

The Small Business Dilemma:

How Rising Health Care Costs are Tough on Small Business



Larry McNeely
July 2009

Maryland PIRG
Foundation



The Small Business Dilemma:
How Rising Health Care Costs are Tough on
Small Business

By Larry McNeely
Federal Health Care Advocate
With the assistance of Zachary Stayman and Ryan Bardoni

Acknowledgements and Credits:

The author offers his sincere thanks to all the individuals involved in the research, writing, and production of this report, including the staff of the affiliated state Public Interest Research Groups: Gynnie Robnett, Jane Regan, Jeff Bernstein, Steve Blackledge, Gary Kalman, Mike Russo, and especially Ryan Bardoni and Zachary Stayman whose dedicated efforts, research, writing, and editing made this report possible.

Some Rights Reserved: Maryland PIRG Foundation issues this report under a Creative Commons “some rights reserved” license. You are free to copy, distribute, or display the work for non-commercial purposes, with attribution. For more information about this Creative Commons license, visit: <http://creativecommons.org/licenses/by-nc-nd/2.5/>

Maryland PIRG Foundation: With public debate around important issues often dominated by special interests pursuing their own narrow agendas, the Maryland PIRG Foundation offers an independent voice that works on behalf of the public interest. Maryland PIRG Foundation, a 501(c) (3) organization, works to protect consumers and promote good government. We investigate problems, craft solutions, educate the public, and offer Americans meaningful opportunities for civic participation.

For more information about Maryland PIRG Foundation, or for additional copies of this report, please visit www.marylandpirg.org.

Table of Contents

Acknowledgments.....	2
Executive Summary	4
Introduction.....	6
Small Businesses and Health Costs: Existing Research	7
Discussion of Survey Results.....	9
Benefits of Reform for Small Business	10
Key Recommendations	11
Conclusions.....	12
Stories	14
Appendix	

Executive Summary

When it comes to health care, American small business owners are getting a raw deal. While the current insurance marketplace offers some options to larger employers, it too often leaves small business owners on the outside looking in. They face unpredictable changes in costs, and far too often they are forced to choose between covering employees and the very survival of their businesses.

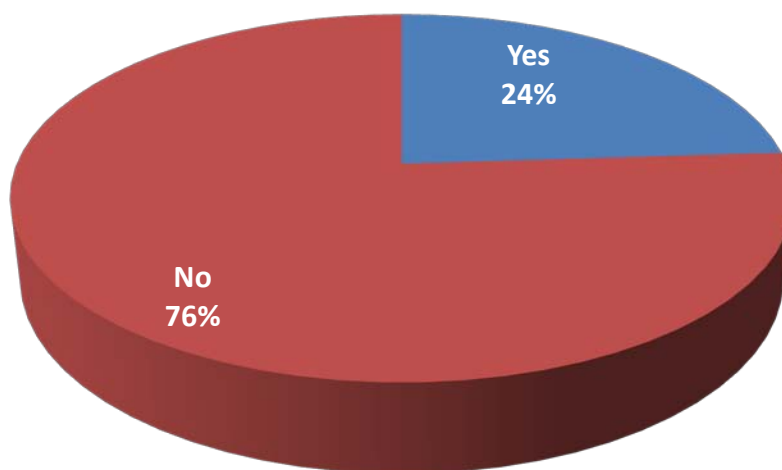
One crucial test of any health reform proposal is whether it offers a better deal to American small businesses. But the key Washington lobbies who claim to represent small businesses have been historically aligned with the political interests most opposed to reform. To more accurately reflect the diversity of views of small businesses on health care, the U.S. Public Interest Research Group has let small business owners to speak for themselves.

Three hundred and forty-three small business owners and managers across the country made their views heard through a survey which investigated the impact of health care costs on their businesses.

Survey Results:

Our efforts revealed that small businesses who do not currently offer coverage would overwhelmingly like to, but are stymied by high costs, complications and red tape. We discovered that those entrepreneurs who do make the sacrifices necessary to provide health care consider it less a moral obligation than a smart business strategy to increase employee productivity and attract and retain talented employees. Finally, we discovered that only a fraction of small business owners surveyed believed that their voices were being heard in the current health care debate.

Are the Interests of Small Businesses Being Recognized in the Health Care Debate?



- 78% of small businesses who do not offer coverage would like to do so.
- 80% of those owners who would like to offer coverage cite cost as a barrier
- 17% of those owners who would like to offer coverage say that they do not offer coverage because it is too complicated
- 55% of small businesses offering coverage do so to attract and retain good employees
- 27% of small businesses offering coverage do so to increase worker productivity
- Only 24% of owners surveyed felt that their interests were represented in the current health reform debate

Benefits of Health Reform:

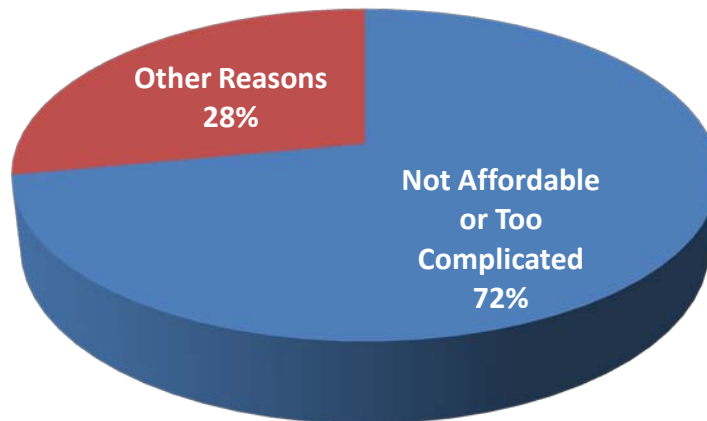
Successful reform could yield serious benefits for small businesses and the country as a whole. Recent analysis by MIT Professor Jonathan Gruber, commissioned by the Small Business Majority, found that health reform would save up to 128,000 small business jobs that would otherwise be lost due to high health care costs. Achieving these benefits will require ensuring that health reform legislation has a mix of policies that work for small businesses, including health insurance exchanges, ending discrimination in issuance, renewal, and pricing of coverage plans based on health history, small business tax credits, and most importantly, a comprehensive push to reduce the growth in overall health care spending.

In Their Own Words

The cost of health insurance for small groups has risen so much over the past few years that it is becoming too much of a hardship to maintain health coverage for our employees.

-Sign shop-Miami, FL

Reasons for not Offering Coverage



Introduction

Health care is a necessity for a every American, [but] the cost has increased by 100% or more over the last five years. [Small businesses] are too small to be attractive to insurance companies and they have taken full advantage. I have no political interest in protecting the supposed rights of insurance executives to continue their annual Hawaiian junkets at my expense.
-Computer networking - Chicago, IL

When it comes to health care, America's small business owners are getting a raw deal. While the current insurance marketplace offers some options to larger employers, the high cost of health care too often leaves small business owners on the outside looking in. They face unpredictable changes in costs. Too often these entrepreneurs are forced to choose between covering employees and the future of their businesses.

It is no surprise that traditional Washington lobbies like the Chamber of Commerce, which claim to speak for small business are opposed to the comprehensive health reform under consideration in Congress.¹ But like many Washington lobbies claiming to represent small businesses, the Chamber has historically been aligned with the political interests opposed to reform. Research

suggests that the small business sector has interests and opinions that are far less monolithic than those advanced by these Washington lobbies and special interests. According to recent polls, small businesses find the costs of the health care status quo far less preferable than the prospect of reform.²

As policy-makers consider options for health reform, they must understand the impact that both the current situation and proposed health reform will have on small businesses and seek out the full range of views in this dynamic sector of the American economy. Intended as an aid to this process, this report summarizes existing research, quantifying the impact of rising costs on small businesses, and details the recent survey and story collection activities conducted by U.S. PIRG.

This spring, from May 28th through June 22nd) U.S. PIRG researchers circulated surveys to small business owners (and collected 309 surveys, through face-to-face interviews and via the internet. In most cases, U.S. PIRG researchers spoke with owners in their place of business. Small business owners filled out surveys and were also asked whether they wished to share a story about the health care challenges facing their business.

Small Businesses and Health Care Costs: Existing Research

Rising Health Care Costs: The Root Problem

I think it inexplicable how much the rate of yearly increases in health coverage has outpaced the average rate of inflation. I cannot think of any other product which I purchase be it housing, transportation, food or clothing which has had a comparable increase in price.
- Clothing store-Bethesda, MD

At the heart of the health care problem for small businesses lies the same challenge facing every citizen, family, and community in the country. Health care costs are currently growing faster than the overall economy. Researchers at the Center for Medicaid Services have found that health care spending is growing three times faster than wages.³ This has led to a crisis of affordability in all sectors of society, as businesses of all sizes are cutting back on what coverage they offer employees. State, local, and federal governments are struggling with massive short- and long-term fiscal imbalances, due in large part to health care obligations. Individual consumers are foregoing necessary medical care due to the cost. As health costs rise year after year, this affordability crisis is afflicting more and more of America. But among small businesses, their employees, and the communities that depend on them, the crisis is felt particularly acutely.

Impact on Small Business Owners

The cost of health insurance for small groups has risen so much over the past few years that it is becoming too much of a hardship to maintain health coverage for our employees.
-Sign shop-Miami, FL

Small businesses face a disadvantage in today's health insurance market, which forces them to pay more while getting less coverage. Today's insurance market rules confine them to the small group and individual insurance markets, while larger pools of employees at bigger companies can access more stable and better regulated large group insurance markets. Additionally, their smaller size compared to larger employers denies them the leverage needed to negotiate better deals on the price and comprehensiveness of their insurance plans. In short, insurance companies have the market power to tell small businesses to "take it or leave it." Furthermore, because of the small size of the pool of employees, just one employee with a serious illness, injury or disability can send an entire small business' rates through the roof. This lack of predictability and stability makes covering employees a difficult proposition for many small business owners.

Overall, the smallest businesses and their employees pay an average of 18% more than larger businesses pay for the same policy.⁴ To make matters worse, these high costs aren't stable. Rather than moving towards parity, health insurance premiums for small firms have increased by 113% since 1999.⁵

The costs for small businesses of continued premium increases will be tremendous. A recent report by Small Business Majority found that small businesses can expect to pay nearly \$2.4 trillion dollars over the next ten years in health care costs for their workers.⁶

Impact on Small Business Employees

These high costs have taken a toll on small business employees' health coverage. As rising and unpredictable costs weigh down small businesses' balance sheets, providing coverage becomes more difficult and places owners in a painful quandary. They can stop offering insurance and face difficulty in competing for top talent, or they can cover their employees, and hope their business' growth outraces the rising cost of benefits. Over time, as more and more small business owners face this tough choice, fewer and fewer small business employees receive coverage. Today, 26 million of America's 46 million uninsured are small business owners, employees, and their dependents.⁷

Impact on Jobs and the Economy

I've had to take a second job to help cover expenses in this faltering economy. Our insurance is almost as costly as our business' rent. I should be working on expanding and improving my business, hiring more staff, etc. Having to work another job and trying to cover health care costs prevents this opportunity for growth.

-Trading Company, Tallahassee, FL

Small businesses are the backbone of communities across America, and when these businesses have to cut jobs, the economic health of their communities takes a turn for the worse. One study estimates that 79% of all new jobs created in this

country are created by small businesses, with 80% of those jobs created by the smallest businesses – those with under twenty employees.⁸ In urban centers, small businesses are the greatest source of new employment, comprising more than 99% of establishments and 80% of new jobs.⁹

But high health care costs are eating into profits, and threatening the future of America's small businesses. In 2009 small businesses are estimated to lose \$700 million in profits due to rising health care costs. By 2018, these losses are expected to reach \$11.9 billion.¹⁰ Small businesses cannot be successful if these costs continue to choke off their profits.

The consequences of this phenomena are not limited to the businesses themselves. The high cost of health care will also dampen economic consumption by depressing the wages of small business employees. If current trends continue, annual wages in 2009 for all small business employees are expected to fall by \$12 billion. By 2018 those wages will fall by \$172 billion.¹¹ Over the ten year period from 2009-2018, small business wages will be reduced by \$834 billion due to high healthcare costs.¹²

Without reform, the small business sector, America's job creation engine, will stall and the consequences will be serious. Without reform, small businesses will have to cut 178,000 jobs by 2018.¹³ Unemployment will continue to grow, and the overall health of our economy will get worse, unless the health care system is reformed.

Discussion of Survey Results

High Cost and Unpredictability of Costs Discourage Coverage-

When you speak to business owners who do not offer coverage, a pattern emerges. Of those not currently offering health insurance to their employees, 78% desire to offer coverage. But of those who desire to do so, 80% state that affordability of that coverage prevents them from doing so. Another barrier often cited in the survey was the predictability of costs. Furthermore, 70% of those who do offer insurance complained that their costs varied somewhat or a lot, regardless of the size of the small business.

My costs have risen an average of 11% each year for the past five years. It has become more difficult to afford health care each year.

-Counseling Service-Winston-Salem, NC

Small Businesses Coverage Decisions are Driven by Business Needs, not Altruism

The decision not to offer coverage is rarely miserly behavior from a greedy employer, but often born of necessity – indeed, when the only employee was the owner only 27% offered coverage, meaning that many self-employed entrepreneurs go uninsured.

For the most part, those who chose coverage indicated that their choice to do so wasn't altruistic – it was motivated by good business sense. 55% cited attracting and retaining good employees as a primary reason for offering coverage, while 27% of owners were motivated to cover their employees because of “increased employee productivity.”

Our employees are the life blood of our business and it's important for them to have access to health care at an affordable cost. Every year, that becomes more difficult with the ever increasing cost of health insurance.

-Bagel Shop, Concord NH

The Smallest Businesses Have the Hardest Time Affording Health Care

Of the small businesses surveyed, only 29% offered coverage to their employees. But, in general, the smaller the business, the less likely it offers insurance to its employees. For example, of the businesses with twenty-five or more employees surveyed, 73% offered insurance. Only 25% of businesses with five or fewer employees can afford insurance. This finding is consistent with findings of broader studies performed by the Kaiser Family Foundation.¹⁴

But that doesn't mean these businesses are blind to the business disadvantages of that choice.

In fact, for many small businesses, particularly in their early months and years, the only employee is the owner. In this case, the squeeze of rising costs gets even tighter:

Our four long term employees are seeking to leave our cafe because the lack of health coverage-some of them have reported to work in spite of chronic, uncared-for illnesses for months.

-Cafe, Washington, DC

Health care premiums are rising, year after year. It's becoming increasingly difficult to afford the premiums for my family as well as all the doctor fees and deductible fees we have to pay. Every year we have to increase the deductible levels just so we can afford the premiums.... It's a vicious circle. It will get to a point where we won't be able to afford health care at all.

-Jeweler-Arlington, VA

Insurance Company Red Tape adds to Frustrations with Health Care

Small business owners' frustration with costs is exacerbated by the difficult-to-navigate insurance market. 17% of the businesses that do not offer insurance attributed their decision, at least in part, to the complications and red tape that go with purchasing insurance.

When I wanted to insure my employees, they gave us so many options, I was like, you got to be kidding me. Besides that, it was expensive...they gave us so many options, you get this, you don't get covered for this....

Health care is absolutely crazy! There's no question about it. I don't have a story about refused coverage or something but, if people need to go, they should be able to go without all the complication and expensive bills.

-Carpet Cleaners- Miami area, FL

Small Business Owners Feel That Their Voice Is Not Heard

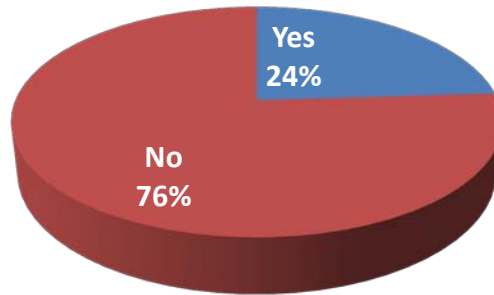
Disturbingly, only 24% of those surveyed felt that their interests as small business owners are being addressed in the current debate in Washington. This reinforces the importance of surveys and stories like those contained in this report. And perhaps more importantly, it suggests that researchers and policy-makers would benefit from further dialogue with and investigation of views within this pivotal constituency.

Benefits of Health Reform for the Small Business Sector:

Given the importance of rising costs and affordability revealed in our survey, one key test of health reform is whether it offers a better health care deal for American small businesses. If not, the rising cost of health care will cause the engine of innovation and job creation that is American small business to stall.

Fortunately, successful reform could yield substantial benefits for small businesses and the country as a whole. As noted earlier in the report, recent analysis from MIT Professor Jonathan Gruber predicted that staying on today's path of cost increases could lead to the loss of 178,000 jobs and \$844 billion in wages in the small business sector alone. But Professor Gruber also found that health reform like those under consideration today could reduce the job losses attributable to higher health costs by 72%.¹⁵ That means 128,000 American jobs saved by strong health reform. Through health care reform we can also help alleviate reductions in wages, and the consequent reduction in demand, due to high costs. by as much as 36%.¹⁶

Are the Interests of Small Businesses Being Recognized in the Health Care Debate?



Key Recommendations

To achieve these benefits, the details of health reform matter. Policy-makers must enact reform with the needs of small businesses in mind. The following are U.S. PIRG's recommendations for making health care work for America's small businesses.

State or National Insurance Pools to Enhance Bargaining Power

Small businesses deserve access to the same deals available to bigger employee pools. The proposals to create an exchange with a state or national buying pool open to all small businesses are examples of just such an approach.

Reform of Insurance Rating Practices to Increase Cost Predictability

Whether within an exchange or across the board, a ban on issuing, renewal, or pricing of insurance policies based on medical histories of enrollees will increase cost predictability for small business owners. It would prevent one sick employee from

exploding a small business' health care costs.

Tax Credits for Small Businesses Who Offer Coverage

Investing in tax credits to small business owners could bridge the gap of affordability for many small employers.

Bring Down System Costs

The four recommendations above will be of some help to small businesses dealing with a today's already costly system. But they will prove ultimately unsustainable, unless our nation reduces the rate of growth in overall health care spending. To that end, U.S. PIRG has called for a range of reforms to make health care more affordable, by squeezing wasteful spending out of our health care system, ensuring that more Americans get the basic preventive and primary care needed to avoid expensive ER visits or hospital stays, shifting incentives to reward more effective medical care, and increasing choice and competition in the

health insurance market through offering a public insurance option that would compete

on a level playing field with private plans.

Conclusion

The stories and surveys produced by U.S. PIRG's researchers describe high costs, unpredictable price increases, and hassles with insurance companies. Without reform, the studies in this report project that there will be no end in sight for these experiences. On the other hand, research also suggests

that lowering health care costs can pay real dividends, not just for small businesses and entrepreneurs, but for the entire economy. It remains for policy makers to choose the future they want for American's small businesses, and for our country as a whole.

- ¹ US Chamber of Commerce, Press Release, June 24, 2009, downloaded from http://www.uschamber.com/press/releases/2009/june/090624_healthcare.htm.
- ² Main Street Alliance, *Taking the Pulse of Main Street: Small Businesses, Health Insurance, and Priorities for Reform*, January 15, 2009.
- ³ Keehan, S. et al. "Health Spending Projections Through 2017, Health Affairs Web Exclusive W146: 21 February 2008.
- ⁴ Commonwealth Fund, *Benefits and Premiums in Job-based Health Insurance*, May 9, 2006.
- ⁵ Kaiser Family Foundation & Health Research and Educational Trust, *Annual Employer Health Benefits Survey, 1999-2007*.
- ⁶ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ⁷ Health Benefit Research Institute and the Kaiser Family Foundation, *2008 Annual Survey of Health Benefits*, September 2008.
- ⁸ Small Business Majority, "Key Facts," downloaded from <http://www.smallbusinessmajority.com/keyfacts.php>.
- ⁹ U.S. Small Business Administration, *State of the Inner City Economies: Small Businesses in the Inner City*, 2005.
- ¹⁰ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹¹ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹² Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹³ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹⁴ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹⁵ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.
- ¹⁶ Small Business Majority, *The Economic Impact of Health Reform*, June 11, 2009.

Name: Derek S. Kennedy

Business Name: Mustard Seed Recycling Co, Inc.

Location: Bethesda, MD

I co-own a small clothing store in Bethesda, MD. We started the business in 1991. In the eighteen years since we started we have seen our health insurance coverage premiums more than double. We now pay CareFirst \$1152/ month for three employees which comes out to \$384 per person. We have the most basic level of coverage. Our monthly fees don't even cover dental and most vision expenses.

I find it inexplicable how much the rate of yearly increases in health coverage has outpaced the average rate of inflation.

I cannot think of any other product which I purchase, be it housing, transportation, food, or clothing, which has had a comparable increase in price.