

# INSIGHT

## Game Changing: Incentive Plan Design in the Current Health Care Environment



**Today's environment** is causing hospitals and health systems to rethink performance measurement. First, organizations are facing revenue pressures. The health care reform law calls for a decline in provider reimbursements and the redesign of the health care delivery system. Other political imperatives, including deficit reduction, are likely to put more strain on providers through additional payment cuts. Second, quality and patient satisfaction are being emphasized, as a wide range of performance indicators are publicly disclosed and reimbursements are tied to outcomes. Finally, the economic recovery has been slow in many areas of the country, so some health care organizations will continue to serve communities with high unemployment and face the prospects of uncompensated care.

These forces will require many health care organizations to reconsider their near- and long-term performance priorities, and to redefine what constitutes "success." In doing so, organizations should examine their incentive programs to ensure they align with current challenges and are governed effectively. The following questions should be examined:

- Are the organization's incentive plan performance measures aligned with current and emerging priorities?
- Are the priority and time horizons given to performance measures consistent with the relative importance of the goals and timelines for achievement?
- Is the board actively engaged in performance measure selection, target setting and outcomes review?

This *Compensation Insight* provides SullivanCotter's perspectives on these questions.

## Performance Measures in Incentive Plans

As a matter of good practice, health care organizations should periodically review incentive performance measures to make sure they are appropriately linked to financial stewardship, mission, community benefit and quality objectives. With today's challenges and changing landscape, organizations should consider the following:

- The economic downturn and the prospect of tightening reimbursements make **financial efficiency** critical. Performance measures that support financial efficiency should be examined, and may include margin, expense ratios, cost per unit of service delivered, staffing ratios and other productivity and cash flow indicators.
- **Quality and patient satisfaction metrics** should be reviewed for their importance in patient care outcomes and linkages to reimbursement under the health care reform legislation over the coming years. Many organizations' plans already incorporate quality metrics, such as those included in the Hospital Quality Indicators published by the Centers for Medicare and Medicaid Services (CMS). Performance in the Hospital Consumer Assessment of Healthcare Providers and Systems (HCAHPS), which covers a range of patient satisfaction statistics, also is being used by health care organizations. Other quality and outcomes measures that might be considered are those linked to reimbursement under the health care reform law: Hospital Value-Based Purchasing indicators, readmission rates and rates of hospital

acquired conditions. Additionally, a number of hospitals track Leapfrog patient safety measures, which many managed care organizations monitor—so, the appropriateness of those measures for the incentive plan should be evaluated.

- Measures linked to changes in **operating structure and delivery model design** are increasingly important, as opportunities to develop Accountable Care Organizations (ACOs) or to participate in pilot plans such as bundled payment arrangements are explored. Goals may be tied to development of the infrastructure required to coordinate care, such as supporting the use of electronic health records (EHR) by physicians. Additionally, **integration and affiliation activities** within the sector are accelerating, as organizations consider the appropriate level of scale, geographic diversity and service mix. The incentive plan may include measures such as process milestones (for example, identifying potential partners/targets, meeting specific integration timetables) or integration outcomes (for example, volume of patients in a service line, market share, consistent use of standard processes across the system).
- The role of **community benefit** measures should be considered for tax-exempt providers. The Form 990 requires increased disclosure of community benefit, and the health care reform legislation mandates that organizations complete a community needs assessment every three years. Measures for potential inclusion may be process-oriented (for example, completing a community needs

assessment and implementation strategy, identifying at-risk populations for diseases such as diabetes) or, ideally, outcomes-oriented (for example, implementing health screening programs with specific targets for the number of patients served, establishing a clinic in an underserved neighborhood, increasing absolute community benefit levels).

## Balance of Measures

In addition to reviewing “what” measures should be included in the plan, the relative importance of priorities and time horizons for achievement should be examined.

- The **weight of organization and individual performance goals** should reflect the appropriate **line of sight** for each organizational priority and participant impact on the goals. Even where incentive plans do not formally assign weights to particular goals, there should be consideration of each objective’s relative priority.
- The **use of “circuit breakers” or triggers**, which allow the incentive plan to be operational, should be considered to ensure that levels of minimum acceptable performance are reflected before incentives are paid.
- As organizations prepare for longer-term strategic shifts in health care delivery, they may wish to consider **goals with a range of time horizons** to reinforce the need to prepare for the future while executing today’s priorities. Organizations may incorporate milestones of longer-range objectives in the annual incentive

plan, or maintain a separate incentive that rewards for multi-year achievements.

## Incentive Plan Governance

Today’s environment elevates the need for the Board and its compensation committee to be actively engaged in designing incentive plans, setting performance goals, and assessing outcomes. While the Board’s role is typically one of oversight, it should be an active participant in the process to provide direction on the plan’s parameters and objectives. Specific actions that should be taken include:

- **Be engaged in selecting appropriate performance measures and targets.** The Board’s compensation committee should work with the full Board to ensure that performance metrics in the plan are aligned with the organization’s operating, capital and strategic priorities. In addition, the Board should understand how specific performance targets are established and should be comfortable that the degree of stretch is appropriate.
- **Conduct a discussion of performance results and payouts.** The compensation committee should be appraised of performance outcomes and work with the Board to ensure it is satisfied that payouts under the plan are directionally aligned with performance. The compensation committee should receive regular updates from management on performance during the year so there are no surprises when the outcomes are known at year end, and should report to the full Board on progress toward goals.



INTEGRITY INDEPENDENCE INSIGHT INFORMATION

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**Conclusion:** Incentives for health care organizations are most effective when they reinforce key business priorities, motivate and retain executives, and support a responsible compensation program. Organizations and their governing bodies should review and continually update their incentive plans so they have the desired impact and reinforce the alignment of performance and rewards. A comprehensive assessment of the plan that accounts for the external changes organizations face will help ensure that the plan remains effective and withstands external scrutiny.

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#### **About Sullivan, Cotter and Associates, Inc.**

Sullivan, Cotter and Associates, Inc. is an independent consulting firm specializing in the assessment and development of total compensation programs for health care and other not-for-profit organizations. Since 1992, SullivanCotter has worked closely with boards, board committees, and management to devise innovative compensation solutions that attract and retain leadership, staff, and physician talent to support their organizational goals while complying with regulatory standards and adhering to best corporate governance practices. A national leader in compensation consulting and benchmarking, SullivanCotter annually conducts the most widely recognized health care executive and physician compensation surveys in the United States.

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