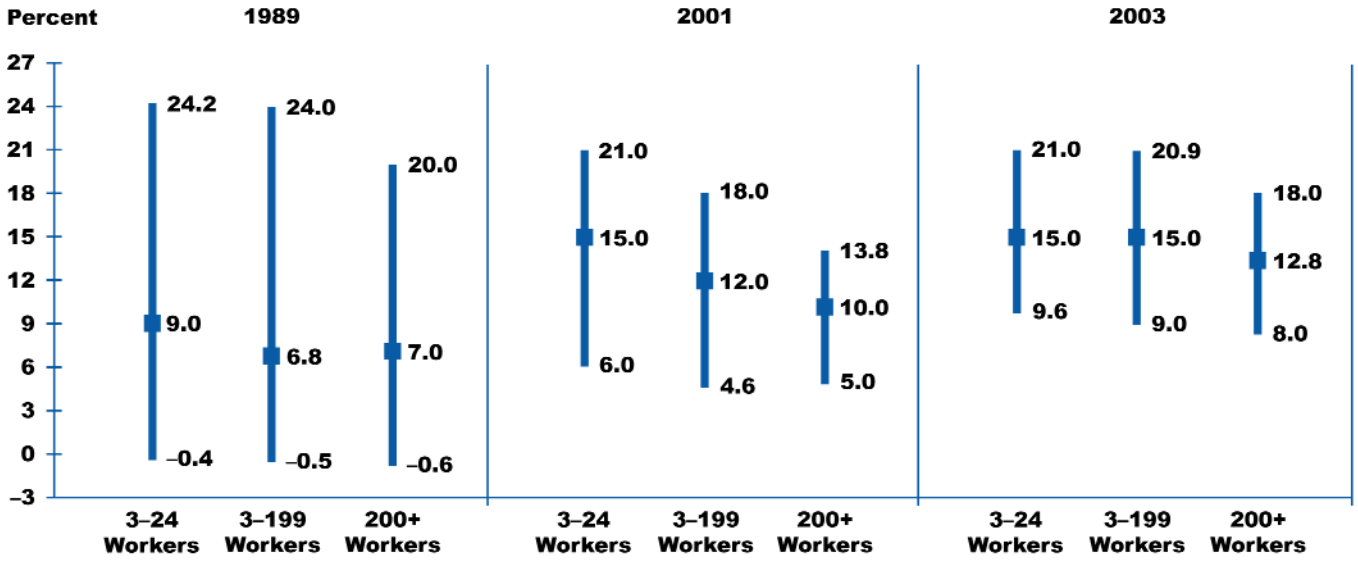
Smaller firms not only have higher average increases in premiums, but there is greater variability in increases each year. Figure 2 shows the range from the 25th to 75th percentile (including the median) in the rate of increase for 1989, 2001, and 2003 as well as the median. In every year, the range from 25th to 75th percentiles is less for large firms than the smallest and small firms.

Figure 1. Percentage Increase in PPO Deductibles in Large and Small Firms, 2000–2003



Source: Kaiser/HRET 2003 Survey of Employer-Sponsored Health Benefits.

Figure 2. 25th, 50th, and 75th Percentiles of Premium Change, by Firm Size by Year

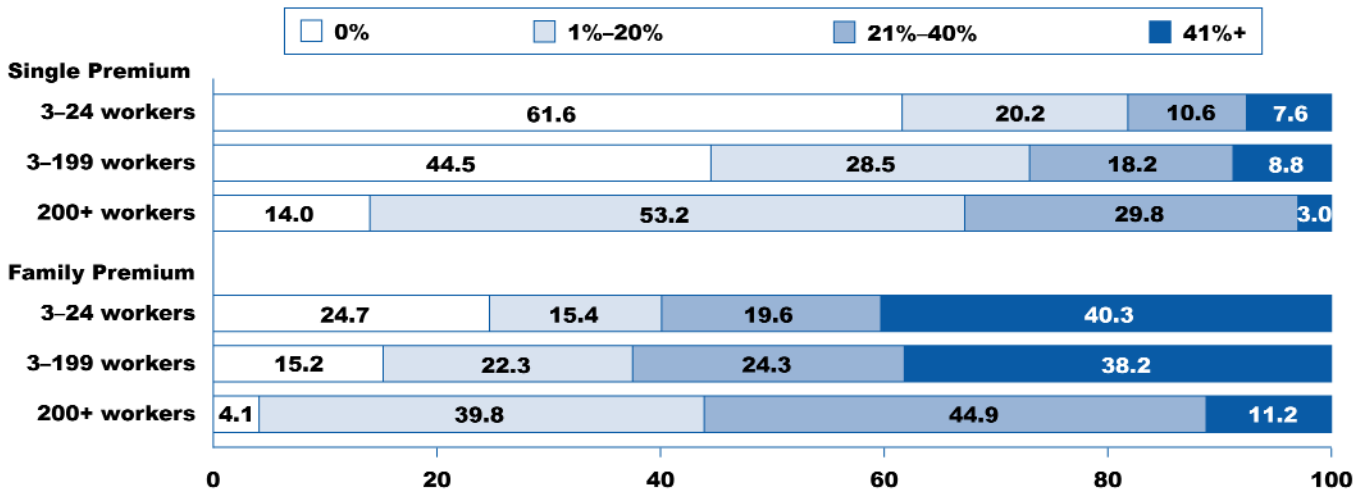


Source: Kaiser/HRET 2003 Survey of Employer-Sponsored Health Benefits.

Share of Premium Contribution

In addition to paying higher deductibles, employees in small firms contribute a greater share of the premiums. In 2003, 40.3 percent of employees in the smallest firms contributed 41 percent or more of the total family premium compared with only 11.2 percent of employees in large firms (Figure 3). Among all small firms, 38.2 percent of employees contributed 41 percent or more of the family premium. For single coverage, 7.6 percent of employees in the smallest firms contributed 41 percent or more of the premium, compared with 3 percent

Figure 3. Share of Premium Contributed by Employees, by Firm Size, 2003*



* Chi-square tests indicate significant distributions between firm size by year and between years by firm size at 0.05 level.
Source: Kaiser/HRET 2003 Survey of Employer-Sponsored Health Benefits.

of employees in the largest firms; however, employees of the smallest firms were more likely to contribute none of the premium (61.6% vs. 14.0%).

This increased cost sharing, especially of family plans, in small firms is consistent with the finding that small employers get less value for their premium dollar than large employers.

Discussion

Small employers not only get less value than large employers when they provide health benefits, but they face greater financial risk in doing so. Lower value is a natural consequence of small size and the failure to join together in pooled purchasing groups with a long-term commitment to shared risk.

Small firms experience greater increases in premiums over time, and are more subject to "buy-downs." In any given year, premium increases, the cost of single coverage, and employee contributions vary more from firm to firm for small than large firms. Small firms lack purchasing power in the insurance market and unlike their larger counterparts, are unable to reduce insurance costs by bearing the risk themselves and self-insuring.

The principal finding of this paper—that small firms not only receive less value for their premium dollar but also must bear greater financial risk—implies that we should not expect small firms to cover their workers at the same rate as large firms. Hence, a fundamental change in the small employer market is necessary. This change requires new options for helping small firms gain access to the advantages larger firms have in purchasing health benefits. Yet the history of voluntary purchasing pools, whether state-sponsored pools such as the California health purchasing pool or privately sponsored pools such as multiple employer welfare associations (MEWAs), suggests that voluntary pools are unable to stay together and gather and gain a sufficient share of the market to realize substantial savings over firms buying through traditional sales distribution panels.[3]

When purchasing pools and MEWAs gain market shares, it is in the economic interest of insurers to "cherry-pick" healthier groups from the purchasing pool. During periods of rapid inflation small groups with healthy workforces are particularly vulnerable to appeals to break away from the purchasing pool. The inevitable conclusion is that fixing the small employer health insurance market requires mandatory participation of small employers in purchasing pools.

Burdened with inherently higher administrative costs, having fewer lives over which to spread the risk of catastrophic costs, and lacking the purchasing power of large firms to negotiate with insurers, small employers are doomed under current practices to separate but unequal status. It's a risky business to go it alone when it comes to health insurance.

What nobody knows is how many individuals decide not to start a business because of the greater risk in the small employer market when purchasing health insurance. If one maintains, as do many in the small business community, that small employers are the principal source of innovation, as well as economic and job growth in the American economy, then this greater risk is costly not only to small employers and their workers but also to the overall American economy.

Notes

[1] P. Fronstin. *Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2003 Current Population Survey*. EBRI Issue Brief No. 264 (Washington, D.C.: Employee Benefit Research Institute, 2003, p.12).

[2] The 1996 survey was sponsored by KPMG Peat Marwick, the 1989 survey by the Health Insurance Association of America (HIAA).

[3] R. Curtis, E. Neuschler, and R. Forland. "Consumer-Choice Purchasing Pools: Past Tense, Future Perfect?" *Health Affairs* 20 (Jan./Feb. 2001): 164–68.

METHODS

Data come from the Kaiser/HRET Survey of Employer-Sponsored Health Benefits, an annual survey of employer-based health plans. Core elements of the survey are a continuation of the benefit survey conducted by the Health Insurance Association of America (HIAA) from 1987 to 1991 and KPMG Peat Marwick from 1991 to 1998. The survey includes as many as 400 questions about each firm's largest conventional or indemnity, health maintenance organization, preferred provider organization, and point-of-service health plans. This study largely uses survey results from 1989, 1996, 2001, and 2003.

Each survey drew its sample from Dun & Bradstreet's list of the nation's private and public employers with three or more workers. To increase precision, each sample is stratified by industry and the number of workers in the firm.* In 1989, the sample included 2,031 firms with three or more workers offering health insurance and the survey response rate was 66 percent. In 1996, the sample included 1,770 firms offering health insurance, and the survey response rate was 50 percent. In 2001, the response rate was 50 percent with a sample of 1,907 firms. In 2003 the sample included 1,856 firms and the response rate was 50 percent.

The principal control variable in the analyses is firm size. We specifically compare firms with 3 to 24 workers (smallest firms) and 3 to 199 workers (small firms) to firms with more than 200 workers (large firms).

We analyzed data using the statistical program SUDAAN. All statistical tests were performed at the 0.05 level.

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* Industry includes: Mining, Construction, Manufacturing, Transportation/Utilities/Communication, Wholesale, Retail, Finance, Service, Government, and Healthcare. Firm Size includes: 3–9 workers, 10–24 workers, 25–49 workers, 50–199 workers, 200–999 workers, 1,000–4,999 workers, and 5,000+ workers.

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