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Where Sound Executive Compensation Policy and CEO Recruitment Intersect

Presented by Integrated Healthcare Strategies, with commentary by Jane Groves and
David Bjork, Ph.D.

Hospital and health system boards often find themselves dealing with competing priorities, one of which may be the issue of hiring an “A-list” CEO while conforming with pre-established compensation philosophies and market realities. To address how boards may best resolve the potentially conflicting issues healthcare organizations may face as they prepare to recruit and compensate an incoming CEO, Integrated Healthcare Strategies asked **Jane Groves**, Executive Vice President and Practice Leader of its MSA Executive Search practice; and **David Bjork, Ph.D.**, Senior Vice President and Senior Advisor of its Governance, Leadership and Executive Total Compensation practice, to share their wisdom in response to relevant questions.

In current economic conditions, which of the following dynamics do you see as predominating: A greater supply of executive talent is available, making it an employers’ market; or a reluctance for candidates to relocate because of depressed housing prices, resulting in richer compensation and relocation packages.

“The recession has reduced the supply of talent available, because it has scared people enough to make them reluctant to move. Unlike other industries, hospitals and health systems have not laid off many executives. The widespread insecurity caused by the recession and the uncertainty caused by efforts at health care reform have led even entrepreneurial executives to value security and stability more than they would in a time of robust growth,” said David Bjork. “Candidates will still move for significant promotions and career development opportunities, but they are reluctant to take lateral moves even if they offer more money. Employers seem to be offering candidates significantly more than they intend to, on the basis of their compensation philosophies, to lure outstanding candidates. They seem more focused than ever on getting the best people available, because of the challenges ahead, and are willing to pay whatever it takes to get the candidates they want”, continued Bjork.

Jane Groves, of MSA Executive Search stated, “while I do believe that in some cases there is a greater supply of executive talent, I do not feel that it is an employer’s market. The key factor that I see holding fully employed executives back from considering a career change is the element of uncertainty stemming from the worst economic climate since the Great Depression, as well as the unknowns with impending healthcare reform.” In our MSA Executive Search practice we have definitely experienced a reluctance on the part of many executives to discuss a career move due to one or more issues in their life including: 1) diminished value of their retirement plan portfolios; 2) vesting provisions in their current plans; 3) reliance upon two incomes (employee and spouse) and the difficulty securing a career opportunity for the trailing spouse; 4) major loss of equity in their home coupled with a depressed housing market that could result in a long sales process and the associated financial burdens. We definitely are seeing clients have to respond with increased relocation assistance and increased hiring bonuses to help defray some of financial burden associated with a relocation. Other considerations such as extended temporary housing and contracting with a relocation assistance company on behalf of the executive are becoming more common,” commented Groves.

In your experience, what are the most serious consequences of an organization paying too much for its new CEO (i.e., internal equity issues? Market backlash)?

“We have not encountered this in the MSA Executive Search practice. Typically, the organizations that we work with have a compensation philosophy that states their competitive pay philosophy and where they want to pay executives. We do, at times, work with a client that doesn’t want to go too deeply into its total compensation pay range for a new executive,” says Groves. “The problem this presents is that if we are recruiting A-list candidates, the client needs to be prepared to go more deeply into its total compensation range than originally planned or budgeted for. Internal equity is usually not an issue as there is typically only one CEO. If it is a system hospital, then internal equity with other CEOs in the system may be a factor, but certainly not the only factor,” continues Groves.

David Bjork of the Governance, Leadership and Executive Total Compensation practice responds, “there are three serious consequences that eventually come to a head: 1) difficulty making the structure of the program work within the board’s policy constraints; 2) difficulty providing salary increases in the years ahead; and 3) reactions from new board and compensation committee members who weren’t party to the original decisions.” Bjork continues, “if the CEO’s salary is too high, it will push total compensation higher than whatever target or limit the board has put on executive compensation, It exposes the CEO and the compensation to risk of intermediate sanctions, and leaves the board open to charges that it has violated its own policy on executive compensation. It makes it difficult to provide annual salary increases that will satisfy a high performer. And it raises the likelihood of friction over executive pay in the future, as new board and committee members wonder how pay ever got to be so far above whatever reasonable policy the board set; and unfortunately, puts the CEO in an awkward position of having to defend something s/he shouldn’t have to defend. There is

another serious consequence- the backlash associated with giving extra perks and benefits to the highest paid executive in the organization, which is hard to justify to nurses, doctors, patients, the community, or regulators, on which the hospital depends for good will.”

Do you believe the new Form 990 reporting requirements have increased the transparency around executive pay? If so, has it resulted in a stronger governor being placed on incoming CEOs' total compensation?

Bjork says, “the new Form 990 is definitely increasing transparency around executive pay because it is being disclosed in greater detail, and for more executives. It distinguishes clearly between salary, incentive compensation, deferred compensation and other benefits, and requires explanations of programs like severance and supplemental retirement plans. It shows executives more information about how their peers are paid.” “The new Form 990 makes comparisons across the industry far easier and more reliable. It has caused many boards to modify executive pay programs so that they will not need to report perquisites that attract far more attention than they are worth, like car allowances and tax gross-ups. The broader societal attack on executive pay has had more effect than the new 990s on constraining executive pay. Boards are retreating from some of the generous terms they offered new executives in the past, especially severance and perquisites like car allowances and country club dues,” Bjork concludes.

Jane Groves adds, “I do believe that transparency has been increased, but there are still so many places where the 990 information is subject to interpretation and misunderstanding. It is very common for an executive we are recruiting to research the 990 data at the client organization, and it often requires a lot of explaining. As we advise our clients, the fact that something has to be reported on the 990 does not prohibit them from offering something to the executive, and it does give them the opportunity to explain the pay or benefit and why it has been offered/granted.”

Are you seeing anything new in terms of executives demanding more in the way of non-cash or deferred compensation. If so, what are the advantages or pitfalls of this approach?

“The executive ranks are certainly a big part of the “graying of the American workforce,” says Groves. She continues, “that factor alone drives the need to offer a broader range of compensation and benefits options. We rely upon the counsel and advice of our colleagues in the Integrated Healthcare Strategies Governance, Leadership and Executive Total Compensation practice to assist our search clients when they want to design a compensation package that addresses specific needs of a new executive.”

Bjork comments, “no. If anything, executives are asking to have deferred compensation and benefits paid as additional cash. Changes in tax regulations have made deferral and supplemental benefits less attractive than in the past, and a little bit more cash attracts less criticism than supplemental benefits and perquisites.”

What are some ways boards and compensation committees can meet the demands of the executives they want to hire without creating internal equity issues?

“Boards need to carefully consider the consequences of meeting what they deem to be unreasonable demands of the recruited CEO so as to avoid an unending cycle,” says Bjork. “Establishing a relationship with the incoming CEO where it is clear that executive compensation is the purview of the Board and compensation committee will lay a strong foundation for effective leadership and governance. A board that cedes that control will fall short of fulfilling its fiduciary responsibilities.”

Groves notes, “as we talked about earlier, as long as boards and compensation committees are diligent about working within a compensation philosophy, they need to be prepared to perhaps create some internal ‘inequities’ when they are hiring a new executive.” Groves continues, the current employment market requires an aggressive approach to recruiting and rewarding A-list talent. Some ways that this can be mitigated are with one-time offerings that do not roll over into the compensation package in future years”

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Integrated Healthcare Strategies offers the most comprehensive array of healthcare-specific human resource consulting services available. Our five specialty practices provide clients with convenient access to insightful consulting advice from industry professionals. Services encompassed within our five practice groups include executive total compensation design; executive search; governance and leadership consulting; physician services; and human capital management consulting services.

The MSA Executive Search practice of Integrated Healthcare Strategies has over 20 years of proven service in executive and director-level searches, and is exclusive to the healthcare industry. Clients have found the right CEO in our first slate presentation 100 percent of the time.

Our Executive Total Compensation practice is focused on the analysis and design of compensation and benefits programs provided to executives, physicians, and other key employees. Our client base encompasses the full spectrum of health care organizations. Integrated Healthcare Strategies takes pride in its creativity and track record in developing innovative solutions to compensation and benefit issues. Our other services include physician strategy and compensation, human capital solutions, labor relations, leadership transition planning, executive search, employee surveys, performance management and trustee governance solutions.

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About the Authors

Jane Groves is Executive Vice President and Practice Leader of the MSA Executive Search practice of Integrated Healthcare Strategies. Ms. Groves may be contacted at Jane.Groves@IHStrategies.com, or at 816.795.1947.

David Bjork is Senior Vice President and Senior Advisor of the Governance, Leadership and Executive Total Compensation practice of Integrated Healthcare Strategies. Mr. Bjork may be contacted at David.Bjork@IHStrategies.com, or at 612.339.0919.