

# Pay-for-Performance in Australian Healthcare

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A Position Paper by the  
Australian Institute of Health Executives (AIHE)

**Release Date: November 2025**

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## Executive Summary

Australia’s health system is at a crossroads. The demands of an ageing population, workforce pressures, and fiscal constraints are intensifying, while community expectations of safe, high-quality, and equitable care are stronger than ever. Traditional funding models have incentivised activity but not necessarily value, resulting in inefficiencies and variation in care quality.

The Australian Institute of Health Executives (AIHE) believe it is both possible, and necessary, to align financial incentives with outcomes. Safety and quality must not be seen as competing with financial sustainability — they are mutually reinforcing and mutually beneficial.

This position paper sets out how pay-for-performance, underpinned by rigorous clinical governance and value-based healthcare (VBHC) approaches, can improve patient outcomes, reduce waste, and strengthen the sustainability of Australia’s healthcare system. It also outlines priority areas, a practical roadmap for implementation, and key policy recommendations.

## Background and Rationale

For decades, activity-based funding has dominated hospital financing in Australia. While this has expanded access, it has also embedded perverse incentives to increase volume rather than focus on outcomes. This system inadequately rewards services that prevent complications, reduce readmissions, or support patients to recover at home safely.

Internationally, pay-for-performance models have been trialled with varying success. The evidence shows that poorly designed programs risk encouraging superficial compliance or “gaming,” while well-designed programs can reduce hospital-acquired complications (HACs), improve patient safety, and encourage innovation.

AIHE recognises that Australia has strong foundations —a mature health system, national safety and quality standards, and established funding mechanisms. The challenge now is to evolve these structures so they incentivise what matters most: patient safety, clinical effectiveness, and sustainable value.

## Our Position

AIHE affirms that:

1. Safety, quality, and financial responsibility are complementary. Funding models must reward outcomes that improve patient wellbeing and reduce avoidable harm, thereby reducing costs in the long term.
2. Clinical governance must be the foundation of all pay-for-performance initiatives. Without rigorous governance, measures may be unfair, distort behaviour, or erode trust.

3. Incentives and penalties must be targeted and proportionate. They should encourage improvement, not punitive withdrawal of resources from struggling services.
4. Equity must be safeguarded. Programs must ensure that disadvantaged populations and complex patients continue to receive fair, high-quality care.
5. Partnerships are essential. Success requires alignment between clinicians, executives, boards, governments, and patients.

## The Role of Clinical Governance

Clinical governance ensures accountability for continuously improving the quality of care and safeguarding high standards. In pay-for-performance systems, AIHE is uniquely positioned to provide the expertise and frameworks that guarantee credibility, fairness, and clinical integrity, including building capability by equipping boards, clinicians, and managers with core clinical governance skills to interpret performance data and embed quality improvement.

## The Role of Health Executives

Health executives and boards have a critical role in ensuring that pay-for-performance models are implemented effectively at scale. This includes expert medical advisory and consultancy in value-based funding frameworks to align payments with patient outcomes and experience, implementing selective contracting to direct services to high-performing providers, supporting health services to apply penalty-based adjustments to reduce preventable harm and aligning organisational incentives and performance systems with pay-for-performance objectives.

## Priority Areas for Implementation

We propose the following priority areas and mechanisms for staged implementation:

1. **Hospital-acquired complications (HACs):** Optimise current penalties and support programs to accelerate reductions in HACs.
2. **Readmissions and length of stay:** Reward safe discharge and coordinated post-hospital care.
3. **Low-value care:** Decommission or penalise services proven to add little benefit, guided by Choosing Wisely recommendations.
4. **Bundled payments for high-variation episodes:** Encourage efficiency and quality in procedures such as joint replacements.
5. **Performance-tiered (selective) contracting:** Use transparent performance tiers to reward improvement and encourage accountability.

## Risks and Mitigation

While pay-for-performance programs offer significant benefits, they also carry inherent risks that must be anticipated and proactively managed to ensure effectiveness:

- **Gaming or upcoding:** When incentives are linked to outcomes, there is a risk that providers may manipulate documentation or coding to artificially improve performance. Mitigation includes independent audits, standardised definitions, regular validation processes, and transparent reporting to discourage manipulation.
- **Avoidance of high-risk patients:** Providers might avoid complex or high-risk patients to protect performance metrics. Mitigation requires robust risk adjustment, ongoing monitoring of case mix, contractual safeguards, and oversight to maintain equitable access for all populations.
- **Reduction in necessary care:** Financial incentives could unintentionally discourage appropriate interventions or lead to premature discharges. Mitigation involves balancing efficiency metrics with safety and outcome measures, including readmissions, adverse events, and patient-reported outcomes to ensure quality care is maintained.
- **Equity erosion:** Pay-for-performance programs without safeguards risk diverting resources from underperforming or disadvantaged services, exacerbating inequities. Mitigation includes embedding equity-focused provisions, providing targeted support, investing in capacity-building, and reinvesting savings into improvement initiatives for vulnerable populations.

## Principles

To ensure credibility and sustainability, AIHE strongly asserts that all pay-for-performance initiatives must:

- Be clinician-led and co-designed.
- Include relevant expertise and thought leadership input across the industry in the design and implementation.
- Use standardised, evidence-based definitions.
- Apply robust risk adjustment for fair comparisons.
- Be piloted and evaluated before broad rollout.
- Promote transparency through public reporting.
- Reinvest savings into quality improvement and workforce capacity.
- Include safeguards against perverse incentives.
- Embed equity protections for disadvantaged populations.

## Roadmap for National Adoption

1. Adopt a nationally harmonised outcome set for all pay-for-performance initiatives.
2. Pilot targeted programs in selected hospitals.
3. Build national registry and data infrastructure. Reinvest financial savings into workforce, registries, and quality improvement.
4. Develop model contracting templates with incentives, penalties, and equity clauses.
5. Mandate clinician-led governance structures and independent evaluation.
6. Evaluate, refine, and scale based on results.

## Conclusion

AIHE believes that well-designed pay-for-performance initiatives can simultaneously strengthen patient safety, improve outcomes, and enhance the financial sustainability of the health system. Clinical governance provides the foundation for fair and credible measurement, while value-based contracting and healthcare executive leadership ensures incentives are aligned with system goals. By adopting a measured, evidence-based approach, Australia can deliver safer, higher-value healthcare for all Australians.

## Acknowledgements

This position paper was developed by the Australian Institute of Health Executives. It reflects our commitment to advancing a healthcare system that is safe, effective, accountable, and financially sustainable.

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