



Small Businesses at Risk:

How Entrepreneurs Slip Through the Health Care System's Cracks

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America's small businesses stand at the forefront of innovation. Our entrepreneurs are the first to adopt new technologies and take new approaches in old industries. As engines of job creation, small businesses are the leading edge that pushes our economy forward.

They are also, unfortunately, on the front lines of the health care crisis.

Many of the problems faced by small businesses are the same ones that plague our families: premiums that rise far faster than wages, endless red tape, and a bewildering insurance marketplace where consumers have few choices and even less bargaining power.

And where they face problems that differ – a whole business' premiums going up when one employee gets sick, the difficulty of recruiting and retaining good employees when health care is so expensive – these failures of our health care system can lead to small businesses shutting their doors, killing jobs and harming our economy.

To be sure, small businesses are not the only group who need health care reform. The unsustainable status quo burdens individuals and families, state and federal governments, as well as large and small businesses. But over 60 million Americans work for small businesses,¹ and the problems they encounter are a key component of the case for reform.

This issue brief examines the many ways our health care system fails small businesses across the country. In addition to drawing on research documenting the scope of these problems, we also include testimonials from small businesses that we have spoken to. Their stories illustrate the risk that health care poses for small businesses – and what needs to be done to fix it.

I – Rising Costs

Ask small business owners about health care, and the first thing they will talk about is the drumbeat of rising health care premiums, year after year after year.² Indeed, annual premiums for family coverage for employees of small businesses have more than doubled since 1999, growing at an

¹ U.S. Small Business Administration, 2006. http://www.sba.gov/advo/research/us_06ss.pdf

² U.S. PIRG Education Fund, *The Small Business Dilemma*, July 2009, available at <http://www.uspirg.org/home/reports/report-archives/health-care/health-care/the-small--business--dilemma---how-rising-health--care-costs-are-tough-on-small-business>.

average pace of over 12% per year.³ This increase occurred while median family incomes only rose 29% over the entire decade.⁴

These unsustainable increases are the fundamental problem that afflicts small businesses – maintaining coverage, much less offering richer benefits to their employees, takes an ever-increasing portion of their revenues. Hiring a new employee becomes more and more expensive, not just because wages increase but because health care premiums for new hires are unaffordable. Indeed, without reform, projections show that health care costs will force small businesses to cut 178,000 jobs by 2018.⁵ Lashed to such a treadmill, many businesses fall behind, forced either to drop coverage or close their doors.

And the problem will only get worse. MIT economist Jonathan Gruber has estimated that if we do nothing and allow health care costs to continue as they have been, small businesses will spend twice as much as they do now by the end of the next decade.⁶ Unless business' earnings somehow also double, that rise represents a significant barrier to entrepreneurs starting new small businesses, and an ongoing drain on existing establishments.

“We used to pay 100% of the health insurance premiums for our employees; however, after a 17% increase in premiums last year and an additional increase of 18% this year, we had to ask employees to begin contributing to their health insurance payments. Our employees struggle to pay their share of health insurance premiums and the \$50 co-pay for every doctor’s visit on their salary.”

*Paul Nippes,
Just Kidding Around,
Montclair, NJ*

II – Declining Coverage

A natural consequence of the ongoing rise in small business health care costs is the decreasing proportion of firms who are able to offer benefits to their employees. Unsurprisingly, the percentage of small businesses who offer health care coverage has declined from 68% in 2000 to 59% currently.⁷

While some employees are able to find coverage nonetheless, many cannot. It is not simply a matter of hard-hearted businesspeople refusing to cover their employees to protect their bottom lines. Some small business owners have alternate sources of coverage, for example through a spouse. But many do not – and when they cannot afford health care for their business, they as well

³ Henry J. Kaiser Foundation, *Employer Health Benefits 2009 Annual Survey*, available at <http://ehbs.kff.org/>.

⁴ U.S. Census Bureau

⁵ Small Business Majority, *The Economic Impact of Health Care Reform on Small Business*, June 2009, available at http://www.smallbusinessmajority.org/econ_research.php.

⁶ *Id.*, p. 7.

⁷ *Employer Health Benefits 2009 Annual Survey*.

as their employees must go uninsured or seek coverage on the expensive, poorly-regulated individual market.

Today, 26 million of America's 46 million uninsured are small business owners, employees, and their dependents.⁸ That so many workers are unable to obtain affordable health care is dramatic proof of the failures of the system.

“All our employees have coverage but it's too expensive. Last year, I asked my employees to take a pay cut or hold onto insurance. One employee wanted to keep the insurance and was the only one and finally decided against it. He was in the emergency room one week later and just finished paying off his bill last week.”

*Jason Hughes,
Sonic Boom Records,
Seattle, WA*

III – Attracting and Retaining Good Employees

Health care costs pose problems beyond those that simply show up on business' ledgers. In order to prosper, small businesses need to be able to attract and keep high-quality employees. Health care is a key benefit and those businesses who do not offer coverage are at a significant disadvantage. A recent survey of small business owners, conducted by U.S. PIRG, found that 55% of those who offered coverage cited attracting and retaining good employees as a primary reason for offering coverage.⁹

Ironically, health benefits can also make it harder to offer the wage increases necessary to retain workers. If a small business increases its personnel costs to keep up with rising health care premiums, it will be less able to give employees a raise. Over time, these choices add up. From 2009 to 2018, the aggregate loss to small business employees' wages due to health care costs will total \$834 billion.¹⁰

“Health care makes up 20% of the total amount I pay in compensation – up from only 12% of compensation. Health care costs eat up money that I could use to give my workers raises or to hire more staff.”

*Tom Campbell,
Regulator Bookstore,
Durham, NC.*

⁸ Health Benefit Research Institute and the Kaiser Family Foundation, *2008 Annual Survey of Health Benefits*, September 2008.

⁹ *The Small Business Dilemma*.

¹⁰ *Economic Impact of Health Care Reform on Small Business*

IV – Low Bargaining Power

Small businesses know that the best way to keep costs down is to shop around. But this is no panacea for the ills that plague our health care system. Due to consolidation among health insurance companies, ninety-four percent of state health insurance markets qualify as “highly concentrated” under U.S. Department of Justice antitrust guidelines.¹¹ That means that there are not many insurance options to begin with.

And once a small business does start exploring its few options, it finds that there are fewer good ones. Small employers have much less bargaining power than larger firms. Increased administrative costs also decrease the value of the benefits they are able to negotiate. The result is that small businesses pay 18 percent more than larger businesses would for the exact same policy – a penalty entrepreneurs can’t avoid merely because the size of their business lets insurers treat them like small fry.¹²

“We offer health care for our employees and it’s very expensive. It gets harder and harder to provide health insurance for employees, especially when the biggest businesses can negotiate a reasonable rate but small businesses, like us, can’t. The insurance companies are dictating what to charge us. This money is taking away from our family, our kids’ college education, and our food.”

*Nancy Glick,
Dalmco Optical,
Pittsburgh, PA*

V – When Sickness Strikes

As bad as the picture is for many small businesses, it gets worse when the owner or an employee gets sick. With a “pre-existing condition” in an owner or employee’s medical history, a business’ ability to get a fair deal is reduced even further. In many states, insurers may refuse to cover the offending medical condition for a year, leaving the employee without coverage just when he or she most needs help.

Further, because insurers adjust their rates based on the overall health of a business’ employees, an employee’s sickness can mean raised premiums for everyone. Along similar lines, businesses that have a workforce that’s older on average can face substantially higher rates compared to a younger company.

¹¹ American Medical Association, *Competition in Health Insurance: A Comprehensive Study of U.S. Markets: 2008 Update*.

¹² Commonwealth Fund, *Benefits and Premiums in Job-based Health Insurance*, May 2006, available at http://www.commonwealthfund.org/usr_doc/Gabel_benefitspremiumsjobbased_925_itl.pdf.

The power insurance companies have to dictate rates is exacerbated by the weak bargaining power of small firms, discussed above. For a business unlucky enough to have an employee who actually needs to use their expensive health care, things can get even worse.

“Because of the economy, we’ve had to cut back on coverage, adding higher deductibles and co-pays. It’s so expensive to use that last year I had an employee who wound not using the company coverage, even though we pay for it. The premiums keep going up, but we can’t move to a new health insurer because pre-existing conditions mean we won’t be able to get anything better.”

*Sue Zuege
Perennial Tea Room
Seattle, WA*

Conclusion

America’s small businesses are critical to our welfare, pioneering new technologies and approaches while creating the jobs that keep our economy growing. But our current health care crisis is putting their unique role at risk. Left unchanged, the status quo will drive small businesses into the red, kill jobs, stifle wages, and see many hard-working American entrepreneurs and employees without coverage when they get sick.

There are few more drastic illustrations of the need for health care reform than the challenges faced by our small businesses. Fortunately, the reforms currently under consideration in Congress address small business’ needs. Reforms approved by key committees would:

- Help small businesses to pool their bargaining power when buying insurance through new buying pools called exchanges.
- Set new rating rules on insurers that would prevent them from jacking up small business’ rates when one employee gets sick.
- Offer tax credits to help small businesses provide health insurance to cover their employees.
- And a public health insurance option would give them the choice of a high-quality, low-cost plan and force private insurers to compete for small employers’ business.

These changes will make our small businesses stronger, lowering their health care costs and keeping their employees healthier. When employees have health care, absenteeism declines and productivity increases. Lowered health costs will make it easier for entrepreneurs to hire new workers and create jobs, boosting the economy.

The stories contained in this report are only a sampling of those small business owners who are worried that their success will be prevented not by any lack of business acumen but rather by a

failed health care system. Small business will not be the only beneficiaries of reform, but these policies would help every single one of them – and all the rest of the small businesses across America.