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Executive Compensation and Governance Considerations for Health Systems

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What's Inside:

Health systems continue to face a difficult environment. While operating margins for the overall industry have shown some modest improvement in early 2023, the long-term financial outlook remains challenging due to increased costs of labor, supplies, and borrowing, as well as ongoing revenue pressures due to service mix changes, access limitations, and volume shortfalls. Concurrently, the demand for executive talent is high due to the departure of experienced leaders and the evolving skills needed to manage increasingly complex operations and changing care delivery models. Consequently, there has been ongoing upward pressure on healthcare executive compensation, despite the challenging financial environment.

Against this backdrop, the scrutiny of executive compensation within not-for-profit health systems is intense. The Federal Trade Commission (FTC) is considering limits on the use of non-compete clauses, the Department of Justice (DOJ) is encouraging links of compensation to compliance, and the media, elected officials, and other stakeholders are questioning compensation levels.

Compensation committees are balancing these financial, operational, talent, and governance risks on their performance and in their executive compensation program. This article summarizes the priorities that health systems and their compensation committees should consider for the rest of 2023 and beyond.

Key Priorities

1. Reward Differentiation

Optimizing the organization's compensation investment is particularly important given the industry's financial challenges:

- **Provide flexibility in the compensation philosophy**: Three areas should be considered for the compensation philosophy to optimize rewards spend: 1) reference a range of market competitiveness (e.g., 50th to 75th percentiles) rather than having one target percentile for all executive roles; 2) provide peer references outside of not-for-profit healthcare when needed for particular roles (e.g., general industry, managed care); and 3) allow for the use of individually tailored programs when needed (e.g., individual retention awards).
- **Direct rewards to high performers and critical positions:** Ensure the differentiation of rewards for top talent. Provide market adjustments to salary to improve competitive positioning. Utilize an incentive program to recognize strong performance through discretionary awards beyond the plan formula.
- **Tailor programs for non-traditional operating segments**: Consider whether a different compensation program is appropriate for select operating segments, such as commercialization businesses, investment functions, and health plans.

2. Talent Strategy and Alignment

The competitive talent market reinforces the need to build talent from within and to optimize the leadership structure:

- **Assess the leadership structure:** Organizations should evaluate the leadership structure to ensure it is optimal for its operations. In SullivanCotter's April 2023 Executive Compensation Pulse Survey of 108 large health systems, about three-quarters of respondents indicated that they are taking actions around their leadership structure. Priorities include a review of leadership headcount, distribution of roles by level, management layers, titling guidelines, and spans of control. Leveling guidelines should be reviewed to support talent development and integration.
- **Conduct regular talent assessments and refresh development plans**: Ensure that there is a robust process for regularly assessing leadership to identify high performers and high potentials. Prepare and regularly refresh development plans to support career advancement.
- **Review succession plans**: Embed succession planning into talent development. Ensure that emergency and permanent succession plans are in place. Identify gaps and determine actions, including internal development, external recruitment, and role redefinition opportunities.
- **Evaluate and mitigate talent risk:** Assess potential retention risks of critical leaders. Determine mitigation strategies, including compensation actions and professional development plans.

- **Integrate diversity, equity, and inclusion (DE&I):** Ensure that DE&I is incorporated into all aspects of talent planning, including leadership development, talent sourcing, pay equity analyses, and organizational structure assessment.

3. Incentive Plan Effectiveness

Examine the executive incentive plan to ensure rewards are appropriately aligned with performance:

- **Focus on key performance priorities:** Ensure that incentive goals reflect critical priorities that align with the health system's evolution. Goals of particular focus include cost efficiency, quality, workforce engagement, access, growth, and patient satisfaction.
- **Account for uncertainty in goal setting:** The uncertain and volatile environment creates challenges for performance forecasts. Consider the use of relative performance indicators, validate that the range of performance standards for threshold/target/maximum reflects current uncertainties, determine if milestone goals are appropriate, and assess if the performance period for goals should be shortened (e.g., using two six-month goals rather than a 12-month goal).
- **Verify incentive performance standards:** Performance standards should reflect appropriate improvement over the baseline and goals that are attainable while representing a reasonable degree of stretch.

4. Governance

Compensation committees will likely continue to exercise business judgment as pay actions are determined. Consider the following:

- **Be flexible:** Balance performance, market uncertainty, and the competitive talent market as decisions are made on performance goals, incentive awards, and compensation adjustments. Prepare to apply discretion when necessary to ensure that recruitment, retention, talent development, and performance needs are met. Consider the development of guidelines to structure the application of discretion.
- **Prepare for potential scrutiny:** The compensation committee should be apprised of and consider the implications of potential scrutiny. Compensation committees should assess the impact of the DOJ's rules to encourage links of compensation to compliance, the FTC's proposals to limit the use of non-compete clauses, state actions around pay transparency, and media and other stakeholder scrutiny. Undertake a review of the executive compensation program attributes, plan

design, employment and severance agreement terms, and policies/practices to determine if adjustments are needed. Update the board on the executive compensation program and governance process to ensure that all members are aware of the organization's program and practices.

- **Understand implications for staff and physician compensation:** Consider receiving educational updates on broader workforce implications as part of enterprise risk management activities. Determine whether changes to physician compensation oversight are required.

→ Key Considerations for Compensation Committees

Not-for-profit health systems are facing a difficult environment. The financial outlook is challenging and there is uncertainty about the future. Concurrently, the demand for executive talent is high, and compensation levels have been increasing. Against this backdrop, the scrutiny of executive compensation is intense.

Compensation committees and health system leaders are balancing these financial, operational, talent, and governance risks in their executive compensation program. Compensation committees should consider four priorities:

- **Reward differentiation:** Provide flexibility in the compensation philosophy, direct rewards to high performers and critical positions, and tailor programs for non-traditional operating segments.
- **Talent strategy and alignment:** Assess the leadership structure, conduct regular talent assessments and refresh development plans, review succession plans, evaluate and mitigate talent risks, and integrate DE&I in talent strategy.
- **Incentive plan effectiveness:** Focus on key performance priorities, account for uncertainty in goal setting, and verify incentive performance standards.
- **Governance:** Be flexible, prepare for potential scrutiny, and understand the implications for staff and physician compensation.

By being vigilant about monitoring the environment and regularly evaluating and refining compensation programs and governance, compensation committees and health systems can ensure that the program supports executive recruitment, retention, and performance.

Conclusion

Compensation committees and health system leaders face a challenging environment that requires balancing the competitive executive and clinical talent market with a volatile and uncertain performance environment, changes to clinical delivery models, and increasing scrutiny of executive compensation. Committees are well served to regularly review the executive compensation philosophy and program, performance goals, talent strategy, and governance practices to ensure that recruitment, retention, and rewards objectives are met and that the program is beyond reproach if scrutinized.

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Effectively Addressing Clinician Burnout: A Key to Enhancing Healthcare Quality

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Recruitment, retention, and financial challenges top the list of urgent and important issues worrying hospital CEOs in 2023. These issues in turn affect quality, safety, and patient experience, ultimately impacting growth and market share.

Burnout, a root cause of workforce and financial challenges, has emerged as a significant issue with far-reaching and multifaceted implications that healthcare executives cannot afford to overlook.

Understanding the Interconnection

Clinician burnout is the manifestation, in an individual, of dysfunction in the workplace. Put another way, the problem with burnout is the workplace, not the worker. Burnout is characterized by emotional exhaustion, depersonalization, and a reduced sense of personal accomplishment.

Contrary to popular belief, burnout is not the result of insufficient personal resilience on the part of clinicians. This misconception leads all too frequently to a misguided organizational response—a focus on enhancing clinician resilience. While there is nothing inherently wrong with offering expanded "wellness" benefits such as meditation, yoga classes, gym memberships, "recharge rooms," or literature-and-medicine affinity groups, these provide temporary symptom relief.

Strengthening individual resilience does not change the underlying conditions in the workplace—the workflows and leadership practices that *cause* burnout. Clinicians realize that their jobs are becoming "undoable" as a result of the array of expectations placed upon them by numerous external stakeholders. They are looking for leaders who recognize this as well.

In *The Burnout Challenge*, the authors demonstrate how burnout results from workplace conditions, within which they identify six job-person mismatches:[1]

- Work overload
- Lack of control
- Insufficient reward
- Breakdown of community
- Absence of fairness
- Values conflict

The first of these, work overload, drives exhaustion and is impacted by workloads and workflows. The other five mismatches drive cynicism and are impacted by leadership. Whether one leads a small team of two or three people, or a health system with 20,000 employees, the leader's personal approach to these mismatches has the most significant impact on the burnout experience for the members of that team.

The Significance of Burnout in Healthcare

Burnout is a systemic problem that affects the entire healthcare ecosystem. The high-stress environment, long hours, emotional toll, cumbersome workflows, and increasingly complex administrative requirements contribute to healthcare professionals, including healthcare executives, feeling overwhelmed, detached, and ineffective.

Burnout among clinicians has been associated with decreased patient satisfaction, higher patient mortality rates, and increased medical errors.

High-quality patient care relies on a trusting relationship and positive interaction between healthcare providers and patients. Depersonalization, one of the manifestations of burnout, can lead to a lack of empathy, a critical factor in patient relationships. Care that lacks empathy results in lower patient satisfaction and less adherence by patients to treatment plans.

A study published in the *Mayo Clinic Proceedings* of 6,695 physicians from August to October 2014 found a significant association between physician burnout and medical errors, even after adjusting for specialty, work hours, fatigue, and work unit safety

1 Christina Maslach and Michael P. Leiter, *The Burnout Challenge: Managing People's Relationships with Their Jobs*, Cambridge, MA: Harvard University Press, 2022.

rating.[2] Nurses are impacted as well. In a recent University of Pennsylvania study, lead author Linda Aiken, Ph.D., RN concluded, "(t)ransformational improvements in hospital nurse staffing and clinical work environments are needed to stabilize the hospital nurse workforce and provide safe patient care."[3]

Often overlooked, healthcare executive burnout rates have now risen to levels that equal those of clinicians. A recent WittKieffer study found that 74 percent of healthcare leaders felt burned out and 93 percent feel that burnout is negatively impacting their organization.[4]

The burgeoning burnout crisis impelled U.S. Surgeon General Vivek Murthy, M.D. to issue a special advisory last year warning that "(b)urnout among health workers has harmful consequences for patient care and safety, such as decreased time spent between provider and patient, increased medical errors, and hospital-acquired infections among patients. Burnout results in patients getting less time with health workers, delays in care and diagnosis, lower quality of care, medical errors, and increased disparities."[5]

The Role of Leadership

Senior leaders and boards, having significant power over the conditions in the clinical workplace, play a crucial role in reducing clinician burnout and improving the quality of care. Leaders must be instrumental in driving systemic changes to identify and address the root causes of burnout in their organization. This requires implementing changes to improve the work environment, allocating resources for mental health support, and advocating for policy changes.

People look up to, and emulate, their leaders. Therefore, leaders need to model healthy behaviors, such as maintaining an appropriate work-life balance, acknowledging mistakes, seeking help when necessary, and demonstrating empathy. Additionally, they should be proactive in identifying signs of burnout and intervene early.

2 Daniel S. Tawfik, et al., "Physician Burnout, Well-Being, and Work Unit Safety Grades in Relationship to Reported Medical Errors," *Mayo Clinic Proceedings*, Volume 93, Number 11, November 2018.
3 Linda H. Aiken, et al., "A Repeated Cross-Sectional Study of Nurses Immediately Before and During the COVID-19 Pandemic: Implications for Action," *Nurse Outlook*, January–February 2023.
4 Rachel Polhemus and Susan Snyder, *Burnout in Healthcare Executives: A Call to Action*, WittKieffer, 2022.
5 Vivek Murthy, M.D., *Addressing Health Worker Burnout: The U.S. Surgeon General's Advisory on Building a Thriving Health Workforce*, May 23, 2022.

→ Key Board Takeaways

- Burnout has been linked to increased risks in quality, safety, patient experience, and staff recruitment and retention—all of which have potentially significant financial and reputational consequences. Boards should carefully follow the data and look for emerging trends in all these areas.
- Ensure that senior leaders foster a healthy work environment. This includes asking management questions such as: Which one or combination of improvement sciences is our organization using to improve workflow and work practices? What are the results?
- Because burnout has become such a pervasive and disruptive factor in hospitals and health systems, board members should become familiar with the six drivers (job-person mismatches) of burnout, one of which is work overload. The other five—lack of control, insufficient reward, breakdown of community, absence of fairness, and values conflict—are significantly impacted by leadership and leadership practices. Consider what changes in current leadership practices and/or organizational culture could be leveraged to improve these drivers of burnout?
- Senior leaders should interview frontline staff—and report their findings to the board—about specific conditions or factors in the workplace that are the most problematic for clinicians vis-a-vis work overload (e.g., suboptimal EHR implementation or support, inefficient workflows, outdated or unnecessary policies and procedures, scheduling snafus). Have management develop a plan with specific changes, timelines, and accountabilities to alleviate staff-identified stressors.
- Set a tone at the top that prioritizes physicians' mental health. Ask management what your organization is doing to provide appropriate mental health support for clinicians.

Strategies for Reducing Burnout

1. **Address workflow and administrative burdens:** Healthcare executives must support clinicians involved in evaluating and streamlining processes to remove waste from clinical workflows. This is best achieved when senior leaders personally shadow frontline clinicians to see and hear firsthand the challenges and

frustrations their staff experience on a day-to-day basis. Such observations enable leaders to prioritize opportunities to address problems with the electronic health record systems, redesign unnecessarily cumbersome workflows, assess what AI-enabled or other technologies could be introduced to automate paperwork, examine work scheduling practices to promote greater work-life balance, and demonstrate a genuine commitment to "Getting Rid of Stupid Stuff" (GROSS)—a growing movement to remove non-value-added work.

2. **Promote a healthy work environment:** It is critical for senior leaders to foster a supportive work culture where all members of the healthcare team feel valued and heard. This ideally involves leveraging improvement science (e.g., Lean, Six Sigma, operations research, design thinking) with direct participation by frontline personnel to improve workflow and work practices. We strongly recommend that leaders champion brief but focused (15 minute) daily huddles in each clinical work unit. An agenda that addresses all the drivers of burnout includes individual recognition, preparation for the day, tracking key metric performance, and problem-solving. A daily management system with tiered huddles will promote open bilateral communication between the C-suite and the frontlines.
3. **Prioritize mental health**: Healthcare institutions should prioritize mental health support for clinicians, including peer support programs and providing access to confidential counselling services from a qualified third party. It is essential to both normalize these services and to foster an ethos where seeking help is not only accepted but encouraged.
4. **Encourage professional development and recognition:** Continuous education and professional growth opportunities can help clinicians feel more competent and confident in their roles. In addition, recognizing their contributions and achievements can boost morale and instill a sense of personal accomplishment.

Conclusion

Reducing clinician burnout is an essential step towards enhancing the quality of care in hospitals and health systems. Healthcare executives and boards need to recognize the significant impact of burnout on both healthcare providers and patients and take aggressive, sustained actions to address it. By alleviating clinician burnout, healthcare institutions can improve patient satisfaction, reduce medical errors, and ultimately, deliver higher quality care.

This is not just a moral and ethical responsibility; it is a strategic imperative. Investing in the mental health and well-being of healthcare professionals—and investing in improving their work environment—will both protect the quality of care that your institution provides and make yours a preferred setting in which to provide as well as to receive care.

The Governance Institute thanks Bruce D. Cummings, M.P.H., LFACHE, and Paul DeChant, M.D., M.B.A., Co-Founders of Organizational Wellbeing Solutions, for contributing this article. They can be reached at bruce@organizationalwellbeingsolutions.com and paul@organizationalwellbeingsolutions.com.

Of All the Reasons for Refreshing the Investment Approach, Complacency Is the Most Common

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The last several years have offered both relatively easy and incredibly difficult investing environments. While managing the complexities of running an organization, we often forget that investment markets also have their seasons of stress that require higher degrees of attention. Perhaps performance is better managed, not by annual returns tied to fairly arbitrary year-end dates, nor by the "market cycle," which many define as far too long, but by the Federal Reserve's cycles of loosening or tightening. By this definition, a new performance period began when the Fed began raising rates in March 2022, ending a period of accommodative monetary policy stretching back to the Great Recession of 2007–2009.

Regardless of how performance is measured, we have entered into a more difficult time to invest, with lower margins for error and the need for heightened attention to managing an organization's investments by the third-party stakeholders involved. When one hears the phrase, "it's a stock picker's market," the time has arrived for investment consultants and all the participants driving investment returns to earn their keep. It is during these times that strong investment teams contribute to growth and stability while weaker teams are exposed—all against the backdrop of their responsiveness to the needs of the organization.

Given the importance of an organization's invested assets, why do organizations tolerate suboptimal investment team dynamics and troubled relationships with their investment consultants? What prevents them from triggering an investment consultant selection process? Perhaps the most common explanation we hear is "complacency." It is during difficult times like this that new ideas, strong viewpoints, and challenging questions are all critical to finding success in navigating difficult markets. Complacency is the antithesis of this ideal.

Drivers of Concern

So why is complacency such a far-reaching concern? After perhaps a decade or more of being in the same cycle of meetings, investment consultants may fall into the trap of not bringing in fresh ideas. We see several reasons why:

- Everyone seems happy enough (don't kick a sleeping dog).
- Introducing new ideas requires risk and management and governance may say "no." Does the relationship allow for small failures?
- The measure of performance is narrow and specific to investment returns, but not well aligned to the changing organization (see sidebar "Pitfalls of a Limited Perspective").
- New ideas may require a higher level of effort, and the fixed-fee structure of the relationship may discourage special assignments.
- There is not enough time and focus dedicated to investments in governance meetings.

→ Pitfalls of a Limited Perspective

Organizations and markets are constantly changing. There is no room for sleeping, and too much blind reliance on benchmarks can cause one to lose focus on greater problems. For example, the Fed was clear in late 2021 that it would begin raising rates, and there was market consensus that the easy money inflating valuations in the equity markets and the fixed income "bubble" would pop. Taking bonds as an example, far too many investment advisors allowed their Bloomberg US Aggregate Bond Index benchmark to dictate a very large share of the overall allocation. The fixed income benchmark fell 13 percent in 2022. Ordinarily, beating a set benchmark by 50 basis points is a job well done, but not so in this example (-1,250 basis points vs. -1,300 basis points). A more preferable outcome would have been an early, clear-headed focus on the broader market realities that would have challenged the suitability of a six-year duration benchmark earlier in the process. A shorter duration portfolio protecting the downside of fixed income investments may have avoided the significant drawdown in the first place and would have been a much better outcome than outperforming the benchmark by 50, 75, or even 100 basis points when the benchmark is down 1,300 basis points. Focused consultants—those who limited duration as opposed to targeting a benchmark—limited their losses.

An evolving and challenging investment environment exposes more than complacency. Consider all the concerns we hear from clients regularly, and ask whether your organization has experienced similar issues with your investment consultant:

- The performance is questionable.
- The consultant is not "clicking" with new committee members.
- A failed manager was selected and the mistake was not acknowledged or not dealt with fast enough.
- The organization is not sure if the consultant's fees are in line with the market, etc.
- The consultant's capabilities aren't matching the changing needs of the organization.
- Investment decision throughput is delayed or inefficient.

Certainly, there are reasons for running an investment consultant selection process that are not an indication of sub-standard performance. Occasionally investment consultants simply need to be reassessed to ensure the ideas, approaches, and fees are "on market." But very often, there is something wrong with the situation that requires an urgent response to the concern to ensure an optimal solution.

→ Key Board Takeaways

As members of the finance or investment committee consider their organization's investment approach, key questions include the following:

- Have we clearly defined the purpose and parameters for our investment platform?
- Do we believe that we give adequate time and focus to investments at our board meetings?
- Do we feel we have a productive and trusting relationship with our investment consultant, including clear lines of communication and a willingness to introduce and consider new approaches?
- How regularly—and how rigorously—do we assess our relationship with our investment consultant?

The issues on this list of concerns do not reside fully with the investment consultant. Management and governance can help shape a culture and process that discourages the complacency trap. Good practices to help shield the organization from these concerns can include:

- Understanding and declaring the role of investments in relation to the organization and its objectives
- Clearly defining the purpose and parameters of the investment platform as a whole (and potentially in segments)
- Setting the team and communication best practices that support success
- Ensuring your external partner can support your goals and offer clear feedback on a consistent basis
- Demanding that investment consultants do their part to ensure the best for the organization, as a trusted partner

If you find issues persist, consider the holistic direction and expectations driving the investment platform and its connection with your organization. Make a plan, obtain buy-in, and execute. Often this requires mediating the investment consultant relationship or conducting a search process. In doing the work, you will likely discover which path is most suitable.

The Governance Institute thanks David Ratliff, CFA, Senior Vice President, and Bobby Bruning, Vice President, with Kaufman Hall's Treasury and Capital Markets practice, for contributing this article They can be reached at dratliff@kaufmanhall.com and bbruning@kaufmanhall.com.