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Aligning Physician Compensation in a Pay-for-Value Era

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Key Board Takeaways

When working to align physician compensation with business and clinical outcomes, the board will need to oversee and hold management accountable for the following initiatives:

- Consider physicians as strategic business partners and not employees, FTEs, or individuals to be "managed."
- Ensure that co-management relationships have a calculable ROI for the organization.
- Hardwire "regulatory quality" and create business relationships around "strategic quality."
- Quality has a financial value so define it as both clinically and financially important.

Many physicians are compensated today based upon work relative value units (wRVUs), a standardized formula that associates value with volume, intensity, and resources worked. The intent is to create a fair market value approach to linking physician compensation with work and effort in a volume-based industry. The assumption is that the more a physician does, the more a hospital or health system will earn, thus aligning the efforts of physicians with those of the organization.

This methodology has a number of significant flaws including:

- Physicians who perform procedures are valued at a much higher rate than physicians who perform cognitive tasks.
- The assumption is made that quality is constant and therefore should not be factored into either the rate nor the conversion factor.
- It is generally assumed that the faster a physician works, the more she/he should be compensated regardless of the potential impact on quality, safety, service, or cost.
- Aligning with volume will generally lead to improved financial performance.

Thus, the traditional methodology for physician compensation may paradoxically undermine quality, safety, service, and financial performance. Healthcare organizations that utilize a robust cost accounting system have actually found that almost half of physicians inadvertently generate a negative margin due to their variable costs exceeding the fixed payments received.

Most agree that the traditional physician compensation methodology should be replaced by a method that aligns physician compensation with value and organizational/payer success and drives superior clinical and financial outcomes.

The following represents an approach that can align the efforts of clinicians with the organizations in which they work to achieve mutually agreed-upon goals and objectives.

1. Align with All Employed and Self-Employed Physicians

Partnerships with both employed and self-employed physicians is far more effective than hierarchy and supports both engagement (pride of ownership) and alignment of interests between physicians and the healthcare organization. This is accomplished through the creation of co-management relationships that reward physicians for both clinical and managerial performance in a way that meets fair market criteria for both. Some executives assume that fair market value is a constant value based upon clinical specialty. However, clinical work has a separate fair market value from management responsibilities;

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management fair market value can increase proportionally to the economic parameters involved such as operating or budgeted revenues. For instance, someone overseeing covered lives worth $5,000,000 can be paid at a significantly higher rate than someone overseeing covered lives worth $500,000 due to the increased level of volume and complexity required.

Such agreements bind physicians to management in a mutually beneficial way and enable both parties to work together to achieve outcomes that have an impact on both organizational performance and individual compensation.

2. Standardize Processes to Achieve Regulatory Quality Goals

Regulatory quality represents externally imposed quality metrics (e.g., value-based purchasing, HCAHPS, readmission rate, etc.) that impact potential payment by both public and private payers. Obviously, the goal for every organization is to achieve the highest possible compliance in all regulatory metrics to optimize reimbursement. This also has the impact of reflecting favorably with regards to publicly reported sites such as Hospital Compare, ProPublica, Leapfrog, and Healthgrades.

The best way to achieve consistently high performance is to standardize processes throughout the inpatient and outpatient clinical settings so that consistent performance around standardized metrics take place. For instance, many organizations utilize "hard stops" and "decision support" tools to ensure that patients receive the right care each and every time, monitoring exceptions to ensure compliance.

Obviously, this level of cooperation requires pre-existing alignment to ensure that both leadership groups are in agreement with how processes are to be standardized and are willing to sacrifice some autonomy to support consistently high performance. Physicians are unlikely to support standardizing processes until they have a "stake" in the outcome through some form of co-management relationship whether employed or self-employed.

3. Monetize All Key Performance Indicators throughout the Organization

Every quality metric has a monetized value to a healthcare organization and can be calculated and compared for significance. For instance, case mix index (CMI), top-box HCAHPS, length of stay, adjusted cost per case, total cost throughout the continuum of care for a defined episode of care (e.g., hip or knee replacement), market share, and readmission rate can all be calculated for a given organization based upon calculated values. This is an important first step in order to develop a compensation methodology for physicians that emphasizes quality, safety, and experience, and enables the implementation of steps four and five outlined below.

4. Prioritize Monetized Metrics through the Creation of a Pareto Chart

Once the financial values of all significant quality metrics are calculated, it is necessary to rank these metrics in order of significance. Like the Italian economist Vilfredo Pareto found in the 19th century, not every metric is equally significant and there are a disproportionally small number of metrics that make a significant impact upon the quality outcomes of an organization. Thus, a Pareto Chart helps organizations to prioritize which metrics to invest scarce resources into due to their predicted return on investment (ROI).

5. Create Co-management Arrangements Based upon Quality Metrics That Will Have the Greatest Impact on Clinical and Business Performance

Once the "vital few" strategic metrics are identified and the financial values calculated, co-management agreements can be formally established between physicians and management that will drive predicted clinical and business outcomes with calculable ROIs. I recommend that co-management agreements have at least an ROI of 2:1 so that for every $1 physicians earn, the organization doubles the value for itself. Thus, each agreement becomes a business unit with both a cost and profit center based upon performance.

The following represents a strategic co-management agreement created for an OBGYN in a for-profit healthcare system last year:

A. Above average wRVUs (FMV1 = $400,000)
B. Supervision of four APNs (allowed by Texas state law) (FMV2 = $200,000)
C. Leadership of Charity OBGYN Clinic (FMV3 = $300,000)
D. Leadership of OBGYN service line with negotiated clinical and business outcomes (all have calculated ROI for both clinician and management) (FMV4 = $400,000)

The value of this contract was $1.3 million for the OBGYN who essentially had four contracts, each with its own fair market value calculation. The value of this contract for his employer was $3.9 million and had an ROI of 3:1. Only contract A had a fair market value calculated based upon clinical work. The remaining contracts were based upon management services to hire and oversee advanced practice practitioners, lead a charity clinic to keep uninsured women out of the emergency department and inpatient units, and leadership of a service line that could generate monetized returns.

Conclusion

As the healthcare industry moves from volume to value it is essential that physician compensation be aligned to both clinical and business outcomes that have strategic value for healthcare organizations. The traditional volume-based payments undermine the ability of physicians and management to work together towards shared objectives and is no longer sustainable. The sooner organizations transition to a physician compensation methodology aligned with value, the sooner they will optimize quality and financial outcomes with payers and their own strategic goals and objectives.

The Governance Institute thanks Jon Burroughs, M.D., M.B.A., FACHE, FAAPL, President and CEO, The Burroughs Healthcare Consulting Network, Inc., for contributing this article. He can be reached at jburroughs@burroughshealthcare.com or (603) 733-8156.