

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

Key words: Performance-based compensation plans, physician practice valuation, physician practice turnaround, medical practice valuation, medical practice assessment, practice management

Abstract

A performance-based compensation plan can be an effective tool for turning around a troubled physician practice. While there is no such thing as a “cookie cutter” performance-based compensation plan that works for all physician practices, there is a development and implementation process that a number of practices have found to be critical to their success. The process involves an inclusive approach designed to achieve the highest possible level of consensus among the physicians, **identification of appropriate performance criteria** and **development** of adequate incentives to produce the desired behaviors.

Background

A significant number of physicians are now practicing as employees of health systems, physician practice management companies or HMOs rather than as entrepreneurs in the role of small business owners. These physicians often receive a guaranteed salary or a salary with a small incentive bonus. Neither method significantly ties compensation to performance, and as a result, many of these practices are performing below industry standards and incurring significant operating deficits.

To turn these practices around, it's important to align physician goals with those of the practice by creating a more direct relationship between provider performance and compensation. The selection of an appropriate performance-based compensation plan is highly dependent on the practice's unique characteristics. No single compensation methodology is appropriate for all practices. 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 are all factors that must be considered.

How the plan is developed will be the key to its effectiveness. A plan will be most readily accepted and provide the greatest opportunity for improving financial performance if the physicians and physician extenders are involved in creating it. Any attempt to implement an otherwise appropriate plan without the input of the providers is likely to meet with significant resistance and doom the plan to failure.

The Objective

The objective of a performance-based compensation plan is to quantify the level at which an individual provider is contributing to the success of the practice and provide compensation commensurate with that contribution. 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 timely and accurate information to gauge their performance. Incentives work; physicians are highly intelligent overachievers that strive to be at the "top of the class." As a manager, your task 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:

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- **Performance** analysis and strategic planning
- Selection of a compensation committee
- Selection of a compensation methodology
- Preparation of plan documents
- Development of implementation procedures

A summary of the actions you should take in each step is provided below.

Performance Analysis and Strategic Planning

Involve one or more of the practice's physicians and physician extenders in the **performance** analysis and strategic planning phase to gain their perspective and ensure the providers feel part of the process. This phase should include:

- **Review of the practice's performance on recent patient satisfaction surveys, HMO reports, and relevant clinical outcomes statistics**
- Analysis of the practice's recent financial and productivity performance, including comparison of the following to industry benchmarks:
 - * Provider compensation
 - * **Operating expenses**
 - * Billings and collections
 - * **Patient visits**
 - * **Relative value units**
 - * **Panel size**
 - * Staffing levels
- Identification of areas of concern
- Establishment of realistic goals for improvement in areas such as **provider** productivity, **overhead expenses, medical management, and** patient satisfaction
- Presentation of the results of the analysis to all of the practice's physicians and physician extenders and solicitation of the providers' assistance in developing a compensation plan that will reward them for their efforts in improving these performance indicators.

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Be careful not to place blame for the practice's historical performance or the meeting will quickly become unproductive. The objective is to obtain consensus that, based on the performance level of comparable practices, there is room for improvement.

Selection of a Compensation Committee

The physicians and physician extenders should select a compensation committee to regularly review and decide issues related to the plan. The committee should consist of no more than ten members and include representation from senior management. A procedure for regular communication between the committee and the other members of the practice should be established so the committee is aware of stakeholders concerns and expectations and the stakeholders are informed about the committee's findings.

Selection of a Compensation Methodology

In order to reward performance you must first quantify it.

- Identify several performance criteria that equitably measure the providers' contributions to the organization's goals. Keep in mind that performance can be measured by numerous indicators and not solely on the basis of production.
- Present a description of the various methods of measuring performance and a summary of the advantages and disadvantages of each to the compensation committee.
- Facilitate committee evaluation and selection of measurement tools.

Develop several compensation methodologies incorporating the selected measurement tools. At this point, present only hypothetical examples of how the methodology will work. It's imperative that there be provider and management buy-in long before actual numbers are presented. **Once physicians are presented with their actual compensation calculations they become preoccupied with how the plan fails to take into account those performance criteria in which they excel, rather than focussing on the criteria that is appropriate for the organization as a whole. This is often also true of management that**

will seek a methodology that will maximize the compensation of those physicians they feel, often based on very subjective measures, deserve a certain level of compensation. A plan that is developed to create a certain level of compensation for certain individual providers will not be appropriate when applied to the entire group. By not presenting actual compensation figures you are more likely to have everyone's attention directed towards objectively determining an appropriate methodology, which incorporates reasonable performance criteria, for the entire practice. Make modifications to the selected plans as indicated until the majority of the compensation committee members are in agreement on a single compensation formula.

Once the committee members are in agreement, present the selected methodology to all of the practice's physicians and physician extenders. Because they were integrally involved in creating the plan, provider members of the compensation committee should be effective in responding to questions and obtaining the support of their colleagues.

Now it's time to develop a financial model for the selected compensation plan using actual provider performance statistics. Take an historical period or an annualization of the current year and present each provider's compensation as if the plan had been implemented. Use a sensitivity analysis to calculate provider compensation assuming realistic improvements in certain performance criteria, and present the analysis to each provider in individual meetings, protecting each provider's confidentiality and allowing him or her to ask questions freely. When appropriate, comments and concerns should be taken back to the compensation committee for resolution.

Sensitivity analyses should also be performed on the practice as a whole to determine how the implementation of the plan will effect the overall financial performance of the organization under various scenarios, such as changes in productivity, the number of providers, the types of services, overhead expenses, payor mix, and reimbursement rates.

Preparation of Compensation Plan Documents

Draft a formal description of the compensation plan and present it to the committee for comment. The practice's legal counsel should also review the document to ensure the plan is in compliance with applicable regulations. Make revisions as indicated by the committee and legal counsel, and present the final plan to the committee for approval.

Development of Implementation Procedures

Once the plan is finalized, establish an implementation process. Make it clear that all providers will be placed on the performance-based plan at the expiration of their current employment agreements. Provide each physician and physician extender a schedule showing his compensation as if the plan were in effect, so he can understand how his performance will impact his compensation. It's a good idea to have the committee review the plan and its impact on the practice at the end of the first or second year of implementation so adjustments to the plan can be made as needed.

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, here 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, so 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 in order to ensure success.

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