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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$480,000</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
</tr>
<tr>
<td>Fixed (Staff Salaries, etc)</td>
<td>($250,000)</td>
</tr>
<tr>
<td>Variable (10% of revenue)</td>
<td>($48,000)</td>
</tr>
<tr>
<td>Earnings Available to MD</td>
<td>$182,000</td>
</tr>
</tbody>
</table>
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

- Full Variable Pay
- Full Fixed Pay
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**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$1000</td>
</tr>
<tr>
<td></td>
<td>+20%</td>
</tr>
<tr>
<td></td>
<td>$1200</td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>$900</td>
</tr>
<tr>
<td></td>
<td>$1080</td>
</tr>
<tr>
<td>Fixed</td>
<td>$-0-</td>
</tr>
<tr>
<td></td>
<td>$-0-</td>
</tr>
<tr>
<td>Net Inc.</td>
<td>$100</td>
</tr>
<tr>
<td></td>
<td>+20%</td>
</tr>
<tr>
<td></td>
<td>$120</td>
</tr>
</tbody>
</table>
Operating Leverage

Income Statement

Revenue $1000

Expenses
  Variable $300
  Fixed  $600

Net Inc. $100
Operating Leverage

Income Statement

Revenue  $1000  $1200

Expenses

Variable $300  $360

Fixed  $600  $600

Net Inc. $100  $240
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?

<table>
<thead>
<tr>
<th></th>
<th>Good</th>
<th>Average</th>
<th>Bad</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>$1200</td>
<td>$1000</td>
<td>$800</td>
</tr>
<tr>
<td><strong>Var. Exps</strong></td>
<td>($480)</td>
<td>($400)</td>
<td>($320)</td>
</tr>
<tr>
<td><strong>Fixed Exps</strong></td>
<td>($400)</td>
<td>($400)</td>
<td>($400)</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$320</td>
<td>$200</td>
<td>$80</td>
</tr>
</tbody>
</table>
**Why Does Operating Leverage Increase Risks?**

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<th>Good</th>
<th>Average</th>
<th>Bad</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$1200</td>
<td>$1000</td>
<td>$800</td>
</tr>
<tr>
<td>Var. Exps</td>
<td>($240)</td>
<td>($200)</td>
<td>($160)</td>
</tr>
<tr>
<td>Fixed Exps</td>
<td>($600)</td>
<td>($600)</td>
<td>($600)</td>
</tr>
<tr>
<td>Net Income</td>
<td>$360</td>
<td>$200</td>
<td>$40</td>
</tr>
</tbody>
</table>
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

- Full Variable Pay
- A Variable Expense
- A Fixed Expense
- Full Fixed Pay
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.
3. Incentive plans should extend to all managers and workers, not just top executives.
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.
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
WARNING!

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

Why?
# Productivity & Incentive Payments

<table>
<thead>
<tr>
<th></th>
<th><strong>Physician A</strong></th>
<th><strong>Physician B</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RVU's</strong></td>
<td>14000</td>
<td>14000</td>
</tr>
<tr>
<td>Revenue</td>
<td>$560,000</td>
<td>$560,000</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>($300,000)</td>
<td>($290,000)</td>
</tr>
<tr>
<td>Provider Base Pay</td>
<td>($200,000)</td>
<td>($150,000)</td>
</tr>
<tr>
<td>Profit / Loss</td>
<td>$60,000</td>
<td>$120,000</td>
</tr>
<tr>
<td>Profit Margin (%)</td>
<td>10.7%</td>
<td>21.4%</td>
</tr>
</tbody>
</table>

**Total in the Incentive Pool for Distribution = $90,000**
## Incentive Payment Calculations

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

<table>
<thead>
<tr>
<th>Physician A</th>
<th>Physician B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basis of Calculation</td>
<td></td>
</tr>
<tr>
<td>RVU's</td>
<td>$45,000</td>
</tr>
<tr>
<td>Revenue</td>
<td>$45,000</td>
</tr>
<tr>
<td>Profit / Loss</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

| 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 -

<table>
<thead>
<tr>
<th>Traditional Parameters</th>
<th>“Turnover Ratios”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charges</td>
<td>Revenue / Tot. Cost</td>
</tr>
<tr>
<td>RVU's</td>
<td>Revenue / Variable costs</td>
</tr>
<tr>
<td>Revenue</td>
<td>Revenue / Tot. Comp.</td>
</tr>
<tr>
<td>Profit / Loss</td>
<td>RVU’s / Tot. Comp.</td>
</tr>
<tr>
<td>Number of patient</td>
<td>RVU’s / Tot. Costs</td>
</tr>
<tr>
<td>encounters</td>
<td>Charges / Tot. Comp.</td>
</tr>
<tr>
<td>Patient satisfaction</td>
<td>Charges / Tot. Cost</td>
</tr>
<tr>
<td>measures</td>
<td></td>
</tr>
</tbody>
</table>

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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Phone: (713) 704-6382
Cmstiernberg@houston.rr.com