Cigna Corporation Client Report

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Executive Summary

Cigna is a global health insurance service company that offers health, life, accident, and dental insurance as well as related products to both individual and business customers. Cigna represents one of the top five largest health service companies in the U.S. in terms of enrollment, covering around 14 million Americans. In addition, Cigna has considerable international operations as it sells supplemental health, life, and accident insurance to approximately 7 million people internationally and covers 1.2 million expatriate customers. Cigna offers general and specialty coverage across a range of insurance areas including dental, vision, pharmacy, behavioral health, and disability insurance. These offerings are provided exclusively through operating subsidies and include preferred provider organization (PPO), health maintenance organization (HMO), point of service (POS), and administrative services only (ASO) or self-funded plans. Cigna has three primary business segments: Global Health Care, Global Supplemental Benefits, and Group Disability and Life. With its proclaimed business strategy of "Go Deep, Go Global, Go Individual," Cigna has driven steady revenue growth in recent years through (1) strategic acquisitions, (2) securing premium increases, and (3) international growth.

Cigna's recent growth, however, faces a number of challenges in the shape of recent health care reform and other market-changing forces like rising medical costs and the emergence of more consumer-driven health care models. Cigna's strong reliance on ASO and self-funded plans provides it a competitive advantage relative to its peers and partially insulates it against the impact of health care reform and rising medical costs. Cigna is well-positioned to withstand many of these threats and, with further investment and focus on key weakness areas, it can make the necessary pivots to capitalize on the changing environment. To deliver on this strategy, DangerZone recommends Cigna focus on continued international expansion into untapped, high growth markets; pursue acquisitions of domestic firms, especially ASO focused companies; invest in digital and information technology to further enhance consumer engagement and plan customization and personalization; leverage its acquisition of HealthSpring Inc. to expand its operations in the growing Medicare Advantage market; and further develop value-based, risk-sharing arrangements with health care providers to incentivize improved care and lower costs.

Company History

In the past 30 plus years of business, Cigna has grown into one of the largest companies in the health care industry and currently ranks 130 in the Fortune 500. The company has moved away from its initial business focus of property and casualty insurance and has committed itself strongly to global and group health care provision with its Global Health Care segment representing 78% of revenues. A great deal of Cigna's business stems from selling plans to large employers and in particular, from self-funded, ASO plans in which Cigna administers health plans for employers but the employers themselves are responsible for paying the medical claims of their employees. Nearly 85% of Cigna's U.S. commercial customers are enrolled in ASO plans.[1] In addition to substantial domestic operations, Cigna in recent years has seen a considerable expansion of its international business with entry into new, high growth markets. Overall, Cigna collects over $32 billion in annual revenue, manages $54 billion in assets, has a market capitalization of $22.08 billion with 276.41 million shares outstanding, employs around 35,000 employees worldwide, has close to 75 million global customer relationships, and sells its health care products and services in over 30 countries.[2]

Cigna Corporation was founded in 1982 through the merger of Connecticut General Corporation and Insurance Company of North America. While Cigna has only been in business for slightly more than 30 years, Insurance Company of North America (INA) had been operating for close to 200 years, formed in 1792 as the first marine insurance company in the United States. In addition, Connecticut General Corporation (CG) was established in 1865 as a life insurance company. This merger brought together a major property and casualty insurer, INA, with a prominent supplier of life insurance and employee benefits, CG. In its early years, Cigna acquired a number of companies operating in various insurance markets including Dental Health Inc. (dental), MCC Companies (mental health and substance abuse), and American Foreign Insurance Association, all of which expanded and diversified Cigna's business. Cigna launched an extremely successful and innovative health and dental care plan to Allied-Signal that initially covered 37,000 employees but its success led to enrollment climbing to over 110,000 within 3 years. Following this prosperous foray into employee benefits, Cigna made a major acquisition

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[1] Cigna 10-K 2013.
[2] "Cigna Fact Sheet." Cigna.com

in 1990 with its purchase of EQUICOR which at the time was the sixth-largest provider of employee benefits. [3]

Despite an initial focus on life, property, and casualty insurance, Cigna in the years following its formation began to shift its operations away from these areas and refocused on group health care and related benefits. In line with this new direction, Cigna sold its individual life insurance and annuities business in 1998 and the next year its domestic and international property-casualty businesses. Continuing with its desire to concentrate on its core business, Cigna sold its domestic accidental death, individual life, and group life reinsurance businesses in 2000 and in 2004, its retirement benefits business. Cigna also launched several new health care offerings in 2004 including CIGNATURE suite of products and Cigna Choice Fund and in 2007 Cigna formed its Health Solutions unit. As Cigna continued to evolve as a leading health insurer, it acquired Great-West Health Care and with it a significant network of hospitals and health care professionals including 4,275 hospitals and over 575,000 physicians. In 2006, Cigna made its entrance into the Medicare market by agreeing to jointly issue Part D prescription drug benefits with NationsHealth.[4]

In 2009, Cigna made history as the first and only health service company to provide around the clock access (24 hours a day everyday) to live representatives for its health plan customers. That same year Cigna launched its first comprehensive health care product in China. Cigna acquired Vanbreda International in 2010 which made Cigna the leader in providing benefits to people living abroad. Continuing its international expansion, Cigna established operations in Singapore, Turkey, and India in 2011. More significantly, Cigna paid $3.8 billion to acquire HealthSpring Inc. in an attempt to dramatically grow its senior and Medicare business segments from 46,000 Medicare members to close to 400,000 members. Cigna also relocated its headquarters to Bloomfield, Connecticut in 2011, moving them away from Philadelphia where they had located been since Cigna's inception.[5]

[3] "Cigna Milestones." Cigna.com
[4] "Cigna Milestones." Cigna.com.
[5] "Cigna Milestones." Cigna.com.

Financial Analysis

Profitability & Shareholder Returns

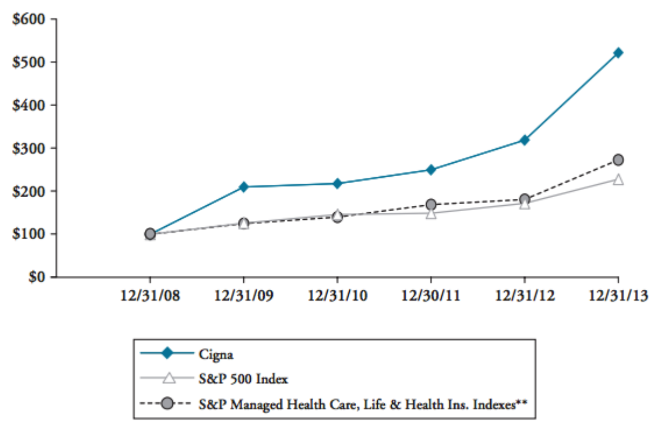
Cigna has achieved four straight years of growth, which is attributed to the company's ability to identify and target new opportunities in high growth markets, largely overseas. From 2012 to 2013, Cigna's revenues increased 11.20% from $29.12 billion to $32.38 billion. This growth is above the industry median of 7.37% but represents a downgrade from the 33.15% growth Cigna had the previous year, although most of this extremely high growth was due to the acquisition of HealthSpring in 2012. For 2013, Cigna posted smaller growth than two of its three main competitors and this slower revenue growth in comparison to its competitors can be attributed in part to its reliance on self-funded plans which tend to provide smaller, slower growth premiums than fully-funded plans.[6] Nonetheless, Cigna's 36-month revenue growth, largely fueled by acquisitions and international growth, outpaced its major competitors (Aetna, UnitedHealth Group, WellPoint). Net income fell over the past year from $1.62 billion to $1.48 billion. Despite this drop, Cigna's prospects going forward are encouraging with healthy projected growth in revenue and earnings.

The vast majority of Cigna's revenue comes from Global Health Care, with Global Supplemental Benefits and Group Disability and Life representing a comparatively small part of the company. Global Health Care premiums and fees provided a bulk (over 70%) of 2013 revenue but also displayed the lowest growth in both premiums and income from operations amongst the three business segments. Global Supplemental Benefits displayed the strongest growth with a 27% increase in premiums and fees in the last year. Such growth can be credited to strong customer growth in South Korea, Cigna's largest international market, and to the joint venture with Turkey's Finansbank. In comparison, Global Health Care only experienced 9% growth in premiums and fees.[7] Within each division, the majority of revenue comes from premiums and fees, while the rest comes from investment income, mail order pharmacies, and investment gains. In 2013, Cigna increased the number of global customers from 14,045,000 to 14,217,000, resulting in an increase in premiums and fees collected. Cigna also experienced a higher volume of mail orders to its pharmacy for specialty medications.

[6] Cigna 10-K 2013.
[7] Cigna 10-K 2013.

Cigna's reduction in net income from $1.62 billion in 2012 to $1.48 billion in 2013 dropped return on equity to 14.52%, below the industry average of 15.32%. This drop in net income is largely due to an after-tax charge of $507 million related to the February 4 reinsurance agreement with Berkshire. Increased income from operations mitigated this partially, and given that this reinsurance payment is a one-time occurrence, the slight dip in net income should not be viewed as a serious problem. Looking at the 5-year return on equity, Cigna's 18.8% exceeds the industry's 16.48%, implying solid returns to shareholders.[8]

Five Year Cumulative Total Shareholder Return*
December 31, 2008 – December 31, 2013



	12/31/08	12/31/09	12/31/10	12/30/11	12/31/12	12/31/13
Cigna	$ 100	$ 210	$ 218	$ 250	$ 319	$ 522
S&P 500 Index	$ 100	$ 126	$ 146	$ 149	$ 172	$ 228
S&P Managed Health Care, Life & Health Ins. Indexes**	$ 100	$ 125	$ 140	$ 169	$ 181	$ 273

* *Assumes that the value of the investment in Cigna common stock and each index was $100 on December 31, 2008 and that all dividends were reinvested.*
** *Weighted average of S&P Managed Health Care (75%) and Life and Health Insurance (25%) Indexes.*

Source: Cigna 10-K 2013

Liquidity & Solvency

	Cigna	Aetna	UnitedHealth Group	WellPoint	Industry Median
Current Ratio	1.17	0.77	0.73	--	0.83
Debt/Equity	0.50	0.59	0.52	0.59	0.53

Source: Hoovers Cigna Competitive Landscape Report 2014

[8] Cigna 10-K 2013.

Cigna has solid liquidity, as its current ratio of 1.17 is well above the industry median of 0.83. This liquidity allows the company to pay off short-term liabilities without resorting to alternative financing measures. As of 2013, Cigna reported close to $2.8 billion of cash on hand which will be sure to solidify its ability to pay off short-term liabilities. With a debt-to-equity ratio of 0.50 falling below the industry's 0.53, Cigna relies slightly less on debt to finance its operations than its competition. That being said, Cigna's long-term debt has increased substantially in the past several years, moving from $2.29 billion in 2010 to $5.01 billion in 2013.[9] Cigna's debt-to-equity ratio has also jumped in recent years in line with this increase in debt. These spikes in debt will decrease Cigna's solvency and increase its risk for lenders which may translate to higher interest payments for Cigna going forward. Nonetheless, Cigna remains around the industry median for debt-to-equity. The industry as a whole relies less on debt and carries considerable cash in order to maintain solvency in the face of market risk exposure that many firms confront due to reliance on investments and investment income. Furthermore, insurers such as Cigna need to keep debt in check so that if medical claims in a particular year are surprisingly high and exceed revenue from premiums, the insurers can remain solvent and have the needed assets and reserves to pay off the medical expenses. Thus, the low debt-to-equity and high current ratio suggest that Cigna is financially sound in terms of its liquidity and solvency.

However, the solvency and profitability of health insurance companies has recently been the focus of increased scrutiny as industry costs are projected to rise 5-6% as a result of health care reform.[10] In particular, the $8 billion health insurance industry fee starting this year will be an additional burden on Cigna. Cigna's share of the fee is determined by its proportion of premiums to industry total and is expected to be $230 million in 2014, $130 million attributed to commercial business and $100 million related to Cigna's Medicare business.[11] In addition to increases in costs as part of the recent reform, the ACA also has imposed mandated floors on insurers' medical loss ratios. These ratios represent what percentage of premiums is spent on medical claims and activities geared towards increasing quality of care. For individual and small-group plans, the minimum ratio is 80% and for larger plans, it jumps to 85%. Administrative costs and profit represent the remaining 15-20%. With this requirement, the reform effectively

[9] Cigna 10-K 2013.
[10] "National Health Expenditure Projections 2012-2022." *Centers for Medicare and Medicaid Services*. 2012.
[11] Cigna 10-K 2013.

puts a cap on profit for many insurers and will force insurers to pay rebates back to customers if they do not meet their minimum ratio. This mandate will likely impact insurer profitability considerably going forward while also encouraging administrative cost reductions.

Despite these threats, Cigna's financial prospects are encouraging going forward. By continuing strategic expansion into high growth markets, Cigna will ensure liquidity and solvency and overcome any issues that health care reform and rising health care costs may cause. The company's earnings are projected to grow 5% next year and 10% in the next 5 years, reaffirming the fact that growing revenues and solid financials across the board make Cigna a stable company. For 2014, Standard & Poor's projects firm-wide premium and fee revenue to grow by 6%, with strong, continued growth in the Global Supplemental Benefits segment as Cigna expands penetration in emerging markets.[12] Furthermore, Cigna benefits from projections of increased enrollment in the Global Health Care segment due primarily to strong growth in Medicare Advantage and International membership which will help to offset estimated declines in fully-funded commercial enrollment. Overall, analysts are optimistic for Cigna in coming years due to its diverse product offerings and commitment to pursue growing markets.

DuPont Analysis

	Cigna	**Aetna**	**UnitedHealth Group**	**WellPoint**	**Industry Median**
Net Profit Margin	4.56%	4.05%	4.59%	3.51%	3.21%
ROE	14.52%	15.67%	17.76%	10.25%	12.50%
ROA	2.73%	4.19%	6.91%	4.20%	4.47%
Asset Turnover	0.60	1.04	1.51	1.20	1.39
Total Debt/Equity	0.50	0.59	0.52	0.59	0.53

Source: Hoovers Cigna Competitive Landscape Report 2014

[12] "Cigna Corp Stock Report." *S&P Capital IQ*. 12 Apr. 2014.

ROE = Profit Margin * Total Asset Turnover * Equity Multiplier

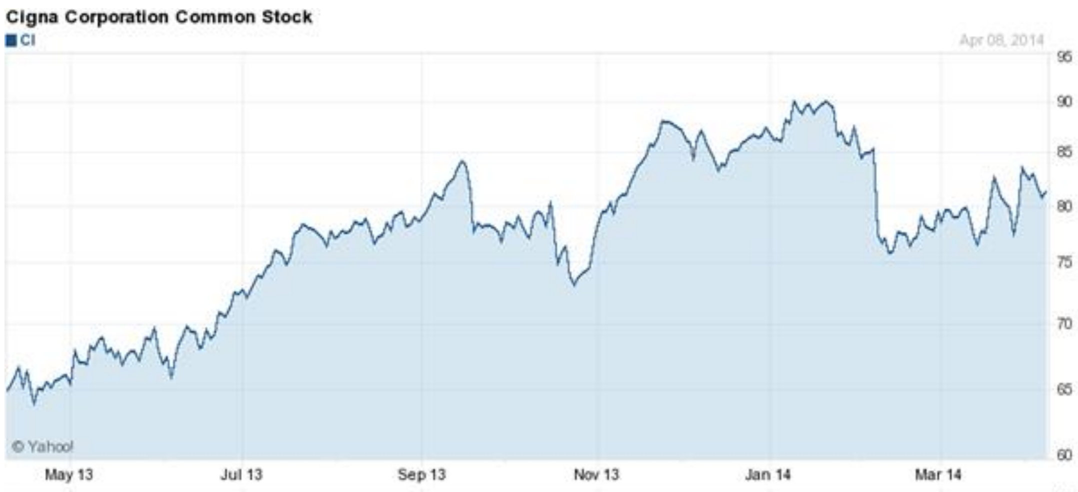
Profit margin measures operating efficiency, and Cigna's profit margin exceeds the profit margins of two of its three closest competitors and is well above the industry median margin. This high margin suggests that Cigna's operations are well-managed and the company is minimizing costs. Total asset turnover tells the amount of revenues generated for each dollar of assets. Cigna has a low asset turnover compared to its competitors and the industry as a whole. This could mean that Cigna is not efficiently generating revenue from its assets, but rather this is more likely explained by Cigna's high total assets compared to many other industry players and its reliance on self-funded plans which tend to offer lower premium revenue than the fully-funded plans that many of its competitors rely heavily upon.

The equity multiplier describes how levered the company is; high leverage means that the company is using a lot of debt, rather than equity, to finance its operations. Cigna's leverage of 0.50 is in line with its competitors and reflects industry tendencies to keep debt levels low. All of these components together show that Cigna's return on equity is above the industry median and is close to its competition's. These statistics are encouraging for Cigna's profitability, as the firm is using investor money to successfully generate revenue and returns for shareholders. Cigna's moderate leverage increases its stability and will help ensure long-term solvency.

Stock Performance

Cigna (NYSE: CI) currently trades around $81 per share at an average volume of 2,223,340, with a 52 week low of $63.03 and high of $90.63. Its market capitalization is $22.08 billion. Cigna trades at a price-to-earnings (P/E) ratio of 15.58, which exceeds the ratios of Aetna, UnitedHealth Group and WellPoint, indicating the market projects slightly more future growth from Cigna than from its competitors.[13]

[13] "Cigna Company Profile." *Yahoo! Finance*.



Source: Yahoo! Finance

Cigna's stock has performed quite well this past year with growth around 25%. The stock price did show two modest downturns during the year, mostly the result of reported earnings falling short of analyst expectations. However, analysts remain optimistic about Cigna going forward with 50% of Yahoo! Finance analysts recommending either buy or strong buy.[14] The other half all advocate for holding Cigna stock. Such opinions are based off expected growth in Cigna's revenues in coming months with increased membership in targeted markets. Cigna's expanding operations in the Medicare Advantage are encouraging for many stock experts who perceive these efforts as an opportunity to profit from the current demographic shift in the United States as the Baby Boomer generation approaches Medicare and Medicaid eligibility.[15]

[14] "Cigna Analyst Opinions." *Yahoo! Finance*.
[15] "Cigna Corp Stock Report." *S&P Capital IQ*. 12 Apr. 2014.

Five Forces Analysis

Internal Rivalry

While Cigna sells a variety of insurance products and services in a number of markets, it derives the largest share of its revenues from the domestic health insurance market and hence, that will be the industry analyzed in this section. Cigna finds itself in an industry that is currently subject to increasing competition due to continuing industry consolidation propelled by economic and political trends as well as the recent introduction of new health insurance exchanges under the Patient Protection and Affordable Care Act. In this ultra-competitive segment, Cigna competes with industry giants such as Aetna, Blue Cross and Blue Shield Association, Humana, WellPoint and UnitedHealth Group. Cigna ranks fifth in enrollment and is the third largest health insurer and managed care organization in the United States with over 75 million customers. Traditionally, while no one health insurer has been able to capture an overwhelming national market share, regional health insurance markets are often highly concentrated with one insurer accounting for over 50% of the market, though the degree of concentration tends to vary geographically. In 2012, two insurers covered more than half of the individual market in 45 states. In 29 states, a single insurer covered 50% or more of all enrollees.[16]

The new health care reform has injected more competition into health insurance markets nationwide by reducing product differentiation and in effect commoditizing health care insurance. Insurance companies as part of their application to sell their products on the public exchanges are instructed to create standardized insurance policies that are then made available online to consumers who can compare the costs and benefits of the plans. In New York alone, the estimated 1.1 million New Yorkers who are expected to buy health insurance through the state's online exchange have a choice of over 17 different health plans.[17] In this case, an insurance company's success will depend on their ability to attract the right mix of health care consumers and keep these customers away from competitors. According to Cigna’s annual report the company has taken a “focused approach “ to public insurance exchanges and participates in

[16] Sperling, Gene. "If You Like Choice, Competition and Entrepreneurship, You Should Like Obamacare." *Forbes* 28 Mar. 2014.

[17] "Startup Insurers Compete on State Exchange." *Crain's New York Business*. 11 Nov. 2013.

only 5 of its strongest states.[18] With consumer switching costs decreasing and the government providing income-based subsidies, consumers are increasingly focusing on choosing the plan with the lowest premiums, forcing insurers to compete more on price than in previous market environments.

Competition also arises from smaller regional or specialty companies who possess strength in a particular geographic area or product line such as administrative service firms and, indirectly, self-insurers. In addition to these traditional competitors, a new group of competitors is emerging. These new firms are focused on delivering employee benefits and services through Internet-enabled technology that allows consumers to take a more active role in the management of their health through financial incentives, access to enhanced medical quality data, and other information sharing. At the same time, major hospital systems have also been considering entrance into the insurance market which would introduce another new form of competition.[19]

With competition in the industry intensifying, current market players have to pay particular attention to key competitive factors that will help them maintain their market share and profit margins. Such factors include: quality and cost-effectiveness of service and provider networks; effectiveness of medical care management; product responsiveness to the needs of customers; price; cost-containment services; technology; and effectiveness of marketing and sales.

Entry and Exit

The barriers to entry into the insurance business are quite high. In order to establish themselves in the industry, new entrants face considerable administrative costs related to the creation of a strong customer base as well as an effective network of hospitals and other health care providers. In addition, a new firm would also need to raise considerable capital in order to maintain the substantial amount of cash reserves needed to remain solvent in the event of unexpected increases in medical claims. The fragmented and geographic nature of the insurance industry will create further challenges for new entrants. As discussed previously, firms compete with one another in order to become the primary provider in the regions where they operate. Therefore,

[18] Cigna 10-K 2013.
[19] "Health Insurance Carriers Business Challenges." *Hoovers.* 2014.

new entrants would have to struggle with an already established major player and find some strategy to steal members away from this dominant firm.

In addition, economies of scale are key to the success of the health care industry's largest players. In pursuit of capitalizing on these economies of scale, major insurers such as Cigna are committed to establishing vast networks of health care providers and services while simultaneously streamlining operations. By increasing the scale of its operations through expanding network size and increasing enrollment, large market players are able to capture advantages in regards to negotiations of contracts between the insurer and providers. In many of the contracts between provider and payor, the insurer agrees to pay predetermined monthly rates to providers regardless of the costs the providers actually incur, an arrangement which incents payors to contain costs. Larger insurers possess greater bargaining power in these negotiations because of their sizable enrollment which could represent a major source of business for providers. As such, these economies of scale that major insurers enjoy can help them to attain a low cost advantage by allowing them to bully providers into agreeing to more favorable contracts.

Furthermore, the passage of the ACA and its many new regulations regarding the health care industry will further discourage new market entrants. As part of the reform, insurers will face a number of new threats to profitability including a sizable increase to industry taxes, escalating from $8 billion in 2014 to $14.3 billion in 2018.[20] At the same time, the required MLR floors will drastically reduce the ability of major insurers to engage in profit enlarging practices as the MLR floor essentially sets a cap on profitability. The addition of these regulations will make earning consistent profits more difficult and decrease the appeal of entrance into an increasingly competitive industry that is characterized by high barriers to entry and economies of scale. As such, threat of new entry for the health care insurance industry will be rather low.

Buyer Power

Within the health insurance industry there are three identifiable buyers, each with varying levels of power – individuals, businesses, and the government. In the United States, health insurance is

[20] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

typically provided by an individual's employer. Large corporate clients that pay millions of dollars a year in insurance premiums have a considerable amount of bargaining power given that insurers will greatly demand their business for the high margins and revenues that it can provide. Traditionally, small businesses and individuals have had relatively low buyer power as they were offered a small choice set of plans each with predetermined premiums and network access. The buyer power of these smaller entities can also vary considerably depending on the region in which they are located. Some markets have many suppliers, all of whom offer a variety of plans, while other regions have one major insurance provider who can exert considerable power over consumers in that market.

That being said, the passage of ACA and the subsequent creation of the exchanges has helped to expand the buyer market. The public and private exchanges provide consumers with a platform to easily compare the different plans that insurers are offering. In addition, widespread access to the Internet has further facilitated individuals' ability to gather information on plans available to them. The reforms that set forth guidelines for firms offering products on the public exchanges largely limit the freedom of companies to offer personalized insurance plans and also make insurers legally obligated to cover customers with preexisting conditions, thereby limiting their ability to price discriminate for higher profit margins. As such, the public exchanges encourage insurers to provide similar quality plans and to compete on price to attract consumers, thereby increasing buyer power.[21] In regards to the private exchanges, due to shifting demand by consumers for more personalized products, many insurers have started to craft and customize their offerings around consumer preferences and needs. In this marketplace, buyers can compare a variety of different insurance plans and choose the one that best suits their needs. Within the private exchanges, insurers compete much more on the characteristics and type of plan. In both of these exchanges, individual buyers now have considerably more power in terms of the variety of the prices and options from which they can choose. More generally, with a high number of insurers offering diverse arrays of products, buyers have a much easier time switching plans due to the multitude of comparable options out there.

[21] Bernadette Fernandez and Annie Mach. "Health Insurance Exchanges Under the Patient Protection and Affordable Care Act." *Congressional Research Service*. 31 Jan. 2013.

With the passage of the ACA, the government has become an important buyer within the industry, especially for firms that have significant offerings on the Medicare exchanges. The U.S. government selects insurers to provide Medicare, Medicaid, and other government plans through a bidding process in the third and fourth quarters of each year.[22] The government chooses insurers based largely on price and as a result, it can exert a much stronger control over the premiums and fees that insurers charge. This buyer power will only expand in coming years as private insurers compete with one another for the increasingly more populated pool of Medicare and Medicaid accounts. In summary, due to a number of factors including reform and an aging population, buyer power for consumers of all sizes stands to increase.

Supplier Power

The primary health insurance industry suppliers are the doctors, hospitals, and medical equipment and pharmaceutical manufacturers who actually provide individuals with the medical devices, drugs, and care they need. The relationship between providers and insurers is one of mutual dependence as each side requires the services of the other in order to successfully run their business. This dependence creates an interesting relationship dynamic in that both sides realize they need the other but each still wants to gain the upper hand in their dealings in order to increase profitability. As a result, the two sides engage in fierce negotiations regarding how much insurers pay to providers for the services they offer to covered individuals. Typically, because insurers through their offerings can dictate which hospitals, doctors, and drugs customers are allowed to use, the insurers often have the advantage in negotiating power. That is, suppliers will yield some of their power in order to remain an active member in the insurer's network and ensure that covered individuals will come to them for care. However, this balance of power can shift in regions where hospitals have consolidated significantly.

In addition to the health care providers, the health insurance industry also deals with another supplier, reinsurance firms. Insurers need access to reinsurance in order to profitably write business. In the U.S., state insurance regulations only allow insurers to issue policies with a maximum limit of 10% of their net worth, unless those policies are reinsured.[23] With

[22] "Medicare Advantage Fact Sheet." *Kaiser.* 25 Nov. 2013.
[23] "Reinsurance." *Insurance Information Network of California*. 1 Jan 2013.

reinsurance, health insurers pay premiums to reinsurers to insure their policies so that if those policies come due, the reinsurer will pay for some of the medical claims associated with the policy. As a result, the insurer can issue policies with higher limits than would otherwise be allowed, thus being able to take on more risk because some of that risk is now transferred to the reinsurer. These reinsurers have moderate power over the health insurers because without them, health insurers are limited in the amount of coverage that they can provide to customers.

Threat of Substitutes and Complements

Currently, the threat of substitute products or services is not a significant factor in the health insurance industry. The recent reform states that individuals can no longer opt out of having health insurance and are required under threat of fine to either be enrolled in an employee sponsored program, purchase insurance from a private provider, or sign up for Medicare or Medicaid. Therefore, the alternative option to insurance would be to pay the fine and then also pay large out-of-pocket fees for any medical care. In light of this unattractive option, most individuals have little choice but to buy insurance.

In terms of providers of insurance, managed care organizations such as Cigna have become the dominant coverage system for Americans. Due to the expansion of these major insurers, consumers have no real alternatives but to buy from these firms. However, the recent health care reform may provide an opportunity for an alternative business model for insurance provision. The ACA established the Consumer Operated and Oriented Plan which is a new form of nonprofit health insurer run by its customers. Small businesses and groups of individuals now have the option to apply for federal loans to form a CO-OP in which the individuals associated are able to work together to offer affordable and consumer focused health insurance.[24] Such a setup could serve as a substitute for the traditional managed care organizations such as Cigna, in that individuals could work with each other for their care provision rather than having to buy insurance from the standard insurers.

[24] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

SWOT Analysis

Strengths	**Weaknesses**
Extensive health care network grants low cost advantage	Low penetration into Medicare Advantage market
Diverse and expansive product offerings	Mediocre financial ratings and higher levels of debt impact borrowing ability
Strong international and expatriate business	Greater exposure to market risk due to reliance on investment income
Low exposure to risk and rising medical costs	Less vertical integration reduces control over providers
Opportunities	**Threats**
Health care reform will lead to increases in enrollment and revenue	Increased competition from existing and new members of industry
Market prime for mergers and acquisitions	Decreasing profitability
Increased demand for ASO plans	Threat of litigation and future regulation
Emerging, fast growing foreign markets	Shift towards more personal coverage
Demographic shifts increase demand for health care	Increased difficulty in predicting costs and setting appropriate premiums

Strengths:

- Extensive health care network within U.S. grants Cigna low cost advantage
    - Cigna is one of the largest health insurers in the United States, and as such it has one of the most extensive and comprehensive networks in the industry with offerings in all 50 states. Cigna has over 1 million global partnerships with health care professionals and facilities including close to 700,000 contracted doctors, just fewer than 6,000 contracted hospitals, over 200,000 dental access points, and over 100,000 behavioral access points.[25] Overall, Cigna is a top five health insurance provider in terms of health plan enrollment and revenue. Cigna's strong position within the market and its widespread network make it one of the premier insurers in the country and in the regional markets within which it operates.
    - As a result, Cigna possesses considerable bargaining power in its dealings with hospitals and doctors because exclusion from the Cigna network can greatly curtail a hospital's or doctor's business as exclusion might drive Cigna enrollees (likely a large population in most markets) to other providers. Through its sizable

[25] "Fact Sheet." Cigna.com

enrollment, Cigna makes itself essentially non-excludable for health care providers. Thus, utilizing its size and the bargaining power it bestows, Cigna can capture a low cost advantage. This low cost advantage arises in large part from negotiating favorable reimbursement contracts with providers that lessen how much Cigna pays for its members' health costs. Such a large network will also be an attraction for customers who are looking for a wide and diverse group of providers that can meet their health care needs.

- Diverse and expansive product offerings
    - Unlike certain insurers that only offer medical or dental or life products, Cigna represents a single source provider of an extensive range of individual and group health care, life, accident, and disability plans. Within its medical plans, Cigna offers a wide spectrum of options including HMO, PPO, Customer-Directed Health Plans, and Individual plans. Cigna also provides programs for seniors such as Medical Advantage and supplemental plans. In all, Cigna possesses one of the broadest and most comprehensive portfolios of products available in the industry, making it essentially a one-stop shop for health care and insurance provision.
    - By offering such a diverse array of products and plans, Cigna possesses a competitive advantage over many of its competitors who only offer limited services or plans which restrict their appeal to customers who prefer to handle all their health care needs through a single entity. In addition, the different coverage options (PPO, HMO, ASO, etc.) also attract a variety of different customers with different needs as Cigna can customize and personalize in ways that other insurers cannot. Offering such a wide array of products serves to provide diversification for Cigna and helps to eliminate risk of being reliant on one source of revenue.
- Strong international and expatriate businesses
    - Cigna has made expanding its international presence and operations a major area of focus in recent years, adopting the "Go Global" strategy as one of its three main strategic goals. Currently, Cigna has sales in more than 30 countries worldwide and has recently entered a number of new markets. In particular, Cigna through joint ventures in Turkey and India has started to sell health, life, and pension products in fast growing, under-penetrated markets. The recent joint venture with Indian

conglomerate TTK established Cigna as the first U.S. insurer to be part of a stand-alone joint venture health insurance company in India.[26] Furthermore, Cigna continues to see growth in its operations in China and South Korea.

- Overall, operations outside the U.S. comprise about one-tenth of the company's earnings base and international premium revenues have shown stronger growth than many of Cigna's other business segments. Cigna's Global Supplemental Benefits experienced growth of 27% this past year in premiums and fees.[27] In addition to the supplemental insurance and various other products offered to citizens of foreign countries, Cigna also has the broadest and best established expatriate network in the industry, covering close to 1.2 million expatriates.[28] With this growing international business, Cigna stands above many of its competitors which focus primarily on the domestic market, allowing Cigna to reduce dependence on the U.S. market, diversify its revenues, and tap into high growth foreign markets.

- Lower exposure to risk and rising medical costs due to heavy reliance on self-funded plans
  - Most of Cigna's competitors' business involves providing fully-funded insurance and health plans to individuals or groups of employees. By offering these types of plans, the insurance companies are directly responsible for paying medical costs on behalf of those they insure. Thus, under fully-funded insurance, the insurer takes on considerable risk as they are liable to the sizable medical bills that their customers accumulate. However, unlike most of its competitors, Cigna centers a large majority of its health care business on providing self-funded or administrative services only (ASO) plans to businesses. In all, 85% of Cigna's business relationships involve an ASO plan. With these plans, Cigna is paid by an employer to administer the health plan of its employees by providing employees access to the Cigna network, processing claims, issuing ID cards, and performing various other services. The employers, however, are directly responsible for paying the medical claims of its employees as opposed to the burden being placed on the insurer. In addition to these self-funded plans, Cigna also sells stop-loss insurance that makes it liable for losses that exceed certain set limits. Therefore, provision of self-funded plans and stop loss

[26] Cigna 10-K 2013.
[27] Cigna 10-K 2013.
[28] "Cigna Corporation Company Description." *Hoovers*. 2013.

insurance to employers provides considerable revenue to Cigna while reducing their risk to medical claims by limiting exposure to a smaller set of losses. With ASO plans, health care reform and rising medical costs do not affect Cigna as much as they do its competitors given that for much of its customer base, Cigna is not actually responsible for paying a sizable share of medical costs for those they insure.[29]

Weaknesses:

- Low penetration into the Medicare Advantage market
  - Cigna in recent years has not participated deeply in the Medicare Advantage market, deciding to offer few private Medicare and Medicaid plans for seniors. Prior to the acquisition of HealthSpring in 2012, Medicare customers had represented only 0.3% of Cigna's enrollment. In recent years, several of Cigna's competitors including Humana and WellCare Health Plans that rely heavily upon Medicare customers have seen considerable growth and sizable profits.[30] With the population continuing to age, more and more Americans will become eligible for Medicare each year, thereby representing a major opportunity for insurance companies to increase their membership and revenues. Thus, Cigna's low penetration in this market may lead to them missing out on a potential chance for profit and revenue growth in coming years.
- Mediocre financial ratings and higher levels of debt hurt borrowing capacity and threaten financial soundness
  - Cigna's subsidiaries are currently rated at A2 by Moody's and A by Fitch while current ratings on Cigna's long-term senior unsecured debt are at Baa2 by Moody's, and BBB by Fitch.[31] These ratings would be considered adequate/mediocre at best and suggest that Cigna faces credit risk and is more susceptible to adverse effects related to changing economic conditions. Major customers with substantial business look to these credit ratings as part of their assessment of a health insurer, and Cigna's mediocre ratings may diminish its ability to win new clients and retain current customers who may be concerned about Cigna's financial stability. In addition to less than ideal credit ratings, Cigna has also seen a major increase in its long term

[29] Cigna 10-K 2013.
[30] Farrell, Maureen. "Medicare Passes on Big Profits to Insurers." *CNN Money* 22 Dec. 2011.
[31] "Financial and Debt Ratings." Cigna.com.

debt in recent years, rising from $2.29 billion in 2010 to its current level of $5.01 billion in 2013.[32] This jump in debt was mirrored by a considerable increase in debt to equity ratio. In all, the mediocre financial ratings and higher leverage together will likely lead to higher costs of borrowing for the firm which will cut into profits due to higher interest payments. The higher debt level also may make it more difficult for Cigna to obtain future funds in order to pursue potentially profitable projects and acquisitions.

- Greater exposure to market risk due to reliance on investment income
    - Unlike many of its competitors, Cigna relies a great deal on income earned through investing activities. In fact, over the past several years, investment income has represented around 50% of pretax income. Other firms in the industry including Aetna and WellPoint have displayed ratios of 25% and lower in recent years suggesting that these companies generate higher income through operations than Cigna does and rely less on investment income.[33] This dependence on investment activities exposes Cigna to a greater deal of market risk than its competitors.
- Less vertical integration than other key insurers in the market
    - Cigna does not own large hospital chains or physician networks in its regions and, as a result, it is not as vertically integrated into the provider space as other competitors are. Cigna specializes in the provision of insurance and has largely decided to stay away from direct ownership and operation of hospitals and physician networks. Other insurers such as Kaiser Permanente have adopted a different business strategy in which they offer insurance plans to members while at the same time owning their own hospitals and clinics as well as directly employing physicians. Thus, in doing so, these firms provide both the coverage and the health care itself. Without such vertical integration, Cigna is not able to directly control the costs or actions of the providers with whom it contracts and hence is vulnerable to potentially higher fees. Lacking these direct provider relationships, Cigna has to undergo fierce negotiations with providers regarding payments and drive the accountability and cooperation of

[32] Cigna 10-K 2013.
[33] Aetna and WellPoint Income Statements. *Yahoo! Finance*.

these providers through less direct means, chiefly threatening their exclusion from the Cigna network.

Opportunities:

- Health care reform will boost membership and premium revenues
    - As of 2012, the Census Bureau reported 48.0 million Americans were uninsured.[34] However, recent health care reforms including the Affordable Care Act have made individuals without insurance subject to penalty. As a result of these reforms, the Congressional Budget Office estimates that there will be 25 million fewer people uninsured by 2016.[35] Given Cigna's considerable size and product offerings, it will likely be a major player in providing insurance and health care plans for these newly insured individuals, increasing Cigna membership and enrollment as a result. While Cigna only sells plans on five of the public exchanges, it remains highly active in the private exchanges, recently launched its own private retail exchange with offerings in several states, and has already enrolled between 75,000 and 100,000 in health plans through the exchanges.[36] This increased membership will have a carryover effect in terms of increasing the bargaining power of organizations such as Cigna with regards to negotiations with doctors and hospitals.
- Potential to acquire firms looking to exit industry due to challenges from reform
    - The recent health care reform will dramatically change the ways in which insurers such as Cigna operate going forward. As such, some companies may decide they want to sell off or downsize some of their business segments in order to exit the health insurance market.[37] With weaker, less financially sound firms looking to exit, Cigna has the opportunity to step in and absorb a number of these firms through mergers or acquisitions. These acquisitions will increase Cigna's size, network, membership, revenue, and market share and in doing so, allow Cigna to capitalize on economies of scale and enhance bargaining power with providers.

[34] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.
[35] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.
[36] Humer, Caroline. "Cigna Says Signed Up 75,000-100,000 for Obamacare." *Reuters*. 1 Apr. 2014.
[37] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

- Increased demand for ASO plans
  - With the passage of the ACA, businesses now face a penalty if they do not offer affordable health insurance to their employees. This reform will help to further strengthen a growing trend in the U.S. of companies switching to ASO and self-funded plans, perceiving them as more cost effective. In addition, businesses that self-fund are not subject to a newly implemented excise tax on premiums and are exempt from the reform's minimal set of essential benefits. As such, surveys have shown that businesses large and small have displayed a greater interest in utilizing self-funded insurance. In one survey conducted by Munich Health North America, 82% of health industry executives said they had witnessed a growing interest from employers of self-funding with 30% expressing significant interest in self-funding.[38]
  - Traditionally, large employers have been the primary utilizers of self-funded programs, relying on insurers to play administrative roles only. In reaction to the ACA and rising premiums for fully-funded plans, many small and mid-size businesses have begun looking to ASO plans as cheaper alternatives.[39] Cigna has already made strides to position itself to attract new customers by focusing on growth in its Select segment (employers between 51 and 250 employees). Furthermore, Cigna offers self-funded plans in many states to employers with as few as 25 employees.[40] Cigna has been a leader in offering ASO plans and this shift by employers represents a major opportunity for Cigna to increase its enrollment and revenues by forming new business relationships, especially with small companies.
- Continued expansion into international markets:
  - Demand for health care has been increasing considerably in many fast developing countries and demand for supplemental plans has also seen increases in recent years. With profitability in the U.S. health care market expected to stagnant or decline going forward, especially in light of reforms which will impact insurers' profitability, Cigna has the opportunity to use its well-established international businesses to expand into fast growing, underpenetrated markets. Cigna has already pursued this strategy in

[38] "Health Insurers Anticipate Increases in Self-Funded by U.S. Employers, Finds Munich Health Study." *BusinessWire*. 15 Apr. 2013.
[39] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.
[40] Cigna 10-K 2013.

India and Turkey. Cigna's growing international footprint gives it a first-mover advantage in scaling outside the U.S., potentially helping to increase profitability, bolster revenue growth, and diversify its geographic revenue streams.

- Demographic shifts increase the demand for health care
    - The United States is currently experiencing a considerable demographic shift as the elderly segment of the population increases with the aging of the Baby Boomers. With this shift, demand for health care services will rise substantially, especially in the Medicare Advantage (MA) and Medicare supplemental insurance markets. With more people qualifying for Medicare each year, the demand for affordable, extensive, and effective insurance will increase. While many members of the aging population will rely on the government to provide insurance, many others will seek out alternative, private options that offer different plans, services, and coverage. In 2013, 28% of the 52 million people on Medicare were enrolled through a private insurer as part of a MA plan. Since 2004, the number of elderly Americans utilizing private plans has almost tripled from 5.3 million to 14.4 million.[41] With the acquisition of HealthSpring in 2012, Cigna has taken the first step in positioning itself to take advantage of this opportunity and reap the benefits from a potentially highly profitable and growing MA and supplemental insurance market.

Threats:

- Increased competition from existing members and new entrants to the industry
    - Cigna faces considerable competition not only from other large, diverse insurance companies but also from a number of stand-alone HMOs and PPOs, and other companies that offer ASO plans and serve only as third-party administrators. Large insurer rivals looking to capitalize on economies of scale and expansive networks will challenge Cigna in the acquisition space, introducing increased consolidation in key regional markets. Cigna also faces increasing competition from large-scale hospital systems that are poised to make entrance into the insurer market by establishing or acquiring their own insurance plans.[42] Given that these large scale hospitals are

[41] "Medicare Advantage Fact Sheet." *Kaiser*. 25 Nov. 2013.
[42] "Health Insurance Carriers Business Challenges." *Hoovers*. 2014.

dominant providers in their region, they have strong incentives to expand into provision of the insurance in addition to the health care itself. Lastly, as mentioned in the Five Forces section, the ACA has improved funding opportunities to CO-OPs which may emerge as a potential substitute for the traditional insurer client relationship. Thus, Cigna faces sizable threats from many different players in the market and if Cigna fails to address the increasingly competitive landscape, it may see its market share and profits slide.

- Decreasing profitability for the market as a whole
  - Industry projections from companies such as S&P Capital IQ look for profitability to stagnate or decrease in coming years for major insurers such as Cigna. These pessimistic projections are rooted in a number of factors including rising administrative fees, increasing health care costs, and rising reimbursement rates.[43] Health care reform has several major impacts on firms' profitability including a sizable annual industry tax and enforced MLR floors that will greatly impact profitability as Cigna must ensure that 85% of premium revenue is spent on health care costs for those they cover. Such a high floor will reduce Cigna's ability to spend and likely force administrative and operational changes to enhance efficiency and cut costs. In addition, medical costs are projected to increase as individuals live longer and more expensive medical technologies emerge. Increased consolidation of the hospital market represents another threat as large hospitals have come to dominate the markets in which they operate. Such an increase in size has boosted the hospitals' bargaining power with insurers, bolstering their ability to collect higher fees.
- Threat of litigation and further regulation
  - While the most recent health care reform will hopefully address a number of problems, further reform is a possibility. Health care spending in the U.S. represents a large amount of GDP (17.9%), and, with an aging population, estimates are calling for a continued increase in coming years. Given this trend and continued challenges with Medicare and Medicaid, future reform and regulation may unfold, introducing uncertainty and new pressures for Cigna. At the same time, Cigna also regularly faces civil litigation for alleged improper practices, rescission of coverage, failure to

[43] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

pay claims, and noncompliance with state or federal regulations. If found guilty of wrongdoing, these lawsuits can involve large penalties that can hurt profitability and decrease public perception of Cigna which would hurt its business substantially.[44]

- Shift in focus towards providing more personal coverage
    - With the establishment of the insurance exchanges, a larger number of individuals are looking to purchase customized insurance plans and a percentage of employers are considering dropping their insurance offerings and letting their employees find coverage on the exchanges.[45] In response, many firms are making a more concerted effort to personalize coverage to their clients and allow them to take a more active role in their health management. The threat of businesses dropping their insurance offerings and the rise of individual focused offerings pose a particular threat to companies such as Cigna that rely heavily on commercial business relationships. In all, Cigna may need to re-structure its business model to accommodate this trend towards personalized individual coverage. If it fails to do so, it could see its commercial relationships and revenue decay.
- Increased difficultly in accurately setting premiums
    - A crucial aspect for firms in the health insurance market is their ability to accurately predict future costs such that they can set appropriate premiums. If premiums are set too low, insurers will suffer as their main source of revenue will be insufficient to pay the medical claims that come due. Companies do considerable research and modeling with regards to future costs and characteristics of those they cover in order to set their premiums. Many companies use historical data as a major component in how they set premium rates. However, the market has seen considerable change in the recent years due to the passing of health care reform and the effects it will have on the types of people insurers cover and on the costs associated with coverage. As such, reliance on historical data will be a major issue as the market changes due to rising medical costs, people living longer, demographic changes, and changing coverage pools as insurers can no longer deny coverage based on pre-existing conditions. These factors all introduce a great deal of variance of costs and risk to Cigna.

[44] Cigna 10-K 2013.
[45] "How US Health Care Reform Will Affect Employee Benefits." *McKinsey&Company*. Jun. 2011.

Strategic Recommendations

With the passing of the ACA, demographic shifts, individuals living longer, and rising medical costs, the health insurance industry is undergoing a major shift. Many of these factors, especially the higher taxes and medical costs as well as the medical loss ratio requirements, will impact the profitability of insurers in coming years. Other market forces including the consolidation of hospitals and their movement into the insurance market also represent major threats to insurance companies. At the same time, the market transition brings with it many potentially lucrative opportunities if Cigna moves quickly and executes with strategic direction and conviction. With the ACA mandate for insurance coverage and increases in the number of Americans eligible for Medicare, opportunities for enrollment and revenue growth will be prevalent in coming years. In looking at the industry going forward, Cigna faces a number of potential paths that it can follow in order to navigate the future challenges of the insurance industry. How Cigna adapts to this new system will be a major determinant of its success in coming years.

Cigna currently holds a unique position amongst its competitors in that it possesses a robust commercial self-funded and ASO business which helps insulate it against many of the increased risks and possible problems in the changing insurance market. As a result, while many of its competitors may feel the need to make drastic changes and alter their business strategies greatly to adapt and survive in the new market, Cigna's current position does not warrant such a reaction. Rather, DangerZone recommends that Cigna focus on maintaining its strong position in the ASO market, seize on opportunities to further its global operations and senior business segment in order to diversify revenues and capitalize on high growth opportunities, look to acquire new firms in order to expand its national reach and strong market share further, expand its value-based and risk-sharing arrangements with providers to curtail rising medical costs, and go individual by investing in technology and analytics geared towards enhancing the consumer experience and data gathering. Such a strategy will allow Cigna to build off and deepen its strengths while at the same time, addressing several major risks. However, these recommended changes to Cigna's business do not represent a major departure from their core business of providing self-funded plans to employers, but rather increase Cigna's presence in certain segments that can help to diversify revenues and protect against potentially harmful trends. Thus, it is not recommended that Cigna try to move into the provider space as a way to keep costs down or to make a dramatic shift in its coverage and focus on greatly expanding its fully-funded programs which offer typically larger premiums but much higher risk. Instead, the goal going forward for Cigna should be to cultivate and enhance its competitive advantage and more deeply expand into highly profitable areas in which it already has a considerable presence and opportunity for growth.

Continued International Expansion in Fast Growing Foreign Markets

In recent years, Cigna has made a strong commitment to expanding its global presence and international business. One of the three main tenets of Cigna's strategy is Go Global. As part of that strategy, Cigna has successfully formed joint ventures and partnerships to begin selling its health and life plans in fast growth markets like China, India, and South Korea. Premiums and fees from Cigna's Global Supplemental Business have grown 32% and 27% in the past two years.[46] Many analysts assess the domestic U.S. health care industry as a rather mature, increasingly saturated market. As such, opportunities for growth are not as plentiful as in past years. In light of these trends, continued international expansion would provide Cigna with many benefits including a decrease in dependence on the domestic U.S market, a diversification in revenues, and perhaps most importantly, opportunities for strong, profitable growth.[47] DangerZone recommends that Cigna remain committed to its Go Global strategy and continue to focus on expanding their global reach by gaining entrance into growing, underpenetrated markets and furthering their current operations in foreign markets.

Many foreign countries have shown increased demand for health and life plans in recent years and, in conjunction, have posted rather high growth rates in terms of premiums and health expenditures. Much of this increased demand arises from emerging economies in which growing income levels have increased widespread demand for higher quality health coverage and life insurance. Demand has been further bolstered by changes in regulatory environments with countries dissolving domestic state monopoly health insurers and opening themselves up to foreign insurers. Market conditions in foreign countries will greatly shape how Cigna can enter each market and what products it can offer. That is, each country has a unique health care

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[46] Cigna 10-K 2013.

[47] Zinkewicz, Phil. "Health Insurers Look To Foreign Markets." *The Rough Notes Company*.

system in place with differences in coverage, quality, and affordability. However, with this diversity, coverage gaps emerge in many of these countries where individuals desire additional benefits or coverage that the market as it stands now is unable to meet. The gaps will differ across markets and thus so will the opportunities available for Cigna. For example, many European countries have state-run universal health care systems and as such, Cigna would be unlikely to provide primary, full-fledged insurance to consumers in these countries. However, in countries such as these, there has been an increased demand for supplemental insurance that extends beyond the basic provision offered by the state and increases the services and networks available to consumers.[48] As such, Cigna which already offers supplemental insurance in a number of countries would be poised to expand its operations into Western Europe to meet this growing demand.

Developing countries like Vietnam, Thailand, Indonesia, Turkey, India, Brazil, and Thailand offer another type of opportunity for Cigna.[49] In many of these countries, Cigna has either already established operations or has the opportunity and incentive to enter into the market either through acquisition or as part of a joint venture with existing domestic companies and sell its numerous primary, supplementary, and life insurance products. When considering entry into a new market, Cigna should keep in mind several key factors including insurance premium growth, demographic changes, regulatory changes, macroeconomic volatility, barriers to entry, and corruption risk. Countries such as Vietnam have displayed high income and premium growth but at the same time, corruption and sovereign risks are major concerns. Indonesia has seen considerable economic growth but barriers to entry are high with obtaining licenses being a major hurdle.[50] Cigna has utilized both direct entry and joint venture in its international business as it sells directly to customers in its largest international operation, South Korea, while offering products by way of joint venture in India, China, and Turkey. In terms of future strategy, direct entrance into many foreign markets seems unlikely given risks, regulatory issues, and potential barriers to entry. Cigna should focus on markets with sizable gaps in coverage and in particular,

[48] Simpson, Stephen. "Cigna Corporation's Diversification Should Deliver Above-Average Growth." *The Motley Fool*. 14 Jan 2014.
[49] "Waves of Change: The Shifting Insurance Landscape in Rapid Growth Markets." *EY.* 2014.
[50] "Waves of Change: The Shifting Insurance Landscape in Rapid Growth Markets." *EY.* 2014.

it should pursue expansion into two key Asian markets, Thailand and Indonesia, through a joint venture with an established market player.

At the beginning of this year, Indonesia rolled out its new universal health care system which has been met with both enthusiasm and concerns. Due to issues regarding adequate funding and its effect on quality of care, demand for additional insurance and access to higher quality of care and services will be high for the higher income individuals of Indonesia.[51] Such a demand will generate considerable opportunities for Cigna to fill this coverage gap as well as pursue life and disability insurance offerings. Thailand has supported a universal health care plan since 2002 to widely positive reviews. Nonetheless, an aging population and underdeveloped disease management programs offer up potential opportunities for Cigna to enter into a fast growing market and provide health care solutions for many individuals.[52] Additionally, Thailand has liberalized its rules on foreign ownership rules for the banking and insurance sectors which will ease Cigna's ability to enter the market through a joint venture with an existing firm.[53] In particular, there has been a trend in many foreign countries of banks becoming important sales channels for life and accident insurance products. Thus, Cigna may consider a partnership with a Thai bank in order to begin selling its life and accident plans in this growing market as it did in Turkey. If successful in establishing itself in these two emerging markets, Cigna should be able to further its already strong growth in international business revenues, diversify its revenues, and reduce reliance on the domestic market.

Pursue Mergers and Acquisitions in Domestic Market

While expanding its international business, Cigna should not overlook its domestic operations which are responsible for a strong majority of its revenue. The domestic U.S insurance market is a rather competitive one as Cigna faces competition from many different firms, large and small. The National Directory of Managed Care Organization states that there are currently more than 1450 health insurers in the U.S. with no one player controlling more than 20% market share.[54] With a considerable number of insurers offering expansive insurance plans and services, the

[51] "Hopes and Fears as Indonesia Rolls Out Universal Healthcare." *IRIN*. 14 Jan. 2014.
[52] "Country Cooperation Strategy at a Glance: Thailand." *World Health Organization*. May 2013.
[53] Frost, Stephen. "Thailand Changes Foreign Ownership Rules Regarding Insurance Business." *Bangkok International Associates*. 2012.
[54] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

market has become increasingly saturated. Growth has been down in recent years with declining enrollment due to high unemployment and as a result, a number of the larger firms have turned to mergers and acquisitions as a strategy to bolster growth and market share.[55] In addition to macro forces impacting the market, considerable changes to the industry are imminent as many aspects of the ACA will be fully implemented this year. As a result, many firms, especially the smaller, more financially weak firms, will face additional threats to their bottom lines including higher industry taxes and higher medical costs. In fact, many of the more vulnerable companies may look to exit the market by dropping or selling their health or life insurance business due to fears of an inability to operate successfully under health care reform and the shifting market environment.[56]

Cigna, protected by its size and financial stability, will be able to withstand many of these pressures and should leverage its position of strength to acquire smaller, challenged firms which complement existing offerings. Acquisitions of this nature would benefit Cigna in that the industry is characterized by economies of scale and through these acquisitions Cigna can expand its national reach and pricing power as well as help to even out the negotiating power between itself and increasingly consolidated hospital systems. Furthermore, many of these smaller companies are likely to be regionally focused which further provides incentive for Cigna to acquire them and establish their presence in previously underpenetrated regional markets. As discussed in the Five Forces analysis, it is unlikely for one health insurer to capture a strong share of the national market but firms can gather considerable market power within specific regions and as such, these acquisitions could allow Cigna to expand into new areas and leverage their quality plans and products to become a major player in previously untapped markets.

In evaluating acquisition targets, Cigna should prioritize targets that fit within its well established business lines and strategy. While Cigna offers a great deal of variety in terms of its products and services as well as the types of plans for both self and fully-funded, most of Cigna's business relies upon a business to business model through employers. As such, Cigna should look for attractive companies that tend to engage in a similar business. In recent years, demand for ASO

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[55] Blumenthal, Robin. "A Merger Wave Hitting Health Care." *The Wall Street Journal.* 30 Oct. 2011.
[56] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

and self-funded plans has increased with many small and medium sized firms electing this type of plan in order to minimize costs in the face of higher premiums in fully-funded plans. Cigna currently stands as a leader in this self-insured market but other companies have been looking to acquire sizable companies in order to further their operations in this segment of the industry such as Aetna's acquisition of Prodigy Health Group, a large third party administrator of self-funded plans. Despite this, Cigna does possess an advantage over its competitors looking to expand into the ASO segment given much of its products are already self-insured plans and hence Cigna will not be forced to convert them from fully-funded to ASO.[57] Thus, Cigna should look to utilize its unique position to pursue acquisitions in order to maintain and further its place in the industry.

Build Off Recent HealthSpring Acquisition to Further Penetrate Medicare Advantage Market and Advance the Development of Value-based Arrangements with Providers

For many years, Cigna maintained a small presence in the Medicare Advantage (MA) market with enrollees only composing .3% of total membership. This market involves an insurer providing plans that serve as substitutes for traditional Medicare programs provided by the government. In this way, the insurers are offering private Medicare coverage for eligible Americans. At the moment, close to 28% of all Medicare eligibles are enrolled in private Medicare programs and this number has been growing considerably in the past 10 years.[58] Despite its previous history, Cigna made a major play in this market with its 2012 acquisition of HealthSpring for $3.8 billion. By acquiring HealthSpring, Cigna gained 340,000 Medicare Advantage members, swelling its enrollment from the meager 46,000 prior to the acquisition. In addition, HealthSpring also brought with it close to 800,000 members in stand-alone Medicare prescription drug plans. [59] With its acquisition of HealthSpring, Cigna is making a major bet on the MA market while at the same time increasing its diversification away from its traditional commercial business operations. This acquisition serves as a jump-start for Cigna's Medicare Advantage business and going forward, Cigna should look to expand this operation given the sizable opportunities for growth in this sector.

[57] Wolf, Tory. "HEALTHCARE RECON. Rise of Self-insurance in Smaller Groups: Opportunity and Threat." *Recon Strategy*. 25 May 2011.

Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

[59] Krauskopf, Lewis. "Cigna to Buy Medicare co HealthSpring for $3.8 Billion." *Reuters*. 24 Oct. 2011.

With the demographic shift currently underway and the Baby Boomer generation approaching Medicare eligibility as 10,000 Baby Boomers are projected to reach the age of 65 every day for the next 18 years,[60] the total pool of Medicare individuals will dramatically increase which will translate to strong growth in the MA market as seniors increasingly switch to MA plans to take advantage of broader benefits and greater variety in coverage options. In addition to the opportunities for considerable enrollment growth in coming years, the Medicare Advantage market represents a major push for Cigna to dramatically increase its revenues. As a primary ASO plan provider, Cigna's premium revenues are smaller than many other companies that offer fully-funded insurance in which they are able to charge higher premiums because they take on the risk of paying medical costs. However, the premiums from Medicare Advantage members are rather high given the older age of enrollees and hence the greater need for care. While margins for this segment of business are lower than typical insurance and the government has been moving to reduce its payments to private insurers offering MA plans in coming years, this strong push into the market represents a major chance for Cigna to seize on growth opportunities that are not present in its traditional commercial business.[61] With this acquisition, Cigna can begin to utilize its expansive national network and reach in order to expand HealthSpring into new states and regions in such a way as to dramatically increase membership.

However, key to success in this market will be keeping medical costs down for the elderly Americans Cigna covers. In that regard, HealthSpring provides two immediate benefits for Cigna: a unique physician engagement and risk sharing model and a chronic disease management expertise. As part of HealthSpring's model, the physicians have a strong incentive to provide quality care and reduce costs because they share in the savings and profits alongside the insurer. The physicians within the network are rewarded for meeting targets for improved care and lower medical costs. Furthermore, HealthSpring is committed to the management of chronic diseases which historically account for a large degree of health care expenditure. As part of this program, members work with care coordinators to ensure that they get the needed screenings and follow up care in a prompt and effective manner rather than waiting to allow

[60] "Insurers Rush to Provide Medicare Advantge Coverage, Despite Obama Pay Cuts." *Forbes*. 1 Mar 2013.
[61] Seligman, Philip. "Industry Surveys Healthcare: Managed Care." *S&P Capital IQ*. Nov. 2013.

issues to worsen and require expensive medical treatments to rectify them.[62] With its acquisition of HealthSpring, Cigna can utilize aspects of HealthSpring's models to further its own Collaborative Care efforts. Currently, Cigna has 89 Collaborative Care arrangements that serve close to 1 million customers. These arrangements which incorporate a pay for value structure with their contracted physicians have received a considerable degree of interest as a potential area in which to invest in order to improve the quality of care and at the same time decrease medical costs.[63] Like HealthSpring's model, Cigna, through its Collaborative Care initiative incents doctors to limit costs and improve care, and these centers tend to focus on preventive care and chronic disease management. The contracted providers provide more coordinated care so as to reduce unnecessary duplication of services and prevent medical errors.

The shift towards pay for performance and risk sharing arrangements with providers represents a major move towards keeping health care costs down. Under the traditional system, costs have been difficult to contain due to a widespread lack of incentives to do so. Hospitals and doctors historically have been compensated by a pay for service basis in which the more tests, procedures, and services they provide, the more money they get. As such, providers had incentive to run expensive and often unnecessary tests and treatments so as to capture greater revenue. At the same time, the insured patients themselves tended to pay little of their own medical costs so they had little motivation to seek out cheaper health care options. That left insurers, employers, or the government depending on the insurance plan (fully-funded, self-funded, or Medicare/Medicaid) to pay for all of these costs.[64] However, pay for performance and risk-sharing models utilized by HealthSpring and Cigna's Collaborative Care can create the needed incentives in all active parties to limit costs as well as provide improved care. By altering the system to pay providers based upon the value they deliver rather than the services they perform, Cigna can meet the widely accepted triple aim of today's health care system: lower costs, improved care, and enhanced consumer experience. Current estimates suggest that fee-for-service remains the status quo for many insurer-provider relationships. As such, going forward, Cigna should work to expand its Collaborative Care programs to service a larger percentage of its customers as well as pursue the creation of more value-based, risk-sharing payment

[62] "A Conversation with Herb Fritch: A Steady Approach to Medicare Advantage." *Managed Care*. May 2013.
[63] "Cigna Accountable Care." Cigna.com.
[64] Surowiecki, James. "Controlling Health-Care Costs." *The New Yorker*. 9 Dec. 2013.

arrangements with its providers. With its high enrollment and large network size, Cigna has the clout needed to push many of the providers it contracts with towards more cost effective solutions.

Invest in Digital and Information Technology

In addition to the Go Global aspect, Cigna's primary strategy has also emphasized a Go Individual initiative. As part of this initiative, Cigna has committed to providing highly personalized health products and services to individual customers. The health care industry in previous years has been primarily characterized by a business to business model with most Americans receiving insurance through their employers and business transactions largely occurring between employers, payors, and the health care providers themselves. However, recent trends in the industry point to the intensification of an already underway shift towards a more consumer-centric market and towards a business to consumer model.[65] Such a shift has been prompted by significant dissatisfaction with the system's performance given its high costs, lack of access, and overall unsatisfactory consumer experiences. As a result, there has been increased demand by consumers for insurance and health care providers to provide more individualized plans and to allow individuals to play a greater role in their health care decisions and expenditures. However, many insurers will not be well-suited for a more consumer-driven market given that the health insurance industry has tended to lag far behind most other industries in terms of understanding consumer preferences. Many major insurance companies including Cigna will be forced to reevaluate their business models in coming years as consumers increasingly look for insurers that provide more personalized products and services.

A critical component to getting ahead of competitors in this area will be the development of digital and information technology that allows Cigna to better interact with, gather data on, and glean the preferences of their consumers. Like many markets, the insurance provider industry is also seeing a move towards a more mobile-centered environment. Cigna needs to develop a successful mobile strategy centered around improving the customer experience and on gathering important data on consumer likes and dislikes. Cigna has in recent years been expanding its

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[65] "New Cigna Corp. Business Strategy: an Exclusive Interview with Mark Boxer." *The Wall Street Transcript*. 25 Oct. 2012.

online and mobile presence and has focused on the development of its Know Me Engine. This online platform encompasses all the various ways in which Cigna collects data on its members. Additionally, Cigna has recently expanded beyond traditional data sources such as health claims and now incorporates games and mobile apps that enhance Cigna's customer engagement.[66] Continued investment in the development of new technology and apps that allow Cigna to track all the interactions it has with its customers as well as their health data should be a priority as it will allow the company to better personalize the experience for the individual.

While Cigna has made strides in taking its digital assets mobile including provider directory and health risk assessments, it needs to continue to expand its online and mobile offerings to include telehealth products that allow consumers to easily receive support from health experts and sensors that can allow for monitoring of an individual's health. Such technology could not only improve customers' access to certain services but also help to lower medical costs by both avoiding unnecessary doctor visits and alerting people to potential problems earlier. Furthermore, telehealth products and health risk assessments will help to better educate consumers about their health and encourage them to take more a proactive approach to their health management.

Staying ahead of its competitors in terms of technology related to consumer engagement and data gathering will be vital for Cigna going forward as it can utilize the data regarding preferences and coverage desires in order to refine their product and service offerings to better meet the demands of its potential customers. By encouraging this consumer-focused approach, Cigna can not only reduce discontent in its own customer base but can also attract many new customers. With the ACA subjecting all Americans to a penalty if uninsured and increasing demand for personalized, consumer-centric plans, many individuals will look to the private and public exchanges as a marketplace in which to gather information and shop for the specific types of coverage and services that they desire. In addition, the ACA will likely influence a sizable number of employers to drop their health insurance. A survey conducted by McKinsey & Co. showed that 30% of employers said they would "definitely or probably" stop offering health

[66] Dolan, Brian. "Understanding Cigna's Evolving Digital Health Strategy." *Mobile Health News*. 21 May 2013.

insurance after 2014.[67] As a result, with these businesses dropping their insurance, those affected individuals will now look to the public and private exchanges for their insurance needs, thereby increasing the opportunities for companies to greatly increase membership and revenue by capturing this wealth of new enrollees. This dropping of employer health insurance will be a threat to Cigna in coming years given its strong reliance on commercial relationships for revenue, and as such, a strong commitment to developing the technological infrastructure needed to engage customers and craft plans to their preferences will be crucial for Cigna going forward. Cigna stands to lose from decreases in commercial membership and thus, it needs to pursue other markets where it historically has been less concentrated such as the individual insurance market as a way to mitigate its losses.

Cigna's involvement in the public exchanges has been rather limited due to concerns over the profitability and margins associated with that area. Currently, Cigna only sells plans in five states. With regards to private exchanges, in their annual report, Cigna's CEO articulated that the company perceives the private exchanges as potential long-term growth opportunities. Cigna currently is quite active in the private exchanges with positions in many of the third-party exchanges and Cigna recently launched a new, proprietary exchange.[68] Cigna should work to actively offer its plans in these private exchanges. Competition amongst insurers is quite high as consumers have a large variety of plans and forms of coverage to choose from but Cigna could separate itself from its competitors by utilizing new technology to further its understanding of preferences and in doing so, effectively adapt a number of its plans and product offerings in areas such as copays, deductibles, network access, and benefits so as to better craft its services to the desires of the consumer. Recently, there has been a trend in consumer demand for high-deductible plans, health savings accounts, and health reimbursement accounts.[69] Such plans grant the consumer greater decision making regarding their health care options and have been shown to decrease costs and increase health profiles. Establishing a reputation as being an insurer that caters to individuals' needs and offers the personalized plans in high demand, Cigna would make great strides in public perception and separate itself from many other insurers.

[67] "How US Health Care Reform Will Affect Employee Benefits." *McKinsey&Company.* Jun. 2011.
[68] Cigna 10-K 2013.
[69] "Cigna: 20% of Customers Participating in HSA or HRA." *InsuranceNewsNet*. 18 Feb. 2013.

In addition, developing the technological tools to not only collect but to analyze data will also be a major key for Cigna going forward. Many industries have turned to examining large datasets regarding consumer information, activity, and preferences in order to identify key trends and patterns present within their business. A major investment in relevant technology will not only help Cigna to enhance its consumers' experience but will further Cigna's data gathering and analytics infrastructure in such a way as to improve Cigna's ability to identify not only inefficiencies in its current business but also highlight particular business areas or geographic regions that offer opportunities for profits.[70] Furthermore, with considerable changes to the market in terms who can receive coverage, how long people are living, and what medical costs will look like in the future, it has become increasingly difficult to accurately predict consumers' medical costs going forward and, as a corollary, to set appropriate premiums. As such, technological improvement and updates to existing models and data analytics will be vital for Cigna in order to better understand and predict a changing industry.

Overall, Cigna must commit to substantial development of information and digital technology so as to enhance its interactions with consumers through mobile products, expand its data gathering ability in order to craft more appealing and personalized plans, improve its public perception, and update its data analytics so as to better model and predict the market and its changes going forward. In addition, spending directed towards investment in research and development of information and digital technology is considered an expense towards improving health care quality and hence is counted in a firm's medical loss ratio. As such, using money in this way will help Cigna to meet its required MLR level. Historically, Cigna has on a number of occasions failed to meet the imposed MLR floor and been forced to pay rebates to its customers. Higher investment spending in health related technology can help to fix this problem, preventing money from leaving the firm that could help improve its business.

Through successful execution of these strategic recommendations, Cigna can position itself for growth in a changing and increasingly competitive market. With recent health care reform and shifts in many market forces, Cigna will face a number of challenges and threats to its business.

[70] JoyJit Choudhury, and , Sundar Subramanian. "Government Sponsored Healthcare shifts to 'Survival of the Fittest.'" *strategy+business.* 5 March 2014.

Substantially higher taxes and MLR floors will hamper its profitability, consolidated hospitals and rising medical costs will increase medical claim expenses, and employers dropping their health benefits will decrease enrollment, and subsequently, revenues. In light of these threats, Cigna cannot maintain its status quo or else it will watch as profits, revenues, and enrollment drop. Instead, it must be active in the near future and adapt itself in such a way as to ensure continued success. Cigna has firmly established itself as a leader in the ASO, self-funded market, and this strong position will help to mitigate some of the negative effects of health care reform and rising medical costs. Thus, Cigna should seek to maintain its advantage in the growing self-funded market but also should refine its other business segments in order to protect itself against emerging threats. DangerZone recommends Cigna (1) expand into fast growing, underpenetrated foreign markets to seize on opportunities for higher profits and revenue growth; (2) acquire domestic firms, especially those whose primary business is ASO and self-funded plans, to capitalize on economies of scale and further build up its advantage in the ASO market; (3) utilize its recent acquisition of HealthSpring to further its Medicare Advantage operations and tap into the revenue growth opportunities that accompany an aging population; (4) build off HealthSpring's physician engagement model to expand its Collaborative Care and value-based, risk-sharing arrangements with providers to control rising medical costs; (5) invest in digital and information technology to improve Cigna's data gathering, customer engagement, and ability to refine its product offerings to better accommodate consumer preferences and in doing so, expand its individual business and enrollment through the private exchanges. These strategies will transform Cigna into a unique and differentiated market player with diversified strengths in a number of high growth markets and ensure that Cigna will be well-equipped to handle and succeed in face of major industry changes in coming years.