Toward a More Perfect Union

Redefining Payer-Provider Collaboration

August 2011

Introduction

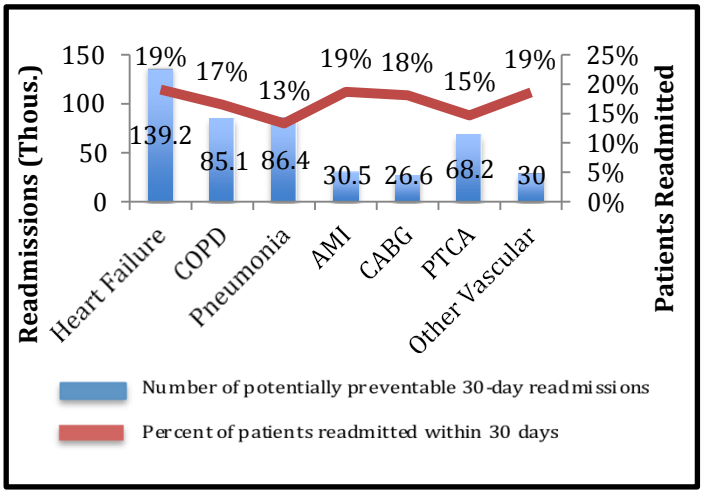
As legislators continue to debate the role of the federal government in administering health care, the need for enhanced coordination between payers and providers has never been more acute. In the last five years, we have seen the most progressive hospitals and health plans enter into partnerships for mutually-beneficial gains. Challenging what was once an openly adversarial relationship, these innovative players are collaborating to share risk, lower cost, and seize market share. Whatever the end result of reform, Health Enterprise Partners contends that the line between payers and providers will continue to blur. We see this trend unfolding in four primary ways:

- Risk-Oriented Payment Restructuring
- Information Technology Integration
- Innovative Physician Employment Models
- Performance Improvement Collaboration

Each of these facets is described in greater detail below.

Risk-Oriented Payment Restructuring

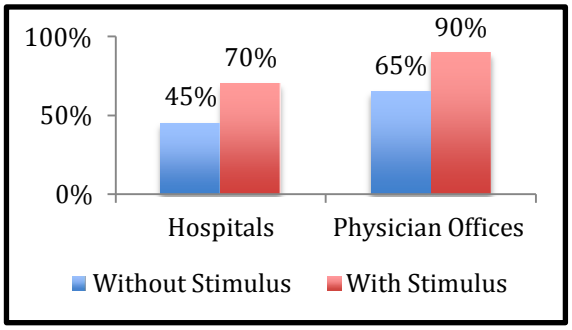
Unsustainable By Any Standards
Medicare Preventable Readmissions



All payment methodologies currently being evaluated by commercial payers as part of reform entail a shifting of the risk relationship between payers and providers. *Readmission penalties,* perhaps the most imminent of these tactics to be implemented, will require hospitals and health plans to partner for care coordination. As it stands, 17.6% of Medicare admissions are readmitted within 30 days of discharge, driving over $15B in excess spending.[1] Similarly, both *episodic and global bundling*—in which a single, risk-adjusted payment is allocated to a hospital— pushes payers, hospitals, and physicians to collaborate in ways they never have before. Finally, the shared savings model presents hospitals and payers with the proposition of sharing in potentially crippling downside risk. Whichever reform frameworks are adopted—and whatever they may be called—we will see the market gradually migrate toward much greater risk assumption by providers.

Information Technology Integration

Wiring for Integration
EMR Penetration, 2019 (E)



It is hardly revolutionary to say that hospitals and health plans have long underinvested in the IT platforms needed to promote efficiency and clinical quality. Spurred by the stimulus, both entities have begun aggressively bolstering their respective IT infrastructures with the products needed to promote alignment. Furthermore, an industry-wide focus on transparency has produced a broad array of

[1] Medicare Payment Advisory Commission.

companies to help hospitals furnish their data to consumers in a more effective way. On the most basic level, the number of hospitals and physician offices possessing an EMR—a necessary component for payer-provider integration—is projected to increase by over 50 percent by 2019.[2] This will, in turn, set the stage for more ambitious data-sharing initiatives. These efforts will be conducted against a backdrop of incentives and penalties associated with maintaining high clinical quality that reinforce the importance of having a robust analytics infrastructure.

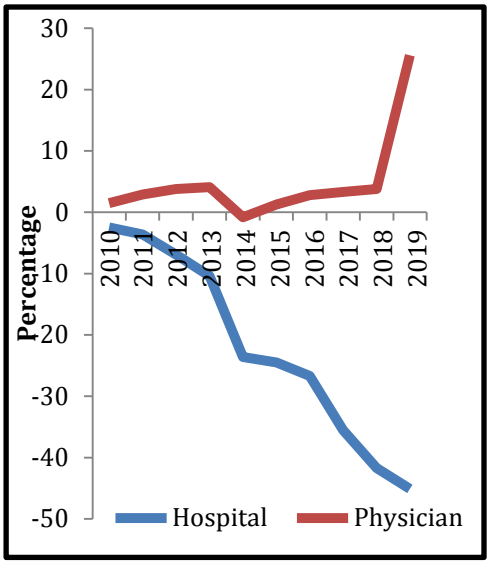
Innovative Physician Employment Models

Capitation in the 1990s tipped off a merger frenzy that drastically reduced the number of hospital providers in the United States. While we remain early in the legislative game, it is widely predicted that the Affordable Care Act will set off a similar wave of horizontal and vertical integration. We should not be surprised to see 500 or more hospitals get swept up in a market share arms race. In such a rapidly consolidating market, scale will become a competitive advantage: those hospitals that join forces with health plans will capture the most share.

Accompanying this centralization of resources is a new generation of physicians that prefer to be employed directly by hospitals and health systems. The physician-hospital consolidation that will occur must invariably involve payers as well. As reflected in the graphic on the right, the projected percentage change in payments to hospitals and physicians over the next 10 years can only serve as a divisive force.[3] Hospitals will increasingly engage physicians in innovative employment models—such as outsourced care and hospitalist programs—which better align payment and incentives between the two groups.

A Divisive Path

Percentage Change in Payments



Performance Improvement Collaboration

Increasingly, hospitals and health plans are taking a longer-term view towards collaboration on performance improvement. Motivated by quality, transparency, and regulatory considerations, payers and providers are striving to meet new sets of benchmarks tied to long-term improvements in patient conditions over time. In the private sector, Thomson Reuters Corporation has popularized the Everest Awards, which rewards payers and providers for joint performance improvement projects. The organization ventures a step further to examine the potential of a variety of collaborative scenarios. Key details from their analysis are displayed at right. [4]

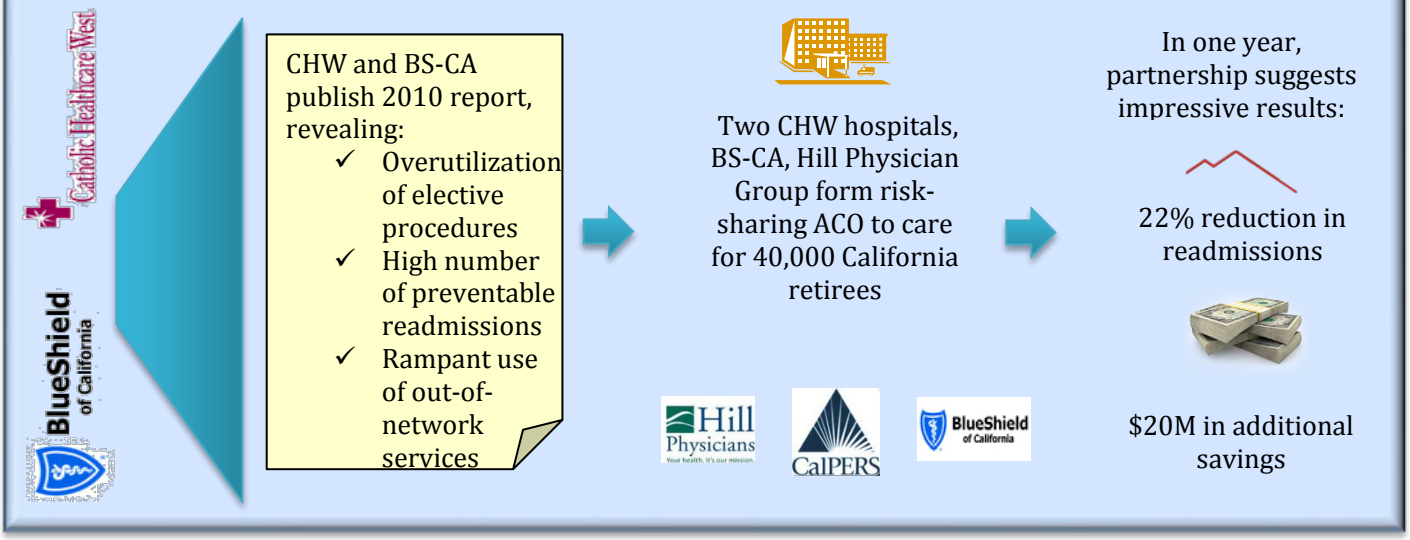
If all Medicare inpatients received a level of care commensurate with the Top 100 hospitals:

- ☑ 107,000 more patients would survive annually
- ☑ 132,000 complications would be avoided annually
- ☑ Expenses would decline in aggregate by $5.9B
- ☑ Average patient stay would decrease by.5 days

[2] Committee on Ways and Means, "Title IV-Health Information Technology for Economic and Clinical Health Act," January 16, 2009,
[3] The Lewin Group, "Cost and Coverage Impacts of the American Affordable Health Choices Act of 2009. " July 27, 2009.
[4] Thomson and Reuters, "Everest Awards: Common Ground for Payer/Provider Collaboration."

Case Study: Partnering for Care and Quality at Catholic Healthcare West

Cognizant of the trends discussed above, forward-looking players have developed innovative risk-sharing partnerships in advance of any government intervention. The following graphic highlights the success of Catholic Healthcare West in creating a high-performing accountable care organization (ACO).



Innovative Companies are Emerging to "Bridge the Gap" Between Payer and Provider

As the sense of urgency surrounding payer-provider alignment increases, a host of companies have emerged to facilitate this transition. As such, HEP believes that this area is ripe for investment. Some of the subsectors that we view as having the greatest impact on payer-provider alignment may be found below.