

# Small Employers and Health Benefits: Findings From the 2002 Small Employer Health Benefits Survey

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Issue Brief

- Overall, 19 percent of small employers offering health benefits made changes to their health plan between 2001 and 2002. Sixty-five percent increased deductibles and co-pays; 35 percent switched insurers; 30 percent increased the employee share of the premium; and 29 percent cut back on the scope of benefits. Twenty-six percent increased the scope of benefits offered.
- Nearly one-quarter of small employers offering health benefits think their firm would change coverage and 3 percent think it would drop coverage if the cost were to increase an additional 5 percent.
- Most small employers offer sound business reasons for offering health benefits to workers. Many report that it helps with employee recruitment and retention, and increases productivity. More than three-quarters report that offering health benefits is “the right thing to do.”
- Most small employers that *do* offer health benefits report that it has a positive impact on various aspects of the business, such as recruitment, retention, employee attitude and performance, employee health status, and the overall success of the business. Most small employers that do *not* offer health benefits tend to think that not offering them has no negative impact on the above aspects of their business or the overall success of the business. However, those not offering benefits are more likely than those offering them to report that most of their employees are high-turnover and stay on the job only a few months.
- Small employers that offer health benefits tend to be distinctly different from those not offering them. Worker income in firms not offering health benefits tends to be considerably lower than in firms that do offer them. Employers not offering health benefits are more likely than those offering them to have a smaller proportion of full-time employees, and employers that do not offer health benefits have a larger proportion of females, workers under age 30, and minority employees.
- Of small employers that offer dependent coverage, more than 40 percent report that workers do not take coverage for their dependents because the dependents have coverage from somewhere else, but 35 percent report that employees decline dependent coverage because they cannot afford the premiums.
- Many small employers that do not offer health benefits are potential purchasers. Eleven percent are either extremely or very likely to start offering health benefits in the next two years, and 22 percent are somewhat likely to start offering health benefits.

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## Introduction

Employment-based health insurance is by far the most common form of health insurance coverage in the United States. More than 100 million workers, or 74 percent of the adult working population, were covered by employment-based health benefits in 2001 (Fronstin, 2002b). Overall, the employment-based health benefits system covered more than 162 million Americans under age 65, or 66 percent of the nonelderly population. Public programs—such as Medicaid, Medicare, and Tricare—covered 15 percent of the nonelderly population.

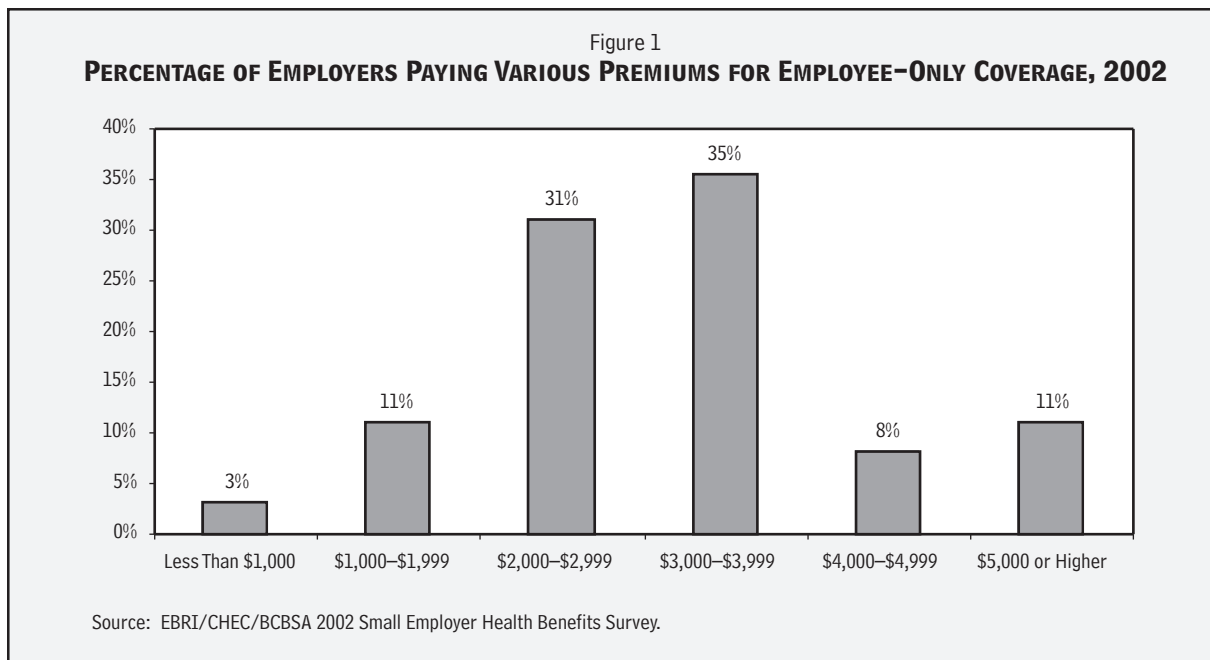
Employers offer health benefits to workers for a number of reasons. Health benefits provide workers and their families with protection from financial losses that can accompany unexpected serious illness or injury. Health benefits can also be used to promote health, to increase worker productivity, and as a form of compensation to recruit and retain qualified workers. When asked to rank the importance of all employee benefits, health benefits are by far the benefit most valued by workers and their families. Sixty percent of workers responding to a recent survey rated employment-based health benefits as the most important benefit (Christensen, 2002).

Most workers with access to employment-based health benefits take up coverage from that employer. In 2001, 82 percent of workers whose employer offered them health benefits were covered by that plan (Fronstin, 2002a). Of the remaining 18 percent not participating in their employers' benefits plan, 61 percent were covered by another health plan. In other words, of workers offered health benefits by their employer, 82 percent were covered by that plan, 14 percent had coverage elsewhere, while 4 percent remained uninsured.

The likelihood that a worker has health benefits from his or her employer varies substantially by firm size. Workers in the smallest firms tend to be the least likely to have health benefits from their own employer. In 2001, 28 percent of workers employed in firms with fewer than 10 employees were covered by their employer's health benefits (Fronstin, 2002b). More than 40 percent of workers employed in a firm with 10 to 24 employees had coverage from their employer, and 56 percent of workers in firms with 25 to 99 employees had coverage from their employer. In contrast, 68 percent of workers in firms with 1,000 or more employees were covered by their employer's health benefits.

The likelihood that a worker has coverage from his or her own employer is a function of whether the employer offers that employee health benefits, and whether the employee takes it when offered. Overall, workers in small firms are less likely to be offered health benefits. In 2001, 44 percent of workers in establishments with fewer than 10 employees were offered coverage, compared with 86 percent among workers in establishments with 100 or more employees.<sup>1</sup> When offered coverage, workers in small establishments are almost as likely as workers in large establishments to take coverage. In 2001, 81 percent of workers in establishments with fewer than 10 employees took the coverage when offered, compared with 89 percent among workers in establishments with 100 or more employees.

While most workers participate in their employer's health plan when it is offered to them, many workers are clearly not offered health benefits or do not participate in the plan when it is offered. Of the 41 million Americans who do not have health insurance coverage, 86 percent are in a family with a worker and 62 percent of uninsured workers are employed by firms with fewer than 100 employees (Fronstin, 2002b). Since workers in small firms are less likely to be offered health benefits than workers in large firms, it is important to understand why small employers are less likely than large employers to offer health benefits, and what might motivate more small employers to offer health benefits to workers.



This *Issue Brief* presents findings from the 2002 Small Employer Health Benefits Survey (SEHBS).<sup>2</sup> It also presents a comparison of the 2002 survey to data collected in 2000.<sup>3</sup> The survey examines a number of issues related to small employers and their decision to offer health benefits to workers. The goal of the survey was to gather information to better understand how to get more small employers to offer health benefits. Since the vast majority of large employers offer health benefits, but many small employers do not, understanding the health coverage decisions of small-business owners is of critical importance in efforts to expand health insurance coverage in the current health insurance system and reduce the growing number of uninsured Americans.<sup>4</sup>

## Health Benefit Costs

Like employers nationally, the employers in the sample have been experiencing double-digit cost increases. In 2002, the cost of employee-only coverage averaged \$3,392 annually for the employers in our sample, up from \$3,008 in 2001.<sup>5</sup> This represents an increase of 13.1 percent between 2001 and 2002 and is consistent with other surveys of small employers.<sup>6</sup>

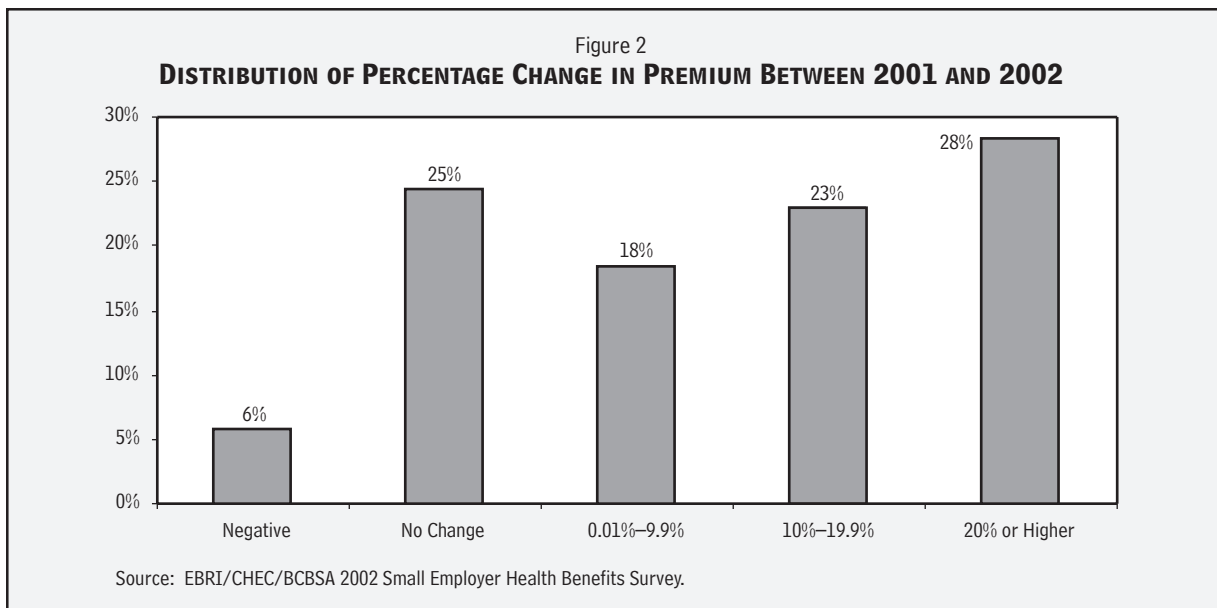
While these averages help to explain important trends on the surface, they mask other important changes that are taking place. For example, while

35 percent of employers paid between \$3,000 and \$4,000 for employee-only coverage in 2002, the premium was less than \$1,000 for 3 percent of employers, between \$1,000 and \$2,000 for 11 percent, between \$4,000 and \$5,000 for 8 percent, and \$5,000 or higher for 11 percent (Figure 1).

While 13.1 percent was the average annual increase in premiums, 6 percent of employers reported a decrease in their premium (although never larger than 1 percent), 25 percent reported no change in their premium, and 18 percent reported that their premium increased less than 10 percent (Figure 2). Furthermore, 28 percent of employers reported that premiums had increased by at least 20 percent.

Overall, 19 percent of the employers that offered health benefits made changes to their health plan between 2001 and 2002. Given recent stories about premium increases, this is a surprisingly small percentage, but it is also related to whether or not an employer made a benefit change in order to avoid large premium increases.<sup>7</sup> Of the employers that did make changes to their benefits plan between 2001 and 2002, employers were more likely to ask employees to pay more when they needed health care services than to make any other change. Sixty-five percent of employers reported increasing deductibles and co-pays, while 35 percent switched to a different insurer (Figure 3). About 30 percent each increased the share of the premium that employees were required to make to participate in the plan and cut back on the scope of benefits offered. Also, 26 percent of the employers in the sample increased the scope of benefits offered.

While only 19 percent of employers that offered



health benefits made changes to their health plan between 2001 and 2002, the employers surveyed in the SEHBS also reported that the cost of health benefits has affected their business in other ways. Some employers reported that they reduced or eliminated pay, raises or bonuses, reduced other employee benefits, or put off equipment and other purchases. Some employers also reported that they either were not able to hire needed workers or they laid off some workers. Overall, 43 percent of the employers in our sample reported that the cost of health benefits affected some aspect of their business other than the actual health benefits. Survey findings also show that 21 percent of the employers not

offering health benefits reported offering them some time within the last five years, with more than 40 percent reporting that the business decided to drop benefits because of the cost.

Affordability for the employer and the worker is clearly a critical factor affecting the future changes to health benefit programs. Overall, 23 percent of respondents from companies offering health benefits think their firm would change coverage and 3 percent think it would drop coverage if the cost of health insurance in general were to increase by an additional 5 percent (Figure 4). If costs increased 10 percent, 42 percent think their firm would change coverage and 7 percent think it would drop

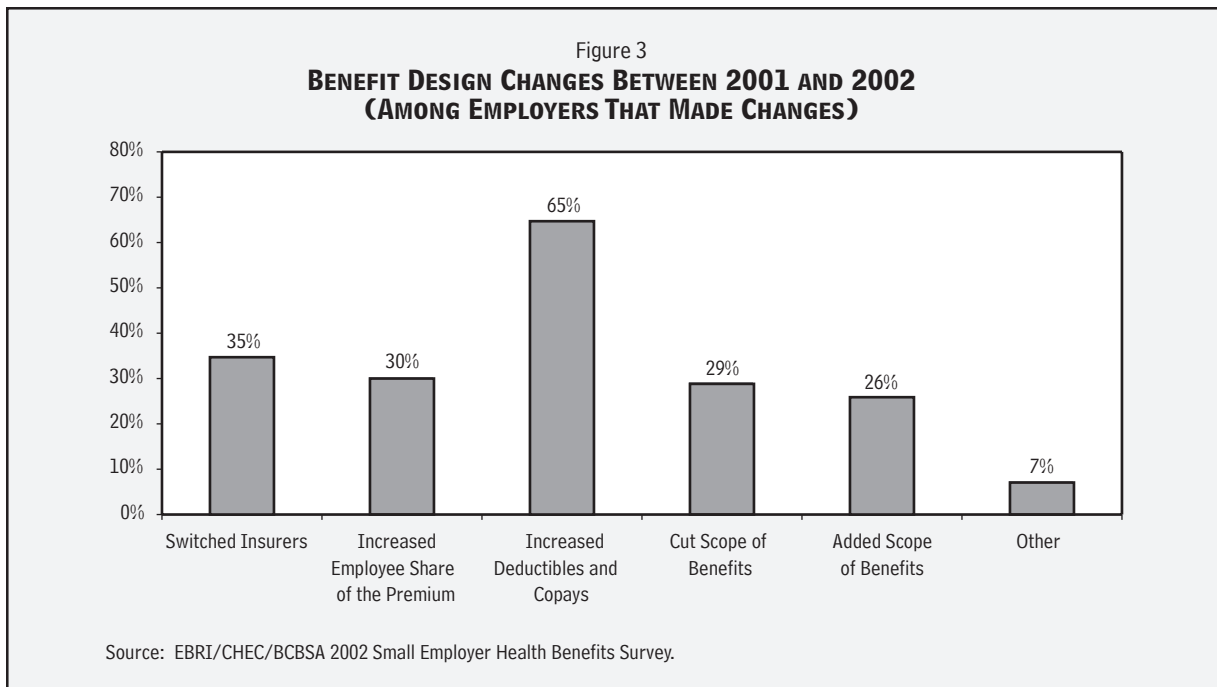


Figure 4  
**POTENTIAL SMALL EMPLOYER REACTION TO INCREASE IN HEALTH INSURANCE COSTS**

If Cost Increased:	Continue to Offer			
	Current Coverage	Change Coverage	Drop Coverage	Don't Know
5 percent	70%	23%	3%	4%
10 percent	46	42	7	4
15 percent	25	54	15	5
25 percent	12	59	22	6

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

coverage. If costs increased 15 percent, 54 percent think their firm would change coverage, while 15 percent think it would drop coverage.

Of the employers reporting that they would drop coverage at various levels of premium increases, 27 percent were either extremely likely or very likely to provide cash assistance to employees to help them buy health insurance on their own. Nearly 40 percent were somewhat likely to provide cash assistance, and 31 percent were not likely. While employers report that they will drop coverage if costs increase, they may not be able to easily drop coverage if cost increases are coupled with a tight labor market. For example, when costs increased 17 percent between 1998 and 2000 for small employers, the percentage of them offering health benefits increased 24 percent (Levitt, et al., 2001). While some employers may have dropped health benefits in response to the cost increase, even more added health benefits, many for the first time, possibly because they were competing for qualified workers during a time of low unemployment.

When given a list of factors that might explain health care cost increases, employers highly ranked a number of the factors as major reasons for cost increases. Roughly 80 percent of employers reported that law suits/

malpractice insurance, hospital fees, and prescription drug costs each was a major reason for cost increases (Figure 5). Fewer than 50 percent reported that technological advances, which are the biggest driver of health care cost increases, were a major reason for cost increases.

## *Impact of Offering Benefits*

Employers offer health benefits for a number of reasons. In general, most employers offer sound business reasons for offering health benefits to workers. Among the small employers responding to the survey, 45 percent reported that a major reason for offering it is that it helps with employee recruitment, while 30 percent said employee recruitment was a minor reason (Figure 6). Many employers also reported that offering health benefits helps increase loyalty and reduces turnover. Fifty-two percent reported that as a major reason, while 26 per-

Figure 5  
**EMPLOYER OPINIONS ABOUT FACTORS THAT ARE THE MAJOR REASON FOR INCREASING HEALTH CARE COSTS, 2002**

	Total	Employer Offers Health Benefits	Employer Does Not Offer Health Benefits
Lawsuits and Malpractice Insurance	83%	81%	86%
Hospital Fees	81	79	85
Prescription Drug Costs	79	79	80
Paying for Medical Care for the Uninsured	68	67	70
Aging Population	66	69	62
Administrative Costs	60	58	63
Doctor Fees	60	57	67
Lack of Preventive Care	46	43	51
Technological Advances	45	46	44
Government Regulations	45	44	49
Patient Use of Medical Services	36	36	37

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 6  
**REASONS FOR OFFERING A HEALTH PLAN, 2000 AND 2002**

	Major Reason		Minor Reason	
	2000	2002	2000	2002
It is the right thing to do.	71%	77%	17%	15%
It helps with employee recruitment.	58	45	22	30
It increases loyalty and decreases turnover.	53	52	27	26
It increases productivity by keeping employees healthy.	37	28	33	36
Employees demand or expect it.	38	34	31	28
It reduces absenteeism by keeping employees healthy.	31	24	37	34
Competitors offer it.	35	29	30	28
Tax deductible for the employer.	23	18	38	42
Not included in taxable income for employees.	11	15	35	32
One or more employees have medical problems.	11	11	23	19

Source: EBRI/CHEC/BCBSA 2000 and 2002 Small Employer Health Benefits Surveys.

cent reported it as a minor reason. Increasing productivity was another reason why many employers offered health benefits, with 28 percent reporting it as a major reason, and 36 percent reporting it as a minor reason. Interestingly, 77 percent of employers reported that a major reason for offering health benefits was because “it was the right thing to do.” An additional 15 percent reported it as a minor reason.

When specifically asked whether offering health benefits has an impact on their business, most small employers with benefits agree that it does. More than 70 percent say that offering this benefit has a major or minor impact on employee recruitment and retention, with roughly one-third reporting that it has a major impact (Figure 7). Nearly 70 percent indicate it has either a major or minor impact on employee attitude and performance, 66 percent each report an impact on the health of their employees and the overall success of the business, 54 percent state offering health benefits has an impact on absenteeism.

The likelihood of reporting an impact is higher for larger than for smaller firms, but even among those

with two to nine workers, majorities indicate that offering health benefits has an impact on each of these issues. According to Figure 7, 63 percent of those with two to nine workers say it has either a major or minor impact on employee recruitment, compared with 85 percent among employers with 25 to 50 workers. About 65 percent of employers with two to nine workers report that health benefits have had an impact on retention, compared to 84 percent among employers with 25–50 workers.

In contrast to the value perceived by respondents from firms with health benefits, most of those from companies that do not offer workers health coverage tend to think that not having health benefits has no impact on these factors. Between 68 and 80 percent of employers not offering health benefits report that not offering them has had no impact on employee recruitment, employee retention, employee attitude and performance, the health of their employees, absenteeism, or the overall success of their business (Figure 8).

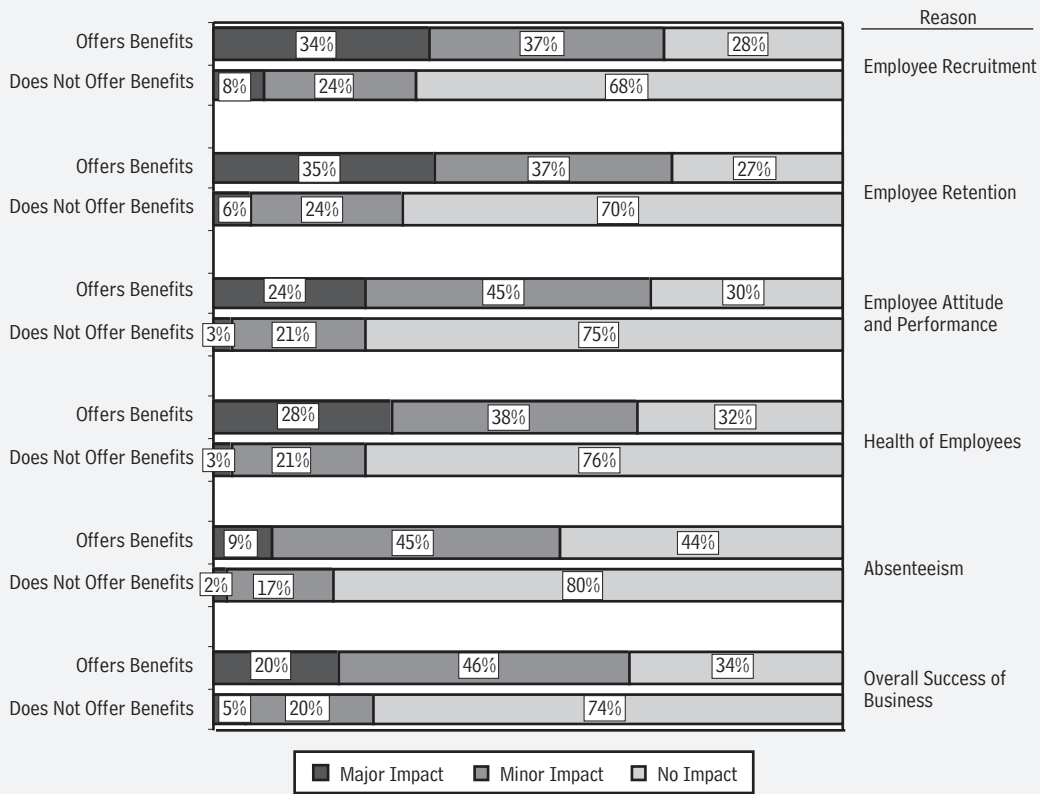
While employers not offering health benefits generally do not perceive that the lack of health benefits

Figure 7  
**IMPACT OF OFFERING A PLAN, BY SIZE OF BUSINESS, 2002**

	Total		2–9 Workers		10–24 Workers		25–50 Workers	
	Major impact	Minor impact	Major impact	Minor impact	Major impact	Minor impact	Major impact	Minor impact
Employee Recruitment	34%	37%	27%	36%	45%	42%	54%	31%
Employee Retention	35	37	31	34	42	43	43	41
Employee Attitude and Performance	24	45	22	43	32	49	23	54
Health of Employees	28	38	28	35	27	43	30	47
Absenteeism	9	45	8	43	13	48	7	56
Overall Success of Business	20	46	19	42	21	53	20	57

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 8  
**IMPACT OF OFFERING OR NOT OFFERING HEALTH BENEFITS TO EMPLOYEES, 2002  
 (BY REASON)**

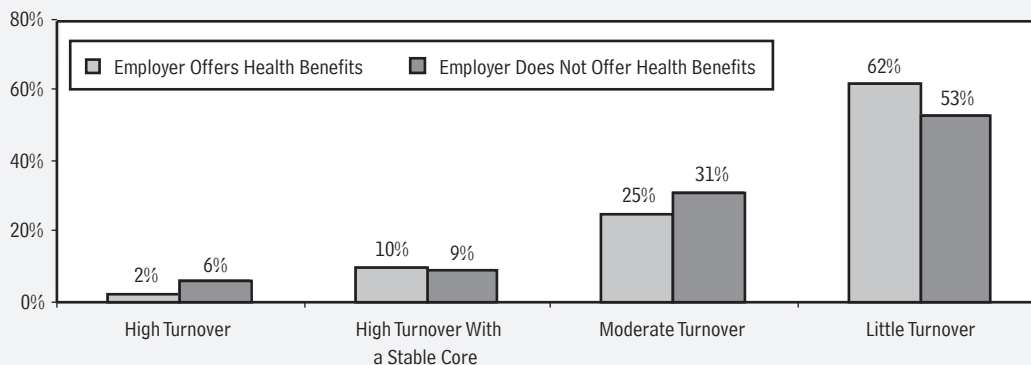


Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

has an impact on employee retention, those without coverage are more likely than those with coverage to report that most of their employees stay only a few months. Specifically, 6 percent of employers not offering health benefits reported high turnover of workers, compared with 2 percent among employers offering health benefits (Figure 9). Furthermore, 53 percent of

employers not offering health benefits reported that they experienced little turnover, compared with 62 percent among employers offering health benefits. It is possible that some decision makers may be unaware of or underestimating the effect that their firm's lack of coverage has on turnover. However, respondents without health benefits who describe their employee turnover as high or

Figure 9  
**EMPLOYEE TURNOVER BY WHETHER EMPLOYER OFFERS HEALTH BENEFITS, 2002**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.



Figure 10  
**IMPACT OF NOT OFFERING HEALTH BENEFITS, BY EMPLOYEE TURNOVER, 2002**

	High or Moderate Turnover		Little Turnover	
	Major Impact	Minor Impact	Major Impact	Minor Impact
Employee Recruitment	12%	29%	4%	19%
Employee Retention	10	35	2	15
Employee Attitude and Performance	5	25	1	18
Health of Employees	3	28	2	15
Absenteeism	3	23	2	12
Overall Success of Business	8	26	3	15

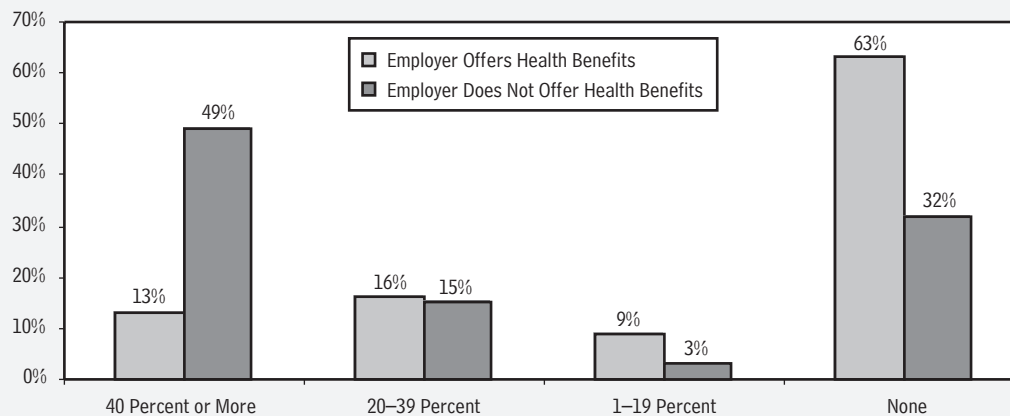
Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 11  
**IMPACT OF NOT OFFERING HEALTH BENEFITS, BY SIZE OF BUSINESS**

	Total		2-9 Workers		10-24 Workers		25-50 Workers	
	Major Impact	Minor Impact	Major Impact	Minor Impact	Major Impact	Minor Impact	Major Impact	Minor Impact
Employee Recruitment	8%	24%	7%	22%	9%	32%	16%	35%
Employee Retention	6	24	5	22	8	37	19	30
Employee Attitude and Performance	3	21	2	21	5	25	5	38
Health of Employees	3	21	2	21	5	23	11	22
Absenteeism	2	17	2	17	3	21	3	22
Overall Success of Business	5	20	5	19	5	26	16	32

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 12  
**PERCENTAGE OF WORK FORCE PAID LESS THAN \$15,000 ANNUALLY, 2002**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

moderate are more likely than those with little turnover to report that not offering health insurance has an impact on recruitment, retention, performance, health status, absenteeism, and the overall success of their business (Figure 10).

Just as the larger employers among those surveyed are more likely than smaller employers to

experience an impact from offering benefits, larger employers that do not offer health benefits are more likely than smaller ones to report an impact due to their lack of employee health coverage. More than 50 percent of employers with 25 to 50 workers report that not offering health benefits has had a major or minor impact on employee recruitment (Figure 11). In addition,

49 percent report that not offering health benefits has had an impact on employee retention, and 43 percent report that not offering health benefits has had an impact on employee attitude and performance. In contrast, between 19 and 29 percent of employers with two to nine workers perceive that not offering health benefits has had an impact on recruitment, retention, performance, health status of workers, and absenteeism.

## Employer Profiles

Small employers that offer health benefits to workers tend to be distinctly different from small employers not offering health benefits. This may partially explain why some companies find that offering or not offering health benefits has an impact on employee recruitment, retention, and performance, while others do not. It may also help explain why some firms do not offer workers health

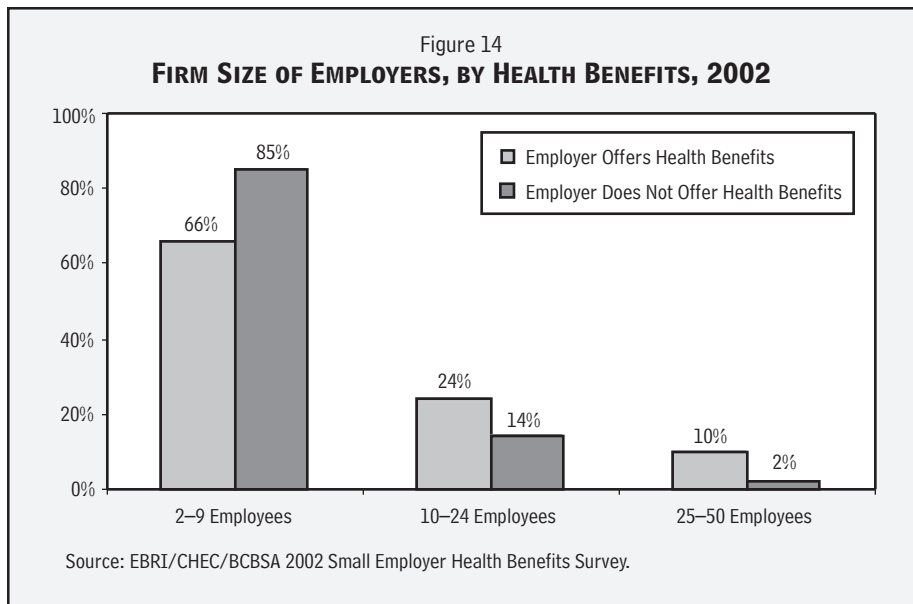


Figure 13  
**WORK-FORCE CHARACTERISTICS, 2002**

Percentage of Work Force	Employer Offers Health Benefits	Employer Does Not Offer Health Benefits
<b>Full Time</b>		
100%	52%	40%
80%–99%	18	7
50%–79%	22	30
Less than 50%	8	22
<b>Female</b>		
100%	6	17
80%–99%	8	9
50%–79%	25	26
Less than 50%	60	47
<b>Under Age 30</b>		
40% or more	19	26
20%–39%	25	24
1%–19%	18	7
None	38	42
<b>Minority</b>		
100%	4	8
50%–99%	10	12
20%–49%	13	11
1%–19%	20	7
None	50	60

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

benefits in spite of experiencing an impact on their business as a result of not offering health benefits.

## Worker Characteristics

The income of workers in firms *not offering* health benefits tends to be considerably lower than worker income in firms that *do offer* health benefits. Nearly 50 percent of employers not offering health benefits pay annual wages of less than \$15,000 per year to 40 percent or more of their employees, compared with 13 percent of companies that do offer health benefits (Figure 12).

In addition to differences in income, companies not offering health benefits are more likely than employers offering health benefits to have a smaller proportion of full-time employees. More than one-half of employers not offering health benefits, and 30 percent of employers offering health benefits indicate that fewer than 80 percent of their employees work full time (Figure 13). Firms that do not

Figure 15  
**ANNUAL GROSS REVENUE OF EMPLOYERS, 2002**

Annual Gross Revenue	Employer Offers Health Benefits	Employer Does Not Offer Health Benefits
Less Than \$500,000	33%	65%
\$500,000–\$999,999	26	17
\$1,000,000–\$1,999,999	17	5
\$2,000,000–\$4,999,999	9	2
\$5,000,000 or More	3	1
Don't Know/Refused	11	9

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

offer health benefits also tend to have larger proportions of females, workers under age 30, and minority employees.

## Firm Size and Revenue

The smaller a firm, the less likely it is to offer health coverage. Of the employers that do not offer health benefits, 85 percent employed fewer than 10 workers (Figure 14). In contrast, of the employers surveyed that do offer health benefits, 66 percent employed fewer than 10 workers. In addition, employers not offering health benefits are more than twice as likely to have annual gross revenues of less than \$500,000. Sixty-five percent of employers that do not offer health benefits had annual gross revenue of less than \$500,000, compared with 33 percent among employers that did offer health benefits (Figure 15). While 29 percent of companies with health benefits report gross revenues of \$1,000,000 or more, 8 percent of employers not offering health benefits report this level of revenue.

Some of the differences in revenues between companies with and without benefits result from the fact that firms with benefits tend to have more workers than those without benefits. However, companies with health coverage generally have higher gross revenues than those without benefits even when comparing companies with similar numbers of employees.

## Firm Tenure

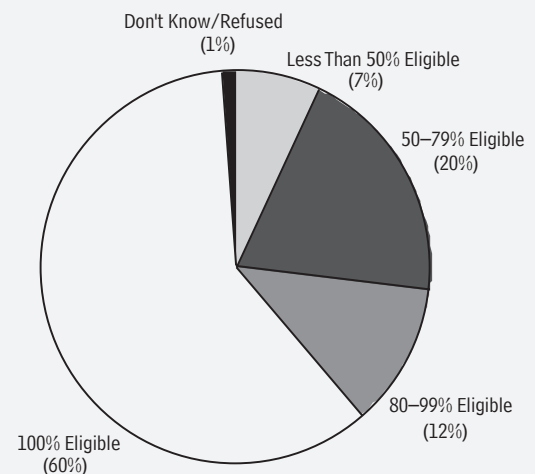
Companies that do not offer workers health coverage have generally been in business for less time than have those that offer coverage. In particular, companies without plans are more likely than those with plans to have been in business for less than five years (13 percent vs. 19 percent), and less likely to have been in business for 30 years or longer (20 percent vs. 12 percent) (Figure 16).

Figure 16  
**AGE OF BUSINESS OF EMPLOYERS, 2002**

Age of Business	Employer Offers Health Benefits	Employer Does Not Offer Health Benefits
Less Than 5 years	13%	19%
5–9 Years	19	20
10–14 Years	15	17
15–29 Years	32	29
30 Years or More	20	12

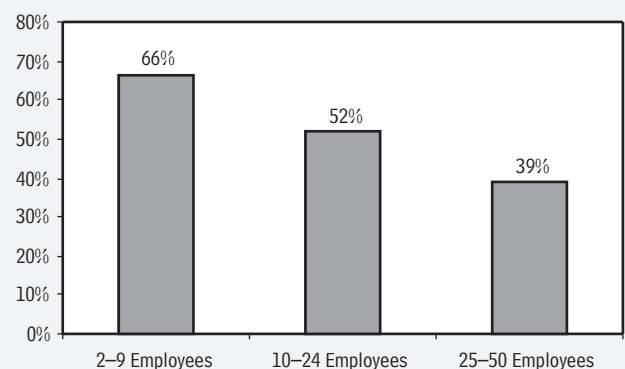
Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 17  
**PERCENTAGE OF EMPLOYEES ELIGIBLE TO PARTICIPATE IN HEALTH BENEFITS PLAN, 2002 (AMONG EMPLOYERS THAT OFFER HEALTH BENEFITS)**



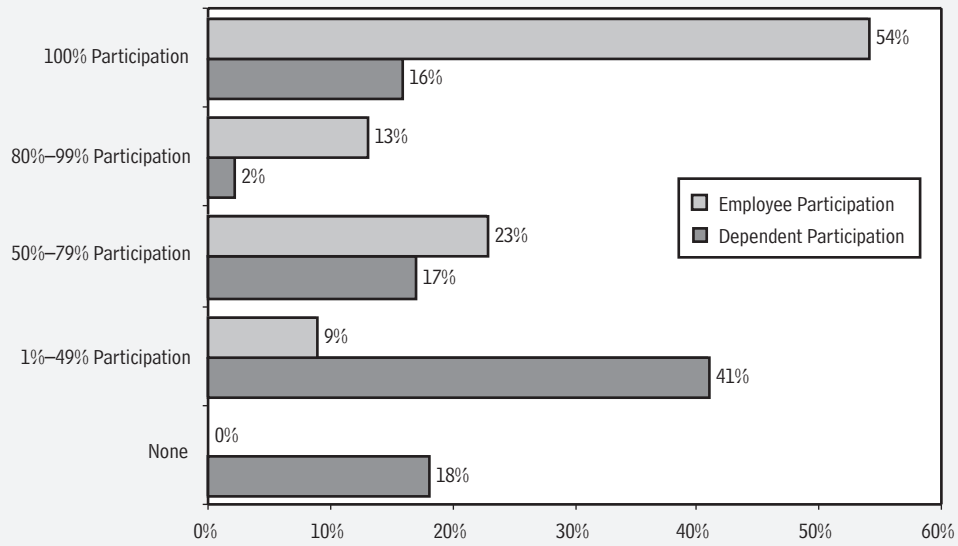
Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 18  
**PERCENTAGE OF EMPLOYERS REPORTING THAT 100 PERCENT OF WORKERS WERE ELIGIBLE FOR HEALTH BENEFITS, 2002 (AMONG EMPLOYERS THAT OFFER HEALTH BENEFITS)**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 19  
**PERCENTAGE OF ELIGIBLE EMPLOYEES AND DEPENDENTS PARTICIPATING IN HEALTH BENEFITS PLAN (AMONG EMPLOYERS OFFERING HEALTH BENEFITS)**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

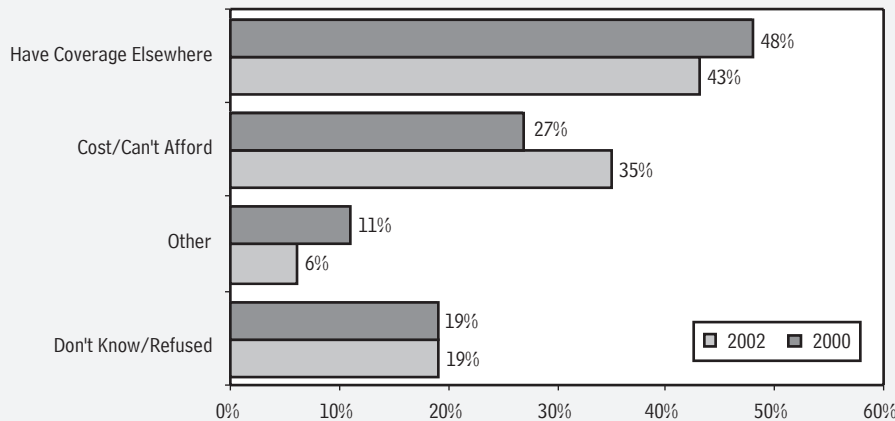
## Employee Participation

Not all workers are eligible to take advantage of the health benefits offered by their employers. Sixty percent of employers offering health benefits reported that all

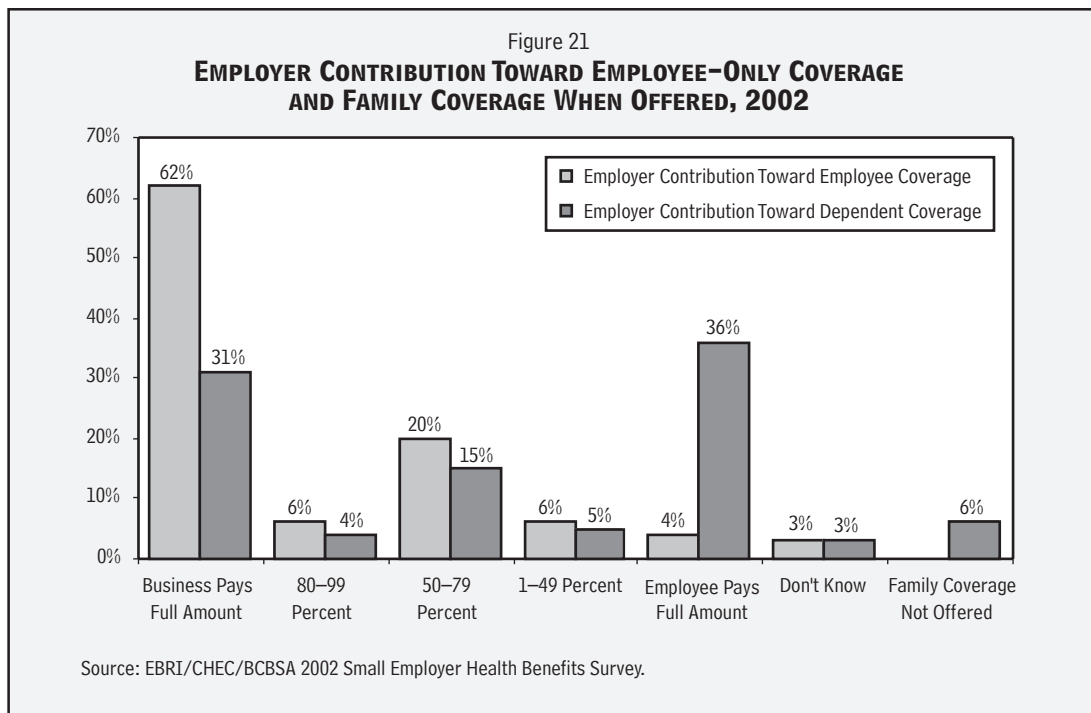
workers were eligible for health benefits (Figure 17). Seven percent reported that less than half of their workers were eligible to participate. Twenty percent report that between 50 percent and 79 percent of workers are eligible to participate, while 12 percent reported that between 80 percent and 99 percent were eligible.

As firm size increases, the percentage of workers eligible for health benefits when offered actually

Figure 20  
**REASONS ELIGIBLE EMPLOYEES MIGHT NOT OBTAIN DEPENDENT COVERAGE AMONG COMPANIES OFFERING FAMILY COVERAGE, 2000 AND 2002 (MULTIPLE RESPONSES ACCEPTED)**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.



decreases. Specifically, 39 percent of respondents from firms with 25 to 50 employees reported that 100 percent of their employees were eligible to participate in the health benefits plan (Figure 18). This compares with 52 percent of employers with 10 to 24 employees and 66 percent of employers with 2 to 9 employees. The eligibility rate also may be due to minimum participation requirements. These requirements in effect require all workers (or a specified large percentage of workers) in a firm to have health insurance coverage in order for an insurer to agree to provide coverage. It protects the insurer from adverse selection, which occurs when healthy workers opt out of the health benefits plan leaving only the unhealthy, and more costly to cover, on average, in the plan.

Not all small employers surveyed who offer health benefits get full participation among eligible workers. Fifty-four percent of employers offering health benefits had 100 percent participation among employees (Figure 19). Among employers that offer health benefits to dependents (6 percent did not offer health benefits to dependents), take-up rates were much lower for dependents than for employees. A mere 16 percent reported that all employees eligible for dependent coverage actually included dependents in the health benefits plan. Employers reported a number of reasons why workers do not accept health benefits for dependents when they are available. Forty-three percent of the employers offering dependent coverage report that the workers do not take coverage for their dependents because the dependents have coverage from somewhere else (Figure 20). An

additional 35 percent report their employees decline coverage because they cannot afford the premiums. This finding is consistent with the fact that small employers tend to pay a greater share of the premium for employee-only coverage than they pay for family coverage. While 62 percent of employers pay the full premium for employee-only coverage, just 31 percent pay the full amount of family coverage (Figure 21). Conversely, only 4 percent require the worker to pay the full amount of employee-only coverage, but 36 percent require them to pay the full amount for dependents.

## Likelihood of Offering Benefits

Some employers not currently offering health benefits have offered them in the past. Overall, 21 percent of companies that do not currently offer health benefits

Figure 22  
**BUSINESS OFFERED HEALTH PLAN IN PAST,  
AMONG EMPLOYERS NOT OFFERING HEALTH PLAN,  
2000 AND 2002**

Offered Health Plan in Past	2000	2002
Yes	12%	21%
No	86	79
Don't Know	2	1

Source: EBRI/CHEC/BCBSA 2000 & 2002 Small Employer Health Benefits Survey.

Figure 23  
**REASONS FOR NOT OFFERING A HEALTH PLAN, 2000 AND 2002**

	Major Reason		Minor Reason	
	2000	2002	2000	2002
The business cannot afford it.	53%	63%	16%	16%
Revenue is too uncertain to commit to a plan.	40	45	16	23
Employees have coverage elsewhere.	43	40	18	21
Employees cannot afford it.	37	43	17	18
Large portion of workers are seasonal, part-time, or high turnover.	34	31	15	18
Employees prefer wages and/or other benefits.	30	28	20	21
Company does not need to offer a plan to recruit and retain good workers.	18	19	17	29
Owner has coverage elsewhere.	40	29	13	14
Setting up a plan is too complicated and time-consuming.	11	8	20	19
Employees are healthy and do not need it.	10	5	17	20
Do not know where to go for information on starting a plan.	8	4	21	18

Source: EBRI/CHEC/BCBSA 2000 and 2002 Small Employer Health Benefits Surveys.

report their business has offered some type of health benefits plan in the past five years, up from 12 percent in 2000 (Figure 22). Just over 40 percent reported that the cost of coverage was the main reason for dropping health benefits, while another 18 percent reported that either too few employees took coverage when offered or because employees did not want it, and 14 percent reported that employees had coverage elsewhere.

### Reasons for Not Offering Benefits

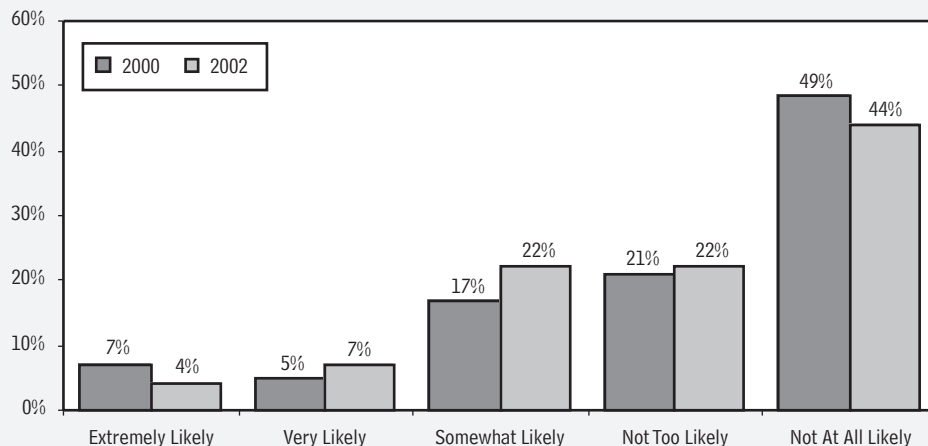
Financial concerns, together with the availability of coverage elsewhere, are the reasons most frequently mentioned for not offering health benefits to employees. Nearly 80 percent of employers not offering health benefits report that a major or minor reason for not

offering them was because their business cannot afford to offer them, up from 69 percent in 2000 (Figure 23). In addition, 68 percent report that revenue is too uncertain to commit to offering a health benefits plan, up from 56 percent in 2000, and 61 percent report that their company does not have a plan because employees have coverage elsewhere, which is unchanged from 2000. Nearly 50 percent reported that they did not offer health benefits because they did not need it to recruit and retain workers, up from 35 percent in 2000.

### Potential Benefit Sponsors

One-third of firms that do not currently offer health benefits are potential purchasers of health benefits for their employees. Eleven percent of employers not

Figure 24  
**LIKELIHOOD OF EMPLOYER OFFERING HEALTH BENEFITS IN NEXT TWO YEARS,  
 2000 AND 2002  
 (AMONG COMPANIES NOT OFFERING A HEALTH PLAN)**



Source: EBRI/CHEC/BCBSA 2000 & 2002 Small Employer Health Benefits Survey.

Figure 25  
**LIKELIHOOD OF OFFERING HEALTH BENEFITS IN THE FUTURE,  
 AMONG EMPLOYERS NOT OFFERING HEALTH BENEFITS, BY SELECTED INDICATORS**

	Extremely or Very Likely	Somewhat Likely	Not Too or Not at All Likely
Company Started Less Than 10 Years Ago	69%	49%	31%
Not Offering Health Plan Has Impact On:			
Employee recruitment	42	44	26
Employee retention	40	37	26
Employee attitude and performance	43	29	19
Health of employees	31	28	21
Absenteeism	26	23	18
Overall success of the business	41	33	20

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

Figure 26  
**FACTORS LIKELY TO MAKE COMPANIES SERIOUSLY CONSIDER OFFERING PLAN, 2000 AND 2002**

	Much More Likely		Somewhat More Likely		No More Likely	
	2000	2002	2000	2002	2000	2002
If it could be demonstrated that absenteeism would decrease.	5%	7%	15%	24%	79%	68%
If it could be demonstrated that it would improve recruitment and retention.	12	10	24	30	63	59
If your employees asked for it.	13	14	37	31	47	54
If insurance costs fell 10 percent.	13	10	30	34	54	55
If there were an increase in the business' profits.	22	24	35	39	41	36
If the government provided assistance with health insurance premiums.	28	30	36	41	31	28

Source: EBRI/CHEC/BCBSA 2000 and 2002 Small Employer Health Benefits Surveys.

Figure 27  
**SUPPORT FOR TAX BREAKS TO REDUCE HEALTH INSURANCE  
 COSTS FOR LOW-WAGE WORKERS, 2000 AND 2002**

	Total		Employer Offers Health Benefits		Employer Does Not Offer Health Benefits	
	2000	2002	2000	2002	2000	2002
Strongly Favor	56%	58%	59%	62%	53%	50%
Somewhat Favor	30	28	30	24	29	34
Somewhat Oppose	4	3	3	3	5	3
Strongly Oppose	3	4	2	2	3	6
Depends	4	3	3	3	6	3
Don't Know	3	4	3	4	3	4

Source: EBRI/CHEC/BCBSA 2000 and 2002 Small Employer Health Benefits Surveys.

currently offering health benefits are either extremely or very likely to start offering a health benefit plan for employees in the next two years (Figure 24). This is statistically unchanged from 2000. An additional 22 percent are somewhat likely to start a health benefits plan, up from 17 percent in 2000. However 66 percent of employers not offering health benefits said they are not likely to offer them in the next two years.

Companies likely to start a health benefits plan differ from others not currently offering a plan in a

number of ways. Those likely to start a health benefits plan are more apt to have been in business for less than 10 years. Nearly 70 percent of employers not offering health benefits, but who are extremely or very likely to offer them in the next two years, report that they have been in business for less than 10 years (Figure 25). In contrast, only 31 percent of those not likely to offer health benefits have been in business less than 10 years. Employers who are extremely or very likely to start offering a health plan are also more likely than those not

Figure 28  
**LIKELIHOOD OF OFFERING HEALTH BENEFITS IF GOVERNMENT PROVIDED VARIOUS TAX BREAKS TO REDUCE HEALTH INSURANCE COSTS, AMONG EMPLOYERS NOT OFFERING HEALTH BENEFITS, 2002**

	Tax Credits to Employers to Reduce Health Insurance Costs of Low-Wage Workers	Tax Credits to Workers to Reduce Their Cost for Health Insurance
Much more likely	30%	26%
Somewhat more likely	47	49
No more likely	22	24
Don't know/Refused	1	2

Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

likely to start offering a health plan to report that not offering health benefits has had an impact on employee recruitment, retention, performance, the health status of their employees, absenteeism, and the overall success of the business.

## Factors That Would Encourage Sponsorship

Employers not offering health benefits were read a list of factors that might make their business more likely to seriously consider offering a health benefits plan. Not surprisingly, respondents are most inclined to say that factors having to do with increasing the affordability of health insurance coverage would make them more likely to consider offering a health benefits plan. For example, if the government were to provide assistance with premiums, 71 percent said they would be much more likely or somewhat more likely to seriously consider offering health benefits (Figure 26). Also, 63 percent would consider offering health benefits if there were an increase in the business's profits, and 44 percent report that they would consider doing so if insurance costs fell 10 percent. Forty-five percent said they would be more likely to seriously consider offering a health benefits plan as a result of employee demand and 40 percent said they would do so if it improved recruitment and retention.

## Tax Incentives

In general, small employers support tax breaks to reduce the health insurance costs of low-wage workers. More than half (58 percent) of employers surveyed strongly favor tax breaks that they could use to reduce health insurance costs for their low-wage workers (Figure 27). An additional 28 percent would somewhat favor such a

proposal. Just 7 percent would somewhat or strongly oppose it. Companies that currently offer health benefits are slightly more likely than those that do not to strongly favor tax breaks. Among employers not offering health benefits, 30 percent said they would be much more likely to offer them if the government provided tax breaks to reduce health benefit costs for low-wage workers, while another 47 percent would be somewhat more likely to offer benefits (Figure 28).

Small employers not offering health benefits would also be more likely to offer them if tax credits for health insurance were available to workers. Just over one-quarter would be much more likely to offer health benefits and another 49 percent would be somewhat more likely to offer them if workers had such assistance (Figure 28).

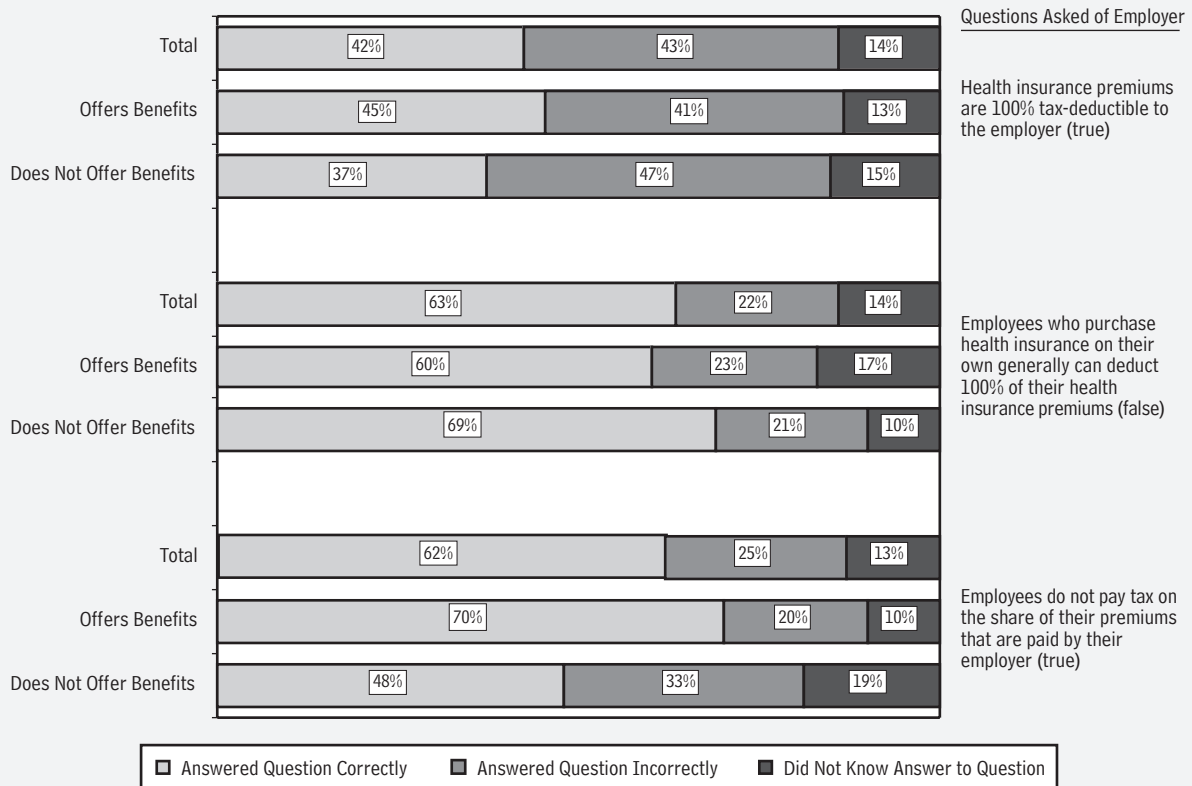
## Employer Knowledge of the Tax Treatment of Health Benefits

Currently, health insurance premiums paid by employers on behalf of workers are tax-deductible for employers as a business expense. They are treated the same way other labor costs and general business expenses are treated under the tax code. For example, the cost of health benefits is tax-deductible just like wages and salaries are tax deductible as a business expense. The amount that employers pay on behalf of workers is excluded, without limit, from workers' taxable income. However, if a worker were to purchase health insurance directly from an insurer, generally none of the premium can be deducted from his or her taxable income. For individuals who do not receive employment-based health benefits, total health care expenses (including premiums) are deductible only if they exceed 7.5 percent of adjusted gross income, and only the amount that exceeds 7.5 percent of adjusted gross income is deductible.

Until 2003, the health insurance premiums of



Figure 29  
**SMALL EMPLOYER KNOWLEDGE OF THE TAX TREATMENT OF HEALTH BENEFITS, 2002**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

the self-employed were treated differently from those for wage and salary workers. Seventy percent of health insurance premiums paid for partners in a business, Subchapter S owners, and self-employed individuals was deductible from such individuals' gross income in 2002. These individuals will be able to deduct 100 percent of the cost of their health insurance beginning in the year 2003.

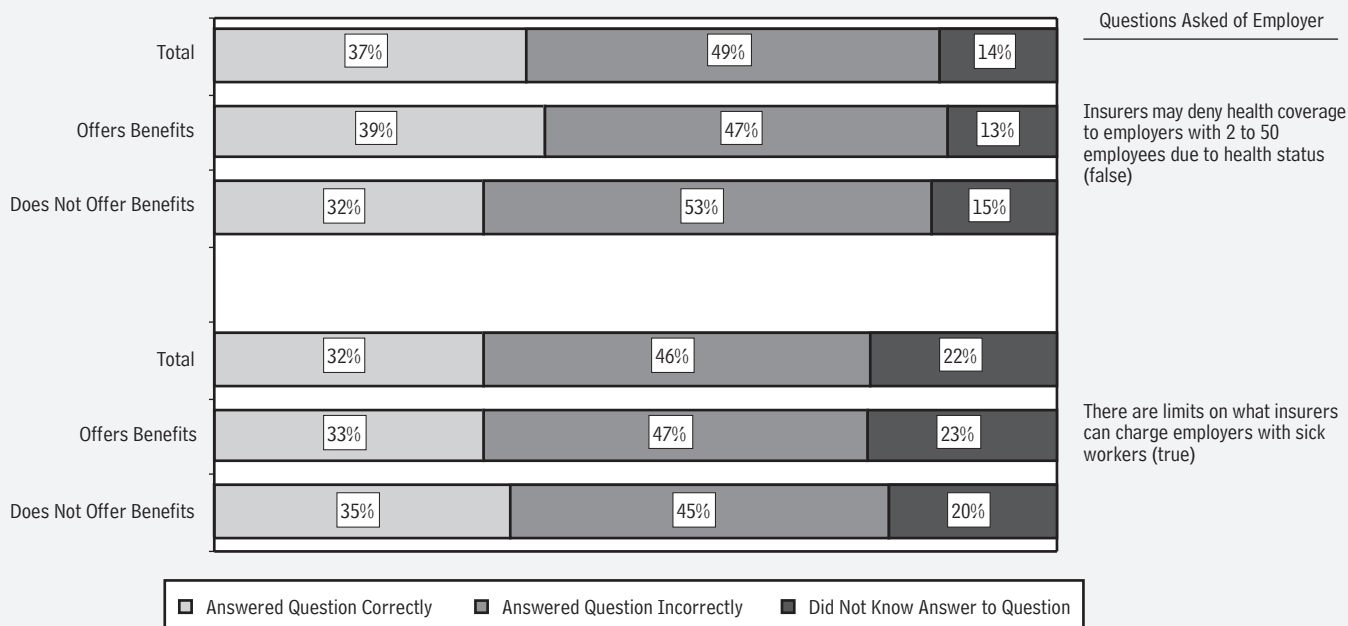
Many small employers are making decisions about whether or not to offer health insurance coverage to their workers without being fully aware of the tax advantages that can make this benefit more affordable. For example, 57 percent of all small employers surveyed in the 2002 SEHBS did not know that health insurance premiums are 100 percent tax deductible for the employer (Figure 29).

With respect to an employer's knowledge about the tax treatment of health benefits as it affects their workers, many continued to make false assumptions. More than one-third are not aware that employees who purchase health insurance on their own generally cannot

deduct 100 percent of their health insurance premiums. In addition, 38 percent did not know that employees do not pay tax on the share of premiums paid by their employer. However, employers offering health benefits were much more likely to be aware of this provision in the tax code than those not offering. Seventy percent of employers offering health benefits understood that the employer's share of the premium was not included in an employee's taxable income, compared with 48 percent among employers not offering health benefits.

While the survey findings show a number of cases where employers offering health benefits were more knowledgeable than employers not offering them about the tax treatment of health benefits as it applies to themselves or their workers, a surprisingly high percentage of employers offering health benefits still did not understand how those benefits are treated by the tax code. It is important for employers to understand the tax treatment of health benefits for a number of reasons. Probably the most important reason is the fact that misperceptions about how health benefits are taxed may prevent employers from offering health benefits.

Figure 30  
**SMALL EMPLOYER KNOWLEDGE OF SMALL GROUP MARKET REGULATIONS, 2002**



Source: EBRI/CHEC/BCBSA 2002 Small Employer Health Benefits Survey.

## *Employer Awareness of Insurance Regulations Affecting Health Benefits*

During the mid-1990s, nearly every state passed laws designed to make health benefits more accessible for small employers. In addition, in 1996, the federal government passed the Health Insurance Portability and Accountability Act (HIPAA), which set minimum accessibility standards across the states. Laws to improve employer access to group insurance included “guaranteed issue” and “guaranteed renewal” requirements. Guaranteed issue laws generally require insurers offering coverage in the small group market to offer coverage to any small group in a particular size category regardless of the health status or prior claims experience of the group’s members as well as other factors. Guaranteed renewal generally means that insurers offering health benefits must renew an employer’s health coverage at the employer’s option.

In many states, laws affecting affordability were passed to change the way health insurers in the small group market determined premiums. In some states, insurers are required to use “rating bands,” which are restrictions on the difference between the highest and lowest premiums an insurer can charge its group members. Rating restrictions vary by state. Some states limit the use of the group’s health status and prior claims experience in determining premiums. The limits can be loose or very tight, depending upon the state. Some states passed laws, known as community rating laws, which essentially prohibit the use of past claims experience or health status in setting premiums for small groups. Some community rating laws even go so far as to prohibit the use of demographics in determining premiums.

Overall, state rating regulations were designed to require insurers to “pool” small employers together in order to provide cross-subsidies for employers with high-cost workers. Small employers are largely unaware of the state and federal laws that have been enacted with the intent of making health insurance more accessible and more affordable for them. For example, more than 60 percent did not know that, under federal law, insurers may not deny health insurance coverage to small employers even when the health status of their workers is poor (Figure 30). Employers offering health benefits were

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less likely than employers not offering health benefits to be unaware of these guaranteed issue and renewal laws (60 percent and 68 percent, respectively).

In general, small employers are not knowledgeable about state small-group market reforms passed during the mid-1990s that essentially make it easier for them to obtain coverage and may make it easier for them to afford coverage. These laws prevented insurers from denying coverage to small employers with unhealthy workers, and also prevented them through the use of rating restrictions from charging unhealthy groups more than healthy groups. It is important for small employers to understand how the insurance market is regulated. Misconceptions about the market may result in fewer employers offering coverage because they were either under the impression that they could not obtain or they could not afford coverage due to the health status of their workers.

## Conclusion

While employment-based health benefits are by far the most common form of health insurance coverage in the United States, many workers are not offered health benefits or do not participate in the plan when it is offered. As a result, of the 41 million Americans who do not have health insurance coverage, 86 percent are in a family with a worker, and small firms employ 62 percent of uninsured workers. Since the vast majority of large employers offer health benefits, but many small employers do not, small-business owners are seen as perhaps the most crucial opportunity in efforts to expand health insurance coverage in the current health insurance system and reduce the growing number of uninsured Americans. In order to better understand how to get more small employers to offer health benefits, the SEHBS surveyed small employers with between two and

50 employees.

This *Issue Brief* presents a number of important findings from the 2000 and 2002 SEHBS as they relate to small employers and their decisions to offer health benefits to workers. First, most small employers offer sound business reasons for offering health benefits to workers. When asked specifically whether offering health benefits has an impact on their business, most small employers with benefits agree that it does. Employers not offering health benefits generally do not perceive that the lack of health benefits has an impact on their business, but there is evidence that it does. This analysis finds that employers not offering health benefits are more likely than those offering them to report that most of their employees are high-turnover and stay with the business for only a few months.

Second, not all workers are eligible to take advantage of health benefits offered by their employer, employees sometimes do not take advantage of health benefits when they are offered, and not all employers offer dependent coverage. This analysis finds that the average take-up rate is higher among employers that contribute at least something toward the cost of health benefits.

Third, one-third of employers not currently offering health benefits indicate they are likely to offer it in the next two years. If employers were given financial incentives to offer health benefits, health insurance coverage could be expanded, though whether the expansion would be significant is the subject of debate.

This SEHBS also identified numerous challenges to expanding health benefits among small employers. Small employers that offer health benefits tend to be distinctly different from small employers not offering them. Worker income in firms not offering health benefits tends to be considerably lower than in firms that do offer them. Employers not offering health benefits are more likely than those offering them to have a smaller proportion of full-time employees, and employers that do not offer health benefits have a larger proportion of females, workers under age 30, and minority employees.

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Even among firms with three to 49 employees, firms that do not offer health benefits tend to be smaller than those that do. In addition, employers not offering benefits are more than twice as likely to have annual gross revenues of less than \$500,000.

Finally, employers—especially small employers—are sensitive to the rising cost of providing health benefits. Nearly 20 percent of the employers in the sample made changes to their health plan between 2001 and 2002. Of those that made changes, they were more likely to ask employees to pay more for needed health care services than to make any other change. If the cost of providing health benefits were reduced, more small employers would offer them. In contrast, if the cost of providing health benefits continues to increase, some employers will drop health benefits. Specifically, if the cost of health insurance increases an additional 5 percent, 23 percent of employers said that they would change their plans and 3 percent report that they would drop coverage.

## Methodology

The Small Employer Health Benefits Survey (SEHBS) was designed to examine the reasons America's small employers (with two to 50 workers) offer or do not offer health benefits to their workers and related issues. The survey was conducted within the United States between July 25 and Sept. 5, 2002, through 18-minute telephone interviews with 502 companies with health benefits and 498 companies without health benefits. Within each group, quotas were established to ensure sufficient representation for analysis by number of employees. The resulting sample was weighted by presence of plan and number of employees to reflect the national population of small employers with two to 50 workers.

In theory, the weighted sample of 1,000 yields a statistical precision of plus or minus three percentage points (with 95 percent certainty) of what the results would be if all nongovernment businesses with two to 50 workers were surveyed with complete accuracy. There are other sources of error on all surveys, however, that may be more serious than theoretical calculations of sampling error. These include refusals to be interviewed and other forms of nonresponse, the effects of question wording and question order, and screening. While attempts are made to minimize these factors, it is difficult or impossible to quantify the errors that may result from them.

The SEHBS was co-sponsored by the Blue Cross and Blue Shield Association (BCBSA), a federation of independent, locally operated Blue Cross and Blue Shield Plans that collectively provide health care coverage to 75 million—more than one in four—Americans; the Employee Benefit Research Institute (EBRI), a private, nonprofit, nonpartisan public policy research organization; and the Consumer Health Education Council (CHEC), a health education organization that was formed to help the American public better understand, acquire, and utilize health insurance. Mathew Greenwald & Associates, Inc. conducted the survey.

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raise a number of important issues regarding access, cost, and take-up. More information on association health plans can be found in Fronstin (2000).

<sup>5</sup> These figures are based on the sample of 339 employers offering health benefits in both 2002 and 2001 and who also were able to report the cost of health benefits for employee-only coverage for both years.

<sup>6</sup> The Kaiser Family Foundation/Health Research and Educational Trust survey found that premiums increased between 14.2 percent and 14.9 percent for employers with three to 49 employees. The survey also found that the annual premium for employee-only coverage was \$3,419 for employers with three to 9 employees, \$3,233 for employers with 10–24 employees, and \$2,867 for employers with 25–49 employees. See Gabel et al. (2002) for more information about the survey.

<sup>7</sup> Plans with reductions, no change, or low increases in premiums might be expected to have been more likely to make changes to keep premium increases from occurring. However, no variation was found in the likelihood making a plan change by the change in the premium. These findings may be due to small sample sizes.

## Endnotes

<sup>1</sup> EBRI estimates from the 2001 Medical Expenditure Panel Survey (MEPS). See [www.meps.ahrp.gov/Puf/PufDetail.asp?ID=87](http://www.meps.ahrp.gov/Puf/PufDetail.asp?ID=87) (last reviewed October 2002) for more information regarding the 2001 MEPS.

<sup>2</sup> In this report, a “small” employer is defined as having between two and 50 employees.

<sup>3</sup> See Fronstin and Helman (2000) for a summary of findings from the 2000 SEHBS.

<sup>4</sup> The Bush administration supports legislation that would make it easier for small employers to form associations to purchase health benefits for employees. Association health plans have their advantages but also

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