



Adapting Executive Incentive Plans to Meet Today's Performance Imperatives

How Health Systems are Evolving Their Approach Amidst an Uncertain Financial Environment

Jeff Softcheck, Principal, SullivanCotter

After four years of heightened financial volatility, 2024 brought a moment of respite for many not-for-profit health care organizations. The path forward remains challenging, however. Despite modest improvements, the industry continues to face strong financial headwinds – including expense categories that are outpacing revenue growth, regional variation in financial recovery, the negative impact that the One Big Beautiful Bill Act is likely to have on health system revenues in 2027 and beyond, and the softening of the broader US economy.

While there are common performance themes throughout the industry, we have observed significant variability in focus depending on each system's circumstances. To assess how organizations are evolving incentive plans to account for financial market dynamics, SullivanCotter recently examined financial statements covering 2019 to 2024 for 133 health systems with greater than \$1 billion in total net revenue. This included a review of short-term incentive plan (STIP) and long-term incentive plan (LTIP) market practices. Based on these analyses, we provide considerations for incentive performance measure selection and goal setting in 2026 and beyond to reflect each organization's financial circumstances and priorities.

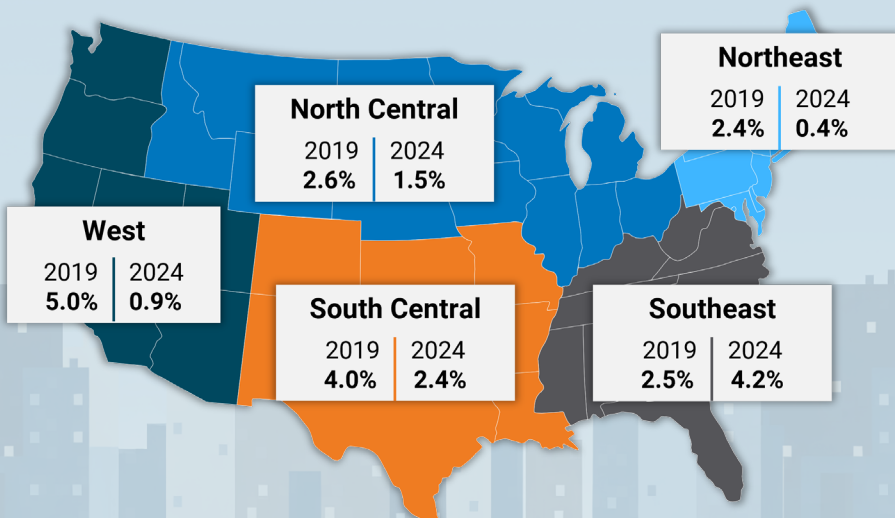
REGIONAL VARIATION IN OPERATING MARGINS AND INCENTIVE PLAN DESIGN

While the national median operating margin for health systems grew incrementally from 0.3% in 2022 to 1.6% in 2024, a closer examination of the past 5 years reveals significant regional differences. In 2019, health systems in the Southeast posted a median operating margin of 2.5%. This was only 86% of the national median of 2.9%. By 2024, these systems achieved a median operating margin of 4.2% – an impressive 263% of the new national median of 1.6%. This growth is largely due to recent double-digit revenue increases in this region, resulting in a 3.3% margin improvement from 2023 to 2024 alone.

In contrast, a very different story is unfolding in the West. These systems have seen a sharp decline as their median operating margin dropped from 5.0% in 2019 (172% of the national median) to 0.9% in 2024 (56% of the national median). For the past three consecutive years, margins have hovered below 1% as revenue growth lagged rising expenses.

Health systems in the Northeast have historically operated on slim margins, which have been further compressed relative to national statistics, while those in the North Central and South Central have generally maintained margin positioning relative to national statistics compared to 2019.

Operating Margin by Region



Across the country, financial sustainability performance measures (i.e., margin/income) continue to represent the single most prevalent and highest weighted incentive plan domain in both STIPs and LTIPs. However, non-financial performance categories carry most of the overall weighting. In STIPs, non-financial measures often comprise 70% of the plan weight and are most commonly focused on quality, safety, patient experience, access, and people objectives such as reducing turnover and enhancing engagement.

LTIPs have evolved to focus on a limited set of measures – financial sustainability, growth and transformational performance priorities – with no notable regional differences. Financial measures remain focused on overall sustainability (e.g., income/margin, expenses, cash), while growth measures span a continuum from broad-based financial growth to targeted growth achieved, for example, via geographic expansion or service line development. Transformational goals, as their name suggests, continue to evolve and adapt to strategic priorities and the market landscape. They emphasize improvement in stubborn performance areas such as quality outcomes and workforce engagement and quantify the expected impact of digital and care delivery objectives on financials and patient outcomes.

While many incentive plan elements are consistent across health systems, select regional differences in incentive plan design have evolved over the last few years, particularly in STIPs, to account for local market dynamics within a one-year horizon.

These changes span a few common areas related to financial performance measurement:

Use and design of a financial circuit breaker that 'opens' the STIP:

- Organizations in the West have increased the use of circuit breakers over time. This has increased from 69% in 2022 to 82% in 2025.
- Other regions have seen a slight decrease (6%) in the use of circuit breakers from 2022 to 2025.
- Systems in the West and Northeast are more likely to have flexible circuit breakers. In the event that minimum financial performance objectives are not met, these circuit breakers reduce rewards for non-financial goal achievement. Reduction is determined at the discretion of the committee that governs the plan, or payouts are

incrementally reduced by a set formula depending on the degree of the 'miss' against the financial goal.

Tailored changes to emphasize system versus entity performance:

- Some organizations have increased emphasis on system-wide financial performance. This is particularly common for systems operating within a distinct region/market where the service redistribution that may be required to see financial improvements may be incompatible with incentivizing by entity. System measurement represents the most common approach to financial measurement – and other goal areas – to reinforce the success of the enterprise over individual operating units.
- Others have increased emphasis on system-wide goals to drive a pay-for-performance culture and stress accountability against distinct budgets or expense reduction targets. This approach is most often blended with some level of system performance recognition.

Careful consideration of the appropriate financial measure selection:

- Organizations in the North Central and Southeast are generally aligned with overall market prevalence. The data shows that 94% of STIPs include income/margin measures, 42% of STIPs include growth measures, and 23% of STIPs include cost efficiency measures.
- Those in the West are twice as likely to include cost efficiency measures than the broader market and are less likely to include margin/income measures. This likely reflects the ongoing margin pressure in the West and the need to align costs.
- Systems in the South Central region are half as likely to include cost efficiency measures, which reflects their relatively strong margins.
- Organizations in the Northeast are 20% more likely to include growth measures.

Isolated changes to weighting of financial performance measures:

- Organizations in the South Central and Southeast decreased weighting on financial, growth, and cost efficiency measures by 5-10% from 2022 to 2025.
- While other regions have seen little change overall across financial measure weightings, these weightings

vary widely (from 20%-50%) at the organization-level and change year-over-year depending on unique performance circumstances.

FRAMEWORK TO ENSURE INCENTIVE PLAN EFFECTIVENESS

Many executive leadership teams and compensation committees have begun adjusting the design of STIP and LTIP incentive plans for 2026 and beyond. By taking intentional steps to restructure or reaffirm incentive plan elements, organizations can ensure the most critical financial and non-financial performance priorities – as well as appropriate measurable and reasonable performance standards – are developed and communicated to participants. The regional differences in incentive plans that have evolved over the last 5 years combined with the future outlook will help inform future decision-making.

Using the following framework can help organizations as they move forward:

Review the plan design:

- Is the use of a financial circuit breaker desired? What is the circuit breaker impact?
- Does the plan have the right emphasis of system versus entity performance?
- What is the role of financial performance in the incentive plan?

Define the performance philosophy:

- What are the guiding principles of the plan?
- What is the intended degree of stretch in the performance standards?
- How should the plan account for ongoing uncertainty in the performance environment?

Select meaningful performance measures:

- What measures will have the greatest impact on the strategy?
- What are appropriate financial measures to include in the plan based on the outlook and strategy?
- Do non-financial performance areas have sufficient investment to see sustained improvement?

Follow a robust goal calibration process:

- Do the selected measures have reliable internal and market data?
- What are the expected headwinds and tailwinds? Can these be quantified?
- How do the goals align with the performance philosophy?

Cascade and communicate goals and associated action plans:

- Are the appropriate change management and action planning processes in place to ensure the entire organization is aligned towards the objective?
- Are the goals and performance during the year adequately communicated to participants?

CONSIDERATIONS FOR MEASURE SELECTION AND GOAL SETTING IN 2026

As planning turns toward 2026, the need to balance financial rigor with transformational priorities becomes even more pressing. As incentives for the upcoming year are considered, each organization should ensure that performance measures and goals are tailored to its specific priorities and circumstances.

Our analysis of financial performance indicates significant variability. While some organizations facing significant financial pressure may double down on traditional measures of success such as margin and income, others may argue their positioning necessitates greater and faster transformation. Systems beginning in a place of greater stability should consider where they can get ahead of the market with additional capital to accelerate performance improvement as a buffer against future impacts.

From pandemic-related turbulence to today's shifting economic and regulatory landscape, health systems have demonstrated remarkable adaptability. The challenge now is to design incentive plans that are both disciplined and forward-focused — supporting near-term stability while laying the groundwork for transformation.

In the short term, STIPs will likely continue to prioritize margin improvement against annual budget targets. This focus helps safeguard operational stability in the face of evolving federal policy, rising labor and supply costs,

and increased economic uncertainty. Organizations should assess what levers are within their control. For example, we have seen organizations in the West choose to prioritize cost efficiency while those in the East have emphasized growth and attempt to quantify external market impact on performance. In parallel, LTIPs will likely remain vital for driving long-term imperatives such as capital investment, impact of tech/AI-enabled solutions, patient access expansion, and diversification of revenue streams for growth.

Incentive plans should incorporate an appropriate degree of flexibility given the potential for rapid shifts in market conditions and reimbursement policy. Compensation committees should remain educated on the external environment, regularly review mid-year incentive plan performance updates and be open to discussing unexpected dynamics. While uncommon, committees may contemplate adjustments to goal definitions, weightings, or performance ranges to ensure ongoing alignment with the strategy and the operating environment. Executives should increase the intentionality of incentive plan measure selection, perform robust analyses to ensure effective goal calibration, and adopt best practice change management principles and goal communication processes.

CONCLUSION

As health systems look ahead, incentive plan design must evolve to be a forward-focused driver of transformation. Success will depend on striking the right balance: building in financial discipline while making space for innovation, adaptability, and long-term growth. To maintain clarity and focus, both STIPs and LTIPs should continue to concentrate on a small set of the most pivotal priorities with clearly defined accountabilities and cascaded goals that connect enterprise operating plans and strategy to business units and functional leaders.

By aligning incentives with mission-critical goals, fostering accountability across the enterprise, and maintaining flexibility in the face of shifting external forces, organizations can ensure that their executive compensation strategies not only withstand uncertainty but also position them to lead in the next era of health care.

Are your executive incentive plans tailored to organizational priorities?

Connect with SullivanCotter to discuss our executive workforce solutions, grounded in data and experience.



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