

# CIGNA STRATEGY REPORT



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## CONTENTS

Executive Summary.....	3
Company Background .....	4
Financial Analysis.....	7
Profitability & Shareholder Returns.....	7
Liquidity & Solvency.....	8
DuPont Analysis .....	9
Stock Performance .....	10
Five Forces.....	12
SWOT Analysis.....	17
Strategic Recommendations.....	23

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## EXECUTIVE SUMMARY<sup>1</sup>

CIGNA is a Global Health Services company that provides integrated health care and related services in order to meet the needs of their individual clients. In addition to being one of the largest health service companies in the US market, CIGNA also operates in 30 countries internationally, with over 70 million customers worldwide. CIGNA also employs over 31,000 people, and takes in around \$22 billion in revenue.

CIGNA has a significant position in the U.S. health insurance market, where it covers 11.5 million Americans with its various medical plans. All products and services are provided exclusively through operating subsidiaries of the CIGNA Corporation, offering PPO, HMO, point-of-service (POS), indemnity, and consumer-directed products. Specialty coverage offerings include dental, behavioral health as well as pharmacy and vision care benefits. CIGNA also offers coverage for group disability, life, and accident coverage in addition to international insurance, which account for about 15% of sales. Internationally, CIGNA sells life, accident, and health insurance in parts of Europe and Asia, and provides health coverage to expatriate employees of multinational companies. While the North American health plan operations still account for a majority of revenue, these diversified and international products account for 40% of sales.

CIGNA is able to achieve this astounding international sales figure due to their extensive geographic reach. In addition to every state and the Virgin Islands, CIGNA has some 7 million members in international markets, about 30 countries. South Korea is the firm's largest foreign market, generating about 30% of its international segment revenues. CIGNA's expatriate health insurance also serves more than 1 million members.

CIGNA does much of its health plan selling with large employer groups through direct sales representatives as well as independent consultants. Currently, the company is aiming to expand its customer base to include the small (50 to 250 employees) and mid-sized (250-5,000 employees) businesses, as well as government entities, and individuals. The international health and life policy sales are conducted via independent distributors.

While CIGNA has maintained steady growth in revenues in recent years due to its expansion in the mid-sized, select, as well as international markets, CIGNA faces a slew of challenges and increased costs with the Affordable Care Act. In order to combat these

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challenges, CIGNA is not adding new corporate accounts, but also offering new and innovative products for individuals. CIGNA recently launched a slew of consumer-directed programs such as low-deductible plans with health savings accounts (through its CIGNA Choice Fund line), incentive programs, health risk assessments, and online tools for comparing coverage options. In addition, CIGNA has worked to strengthen its network of providers through strategic alliances with regional managed care organizations in order to improve care quality and lower costs.

CIGNA is also focusing on combatting the rising health care costs by entering favorable reimbursement contracts with providers and streamlining administrative duties and operations. It has been forced to leave select markets due to cuts in Medicare reimbursements, and instead is choosing to pursue areas which will be more profitable under the new laws. Internationally, CIGNA endeavors to expand its geographic footprint, especially in emerging markets. For example, in late 2012, CIGNA formed a joint venture with Saudi Arabian Insurance Company to increase its offerings in the Middle East.

## COMPANY BACKGROUND<sup>11</sup>

CIGNA Corporation is the product of a merger between the Insurance Company of North America (INA) and Connecticut General Corporation (CG) in 1982, propelling CIGNA to become one of the largest publically owned insurance and financial services company in the United States. The name CIGNA stems from the combination of the initials of these two historically important companies, and hence CIGNA's history traces back over 200 years.

### **Early History: Founding to mid 1800s.**

The Insurance Company of North America was formed by a group of prominent Philadelphian businessmen who believed that an insurance company was needed in close proximity in order to expand their businesses. INA established itself as America's first Marine Insurance company and offered protection for ship hulls and cargoes against fire. In only a few years coverage was expanded to buildings, and in 1807 INA established the agency system by expanding west and opening an agency in Lexington Kentucky. This

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westward expansion helped protect INA from losses stemming from the tumultuous time period, including the war of 1812 as well the Civil War.

### **Post Civil War- Early 20<sup>th</sup> Century**

While expanding westward helped protect against losses, it also opened up the possibilities to new risks, such as the great Chicago Fires in the 1870s and the San Francisco Earthquake in the early 1901, resulting in great losses.

The boom in industry from WWI also propelled INA to seek profits in unusual risks, such as insuring automobiles against fire, theft, and collision in 1907, as well as navy ships which suffered from German U-boat attacks. INA also provided both accident and health insurance for men working on the Manhattan Project. It introduced the first widely available homeowner coverage in 1950, and in 1978 bought HMO International, which was then the largest publicly owned health maintenance organization in the U.S.

### **Post War Boom and Reorganizations**

In the years following the war, INA boomed in sync with the economy, which was greatly helped by INA's newfound ability to sell multiple-line insurance. This expansion, as well as changes in the business environment and the company, prompted the Insurance Company of North America to become the major subsidiary of INA Corporation in order to offer more and diversified products and expand both regionally and internationally. In addition, INA Corporation organized or acquired several life insurance subsidiaries, as well as branched out into health and life insurance by acquiring hospital companies and HMOs.

### **The Other Half- Connecticut General**

The history of Connecticut General is also an integral part of CIGNA's past. Connecticut General was founded in 1865 when Guy R. Phelps, one of the founders of Connecticut Mutual Company, saw a need for "substandard" insurance- life insurance for high risks. Although CG expanded to 25 states after the Civil War, increasing competition, cost cutting, and poor public perception led the company to focus on the New England area.

In 1912 the company created an accident department, and also established group insurance, receiving its first big contract to insure 5,400 employees of Gulf Oil in 1917.

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WWII spurred CG to offer group hospital and surgical benefits, as well as coverage for atomic energy workers similar as INA did. Connecticut General is also responsible for the marketing of life insurance through estate planning, a concept that emphasized a client's total assets, family circumstances, and plans for the future.

In 1962 CG acquired Aetna, a major firm in fire and casualty insurance, in order to gain a broader position in insurance. This acquisition is in line with the trend in the industry of the time of creating larger companies to offer more lines of insurance. Similar to INA, CG also created a holding company, Connecticut General Insurance Company in 1967, with Connecticut General Life Insurance Company becoming a subsidiary.

After the Aetna acquisition, CG began to greatly expand into employee benefits, such as group health insurance and pensions, with its casualty and fire insurance department remaining small.

### **CG and INA Merge- CIGNA is born.**

In 1982 Connecticut General and the Insurance Company of North America merged to form CIGNA. This merger brought two complimentary companies together in various ways. While INA's strength was in its property and casualty insurance and had a strong international presence, CG focused on its life group insurance on the domestic market.

While there were a few challenges in the initial stages of CIGNA, which were exacerbated by the declining economy of the early 1980s, CIGNA prospered as the economy picked up and was able to capitalize on its newfound economy of scale. In 1984 CIGNA acquired American Foreign Insurance Association to strengthen its position abroad as well as to quell an internal conflict. CIGNA also began to position itself as a provider of managed health care, selling its individual insurance products division to InterContinental Life in 1988.

### **1990s To The Present- Strategy Focus**

In the early 1990s, CIGNA focused on increasing its small and midsized commercial clients revenue in the US. CIGNA continued to grow in the 1990s, acquiring the nation's sixth largest insurance and healthcare provider EQUIQOR Equible-HCA Corporation, and by 1997 CIGNA offered a full range of services in all 50 states after acquiring Healthsource,

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an HMO which serviced rural areas and smaller cities. CIGNA also started to focus more on its employee benefits by forming CIGNA IntegratedCare, whose integrated approach lowered employers' costs and helped remove gaps and redundancies in care.

At the same time, CIGNA began to divest in its non-core businesses, such as CIGNA property and casualty, as well as auto and travel insurance; operations which were experiencing chronic losses due to weak underwriting standards and poor relations between the agents and the company. After selling these units to ACE limited in 1999, CIGNA continued its focus on expanding its global health, life, and pension business, acquiring several companies such as Great-West Healthcare, U.K. based Vielife, and Star HRG. CIGNA also entered the Chinese Insurance market in 2002, and continues its international exposure by opening operations in Singapore, Turkey (FirstAssist acquisition) and India (joint venture with TKK Group) in 2008. In 2006 CIGNA began to capitalize on the Medicare program by offering Part D prescription drug benefits with distributor NationsHealth. CIGNA also became the world's leader in benefits for those living abroad by acquiring Vanbreda international in 2010. Most recently, it acquired HealthSpring to further enhance its position in the senior and Medicare management market.

## FINANCIAL ANALYSIS

### Profitability & Shareholder Returns

CIGNA has increased revenue and bottom-line profits since the market rebound in 2009, at a steadily increasing rate year-over-year. Net revenues increased 33% from 2011 to 2012 fiscal year, with shareholders' income increasing 29% over the same period. Adjusted income from operations increased 27% in 2012, largely attributable to earnings contributions from HealthSpring, as well as overall revenue growth in the other ongoing operating segments. The company has just over 14 million medical customers worldwide, up 2% from 2011.<sup>iii</sup>

CIGNA generates revenue in three main ways. CIGNA's main business is in the sale of international health care and supplemental health, life and accident benefits (formerly the

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international operations segment), called “Global Health Care” and “Global Supplemental Benefits” in the company’s financials; and domestic “Group Disability and Life.” Revenue from the company’s Global Health Care business increased 34% in 2012 from fiscal year 2011. Global Supplemental Benefits business revenue increased 48% from fiscal year 2011, and revenues from Group Disability and Life fell, but only by 3%, inconsequential to the firm’s general operations because of the section’s relative size.<sup>iv</sup>

Premiums and fees increased by 38% in 2012, compared with 2011, including contributions from the HealthSpring acquisition, customer growth in the other targeted market segments of the Global Health Care business and continued business growth in the Global Supplemental Benefits and Group Disability and Life segments. Net investment income remained flat in 2012, compared with 2011, primarily reflecting higher average investment assets and improved results from partnership investments offset by lower reinvestment yields. Mail-order pharmacy revenues increased by 12% in 2012, compared with 2011, primarily reflecting higher prescription volume for injectable medications, partially offset by price decreases related to a shift to generic oral medications from brand names. Other revenues declined 3% in 2012, compared with 2011. The decline primarily reflects the absence of revenue in 2012 from CIGNA Government Services, which was sold in the second quarter of 2011, partially offset by contributions from HealthSpring. Realized investment results in 2012 were lower than in 2011, primarily due to the absence of gains on sales of real estate held in joint ventures reported in 2011 and lower prepayment fees received on fixed maturities. However, this was partially offset by lower impairment losses and higher valuation on hybrid securities.

## **Liquidity & Solvency**

CIGNA current ratio, a measure of the company’s ability to pay off liabilities with current assets, is 1.07, reflecting the middle of the range for the sub-industry of large “Managed Health Care” providers. While this ratio is smaller than many industry competitors such as Humana (1.84), this is primarily due to the stretching of CIGNA’s assets for its recent growth and acquisitions. Cigna’s return on equity is 18.2%, which is high for the industry and is an indicator of the competence of the management in returning value to shareholders.



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The company's debt to equity ratio is 0.5, which reflects the industry's low debt holdings due to the need for solvency as a result of exposure to market risk with the firm's investments.

Most analysts expect firm-wide premium and fee revenue to increase in 2013, with Standard & Poor's projecting this cash flow to grow by 9% in 2013. The Global Health Care segment may realize an almost 2% rise in medical membership, assuming double-digit Medicare Advantage and International enrollment gains outweigh projections for a mid-to-high-single digit decline in commercial risk enrollment. Analysts generally cite CIGNA'S growing diversity and long-term earnings per share growth prospects as promising. The company's commercial business has been steadily growing, and should continue to grow membership and well-structured approach to customer service.

The largest threat to the firm's profitability is increased competition between the large group providers as a result of pressure from government healthcare reform. To help pay for health care reform, the MCOs face fees totaling \$67 billion over a 10-year period beginning in 2014. Meanwhile, the law placed certain restrictions on the group in 2010, and, beginning in 2011, commercial plans faced floors for medical spending as a percentage of premiums (referred to as the medical cost ratio -- MCR, or medical loss ratio -- MLR).<sup>v</sup>

## **DuPont Analysis**

(In Millions \$)

Net Income (NI): 1,327

Pretax Income (PI): 1,968

EBIT: 2,350

Total Sales (S): 21,998

Total Assets (A): 51,047

Total Shareholders' Equity (E): 8,344

$NI/PI (1:1.48) \times PI/EBIT (1:1.19) \times EBIT/S (1:9.36) \times S/A (1:2.3) \times A/E (1:1.16) \approx ROE$

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(15.9)

$NI/S (1:16.5) \times S/A (1:2.3) = 2.6\% = ROA$

$ROA (.026) \times A/E (6.25) \approx ROE (15.9)$

The firm's tax burden (NI/PI), is within the low range of the sub-industry, and reflects CIGNA's second best rank in pre-tax margin profits of 8.24% in the sub-industry.<sup>vi</sup> The firm's interest burden is also low (PI/EBIT), which is in line with the previous assumption of low debt in an industry that needs to stay highly liquid for investment purposes. The firm's high return on sales (EBIT/sales) also reflects the large expenses related to increases in the floors on medical spending as a percentage of premiums (medical cost ratio). Asset turnover (sales/assets) is reflective of the size of assets that need to be held relative to revenues from premiums (this is highly related to the risk incurred by exposure to liquid financial markets). The firm's leverage ratio is high, but it is easily described by, again, the funds that must be held for liabilities related to claim obligations for policyholders, reflecting the high expenses related to the health insurance industry. However, CIGNA has a very attractive leverage ratio for the industry, ranking 6<sup>th</sup> in the accident and health insurance industry. As a result of the increasing medical loss ratio from the ACA, CIGNA's (and the sub-industry as a whole) leverage ratio (assets/equity) should increase over the next few years. This stems from the necessity of insurers to put more of their insurance premiums into their medical costs, channeling more capital into equity. The firm's return on assets (4.6%) reflects the same restraints affecting the leverage ratio.

## Stock Performance

CIGNA's stock has performed well over the past year, with a current all-time high stock price of \$66.72. The stock has made a tremendous climb since the summer of 2012, when it hit a 52-week low of \$39.01. Analysts are moderately bullish on the stock, with S&P giving the stock a 4 out of 5 stars rating. Out of the 19 analysts covering CIGNA, 11 rate it a "strong buy", 1 as "overweight," and 7 as "hold." The average 12-month price target is \$72, a moderate increase in stock price, which can be attributed to a confluence of factors.

Analysts see a rise in membership and revenue gains, primarily spurring from

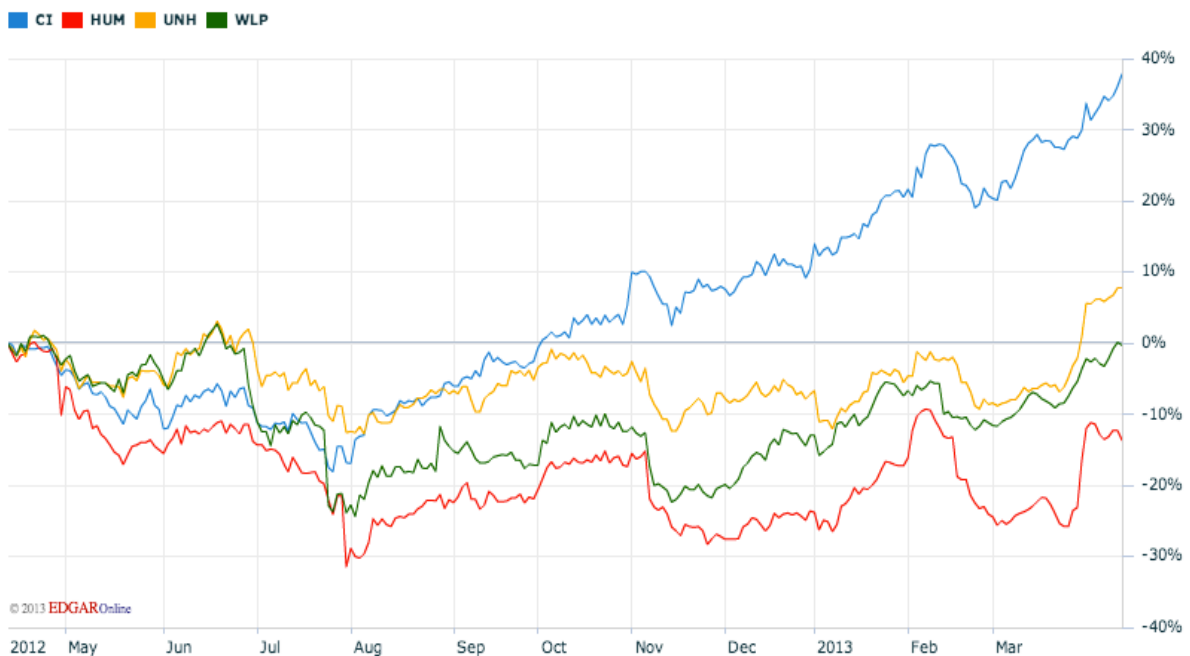
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Medicare Advantage Plan D memberships, as well as future double digit M&A and international enrollment gains. This growth is expected to offset a mid to high single digit decline in commercial risk enrollment. Furthermore, CIGNA's diverse offerings are promising for membership gains, and its full-stop loss option Administrative Service Only (ASO) plan is predicted to boost revenues. Long term, the stock is also expected to fair well, as CIGNA is well positioned to profit from the aging demographics of the U.S. and further expansion into the global market. However, profits may be stunted due to intense competition in the industry, as well as higher than expected medical costs.

### CIGNA vs. Competitors' Stock Performance



Source: Nasdaq.com

As the graph above illustrates, CIGNA has seen nearly a 40% climb from a year ago, handily outperforming its main competitors in the industry. Even with a market cap of \$19.08 billion, CIGNA is one of the smaller competitors to many of the industry giants, including Aetna (\$18.62 B), United Health (\$64.60 B), and WellPoint (\$21.22B). However, CIGNA



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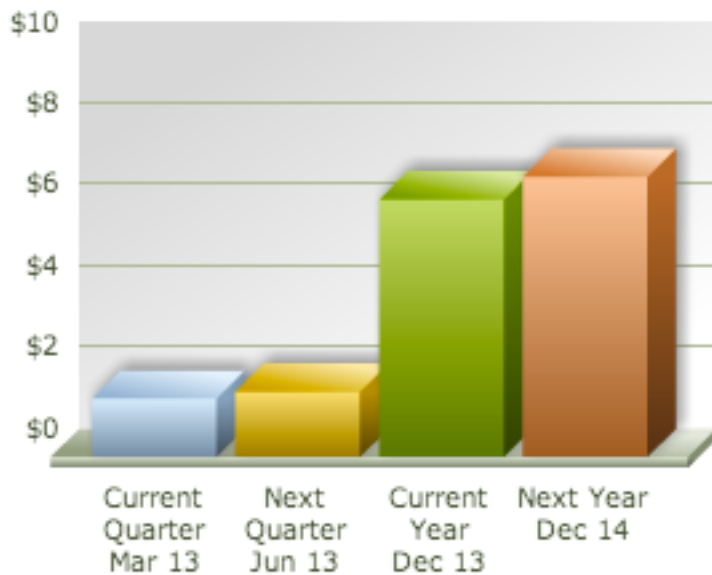
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has experienced far greater year over year quarterly revenue growth than its competitors at \$.041 a share compared to the next closest Aetna, which only experienced growth of \$0.16 a share. This is due to CIGNA's rapidly growing company profile, compared to its more stagnant competitors. While CIGNA's stock has climbed quickly in the past year, it still has an attractive Price to Earnings (P/E) ratio of 12, which is lower than most of its closest competitors and the industry median of 14.35.<sup>vii</sup> CIGNA's net profit margin was also an impressive 5.57%, beating its closest competitors and the industry average of 3.28%.

**Sub-Industry : Managed Health Care Peer Group\*: Managed Care - Large**

Peer Group	Stock Symbol	Stk.Mkt. Cap. (Mil. \$)	Recent Stock Price(\$)	52 Week High/Low(\$)	Beta	Yield (%)	P/E Ratio
<b>Cigna Corp</b>	<b>CI</b>	<b>19,079</b>	<b>66.72</b>	<b>66.75/39.01</b>	<b>1.39</b>	<b>0.1</b>	<b>12</b>
Aetna Inc	AET	18,624	56.78	56.93/34.58	1.19	1.4	12
Health Net	HNT	2,299	29.01	37.58/16.65	1.21	Nil	20
Humana Inc	HUM	12,282	77.56	90.81/59.92	1.13	1.3	10
UnitedHealth Group	UNH	64,601	63.03	63.95/50.32	0.89	1.3	12
WellPoint Inc	WLP	21,219	69.79	72.79/52.52	0.93	2.1	9

**Net Profit Margin 2012<sup>viii</sup>**



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## FIVE FORCES

### **Internal Rivalry**

CIGNA is the third largest Health Insurer and Manage Care Organization in the United States, and due to their vast array of product offerings, operates in a variety of competitive landscapes. The market most applicable for this analysis, however, is the primary health insurance market, with large insurers underwriting health and medical insurance policies, as well as administering group hospitalization plans, Health Maintenance Organizations (HMOs), and Preferred Provider Organizations (PPOs). In this ultracompetitive segment, CIGNA competes with industry giants such as Aetna, Blue Cross and Blue Shield Association, Humana, WellPoint and United Health Group. With over 70 mill customer relationships, CIGNA ranks fifth in enrollment.

It is important to note that because CIGNA receives approximately 40% of its sales from abroad, it also competes with international companies such as AEGON (Netherlands), and Allianz (Germany) as well as others. Currently, South Korea accounts for CIGNA's largest segment of international revenues (30%), but the company has made investments to go deep into target markets such as China, Turkey, and India.<sup>ix</sup>

However, in the U.S. alone, there are approximately 1,000 companies with combined revenues of \$500 billion, which is expected to grow at a high rate in the near future.<sup>x</sup> Growth forces include the ageing of the U.S. population, the rising costs of medical care, as well as the Affordable Care Act (ACA) of 2010, which will increase the number of Americans on health insurance rolls by \$29 million (CBOs estimates). CIGNA faces immense competition on a state-by-state and local basis, as the ACA has created small group policy exchanges, which allows consumers to compare each MCO's plan clearly. In addition, the ACA has also created Consumer Operated and Oriented Plans (CO-OPs), which are designed to offer individuals and small businesses consumer friendly and affordable health care options by coming together and applying for a federal loan. While these plans will most likely only represent a small percentage of the market, they are rapidly gaining attention from employers, and are viable threats to traditional health insurance plans.

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## **Entry and Exit**

There are substantial barriers to entry, which deter the vast majority of new entrants into the marketplace, making the threat of new entrants into the industry very low.<sup>xi</sup> Because of the fragmented and geographic specific nature of the industry, each firm competes to become the dominant provider of an area. In the healthcare business, economies of scale reign supreme, with powerhouses such as CIGNA being able to create vast networks of healthcare providers and services while simultaneously streamlining operations. The expansion of a health insurer's network also aids in the negotiation of contracts between the insurer and healthcare providers, known as capitation rates. Healthcare professionals pay these rates, which are predetermined monthly to healthcare providers regardless of the costs they incur, which spurs cost saving measures. However, the larger the MCO, the more customers and accounts they bring with them, earning them greater bargaining power with existing physicians and hospitals. Thus, incumbents face an immense challenge in creating a customer base and comprehensive network of medical providers, all while absorbing customer's medical costs in an attempt to remain profitable with the proper mandated cash reserves.

The ever-changing landscape of the healthcare industry is also a disincentive for new entrants. The most important aspects for an MCO to enter a market include adequacy of capitation rates, the stability of enrollment volume, and the administrative costs of participating. However, the Affordable Care Act has created a slew of regulations, which are increasing taxes and fees on healthcare insurers, increasing from \$8 billion in 2014 to \$14.3 billion in 2018. The ACA is already drastically reducing previously widespread profit enlarging practices of large MCOs, while at the same time, mandating that 80-85% of the premiums for healthcare expenditure be spent on quality improvement initiatives, leaving only 20% for SG&A costs.<sup>xiii</sup> The US Dept. of Health and Humans Services has announced that insurers who cannot comply with this Medical Loss Ratio (MLR) will be required to pay \$1.1 billion in rebates and fees. These new added fees and regulations, some of which will not be taking place until 2018, are adding increased risk and uncertainty in the market place, allowing for only the most efficient firms to compete. Due to this, the largest MCOs are

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already planning to acquire smaller firms who are unable to compete with the economies of scale and cost saving measures needed, further increasing industry concentration.<sup>xiii</sup>

The difficulty for smaller firms to enter is further exacerbated by the federal governments allowance for large private health insurers to compete for state-administered Medicare and Medicaid plans. Previously, small firms were able to compete by the formulation of specialty plans catering to Medicare and Medicaid recipients or other specialty plans. This allowance only makes the industry even more inhospitable for small firms.

### **Threat of Substitutes/Compliments**

Due to the prolific growth of MCOs there are very few substitutes in the managed care and health insurance market. Managed care has become the predominant coverage system for most Americans due to its ability to manage costs, while at the same time provide for the best quality coverage.<sup>xiv</sup> Due to the increasing demands on large businesses to provide a range of benefits for their employees under tight budgets, CIGNA, like other health insurance providers, has developed an array of service plans. These range from selective networks of providers (HMOs and PPOs), to more flexible but costly point of service plans (POS). In addition, CIGNA is involved in pharmaceutical benefits management program with its prescription home drug delivery program.

The individual mandate of the Patient Protection and Affordable Care act states that individuals can no longer opt out of having health insurance, requiring them to buy coverage from a private provider (if not enrolled in an employee sponsored plan or Medicare/Medicaid), lest they pay a penalty. While there is the illegal option of purchasing drugs from abroad, there is no replacement for healthcare coverage, with little choice but enrolling in some form of managed care.

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### **Power of Suppliers**

The power of suppliers in the industry is moderate to low. The main suppliers in the health care industry include private practice physicians and hospitals, as well as pharmaceuticals and medical equipment manufacturers. Because health care providers are unable to directly serve their client base, they rely on managed care organizations for their clients or sales, thus generating MCOs' great bargaining power. Like wise, MCOs realize that without the health care suppliers, their business would not be needed, and thus tough negotiations between both parties occur. This often results in drastically different costs for equipment of medical procedures, which are often kept secret by both parties. Because MCOs operate throughout the healthcare spectrum as integrated delivery systems, they often have the advantage in negotiations. This is because a consumer often moves within many areas of the healthcare arena, with large MCOs being able to decide which hospitals, medical equipment, and doctors customers are allowed to use. Thus, if suppliers wish to remain integrated in the network, they must give up some power. On the other hand, MCOs cannot be too aggressive in the negotiations at the threat of losing their suppliers to a competitor.

### **Power of Buyers**

The power of buyers varies drastically depending on if the buyer is an individual, business, or the government. Individuals and businesses have low bargaining power, as they are simply presented a choice of plans from which to select, with predetermined premiums and fees. Buyers often have a variety of choices for healthcare plans, but in some markets, there may be only one feasible provider. It should be noted, however, that buyers now possess more information than ever, and are able to choose from more customized options. Buyer power is further improved with the new exchanges the ACA has created, which allows for customers to easily compare options in their state.

The government, however, has great leverage with managed care organizations, as they possess a wealth of accounts with Medicare and Medicaid. The U.S. government selects MCOs to provide Medicare, Medicaid, and other government plans through a bidding process in the third and fourth quarters. The government selects an MCO based on price



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and has a greater control on premiums and fees, with this power only expanding as private insurers vie for the additional government Medicare and Medicaid accounts resulting from the Affordability and Care Act.

## SWOT ANALYSIS

<b>Strengths</b>	<b>Weaknesses</b>
Expansive network gives cost advantage	Low financial rating impacts borrowing ability
Comprehensive offerings attract customers	High level of indebtedness impacts the financial security of the company
Burgeoning international business reduces domestic reliance	Lower market share in Medicare products
Strong Acquisitions	
<b>Opportunities</b>	<b>Threats</b>
Affordable Care Act increasing base membership	Intense market competition
Acquisition of HealthSpring increases presence in under-penetrated area	Increasing medical costs likely to impact profitability
Increased demand for employee sponsored programs	The Affordable Care Act
Rise of ASO plans	Negative publicity could affect business

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## Strengths

- Network Size
  - CIGNA has one of the strongest national networks in the country, and is in the top 5 largest providers of group disability, life and accident insurance in the US, based on premiums.
  - This network includes over 5,600 hospitals, and approximately 667,400 providers. CIGNA also has an impressive behavioral care network, with approximately 108,000 access points to independent psychiatrists, psychologists, and social workers, with 62,000 contracted pharmacies.
  - This immense national network gives CIGNA an immense buyer power with hospitals and physicians, which enables a low cost advantage for customers.
- Comprehensive Offerings
  - CIGNA offers a full range of health care and individual and group insurance plans and programs. This allows the company's operating subsidiaries to offer one of the greatest arrays of innovative products and services.
  - CIGNA's ability to be a virtual one-stop shop for health care and insurance plans gives the company a competitive edge.
- Growing International Business
  - CIGNA's rapidly expanding international business has been fairing handsomely over the last few years. In 2011, the international segment recorded revenues of \$3,113 million, an increase of 30.7% over 2010.
  - The growing revenues of the business, which come from the myriad of joint-venture agreements in order to sell a range of products around the world, helps mitigate the declining revenues from other weak segments, and lead to overall profitability for the company.
- Acquisitions
  - CIGNA has proven itself at making impressive acquisitions which have improved market access and profitability. Examples include HealthSpring,

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which is allowing CIGNA to compete within the Medicare market, as well as Great West, giving a larger presence in the small group and middle markets.

## Weaknesses

- Low financial rating increases financing costs
  - Currently, CIGNA suffers from mediocre credit ratings: ‘Baa2’ (Adequate) at Moody’s, ‘BBB’ (Adequate) with S&P, and ‘BBB’ (Good) at Fitch. The company’s lower ratings at the parent company level increases the cost of borrowing funds, and can adversely affects its subsidiaries new sales and retention of current business.<sup>xv</sup>
- High level of indebtedness hurts financial soundness
  - CIGNA’s long-term debt has increased significantly from FY2007-2012, with a compounded annual growth rate of 29% to \$4,990 million, with the company’s equity capital also increasing 15% during the same period. CIGNA’s high debt to equity ratio (worse when compared to Aetna, United Health Care, and WellPoint) has hurt its chances for more acquisitions due to reduced profits.
- Low exposure to Medicare Market
  - Despite CIGNA’s recent acquisition of HealthSpring for \$3.8 billion in January of 2012, this only increases its market of the managed care market by 3%, or 340,000 people. Previously, CIGNA only had 46,000 Medicare Advantage members. This marks a strategy reversal, as CIGNA virtually exited the Medicare Advantage market in 2011.

## Opportunities

- **Inclusion of uninsured population to drive membership base and business growth**
  - The US Census Bureau estimates that there are about 46.8 million uninsured people as of 2011. The Affordable Care Act mandates will increase the number of people into the health insurance market by approximately 30 million.

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- The ACA also contains provisions such as the expansion of Medicaid eligibility, subsidized insurance premiums, and incentives for businesses to provide health care benefits, which can also positively influence CIGNA's membership growth.
- **CIGNA's acquisition of HealthSpring is a good start for breaking into the Medicare market.**
  - As previously noted, CIGNA is greatly underrepresented in the Medicare Management market, with the acquisition of HealthSpring being its largest bet on the potential for profitability in this market. HealthSpring has 340,000 Medicare Advantage members in 11 states and D.C, as well as a prescription drug business serving 800,000 customers.
  - The aging demographics of the U.S. should help the HealthSpring acquisition improve its presence in the Medicare market. For instance, the number of those aged 65 or older will increase by 80% by 2030.
- **Demand for employee sponsored programs likely to increase**
  - Changing demographic shifts and rising health care costs are driving demand for innovative products and services that are cost-effective and flexible. Employers are expressing a growing interest in employee wellness due to findings of better health leading to increased productivity and profitability.
  - CIGNA is an industry leader in specialized employee sponsored programs, and is well positioned to deliver the integrated solutions needed to meet the needs of these employers and employees.
- **The rise of Administrative Services Only (ASO) Plans**
  - As a response to more cost effective solutions, many employers are turning to ASO plans to ensure their employees. These plans hold the employer exclusively liable for all the financial claims of employees up to a stop loss point (usually \$10,000), with the MCO acting merely as an administrator.
  - CIGNA is a leader in pursuing this rising trend, with much of its growth in its small and middle market stemming from ASO enrollment. This trend is also likely to accelerate, with traditional risk-based health premiums likely to rise.

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## Threats

- **Cigna faces intense competition from many market players**
  - CIGNA's competes primarily with large insurance companies, but also with stand-alone HMOs and PPOs, third-party administrators, national managed pharmacy, as well as behavioral health and utilization review service companies.
  - Despite CIGNA's impressively large network, the health care industry is a very fragmented market, with each company competing for a small local market due to individual state mandates. The nature of this competition makes absolute control of an area extremely difficult, leaving competitors in a position to strike a contested area.
  - The health care industry is also witnessing the emergence of a new group of competitors, who are focused on delivering employee benefits and services through Internet-enabled technology. They allow users to manage and play a more active role in their health. While CIGNA is working on providing internet tools for customers, these companies are increasing the IT race in the industry at a rapid pace.
- **Higher medical costs likely to impact profitability**
  - There are a myriad of factors which are raising the costs of managed care organizations. Medical costs are chronically increasing, with reimbursement rates to hospitals and physicians increasing as well. Reimbursement rates are likely to increase in the future, as hospital mergers become more likely and they command more buyer power in negotiations with CIGNA.
  - Another aspect of rising medical costs stem from the advances made in technology, which are allowing sick people to live longer. A large part of CIGNA's profitability stems from its ability to predict future health care costs and implement proper underwriting criteria. The rampant rise of advanced technology in the health care industry impacts CIGNA's

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forecasting ability throughout the health care system, making it harder to increase its premiums in line with costs and hurting profit margins.

- **The Affordable Care Act will also affect the operations and profitability of CIGNA.**
  - There are several provisions that will increase the costs for CIGNA. This includes an annual industry tax of \$8 billion with rising amounts every year, new taxes on medical devices, as well as annual fees on prescription drug manufacturers and higher coverage requirements.
  - The ACA changes the medical loss ratios for all commercial health plans to 80%, with companies having to return portions of their premiums to their customers each year if premiums are not spent on health care costs. This forces CIGNA to closely monitor its spending, and may force large changes in administration and internal operations, as well as program offerings.
  - In combination with the ban on lifetime and annual limits, the MLR may create stricter underwriting standards, and lessen the availability of successful plans, such as ASOs.
  - The creation of health insurance exchanges allows CIGNA to compete for millions of customers, but simultaneously cripples its ability to do so. This is because the new exchanges limit sources of differentiation by requiring minimum standards of coverage and limits the types of policies offered. Thus, CIGNA will not be able to fully capitalize on its market leading individual plans or marketing strategy.
- **Negative public perception may hurt CIGNA.**
  - Private health insurance companies have come under increasing scrutiny from the public and legislators alike due to the increasing costs of health care, while executives receive large bonuses. Negative publicity may further enact government scrutiny of industry practices and increase CIGNA's costs of doing business by affecting its ability to market its products and services.

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- Public perception is becoming more critical, especially as insurers compete for individual accounts, a group who are more aware of health insurer's brand name and reputation.

## STRATEGIC RECOMMENDATIONS

CIGNA currently embraces a three-pronged approach in its company strategy, “go deep, go individual, go global.” This translates into expanding and strengthening areas and markets which CIGNA already has an advantage in, both domestically and abroad, as well as engaging consumers on the individual level. Bridges Consulting Group agrees with these fundamental goals to growing business, and has identified key priorities in order for CIGNA to execute this strategy.

### **Strategies For Cost Savings Under the Affordable Care Act**

Firstly, CIGNA will need to implement both cost saving measures and improved health service outcomes in order to comply with the ACA Medical Loss Ratio mandates. As of this fall, CIGNA has already paid out millions of dollars to various states in the form of rebates due to their failure to meet these ratios.<sup>xvi</sup> CIGNA can help combat this problem through many approaches. Firstly, CIGNA should continue its focus on cutting medical costs, while increasing operational efficiencies, and negotiating favorable contracts with hospitals and physicians. It should continue to monitor and promote physicians and hospitals which deliver quality health care while still being cost prudent.

Furthermore, Bridges recommends increasing the focus on preventative care and holistic health management programs. While focusing on getting patients out of the hospital quicker and with better health results should be of prime importance, CIGNA should expand its wellness, preventive care, and chronic disease management programs in order to cut costs well into the future. Money spent for these programs also contributes to MLR targets. One way to do this includes the expansion of the collaborative accountable care (CAC) clinics, with 58 programs now being offered in 24 states. These clinics, which focus

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on preventative measures for and management of high risk patients with chronic diseases, provide great promise in their ability to achieve the triple aim of improved health, affordability, and patient experience, all while cutting medical costs.<sup>xvii</sup> Bridges believes in the further utilization of this model, as well as others that incentivize hitting targets for improving quality and lowering medical costs, such as health care plans with savings accounts. We believe that CIGNA is well on track to hit the 100 programs mark in 2014, and should expand further.

## **Invest in Technological Upgrades and Innovation**

Continual innovation in information technology will be of prime importance in helping CIGNA achieve its strategic goals. Improving the technical infrastructure of the company will convey a multitude of benefits and will allow CIGNA to implement the smartest and most efficient choices. In general, the success of CIGNA is inherently tied to the company's ability to provide accurate medical cost projections and charge appropriate risk based premiums. This essential function will only become more challenging as uncertainty from new regulations takes effect and medical service utilization becomes more volatile due to changes in medical technology. The health care industry marketplace is constantly evolving in complexity and breadth, and will require great enhancements in understanding all aspects of the patients' experience in order to formulate the most beneficial plans at the right price.

Upgrades in IT will also be crucial for CIGNA's ability in giving customers the data and resources needed to make decisions, as well to evaluate operational inefficiencies and areas for improvement. For example, technology is especially important for the success of collaborative accountable care clinics, whose care coordinators rely on patient- specific data that identifies those who were recently released from hospitals that are at risk for readmission, or patients who may be overdue for important health screenings or prescription refills.

Bridges also believes that technology improvements will help CIGNA attract and maintain customers. Currently, less than 3% of CIGNA's revenue comes from the individual market, with plans limited to ten states. The creation of state health exchanges by the ACA and the individual insurance mandate will have national health insurers compete



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for millions of individual accounts. In order to further penetrate the market, CIGNA must transition itself from an insurance provider that orients itself around large business entities to individuals. In doing so, CIGNA will need to rethink its customer relationships, as well as how it markets its products and services.

One vital step to success in the individual insurance market will revolve around CIGNA's ability to differentiate itself as a company that understands individuals' needs, and can formulate the most appropriate plans for them. This translates not only into an expansive arsenal of products and services to meet an individual's needs, but also ways to consult with the customer in order to make the right choice. Therefore, technology upgrades should not only include better data collection and analytics, but also improve communication between CIGNA and potential customers by utilizing social media platforms, online services, as well as mobile devices. Bridges applauds CIGNA's efforts in this regard, having won recognition for its online health care cost and quality systems by *InformationWeek*, such as its "Find Doctors and Services" engine which allows users to compare physicians costs based on the actual payout of claims, even at different hospitals.<sup>xviii</sup> However, the continual innovation in this field, including even more precise data and customizable options, are worthy areas for R&D spending.

## **Effective Marketing**

Bridges Consulting Group also believes CIGNA will need to continue its aggressive marketing campaigns in order to foster growth in the individual market. CIGNA's \$25 million "Go You" campaign correctly harnesses the feelings of consumers who wish to be recognized as distinct individuals capable of making their own choices, including their health care. Bridges believes the message the campaign is sending should help CIGNA with the negative public perception that generally shrouds health insurers, but believes its efficacy can be improved. We find that the advertisements optimistic, but sometimes vague mottos need to be combined with more concrete examples of CIGNA's ability to empower the consumer. For example, advertisements that have slogans such as "you were born an individual. Make sure you stay that way," should also be made to highlight CIGNA's industry leading customizable plans that customers enjoy, or the benefits of CignaMobile. Advertisements that start out with messages of self-fulfillment, "deep inside you there's a

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person who refuses to be kept deep inside you,” should end in a more tangible message. Bridges thinks it is important brand strategy to express the attention to service and personalization that CIGNA strives for. For instance, customers should know that with CIGNA, one can cost-compare medications covered in their health plan and search real-time drug prices at 60,000 pharmacies nationwide.<sup>xix</sup> This is in hopes of having CIGNA form a unique brand among the health care industries, which differentiates itself as the company which works the hardest to cater each individual’s specific needs.

## **International and Domestic Expansion Through M&A**

### **International and Expatriate**

In order to further fulfill the “go deep” as well as “go global” facets of the company’s strategy, CIGNA should continue to look for opportunistic acquisitions, mergers, and joint ventures both domestically and abroad. CIGNA is positioned for growth, and has grown rapidly in its geographic segments served and services offered with the aid of its past acquisitions. While the U.S. accounts for over 80% of global private health coverage, it represents only 4.6% of the population, leaving ample room for expansion. Abroad, CIGNA has lead the way in international expansion, and is the only insurer to have a meaningful expatriate coverage program. In addition, CIGNA was the first to tap the Indian market with the TTK joint venture, where private health coverage is only at 4%.

Bridges recommends that CIGNA continue its expansion globally in order to boost revenue, and advises that the company invest further into understanding international countries’ demographics and market conditions. Like the TTK agreement, CIGNA should partner with companies with strong brand names in those countries, and look for specific niche markets where there are gaps in coverage for consumers with relatively high incomes. It should also look for countries experiencing rapidly rising health care spending due to high rates of chronic diseases, as CIGNA will be able to leverage its health, prevention, and wellness management programs.

CIGNA should also concentrate on one of its fastest growing segments, the expatriate coverage market. After the \$400 million purchase of Belgium based Vanbreda international, CIGNA became the dominant insurer for those working in nongovernmental organizations and corporations, with a 32% increase in revenue from last year in this

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segment.<sup>xx</sup> While CIGNA is currently focused primarily on expansion in the Asian markets (China, India, Korea, Turkey), CIGNA should use its ties formed with the expatriate market to expand their market in Western Europe. This market should not be overlooked, with studies finding that Greece, Italy, Portugal and Spain represent the best opportunities. Getting a foothold in these countries before the competition should help CIGNA truly transition into its role as a global health care services provider.

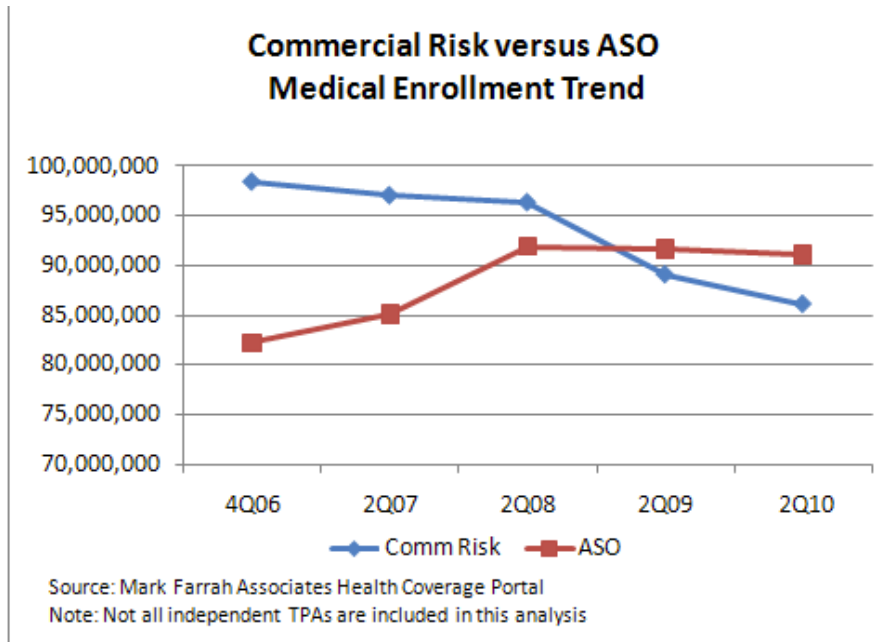
## Domestic Expansion

Domestically, two of CIGNA's most recent acquisitions, HealthSpring and Great-West Life & Annuity Insurance Company, have helped CIGNA gain traction in areas that will prove vital for the future. These include the rapidly expanding Medicare Advantage market, and the small to mid size markets, respectively. Through these activities CIGNA not only greatly expanded its network, but was also able to use the newly acquired HealthSpring pipeline to offer seniors an array of products. In addition, many smaller companies without the necessary economies of scale will be under financial distress due to the fines and taxes imposed by recent legislation. This should allow for attractive opportunities to acquire these firms, and these firms should be on CIGNA's radar.

Acquisitions should also be an instrument for increasing CIGNA's administrative services only (ASO) plans. As the economic recovery continues amidst the new health care regime, more companies, especially in the small and middle markets, are turning to ASO plans in order to have more control over their health care and to avoid a few reform obligations. Currently Cigna is the leader in the self-insured market, but major competitors such as Aetna are threatening market dominance with the recent \$600 million takeover of Prodigy. CIGNA must remain vigilant in its select and mid sized market growth strategy, and should proactively search for future acquisitions in this field. A rise in ASO business will also help balance out the risk pool, for the recent trend in ASO coverage has been skimming the healthiest out of the fully-insured pool, leaving risk based coverage with higher risk individuals.<sup>xxi</sup>

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Source: <http://www.markfarrah.com/healthcare-business-strategy/ASO-Products-for-Self-Insured-Companies-Continue-to-Surpass-Fully-Insured-Options.aspx>

The lead in this market is essential to maintain, for large nationals with relatively small exposure in this market have an advantage over regional insurers with mid-sized groups in risk products. This is because large insurers with small local share like CIGNA have a greater potential for this new market than the latter, which will face steeper challenges in converting their products and risk greater profit cannibalization.<sup>xxii</sup> Greater ASO business will also help defray the costs of services by demanding less capital costs in addition to presenting higher margins, and will help CIGNA hit its MLR target ratios. However, because the ASO market is also under the umbrella of the ACA reforms, including bans on lifetime and annual limits on certain services, and increasing loss ratios for reinsurers, there may be a tightening in the underwriting of these policies. It is important for CIGNA to take the charge in this market and offer an array of differentiated products in order to expand market share. Bridges recommends that CIGNA invest in its ability to create innovative plans that can mitigate the rising stop-loss premiums, such as by suggesting to customers they carry specified or critical illness policies in addition to their health benefit policies. This will increase the cost of self-insuring, but may still be an attractive policy compared to risk based products.

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## **Invest in Human Resources**

CIGNA is rapidly expanding and adding thousands of employees and managers to the company every year both abroad and internationally. With the multitude of new people in the company, it will be challenging to instill a sense of a shared purpose and mission. The addition of new people from a vast array of cultures should be one of CIGNA's strengths, rather than a bureaucratic nightmare. Therefore, Bridges advocates the harnessing of these new resources to inspire a culture of innovation and learning, by both connecting employees around the world and implementing training programs. CIGNA has already taken a great first step with its multilingual employee portal, which lets employees from various countries communicate with each other through blogs, videos, and audio podcasts.<sup>xxiii</sup> Bridges believes in further investing in this technological infrastructure, as well as creating incentives to generate quality content, so that colleagues can learn from each other and easily access shared knowledge.

Furthermore, CIGNA should continue and expand its formal training programs, especially for newly acquired employees. Leadership, segment management development, and direct marketing programs will allow CIGNA to draw upon its talented managers and employees to create a collaborative and growth-focused climate.

It is also essential for CIGNA to create management continuity as the company absorbs smaller firms, many of whom have differentiated business models and values. CIGNA must realize that the management which has lead to these successful businesses may have valuable roles in the CIGNA management team, and many of them contain specialized and in depth knowledge of their respective markets. This makes replacing these managers especially difficult, and instead, Bridges believes that CIGNA should create significant incentives to newly acquired management, ensuring these critical components stick around for more than the short period of time after the merger.

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