



## INTEGRATED HEALTHCARE STRATEGIES™

www.IHStrategies.com

*Exclusive to Healthcare. Dedicated to People.™*

### Conducting Effective Compensation Committee Meetings Part 3 of 3: Getting What Is Needed from a Compensation Committee That Manages Rather Than Governs

Presented by Integrated Healthcare Strategies  
as Authored by Dan Schleeter

In working with clients over the years, IHStrategies consultants have seen compensation committee behaviors like the following frustrate many CEOs:

- Postponing regular pay decisions because the committee wants to discuss a specific issue it wants to pursue
- Generating their own solutions, rather than asking management or consultants for recommendations and then accepting or rejecting them
- Discussing forms of executive pay that have little or nothing to do with health care or the organization

Fortunately, IHStrategies consultants have also seen many effective compensation committees in action. Their strategies and techniques for dealing with common problems can be useful in many settings. In an effort to share what we have observed, we have presented a three-part series on the topic of conducting effective compensation committee meetings.

In part one, titled *Protection from Intermediate Sanctions*, we explored the fundamentals of establishing a rebuttable presumption of reasonableness, and suggested two simple actions to take in executive compensation committee meetings to assure that risks of financial penalties under the law are minimized.

In part two, titled *Diagnosing and Solving Committee Inability to Complete its Agenda*, we discussed the most common reasons committees struggle to get their work done in a timely fashion, and suggested some strategies and techniques to assure that there is ample time for productive committee discussion.

Continue reading below for the final part of this three-part series.

### **Part III: Getting What Is Needed from a Compensation Committee that Manages Rather than Governs**

#### *Synopsis*

- Typical examples of compensation committees going their own way, and the consequences
- How and why the above situation arises
- Redefining roles: governance, not management
- Redefining expectations: thoughtful advice to refine pay plans, not taking action
- Utilizing member strengths in discerning, questioning, thinking, and addressing constituent interests

#### **Examples and Consequences of Compensation Committees Going Their Own Way**

The recession and media focus on executive pay has caused many healthcare compensation committees to question their executive total compensation philosophies. In one recent case, a committee stacked with high-profile leaders from Fortune 500 companies wanted to talk about rewarding the executives in ways like those in their own companies. The committee charged the consultant to come up ways to change the compensation mix by reducing salaries and increasing incentive pay opportunity. On further analysis, comparison of the committee's preferred pay program to others in nonprofit health systems demonstrated that it would be difficult to defend the reasonableness and the appearance of executive compensation with maximum bonus awards, and difficult to retain executives in their absence. The resulting detour of committee business caused a long delay in a key decision about an executive supplemental retirement plan.

In another recent consulting assignment, the compensation committee rejected the incentive plan goals proposed by the CEO, believing they would be too easily achieved. Rather than redirect management, the committee then set out to suggest significantly different goals, but these proved difficult to measure, and it was equally difficult to establish a benchmark for current performance. By the time a third set of goals were finally shared with the executive team, the year was half over, making the goals relatively ineffective in changing behavior.

A third problem of this nature arose when a board chairman negotiated a contract with a new CEO that included a more generous severance arrangement than is typical in healthcare. A year later, when the board decided to fire the CEO, they were surprised by the amount of the payout and embarrassed when it was exposed in the local newspaper.

Board members are chosen for their business knowledge, their judgment, and their ability to question and challenge the way things are done. They are also chosen because of their success in their own fields. They may have little or no experience with nonprofit organizations. They are typically action-oriented people, and the role of advisor is often new to them. In some cases, they are inclined to manage situations, rather than staying within the confines of the governance role. In doing so, they are simply acting in the way their instincts and experience tell them to act.

Our consulting experience shows that compensation committees that try to design their own programs, rather than working with outside experts or their own executives, often slow the decision-making process and reduce the effectiveness of the compensation programs in impacting behavior. Experience also shows that educating committee members on the roles and expectations of board service can help them become stronger, more effective board and committee members.

### **Redefining Roles: Governance, not Management**

In their own organizations, board members are accomplished managers that are typically instrumental in setting salaries for their subordinates and managing benefits and incentive programs for their executive teams. They are experts in their own fields of manufacturing, retail sales, legal assistance, or accounting, but often not in healthcare.

The not-for-profit health care field is different than other industries. Not-for-profit health care organizations face very different regulatory guidelines when it comes to executive compensation. Given their mission to serve community health needs and justify their not-for-profit status, health care organization executive compensation has unique requirements and characteristics.

As a result, when most board members become compensation committee members, they need to rely on the expertise of their management team and outside advisors for the healthcare context. To effectively oversee executive compensation, committees need to understand norms and practices within the healthcare industry. This context for their decisions can only come from questioning their management and consultants.

With this context, committee members can exercise judgment and discernment based on their abilities to question, to think and to evaluate ideas. Their role is to ask tough questions, and provide guidance on a global level. The challenge is to make sure that members understand and appreciate the importance of the governance role, and the limitations of the role.

### **Redefining Expectations: Thoughtful Advice, Not Action**

In an ideal situation, the compensation committee is an effective partner with the CEO in rewarding and retaining executives and focusing their efforts on strategic goals. The committee

cannot expect to micro-manage the performance of executives, or to override the CEO's judgment about performance issues. Nor can the committee expect to be able to define performance standards on goals such as quality improvement or patient satisfaction without relying on management to tell them how they are performing today, or without outside experts to help them understand how their performance compares to other similar institutions.

It is important for the compensation committee to make policy decisions about how executives will be compensated. They are ultimate arbiters of how executive pay will balance the values and expectations of the community with the needs of the organization and capabilities of the executive team to change performance. It is appropriate, then, for the committee to provide advice to refine the recommendations of others, to expect significant changes where required, but probably not in most cases to independently create their own policy..

### **Utilizing Member Strengths in Discerning, Questioning, Thinking, and Addressing Constituent Interests**

In looking for potential board members, CEOs choose the best people they can find. These are usually prominent local business people or professionals who have little or no experience with health care or the not-for-profit world. They may also have little or no experience working in a governance role. What CEOs need from compensation committee members is advice and help in thinking through the issues that affect their ability to change performance and achieve strategic goals. They also need help in understanding the points of view of various constituent groups. Often, committee members can provide very valuable advice to a CEO in dealing with various constituent groups on executive compensation matters. Even though the constituent groups are somewhat different in health care, many of the dynamics and interpersonal issues are similar.

One key to getting what is needed from a compensation committee lies in making sure committee members understand their roles, and what is expected of them as members of the committee. This should be deliberately communicated when the member is recruited for the role.

The four strategies listed below can help executive compensation committee members understand their role without compromising their independence.

- Establish a protocol for bringing new members onto the board. Begin with a meeting with the CEO and board chair to discuss roles and expectations. Help the new member understand that board service entails coaching and delegation, rather than taking action. Let them know their judgment and insights are valued, but they need to be impartial and avoid bringing personal biases to the decision-making process.

- Find some way to reinforce what governance is, and what it isn't. Some organizations utilize a board member job description, with specifics for committee roles. Language emphasizing governance and not direct management is used.
- Consider having new members serve on the board for a year or two before giving them committee assignments. Take that opportunity to vet them as board members and determine where they can be most effective. Consider amending the bylaws to make this vetting period a standard practice.
- Consider bringing people with special expertise onto the committee as non-voting members. Observe how they perform in an advisory capacity as you evaluate their potential as future board members.

Another key to getting what is needed from a compensation committee is to provide context for the decisions the committee is expected to make. This can be done in many different ways, some minor, others more involved.

One small but significant example is providing context for decisions on incentive goals, such as how current performance compares to national norms and what last year's performance was. Another minor, but potentially important example is in reminding members of past decisions and actions whenever a proposal is made. Finally, consider special "educational sessions" to teach committee members about health care subjects they are likely to be unfamiliar with. One example is a session on the measurement of quality in health care, so that members are more informed when they make decisions approving incentive goals.

## **Summary**

This article discusses the problems that can arise when a compensation committee asserts its independence by designing executive compensation solutions itself. Certainly, board members are expected to be independent of management, but the role they need to play is that of making policy and exercising oversight. Implementing policies and decisions and managing day-to-day operations are rightfully the job of the CEO. Board members are typically people of action, and the more passive governance role and responsibilities may be new to them. A thoughtful process for selecting and orienting board members and defining roles and expectations can lead to more effective committees, as can making an effort to provide context for the decisions the committee must make.