

# Healthcare FINANCIAL MANAGEMENT

## Designing an Incentive Compensation Program that Works

*The right incentive  
compensation  
program can become  
an organization's  
new standard of  
excellence.*

BY STEPHEN LAVERTY, MBA; BARBARA J. HOGAN, JD; AND LINDALEE A. LAWRENCE, MBA

*To encourage innovation and improve departmental and organizational bottom lines, Winchester Hospital, Winchester, Massachusetts, developed and implemented a middle management and staff incentive compensation plan. Middle managers and staff who participate in projects that provide savings to the hospital are paid a share of the savings. The plan allows staff the option of designing "horizontal" projects, in which a project leader carries out a project individually or with peers, or "vertical" projects, in which a project leader directs a team of key individuals.*

*Increasing numbers of vertical projects have been proposed since the plan's inception in 1994. In addition to increasing the hospital's operating income, the program provides cost-effective, variable compensation, which especially appeals to motivated, high-performing employees; motivates employees to overcome roadblocks; facilitates a team approach that bridges traditional departmental boundaries; and encourages a beneficial and collegial competitiveness among managers.*

In 1994, Winchester Hospital, Winchester, Massachusetts, implemented an incentive compensation plan, a voluntary program that encourages middle managers and staff to develop cost-saving or revenue-enhancing programs for the hospital by offering them a share of the savings on revenues as an incentive award payment. The percentage of managers participating in the program and the savings realized have been substantial and have increased steadily (see Exhibits 1 and 2).

Projects can be either "horizontal" or "vertical." The

project leader of a horizontal project carries it out individually or with peers, whereas the project leader of a vertical project forms a team of key individuals important to the project's long-term success. Vertical projects often are more complex to manage because they tend to be wider in scope and involve more people. By the plan's second year, however, Winchester had received several vertical project proposals.

At the team leader's request, trained facilitators may assist in vertical project planning by providing the following input:

- Identifying the goals or projects, or both, that will affect a department's bottom line;
- Helping to develop the cost-benefit analysis;
- Creating the action plan and establishing benchmarks to measure progress and success throughout the year;
- Ensuring participation and inclusion of all key employees; and
- Ensuring that the work moves forward on a timely basis and stays within established quality and cost parameters.

Participants in the program can choose to develop a new project or to modify an existing one. Individuals are eligible for incentive awards of up to 15 percent of base salary, subject to a maximum team pool of 50 percent of the net benefit to the hospital.

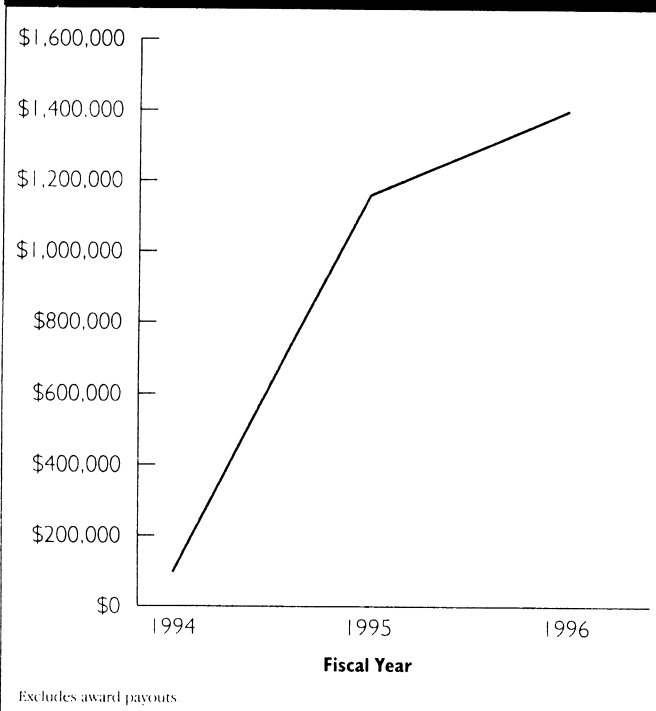
Diligent administration, communication, and feedback are provided by two coadministrators representing finance and human resources. A steering committee composed of executives and directors reviews and oversees

the proposed projects and helps to ensure that all projects reflect the hospital's business plan and objectives. The committee may reject proposals or request revisions to them. Exhibit 3 outlines key administrative work steps of projects throughout the year.

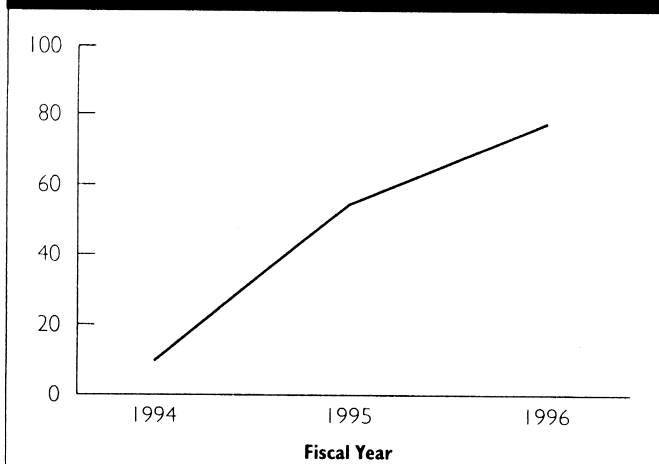
### Success Factors

The success of this program is reflected in the increasing number of projects proposed each year, the savings to the hospital, and the broad participation of managers. Some

**EXHIBIT 1: PROGRAM SAVINGS, 1994-96**



**EXHIBIT 2: PERCENTAGE OF MANAGERS PARTICIPATING IN THE INCENTIVE COMPENSATION PLAN, 1994-96**



**EXHIBIT 3: INCENTIVE PROGRAM ADMINISTRATION PROCESS**

- Program administrators lead brainstorming sessions for new project ideas.
- Project leaders and staff propose and design projects before budget development.
- Program administrators from human resources and finance review, assess, and provide feedback on project design and measurement standards.
- Administrators and project leaders agree on measurement standards and targets.
- Steering committee reviews and approves project proposals before fiscal year.
- Project leaders prepare semiannual written summaries for administrators and steering committee.
- All incentive project participants sign participation agreements.
- Executives meet semiannually with program administrators to identify problems and assess progress.
- Program administrators and project leaders review project outcome and participation and calculate awards.
- Hospital pays awards within 60 days after fiscal year end.

**EXHIBIT 4: INCENTIVE PROGRAM STRENGTHS**

- Program savings enhance hospital operating income.
- Program structure provides a framework for thinking "out-of-the-box."
- Meaningful rewards provide strong motivation for individuals to resolve "roadblocks."
- Program serves as a unique compensation tool, enhances recruitment efforts, and supports selection of managers who are comfortable working with incentives.
- Program provides cost-effective, variable compensation especially for employees who are at the tops of their pay ranges.
- Program flexibility encourages all project ideas.
- Program facilitates a teamwork approach that bridges departmental lines.
- Program encourages a beneficial and collegial competitiveness among managers.

of the less easily quantified benefits of the program, such as fostering a team approach to problem solving and encouraging a beneficial competitiveness among managers, are listed in Exhibit 4.

While critics of incentive programs argue that employees should not receive extra compensation for doing their jobs, supporters argue that many of these projects would not come to fruition without incentives. Winchester's incentive program coadministrators believe that at least 50 percent of the initiated projects would never have occurred without the added motivation of the incentive rewards.

**EXHIBIT 5: POWER PLANT CONVERSION AND ENERGY CONSERVATION UPGRADE PROJECT**

Project Description	
<b>Project Objective</b>	Power plant conversion to dual fuel capability and automation.
<b>Project Leader</b>	Director of support services.
<b>Team Members</b>	Director of support services, manager of engineering, administrative assistant, power plant foreman.
<b>Savings and Incentive Award</b>	The project resulted in \$78,600 in savings to the hospital with payment of the full incentive award to all team members. In addition, the project encouraged teamwork over a two-year time frame and promoted an interest in energy conservation.
<b>Administration</b>	This project required an investment of \$500,000 in equipment, which was amortized in calculations of the savings. When presented as a package with projected savings, the outlay was approved outside of the traditional budget process through which projects compete for budgeted dollars. This project demonstrated that some worthwhile projects should be implemented and measured over a period of more than one year.

**EXHIBIT 6: DISPOSABLES PROJECT**

Project Description	
<b>Project Objective</b>	To identify disposables that can be reprocessed.
<b>Project Leader</b>	Unit director, surgical services.
<b>Team Members</b>	Operating room circulation nurses, scrub nurses, and technicians on all shifts, materials manager, and staff.
<b>Savings and Incentive Award</b>	The increasing use of disposables makes it difficult to identify the budgetary savings of reprocessing. Savings of \$12,000 produced a small award to all team members. The educational benefit of understanding and questioning the use of high-priced supplies may have long-term benefits.
<b>Administration</b>	The project involved gaining the support of all unit personnel and physicians about the opportunity to realize savings while maintaining high quality.

The success of this program has rested on a number of unique factors, including the following:

- The "artistry" of senior executives in establishing corporate business objectives that stretch employee capabilities, yet remain reasonable and feasible.
- A meaningful reward system that also is a source of recognition for initiative and innovation.
- The organization's support of risk taking.
- The finance department's ability and commitment to help managers develop measurable, quantifiable cost/benefit analyses and then to sponsor the projects to senior management.
- The strong administrative partnership between finance and human resources that provides follow-up, honest assessment, and constructive feedback to managers who submit proposals.
- Manager and employee commitment to designing programs that enhance operational quality.
- Measurement goals—benchmarks used to measure accomplishment of project goals—that are agreed upon and adhered to.

**Examples of Projects**

Exhibits 5 and 6 illustrate two vertical projects undertaken at Winchester Hospital. Both projects included extensive education for all members and participants regarding new procedures and working relationships.

The power plant conversion and energy conservation upgrade was implemented and measured over two years. Boilers were converted to dual oil and natural gas fuel capability. By burning both types of fuel, the hospital can

***...at least 50 percent of the initiated projects would never have occurred without the added modification of the incentive rewards.***

purchase fuel more cost-effectively by negotiating a lower-cost interruptible gas rate. To date, the project has resulted in savings of \$78,600 for the hospital.

The disposables project involved a large group of team members and nonincentive participants, such as physicians, and resulted in savings to the hospital of \$12,000. Disposable items were chosen for reprocessing based on the purchase cost versus reprocessing costs and the ability to safely and effectively reprocess them. Procedures were developed

for packaging and shipping items for disassembly, cleaning, sharpening, and sterilization by a vendor, licensed as a manufacturer, to the specifications of the original manufacturers. In addition, liability for the effectiveness of the process was assumed by the vendor, not the hospital.

To institute the disposables project, approval was needed from the OR and Infection Control committees and from the Quality Assurance Department. Training sessions to educate staff members on the cost-effectiveness of this project were led by the hospital's central material supply staff and a representative of the vendor. Both the disposables project and the power plant conversion and energy upgrade project are ongoing.

### Elements of Success

Based on the experiences of the managers and their incentive teams, elements of successful projects include the following:

- Identifying and involving project team members whose organizational and technical support are necessary for a successful outcome;
- Developing written summaries of the roles and accountability of participants on each project;
- Providing clear information to all participants about elements and award levels of the incentive plan;
- Allowing managers to start with smaller, more manageable teams and gain experience with the plan;
- Including processes and procedures that will help ensure the permanence of any changes and improvements; and
- Communicating frequently with the team about project status and team performance, and maintaining close contact with executives.

### Future Challenges

As Winchester Hospital continues to improve the efficiency and quality of plant and operations, future opportunities will not be as obvious or as easy to define. Future savings will require increased teamwork throughout the organization and more innovation in designing new programs. Implementation and measurement periods may lengthen, and more people may share in team rewards. The plan will continue to serve as a vehicle for managers and staff to test leading-edge approaches to motivation, recognition, and performance evaluation.

Over time, participation in the incentive program has become a standard of excellence for all Winchester managers. As healthcare management jobs consolidate and pay opportunities flatten, the plan represents a unique opportunity for substantial recognition and reward. ■

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#### ABOUT THE AUTHORS



Stephen Laverty, MBA, is president and CEO, Winchester Hospital, Winchester, Massachusetts.



Barbara J. Hogan, JD, is vice president, human resources and legal affairs, Winchester Hospital, Winchester, Massachusetts.



Lindalee A. Lawrence, MBA, is president, Lawrence Associates, Wellesley, Massachusetts.

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