

# Exploiting Perverse Incentives:

Kentucky Basketball and Prime Healthcare

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By David Johnson, CEO

Hoping to become college basketball's first undefeated champion in almost forty years, the Kentucky Wildcats captured the nation's attention as they qualified for this year's "Final Four" tournament in Indianapolis.

Everybody loves a winner. The real question, however, is whether Kentucky's team represents the height of college athletics or merely operates as a professional basketball development program.

Perverse incentives distort behavior and generate undesirable consequences. They cause the most damage when focused on the wrong outcomes (winning at all costs) or when incentives are process-driven (treat patients as much as possible) rather than outcomes-driven (curing patients).

Healthcare payment is riddled with perverse incentives. Providers optimize revenues by applying complex coding formularies to treatment activities. Many overstep. Medicare fines for improperly billed "short-stay admissions" highlight the regulatory challenge of monitoring payment compliance.

Even when legal, perverse incentives foster unethical behavior. When taken to extremes, the consequences of pursuing perverse incentives can be catastrophic.

This article explores how perverse incentives infect college basketball (winning at all costs) and healthcare (singularly pursuing payment) by examining college basketball's most successful team (University of Kentucky's Wildcats) and healthcare's fastest growing health system (Prime Healthcare Services)

## Madness in March

Perverse incentives and their unenviable consequences were on full display in this year's NCAA college basketball tournament (a.k.a. March Madness). Professional basketball's age limit has turned big-college basketball into an NBA (National Basketball Association) development league.

March Madness is huge. Tens of millions of Americans complete "brackets" for the month-long college basketball tournament. Television networks pay the National Collegiate Athletic Association ("NCAA") over \$700 million each year to broadcast the single-eliminations games. "Cinderella" stories, high drama and plot twists abound.

Here's the catch. Big-schools always win the tournament and reap \$ millions in publicity, alumni donations and brand cachet. Chasing tournament glory fosters ferocious compe-

tion for America's best high school basketball players. No big school personifies a winner-take-all mentality in college basketball more than the Kentucky Wildcats.

## Kentucky Basketball under Coach Calipari



In 2009, John Calipari began his "dream job" as head coach of the University of Kentucky's legendary basketball program. UK's program had fallen on hard times. They hadn't advanced to the Final Four since 1998. Worse still, Kentucky failed to qualify for the 2009 NCAA Tournament.

Coach Calipari quickly improved the program by recruiting more McDonald's All Americans (the nation's twenty-four best high school players). NBA rules essentially mandate that U.S. players attend one year of college. Powerhouse collegiate programs, like Kentucky's, "rent" the best players until they're NBA-ready.

In Calipari's six years at Kentucky, the Wildcats have advanced to the national semi-finals (the "Final Four") four times. They won it all in 2012. NBA teams have drafted eighteen of his players with seven more expected to go in this year's draft. None of these elite players graduate. Basketball recruits don't attend Kentucky to pursue higher education. They're pursuing professional basketball careers.

Kentucky basketball is riding high. Heading into its Final Four match-up against Wisconsin, the undefeated Wildcats ranked number one and appeared unbeatable. The team had nine McDonald's All-Americans and another player projected as a top-ten NBA draft pick. Only one player, seldom-used senior Tod Lanter, was from Kentucky.

Recognizing Calipari's success, the University now pays him \$8 million per year plus bonuses. On its road to tournament glory, however, Kentucky basketball slaughters quaint concepts like education first, amateur athletics and student-athletes.

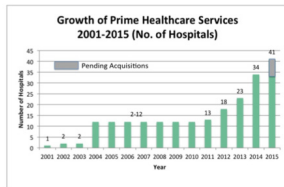
Truth, beauty and justice can prevail. Playing with local student athletes and no McDonald's All Americans, the Wisconsin Badgers defeated Kentucky 71-64 in a hard-fought game.

## Prime Healthcare Services: America's Fastest Growing Health System



Prime Healthcare

*Saving hospitals. Saving jobs. Saving lives...*



With only one California hospital in his portfolio, Dr. Prem Reddy founded Prime Healthcare Services in 2001. Today, Prime operates thirty-four hospitals with thirty-five thousand employees in eleven states.

According to a November Modern Healthcare cover story, Prime acquires failing hospitals and makes them profitable by billing aggressively, adding profitable service lines, slashing managerial costs and negotiating better payor contracts.

Among Prime's more controversial tactics are pushing volumes, inflating prices for out-of-network billing (particularly in emergency services) and upcoding. It's telling that "saving hospitals" and "saving jobs" come before "saving lives" in Prime's tag line.

A single story illustrates Prime's approach. In November 2008 Prime acquired Shasta Regional Medical Center in Reading, California. Shortly thereafter, Medicare patients in Reading experienced an explosive outbreak of kwashiorkor, a nutritional disease that "almost exclusively effects impoverished children in developing countries". After diagnosing only eight episodes of kwashiorkor in 2008, Shasta Regional diagnosed 1030 kwashiorkor cases in 2009. This was seventy times the state average of 0.2 percent.

Kwashiorkor diagnoses generate incremental Medicare reimbursement payments.

Taken to its extreme, fee-for-service payment can generate counter-productive, winner-take-all behavior. Hospitals bill aggressively and gut costs with reduced regard for quality and outcomes. No health system personifies fee-for-service's predatory economic behavior more than Prime Healthcare Services.

### Hypocrisy

Kentucky basketball and Prime Healthcare are logical manifestations of "broken" systems riddled with perverse incentives. Both Kentucky basketball and Prime Healthcare aggressively pursue strategies to optimize performance. Unfortunately, their success comes at society's expense.

Perverse incentives invite hypocrisy. Organizations speak one truth and live another. The NCAA touts the benefits of athletic scholarships while operating a development program for professional basketball. Prime "saves" hospitals by bilking payors.

### Healthcare's "Cure" for Perverse Incentives

While positive payment reform is occurring, perverse incentives will continue in healthcare delivery for the foreseeable future. How should providers respond? Here are a few suggestions:

1. **Don't Dig a Deeper Hole:** Refrain from new investments and strategies predicated solely on receiving higher payment rates. If a new initiative doesn't provide better care at lower costs, don't pursue it.
2. **Migrate Care to Lower-Cost Facilities:** Don't expect to receive higher payments for routine procedures performed in high-cost inpatient settings. Respond to payor and consumer demands for routine care in lower-cost, more convenient ambulatory settings. Where possible, extend hours to increase access and reduce per-unit costs.
3. **Standardize, Reduce Variance and Improve Quality:** Become a true "clinical outcomes" organization. Practice care that generates the best outcomes. Quality improvement and cost reduction will follow. Publishing care outcomes increases accountability and accelerates improvement. Dr. Rick Afable, the CEO for St. Joseph Hoag Health, asks this provocative question, "Which of our patients signed-up for the higher variation, lower quality care?"
4. **Understand Costs:** Deep-six any cost accounting systems tied to revenues (i.e. ratio of costs to charges). Move toward time and activity-based systems that align per-unit costs and revenues in meaningful ways.
5. **Speak and Live the Truth:** most health systems say they put patients interests first, but often sublimate patient needs to physician demands, reimbursement realities and organizational inertia. Consumerism is coming to healthcare. Providers that square their operations with their rhetoric win customer trust and competitive advantage.

America can live with an over-hyped college basketball tournament. The country, however, cannot afford healthcare payment models that promote excessive treatment and predatory billing. Health systems that deliver better, more affordable and convenient healthcare deserve far more acclaim than all NCAA champions combined.