

Transition Strategies: Managing the Hidden Costs of Senior Leadership Changes

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Introduction

- Overall organizational leadership vulnerability in healthcare is on the rise
- The direct cost of losing a CEO has been well-researched and documented but the indirect, or “hidden” costs can be two to four times greater in monetary terms than direct costs
- Intangible costs are harder to calculate in quantitative terms but can contribute significantly to inhibiting a smooth and successful transition of leadership
- Whether a CEO leaves on voluntary or involuntary terms, the onboarding and transition of a new CEO can last one to three years
- There are proven governance and leadership strategies that can mitigate the direct and indirect costs and ensure a successful transition

CEO Tenure Across the U.S.

- According to 2015 Fortune 500 and S & P data, the average CEO tenure in Healthcare was **8.4** years

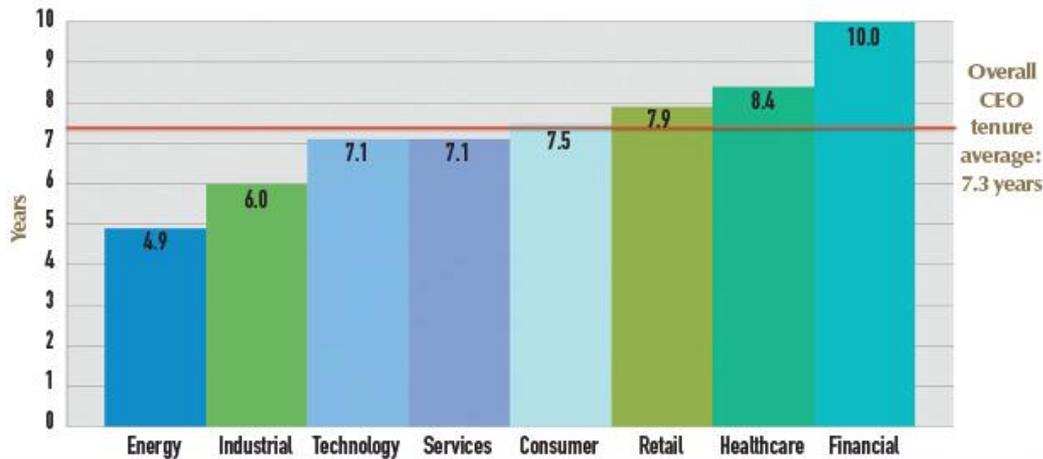
GET IT WHILE YOU CAN

The average tenure of CEOs is dropping, which makes it important for executives to earn top dollar when they are sitting on top.

The Financial sector has the longest tenured CEOs (10 years)

Average tenure in years by 2015 sitting CEOs by industry

2015 Fortune 500 and S&P 500 (672 companies; 677 sitting CEOs)



Source: Crist Kolder Associates

- However, according to a 2014 Black Book Rankings poll, the average hospital CEO tenure was about **3.5** years

CEO Tenure Across the U.S.

- *“The Silver Tsunami”* - time-to-retirement among healthcare leaders is shortening *
 - **57** = Average age of today’s CEO in Healthcare
 - Almost **50%** of members of the American College of Healthcare Executives are over the age of 50
 - Trend analysis suggests **26%** of all leaders (executives, directors and managers) have less than 24 months until their retirement
 - That figure increases to **38%** for the executive-only group

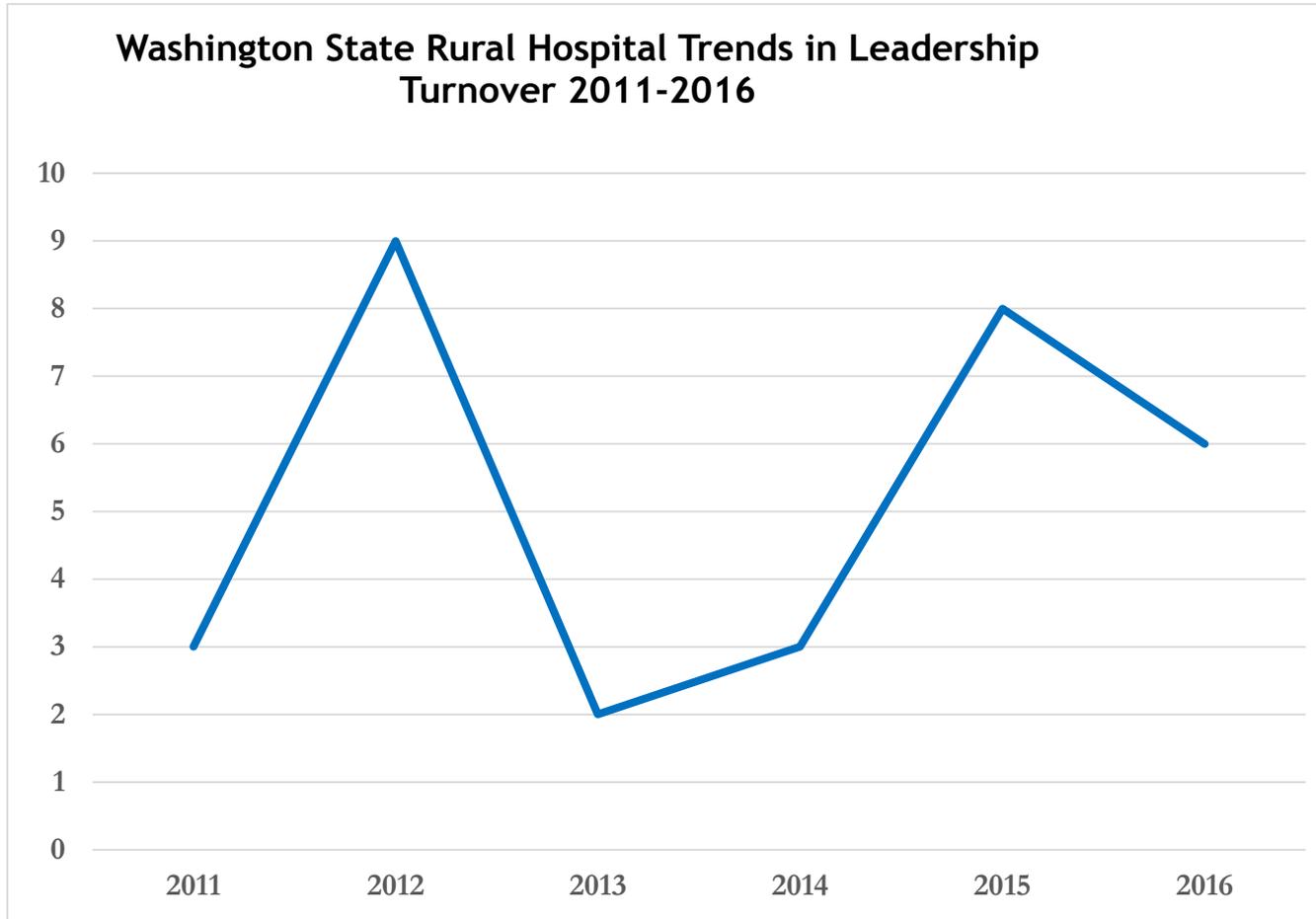
Healthcare CEO Turnover Across the U.S.

- Healthcare CEO turnover rate hit **20% in 2013** but decreased to **18% in 2014** - **still** an all-time high
- Healthcare led all industries in CEO turnover in 2013 and 2014, as reported by Challenger, Gray & Christmas
- **56%** percent of CEO turnovers in Healthcare are involuntary

Washington Rural Hospital CEO Turnover 2011 - 2016

- There were **31** CEO changes caused by retirement, replacement or a career move
- **42%** of the turnover was caused by long-tenured CEO retirement
- **58%** of turnover was for non-retirement reasons such as left to take another job or was dismissed
- During that timeframe, **28** hospitals were affected by CEO turnover

Rural Hospital CEO Turnover 2011 - 2016



Direct Financial Cost to Replace a CEO

- Industry experts estimate the cost associated with replacing a CEO in healthcare can be anywhere between two and four times the amount of the CEO salary (typically four)
- For example (assuming a base salary of \$300K)
 $4 \times \$300,000 = \text{a total cost of appx. } \1.2M
- If a CEO has a contract, the cost could be higher or even significantly higher

Indirect Financial Cost to Replace a CEO

- Almost **50%** of CFOs, COOs, and CIOs are fired or leave within nine months of a new CEO being hired
- **87%** of CMOs are replaced within two months of a new CEO appointment
- So assuming there are eight members of an executive team and four leave:*
 - 4 positions x \$200,000/yr. x 4 times salary = \$3.2M
 - Total estimated cost for search could be **\$4.4M**
 (CEO/\$1.2M + cost of executive team/\$3.2M = \$4.4M)

* Sinnott, Becker's Hospital Review

Other Indirect or “Hidden” Costs

- For struggling hospitals replacing a CEO is occurring at the same time the organization is reducing staff and operating costs
 - For example, assume the average cost of a healthcare position (salary plus benefits) is \$60,000. If the cost of a lengthy or failed CEO search were prevented, that could potentially save, on average, 73 employees from losing their jobs ($\$4,400,000 / \$60,000 = 73$ positions)
- An Interim CEO, whether internal or external to the organization, may still be viewed or act as a “lame duck” or is being “tested” or “auditioning” for the role

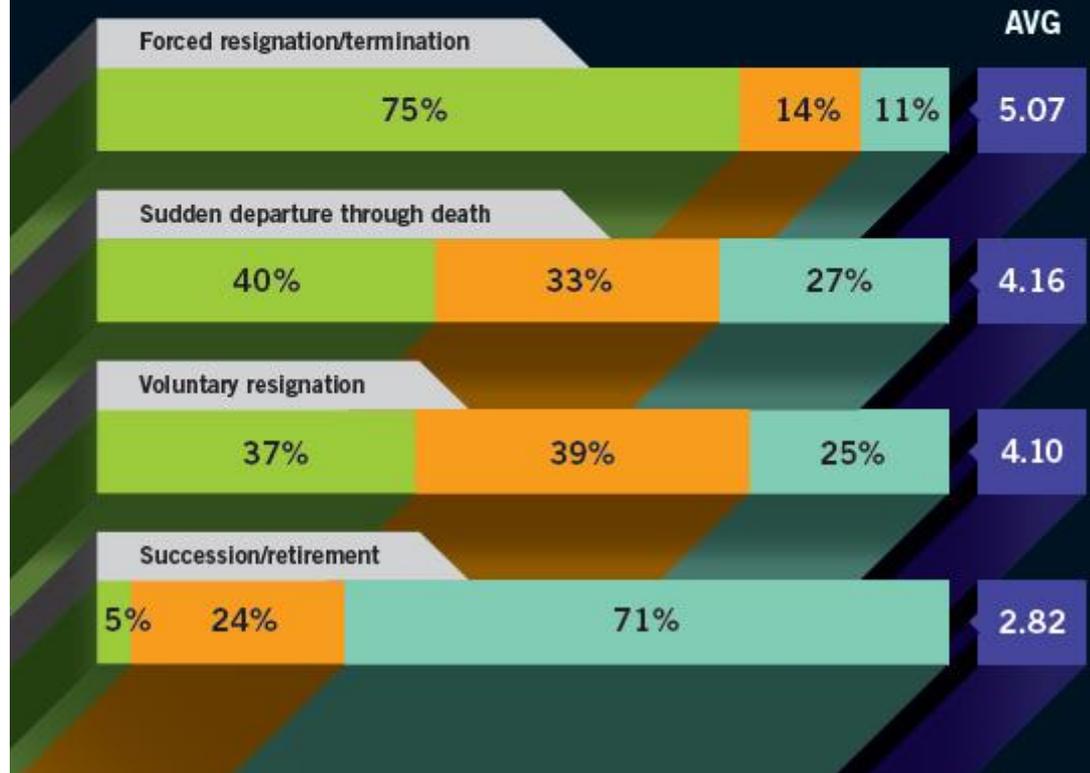
Intangible or “Hidden” Cost of Losing a CEO

- **Knowledge Capital Costs**
 - Loss of knowledge, skills and experience of departing leader
 - Other leaders may leave with the CEO or leave because of other reasons
 - Snowball effect as other leaders and skilled employees throughout the organization reassess their options
- **Human Capital Costs**
 - All or part of the CEO’s responsibilities shift to “surviving” senior leaders who may already be maxed out
 - Senior leadership churn and reshuffle takes it’s toll on all employees as some initiatives, projects and even daily work may stop or take longer
 - Emotional toll and increased stress levels can result burn out and increased absenteeism
- **Loss of confidence and trust by Community, Employees and other Stakeholders**

CEO DEPARTURES PUT VALUE AT RISK

Planned successions best preserve stock price.

- Significant value at risk
- Moderate value at risk
- Little value at risk



Time to Replace and Transition a CEO

- In Healthcare, **75%** of CEO positions are filled within six months of the previous CEO's departure
- Depending on the size and complexity of the system or hospital, successfully onboarding and transitioning a new CEO may take anywhere from 1 - 3 years
- A CEO transition is *not* the same as onboarding, which is a formal, short-term, agenda-driven orientation program of briefings and meetings (an onboarding plan can be a useful component of the transition process)
- Transition plans include integrative activities designed to maximize the chances of success that occur after the new CEO takes the job

Hiring a New CEO Can Improve Performance

The Good News Is...(If the new CEO stays long enough)

- 42% of facilities developed new services as a result of CEO turnover
- 40% initiated strategic planning, 37% cut costs, and 30% made sustained efforts to improve quality
- 73% of new CEOs report improved hospital culture as a result of turnover
 - 71% reported improved employee morale and medical staff relations
 - 60% reported improved financial performance

What Can You Do Now to Mitigate Costs and Ensure a New CEO is Successful?



Best Practice Strategies: Understanding the Challenges for Healthcare Leaders

- Increasing levels of complexity:
 - Healthcare reform
 - Government mandates (State & Federal)
 - Complexity and speed of change
 - M & As, Partnerships, Affiliations, Joint Ventures
 - Competition (Skilled Staff, Resources, \$, etc.)
 - Populist Movement - more political scrutiny and involvement
 - Pressure to increase revenue and regional footprint

Best Practice Strategies: Understanding the Challenges for Healthcare Leaders

- Urgent need to be strategic while many are more operations-focused (especially in a data-driven environment)
- Executive compensation structures tied to performance goals and metrics
- Recruitment of skilled professionals:
 - Physician shortages especially in Primary Care Physicians and fierce competition in some areas for physicians with coveted specialties
 - Skilled nursing shortages - an estimated 12,000 in the state of Washington by 2020
 - One in three practicing physicians in the U.S. is over 65 and close to retirement - many will retire in the next three years

Best Practices Strategies: Before Losing a CEO

The Board's responsibility:

- Have clear criteria and reasons to terminate a CEO such as illegal, unethical or immoral actions
- Ask: Has the CEO had enough time to advance the strategic agenda agreed on?
- If a CEO and the his/her senior leadership team are struggling as evidenced by key performance indicators then:
 - Investigate to identify root causes
 - Determine if and how the problem(s) can be addressed and/or solved while keeping the CEO in place
 - Collaborate on an improvement path and plan with specific actions, measures and milestones
 - Be supportive

Best Practices: After Losing a CEO

- Carefully consider both internal and external candidates
- Is the expectation to maintain stability, improve performance measures or implement a “turnaround plan”?
- If there is a gap in knowledge, skills and experience with the current leadership team the board may need to go outside the organization which has both fiscal and time-lag implications
- Have a time-bound replacement process in place
 - Interim vs. permanent appointments have become increasingly common but can be detrimental to the organization

Best Practices: After Losing a CEO

- Carefully consider the cultural and political aspects of the organization that will be problematic for the interim and new leader in the early months
- Transparency and continual communication with what can be shared to all levels of the organization will minimize confusion and the emotional toll
- Leadership responsibilities are typically shared among the leadership team, however, be clear on what is short-term and what is a permanent shift of responsibilities
- Collaboration with the senior leadership team during the hiring, onboarding and transition process is a must

Best Practices Strategies: Succession Planning

According to a 2010 survey of healthcare leaders, less than 7% were well positioned for the sudden departure of a key executive and only 25% were firmly committed to succession planning

- The Board and CEO both have succession responsibility
- Identify what the CEO's role should be in planning their successor
- Develop a realistic and “working” profile of the skills, competencies and experience required to fill the role

Best Practices Strategies: Succession Planning

- With increasing complexity and shifting priorities, the profile of the CEO must shift along with it
- Investigate in advance where to source candidates
 - High potential internal candidates
 - Historic sources may be drying up, and
 - New skills and competencies may require looking outside of healthcare, e.g. business schools and other industries
- Vet candidates using consistent, non-biased criteria
- Also plan for who will succeed individuals in all key leadership roles

Best Practice Strategies: What Works

- Acknowledge that leading or managing at any level in healthcare is difficult and complex, the differentiation of complexity is still absolutely essential to understand probabilities of success
- Be accountable for financial and resource stewardship - know the direct and indirect costs of replacing a CEO and be prepared to mitigate them
- Identify the key competencies, skills and experience required to lead both now and in the future

Best Practice Strategies: What Works

- Succession planning - be active participants
- Hire the best candidate and have an effective onboarding and transition plan
- Consider longer term contracts (5-10 years)
- Consider executive coaching and development to help get a CEO (and the team) on track

Q & A

Thank you

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