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Health care: The hidden business killer

Soaring health insurance costs hurt small companies more than their big rivals. Here's how smart entrepreneurs are coping with the crisis.

By [Patricia B. Gray](#)

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(Fortune Small Business -- Rich Gallo says he can't afford to provide health insurance for his nine employees. For a long time he put off buying insurance for himself, figuring he needed time to shop carefully. Gallo's desk was piled high with policy proposals when he suffered a heart attack. Lacking insurance, he delayed going to the hospital for several hours.

"I could have died," says the 50-year-old owner of Office Outlet, an office-products supplier in Indiana, Pa. Medical care related to Gallo's heart attack cost \$200,000, which was paid by the state welfare department, a foundation affiliated with the hospital, and donations from Gallo's church.

Gallo isn't the only small business owner struggling to cover the cost of health care. The long-simmering crisis has [reached a flash point](#) in the past few months. Premiums on group policies have soared by as much as 30%, on top of double-digit increases in each of the past five years. Coverage is shrinking. Thanks to insurer consolidation, policy choices are more limited than ever. And in a seller's market for insurance, small business owners have little room to negotiate prices or terms.

The escalation of the health-care crisis couldn't come at a more difficult time. Sales and profit margins are dwindling amid a weakening economy and a credit crunch. As a result, companies can no longer pass higher health-care costs on to their customers.

"Many of our members are wrestling with very tough issues," says Karen Kerrigan, CEO of the Small Business and Entrepreneurship Council, an advocacy group based in Oakton, Va. "Do they lay off some workers in order to provide coverage for the rest?"

President Barack Obama has promised reform, but health care is only one item on an urgent to-do list that is also crowded with two wars, a ballooning budget deficit and a faltering economy. Health care may indeed get a sweeping overhaul under the new administration, but policymakers will probably exercise caution in changing a system that accounts for 16% of the U.S. economy. Many powerful interests will



have their say in crafting legislation, including (but not limited to) insurers, state regulators, doctors and the drug industry. Proposals range from eliminating employer-based health insurance and requiring all Americans to buy plans through state-run agencies, to lowering the cost of insurance by allowing employers to join insurance associations that pool risk across state lines. (For more on the policy debate, see "[Fixing Health Care](#).")

Relief could take years. That's cold comfort to Donna Partin, who owns two Merry Maids franchises that employ a total of 40 workers in Camp Hill and York, Pa. Only about a third of her employees opt for coverage, and Partin pays a total of \$5,000 a month to insure them. (Partin owns another Merry Maids franchise in St. Augustine, Fla., where she cannot afford coverage for her 10 employees.) Her premium has tripled since 2000.

"I'm paying more and more for less and less every year," Partin complains. Like many owners, she says health insurance is vital because it helps her retain trusted workers, which is particularly important for a housecleaning business. To maintain coverage, she has pared other benefits, such as vacations and bonuses.

The health-care crisis has hit entrepreneurs like Partin particularly hard. Small businesses typically pay 18% more for health insurance than big companies, which can use their purchasing power to drive down the cost of coverage, according to a study by the Commonwealth Fund, a health policy research foundation. And the number of small firms that provide health insurance to their employees has been shrinking every year: 59% in 2007, down from 68% in 2000, according to the Kaiser Family Foundation. Of the 46 million uninsured in the U.S., 27 million are small business owners, their employees or their dependents.

The good news? Many U.S. entrepreneurs are finding innovative ways to cover themselves and their employees.

Take Steve Cole, 59, who runs an auto body shop in Villa Park, Ill. For more than a decade, providing health insurance for himself and his five employees was a "headache." Now it's a migraine. In 1997 an employee's wife had a bout with breast cancer. Cole's monthly premiums promptly soared from about \$300 to about \$1,800 per employee. Every year since then, Cole and his broker, C. Steven Tucker at SmallBusinessInsuranceServices.com (SBIS) have engaged in a complicated dance they call the shuffle. It involves switching insurers almost annually to qualify for low introductory premiums. Cole does get lower premiums - he's had eight insurers in the last 10 years - but at a price: He spends six to eight hours each fall filling out new insurance forms.

This year Cole's monthly premium climbed 30%. He then switched to a policy that primarily covers medical catastrophes - but there's a catch. His bad back and sinus problem are considered pre-existing conditions and aren't covered under the policy. Soon, Cole frets, he may be uninsurable. "This is an ugly situation," he says. "I just hope I can hang in there until I qualify for Medicare."

In some states small firms have banded together to qualify for lower group rates on insurance. In Cleveland, for example, companies with 500 employees or fewer can buy health insurance through the [Council of Smaller Enterprises](#) (COSE), the partner of the regional chamber of commerce. Rates are about 8% lower than on the open market. Some 14,000 companies participate in the pool, which dates back to the 1980s. But Cleveland's experiment has not been widely imitated. Pools are difficult to organize and costly to administer. And insurers are less motivated to participate now that there's less competition in the industry. (For more on pools, see "[Why pools haven't worked](#).")

Insurance woes are forcing many entrepreneurs to rethink their business plans. In 2007, Debbie and Ned Wicker launched Mission Enabled, a Web publishing business based in Oconomowoc, Wis. The Wickers knew that one of their biggest challenges would be finding affordable health insurance for themselves. Debbie's former employer had been paying an annual insurance premium of \$18,000 for the Wickers. (Ned, 58, had tested positive for high blood sugar several years before. That triggered the high premium, even though he hadn't developed diabetes.)

Debbie, 51, discovered an ingenious solution when she took a class at the University of Wisconsin. By enrolling in one course each semester, she qualified for low-cost student health insurance with an annual premium of \$4,000 and a deductible of \$250. (Her annual tuition bill is \$2,200.) "I'm lucky I found a loophole," Debbie says. "Without it we're basically uninsurable."

What a difference a decade makes. Back in the 1990s, the Wickers owned a sports magazine with a circulation of 45,000. They offered health insurance to all 20 of their employees. But they sold the magazine in the late 1990s, and their new Web venture relies entirely on freelance contractors.

"I liked having workers on the payroll and offering benefits," Debbie says. "I think it's patriotic - jobs for America and all that. Will I do it again? Probably not. Insurance costs are a big disincentive to an entrepreneur."

Whittling down coverage

Small businesses that do provide health benefits are trying to cut costs any way they can. Many firms impose long waiting periods before new hires become eligible for health coverage.

"Thirty days used to be common," says Alex Miller, an insurance broker in Armonk, N.Y. "Then they pushed it to six months. Now some workers are waiting a year for their coverage to kick in."

Once they qualify for health benefits, employees are likely to receive bare-bones coverage that doesn't include dependents. Such policies also tend to exclude alternative treatments such as acupuncture as well as conditions such as infertility. They often trim mental-health benefits by limiting therapy sessions.

And many employers reduce insurance costs by choosing plans with high deductibles. At Northridge Holdings, a 15-employee real estate investment company in Addison, Ill., single workers pay a deductible of \$2,600; the family deductible is \$5,200. That's not unusual: More than a third of covered employees of small businesses - those with a workforce of fewer than 200 - pay deductibles of at least \$1,000 before coverage kicks in, according to a survey by the Kaiser Family Foundation and the Health Research & Educational Trust. That's up from 21% in 2007.

Another option for business owners is bypassing the health-insurance market and covering employee medical costs directly. Fifteen years ago, Thomas Johnson left Ghana in search of the American dream. A skilled woodworker who had studied classical joinery in Italy, he arrived in the U.S. with \$20 and a young man's zeal for hard work. Today, Johnson owns Thomas A. Johnson Furniture, a successful furniture-making business in Lynchburg, Va. Eight employees - apprentices, in his view - work side by side with him to learn how to craft fine furniture.

Unable to afford group health insurance, Johnson pays out-of-pocket for his employees' medical expenses. So far the bills have been minimal and mostly for antibiotics. Skilled woodworkers are hard to find, and Johnson can't afford to lose those in whom he has invested so much time.

"My workers are part of my business and part of my family," he says. "They are exceedingly valuable to me." To him, paying their medical bills is a matter of honor - and pragmatism.

It's also risky. By picking up the tab for medical bills, according to some legal experts, Johnson has set a precedent that could obligate him to pay for all his workers' medical expenses - even for a catastrophic illness such as cancer, which typically costs hundreds of thousands of dollars to treat. Johnson acknowledges that a big medical bill would devastate his business, which posted 2008 revenues of \$400,000. But he can't afford to buy insurance in the current economic downturn.

"What I am doing is very dangerous, I know," he says. "But I don't have a choice."

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Employers who buy health insurance can pare costs in several ways. Some pressure employees to switch to generic drugs, take preventive measures during flu season, and limit doctor visits for colds and other minor maladies. Others have tried to lower insurance costs by putting a price on vice - penalizing unhealthy behavior [such as smoking and overeating](#). Sixteen percent of the nation's largest employers make workers who smoke contribute more than nonsmokers to cover health-insurance premiums, according to Mercer, a global human resources consulting firm.

Small business is following suit, adding thousands of dollars to the deductibles of workers who suffer from obesity or high cholesterol. (To comply with federal law, employers must offer programs such as smoking-cessation classes or Weight Watchers ([WTW](#)) to help workers get fit.)

At Independent Alliance Banks, a bank holding company in Fort Wayne, employees can undergo an optional annual screening that measures body mass index, blood pressure, cholesterol and tobacco use. Test results determine employee deductibles; merely taking the test leads to a reduction. Independent Alliance's family plan sets a deductible of \$1,400 for workers who score in the healthy range on all four tests. For those who won't take the test, that number jumps to \$5,400. Independent Alliance hasn't exactly set the bar too high to start - employees can be substantially overweight, but not obese - but promises stricter standards in 2010.

Such penalties represent a new twist on a decadelong effort by employers to reverse the nation's slide into sloth - and save money on insurance. In the 1990s companies of all sizes started wellness programs to push workers to shape up and lose weight. Some even offered rewards such as movie tickets and cash. Results were mixed.

"People put pedometers on their dogs to log mileage and did all sorts of crazy things to win the prizes - anything but exercise or lose the weight," says Doug Short, CEO of BeniComp, which crafted the cost-reducing plan for Independent Alliance. "Now people have to take responsibility for their health."

Anecdotal evidence aside, it's unclear that wellness programs make a major dent in health-care costs. And despite the increasing popularity of this approach, it has another downside: TMI. That's "too much information" - about workers and their private lives. Some business owners confess they are uncomfortable discussing personal health issues with workers or sponsoring contests that require embarrassing weigh-ins reminiscent of *The Biggest Loser*.

"I have one employee - kind of a big guy - and we've got to keep him under a certain weight," says Cole, the body-shop owner. "I hate telling someone to lay off the doughnuts. And I don't like nagging folks not to go to the doctor for a sniffle, but I do it now." ■

How does your business handle health care? [Tell us about it.](#)

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