

Physician Productivity & Compensation

Charles Stiernberg, MD, MBA



*Medical Director, University Care Plus
Cmstiernberg@houston.rr.com*

&

*Professor of Otolaryngology
University of Texas Medical School*

Traditional Private Practice

“Eat What You Kill” Model

Revenue	\$480,000
Operating Expenses	
Fixed (Staff Salaries, etc)	(\$250,000)
Variable (10% of revenue)	(\$48,000)
<hr/>	
Earnings Available to MD	\$182,000

Options Post Residency

- 1. Vast Majority - start in “Salaried” Jobs, i.e. employment**
- 2. Why? Because of the large Up-front costs of starting a practice**
- 3. Typical options for employment:**
 - Physician Owned Groups**
 - Other Entities, i.e. HPO’s, Military, Med Schools**

The Key Question

What is a fair compensation package for an employed physician?

Today's Models

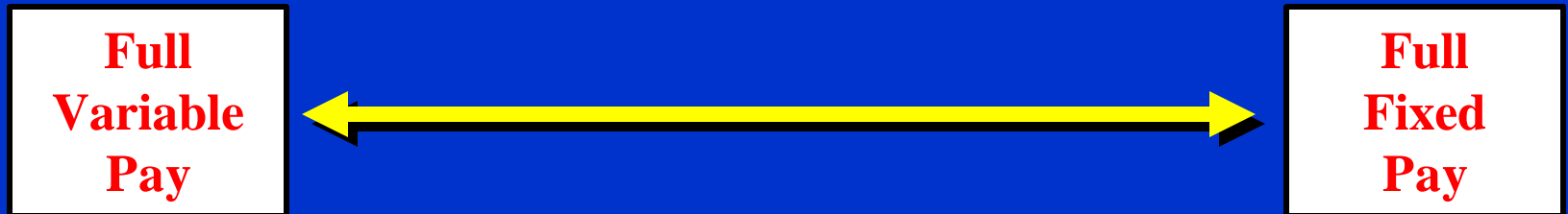
Different Formulations of:

Fixed “Base Pay” amount

+

*“Productivity-based” incentive
(variable)*

Physician (Provider) Compensation



Financial Concepts & Provider Compensation Plans

- ✓ **Operating Leverage**
- **Ownership Premium**
- **Marginal Utility of Money**

Operating Leverage

- Fixed expenses to variable expenses ratio
- Provides leverage to the bottom line -

But at an increased Risk!

Operating Leverage

Income Statement

Revenue	\$1000	→ +20%	→ \$1200
Expenses			
Variable	\$900		\$1080
Fixed	\$ -0-		\$ -0-
Net Inc.	\$100	→ +20%	→ \$120

Operating Leverage

Income Statement

Revenue \$1000

Expenses

 Variable \$300

 Fixed \$600

Net Inc. \$100

Why Does Operating Leverage Increase Risks?

- **First, imagine 3 possible states of the economy:**

Good - Revenues = \$1200

Avg - Revenues = \$1000

Bad - Revenues = \$800

Why Does Operating Leverage Increase Risks?

	<i>Good</i>	<i>Average</i>	<i>Bad</i>
<i>Revenue</i>	<i>\$1200</i>	<i>\$1000</i>	<i>\$800</i>
<i>Var. Exps</i>	<i>(\$480)</i>	<i>(\$400)</i>	<i>(\$320)</i>
<i>Fixed Exps</i>	<i>(\$400)</i>	<i>(\$400)</i>	<i>(\$400)</i>
<i>Net Income</i>	<i>\$320</i>	<i>\$200</i>	<i>\$80</i>

Why Does Operating Leverage Increase Risks?

	<i>Good</i>	<i>Average</i>	<i>Bad</i>
<i>Revenue</i>	\$1200	\$1000	\$800
<i>Var. Exps</i>	(\$240)	(\$200)	(\$160)
<i>Fixed Exps</i>	(\$600)	(\$600)	(\$600)
<i>Net Income</i>	\$360	\$200	\$40

Why Does Operating Leverage Increase Risks?

Increased Operating Leverage widens the range of possible outcomes to the bottom line (Profit/Loss) ...

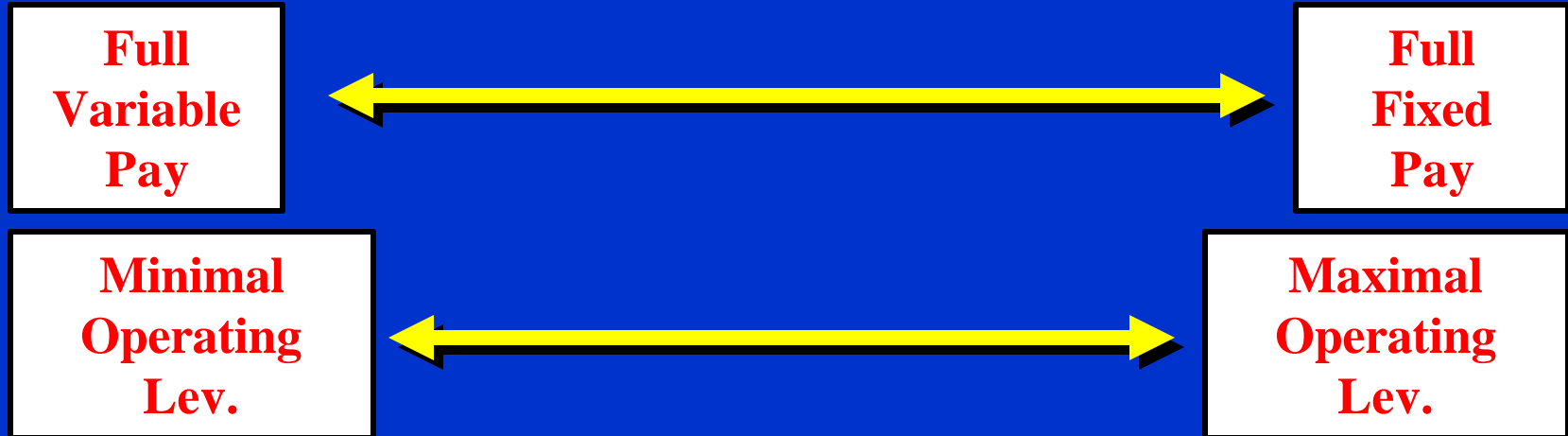
*Hence it increases **Risks**.*

Operating Leverage as Applied to Physician Compensation



From the Employer's Perspective

Operating Leverage as Applied to Physician Compensation



From the Employer's Perspective

Operating Leverage as Applied to Physician Compensation



From the Employer's Perspective

Designing Compensation Models

The Classic “X Y Z” Model

X - Base Pay (Fixed)

Y - Negotiated or for specific assignments, e.g. admin (Fixed)

Z - Incentive (Variable)

*Designing the Incentive
("Z" Variable)
Component*

The Ten Principles of Incentive Plans

1. Incentive payments must be a major, not a minor, part of total compensation.

> 20% of TC is Great!

< 5% of TC is Poor!

The Ten Principles of Incentive Plans

- 2. Payoff for high performers must be substantially higher than for average performers.*

The Ten Principles of Incentive Plans

- 3. Incentive plans should extend to all managers and workers, not just top executives.*

The Ten Principles of Incentive Plans

- 4. Incentive plans must be administered with scrupulous care and fairness ... they must be consistent and unalterable*

The Ten Principles of Incentive Plans

- 5. Incentives must be tightly linked to performance targets in the strategic plan ... not other factors that are thrown in because they are nice.*

The Ten Principles of Incentive Plans

6. Performance targets for individuals and groups must be linked to outcomes that they can affect.

The Ten Principles of Incentive Plans

*7. Keep the time between
performance review and pay-
off as short as possible.*

The Ten Principles of Incentive Plans

- 8. Make liberal use of non-monetary rewards ...
recognition, plum assignments,
etc.*

The Ten Principles of Incentive Plans

- 9. Skirting the system to find ways of rewarding non-performers must be absolutely avoided ... once “good” excuses creep into justifying rewards for non-performers, the door is wide open for all kinds of “legitimate” reasons.*

The Ten Principles of Incentive Plans

10. Incentive plans must be prospectively communicated (in writing) and well understood by everyone.

Benchmarking & Measuring Productivity

*Benchmarking provides a realistic
basis for setting performance
targets ...*

*RVU's are the best, especially for
comparing productivity to
external providers*

Benchmarking & Measuring Productivity

WARNING!

- 1. RVU's as a Benchmark are good*
- 2. BUT should not be the only Measure of provider productivity.*

Why?

Productivity & Incentive Payments

	<i>Physician A</i>	<i>Physician B</i>
<i>RVU's</i>	14000	14000
Revenue	\$560,000	\$560,000
Operating Expenses	(\$300,000)	(\$290,000)
Provider Base Pay	(\$200,000)	(\$150,000)
Profit / Loss	\$60,000	\$120,000
Profit Margin (%)	10.7%	21.4%

Total in the Incentive Pool for Distribution = \$90,000

Incentive Payment Calculations

\$90,000 Available in Pool for Distribution (Half of Profit)

	<i>Physician A</i>	<i>Physician B</i>
<u>Basis of Calculation</u>		
RVU's	\$45,000	\$45,000
Revenue	\$45,000	\$45,000
Profit / Loss	\$30,000	\$60,000
Total Doctor Compensation		
RVU's	\$245,000	\$195,000
Revenue	\$245,000	\$195,000
Profit / Loss	\$230,000	\$210,000

What's the Best Method? Are there better ones?

Incentive Payment Calculations - Performance Parameters -

Traditional Parameters

Charges

RVU's

Revenue

Profit / Loss

Number of patient
encounters

Patient satisfaction
measures

Incentive Payment Calculations

- Performance Parameters -

Traditional Parameters

Charges

RVU's

Revenue

Profit / Loss

Number of patient
encounters

Patient satisfaction
measures

“Turnover Ratios”

Revenue / Tot.Cost

Revenue / Variable costs

Revenue / Tot. Comp.

RVU's / Tot. Comp.

RVU's / Tot. Costs

Charges / Tot. Comp.

Charges / Tot. Cost

Revenue / (Tot. Comp.+ Var.Costs)

Advantages of Tot. Comp + Variable Costs as Denominator

- 1. Rewards Providers who control their
Variable Operating Costs !!!**
- 2. Links an institution's budget to
outcomes**

Individual vs Group Incentives

Individual-Based Plans

- *Advantages:*
 - *Highly motivating for individuals*
 - *Do not compensate “deadwood”*
- *Disadvantages:*
 - *Competition inside the organization for the same patients*
 - *Does not credit providers for “downstream” benefits*

Group-Based Plans

- *Advantages:*
 - *Promotes Team Work*
 - *Promotes “niche” expertise*
 - *Keeps referrals inside the group practice*
- *Disadvantages:*
 - *Potential for individuals not to carry their “load”, i.e. deadwood*

The Hybrid Plan

- *Example:*
 - *Fifty Percent of “profit” is allocated to individuals for individual productivity*
 - *Fifty Percent of “profit” is allocated equally to everyone in the unit*

The Hybrid Plan

- *Motivates individuals but not too much internal competition*
- *Does not overly compensate “deadwood” when the whole group does well*
- *Promotes team work and internal referrals*
- *Provides some credit to primary providers for the downstream income*

Thank You!

Charles Stiernberg, MD, MBA
Medical Director, University Care Plus

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Professor of Otolaryngology

Phone: (713) 704-6382

Cmstiernberg@houston.rr.com

