



McKinsey Center for U.S. Health System Reform



Reform Center Health Intelligence

Insights from the McKinsey Center for U.S. Health System Reform

Employers Planning Now for a Post-Reform World

As much as the Affordable Care Act (ACA) was intended to overhaul the nation's healthcare industry, its impact is being felt well beyond the medical sector. The law sets in motion the most far-reaching change in the value and nature of employer-provided health benefits in a generation. It introduces new requirements for employers, but more importantly provides significant opportunities for businesses to completely rethink benefits strategies.

Beginning in 2014, all companies with more than 50 employees must provide health insurance or pay a penalty. Their decisions will rest on a complicated mix of direct economic and non-economic factors.

Not only must employers decide whether to continue or begin offering insurance, but also who will pay for it, where it will be purchased, what it will cover, and how aggressively to promote healthier lifestyles. These fundamental decisions could have vast—and largely unknown—consequences on employee coverage, recruitment and retention, corporate profitability and competitiveness and the success or failure of some health-related companies.

Many employers have already begun changing their benefits policies in anticipation of provisions in the new law that provide tax credits to small businesses and give all companies unprecedented authority to incentivize healthy behaviors through premium adjustments. Some companies are literally getting into the business of primary care, while others are considering whether the creation of new state-based purchasing exchanges is reason to remove themselves entirely from healthcare.

The addition of employer penalties and tax-credits, creation of insurance exchanges, and the availability of subsidies for some workers alters the incentives driving employer decision-making regarding health insurance.

Most employers have not yet developed comprehensive strategies for the new environment. Instead, companies are making “no-regrets” moves aimed at lowering medical costs, which they likely would have done regardless of legislative action. For example:

- Management in multiple industries view reform as an opportunity to further shift costs away from the employer and toward the employee.
- Because of reduced tax benefits under the new law, some employers are shifting coverage for retirees from employer plans to Medicare or Medicare Advantage (e.g., 3M, Unilever) to reduce employer costs.
- A growing number of employers are embracing wellness programs as a way to reduce medical spending. Under the new law, employers in 2014 will be able to return up to 30% to 50% of premiums in cash back or additional benefits to employees who participate in a range of wellness activities. As additional incentive, the ACA provides federal dollars for program management such as data collection.
- Employer demand is fuelling the growth of entrepreneurial firms that offer primary care either on-site or in close partnership with local communities. These include clinics ranging from chronic disease management to primary care.

A Framework for Employer Responses

On first blush, the math seems straightforward—and tilted in favor of dropping coverage. The typical insurance policy today costs more than \$5,000, about \$3,000 more than the \$2,000 per worker penalty most companies would pay.

However, the calculus around total employee compensation is more complex. In order to stay competitive, businesses may feel pressure to compensate workers for any perceived reduction in benefits. Therefore, the cost of “making employees whole” would significantly reduce or eliminate the savings, and any savings captured by companies are likely to be short-term in nature.

Longer term, savings in total compensation costs would likely dissipate. As government subsidies reduce labor costs, demand for labor will rise, bidding compensation costs higher, particularly in competitive markets.

How employers respond overall is uncertain and will depend on the demographics of the workforce. Employers in talent-driven industries – especially those with well-compensated employees such as professional services – are likely to continue to offer comprehensive, employer-subsidized coverage.

Employers in low-wage, high-turnover, low-margin industries (e.g., retail) are more likely to change their benefits as new subsidies become available for many of their workers. Under the law, if a firm drops coverage, lower-income employees will be able to buy comparable subsidized coverage on the new exchanges that can cost less than they now pay for employer-coverage. For these workers, dropping benefits would

produce pure savings for the firm, but the firm would also need to consider the impacts on its higher-income employees.

Even at this early juncture, there have been a wide range of responses from companies. For example, a large financial services institution has opted to continue offering health coverage in part because it is valued by employees. On the other hand, several employers in retail and other low-wage industries are considering making major benefit changes.

Even for firms facing an economic incentive to opt-out of benefit provision, there may be other considerations, such as:

- Employees may react negatively if they perceive the employer is rescinding benefits that they already earned.
- If the employer competes directly for talent with another company that continues to offer benefits, recruitment and retention could suffer.
- Particularly for firms with a public profile, negative perceptions stemming from dropping health benefits could adversely affect revenues and profits, even if the employer action does not leave employees worse off.

Because it is widely expected to significantly change the U.S. healthcare landscape, the ACA provides employers with a unique opportunity to re-evaluate employee benefits strategy more broadly, well beyond the extremes of whether or not to continue offering traditional health insurance.

To succeed under the new law, savvy businesses have already begun to evaluate benefits offerings from a return-on-investment perspective. The types of questions firms will weigh in the process include:

- How important will employer-sponsored coverage be for future talent attraction and retention?
- To what extent do the offered benefits promote objectives of productivity and reduced absenteeism?
- How much will employees value their employer offering coverage directly, versus a defined contribution or other forms of compensation?

Complicating matters, firms will need to make benefit decisions against the backdrop of enormous legal and political uncertainty about implementation.

By defining their post-reform benefits positioning on a return-on-investment basis, employers will be best prepared to consider the broadest possible set of potential long-term strategies – not only the extreme options of continuing to offer today's coverage or dropping all coverage, but also the myriad options that fall in between. Considering post-reform benefits from this perspective will best enable employers to minimize benefits costs while maximizing value for employees, and ultimately for the employer as well.

Additional resources:

<http://www.kff.org/insurance/snapshot/Health-Benefit-Offer-Rates-and-Employee-Earnings.cfm>

<http://www.latimes.com/health/healthcare/la-fi-health-coverage-20101227,0,5024491.story>

– Bowen Garrett, Ceci Connolly and Bob Kocher

January 10, 2011