As the healthcare industry seeks to reduce the cost and improve the quality of care delivery, payment reform has moved to the forefront of the conversation. Among the many factors that are driving this focus on payment reform, 3 trends stand out.

First, the industry is moving away from rewarding activity and toward paying for outcomes, supporting advocates who express the notion that rewarding results is paramount. This is part of a larger shift in healthcare from providing “sick care” to promoting health and wellness.

Second is the realization that for any healthcare reform to succeed, it must bring about greater alignment between payers, providers, employers, and patients—with appropriate incentives to improve quality, efficiency, and outcomes.

And third is the understanding that reducing the enormous variability in care—not just reducing cost—must be inherent to any initiative.

To date, 2 main payment approaches have been deployed in the industry. The fee-for-service model, in which the payer has the full insurance risk, has resulted in poor coordination of care and overutilization, because coordination is generally not reimbursed in fee-for-service models. On the other end of the spectrum, capitation transfers the insurance risk to the provider, by providing a lump sum for the care of each individual, leading to underutilization to the detriment of quality care.

In between these 2 approaches is a system known as “bundled payment” or “global payment”—an emerging approach that is getting significant “buzz” in the industry, and is considered by health economists and other health experts to be one of the most promising initiatives for addressing meaningful payment reform.

**The Benefits of the Bundled Payment Model**

“Bundled payment” refers to a single payment for all care related to a treatment or condition—a payment that is then divided up among multiple providers across many settings. Also called “episode-based payment” or “case rate payment,” bundled payment is seen as an approach that aligns provider and payer incentives to improve both cost and quality. An episode can take many forms—a single rate for all services relating to a particular procedure, combining hospital care and post-acute care, or all treatment of a chronic condition for a defined period of time.

In a bundled payment system, providers take on more financial responsibility for outcomes than in a fee-for-service model. As a result, they have an incentive to use resources wisely. This mechanism is designed to address overutilization, by discouraging duplication of services that provide little or no benefit. When multiple providers in various settings are held accountable for the total cost of care, through shared payment, they have an incentive to coordinate care.

Because providers would not receive additional payment for extra treatment resulting from an unintended consequence of care, such as a hospital-acquired infection and readmission, providers have an incentive to improve the quality of care as a way to prevent costly complications.

**Cutting Costs with Bundled Payment**

The Congressional Budget Office has projected that bundling hospital and postacute care for Medicare patients would save $18.6 billion (0.05%) by 2019. A recent RAND report concluded that bundled payment was the most promising approach for controlling US healthcare spending.

Applying the bundled payment model to the care of all patients with 1 of the 6 chronic diseases and 4 acute conditions that require hospitalizations would lead to a spending reduction of 5.4% across 10 years, mostly by reducing avoidable complications.

For any payment reform model to gain acceptance, it also needs to be aligned with government initiatives. In its goals for value-based purchasing, the Centers for Medicare & Medicaid Services (CMS) has described the possibility of developing “units of payment that go beyond the current approach of paying physicians and hospitals for their individual treatments and instead develop payments for broader bundles of services which

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eventually could even include entire episodes of care for all providers. Physicians and hospitals could then decide how best to provide these services in a more efficient manner on a patient-by-patient basis, and could allocate the payment among themselves in a way that allowed each to share in the savings." This model is already being tested in the current CMS Acute Care Episode Demonstration.

Bundled payment meets many of the government’s goals for value-based purchasing, including payment incentives that are linked to quality and efficiency, joint accountability (clinical and financial) between clinicians and providers, and payment systems that support smooth transitions across providers and settings.

If incentives are truly aligned, and processes are well-integrated, bundled payment may present a win-win for health systems. Organizations that are prepared to work collaboratively will not only be payment reform leaders but will be among the first to reap the benefits of such a system.

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**Obstacles to Implementation**

Although a solid case can be made for bundled payment conceptually, executing this idea presents real challenges, including:

- Defining the “episode of care” that is appropriate for a bundled payment, and creating case definitions that are consistent enough to be applied across varying payment arrangements. The American Medical Association has expressed concern that the science of developing reliable episode groupers is in very early stages, and that very little data are available to identify services where consistency of care across patients would lend itself to this approach.

- Persuading physicians and other providers to adopt changes and modify behavior. The necessary collaboration may occur more readily in integrated systems, where bundled payment is likely to first gain ground. However, as accountable care organizations mature, and alignment between facilities and physicians improves, a broad range of successful models may emerge.

- Shortage of primary care physicians. Providers may be concerned about investing time in a new, unproved primary care model, even if it focuses on better care coordination.

- Current organizational models of disparate stakeholders will pose challenges for bundled payment, especially in community-based care. Physicians may be wary of a hospital in charge of administering their payments.

- Reconciling bundled payment with regulations against self-referral.

- Accounting for patients changing insurance or geographic location during the defined treatment episode.

The largest issue we are now facing is how to build the contracting and payment infrastructure to handle a new payment model. For example, contracting systems will need to specify episodes, and payment systems will need to recognize and correctly handle submissions for episode services versus services that are outside of episodes and should be paid separately.

**Delivering on the Promise of Bundled Payment**

Bundled payment is a fast emerging component of payment reform, and perhaps the most promising new initiative for reducing the cost and improving the quality of care delivery. Despite the many challenges in executing bundled payments, there is a strong interest in this option from all stakeholders—providers, payers, and the government.

The early experiments in bundled payment—including the Geisinger system and the Prometheus Payment model—have provided valuable insights and have been used in many savings projections for bundled payment that demonstrate clear advantages over fee-for-service models.

Next-generation payment systems are now available that provide, for the first time, the flexibility to look at claims across multiple providers, multiple facilities, and across time. Industry adoption of this new breed of payment system is critical to ensuring bundled payment moves from the experimental stage to broad market acceptance.

In a follow-up article, we will delve into the current state of bundled payment, including a look at pilot projects, key learnings, and what tools and processes are needed to realize the full potential of bundled payments.

**References**


