"Amazoning" Healthcare's High Prices

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By David Johnson, CEO

A recent Kaiser Health News article reports that prices for basic women's health services vary dramatically within and across markets. The cost for mammograms in Dallas range from $50 to $1,045.

A January Blue Cross report on joint replacement surgeries between July 2010 and July 2013 reflects the same pattern. Massachusetts Blue Cross plans paid hospitals median prices between $17,910 and $73,987 for hip replacement surgeries. Median knee replacement prices in New York City ($61,266) were almost four times higher than in Montgomery, Alabama ($16,097).

A July Blue Cross report found even greater variation in angioplasty payments between March 2011 and March 2014. Blue Cross plans paid Los Angeles hospitals median prices between $10,749 and $67,937 (a 532% variation). The median angioplasty cost in Sacramento was $61,231 versus $15,494 in Birmingham, Alabama.

Healthcare's worst-kept secret is that individuals, companies and governments pay remarkably varied prices for routine procedures with no discernable difference in outcomes.

Policy explanations for extreme payment variation will not protect high-cost hospitals from losing treatment volume as market forces drive customers to lower-price providers.

Regulatory versus Market Mindset

In normal markets, prices reflect intrinsic supply-demand relationships. Managers employ a "market mindset" to create value for customers and profits for their companies.

In healthcare, payors compensate providers in accordance with complex reimbursement formularies. Contrary to normal market function, there are no negative consequences for receiving higher payments for routine services. This spawns a regulatory mindset among health company executives. Managers strive first to optimize revenues, not value.

Unlike normal markets where consumer preferences shape supply-demand relationships, patients/customers tolerate pricing variation. With little awareness of healthcare prices and limited payment responsibility, they follow doctors' advice regarding when and where to receive treatments.

Healthcare's artificial/regulated market environment has benefited providers for decades. However, there's disruption on the horizon. Creative companies with better information and tools are establishing customer-friendly, value-based purchasing models for routine services.

Amazoned! The Case of Disappearing Book Stores, Publishers and Distributers

When Aaron Martin was leading Amazon's foray into self-publishing, his worldview was both simple and devastating. The only irreplaceable components of the "book business" were the authors and the readers. Amazon technology could diminish and even replace publishers, distributors and book stores.

Vision became reality. Amazon systematically attacked each of these vulnerable supply-chain components:

- In 1997, Amazon launched its e-commerce platform to sell and distribute books directly to consumers. Amazon offered vast selection, low prices and home delivery. Incumbent book distributers and sellers struggled to compete with Amazon's superior service offerings. Like travel agencies, book stores became unnecessary and closed by the thousands.
- In 2005 Amazon attacked publishing. Through acquisition, Amazon acquired on-demand publishing capabilities and unified them under its "CreateSpace" brand. CreateSpace offers overnight publishing for authors with attractive royalty payments. Authors jumped for greater editorial control and more income. According to a 2013 Bowker report, self-published books nearly tripled between 2007 and 2012.
- In 2007 Amazon attacked book distributors again in 2007 with the launch of e-books suitable for on-line reading. E-books are less expensive, more portable and easier to search/annotate. Readers love them. PWC projects e-book sales will surpass printed book sales by 2017.

In ten short years, the Amazon-led disruption of the book industry has liberated authors and readers while decimating intermediaries. Authors have greater autonomy, more publishing options and higher earnings. Readers have greater selection, lower prices, incredible convenience and powerful curating tools.

Publishers, distributors and booksellers, however, are reeling. They've either adapted their business models to new market realities or exited the industry. Amazon's marketing slogan, Amazon.com and you're done, could be listed as the cause of death from a coroner's report on the demise of book stores.

"Amazoning" Healthcare

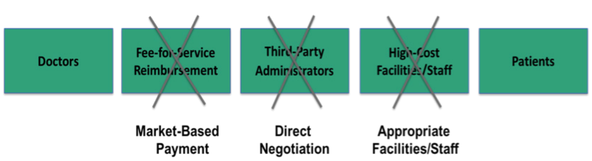
Aaron Martin left Amazon in January 2014 to lead strategy and innovation at Providence Health & Services, one of the nation's largest healthcare systems. Aaron believes the same forces that disrupted book publishing, distribution and sales are now attacking healthcare. His job, in essence, is to prepare Providence for the industry's pending disruption.

In Aaron's mind, the analogs for authors and readers in healthcare are doctors and patients. The intermediate supply-chain components are vulnerable. These include hospitals, insurance companies, brokers, device manufacturers and pharmaceutical suppliers.

Fee-for-service (FFS) reimbursement still dominates. A 2015 Health Management Academy and H2C survey of leading health systems found FFS payments still account, on average, for 85% of revenues.

FFS payments reimburse providers for their costs, which include treatment complexity, wage rates, indigent care volume and educational expenses. FFS payments divorces healthcare prices from normal supply-demand relationships. It is the root cause of the pricing variation embedded in U.S. healthcare delivery.

FFS payment system incentivizes high-cost, inefficient, hospital-centric care delivery, even for routine procedures. Third-party intermediaries are well-positioned to exploit excessive FFS reimbursement, over-compensated third-party administrators and high-cost delivery. They will employ the following tactics: 1. Market-based payments for routine treatments; 2. Direct negotiation/contracting between doctors and patients; and 3. Appropriate, lower-cost facilities and staffing levels.



In "Amazoned" healthcare, value-based care delivery wins. The market will guide purchasers toward high-quality, lower-cost providers with great service.

Mind the Gap: The Danger of High Reimbursement Payments

Most hospital-based colonoscopies cost between $3,000 and $4,000. In addition to paying for the gastroenterologist performing the procedure, this price includes a hefty facility charge and payment for a licensed anesthesiologist. Other gastroenterologists perform the same procedure profitably for $700 in their offices nurse anesthetists. Why pay more?

The wider the "gap" between reimbursed prices and market prices, the greater the opportunity for disruptive technologies to redirect customers to lower-priced treatment alternatives.

"Bundling" companies like HealthEngine and Medycation have technology platforms that enable individuals to shop on-line for routine healthcare services.

Bundling companies receive price bids from physicians and facilities for providing specific services. They assemble procedure "offerings" with prices to create one-stop shopping experiences for customers. Think Priceline for healthcare services. Expect bundlers to arrange ever more colonoscopies, angioplasties, joint replacements and other routine procedures as their value-based business models gain traction.

Given equivalent quality, transparency forces prices to coalesce at the lowest-price levels. Pricing variation shrinks dramatically. This happened in California when CalPERS introduced $30,000 reference pricing for joint replacement surgery. Five-fold pricing variation collapsed as payments for joint replacement surgery coalesced around the $30,000 price point.

Warning

No individual, self-insured employer or government wants to pay more for routine procedures than necessary. This age-old economic reality is creeping into healthcare services. High-cost providers who fail to develop alternative, lower-cost treatment platforms will lose market relevance