CASTLIGHT HEALTH

Carrots vs. Sticks: Customize Your Benefit Program Design to Get Results

White Paper

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As health care costs continue to soar, many employers have turned to programs involving "carrots" or "sticks" to motivate employee behavior. Transparency solutions are a critical component of getting these programs off the ground and generating results.

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Executive Summary

With US health care expenditures soaring to a projected $2.9 trillion in 2013[1], employers — who bear the brunt of these expenses — have been searching for ways to better manage the cost of employee health plans. Benefits executives are increasingly implementing lifestyle management or wellness programs that include incentives (carrots) or disincentives (sticks) to influence employee behavior. The objective is improved employee health, which can lead to productivity gains as well as reduced health care costs.

Another trend is the transition from traditional plans such as HMOs and PPOs to more progressive offerings such consumer-directed health plans (CDHPs). CDHPs are often provided together with ample carrots and sticks to give employees additional motivation to improve their health and reduce out-of-pocket costs. These incentives and disincentives not only encourage employees to stay within cost-sharing limits, but they also have the potential to decrease the number of sick days while containing benefit costs for your company.

Whether the carrots or sticks are designed to encourage employees to lead healthier lifestyles or become better health care consumers, for employees to properly respond to these motivational efforts, it's important that they have access to a well-designed health care transparency solution that provides the critical information they need.

In this white paper, you'll learn what you need to know to more effectively manage the cost of your health care benefits package. The paper explores:

- How leading benefits executives are employing carrots and sticks to encourage employees to live healthier lifestyles and make better decisions
- Why carrots and sticks are two sides of the same coin, and the "spin" you put on your incentives or disincentives often determines their effectiveness
- How the specific approach you take will depend upon your company's culture, desired actions and budget availability
- Why a comprehensive, easily accessible health care transparency solution is essential to increase employee accountability for health care costs, regardless of the approach you choose for your company

Carrots and Sticks: How Are They Defined?

Chances are, you're familiar with the concept of carrots and sticks. While the design of these incentives or disincentives may vary, the purpose is the same — to promote smart health care decision-making and healthy activities, such as biometrics, coaching, or other wellness programs to create a healthier workforce. These not only drive down your health care costs but may also improve productivity, enhance employee satisfaction, reduce turnover, and decrease other expenses such as those related to workers compensation or disability insurance.

Most carrots or sticks — the latter are sometimes referred to with tongue in cheek as "frozen" carrots — are designed to encourage employees to lead more active lifestyles, become better informed about their health or make improved decisions regarding the use of medical services. Employees who already score high on health assessments might be rewarded for participating in activities that contribute to ongoing health.

Incentives and disincentives are used to target tobacco users; employees who suffer from chronic illnesses such as heart disease, cancer, stroke, or diabetes; or to address the biggest chronic health issue in the US today — the growing obesity epidemic. More recently, they've also been used to encourage employees to seek out high-value providers or discourage them from seeing low-value providers.

Here are some examples of how carrots and sticks are being used to shape employee behavior in health care:

Carrots

- Significant discounts for health club memberships — with full reimbursement after a pre-determined number of visits
- Discounts on monthly premiums or contributions to health savings accounts (HSAs) or health reimbursement accounts (HRAs) for employees who don't smoke
- Wellness discounts for employees who meet company biometric standards for blood pressure, cholesterol, glucose, or BMI
- Cash awards, gift cards, contributions to HSAs or HRAs, or lower out-of-pocket maximums for completing an initial health assessment focused on healthy eating habits, daily exercise, alcohol consumption, and even seat belt usage
- Follow-up awards for employees who enroll in coaching programs designed to improve scores in the above health assessment categories

Sticks

- Higher monthly premiums or reduced contributions to HSAs or HRAs for employees who use tobacco products
- Mandating that employees pay any additional costs above the typical median costs for a lab procedure
- Making health assessments optional — but charging employees who choose not to participate higher premiums or making smaller contributions to health accounts
- Increased premiums or decreased contributions to health accounts for employees falling into mid- to high-risk categories on health assessments who don't elect to consult with a health coach
- Financial penalties assessed to employees with chronic conditions who fail to fill scripts as scheduled or obtain periodic tests as needed

The objective of all these incentives and disincentives is to transform employees from passive takers of health care benefits into active and well-informed consumers. A prime focus is on improving the lives of individuals with chronic diseases — which according to the Centers of Disease Control and Prevention, account for 7 out of 10 deaths by Americans annually and consume an enormous percentage of the nation's annual health care spend.

Carrots or Sticks: Which Are Better?

A question that many benefits executives frequently consider is: should I use carrots or sticks to achieve the behavioral changes our company desires? The answer, according to an article in *The Economist*, is not as simple as choosing one or the other. Instead, the article suggests that success may well depend upon the "spin" you put on the incentives and the communications strategy you employ. Often, "carrots dressed as sticks" will have the most impact.

The article details how researchers Tanjim Hossain of the University of Toronto and John List of the University of Chicago explored ways to make an employee-bonus scheme more effective. While the obvious answer might have been to increase the size of the bonuses, what Hossain and List did was to divide workers at a Chinese electronics factory into two groups. One group was told that they would receive a bonus of 80 yuan (approximately $12) at the end of the week if their output met or exceeded certain levels. The other group was informed that they had been "provisionally" awarded the 80-yuan bonus, but would lose it if they fell short of the identical production expectations (see Figure 1).

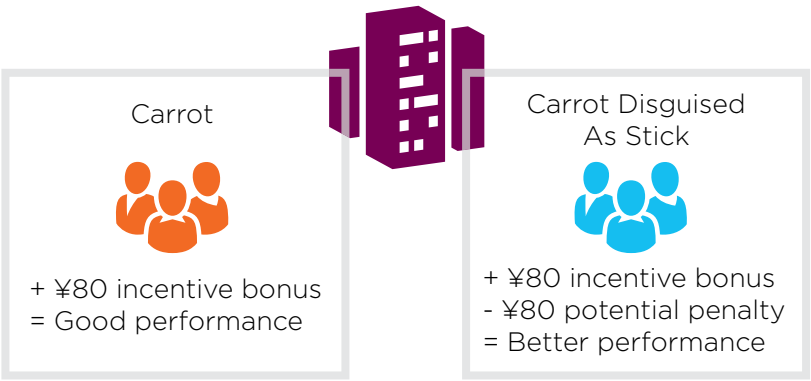

Figure 1: Researchers Tanjim Hossain and John List found that carrots dressed as sticks often have the most impact.

Clearly, both of these programs relied on carrots — but in one, the carrots were enticingly dangled to motivate positive efforts, while in the other, the carrots were "frozen," and used to give employees the occasional whack when needed. Not unexpectedly, what the researchers discovered was that "fear of loss was a better motivator than the prospect of gain." Both approaches worked, but employees were more motivated to work harder to ensure that an award was not taken away. As Hossain and List concluded, "Carrots...may work better if they can somehow be made to look like sticks."[2]

Leveraging Behavioral Economics

As you look for ways to maximize your use of employee health incentives, considerable knowledge can be leveraged from the field of behavioral economics. In an article in *The New England Journal of Medicine*,[3] the authors stated that the "effectiveness of incentive programs depends critically on how the incentives are timed, distributed and framed,[4] and several factors might make insurance premium adjustments — the most common implementation mechanism — less effective dollar for dollar than other approaches." One of these key factors is that most individuals "...place more weight on the present than the future — they're more attracted by immediate than delayed benefits and more deterred by immediate than delayed costs."

According to recent research from the University of Toronto and the University of Chicago, carrots may work better if they can somehow be made to look like sticks.

To date, more employers are opting for carrots rather than sticks. According to a survey of 800 large and midsize employers[5], the majority of these organizations, or 57 percent, are relying on carrots such as lower insurance premiums or contributions to HSAs and HRAs as motivation to engage employees — while only 17 percent are using sticks. But that 3.5 to 1 ratio is expected to shift to less than 2 to 1 in the near future, with an additional 36 percent considering the imposition of disincentives over a three- to five-year period, while 28 percent more are thinking of including incentives. Figure 2 shows how these two approaches are projected to change in the near future.

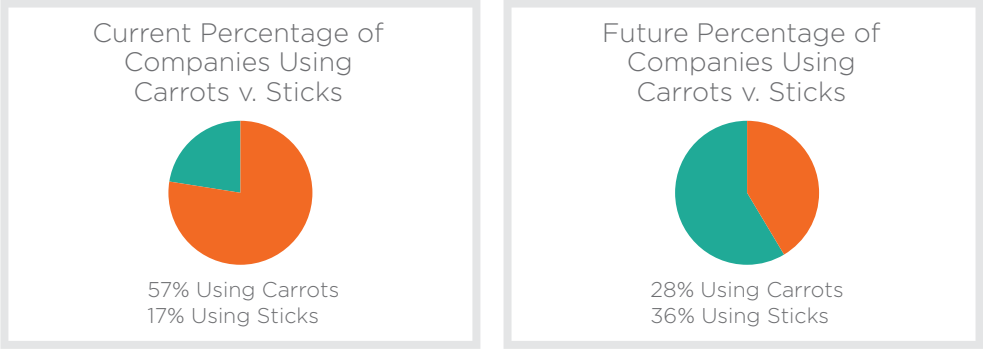

Figure 2: While more companies are relying more on carrots versus sticks now, it is projected that the weight of these two approaches will change in the near future, with more companies opting for sticks.

There are many ways that you can structure incentive programs while still achieving significant cost mitigation. In *The New England Journal of Medicine* article, the authors suggest, "Ideally, incentives should provide small but tangible and frequent positive feedback or rewards." For example, you could award points similar to a traditional retail loyalty solution. All participating employees would be entered from day one in periodic raffles for prizes such as travel or consumer electronics. But to redeem their points for individual cash or merchandise awards, employees would have to grow their engagement over time by actively taking part in lifestyle management or wellness programs that provide measurable cost savings for the company.

What's the impact of such programs? The Wellness Council of America, citing a literature review published by Harvard economists Katherine Baicker, David Cutler and Zuiri Song, concluded that companies save an average of $3 for every $1 invested in workplace wellness programs over a typical three-year time period.[6]

Three Key Considerations for Program Design

Choosing the Best Approach

If you've already decided to implement some type of incentive or disincentive program, how do you choose which is best? This can be particularly difficult when tactics have net identical outcomes for employees. Figure 3 demonstrates how employers may often have the choice of implementing economically identical programs that are deployed in different ways. It illustrates two programs that can be used to motivate employees to choose a higher quality provider.

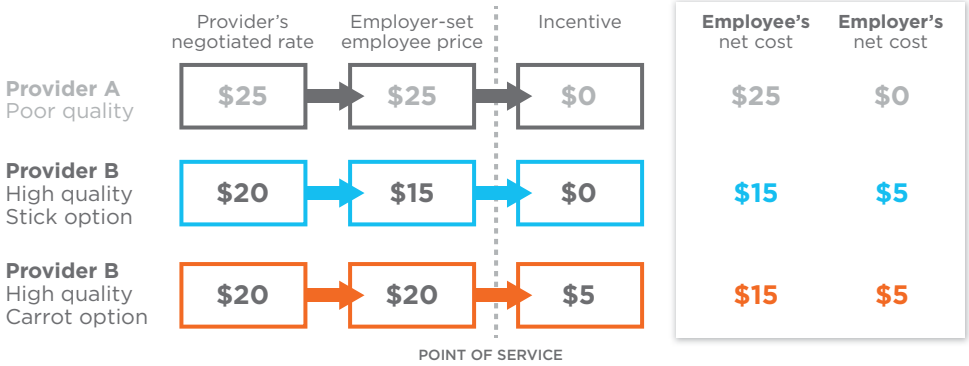

Figure 3: Although carrots and sticks may be economically identical from an employee's perspective, the way in which these programs are communicated may be quite different, and ultimately affect engagement and potential cost mitigation for the employer.

Not surprisingly, your decision often depends on a number of elements such as your corporate culture, desired actions in response to the carrots or sticks, and what your budget requirements might be. Your decisions may also be impacted by how you leverage messaging to communicate the program's objectives and other critical elements.

Consider these three key factors:

1. Company culture
2. Desired actions
3. Budget requirements

Company Culture

Some organizations have a culture in which employees are accustomed to management directives. For example, this might be the case in highly regulated industries such as banking or insurance or in bottom line-oriented businesses such as retail. In these organizations, employees learn to live with set policies regarding training, applicable compliance mandates and business practices. So, it may not be disconcerting at all for an organization to provide directives regarding health care benefits that dictate what employees must do in order to keep from being penalized (sticks).

However, in cutting-edge technology businesses, advertising or design environments — where creativity is often valued over conformity — employees might be more responsive to being advocated for ("if you do these things that are good for you — and the company — we'll reward you") rather than being dictated to ("meet these requirements, or else").

Desired Actions

Another major consideration as a benefits executive is what actions do you want your employees to take in response to the various incentives offered? For example, carrots are easily understood and administered. Awarding individuals who participate in incentive-based programs is likely to increase good will among your employee population. On the other hand, penalizing employees for missing targets such as those set forth in reference-based pricing programs or for not completing prescribed coaching might foster dissatisfaction and often requires time-consuming claims adjudication — especially when it involves complex procedures such as colonoscopies or surgery.

Further, it's important to be able to tailor actions to different circumstances. For instance, a disincentive-centric, reference-based pricing program that encourages employees to shop for the least expensive service options to avoid paying high deductibles and out-of-pocket costs might be ideal for laboratory tests and advanced imaging procedures such as MRIs, but likely wouldn't be at all appropriate for cancer treatments, or an emergent cardiology procedure where personal choice or convenience may be paramount.

Your benefit program design depends on your corporate culture, the actions you want your employees to take, and, of course, your budget. But don't overlook the messages you use to communicate your program's objective and benefits.

Budget Requirements

While the net economic incentive for individual employees may be the same, it's often quite different from an employer's point of view. How much can you afford to spend molding employee behavior? Incentives can be relatively expensive if you're contributing $25 or $50 to every employee's HSA or HRA or reducing premiums by specific amounts simply for completion of an assessment or enrollment in a wellness program. Alternatively, a stick-driven offering such as reference-based pricing may do the opposite — limiting your cost exposure by setting a reasonable amount that you're willing to pay for various types of services or elective procedures and then requiring the employee to cover any costs above that.

CARROTS AND STICKS IN ACTION

Centers of Excellence

In 2012, big-box retailer Walmart created an innovative centers of excellence (COEs) program in which it identified exceptional health care systems nationwide — from both a quality and cost perspective — for complex medical procedures ranging from heart and spine surgery to transplant care.[7] Walmart covers all of its enrolled employees' costs for procedures done at these COEs — plus travel, lodging and meals for both the patient and his or her caregiver.

This kind of action requires a substantial upfront investment by the employer, paid against the promise of potentially significant cost savings going forward by encouraging its employees to choose these hospitals over other alternatives.

Reference-Based Pricing

A reference-based pricing program launched without a transparency solution by a nationwide grocery chain was initially met with strong resistance from employees because they could not effectively shop for care that offered the best balance of high quality and low price.

When the same plan was reintroduced with the robust Castlight transparency solution, the personalized price, quality and educational material on the design of the reference-based pricing program resulted in well-informed, knowledgeable employees who could make quality health care decisions. In the case of one individual with a chronic condition, he went from paying for costly laboratory services quarterly at a particular hospital, to testing at a nearby clinic at less than one-fifth the expense.

If you're considering a full-replacement CDHP or a reference-based pricing program, it seems only fair to provide your employees with information they need to make better, smarter health care decisions.

Why a Transparency Solution Is Essential

Benefits programs often can't get off the ground because employees not only lack understanding of the programs themselves and the options available to them, but they also lack awareness regarding their current behaviors as benefits consumers. This is especially true when it comes to making decisions about utilizing and consuming health care. In fact, Castlight Health has found that while only 25 percent of employers believe that their employees are responsible consumers of health care, 96 percent of employees believe the same of themselves.[8]

Given this chasm between employer and consumer perceptions of responsible health care consumption, you simply can't make incentive or disincentive programs work effectively for you or your employees without a comprehensive health care transparency solution. This enables people to see provider-specific information on the costs and quality of medical services — ranging from diagnostics to hospital stays and surgical procedures — so individuals can obtain better care and while reducing their costs.

When looking for a transparency solution to amplify your benefits programs, make sure that you consider these attributes:

- **Precision and accuracy of information.** It wouldn't be fair for you to ask your employees to make better decisions and become informed health care consumers without providing them with needed education and information. This is especially true if you're considering a full-replacement CDHP or reference-based pricing program. For example, if you set reference prices for various diagnostic tests and procedures, you must make it easy for consumers to be able to identify physicians and clinics where they can have the service or procedure done within the price constraints.
- **Relevance and presentation of information.** Employees should be able to review quality criteria and price levels in one aggregated, personalized database in order to be able to efficiently make the best choices for them. For example, in May 2013, the U.S. Department of Health and Human Services released a huge volume of information on how the cost of medical 130 inpatient and outpatient procedures vary from one facility to another. While that may be enlightening, if your employees can't efficiently leverage it to make good, individualized decisions, it doesn't necessarily make information transparent.
- **Optimal return for your effort.** The right transparency solution should not only address your employees' needs, but yours as well. Chances are that means you'll want a comprehensive, one-stop service-as-a-solution (SaaS) option, such as the one Castlight Health offers. That way, you and your colleagues can continue to focus on your business priorities — not on rolling out and supporting a health care transparency platform.

Conclusion

A growing number of large employers are offering incentives to encourage employees to live healthier lifestyles and manage the rapidly escalating cost of health care. In fact, only a small minority of companies are not using or looking into incentives or disincentives to encourage healthier behaviors and reduce costs — and many plan to extend these programs soon to spouses and even entire families. This is especially critical with the increasing popularity of CDHPs as a means for employers to manage the continuing rise in health care costs.

With relatively subtle differences between carrots or carrots masquerading as sticks, virtually all employees of medium-sized to large firms can expect to see some sort of incentive/disincentive program built into health care offerings in the not-too-distant future.

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About Castlight Health

Castlight Health enables employers, their employees, and health plans to take control of health care costs and improve care. Named #1 on The Wall Street Journal's list of "TheTop 50 Venture-Backed Companies" for 2011and one of Dow Jones' 50 Most Investment-Worthy Technology Start-Ups, Castlight Health helps the country's self-insured employers and health plans empower consumers to shop for health care.

Castlight Health is headquartered in San Francisco and backed by prominent investors including Allen & Company, Cleveland Clinic, Maverick Capital, Morgan Stanley Investment Management, Oak Investment Partners, Redmile Group, T. Rowe Price, U.S. Venture Partners, Venrock, Wellcome Trust, and two unnamed mutual funds.

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