A Balancing Act for Healthcare Boards: Executive Pay, Organization Performance, and the Pandemic

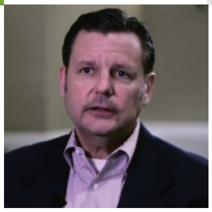
Pearl Meyer

Ask the Expert.

Steve Sullivan and Ed Steinhoff, *Managing Directors*

Healthcare providers and insurers have had very divergent, disruptive experiences in 2020 and 2021, leading to unique sets of challenges and opportunities in executive compensation program design. Managing Directors Steve Sullivan and Ed Steinhoff discuss how their provider and insurer clients are balancing pay and financial and operational performance, and how they are approaching retention in the current unusual labor market.

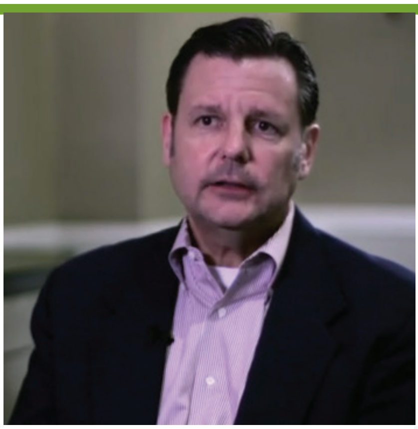
Q. The impacts of the pandemic have been quite different for providers and insurers. How are you seeing that reflected in executive compensation?



A: Ed: We are seeing those differences reflected in the design of executive compensation programs going forward, and are certainly seeing those differences in payouts for performance-based metrics. Insurers generally have had two very solid years in a row now, performance-wise.

A: Steve: On the provider side of the healthcare equation, it's a different story. Over this past year, I've worked with a few health systems whose compensation committees have decided to override the financial requirements in order to deliver a reward for management teams that have been working harder than ever before. Many systems didn't pay an incentive in 2020, or it was forfeited or they made a partial payout—ultimately the full incentive was not delivered. Our advice in the current tight employment market is that committees shouldn't deliver less than what's been earned two years in a row. In quite a few of these organizations some incentive has been earned in 2021, either through discretionary decisions or modified metrics, or possibly changes to the plan financial trigger. Some of these compensation committees will forgo the margin or operating income requirement and they're paying for the non-financial achievements.

A: Ed: The story is different for many payers, where above-target levels have been reached in the financial performance area. Where there is some question is what happens after two or more such high-performance years? The compensation committees I'm working with are trying to understand how to set appropriate financial goals that aren't lay-ups, but also take into account the ongoing uncertainty of our public health situation. Analysis of how incentive payouts as percentages of target compare with peer organizations helps committees assess how much stretch has been incorporated into their financial goals. Committees are also incorporating non-financial goals in annual and long-term incentives, whether those are based on diversity, equity, and inclusion or other ESG-related issues or on strategic milestones for future growth.



Q. Are there any areas of commonality right now between healthcare and insurance organizations?

A: Ed: One area where I think there is some commonality is the so-called "great resignation." Both providers and insurers are facing the impact of losing talented, experienced executives, either to early retirement, exodus to other industries, or just new opportunities with other organizations.

However, because insurers have been able to maintain target or above incentive plan payout levels, there is generally less retention risk than at provider organizations. Insurers also generally have available funds to provide base salary adjustments – increasing base salaries above median in some cases – and perhaps adding some level of retention bonuses.

A: Steve: Larger providers are having to come up with an unprecedented array of approaches designed to strengthen engagement with their leaders. The use of discretionary payments is one approach that's on the minds of compensation committees, but now they're having to consider a variety of employment touchpoint programs outside traditional cash compensation. Committees are already rolling out initiatives addressing work-life balance, remote working arrangements, career enrichment, and leadership assessment and development. At this point in time, what you're doing to retain people—be they executives all the way down through the organization to entry level workers—is the number one issue right now. The employment challenge is further compounded by one of the single largest negatives drawing on their finances: the use of temporary and traveling clinical care providers, whose costs are quite astounding. These investments are all being made against the backdrop of the need for these programs to be delivered in an empathetic, humanistic style of leadership.

Q. Do you foresee any long-term effects of this pandemic experience on healthcare organization compensation?

A: Ed: I don't think anyone expects to completely "return to normal." Where I expect we may see some fundamental and permanent shift is in the board itself. I'm seeing some early moves to bring in directors with more specific healthcare experience. While the vast majority of directors on insurer boards are experienced in board service, it's often in industries outside healthcare. It's becoming clear that familiarity with the unique challenges is very helpful to the organization. Absent that, there's an educational component, specifically around the compensation plan metrics, that is also helpful and increasingly common. Lastly, I believe the move to incorporate more non-financial metrics will be long-lasting and serve to moderate the variability in incentive payouts structured on only financial performance.

A: Steve: I'm seeing a trend at the board level as well. On the provider side, directors/trustees are often very experienced business professionals, but they may not have the same for-profit board experience that's common at the insurers. We're seeing health system boards look for experienced public or for-profit private company directors to help them deal with all of these challenges. I'm also seeing an expressed interest in strategy-specific, closely aligned compensation plans among provider organizations historically opposed to such arrangements. Not-for-profit, mission-driven organizations are realizing that what they had before didn't necessarily work as well as they thought. There's a new level of recognition that a carefully designed long-term incentive plan and other approaches to enriching the employment experience can be real differentiators in terms of executive recruitment and retention and organizational performance.

About Ed Steinhoff

Ed Steinhoff, a managing director in Pearl Meyer's Chicago office, has more than 25 years of experience in executive compensation. He works with the boards of directors and senior management teams of public and private companies, ranging from small and middle-market firms to multi-billion dollar corporations, to design pay programs that drive business performance and value creation, secure high-performing executive talent, and withstand external scrutiny.

About Steve Sullivan

Steve Sullivan, a managing director in Pearl Meyer's Chicago office, has more than 20 years of consulting and industry experience assisting clients in executing their strategic human resources and compensation initiatives. His focus has been in the areas of executive compensation program benchmarking, design, and oversight in the healthcare industry and for tax-exempt businesses. Mr. Sullivan also advises clients in the areas of sales and performance incentives, recruitment, motivation and retention, strategic compensation program design and implementation, and organizational change.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Rochester, and San Jose.

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