

Building Bonds: Pathways to Better Board/CEO Relationships

Hospital CEOs and their boards must build and sustain vibrant, trust-based relationships in order to successfully navigate the opportunities and challenges in today's complex and fast-paced health care world. That trust requires leadership excellence in a number of key areas, including clear and consistent communication, adherence to well-defined roles and responsibilities, and clear CEO performance expectations and accountabilities that are appropriately rewarded using responsible compensation assessment policies and procedures.

The board/CEO relationship should be a trusting partnership, where both trustees and the CEO work together, united as a team to achieve the greatest level of organizational success. The relationship can be enhanced by clearly understanding one another's needs and expectations, clear and consistent communication, shared goals and objectives, dialogue-rich and purposeful meetings, and constant sharing of timely and critical information. Those are the ingredients of a successful partnership and relationship.

Good chemistry between the board and its CEO is vital to organizational success. Mutual respect, candor and absolute trust distinguish the very best board/CEO relationships. Trust, however, is the most critical component for boards and CEOs. Close communication and effectiveness are the results of trustful relations.

Building Trust

Trust plays a vital role in the ability of the CEO and trustees to communicate openly and honestly. Without trust, individuals may be

hesitant to participate in discussions, raise issues, or share their viewpoints.

In order to build mutual trust, the board and the CEO must rely on one another for support, consultation and advice, and complement one another's strengths and responsibilities.

The CEO must build a positive rapport and a professional relationship with all board members. He or she must understand clearly what motivates each trustee to be involved with the organization and be knowledgeable about the interests and needs of each individual trustee.

The CEO must also be aware of any gaps in trustees' understanding of current issues and trends, ensure that regular board education responds to trustees' needs, and encourage trustees to learn and ask questions in an open, safe environment. CEO attentiveness to individual trustees' needs demonstrates interest and support and helps build a positive, trustful environment for dialogue and decision-making to take place.

When the board/CEO relationship is good, the board has supreme confidence in the CEO's ability to lead the organization and in the board's ability to provide encouragement, support and outside perspectives to help enable that leadership. When it is good, the board and CEO are able to work together in a collaborative fashion to design clear, focused approaches to challenges and issues because they address the right issues in the right way at the right time.

On the flip side, when the relationship lapses and ends up in the "relationship ICU," persistent questions about focus, intent and appropriateness permeate board discussions and inhibit effective board decision making. Much second-guessing takes place, oftentimes behind the scenes or in the parking lot. Coalitions and factions begin to form and important decisions are tabled due to uncertainty or a lack of trust—a downward spiral of trust and confidence results.

Creating Success: Mutual Needs

Establishing a successful relationship takes work on the part of the board and the CEO. There are a number of ingredients inherent in a good Board/CEO relationship, including:

- Communication is clear, concise and accurate, and candor is the order of the day;
- Both the board and the CEO are "on the same page," and display a mutual understanding of issues from their own unique perspectives;
- Roles, responsibilities and accountabilities are clear and well-expressed;
- The board has a clear understanding of its policy and strategic "place" in the leadership

Board and CEO Needs

Board Needs

- An understanding of emerging issues and challenges impacting the organization.
- The CEO's perspective of the barriers to success.
- Clarity around how they can be the best leadership asset to the CEO and the hospital in dealing with these issues and barriers.
- Crisp, clear and concise overviews that help the board keep their thinking at a high level and avoid the tendency to "wander" into operational areas that are inappropriate.

CEO Needs

- An understanding of the information and perspectives the board requires in order to lead with purpose and vision.
- A curious board.
- A board with a culture of candor and commitment, offering energetic participation, creative thinking and a willingness to challenge the status quo.

If the board/CEO relationship is not operating at a productive, high-level, there is always the looming potential for leadership to descend into a destructive spiral of mistrust, miscommunication and misunderstanding.

continuum, and egos are not allowed to suppress the important work at hand; and

- A strong sense of synergy results from a mutual understanding of what both the CEO and the board bring to play in tackling the complex challenges that face the organization.

Purpose Wandering

Board members sometimes, knowingly or unknowingly, begin to wander into the CEO's domain, and the results of that meandering can be problematic. To avoid "purpose wandering," roles and responsibilities should be clearly expressed in writing. This helps define the fine line between strategic leadership and operational leadership. Too often roles and responsibilities are unclear and unfocused. A formal, written set of roles and responsibilities will help prevent both the board and the CEO from inappropriately trying to assume the other's responsibilities.

The What vs. the How. While the board is responsible for the high-level strategic focus and direction of the organization, the CEO and his or her administrative team are responsible for the day-to-day operations and details of designing action plans implementing the strategic plan. One is the "what," the other is the "how."

The Board's Focus. On a global basis, the board is responsible for the selection and evaluation of the CEO, high-level strategic planning, the development of policies and procedures and approving decisions with strategic implications - such as budgets, facility and equipment decisions and personnel policies. These specific policies or procedures are often recommended to the board by the administrative team, who rely on the board to review the information and discuss the pros and cons of each decision before coming to a consensus.

The CEO's Focus. In contrast to the board's high-level focus on long-term planning and approval of budgets and policies, the CEO is responsible for ensuring the day-to-day operations fulfill the board's long-term plan for the organization. The CEO provides regular

Define the Responsibilities in a Matrix

A good idea for delineating board and management responsibilities is to develop a matrix of responsibilities in a broad range of areas, such as hiring, budgeting, personnel policies, compliance, advocacy, community relations, quality, credentialing and more. The group or individual's specific responsibility may then be clearly defined, and gray areas can be avoided. The matrix should briefly define whether the individual or group develops, directs, reviews, provides input, and/or approves work in each area.

updates to the board about the organization's success in achieving its goals; informs the board about current and emerging challenges facing the organization; and presents budgets, capital purchases, personnel decisions, fees and billing and collection policies, and potential new policies or procedures to the board for review and approval.

When trustees and the CEO focus on fulfilling their respective roles, the result is an organization that is able to leverage the best resources of both of these important leadership assets.

The Board Meeting: The Center of Communication Success or Failure

The board meeting is the center of communication and relationship success or failure. Unfortunately, board meetings are often not as effective as they should be due to poorly planned agendas, time wasted on routine reports and too much emphasis on operational issues and details, thereby frustrating the CEO.

Board meetings should focus on the vision, values, governance policies and strategic leadership issues critical to future success. It's essential that all board members be fully-informed about important issues, and that agendas be geared toward the strategic future of the organization. If boards only ensured this one single leadership focus, board and CEO relations in hospitals across America would improve dramatically.

Ensuring Effective Meetings. Effective, high-performance boards spend most of their time on important strategic and policy issues. They engage in rich discussion and dialogue, assess outcomes, and participate in ongoing education. They focus on the issues that are most critical to the organization, and where they can have the greatest impact.

One way to ensure that meetings are focused on where the hospital is headed, rather than where it has been, is to design the agenda around the "25/75" rule. According to many

governance experts, no more than twenty-five percent of meeting time should be spent discussing past issues, and on retrospective reporting and analysis. At least seventy-five percent of board time should be dedicated to issues in which the board has the greatest impact: planning, setting policy, making critical decisions, and setting future direction.

The CEO plays a major role in this area. He or she should ensure that trustees receive materials to review well in advance of board meetings. In addition, the CEO should work closely with the board chair to ensure that meetings are orchestrated to maximize meaningful dialogue and a focus on the future.

How Did We Do? The first five minutes after the board meeting count, too. Many boards pack up and leave the moment adjournment is announced. But what if you knew your board meetings could become more energized and effective if you gave just five more minutes of your time at the close of each meeting?

Legal Language Trustees Need to Understand

Disqualified Person	A "disqualified person" in compensation matters, according to the IRS, is any executive who can exercise "substantial influence" over the organization. Examples of persons with substantial influence include persons making substantial contributions to the organization, those who draw compensation based on revenues from activities under the CEO's control, persons with managerial authority, or who serve as key advisors to a person with managerial authority, and trustees actively involved on the board at the time an executive of substantial influence earns an "excess benefit."
Excess Benefit	An "excess benefit" is an economic benefit that exceeds the value of the disqualified person's services. The excess benefit is the difference between the value of what the organization receives and the value of what's been given to the disqualified person. An excess benefit transaction can occur when the disqualified person's compensation is considered above fair market value or is deemed unreasonable.
Intermediate Sanctions	"Intermediate sanctions" are financial penalties imposed by the IRS on managers of tax-exempt organizations that engage in excess benefit transactions. You never want to see a letter from the IRS with the words "immediate sanctions" on it.

Boards that conduct the most efficient and effective meetings fine-tune their meeting work through the use of individual board meeting evaluations. These evaluations can be completed in five minutes or less. Simple questions might include:

- Did we focus on the right issues?
- Did all members participate in an active way?
- Did we develop our “knowledge capital” with pinpointed board education?

Comments could also be sought regarding the helpfulness of board materials, meeting direction and focus, issues as they relate to the strategic plan, fairness of deliberations, and a sense of whether each member left the meeting knowing what he/she needs to do next. Completing these individual meeting evaluations helps the CEO and board chair to continually refine the board agenda and respond to board needs.

Executive Sessions

One of the most productive places for candid and forthright board/CEO discussion to take place is in an executive session.

Executive sessions are settings that allow the board to handle confidential matters behind closed doors without staff or “outsiders” present. They typically take place following adjournment of the regular board meeting, but they may also take place before or during the meeting.

Typical Agenda Items. Appropriate topics for an executive session may include personnel matters, investigations or updates on alleged improper conduct, CEO performance

assessment, legal negotiations and financial discussions with an auditor, or other topics that must remain highly confidential for a limited period of time. Items appropriate for executive sessions will vary if the organization is a public or private hospital and depending upon state laws and regulations.

In addition, there are times when the board simply needs to have an opportunity to openly and confidentially share opinions among board members on a particular topic. In order to be effective and not misused with a “shadow-agenda,” executive sessions should address only pre-determined issues and not delve into discussion and decision-making that could more appropriately be conducted in the regular board meeting. The executive session is not an excuse to avoid difficult topics and conversations or inappropriately hide board deliberations behind closed doors.

Good Reasons for Executive Sessions.

Holding regular executive sessions can go a long way toward building a strong sense of connection and communication between the board and the CEO. The executive session enables both to engage in the kind of dialogue that is oftentimes difficult during a regular board meeting when staff members and, in the case of public hospitals, the press and members of the community, may be in attendance.

Rules of Engagement. The following rules are critical to observe in order to ensure successful executive sessions:

- Executive sessions should be short and highly focused;
- They should never be used as a method for operating “under the radar” of the regular board meeting;

- They should not be an ad hoc, anecdotal free-for-all;
- If the CEO is not present, he or she should be provided with a summary of the session immediately after the meeting; and
- Sessions should be held with the CEO's support and approval.

CEO Compensation and Evaluation

One of the most important board responsibilities is hiring, motivating, and retaining the hospital CEO. Maintaining clear performance expectations and ensuring a regular compensation and performance review of the CEO encourages frequent and open communication between the board and CEO and helps ensure the CEO's performance drives achievement of the hospital's goals.

Throughout the process, it's critical that board members maintain an organization-wide focus, ensuring that the CEO's compensation is aligned with the organization's goals and that no conflict of interest exists between board members and CEO compensation decisions.

Defining the Board's Role. When determining CEO compensation, the board should take into account a variety of factors, including:

- Overall organizational performance in meeting board expectations;
- The challenges and risks addressed by the CEO;
- A comparison of the CEOs compensation with his or her peers who lead similar-sized organizations;

- The risk or volatility of the position;
- The CEO's tenure in the organization; and
- The implications of the loss of the CEO in the event that inadequate compensation causes the CEO to seek employment elsewhere or become the target of executive recruiters who are constantly on the lookout for high performers to recruit for their clients.

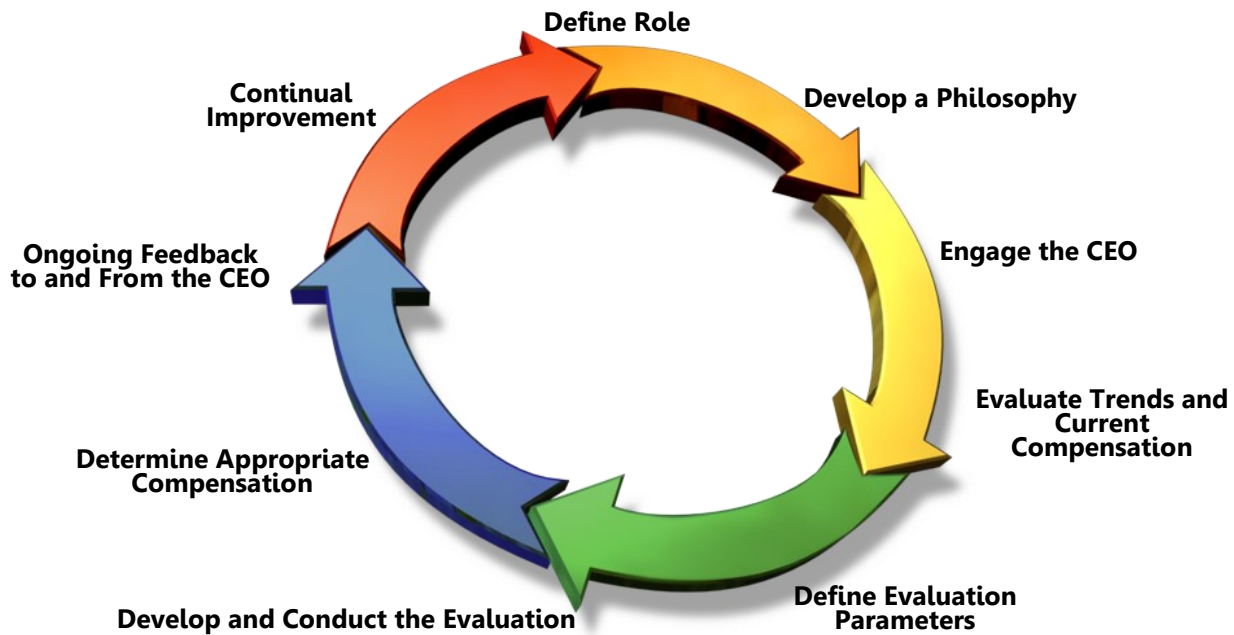
The compensation and performance evaluation is straightforward, but it does include a number of key steps that should be undertaken in a logical and progressive order.

The process begins with a clear definition of the role of the compensation and performance review process in building leadership loyalty and commitment and ensuring leadership success and continuity. In addition, a compensation committee should be established, and its purpose should be clearly defined in the document that includes the committee's mission, composition, objectives and action plans, responsibilities and time frames, and projected outcomes.

The Compensation Philosophy. Once the board's role has been clearly defined, a compensation philosophy should be developed, which includes the role of CEO compensation in stimulating high-performance, and as a reward for achieving board-approved priorities. The philosophy should outline the organization's position regarding the level CEO compensation should be at relative to the CEO's peer group and define the organization's philosophy on pay-for-performance. It should be tailored to and support the organization's culture, mission and strategy, and it should explain the values and goals the organization seeks to reward.

The Compensation Policy. Once the compensation philosophy has been developed,

The CEO Compensation and Evaluation Process



a policy to support the philosophy should be created. Like the philosophy, the compensation policy should be aligned with the hospital's mission and strategic goals. It should define such areas as the purpose of the performance and incentive compensation program; the process for controlling and administering the compensation and performance review; the criteria for the identification of incentive targets and the payment of performance incentives; the timeframe for the evaluation process; and details of the process for payment of incentive compensation earned in the event of the CEO's termination, death or disability.

CEO Engagement. The CEO should be engaged in the process early on to ensure that he or she agrees with the compensation committee's work plan and that there is enthusiastic CEO buy-in to the compensation philosophy. The CEO should provide input to the compensation committee to enable it to best understand his or her contribution to

organizational success. This is typically done later on in the process when the CEO reports on the results of his or her personal objectives and success in achieving board-defined performance objectives.

The Compensation Evaluation. It's at this point that the serious work of the compensation committee begins. The committee should evaluate current trends in CEO compensation and seek out information on comparative salary, incentive compensation and benefits for organizations of similar size around the country. At the same time, the committee can begin to define the parameters for the CEO's evaluation and determine the performance criteria to be used. It is critical to reengage the CEO during this process to ensure that he or she is in agreement that these criteria are appropriate and that he or she agrees to be held accountable for achieving them.

What Protects Boards and Individual Trustees?

There are some inherent legal risks in CEO compensation assessment that trustees need to understand. There are three key ways for the board to protect itself and individual trustees in deliberations and decisions about executive compensation:

- Executive compensation must be approved by the governing body, or by a compensation committee whose members have no conflicts of interest;
- The governing body or compensation committee should collect and use relevant data to establish fair market compensation levels when approving executive compensation; and
- The basis for compensation approval must be adequately documented in written or electronic records.

When trustees ensure adherence to these compensation principles, they have what the IRS refers to as “**rebuttable presumption.**” A board has rebuttable presumption on the reasonableness of executive compensation if it approves CEO compensation based on appropriate data that helps determine comparability or fair market value and documents the basis for its determination at the time it makes its decision.

The Compensation Committee

The board is solely responsible for ensuring that the CEO is appropriately and fairly compensated. The compensation committee performs the bulk of the work and is responsible for ensuring that:

- A current written CEO job description exists and has been reviewed and approved by the CEO;

CEO Evaluation Goals

- Expectations should be clearly identified well in advance of the evaluation
- The evaluation should be a continuous, year-long process culminating in a formal annual performance review, with no surprises for either the board or the CEO
- The evaluation should provide meaningful feedback to the board on the CEO’s success in achieving board-approved objectives
- The evaluation process should enhance board/CEO working relationships
- The evaluation should link the attainment of organizational objectives with the CEO’s personal performance objectives
- Data, not subjective assessments, should be the foundation of the evaluation and decisions about compensation
- Leadership in achieving the mission, values and vision should be a centerpiece of the evaluation
- Compensation should be driven by specific performance in specific areas, including achievement of quality outcomes

Typical CEO Evaluation Criteria

The CEO should be evaluated using pre-determined criteria and goals specified in the CEO compensation policy established by the board's compensation committee and agreed to in advance by the CEO. The evaluation may include a "360-degree" approach that seeks feedback on qualitative performance from the board, medical staff leaders, senior management, and the CEO him or herself. Measurement should also utilize performance in achieving defined objectives, including financial success, patient satisfaction, strategic performance, etc.

Quantitative Measures

Potential quantitative measures may include, but not be limited to:

- Financial and operating performance, using a variety of ratios, with comparison to peer groups
- Market share growth
- Physician satisfaction
- Employee satisfaction
- Patient satisfaction
- Achievement of hospital strategies/objectives
- Achievement of specified quality measures

Qualitative Measures

Qualitative measures can help identify how well the CEO performs in several important areas, including:

- Medical staff relations
- Internal operations
- Leadership and strategic development
- Financial development
- Community relations
- Board relations and development
- Communication
- Problem solving
- Ethics
- The CEO's success in accomplishing specific organization and personal objectives defined by the board at the beginning of the evaluation period

For example, in the area of community relations, the CEO may be held responsible for such accountabilities as working effectively with community leaders and with other health providers in the region; encouraging public trust and confidence among the community, and continually maintaining a high awareness of community needs and identifying ways to meet those needs.

- There is an agreement by the board and CEO on the performance measures that will be used to evaluate the CEO's success;
- There is full agreement with the CEO on the basics of his or her compensation, including base pay, annual incentives, benefits, and additional executive benefits, as appropriate;
- The board has full knowledge of the comparability of the CEO's compensation to that paid to CEO's in organizations of similar size and scope; and
- There is a process for regularly reviewing the compensation strategy to ensure its alignment with the organization's mission and goals, strategies, critical success factors, changes in CEO responsibilities and the dynamics of the health care environment.

The compensation committee should utilize benchmarking data that satisfies all IRS requirements, including an examination of compensation levels paid by similar organizations, both taxable and exempt, for comparable positions. It should compare the hospital or health system to organizations similar in size and utilize compensation surveys compiled by independent firms and/or organizations.

Conducting the CEO Compensation Review

Boards should consult hospital executive compensation surveys to compare their CEO compensation to defined peer groups. This data is available from a variety of sources and may also be available from your state hospital association. Inflation implications should be

considered, and current market trends for base pay and incentive pay compensation structures should be factored into the analysis.

The degree of success of the CEO in achieving board-approved objectives should also be a major factor in determining CEO salary and incentive compensation. Trends in various financial and operating indicator areas and the organization's financial and operating success over the previous year should be considered by the board of trustees when reviewing the CEO's compensation structure and level. These operating and financial indicators may be compared to other hospitals in the organization's peer group (for example, by revenue, number of beds, geographic location, etc.).

Financial and operating indicators are no longer the only metrics by which to measure successful CEO performance. As organizations face public scrutiny of costs and as they seek to advance and succeed in a value-based health care environment, growing attention is being focused on linking CEO compensation to the organization's value-based performance, quality and community impact. In particular, boards are taking steps to link CEO compensation to the organization's quality metrics and physician engagement, alignment and recruitment.

Ensuring Performance and Alignment: The CEO Evaluation

Establishing a CEO compensation process is an important first step, but there's more to be done. The CEO evaluation provides the CEO with specific direction on board expectations and ensures a consistent focus by the CEO on the board's most urgent and critical priorities.

In essence, the evaluation is a process for ensuring continuous leadership accountability, renewal, focus and success. An effective CEO evaluation will:

- Identify and confirm the essential functions and personal attributes necessary to CEO success;
- Provide a valuable opportunity for well-planned, constructive two-way communication between the board and the CEO;
- Identify specific areas requiring increased attention by the CEO; and
- Ensure that the CEO is appropriately rewarded for his or her performance in meeting the board's expectations.

Communicating Results and Driving CEO Performance Improvement

Communication of the results of evaluation and compensation decisions to the CEO in a timely manner is important in building a climate of trust and maintaining a strong relationship between the board and the CEO. The discussion of the CEO's evaluation should be used as a tool to strengthen the relationship between the CEO and the board, enhancing communication and identifying both strengths and potential areas for improvement. When sharing the results, a meeting should be held with the board and CEO to present the findings and provide the CEO with an opportunity to give feedback.

Action Agenda

- Examine your compensation and performance evaluation process and policies. Do they satisfy the IRS's requirements for rebuttable presumption? Do they inspire CEO commitment and loyalty? Do they energize and reward high performance?
- Have a candid conversation with your CEO about your board/CEO relationship. How trustful is it? How can it be improved? What are the barriers to better dialogue and streamlined accountabilities?
- Reexamine your respective roles and responsibilities. What are the major functional leadership areas of responsibility? Where is there a clear delineation of authority and responsibility? Are there grey areas? If so, how can they be clarified?

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