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CEOs' Attitudes About Contracts for Themselves and Their Management Team Members

American College of Healthcare Executives Division of Research

CEO

CEO Circle White Paper

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AMERICAN COLLEGE OF HEALTHCARE EXECUTIVES

CEOs' Attitudes About Contracts for Themselves and Their Management Team Members

Executive Summary

In spring 2008 ACHE surveyed 981 hospital CEO affiliates regarding executive employment contracts for themselves and their management staff. Responses were received from 505 (52 percent) of those individuals. Whereas 75 percent of CEOs in freestanding hospitals reported having a contract, that was the case for only 32 percent of those affiliated with a system. Overall, respondents tended to feel that a contract provided protection in the face of key organizational changes: 87 percent felt it provided adequate protection in the event of involuntary separation; 74 percent felt it adequately protected them in the event of a change in control; and 74 percent felt it gave them security if board or corporate office leadership changed. Respondents also tended to agree that a contract increased their ability to take necessary risks in their roles as CEOs (73 percent agreeing).

Extending executive employment contracts to other members of the senior management team was less common. Even among those CEOs who themselves have a contact, only two-fifths (43%) reported at least one other senior executive in their organization having a contract.

Background

Since ACHE's earliest days, the use of an executive employment contract for CEOs has been a subject of interest. For example, writing in 1938, the Model Contract Committee issued a report suggesting that a contract served to underscore the CEO's role as the ultimate authority to manage the hospital, subject to the rules and regulations of the governing board and its ability to discharge the executive. Today, executive employment contracts are widely understood to confer important benefits for both the hospital and the CEO. The literature also tends to note few countervailing drawbacks. A summary of potential advantages and disadvantages discussed in the literature is presented in the Appendix (page 10).

While much has been written about executive employment contracts, the research undertaken by ACHE is designed to specifically assess the perceptions of our affiliates who are hospital CEOs. On March 25, 2008, ACHE's Division of Research sent an executive employment contract survey to 981 hospital CEO affiliates of ACHE. By the April 15 deadline date for returning the survey, 505 responses were received (52%).

The results of the survey are the source for the bulk of this report. However, additional insights also were provided from interviews with executive search firm consultants and focus groups that were held during the March 2008 ACHE Congress on Healthcare Leadership.

In subsequent sections of the report, we first offer an overview of the reported prevalence of CEO contracts and their main advantages as perceived by those who have them. Next we present issues related to contracts among non-CEO executives in hospitals where the CEO enjoys one. We then describe the responses of CEOs who do not have a contract and their attitudes about their lack of a contract. The report concludes with highlights of the interviews with executive search consultants and focus groups regarding emerging features of executive employment contracts.

Prevalence of Hospital CEO Contracts

Among the hospital CEOs who responded to the survey, 56 percent indicated they currently have an employment contract and another one percent indicated their contract was under development. The remaining 43 percent did not have a contract (see Figure 1). As was also found in a similar 2006 study by ACHE, a significantly higher proportion of CEOs in freestanding hospitals (75 percent) have a contract compared to CEOs in system hospitals (32 percent reporting that they had an employment contract) (see Figure 2).

The survey also showed that a higher than average proportion of CEOs in the Northeast region have contracts (73 percent) while a below average proportion of CEOs in the South have a contract (47

Figure 1.
Contracts Among ACHE-Affiliated Hospital CEOs (percentages)

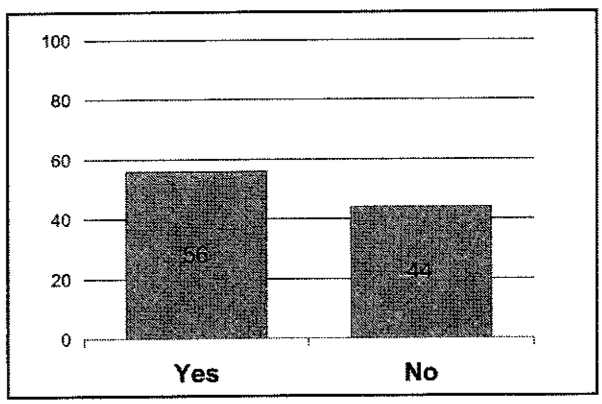
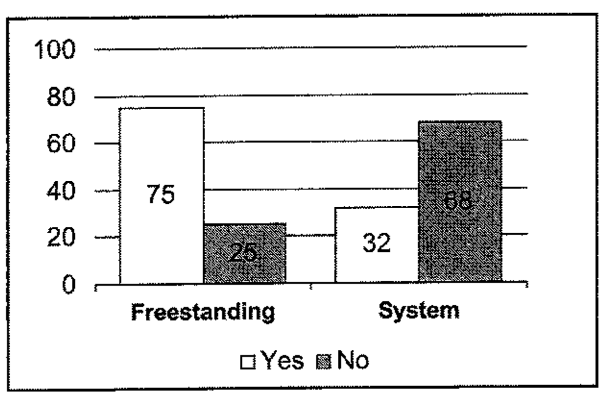


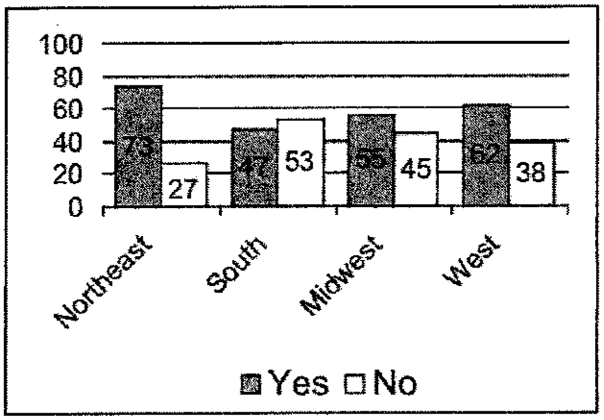
Figure 2.
Contracts Among ACHE-Affiliated Hospital CEOs by System Membership (percentages)



percent) (see Figure 3). Few differences were evident in the proportion of CEOs with a contract when comparing hospital size or size of place (rural, small city, large city, metropolitan areas).

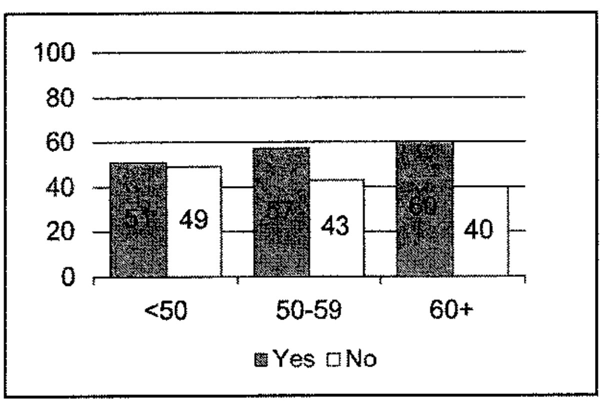
Personal attributes were somewhat related to having a contract. For example, while 51 percent of CEOs under age 50 had a contract, 60 percent of older CEOs (over age 60) said they had one (see Figure 4).

Figure 3.
Contracts Among ACHE-Affiliated Hospital CEOs by Region (percentages)



Similarly, while 47 percent of women had a contract, 58 percent of men reported having one (see Figure 5).

Figure 4.
Contracts Among ACHE-Affiliated Hospital CEOs by Age Group (percentages)



Almost two-thirds of those with contracts had additional parties involved when their contract was negotiated. Most typically, an attorney employed by the hospital was involved (76 percent). A minority of respondents reported involvement by their own attorney whom they directly hired (34 percent), a compensation consultant (24 percent) or an executive recruiter (13 percent) (see Figure 6). More research is needed to determine what impact, if any, these third parties may have on the negotiation process or the content of employment contracts.

Figure 5.
Contracts Among ACHE-Affiliated Hospital CEOs by Gender (percentages)

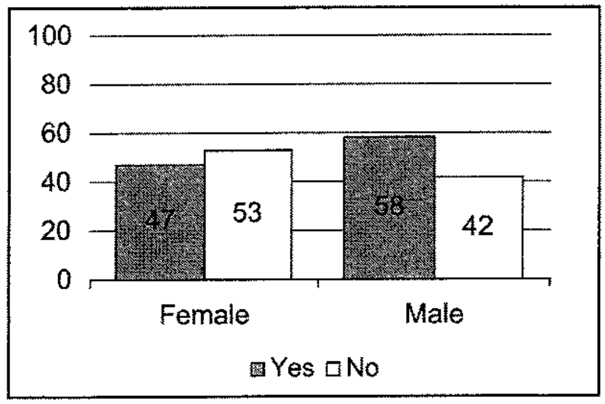
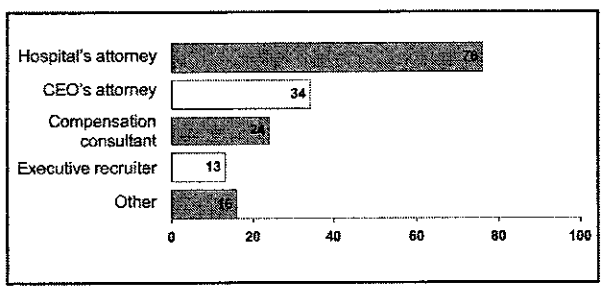


Figure 6.
Parties Involved in Negotiating CEO Contracts (percentages)



Perceived Benefits of Hospital CEO Contracts

When asked about how they perceived their contract, the CEOs' responses fell into two categories: commonly acknowledged benefits--those benefits agreed to by over 70 percent of respondents—and less common benefits acknowledged by 40 to 50 percent of respondents. (see Table 1)

Table 1.
Respondents that have a contract that agreed or strongly agreed to each of the 11 statements included in the survey. (percentages)

	Percent Agree or Strongly Agree*
What I value most about the contract is knowing that I have adequate protection in the event of involuntary separation.	87
The contract's "non compete" requirements are reasonable (excluding "does not apply" responses).	75
The contract gives me security when board/corporate office leadership changes.	74
The contract protects me adequately in the event of a change in control.	74
Knowing I have a contract helps me take necessary risks in my role as CEO.	73
My contract is very specific about what is expected of me as CEO.	50
With a contract I feel greater freedom to implement new programs and services.	49
What's most important is knowing that my job is secure for the next few years.	49
With a contract I can exert more forceful leadership with the board/corporate office.	45
I prefer a contract which specifically states what is expected of me to a more general one.	44
A contract communicates to the medical staff that I have the strong backing of the board/corporate office.	42

** Based on a five-point scale from "strongly disagree" to "strongly agree."*

Respondents felt that contracts provided protection in the face of key organizational changes: 87 percent felt it provided adequate protection in the event of involuntary separation; 74 percent felt it adequately protected them in the event of a change in control; and 74 percent felt it gave them security when board or corporate office leadership changed (see Table 1).

While respondents overwhelmingly felt employment contracts provided protection in the face of change, contracts were not necessarily viewed as important for actual job security, with 49 percent agreeing or strongly agreeing to the statement that "what's most important is knowing that my job is secure for the next few years" (see Table 1).

There was variability in attitudes toward the impact of a contract on decision making. On the one hand, respondents tended to feel that employment contracts increased their ability to take necessary risks in their roles as CEOs (73 percent agree or strongly agree) (see Table 1). On the other hand, there was less agreement regarding specific situations. Only 49 percent felt a contract gave them greater freedom to implement new programs and services; 45 percent felt they could exert more forceful leadership with the board or corporate office; and 42 percent felt that the contract served to communicate strong backing of the board or corporate office to the medical staff (see Table 1).

Content of Hospital CEO Employment Contracts

There was a mixed reaction among respondents when asked about the level of specificity of their employment contracts. Of respondents with an employment contract, 50 percent agreed or strongly agreed to the statement that the contract was "very specific about what is expected of me as CEO." Less than half (44 percent) agreed or strongly agreed to the statement, "I prefer a contract which specifically states what is expected of me to a more general one." On the other hand, 27 percent were neutral and 29 percent disagreed or strongly disagreed to the statement about preferring a very specific contract (see Table 2).

Hospital CEOs with employment contracts were also asked about non-compete clauses. Twenty-two percent indicated that the issue of non-compete requirements did not apply. When those responses are removed from the analysis, three-quarters of the remaining respondents stated that they felt their non-compete requirement was reasonable and only eight percent disagreed (the remaining being "neutral") (see Table 2).

Overall, the responses of hospital CEOs with executive employment contracts suggest that the main perceived benefits of having a contract relate to the personal financial protections offered and the ability to take risks in the face of changes confronting their organizations. Less frequently perceived benefits of contracts are more explicit definition of the executive's role and the sense of freedom the CEOs feel to implement programs or be forceful with the board and medical staff.

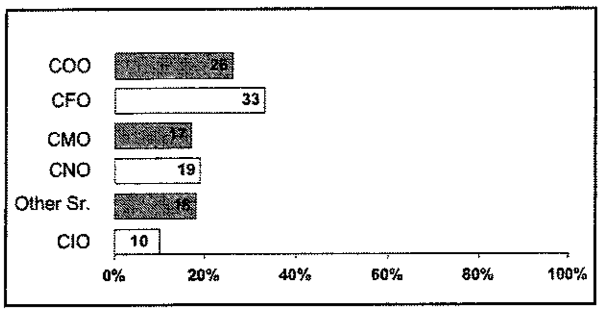
Table 2.
Benefits of CEO Contracts (percentages)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Protection if fired	1	5	7	33	54
Helps in risk taking	2	6	19	42	31
Protection from change in control	2	8	15	44	30
Security when board/corporate leaders change	2	9	16	54	20
Contract specific about CEO's role	2	16	32	39	11
CEO prefers specific role over general role	3	26	27	32	12
Know job is secure for next few years	4	15	31	37	12
Feel free to implement new programs and services	3	17	30	38	11
Can exert forceful leadership with board/ corporate office	4	17	34	35	10
Tells medical staff 'I have strong backing'	6	22	30	29	13
'Non compete' requirement reasonable	2	6	17	60	15

Prevalence of Employment Contracts Among Non-CEO Executives

While 56 percent of CEOs reported having a contract for themselves, only 43 percent of that group said that they offered a contract to at least one other senior executive in their organization. Respondents reported that contracts were offered to the following individuals: CFOs (33 percent), COOs (26 percent), CNOs (19 percent), CMOs (17 percent), CIOs (10 percent) and other senior executives (18 percent) (see Figure 7).

Figure 7.
Contracts Offered to Non-CEOs in Hospitals Where CEO Has a Contract



Even though only 43 percent of the CEOs who have contracts offer them to other senior executives on their teams, most CEOs—including those who do not offer them—regard such contracts positively. For example, two-thirds of all respondents with a contract agreed that offering non-CEO executives a contract can help recruit valuable talent and 58 percent agreed they can help retain non-CEO executives.

However, over half (56 percent) of the respondents stated that contracts for non-CEOs are not needed as long as there is a clear and fair policy on severance. Moreover, only a third thought that contracts for their senior executives could help facilitate mergers and other consolidations. Finally, the CEOs were ambivalent in acknowledging that non-CEO executive contracts could improve their organization's competitive position by allowing the hospital to impose a non-compete requirement. Just less than a third agreed, as many disagreed and 40 percent were neutral.

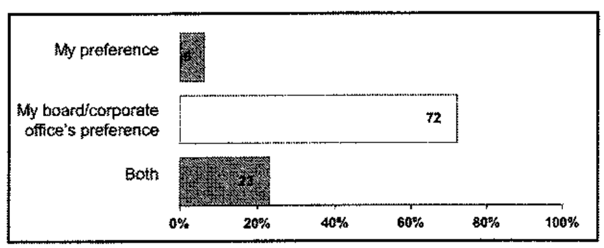
Thus, offering non-CEOs a contract occurs in just over two-fifths of hospitals where the CEO has one. When they are offered, the contract most commonly is provided to the COO or the CFO. The most commonly acknowledged benefits of such contracts are in recruiting and retaining non-CEO executives in the hospital.

Attitudes of CEOs Without Employment Contracts

As previously indicated, 44 percent of the CEOs surveyed do not presently have a contract. These respondents were disproportionately located in systems. They also tended to be slightly younger and were more likely to be female. Of the CEOs without a current contract, 26 percent had had one previously—4 percent stated they previously had a contract with their current organization or system and 22 percent had one with another employer. The remaining 74 percent never had a contract.

Most CEOs that do not have a contract stated that this was the preference of their board or corporate office rather than their own preference. Seventy-two percent said it was the board or corporate office's policy and only six percent said not having a contract was a result of their own preference. An additional 23 percent said it was both their own and their board or corporate office's preferences (see Figure 8).

Figure 8.
Reason for Not Having a Contract



When asked what their organization's practice was with regard to employment contracts for executives in their position, 85 percent stated their organization never offered contracts. Another 12 percent said that sometimes their organization offered contracts for a year or longer and three percent stated they offered contracts only for a short initial term. Thus, CEOs without a contract are by and large based in organizations that have an established practice of not offering CEO employment contracts. Eighty percent of CEOs in such organizations are employed in systems compared to 54 percent in freestanding hospitals.

For the most part, CEOs without employment contracts were disappointed by not having one and they tended to reject notions that a contract might have a negative impact (see Table 3). For example,

- Sixty-eight percent disagreed that "raising the issue of a contract with the board/corporate office may cause them to consider others for my position." This is a resounding rejection of one of the alleged disadvantages of contracts for CEOs (see Appendix, page 10).

- Sixty-two percent disagreed that "a contract would call into question the special relationship of trust that I have with my board/corporate office." This response also calls into question an alleged disadvantage of contracts for CEO as noted in the Appendix.

- Fifty percent disagreed with the statement that "our severance policy gives me all the security I need." (Twenty-nine percent of respondents agreed with that statement.)

- Forty-seven percent disagreed that a contract could limit their ability to take other positions in the community after they left the hospital. (Twenty-nine percent concurred with the statement.)

- Finally, 71 percent disagreed with the statement that they did not need a contract since they were near the end of their career.

To summarize, the 44 percent of CEOs who reported they did not have a contract were unhappy about it and pointed to the practice established by their board or corporate office as the main impediment to obtaining one. While these hospitals or systems sometimes made exceptions, most typically they never offered contracts. These CEOs rejected several alleged disadvantages of contracts including that raising the issue would engender a search by the board or corporate office for their replacement or threaten the trusting relationship with the board or corporate office. Although 29 percent were concerned about non-compete restrictions, nearly half said this was not an issue. Fully half of the CEOs did not believe that the hospital's current severance policy afforded them adequate security.

Table 3.
Views of CEOs Without a Contract (percentages)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Not needed since end of career	29	42	16	9	4
Raising issue may cause a search	21	47	20	9	3
Questions the trust with board or corporate office	22	40	21	13	5
Severance policy gives security	19	31	21	22	7
Limits taking other positions in community	15	32	23	26	3

Emerging Features of Employment Contracts

To supplement the results of the survey of hospital CEOs, interviews were conducted with leading executive search firm consultants and focus groups were conducted in March 2008 at the ACHE Congress on Healthcare Leadership. The comments from participants in the interviews and focus groups suggest features that CEOs may wish to address as they consider negotiating a new contract or renegotiating an existing contract.

In general, participants in the interviews and focus groups felt employment contracts for CEOs were beneficial, particularly the more experience one had. However, only a few CEO informants said their senior executives had a contract, most indicating that the human resource policies provide adequate severance. While special arrangements may be negotiated for some uniquely talented individuals, those arrangements are not necessarily in the form of a formal contract.

Some of the contract features mentioned were designed to increase financial security or professional development, such as specifying an annual retention bonus; specifying post-retirement health insurance and long-term-care coverage; or providing for tuition, paid time off and a subsequent pay increase upon completing a relevant advanced degree.

Several changes in executive compensation contracts are the result of the general movement toward increased transparency, as well as the specific requirements of the redesigned IRS Form 990. Examples mentioned included increased use of an independent firm to audit contracts, elimination of perquisites such as country club memberships or automobile allowances, and incorporating flexible spending accounts into base pay.

Overall, several aspects of employment contracts mentioned by the interviewees and focus group participants involved greater protection for the organization. The types of contract clauses mentioned included:

- an intellectual property clause that specifically states that new ideas contributed by the CEO belong to the hospital
- a clause restricting the CEO from sitting on a for-profit board without the hospital board's permission
- a clause to deal with potential occurrences of "professional embarrassment"
- an overall confidentiality clause
- an anti-defamation or disparagement clause
- a clause specifying evaluation criteria, going beyond financial performance to include quality measures and outcomes

Noting the various contract components designed to protect the organization, one informant indicated that his employment contract represented more of a list of things he could not do rather than what he was expected to do. Furthermore, through mechanisms such as "golden handcuff" clauses, some contract components serve to reduce the flexibility of the CEO by restricting the CEO's ability to leave quickly. Finally, it was noted that the negotiation process worked best for the CEO if negotiating with one individual.

Conclusion

In addition to confirming the prevalence of contracts among hospital CEOs, we have shown that many of the advantages argued by proponents of contracts are, in fact, perceived by CEOs who have them—notably, ensuring adequate protection in the event of involuntary separation and aiding the CEO in taking necessary risks to lead the organization. Conversely, most CEOs said they were not overly concerned about the alleged disadvantages of contracts. Most CEOs were not concerned that raising the issue of a contract would prompt the board or corporate officials to seek other candidates to replace the incumbent, nor were they concerned about overly restrictive non-compete requirements or engendering a lack of trust in the relationship.

In fact, most CEO respondents who did not have a contract expressed disappointment that this key tool to support their efforts to be innovative and decisive was not made available to them. Possibly, the evidence accumulated in this study could be used to help convince those responsible for hiring and evaluating hospital CEOs that contracts merit serious consideration and enhance the leader's potential to effect needed change and positive health outcomes in their communities.

About the survey

The 2008 fax survey that represents the data reported here was sent on March 25, 2008, to 981 hospital CEO affiliates of ACHE. The sample included 445 CEOs who had responded to a prior survey that dealt with executive employment contracts in November, 2006. By April 15, 2008, the deadline date, 505 responses were received, 259 of whom had responded to the 2006 survey and 246 who were newly sampled individuals. Overall, this represents a 51.5 percent response rate.

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APPENDIX
Commonly Cited Advantages and Drawbacks of CEO Employment Contracts from the Hospital/Board Perspective

Commonly Cited Advantages*	Alleged Drawbacks**
Defines expectations and promotes fair CEO evaluation	
Enables necessary change such as change of control	
Promotes a businesslike relationship whereby hospitals' internal management must fulfill the mission	Requires the hospital to pay if the relationship deteriorates
Allows executive decisions to be based on hospital's mission and strategic goals and not their political implications	
Improves governance by promoting continuity of management and attracting talented executives	Can negatively affect the relationship with the CEO if the CEO perceives a loss of career flexibility
Levels the balance of power between medical staff and the CEO	May cause board members or medical staff to feel their leadership role is usurped by the CEO
Can require confidentiality of CEO after they leave the hospital	
Generally provides a formal time frame for assessing continuation of the employment relationship	
Offers symbolic value of the board's expectation for leadership and support of the CEO vis-à-vis the medical staff	
Defines expected role and ensures it cannot be diluted	
Encourages systematic performance evaluation of the CEO by the board	***Provides a false sense of security***
Discourages board from arbitrary behavior about terminating employment of CEO	Increases CEO turnover by providing boards with easily accessed termination procedures
Counters the risk CEOs face in making controversial decisions	Limits the CEO's future options by restricting the recruitment of employees after leaving the hospital to go to another organization
Helps overcome the risk engendered by exclusion of some physicians in joint ventures between hospitals and physicians	***Restricts the CEO's mobility through use of non-compete provisions***
Provides some degree of financial security in the event of termination	***May place previously assumed trust into question***

*Notes: *The advantages listed in **bold italics** are consistent with the perceptions reported by hospital CEO respondents to the ACHE survey. **The alleged drawbacks in **bold italics** are NOT consistent with the perceptions reported by hospital CEO respondents in the ACHE survey.*