Manuscript Number: JHM-D-11-00061R2

Full Title: Managing Pay for Performance; Aligning Social Science Research with Budget Predictability

Short Title: Original Research Article

Keywords: Pay for performance design, P4P, Pay-for-Performance, incentives, organization, competition, rewards, social science research, healthcare

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Manuscript Region of Origin: USA

Abstract: Managers and policy makers need practical guidelines to assess the increasingly popular pay-for-performance (P4P) programs. Ideally P4P programs should avoid pitfalls and be budget neutral. Evaluations of P4P programs are mixed and confusing. Methodological problems are common. This article first identifies and summarizes obstacles to effective P4P programs that should be avoided. Second, social science research results going back decades are culled to provide evidence-based P4P best practices. These are summarized and their concrete applications indicated (Table 1). Surprisingly, the now-common zero-sum and "earn it back" P4P incentive systems are found to have important drawbacks. Social science research suggests that punishing participants for lower performance may end up reducing individual and organization performance, especially when involvement is obligatory. Optimal P4P systems reward all participants for performance improvements. Third, we link P4P design to budgetary considerations. Practitioners are faced with budgeting for P4P systems in advance. This is complex because of the difficulty of calculating the cost of such programs prior to implementation. The solution is to incentivize performance that, at the same time, improves quality and reduces costs. These P4P designs are critical if budget neutrality is a priority and resources are limited. Cost-calculations are straightforward. By definition, the greater the participation, the higher the savings. P4P strategies should first focus on this combination, where payer and provider incentives are aligned. We conclude by recommending this fail-safe P4P approach to practitioners because it is both evidence-based and doesn't require large, upfront investment. More research on this topic is also advised.

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Executive Summary

Managers and policy makers need practical guidelines to assess the increasingly popular pay for performance (P4P) programs. Ideally P4P programs should avoid pitfalls and be budget neutral. Evaluations of P4P programs are mixed and confusing. Methodological problems are common. This article first identifies and summaries obstacles to effective P4P programs that should be avoided. Second, social science research results going back decades are culled to provide evidence-based P4P best practices. These are summarized and their concrete applications indicated (Table 1). Surprisingly, the now-common zero-sum and “earn it back” P4P incentive systems are found to have important drawbacks and may be counterproductive. Social science research suggests that punishing participants for lower performance may end up reducing individual and organization performance, especially when involvement is obligatory. Optimal P4P systems reward all participants for performance improvements. Third, we link P4P design to budgetary considerations.

Practitioners are faced with budgeting for P4P systems in advance. This is complex because of the difficulty of calculating the cost of such programs prior to implementation. This problem can be solved by incentivizing performance that at the same time improves quality and reduces costs. These P4P program designs are critical if budget neutrality is a priority and resources are limited. In these types of P4P design, cost-calculations are straightforward because by definition, the greater the participation, the higher the savings. P4P strategies should first focus on this combination, where payer and provider incentives are aligned. We conclude by recommending this fail-safe P4P approach to practitioners because it is both evidence-based and doesn’t require large, upfront investment. More research on this topic is also advised.

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