

## **Leadership Compensation in Nonprofit Organizations**

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When I was CEO of Watson Wyatt Worldwide (a global compensation and benefits consulting firm), my staff and I saw many nonprofit and for-profit clients struggle with a variety of compensation issues. But I'm convinced that managing leadership compensation effectively is easy if nonprofit boards follow five important steps.

**1. Make compensation a priority.** Many nonprofits avoid discussing compensation on the assumption that people join a nonprofit organization to save the world, not to earn higher pay.

Compensation can be an especially sensitive subject for charitable nonprofits. If they are barely getting by on donor contributions and grants, there is never a good time to ask for a raise. So the board frequently feels uncomfortable addressing compensation issues and employees may be reticent to express their concerns about pay. And so the problem lingers.

The solution is simple: The board chair and/or the chair of the compensation committee (if there is one) need to make management compensation a priority. There should be a defined process for a periodic review of market rates for key staff positions to ensure the organization's compensation structure is reasonable and competitive. The process should include a thorough evaluation of the chief executive's performance and a determination of how this evaluation will affect pay decisions.

Most important, the chair should meet with the chief executive annually to discuss performance, compensation, and goals. The board and chief executive should agree on how performance is assessed and on performance goals and expectations. The full board needs to be familiar with the performance evaluation results, regardless of who carries out the evaluation process.

**2. Measure organizational performance.** In the private sector, the profit motive drives many things, including compensation. It isn't difficult to justify incentive bonuses in years when profits far exceed budget. The money is there. Organizations in the public sector, however, have a difficult time defining performance measures, which can add to the difficulty of setting compensation levels.

But there is good news. Nonprofits are paying more attention these days to setting clear organizational goals and metrics for determining success, often with the encouragement of foundations and venture philanthropists. Such measures often can be used in helping assess salary levels or variable bonuses, for organizations where bonus programs are appropriate.

I am not suggesting that nonprofits set rigid formulas to tie salaries or bonuses to measures of organizational performance. This is usually a mistake. However, if there is a

clear understanding about key performance measures between the board and the organization's leadership, determining what to pay becomes much easier.

**3. Develop a clear compensation strategy.** Too few nonprofits address questions such as where their salaries should fall in regard to the competitive market or whether pay should be distributed based on group or individual performance. Without a defined strategy for determining desired pay levels, it is very difficult for organizations or boards to deal with individual pay decisions. Intermediate sanctions require the board to be able to justify executive (and senior staff) compensation in terms of comparable pay elsewhere. Nonprofits must be able to do this if they want to keep the IRS out of their business, particularly when they're dealing with relatively high levels of compensation.

Years ago, I helped address these questions for a large San Francisco museum. Employee surveys signified that morale was low and pay was a huge issue. Employees did not understand how their pay was determined and were worried about soaring living costs, especially for housing. With few comparable organizations in the community, market comparisons within the nonprofit sector were difficult. So we focused on the private sector and developed a strategy to pay about 10 percent below the private sector for similar skills and positions, with the differential offset by the excellent work environment and flexible employee benefits the organization provided. A review of salaries indicated that only a few needed adjusting. Once these changes were made and the compensation strategy and its rationale were communicated, employee morale improved markedly. And the board had a good basis on which to determine future compensation decisions.

**4. Be transparent.** Some boards limit those involved with the chief executive's compensation to a few senior members of the board, wanting to keep the process confidential or to avoid the "too many cooks" problem. (The actual compensation becomes public information, disclosed in the Form 990.) Whatever the reason, the contents and conditions of the chief executive's compensation and benefits package, and any changes to that package, should be discussed openly with, and ultimately approved by, the full board. Failure to do this can cause damaging and embarrassing problems.

**5. Oversee executive spending.** Statistically, greed in nonprofits is a very rare thing, but it does exist — problems at the United Way, and more recently at American University, are ample evidence of this. Accordingly, it is essential that boards of directors conduct periodic reviews of executive spending and expense accounts to ensure that expenses are not only legal but also justifiable in terms of the organization's mission and finances.

If you try these steps, you'll realize they are not difficult. They involve standard oversight, not sophisticated technical issues, and any board intent on doing its fiduciary duty should be able to handle them. So do it!

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