

## **Successfully Implementing a Performance Based Compensation Plan – The Secret is in the Development Process**

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### **Abstract**

*A performance-based compensation plan can be an effective strategy to assist in the turnaround of troubled physician practices. However, there exists no performance-based compensation plan that is appropriate for all physician practices. What has emerged, among the few organizations that have successfully implemented a performance-based plan, is a development process rather than a ubiquitous compensation methodology. Utilizing a strategy of inclusion, as many of the practice's providers should, to the greatest extent possible, participate in every step of the development process. By implementing a plan that has been developed with the highest possible level of consensus and that incorporates adequate incentives to produce the desired behaviors, the compensation plan can successfully align the goals of the providers with those of the practice.*

### **Background**

A significant number of physicians are now practicing, not as entrepreneurs in the role of small business owners, but as employees of health systems, physician practice management companies and HMOs. None of these models can be described as a resounding success, as several of these organizations are faced with significant operating deficits. Under pressure from irate board members, these organizations are now attempting to develop techniques to turnaround their troubled physician practice operations.

An effective strategy is to align the goals of the providers with those of the practice by creating a more direct relationship between provider performance and compensation. In many of the aforementioned models, physicians, and to a greater extent physician extenders, receive a guaranteed salary not quantified by performance measures or are paid a salary with a small incentive bonus which is inadequate to induce the desired behaviors. Often what results are providers that are performing at or below generally recognized industry standards, while at the same time receiving above average compensation.

It has become increasingly clear, however, that no single performance-based compensation methodology is appropriate for all practices. As management begins to review various compensation plans it will become immediately apparent that the selection of an appropriate plan is highly dependent on the specific characteristics of their practice. The level of capitation, the culture, the mix of specialists and primary care physicians, the type of organization with which the practice is affiliated and the objectives management seeks to realize by utilizing the plan are all factors that must be

considered. Further, any attempt to implement an otherwise appropriate plan without the input of providers will meet with significant resistance that will in all likelihood doom the plan to failure.

While a specific plan has not proven successful for all practices, a development process has. The active participation of providers in every step of the development process has emerged as a paradigm for the successful implementation of a productivity-based plan. An effective plan, which has been developed with the greatest amount of provider involvement, will be most readily accepted providing a tremendous opportunity for improving financial performance.

### **The Objective of the Plan**

The objective of a performance-based compensation plan is to quantify the level to which an individual provider is contributing to the success of the practice and providing compensation that rewards that effort. For the plan to be effective, providers must understand the performance standards necessary to achieve the desired level of compensation and must be provided with accurate information. Incentives work, physicians are highly intelligent overachievers that strive to be at the “top of the class.” Therefore, the caveat for management is to choose the incentives carefully and run the numbers. Make sure the behaviors you agree to reward are in fact the characteristics that will produce a successful physician practice.

### **The Development and Implementation Process**

In our experience, a successfully developed and implemented performance-based compensation plan generally follows these steps:

- Financial Analysis and Strategic Planning
- Selection a Compensation Committee
- Selection of a Compensation Methodology
- Preparation of Plan Documents
- Development of Implementation Procedures

### **Financial Analysis and Strategic Planning**

An analysis is performed on the practice’s most recent financial and productivity statistics. Provider compensation, overhead expenses and productivity, as measured by visits, relative value units, panel size, collections and billings, are all benchmarked to generally accepted industry standards. This exercise will highlight the areas of concern. Management can then develop strategies for improvement by identifying realistic productivity and non-productivity goals. Non-productivity goals may include improvements in clinical outcomes, patient satisfaction, citizenship and leadership. It is helpful to involve a physician leader in this exercise both to understand the physician perspective and to begin to make the providers feel that they are part of the process.

This analysis is presented to all of the practice’s physicians and physician extenders. There should be no attempt to place blame for the practice’s historical performance or the meeting will quickly become unproductive. The goal is to demonstrate to the providers that, based on the performance level of comparable practices, there is room for

improvement. Management should indicate that they seek the providers' assistance in developing a compensation plan that will reward providers for their efforts in improving these performance indicators and the other goals identified by the organization.

### **Selection a Compensation Committee**

The physicians and physician extenders should select a compensation committee, the members of which will meet regularly to review and decide issues related to the plan. It is recommended that the compensation committee consist of no more than ten members and include representation from senior management. This will in all likelihood exclude some providers. It is therefore important that the facilitators in some way communicate directly with all of the stakeholders of the compensation plan. All of the practice's providers and senior management should be interviewed regarding their concerns and expectations. The results are summarized and distributed at the first committee meeting.

### **Selection of a Compensation Methodology**

In order to reward performance it must first be quantified. Performance can be measured by numerous indicators and not solely on the basis of production. The compensation committee should be presented with a description of the various methods of measuring performance and a brief description of the advantages and disadvantages of each. Committee members should be led in a discussion of the merits of each measurement tool. Several performance criteria should be selected that equitably measures the providers' contributions to the goals of the organization.

Several compensation methodologies are developed which incorporate the selected measurement tools. At this point only verbal descriptions and hypothetical examples are presented. It is imperative that there be provider and management buy-in long before actual numbers are presented. Throughout several meetings the selected plans are revised until the majority of the compensation committee members are in agreement on a single compensation formula. The selected methodology is presented to all the practice's physicians and physician extenders. The provider members of the compensation committee will be effective in obtaining the support of their colleagues as they discuss the plan they helped to create. Any comments or criticisms should be addressed to the satisfaction of the inquisitor.

A financial model is developed for the selected plan and provider compensation is calculated utilizing actual provider performance statistics. It is most useful to take a historical period or an annualization of the current year and present each provider's compensation as if the plan had been implemented. A sensitivity analysis is developed that calculates provider compensation assuming realistic improvements in certain performance criteria. The analysis is presented to each provider in individual meetings to protect confidentiality and allow the provider to freely ask questions. When appropriate, comments and concerns should be taken back to the committee for resolution. Sensitivity analyses are also developed for the practice to determine how the implementation of the plan will effect the financial performance of the organization under various scenarios. Typical sensitivity assumptions include changes in provider productivity, overhead expenses and reimbursement rates.

### **Preparation of Compensation Plan Documents**

A complete compensation plan is drafted and presented to the committee for comment. The document is also reviewed by the practice's attorney to ensure compliance with applicable regulations. The plan is revised based on the recommendations of the committee and the attorneys. The final plan is presented to the committee for approval.

### **Development of Implementation Procedures**

Once the plan is approved an implementation process is developed. Management should begin to immediately provide the physicians and extenders with a schedule presenting their compensation as if the plan were in effect. This will assist the providers in becoming familiar with how their behaviors will impact their compensation. It should be understood that at the expiration of their current employment agreements all providers will be placed on the performance-based plan. The committee should review the plan at the end of the first or second year.

### **Lessons Learned**

The critical success factor in the development and implementation of a performance-based plan is an effective facilitator. If you as the practice manager attempt to do-it-yourself the following are a few thoughts to keep in mind; all compensation plans have a downside the goal is to be fair, expect that the process will produce conflict, committee meetings can quickly become unproductive it is essential to carefully plan an agenda and follow it. If you decide to use a consultant choose a firm with significant experience in working with organizations similar to your own.