Pearl Meyer

CASE STUDY

JPS Health Network: Evolving a Healthcare Leadership Team with Executive Compensation

The Organization

The organization is a county-owned hospital that employs more than 6,000 people and generates $1B in revenue annually. It features a Level 1 trauma center, is the main teaching hospital for two universities, and supports the residency and general surgery residency programs for two other medical centers. Beyond the hospital, there is a system network of community- and school-based clinics. The organization is widely viewed as a healthcare leader offering primary care, behavioral health, cancer care, women's health, dental, and other services.

The Strategic Challenge

> *"Using long-term incentives reduces the risk of paying awards before the organization fully implements its strategic priorities."*

The introduction of the Affordable Care Act (ACA) is the latest in a series of major developments fundamentally shifting the model of healthcare delivery away from fee-for-service, to a focus on keeping people healthy. JPS, like other organizations, faces a considerable challenge to adapt its strategies and operations to this new environment. Long driven by metrics such as admission count, case mix, procedure type, and volume, they have had to re-imagine a future governed by very different definitions of success: clinical quality and safety, patient experience, community health, and efficiency.

Because insurers are phasing in these new reimbursement criteria, the industry faces an unprecedented transitional period. The organization will continue to be reimbursed for many traditional fee-for-service arrangements, even as the new fee-for-value criteria become an increasing part of the strategic equation. They are simultaneously managing to traditional financial, clinical, and other performance criteria for the near term, while working to identify and implement their future population health-focused organizational objectives further down the road.

The Compensation Challenge

The organization's leadership team and board recognized there were dramatic shifts that had to be made in the leadership mix in order to enact new core business strategies. The roles and responsibilities of senior leaders were changing quite significantly. The board realized that they must expand the senior team and integrate a wider variety of leaders into the C-suite to accurately reflect the shift in strategy. This would include physicians (who may not have extensive business backgrounds) and non-healthcare executives from other industries like finance and retail. These leaders would likely come with very different compensation expectations than the traditional healthcare administrator.

To build cooperation and collaboration among these diverse leaders with challenging new roles, JPS would need to develop fair, equitable, and motivating executive compensation arrangements that would support collective successful execution.

This go-forward executive compensation program would need to balance short-term incentives to drive success in the waning fee-for-service environment, while providing long-term leading metrics to drive the building of new business and patient care models in the emerging fee-for-quality marketplace.

The challenge was to develop and implement a new executive incentive plan design that would reflect evolving business strategies, while also balancing issues around pay expectations and equity, motivation, retention, recruitment, and regulatory compliance.

The Solution

As a member of the senior executive team and in her role as executive liaison to the compensation committee of the board, the SVP of Human Resources helped define the organization's long-term business strategy. She then led the effort to outline the human resource strategy necessary to support its execution. A key component of this was the need to map the new strategy into a redesigned executive compensation program.

An executive compensation market competitiveness assessment was conducted, which highlighted quantitative and qualitative gaps between the current compensation program and the competitive market for top healthcare leadership positions. These gaps had to be addressed to serve both retention and recruitment. The need to gravitate to more of a pay-for-performance culture and to extend the time horizon beyond annual goals was also identified. While past programs were heavily geared to rewarding individual performance, a shift was needed to encourage collaboration across corporate and collective, team-based goals.

Maintaining Current Business Strength—The Annual Incentive Plan

The compensation committee knew that traditional short-term annual milestones and associated incentive awards would not be sufficient to drive successful long-term transformation, but were critical to the current operation of the organization. They based 25% to 50% of executives' total variable compensation opportunity on the immediate, 12-month key goals identified to ensure the continued viability of the organization:

- Patient access to care;
- Expansion of evidenced-based care;
- Quality across inpatient, outpatient, and emergency department care; and
- Growth in net operating margin.

These short-term goals and metrics were also selected because successful execution could lead to stronger performance against the long-range indicators of success which were to comprise their long-term incentive plan.

Developing Future Business Strategy and Leadership Teams—Long-Term Incentive Plan

The biggest change to the compensation program was the introduction of a long-term incentive plan (LTIP). An LTIP is a common component of executive pay programs in many other industries, and would be introduced to the organization as a way to solve issues such as the extended timeframe needed to build and implement new programs from the ground up, the board risk associated with large, long-range capital investments, and the potential pay disparity between current leaders and incoming talent.

For example, the organization's ability to improve rates of proper diagnoses and treatment of ambulatory care cases and delivering that treatment at high levels of clinical quality is central to its mission to improve population health in its identified service areas. Identifying the organization's approach to this challenge and implementing specific strategies and organizational changes to achieve positive results in an efficient manner would require considerable coordination across teams over multiple years. Thus the long-term incentive plan was structured around consistent improvement year-over-year in the organization's ACSC (Ambulatory Care Sensitive Conditions) score and its ability to simultaneously drive targeted levels of net operating margin across the entire healthcare system.

With the long-term incentive in place, executives were eligible to be rewarded based on their ability to collectively achieve transformational milestones across a multi-year timeframe.

At the same time, the board had to make decisions regarding capital investments and potentially broad organizational changes. An accurate assessment of executive team performance against long-range goals requires a multi-year sample of business results, which should be available before performance incentives are paid. Using long-term incentives would allow the board to reduce the risk of paying awards before the organization fully implements strategic priorities successfully and begins to realize the financial gains associated with them.

Retention was addressed via a change from discrete, end-to-end award grants and vesting periods to ongoing annual award grants, with three-year cliff vesting periods. Participating executives choosing to voluntarily separate service would thereby forfeit portions of multiple award grants, serving as a deterrent to leaving the organization.

The addition of long-term incentives also generally solved for potential pay disparity, retention, and recruiting issues that could emerge as a result of the industry shifts. By aligning all executives toward common goals with common pay-out opportunities over longer periods of time, individual differences in pay become more flat. Additionally, an LTIP offers a well-known pay component for executives brought in from other industries and offers wealth creation opportunity for those physicians needed on the leadership team who might otherwise forfeit private practice earnings.

Results

As the executive team began to drive measurable results for the annual incentive plan, improvement in areas like patient access, use of evidence-based care, and outpatient clinical quality expanded the organization's opportunity to encounter and successfully treat ambulatory care-sensitive conditions. The focus on operating margin balanced between short- and long-term outcomes helped facilitate the right conversations concerning the timing of investments and prioritizing immediate and longer-range business initiatives.

While the organization is only one year into its new executive compensation program, both executives and compensation committee members have reported unprecedented levels of open and frank dialogue between the two groups concerning the board's long-term vision for the organization, the role of leadership in executing that vision, and the respective role of each executive in achieving success.

Carefully-designed executive compensation is playing a key role in the evolution of JPS Health Network. Remarkably, both physician executives and newer leaders with non-healthcare backgrounds have said that for the first time in their careers they understand the unified vision of success and the manner in which they personally contribute to that success.

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 New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.

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