Pearl Meyer

ADVISOR BLOG

Why Healthcare M&A Organizations Need to Review Executive Compensation Plans

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Given the multiple announcements in late 2017 and continuing into the first quarter of 2018, it's clear that merger and acquisition activity in the healthcare industry is a robust trend. Primary motivations for these mergers appear to be a combination of greater efficiencies, decreased operating costs and costs of capital, greater market visibility, clinical standardization and optimization, and greater bargaining power to negotiate better rates from insurance companies—any and all of which could result in a bigger revenue stream. Since 2010, there have been over 700 transactions[1]. However, various research and articles (for example, this Modern Healthcare piece) have concluded that the success of these M&As has been mixed from an economic perspective.

These mixed results have also led to some level of skepticism as to whether hospital M&As really benefit the patients they serve in terms of the quality, access, and cost of care. In addition, in some corners there is concern relative to the levels of compensation that executives may stand to earn from healthcare systems that grow in size.

In the Northeast, where healthcare M&As have been particularly large and high-profile, Rhode Island's Senate Majority Leader recently filed two bills related to hospital compensation. The first would cap executives' pay at 110 percent of the average for their peers in the region. The second would prevent top hospital leadership from being awarded financially for supporting a merger.

While the potential success and ultimate benefits to the public of this proposed legislation is not entirely clear—and the potential for a ripple effect to other states may be limited—this action may be an impetus for any healthcare organization going through an M&A to

[1] https://www.kaufmanhall.com/sites/default/files/2017-in-Review_The-Year-that-Shook-Healthcare.pdf

carefully assess its approach to executive compensation to ensure that there is a clear and defensible rationale for the levels of compensation provided to its executives.

Recognizing that during a merger or acquisition, there is natural organizational tension and uncertainty that may necessitate using compensation to ensure executive retention, boards should ensure that such actions are aligned with the business strategy and grounded in market practice. In fact, executive salaries and incentive opportunities in whole, not just during strategic transactions, should be aligned with a thoughtfully developed compensation philosophy and supported by market practice.

While this may seem painfully obvious, it's important for healthcare boards to bear in mind that the scope and pace of the merger environment can lead to quick fixes that are not always carefully considered, which in turn may result in the type of compensation the Rhode Island Senator is seeking to eliminate with a fairly blunt instrument.

About the Author

Jim Hudner is a managing director in the Boston office of Pearl Meyer. He consults in the areas of total compensation strategy, executive compensation, compensation planning, base salary management, incentive plan design. and performance management. Mr. Hudner brings 30 years of consulting experience to his position and has consulted to organizations in a wide range of industries including technology, higher education, research organizations, financial services, and manufacturing.

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, and Los Angeles.

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