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An Integrated Approach to Managing and Rewarding Health Care Talent

2008/2009 Report

Watson Wyatt Worldwide

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AMERICAN SOCIETY FOR HEALTHCARE HUMAN RESOURCES ADMINISTRATION
OF THE AMERICAN HOSPITAL ASSOCIATION

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Executive Summary

Even during the current financial downturn, the health care industry continues to face a talent crisis. An aging population is increasing the demand for health care services and the need for critial-skill employees. Health care providers have addressed the issues of attracting and retaining critical-skill employees more proactively than general industry, but they still need to improve to meet these challenges.

Watson Wyatt and the American Society for Healthcare Human Resources Administration (ASHHRA) conducted a 2008/2009 study of the health care industry. It reveals that a major challenge for health care organizations is the need to expand their facilities and human capital to meet the increasing demand for their services. Watson Wyatt research shows that an integrated approach to reward and talent management – one that touches all stages of the employment life cycle – is most effective in enhancing an organization's attraction and retention efforts; however, as with general industry, few health care organizations have implemented an integrated approach.

Key Findings

- What employers believe attracts employees to their organization is fairly well aligned with what employees indicate attracts them. The nature of the work, employer reputation and the total rewards package (base pay and benefits) are keys to attracting health care employees, especially critical-skill employees.
- Fifty-two percent of respondents have difficulty caused by turnover of critical-skill employees. Top causes of turnover are base pay, stress, commute, work/life balance and promotion opportunities. Health care organizations are taking actions to address these core retention issues, including market-based pay increases, more flexible work arrangements and shift opportunities, enhanced career ladders, and more onsite training for credentials and certifications.
- Firms in the health care sector are well ahead of firms in general industry in performing formal workforce planning analysis. More than 60 percent of health care organizations are conducting key workforce planning analytics – nearly double the percentage of general industry firms.
- More health care organizations are implementing incentive programs, including broad-based plans covering all employees (31 percent). Target incentives for management have increased compared with the 2006/2007 study. Incentive plans are focusing more on financial measures than they have in the past, although quality and patient satisfaction measures are also used.
- Performance management programs within the health care industry support career development and tend to focus on training and certification rather than driving actual performance. Only 15 percent of respondents use performance management to help average or poor performers improve.
- Only 46 percent of study participants have defined their employee value proposition (EVP), and only about one-third of those have aligned other key talent management practices such as performance management, career development and succession planning with their EVP.
- While organizations are increasing their level of attention to governance of executive pay, there is still room for improvement. Many organizations might not be prepared for the requirements and implications of the new IRS Form 990 that strongly imply that the IRS is looking for governance processes that follow Internal Revenue Code Section 4958 (or Intermediate Sanctions).

About the Survey

The 2008/2009 Strategic Rewards in the Health Care Industry survey was completed in June and July 2008 by 67 organizations employing more than 500,000 full-time equivalent employees. The survey participants were primarily hospitals (82 percent): Fifty-eight percent were members of a hospital system and 24 percent were stand-alone hospitals. Of the hospitals that were part of a system, the typical system included 10 hospitals. The remaining responses came from nonhospital health care providers and clinic systems.

The typical health care organization in this study had revenues between $500 million and $1 billion, similar to the profile of participants in the 2006/2007 study. The average organization employed more than 6,500 full-time employees and almost 2,500 part-time employees, with a median of 2,500 and 700 respectively. Not surprisingly, the growth estimates projected by each size group indicate robust growth further supporting the need for continued talent acquisition.

Survey participants provided information on a number of elements of talent management and reward covering the following key topics:

- Key business challenges and performance metrics
- Attraction and retention
- Workforce planning
- Training and development
- Performance management
- Compensation
- Governance

Figure 1 | Organization Type

Type of organization	Percent of respondents
Hospital-based	82%
Hospital system	58%
Stand-alone hospital	24%
Nonhospital health care provider	15%
Clinics only	3%

Figure 2 | Projected Future Growth

Net revenues	2007	2008 (estimated)
Greater than $3B	11%	12%
Between $1B and $3B	16%	20%
Between $500M and $1B	29%	23%
Less than $500M	44%	45%

This report incorporates key findings based on data collected in the survey and other Watson Wyatt research to assist in effectively managing the human capital challenges in the health care industry.

Introduction

While many industries are cutting back in the current economic crisis, the health care industry must expand to meet the growing demand for its services. The demand for health care is driven primarily by three factors: population demographics, government policy and employer-provided benefits. If there is no major change in employer health care coverage, the aging of the U.S. population combined with government policies expected to increase the demand for health care services will continue to drive sustained growth in the health care sector.

The health care workforce is aging at the same rate as the general population, causing a scarcity of experienced talent in the industry. Increased demand and slower growth in labor supply are further exacerbating the war for talent within the health care industry.

As shown in Figure 3, the biggest issues health care organizations face are the need to expand facilities and human capital challenges. Fortunately, high turnover of critical-skill employees and difficulty recruiting and staffing physician positions do not appear to have had an impact on patient satisfaction or safety so far.

The health care industry has thin operating margins – less than 4 percent in 2007 that are expected to tighten further. Without significant productivity improvements, health care organizations will be hard pressed to fund their capital expenditure and expansion plans. These efforts will be complicated by potential cost-increasing trends such as:

- Greater scrutiny on quality of care, patient service and patient satisfaction
- Regulatory trends requiring increased staff-to-patient ratios
- Scarcity of labor – particularly critical-skill employees

Health care organizations will need to make further technology investments to increase efficiency and reduce errors as well as focus on talent management, staffing and reward practices that maximize the impact of every dollar in human capital expense.

Success requires effective workforce planning to identify which employees will be needed, when they will be needed and where they can be sourced. The workforce plan is the road map for attraction and retention strategies. Organizations should allocate their investments in human and physical capital based on data and analytics on workforce behaviors and trends. This will ensure they target the right investments to get the right people in the most cost-effective way. Successful organizations will take a strategic and holistic approach to reward and talent management to provide the best patient care.

Figure 3 | Expansion and human capital issues are the main difficulties facing the health care industry

Issue	Percentage of respondents*
Need for facility expansion/capital expenditures	71%
Turnover of critical-skill employees	52%
Difficulty recruiting and staffing physician positions	40%
Low patient satisfaction	19%
Low quality and safety scores	5%

**Percentage of respondents indicating this was an area of difficulty to moderate or great extent*

Talent Issues and Practices

New and growing challenges have intensified the fight for talent in the health care industry.

Figure 4 | HR responses to talent challenges

Globalization	Increase in bringing foreign talent to United States; movement toward offshoring nondirect patient care services	
Regulatory Changes	Staffing rations and licensing requirements becoming more stringent	
New Competitors	New competitors for talent (e.g., education, insurance, corporate, retailers)	
Industry Growth	Increasing demand for health care industry services due to aging population	
Efficiency	Technology and redesigned work processes reshaping talent requirements	
High Turnover	Remains an ongoing challenge – impact on executive and nonclinical jobs growing	

HR Responses

- Define and brand the Employee Value Proposition
- Create succession plans
- Realign total rewards package
- Promote employee engagement
- Optimize systems (e.g., recruiting, HRIS)

Integrated Talent Management

An integrated approach to reward and talent management enhances the effective execution of human capital strategies throughout the employment life cycle. Organizations need to leverage a combination of approaches to address the attraction and retention challenges facing the health care industry. Effective talent management integrates recruiting, compensation, performance management, succession planning, learning, career development and workforce planning.

As part of an integrated reward and talent management approach, health care organizations should:

- Define the organization's employee value proposition and invest in areas that create a competitive advantage for attraction and retention
- Perform formal workforce planning activities to align talent acquisition, deployment and development efforts with internal and external market supply and demand
- Implement recruiting best practices to ensure an efficient and effective recruiting process
- Effectively deploy reward, recognition and performance management programs to attract, retain and engage employees
- Establish formal and articulated career development and succession planning programs

Attracting Critical-Skill Health Care Employees

Employers believe that all employees (critical-skill and otherwise) join health care organizations due to employer reputation, base pay, health care benefits, organization culture and nature of work (Figure 5). Watson Wyatt's 2008/2009 WorkUSA research shows that employees also cite the nature of work, base pay and health care benefits as top reasons for joining; however, while fewer than 10 percent of employees cite organization culture, non-physicians are more likely to cite the length of commute and job security, while physicians are more likely to cite career development.

Retaining Critical-Skill Health Care Employees

Health care organizations are facing significant retention challenges. Fifty-two percent of all respondents have difficulty caused by turnover of critical-skill employees while 40 percent are adversely affected by difficulties recruiting and staffing physician positions. Respondents report overall turnover rates of 15 percent. First-year and nurse turnover rates are

Figure 5 | Employers overestimate the importance of organization culture in attracting employees

Rank	Employer view		Employee view*		
	Critical-skill employees	All employees	Physicians	Nurses	Other health care employees
1	Employer reputation	Employer reputation	Nature of work	Nature of work	Nature of work
2	Base pay	Base pay	Employer reputation	Job security	Job security
3	Organization culture	Health care benefits	Career development	Commute	Health care benefits
4	Health care benefits	Organization culture	Health care benefits	Employer reputation	Commute
5	Nature of work; organization's mission	Organization's mission	Base pay; work/life balance	Base pay	Base pay

**Data on the employee view is based on findings from 2008/2009 WorkAttitudes research.*

Figure 6 | Employees are leaving for better pay, improved quality of life and promotion opportunity

Rank	Employee view*		
	Physicians	Nurses	Other health care employees
1	Stress	Stress	Stress
2	Base pay	Base pay	Base pay
3	Length of commute	Work/life balance	Promotion opportunity
4	Promotion opportunity	Trust/confidence in management	Work/life balance
5	Trust/confidence in management	Length of commute	Length of commute

**Data is based on findings from 2008/2009 WorkAttitudes research.*

Figure 7 | Actions taken to retain critical-skill employees

Most common	Common	Rare
Implemented/increased use of recognition programs	Increased tuition reimbursement	Changed policies and practices to promote work/life balance
Implemented market-based pay increases	Offered more flexible work arrangements	Implemented off-cycle pay increases
Increased efforts to survey employee opinions	Offered onsite training to acquire credentials and certifications	Offered time off for training to acquire credentials and certifications
Offered or enhanced career/clinical ladders	Implemented special pay or benefit plans to improve retention	Offered rotational assignments/ opportunities
Implemented or extended mentoring/on-boarding process	Offered more varied shift opportunities	Implemented a broad-based incentive plan

frequently twice that, at 30 percent or higher. Health care workers tend to leave due to issues around base pay, stress, commute, work/life balance and promotion opportunities (see Figure 6).

The programs health care organizations are using to improve retention among critical-skill employees are well-aligned with the reasons for turnover cited by employees. Organizations are offering or enhancing career and clinical ladders and onsite training for credentials and certifications to address employee career development needs. They are granting market-based pay increases to address disparities in base pay and offering more flexible work arrangements and shift opportunities to help with stress and work/life balance. Still, most organizations could benefit from changing policies and practices to promote a healthier work/life balance, an action that is still rare (Figure 7).

Growing Trend: Workforce Analysis and Planning

Workforce planning links business planning and people needs in a structured way to address the external and internal environmental changes impacting the talent supply and demand in the industry. The analysis helps identify potential gaps between current and anticipated job skills so organizations can avoid shortages in key areas. Workforce planning data and analytics should be used to prioritize changes to talent management programs.

Health care organizations are well ahead of general industry in workforce planning activities. As shown in Figure 8, health care organizations are often twice as likely to be conducting key workforce planning activities such as analyzing changes in supply of and demand for workers. This represents a substantial change from our

Important to Retain Older Critical-Skill Employees

Retaining older workers for longer periods is an increasingly common strategy to help mitigate shortages created by unwanted turnover and the lack of newly trained personnel. Organizations are looking at ways to keep workers in the labor force longer, including redesigning existing retirement plans to entice critical-skill employees to continue working and delay their retirement. The Pension Protection Act of 2006 is allowing for in-service distributions from the pension plan at age 62, supporting the concept of phased retirement.

Extending retention might also involve redesigning jobs to accommodate the older worker. For instance, a reduction in hours of bedside work would not only benefit aging registered nurses (RNs) but also their employers, as the RNs can be redeployed to serve as long-term mentors/preceptors to newer hires. This would provide the human capital required to implement extended, formal on-boarding and mentoring programs. Approximately one-quarter of health care organizations are offering abbreviated shifts (eight hours or less) to RNs, which addresses the needs of older nurses as well as the broader interest in maintaining work/life balance.

Figure 8 | Health care leads general industry in the area of workforce planning

Percentage of respondents conducting formal analysis of:	Health care industry	General industry
How the demand for workers in targeted workforce segments will change in the next 3-5 years	62%	30%
How the supply of workers in targeted workforce segments will change in the next 3-5 years	67%	34%
Where to source talent to meet staffing needs	71%	49%
What proportion of your workforce will be eligible to retire in the next five years	68%	43%
How your staffing needs will change over the next 3-5 years	65%	36%

2006/2007 report where only 15 percent of organizations reported developing formal workforce plans based on this type of analysis.

Health care organizations have often been leaders in workforce planning due to a number of factors:

- Demographics: The population of health care workers is aging faster than most industries.
- Education requirements: Degree requirements for health care workers are becoming more stringent while educational programs are in tight supply.
- Shortage of talent: The supply of physicians and other clinical professionals is diminishing while demand is increasing.
- Advancements: Newer workers need to be more highly qualified than before due to technical advancements.
- Increased competition: It is relatively easy for critical-skill employees such as physicians and nurses to move from one organization to another based on geographic proximity and other factors.

Given its attraction/retention difficulties, increased workforce analytics are helping health care organizations scope the problem and put the industry ahead of the curve; however, identifying and scoping the problem doesn't necessarily mean health care organizations are prepared to address it successfully.

Employee Value Proposition: A Missing Key to Attraction and Retention

The employee value proposition includes the collective array of programs the organization offers in exchange for employment. Every organization has an EVP, but it might not be intentional. The best organizations have a clearly articulated, organization-wide EVP based on their talent needs and strategic objectives. Fewer than half (46 percent) of the organizations in our survey report having an articulated, organization-wide EVP. The remaining organizations are developing their EVPs through ad hoc decisions made in the interactions between employees, managers and HR professionals.

Developing an organization-wide EVP can provide the basis for more effective talent management. Most of the organizations that have actively defined an EVP are using it for recruiting talent. Unfortunately, only about one-third of organizations with an EVP have taken the next step of aligning other key talent management practices with their EVP.

As Figure 10 shows, while most organizations have identified ways to differentiate their offering and invested in those elements, very few have taken the additional step of identifying potential employees most likely to be attracted to the offering. This greatly limits their ability to effectively target scarce recruiting resources.

Figure 9 | Organization-wide EVPs are mostly used for recruiting

Use of EVP	Percentage of organizations*
Communicated EVP to recruiting function	94%
Discuss EVP with job candidates	87%
Developed recruiting materials that reference EVP	77%
Feature EVP on Web site	58%
Modified performance management, career development or succession planning to better align with EVP	35%

**Represents percentage of health care organizations with an organization-wide EVP who are using it for these purposes*

Figure 10 | Organizations are seeking to differentiate their EVP but have not taken actions necessary to target their offering

	Percentage of organizations taking action	Percentage effective*
Identified elements of your EVP that differentiate it in the marketplace	66%	74%
Increased investment in elements of your EVP that differentiate it in the marketplace	65%	72%
Developed profiles of employees likely to find your organization appealing	20%	85%

**Represents percentage of organizations that have taken the listed action and found it effective*

Improving the Recruiting Process

An attractive and differentiated EVP is just one component of an effective and efficient recruiting process. The most common actions for improving the recruiting process are:

- Increasing referral bonus programs
- Enhancing the organization's Web site
- Partnering with external recruiting agencies

While organizations rate referral programs and improving the Web site as highly effective, they are less likely to rate partnering with external recruiters as effective (Figure 11).

In contrast, the most effective programs are:

- Applicant tracking systems
- On-boarding programs to facilitate assimilation by new hires
- Analyzing source-of-hire data

Although most health care organizations have an applicant tracking system due to their sheer volume of hiring, on-boarding programs and analyzing source-of-hire data are less common. Applicant tracking systems collect data that can be used to establish effective recruiting metrics, but most organizations fail to capture the key data such as source of hire.

Figure 11 | Referral bonuses and enhanced Web sites are both common and highly effective

	Frequency of action		
	Most common	**Common**	**Rare**
Most effective	Referral bonuses	On-boarding programs Applicant tracking system	Analyze source-of-hire data
Highly effective	Enhanced Web site	Manager training for interview skills	Invest in sourcing
Effective	Partner with external recruiters	Internships and contract workers	Alumni programs Signing bonuses

Total Rewards and Performance Management

The 2008/2009 results reveal a convergence of cash compensation practices between the health care industry and general industry. The total budget for increases at the typical health care organization is around 4.5 percent, only slightly higher than for general industry (4.1 percent, as of May 2008), according to Watson Wyatt's "2008/2009 Global Strategic Rewards Report." In December 2008, the general industry average had dropped to 3.0 percent.

Health care organizations provide relatively small differentiation in merit increases between employees who far exceed expectations and those who meet expectations. In addition, health care organizations continue to provide merit pay to employees who only partially met expectations. These numbers reflect some distinction in merit increases based on performance but less than the distinctions made in general industry.

Heavier Emphasis on Short-Term Incentives

More health care organizations are implementing incentive programs, including broad-based plans covering all employees. Nearly all health care organizations provide an incentive opportunity to executives down through the director level (up from two-thirds of organizations in 2006/2007) and more than half provide incentives to managers and supervisors. Thirty-one percent of organizations offer incentives to nonmanagement employees. Incentive targets have increased in 2008/2009.

- Executive targets are typically 30 percent or more (versus 20 percent or less in 2006/2007).
- Vice president targets are more than 20 percent.
- Director targets are at about 15 percent.
- Manager targets are at 10 percent.
- All-employee plans target 5 percent for nonmanagement.

Figure 12 | Health care organizations are providing modest merit increase budgets

	2008	2009 (projected)*
Merit increase budget	3.45%	3.45%
Promotions	0.50%	0.50%
Market adjustments	1.00%	1.00%
Cost-of-living adjustments	0.00%	0.00%
Total (as reported, not calculated)	4.50%	4.50%

**Data as of July 2008*

Figure 13 | Health care organizations make some distinction in merit increases based on performance

Employee performance rating	Percentage of employees	Merit increase
Did not meet expectations	1%	0%
Partially met expectations	5%	2%
Met expectations	70%	3%
Exceeded expectations	20%	4%
Far exceeded expectations	5%	5%

Incentive plans in health care are focusing increasingly on financial measures (margin, revenues or expense budget) but also include quality of care and patient and employee satisfaction, as well as some department-specific measures.

Recognition Programs as an Effective Retention Strategy

Formal recognition programs are an integral part of a comprehensive reward and talent management strategy. These programs typically have a high return on investment.

- Employees value being recognized for achievements, even beyond financial awards.
- Awards can be directed toward individuals and/or teams.
- They can reinforce desired behaviors in a timelier manner.
- They are generally cost-effective in terms of overall dollars spent.

More than half of health care organizations use recognition programs to retain critical-skill employees. These programs are even more common as tools to retain all employees.

Performance Management Needs to Focus on Performance

Performance management is the single most direct way for management to communicate the organization's values and expectations. General industry uses performance management to drive performance by linking rewards to individual performance. Health care organizations are more likely to use performance management programs to promote career development objectives such as training and certification than to measure performance. Only 15 percent of health care organizations design their performance management system to help average or poor performers improve. This is a missed opportunity to engage employees, as Watson Wyatt research shows employees would rather be given poor performance ratings and coached to improve than given above-average ratings without that feedback and coaching. Health care organizations should refocus their performance management process on helping employees improve their performance in their current role as well as developing skills for future career opportunities.

Executive Compensation, Benefits and Governance

The 2008/2009 survey shows a convergence of health care and general industry around the design and governance of executive compensation. Variable pay programs (short- and long-term) are being used more widely in the health care industry to achieve desired outcomes, and organizations are voluntarily adopting some of the best practices in executive compensation governance that are prevalent in publicly held companies.

Long-Term Incentive Plans

Health care organizations appear to be using more long-term incentive plans (LTIPs) in their executive compensation programs. Thirty-eight percent of respondents have an LTIP – up from 13 percent of respondents in our 2006 survey. The health care sector is finding that LTIPs can be effective performance-contingent awards, with the added advantage that these long-term performance plans will not "go underwater" in the health care sector like many stock option plans have at public companies. LTIPs for health care organizations, however, are not simple to develop or implement effectively.

In the health care sector, LTIPs are typically restricted to senior management – usually stretching from the CEO down two levels to the vice presidents, with the target payout level (typically a percentage of salary) declining at the lower levels.

These plans can be an important element of the total executive compensation program by motivating and rewarding executives to achieve long-range growth goals. Participants tend to seek a balance between financial measures such as operating margins, controlling expenses within budgeted levels and achieving revenue growth as well as clinical measures around quality of care and patient satisfaction. This reflects the need to achieve financial stability, maintain high quality of care, and meet current and expanding community needs.

Executive Benefits and Perquisites

Executive benefits continue to play an important role in the total compensation package. The new SEC disclosure rules have resulted in many public companies scaling back or eliminating supplemental perquisites and benefits. It will be interesting to see if the introduction of the new IRS Form 990 disclosure requirements will have the same impact in the health care sector.

The most common executive benefits in the health care sector remain supplemental life, long-term disability and deferred compensation (Figure 14). These programs are more

Figure 14 | Executive benefit packages as attraction and retention tools in health care organizations

	Health care		All industries*	
	2008	2006	2008	2006
Supplemental life insurance	79%	65%	28%	20%
Supplemental long-term disability	68%	56%	27%	18%
Deferred compensation	71%	52%	41%	39%

** Data is from Watson Wyatt Data Services' 2008/2009 Survey Report on Non-Qualified Benefits & Perquisite Practices* common in the health care sector than in general industry because the health care sector does not have significant long-term wealth accumulation vehicles such as equity. These benefits help attract executive talent by allowing the organization to invest in the financial well-being of its executives and their families.

These executive benefits are standard elements of many packages. Health care organizations are also likely to provide such additional executive perquisites/supplemental benefits such as excess/restoration retirement plans, employment agreements and change-of-control protection to their top executives. Change-of-control protection is becoming a major concern for executives, as mergers, alliances and affiliations increase in number and financial necessity. While providing a car or car allowance to top executives is still fairly prevalent within health care organizations, other perquisites such as an executive medical plan, first-class air travel, companion travel expenses and loans are not (approximately 10 percent or fewer).

Public companies have taken much criticism for providing executive perquisites to CEOs and other officers since the SEC proxy disclosure rules were enhanced in 2007. The spotlight is about to shift to tax-exempt organizations, including health care, with the new disclosure requirements about perquisites on the 2008 IRS Form 990.

Governance

Being a board member of a not-for-profit health care organization is increasingly complicated, requiring board members to balance the organization's mission for community benefit and health with financial soundness and business-like practices. Directors must be independent and exercise their fiduciary duties of care and loyalty to the community, tasks that require significant due diligence.

In August 2008, the IRS released instructions for completing its new Form 990, which tax-exempt health care organizations will be required to begin using for fiscal years beginning on or after January 1, 2008. This is a complete overhaul of the previous form and contains many significant developments related to executive compensation disclosures and governance. While not quite as onerous as the compensation discussion and analysis requirements in proxies for public companies, nonprofit organizations will be required to describe (among many other areas) in narrative form:

- The process for determining compensation for the CEO, other officers and key employees (covered employees)
- Any compensation payments made at the discretion of the compensation committee or board (e.g., salary increases, incentive awards, bonuses, supplemental executive retirement plans, etc.)
- A detailed reporting of all amounts of compensation paid to covered employees, including the value of deferred amounts, benefits and loans
- Compensation plans contingent on revenues or net earnings of the organization
- The process for the board to review Form 990 before it is filed

Furthermore, the new form requires a detailed accounting of the compensation paid to all directors, officers, trustees, key employees, five highest compensated employees and independent contractors – a much larger group than required for public companies and larger than what was required previously. This will entail a detailed breakout of each compensation element such as base salaries, incentives, supplemental perquisites and benefits (by item), retirement values, deferred compensation reported in prior years and nontaxable compensation for each individual. A new section on certain expenses (such as first-class travel, housing allowances, health and social clubs, and discretionary spending accounts) is also now required where filers must indicate whether they provide such programs and whether a formal policy exists for each. Finally, a section detailing other governance items such as excess benefit transactions, transactions with interested parties and loans to/from interested parties will be required with details behind each transaction.

The importance of compiling accurate and complete information cannot be overemphasized, and organizations are behind the curve if they haven't already begun the process of drafting their filing. Given the extent of the new disclosures, it will be critical to ensure the governing body has enough time to review and digest the new disclosure so it has adequate input and approval before the form is filed.

Many tools assist organizations in the governance of executive pay including:

- A compensation committee charter that defines the precise duties, responsibilities and processes employed to govern executive compensation matters
- An executive total compensation philosophy that articulates specifically the elements of the compensation package, objectives, rationale, policies, measures/metrics (e.g., incentives), and the procedure for review and change
- Program policies that specify the benefits, eligibility and administration of individual programs or practices related to executive compensation (e.g., severance, car allowance, relocation, etc.)
- An intermediate sanctions process established by the IRS for organizations to establish a rebuttable presumption of reasonableness of executive pay and pay decisions

The 2008/2009 study results confirm organizations are paying more attention to executive pay governance in health care: Eighty percent check for conflicts of interest for board members, 79 percent have a written charter, 70 percent have a written formal executive compensation philosophy and 70 percent engage a compensation consultant whose primary relationship is with the compensation committee. Some practices, however, can still be improved.

- Only 60 percent obtain an opinion letter of reasonableness about executive pay actions annually, and 22 percent obtain one periodically.
- 50 percent have the board or compensation committee approve the Form 990 disclosure annually.
- Fewer than 25 percent of organizations that offer executive benefits and perquisites do not have a formal written policy on these programs.

Although most organizations obtain an opinion letter of reasonableness in total, almost one-quarter are doing it only periodically. Organizations will be better served by obtaining an opinion at least annually to guarantee they are assessing the reasonableness of all pay actions or programmatic changes as they occur. Organizations that lack formal policies and processes could struggle to prepare their new IRS Form 990 disclosure.

The IRS has identified the tax-exempt sector as one that needs attention regarding governance practices and, to that end, has two very effective tools in its arsenal of compliance and review:

- Intermediate sanctions for excess benefits and compensation
- IRS Form 990

Intermediate sanctions rules (found in Internal Revenue Code Section 4958) allow the IRS to penalize both the executives who receive unreasonable compensation and the board members who approve it. Health care organizations can avoid these penalties by taking some straightforward steps involving both management and the board or compensation committee to ensure they are obtaining the rebuttable presumption of reasonableness. The new IRS Form 990 requirements make clear that the IRS wants organizations to follow the three-step process to determine reasonable compensation for Section 4958 purposes. Although more organizations are taking these steps, compliance is still less than 100 percent, opening up organizations to a higher risk of IRS review.

Summary of Best Practices

Integrated Reward and Talent Management

Develop and implement an integrated approach to reward and talent management. Approach your reward and talent management programs from a holistic perspective that examines processes throughout the full employment life cycle. Health care organizations have their own unique talent management challenges, but taking cues from general industry for compensation and performance management programs can help alleviate some attraction and retention issues.

Strategic Workforce Planning

Workforce planning links business planning and people needs in a structured way to address the changes an organization faces. The analysis helps identify gaps between current and anticipated job skills so organizations can avoid shortages. Organizations should focus on understanding demographic, turnover, retirement and sourcing patterns in critical jobs and utilizing these analytics to establish internal and external benchmarks for staffing levels relative to business volume as well as performance metrics related to recruitment, retention and cost.

Employee Value Proposition

Develop and communicate your organization's employee value proposition to attract the right employees who best fit the organization's values, culture, goals and work environment. Employer reputation is the top reason critical-skill employees join health care organizations. Creating and communicating a strong EVP is an effective way to differentiate your organization in the marketplace to attract and retain employees.

Performance Management

Performance management needs to evolve in the health care industry from its current focus on development to include a true evaluation and recognition of performance. An effective approach will help employees set performance goals that are aligned with the organization's strategic direction, reward those who contribute to the organization's success and improve employee performance. A performance management program should link formal organizational goal setting to individual objectives, provide coaching and feedback to employees, motivate top performers while helping average performers improve and managing out poor performers, address developmental and training needs, and link pay decisions to results of the review process.

Governance

Implement best practices that exist for both health care and public company institutions by formalizing all aspects of the executive pay process. A well-articulated executive compensation philosophy is the foundation for assessing and making pay decisions and for implementing programs that align with the organization's goals and mission. Ensure that the body charged with making executive pay decisions is independent and has a clearly articulated charter to guide its responsibilities. Further, create formal written policies around each program to further assist the board and management in administering executive pay – and if you deviate, be ready to explain why. Be prepared for the new IRS Form 990. Start collecting compensation data and drafting your Form 990 disclosure. It is clear from the new requirements that the IRS would like organizations to follow the process to establish the rebuttable presumption of reasonableness under intermediate sanctions rules. This has been a best practice since the rules were introduced and should be followed by every nonprofit organization regardless of whether they are eligible for the presumption.

Conclusion

The health care industry will need to adapt to manage the increased demand for its services coupled with the human capital challenges of attracting and retaining critical talent. Employee compensation and benefits represent some 50-60 percent of costs to hospitals. The industry has a high turnover rate (well above the average for most industries), and like the general population of the United States, its labor population is aging. These problems are further exacerbated by more stringent professional certification qualifications, shortages of qualified faculty in education and better employment options outside of health care. There is a bottleneck in the supply of younger workers, shrinking the overall talent pool and forcing many organizations to look more closely at their HR policies – how they attract new employees, retain current ones and ensure a continuous stream of qualified workers through education programs.

Successful organizations have discovered that approaching talent management issues from a holistic perspective and integrating talent management programs into the business planning process helps them invest in strategies that will attract, engage and retain the right talent for the organization at the right cost.

The best practices outlined in this conclusion provide a proper framework to evaluate the best course of action for your health care organization. Taken together, these practices will help focus efforts on the critical human capital needed for a successful organization.

About Watson Wyatt Worldwide

Watson Wyatt is the trusted business partner to the world's leading organizations on people and financial issues.

Our client relationships, many spanning decades, define who we are. They are shaped by a deep understanding of our clients' needs, a collaborative working style and a firm-wide commitment to service excellence.

Our consultants bring fresh thinking to client issues, along with the experience and research to know what really works. They deliver practical, evidence-based solutions that are tailored to your organization's culture and goals.

With 7,700 associates in 32 countries, our global services include:

- Managing the cost and effectiveness of employee benefit programs
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To find out more about services for health care organizations, call 800.388.9868 or visit us on the Web at watsonwyatt.com.

About ASHHRA

Founded in 1964, The American Society for Human Resources Administration (ASHHRA) is the leading voice for HR professionals in health care – linking people and organizations to leadership practices, best practices to patient outcomes, and outcomes to business results. Headquartered in Chicago, IL, the society has more than 3,400 members and services the needs of over 51 chapters throughout the United States. For more information about ASHHRA, visit www.ashhra.org.

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NA-2009-11079