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Keeping Physician Compensation Affordable

Identify a target amount per physician, install process improvement initiatives and provide performance incentives to ensure that compensation doesn't bankrupt your system.

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Health systems do not necessarily expect employed physician practices to operate in the black, but they are operating so deeply in the red that many systems are becoming financially anemic. Further contributing to the fiscal drain is the fact that physician compensation rates are increasing while reimbursement rates are declining. These trends threaten the financial solvency of health care organizations and, as a result, hospital boards and leadership teams are tending more critically to the financial performance of their physician enterprises.

To become or remain economically sustainable, health systems need to correlate physician compensation with market factors and the financial realities of a practice.

Designing Compensation Arrangements

Using only external market data to establish compensation — an industrywide practice — often results in remuneration that has no relation to the financial position of a discrete enterprise. This practice puts health systems in a precarious position, particularly when they factor in physician compensation and reimbursement rates that are trending in opposite directions. As a result, health systems simply are spending more than they can afford to employ physicians.

Organizations can balance compensation with financial realities using three steps:

Step 1: Quantify a theoretical "investment per physician" for your organization. The majority of hospital and health system leaders have only a vague notion of what the ideal financial investment (or loss) per physician should be. While high-level benchmarks can be useful in establishing a starting point, organizations must consider their unique configurations and characteristics when determining what investment their group can tolerate. Factors to evaluate and adjust for include:

- specialty mix
- payer mix
- accounting practices (e.g., ancillary income, overhead expenses)
- managed care contracts
- ratio of clinical full-time equivalents to physician head count
- unavoidable hospital or health system inefficiencies (which should not be factored into physician compensation planning)

This exercise requires a significant investment of time and resources, yet it is vital. Organizational leaders quickly learn that they need to analyze current practice and performance patterns collectively, as well as develop attainable financial targets when designing sustainable compensation arrangements. However, this process should not occur behind a curtain. Creating transparency is an essential component for eliciting input, building trust and removing the "us vs. them" mentality that creates conflict between administrators and physicians during organizational change.

Step 2: Identify improvement opportunities and instigate continuous operational improvement initiatives. Completing Step 1 likely will unpack a list of organizational and operational factors that hinder the financial performance of the physician organization. Systems can find improvement opportunities in patient-throughput processes, support-staff deployment and patient access. Administrative and physician leaders must band together and create a culture that ferrets out improvement opportunities.

For example, if an organization determines that significant improvement can be gained through redesigning patient access protocols, administrative leaders and physicians ought to collaborate to determine the best way to standardize and use patient appointments based on electronic health record data. It is important that organizations employ a structured approach that includes physician participation and defined accountabilities, with regular monitoring and reporting. Subsequently, as performance gains are realized, physicians should share in the benefits resulting from the improvement efforts.

Step 3: Pursue an "economic adjustment factor" to calibrate physician compensation arrangements. This factor transitions physician compensation away from a simple market-based approach to one that incorporates the actual economics of the organization.

The specific mechanism for incorporating the economic adjustment factor is unique for each organization. Some take a formulaic approach in defining specialty-specific conversion factors (e.g., payments per work relative value unit) or base compensation levels; others include them in nonproductivity-based performance incentives.

Regardless of the mechanism, the adjustment-factor calculations need to be flexible enough to recognize improvement (or deterioration) of performance. Implementation requires significant cooperation and organizational trust, especially if the adjustment factor is determined on the basis of the organization's financial performance; some physicians may not be able to impact performance directly. However, successful execution of this approach can yield compensation arrangements that are competitive and are accurate reflections of the organization's financial performance. The degree of economic adjustment and the pace of implementation depend on the financial position of the organization as well as the mutual confidence of the physicians.

Striking the Right Balance

Conversations about compensation are difficult, but that should not deter hospitals and physicians from having them. Health system leaders must seek solutions to maintain physician compensation levels that are competitive in the market, while ensuring that those arrangements are not bankrupting their organizations.

There is no silver bullet for how compensation should be structured, but sustainable arrangements often can be accomplished by engaging physicians in aligning incentives with the financial performance and reality of the enterprise. By taking the three steps outlined and approaching the process as a partnership, administrative and physician leaders are positioned to align organizational interests, maintain economic stability and provide the competitive pay necessary to attract and retain high-quality physicians.

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