Stanford eCorner

Incentives Do Matter

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Rock Health CEO Halle Tecco argues why healthcare does not exist as a free market in the United States. With prices held as proprietary information by hospitals, and doctors and providers compensated by volume through fee-for-service models, Tecco identifies why changes to the incentive structures are critical for improving healthcare in America.

Transcript

Healthcare is not a free market. The prices are not transparent to us unlike any other big ticket expense. If anybody has bought a car or a house or even a haircut, it's virtually impossible to know how much a medical procedure cost until you get the bill. If you try calling a hospital and asking them how much something very routine cost, they will tell you that that's proprietary information. Not only are healthcare prices opaque, but they're based on what hospitals and doctors do rather than what patients need. In theory, hospitals determine the price of procedures using what is called a charge master. Essentially this is a database containing all the procedures that they perform and the associated price. However, insurance companies, they like to negotiate prices and since they cover many, many lives in a region, a hospital has little leverage if they want to see those patients. So the only people who really end up paying the full price that's listed on the charge master are those who are least able to pay, the unemployed, or the - sorry, the uninsured. A problem with how we price healthcare traditionally is that hospitals and doctors are paid based on the volume of procedures that they perform.

The fee for service system only creates perverse incentives rewarding volume rather than health outcomes. And it does little to encourage preventative care, even if it would significantly improve a patient's outcomes in the long run. Do you think a hospital makes more money from preventing or treating a heart attack? Yes, they absolutely make way more money treating a heart attack than educating patients so that they don't get the heart attack in the first place. One of our entrepreneurs told me a story that I really like. During the 1800s the British colonies were sending their prisoners to Australia and they were paying the ship captains for every prisoner that would get on the ship. As you can imagine the ship captains would then take as many prisoners as they could and stuff them in the ship and send them to Australia. But only about half of the prisoners were surviving that long trip. And they thought this was a problem, so they started sending doctors on board. They started providing citrus to combat scurvy, but nothing worked. Still about half of the prisoners will die before they get to Australia.

Then Economist Edwin Chadwick suggested a change in the incentive structure for the ship captains. Instead of paying them for every prisoner that boarded the ship in the U.K., instead, why not pay the ship captains for every prisoner that got off alive in Australia? Can you guess what happened? Survival rates went from 50% to 98%. The moral of the story is that incentives really do matter and we've fallen into this system where our incentives are just completely out of wack.