

Nonprofit Studies Program

Working Paper 09-03
January 2009

Compensation Practices at Nonprofit Human Service Organizations

Eric C. Twombly
Jennifer Claire Auer



ANDREW YOUNG SCHOOL
OF POLICY STUDIES



ANDREW YOUNG SCHOOL
OF POLICY STUDIES

**Compensation Practices at
Nonprofit Human Service
Organizations**

Working Paper 09-03

Eric C. Twombly
Jennifer Claire Auer

January 2009

Nonprofit Studies Program
Andrew Young School of Policy Studies
Georgia State University
Internet: aysps.gsu.edu/nonprofit

Compensation Practices at Nonprofit Human Service Organizations

Eric C. Twombly

Department of Public Management and Policy Department
Andrew Young School of Policy Studies, GSU

Jennifer Claire Auer

The Urban Institute

Biographic Sketches

Eric C. Twombly is an assistant professor of public administration and urban studies at the Andrew Young School of Policy Studies at Georgia State University. Dr. Twombly has written extensively on nonprofit health and human service issues in the nonprofit sector.

Jennifer Claire Auer is a research associate at The Urban Institute. Her research interests include the impact of welfare reform on nonprofit organizations, the role of foundations and philanthropy in society, and compensation practices in the nonprofit sector.

Abstract

This study attempts to expand our knowledge of nonprofit executive compensation by exploring several determinants used by charities to pay their top officials. The study focuses specifically on groups that provide community-based human services, an area of the nonprofit sector that has grown exponentially in recent years. Drawing on data of more than 1,300 community-based providers that are located in eight metropolitan areas, the analysis assesses the extent to which various internal and external factors predict executive compensation at these organizations. The chief findings suggest that executive wages significantly and positively relate to organizational size, as well as previously untested environmental factors such as organizational density and community needs in metropolitan regions.

The issue of executive compensation in the nonprofit sector has sparked intense debate in media and policy circles. Some argue that nonprofit compensation levels which mirror rates in for-profit firms are necessary and justified because organizational productivity and efficiency depends on the ability of nonprofits to attract and retain effective leaders. Others vehemently argue that compensation rates for nonprofit leaders should not be based on commercial rules. They feel that some nonprofit salaries are excessive, and deflect organizational resources from the pursuit of nonprofits' charitable missions. Swirling around the debate are press accounts of executive pay scandals at notable charitable organizations, such as the United Way of the National Capital Area, and the recently increased efforts by the Internal Revenue Service to pursue charities that "excessively compensate" their chief executives.

This important debate, however, has been pursued with limited empirical information to guide our understanding of how wages are set at nonprofit organizations, particularly in the human service field. This study attempts to expand our knowledge of nonprofit executive compensation by exploring a new theory of the determinants used by charities to pay their top officials. The study focuses specifically on groups that provide community-based human services, an area of the nonprofit sector that has grown exponentially in recent years and which currently faces substantial challenges as state and local budget problems force funding and program cuts. Drawing on data of more than 1,300 community-based providers that are located in eight metropolitan areas, the analysis assesses the extent to which various internal and external factors predict executive compensation at human service organizations.

Theories of Nonprofit Executive Compensation

Scholarly inquiry into nonprofit executive compensation has generally focused on two areas: analyses of wage differentials between the nonprofit and for-profit sectors for comparable work, and determinants of nonprofit compensation across industries (e.g., health, arts and cultural, education). The first body of research was led by Hannsman (1980), whose early theoretical work suggests that leaders may voluntarily receive lower compensation to work at nonprofit organizations. Weisbrod (1983) finds some empirical

evidence of a wage penalty for nonprofit workers, suggesting that public interest nonprofit lawyers earn roughly 20 percent less than comparable attorneys in the corporate sector. Preston (1989) found a similar wage penalty for nonprofit managers in the child care industry. Their findings support the notions that executives may sort themselves into for-profit and nonprofit sectors because of personal objectives (Young, 1986), and that leaders in the nonprofit sector may “donate” their labor to receive non-pecuniary benefits instead of monetary compensation (Rose-Ackerman, 1986).

The second thrust of research has explored the determinants of wage setting across nonprofit industries. Several predictive factors, such as organizational performance (Weisbrod, 1989; Steinberg, 1990; Roomkin & Weisbrod 1999; Hallock, 2000) and the use of alternative compensation (e.g., bonus pay) as supplements to wages (Dumond, 1997; Roomkin & Weisbrod, 1999) have been assessed. Moreover, Oster (1998) conducted an empirical study of wage determinants among nonprofit leaders and found that ideology (i.e., religious affiliation) and the types of services provided are significant predictors of executive pay. In most studies, including the work by Oster (1998), organizational size is the chief determinant in nonprofit executive wage setting (Hallock, 2000; Twombly & Gantz, 2001; Frumkin & Keating, 2001). Indeed, these studies suggest that the bigger the nonprofit organization, the higher the compensation of its chief executive officer.

While the research on nonprofit executive compensation has yielded much useful information, two problems highlight the need to expand existing theory. First, that the majority of empirical studies have examined the differences across broad nonprofit industries often obscures the extreme heterogeneity within nonprofit subsectors and specific industries. The nonprofit firm is quite unique in its legal and economic constraints. Indeed, in contrast to proprietary firms, nonprofits are exempt from corporate income taxes (Ruhm & Borkoski, 2000) and often receive preferential treatment in state contract procurement processes (Frank & Salkever, 1994). Nonprofits also have no shareholders, do not issue stock, and cannot distribute economic residuals. Therefore, exploring the compensation practices in the universe of nonprofits makes sense, because nonprofit formation is generally based on the same legal considerations, whether the group focuses on higher education, religion-related activities, or animal rights. However,

the heterogeneity in each of these industries, and diversity in the goods and services they provide, also calls for a detailed, empirical assessment of wage determinants in particular subsectors. In the human service field, for instance, there are youth development organizations, job training providers, multipurpose nonprofits and others that vary in their reliance on particular types of funding and other factors.

Second, research on nonprofit executive compensation has often sidestepped the role of market forces and interorganizational competition for qualified and talented leaders. But, like for-profit organizations, nonprofits must compete with groups that provide similar goods and services. Competition among nonprofits creates organizational rivalry for capital, labor, customers and revenues (Chang & Tuckman, 1990; Tuckman, 1998), and nonprofits vie with other groups for board members, superior reputation, volunteers, and other non-economic factors (Brody, 1996). Because the pool of executive leadership is finite, nonprofit organizations must compete for the most qualified individuals to head their operations.

Research on nonprofit executive compensation should move beyond cross-industry analyses and incorporate the organizational dynamics and competition that underscore the nonprofit sector. Therefore, focusing on specific types of community-based human service nonprofits in metropolitan areas, this paper proposes two new models of executive compensation that includes both internal and external factors that contribute to wage setting and total compensation at these charitable organizations. Analyzing the compensation practices of human service nonprofits is timely and relevant. While community-based providers supply a wide array of services, they typically focus on populations in need – low-income families and children, immigrants, and the elderly – thus overcoming the problem of comparing executive compensation factors across broad industries. Moreover, leadership qualities are vital in community-based human service nonprofits. In serving as crucial roles in the lives of vulnerable populations, leaders of these charities must have the skills to navigate complicated contracting structures and to secure donor contributions to support their operations.

The tenets of the models include wages and total compensation as dependent variables, and internal and external factors as independent predictors. The equations of the models are:

Model 1: $Wages_{it} = \alpha + \beta_1 Fiscal\ Performance_{it-1} + \beta_2 Donor\ Support_{it} + \beta_3$
 $Organizational\ Size_{it} + \beta_4 Regional\ Organizational\ Competition_{it} + \beta_5 Community\ Need_{it}$
 $+ \beta_6 Regional\ cost\ of\ living + \beta_7 Type\ of\ Human\ Service\ Provider + \varepsilon$

Model 2: $Total\ Compensation_{it} = \alpha + \beta_1 Fiscal\ Performance_{it-1} + \beta_2 Donor\ Support_{it} +$
 $\beta_3 Organizational\ Size_{it} + \beta_4 Regional\ Organizational\ Competition_{it} + \beta_5 Community$
 $Need_{it} + \beta_6 Regional\ cost\ of\ living + \beta_7 Type\ of\ Human\ Service\ Provider + \varepsilon$

Total compensation includes wages and taxable benefits, such as deferred compensation, contributions to benefit plans, and income from expense accounts and other allowances. Internal factors in the model are fiscal performance, donor support, and organizational size. External factors are proxies for organizational competition and the need for social services. The models also control for the cost of living in metropolitan regions and the particular types of providers, which may impact wage setting.

Data and Methodology

The research design of this study includes a descriptive analysis of the compensation practices of nonprofit human service organizations and multivariate analyses of the determinants of wages and total compensation for their chief executives. The primary data source is the 1999 National Nonprofit Database, which was created by the National Center for Charitable Statistics (NCCS) and contains digitized information for 501(c)(3) public charities that filed Forms 990 with the Internal Revenue Service. The variables in the dataset include most of the Form 990 line items, such as financial and compensation information.

The units of analysis are individual human service nonprofits that were identified in the NCCS data files through the National Taxonomy of Exempt Entities (NTEE), a classification system of nonprofit organizations. The nonprofits in the study include children and youth providers; emergency assistance providers (e.g., cash, food and shelter); family service providers (e.g., counseling); low-income housing groups; job and vocational training providers; multipurpose service nonprofits, such as the Urban League; groups that focus on substance abuse treatment and prevention; and other types of

nonprofits that target social services to specific populations, such as immigrants and the elderly. The groups were selected for the study because they are locally-based nonprofits or affiliates of national groups that provide services to improve the lives of local residents, particularly from low-income backgrounds.

The analysis includes social service nonprofits in eight metropolitan areas: Fort Lauderdale, Minneapolis-St. Paul, Oklahoma City, Pittsburgh, Providence, Salt Lake City-Ogden, San Francisco, and Washington, DC. Of the 46,802 human service organizations in the 1999 NCCS data file, 3,551 (or 7.5 percent) are located in these eight urban areas. In comparison, of the roughly 222 million people who lived in U.S. metropolitan regions in 1999, 16.6 million (7.5 percent) resided in the eight sample metro areas.

The eight metropolitan regions were selected for the study because they vary by their number of residents, economic climate, number of nonprofit human service providers, and other characteristics (table 1). For example, among the eight metro areas, Washington, DC has the largest population (4.7 million residents in 1999), the highest median household income (\$45,900), and the biggest human service sector (866,000 nonprofits). In contrast, Minneapolis-St. Paul has the lowest unemployment rate (1.6 percent) and the fastest growing nonprofit human service sector. The other metro areas also vary along these dimensions. Taken together, the metro areas provide a diverse array of demographic and economic conditions through which to assess nonprofit executive compensation.

Table 1. Socioeconomic Characteristics and Distribution of Human Service Nonprofit Organizations, by Metropolitan Area

Metropolitan Area	Population (in millions)*	Median Household Income**	Unemployment Rate*	Human Service Nonprofits		
				Number	Per 10,000 residents*	Organizational Growth Rate***
Fort Lauderdale, FL	1.5	30,600	4.1	134	0.9	2.4
Minneapolis-St. Paul, MN	2.9	36,500	1.6	540	1.9	10.0
Oklahoma City, OK	1.0	26,900	3.2	153	1.5	-2.2
Pittsburgh, PA	2.3	26,700	3.9	365	1.6	3.4
Providence-Fall River, MA-RI	1.1	31,900	3.7	294	2.6	1.9
Salt Lake City, UT	1.3	30,900	2.5	96	0.8	0.7
San Francisco, CA	1.7	40,500	2.4	467	2.8	1.2
Washington, DC	4.7	45,900	2.5	866	1.8	7.3

Sources: U.S. Bureau of the Census; U.S. Bureau of Labor Statistics; authors' tabulations of the 1998 and 1999 National Nonprofit Databases, National Center for Charitable Statistics, The Urban Institute

*1999 data

**1989 data

*** Growth period in numbers is between 1998 and 1999

The study uses two dependent variables: wages and total compensation for chief executives. The information for wages and other forms of compensation, such as deferred compensation and contributions to retirement plans, is reported on Part V of the Form 990. The chief executive, defined as the person who leads the daily operations of the organization, was identified through a threefold process. First, a computer program searched and coded the data extract of human service groups by key terms (e.g., President, Chief Executive, Executive Director). The computer output was manually verified to ensure the program's reliability. Second, in cases where the computer program revealed more than one possible chief executive, the Forms 990 were manually reviewed to select the appropriate person. Of the 3,552 nonprofits in the eight regions, 1,619 (46 percent) reported positive wage information for a chief executive. Although some groups did not complete Part V of the Form 990, more than 80 percent of the 1,933 remaining organizations entered zero as wages for their chief executives. A manual review of the Form 990's zero filers suggests that most are volunteer organizations. Because the analysis focuses on determinates of wages and compensation, both missing and zero filers are excluded.

The independent variables include internal and external factors. The internal factors are fiscal performance and donor support. Financial performance is measured as equity balance (total assets minus total liabilities); operating margins (the extent to which revenues exceed expenditures); and fundraising effectiveness, which is the change in total donor contributions from 1998 to 1999. Each measure focuses on a different aspect of nonprofit managerial activity.

To predict the wages and total compensation of nonprofit chief executives in 1999, the fiscal performance measures were derived from information on Forms 990 filed in 1998. However, of the 1,619 nonprofits in the sample that reported positive compensation in 1999, 236 organizations (14 percent) did not file Forms 990 in 1998. These groups, therefore, are excluded from the estimation models, resulting in a final panel population of 1,383 community-based human service organizations. Nonprofits in the panel exhibit some different characteristics than the excluded organizations (table 2). For example, panel groups are less likely to focus on housing and more likely to provide

youth services, family and personal services, job training, and substance abuse assistance. Nonprofits in the panel are less likely than others to be located in the Pittsburgh metro area and more likely to be in the Providence-Fall River region. The panel is also significantly larger in terms of revenues and assets than the excluded groups, although the differences in their administrative costs do not vary significantly. The excluded nonprofits may have formed in 1999 or failed to file their Forms 990 with the IRS in 1998.

Table 2. Characteristics of Human Service Nonprofit Organizations in the Sample Metropolitan Areas

Characteristic	Panel Organizations N=1,383		Other Organizations N=2,169	
	N	%	N	%
Type of Service				
Children and youth services	230	16.6	269	12.4
Emergency services	80	5.8	125	5.8
Family and personal services	219	15.8	279	12.9
Housing	197	14.2	668	30.8
Job and vocational training	126	9.1	118	5.4
Substance abuse	139	10.1	125	5.8
Multipurpose human services	173	12.5	243	11.2
Other human services	219	15.8	342	15.8
Metropolitan Area	N	%	N	%
Fort Lauderdale	52	3.8	108	5.0
Minneapolis-St. Paul	258	18.7	423	19.5
Oklahoma City	75	5.4	96	4.4
Pittsburgh	146	10.6	285	13.1
Providence-Fall River, MA	179	12.9	175	8.1
Salt Lake City-Ogden	56	4.0	72	3.3
San Francisco	201	14.5	364	16.8
Washington, DC	416	30.1	646	29.8
Financial Data	Mean		Mean	
Total revenues (\$)	2,876,000		1,399,000	
Total assets (\$)	3,141,000		2,476,000	
Administrative costs/total expenses	16.7		16.0	

Source: Authors' tabulations of the 1999 National Nonprofit Database, National Center for Charitable Statistics, The Urban Institute

The other internal predictor of executive wages and compensation is donor support, which is measured as charitable contributions from individuals, foundations, and other federated campaigns such as the United Way. The model also controls for the heterogeneity of the human service field by using dummy variables for the eight categories of providers noted above, as well as organizational size, which is measured by the nonprofit's total assets and its "market share", which equals the revenues for each group as a percentage of the revenues for all human service nonprofits in its metropolitan region.

External factors, calculated at the metropolitan level, include organizational competition and community need. Organizational competition is measured in two ways: the "density" of these providers, which equals the number of nonprofit human service organizations per 10,000 residents, and the growth in the number of community-based human service groups from 1998 to 1999. The measures of community need, obtained from the U.S. Bureau of Labor Statistics and the U.S. Bureau of the Census, are the unemployment rate and percentage of residents in poverty. To control for regional differences in the cost of living, the model also includes the median household income at the metropolitan level.

Internal Factors

Fiscal performance. Like for-profit firms, nonprofits must maintain fiscal solvency to continue their operations. It is important for charities to monitor their fiscal health because they are unable to access capital markets to the same degree as proprietary firms. Not all groups succeed at maintaining their financial health, and some go out of business. Currently, donors, funders, and government regulators have all expressed interest in nonprofit fiscal health and vulnerability (Trussel, 2002), particularly on the heels of financial scandals that have rocked well-known and large charities, such as the United Way of the National Capital Area. In this charged funding environment, nonprofit leaders are ultimately held responsible for the financial positions of their organizations (see Frumkin & Keating, 2001). But leadership and responsibility cuts both ways. Indeed, executives might be punished for poor financial performance. By the same token, they

may be rewarded for strong fiscal health in which compensation becomes “performance sensitive” (Jensen & Murphy, 1990). Therefore, the first hypothesis is:

- H1: Executive compensation at human service nonprofits is significantly and positively related to fiscal performance.

Organizational size. As noted above, research has shown that organizational size is a critical determinant of nonprofit executive wage setting (Oster, 1999; Hallock, 2000; Twombly & Gantz, 2001; Frumkin & Keating, 2001). Size relates to executive compensation in at least two ways. First, it serves as a proxy for managerial duties, complexity, and span of control (Murphy, 1998). Nonprofits with more revenue sources, larger administrative structures, and greater product output are typically more difficult to manage than smaller groups. Second, size can legitimize organizations (Scott, 1995). Big charities often have higher prestige and access to community resources by virtue of the scope of their activities (Frumkin & Keating, 2001). This is evident in human service regimes, where large groups often press local officials for better reimbursement rates or more favorable contracting requirements. Therefore, the second hypothesis is:

- H2: Executive compensation at human service nonprofits is significantly and positively related to organizational size.

Donor support. There is evidence that the nonprofit sector has become more commercially oriented (Weisbrod, 1998; Anheier & Toepler, 1998). Some groups created for-profit subsidiaries, while other organizations now produce goods and services that do not relate specifically to their charitable purpose. Although nonprofit commercial activity is not new, its growth suggests a sector that is becoming more business-oriented, despite its charitable *raison d’etre*. This is particularly relevant in the human service field, where charities may look to diversify their revenue streams to offset potential funding losses due to donor choice policies, the flagging economy, and other factors. But in local social service regimes, where commitment to the public good and charitable mission runs strong, boards of directors often reward chief executives for maintaining ties to charitable donors. Therefore, organizational leaders of community-based providers who can generate significant funding from donor support may be more highly valued than other nonprofit chief executives. As a result, the third hypothesis is:

- H3: Executive compensation at nonprofit human service organizations is significantly and positively related to reliance on charitable donations.

External Factors

Organizational Competition. Top leaders of community-based human service groups must often be proficient fundraisers and administrators, and, in many cases, be adept at advocating for their organization and clients in local political environments. Not everyone can perform these tasks. As a result, in any given metropolitan area there are a limited number of potential and qualified organizational leaders. But the ability of a charity to attract the best person to lead its group can be hampered by two factors in metro regions: a large number of nonprofits, relative to the population, that provide similar goods and services, and an expanding social service sector, in terms of the growth in the number of human service providers. Both factors provide more choices and opportunities for chief executive employment. Following the basic tenets of labor market supply and demand, the ability of qualified individuals to exercise their “exit” option – either by leaving their position or demanding higher wages – should elevate compensation (see Hirschman, 1979). Therefore, the fourth hypothesis is:

- H4: Executive compensation at human service nonprofits is significantly and positively related to the competition for organizational leaders.

Community Need. In metropolitan regions where the needs of low-income families and children are great, human service organizations face considerable demand for their services. For example, in a metropolitan area where unemployment is relatively high, community-based providers must focus on job training, vocation skills building, and job placement. But a high level of unemployment can be associated with acute needs for emergency cash, groceries, and even temporary shelter services, creating strong demand at local human service charities. And compared with nonprofits in more affluent areas, groups in economically distressed regions may experience more difficulty in raising donor contributions to support their activities. Nonprofit leaders in relatively poor communities are often left with the daunting task of balancing scarce organizational resources with high levels of service demands. As a result, nonprofit chief executives must think creatively about ways to maximize production while maintaining their

organization's fiscal solvency. In other words, community needs can increase managerial complexity at nonprofit human service providers. Similar to the hypothesized effect of size on executive compensation, this study expects the following statistical relationship:

- H5: Executive compensation at human service nonprofits is significantly and positively related to poor economic conditions in metropolitan areas.

Findings

On average, chief executives of community-based human service nonprofits earned roughly \$55,800 in wages and \$59,200 in total compensation in 1999 (table 3). Among specific types of providers, job training providers paid their top officials the highest salaries (\$65,500 in wages), while chief executives at emergency service providers (such as soup kitchens, food pantries, etc.) earned the lowest average wages (\$47,900). The pattern is also evident in total compensation. On average, the leaders of job and vocational training organizations received more than \$71,000 per year in total compensation, while the total compensation packages of chief executives at emergency service nonprofits averaged \$51,300.

Taxable benefits constitute a relatively modest portion of the compensation of chief executives in the community-based human service fields. Less than half the organizations (46.5 percent) report the payment of taxable benefits to their chief executive (table 4). Among groups in the study, job training organizations (60 percent) are the most likely to pay taxable benefits, while groups that serve children and youth (36 percent) are the least likely. In general, taxable benefits comprise nearly six percent of the annual compensation for chief executives in the community-based human service field, meaning that roughly six cents of every dollar of executive compensation comes from taxable benefits.

Table 3. Distribution of Wages and Compensation by Type of Human Service Nonprofit Organization

Type of Organization	N	Wages			Total Compensation		
		Mean	S.D.	Median	Mean	S.D.	Median
Job and vocational training	126	65,500	35,400	56,800	71,100	39,000	66,700
Substance abuse	139	61,900	36,500	56,400	66,600	42,900	58,400
Housing	197	59,200	37,200	53,300	62,700	40,300	55,600
Multipurpose human services	173	57,000	35,200	48,300	60,800	39,600	50,000
Family and personal services	219	53,200	33,100	47,800	56,300	36,600	51,500
Other human services	219	52,600	31,800	47,800	55,500	34,700	47,900
Children and youth services	230	51,100	31,300	45,700	52,800	33,700	47,800
Emergency services	80	47,900	31,900	42,000	51,300	35,000	44,400
All Human Service Organizations	1,383	55,800	34,300	49,900	59,200	38,000	52,000

Source: Authors' tabulations of the 1999 National Nonprofit Database, National Center for Charitable Statistics, The Urban Institute

Table 4. Provision of Taxable Benefits and Percentage of Income From Benefits, by Type of Human Service Nonprofit

Type of Organization	Reporting Taxable Benefits		
	N	% of Organizations	% Compensation from Benefits
Children and youth services	82	35.7	3.9
Emergency services	33	41.3	6.5
Family and personal services	87	39.7	5.5
Housing	102	51.8	5.6
Job and vocational training	75	59.5	7.9
Substance abuse	77	55.4	7.0
Multipurpose human services	93	53.8	6.3
Other human services	94	42.9	5.3
All Human Service Organizations	643	46.5	5.8

Source: Authors' tabulations of the 1999 National Nonprofit Database, National Center for Charitable Statistics, The Urban Institute

Internal Determinants of Executive Compensation

The analysis reveals some important findings regarding the relationship between internal factors and executive compensation at human service nonprofits. First, there is some support for the hypothesis that fiscal performance is linked to managerial pay at social service charities. Indeed, the proxy for fundraising effectiveness – a key indicator for human service nonprofits – is positively and significantly related to chief executive wages (table 5). For every \$10,000 in additional contributions raised by the organization, the chief executive is rewarded with roughly \$22 in annual wages. Effectiveness in fundraising is also a significant determinant of total compensation (table 6), yielding \$25 in wages and benefits for nonprofit chief executives for every \$10,000 in additional charitable contributions from 1998 to 1999.

Table 5. Determinants of Wages for Chief Executives at Human Services Nonprofits

Variable	Coefficient	Standard Error	Significance
Equity balance (per \$10,000)	-7.80	3.30	**
Margin (per \$10,000)	-43.10	13.50	**
Growth in donor support (per \$10,000)	21.60	5.40	*
Total assets (per \$10,000)	18.40	2.80	**
Market share	1,926.80	320.68	**
Donor support (per \$10,000)	12.50	1.60	**
Children and youth services	-271.95	2,858.92	**
Emergency services	-3,779.36	4,021.41	
Family and personal services	3,038.87	2,911.72	
Housing	1,437.03	3,000.29	
Job and vocational training	13,032.24	3,396.09	**
Substance abuse	6,757.59	3,371.75	*
Multipurpose human services	3,945.87	3,119.15	
Growth rate	974.62	357.30	**
Organizational density	2,902.25	1,413.15	**
Percent of residents in poverty	510.74	1,275.14	
Unemployment rate	6,651.20	2,185.22	*
Median household income	0.64	0.19	**
Intercept	-11,514.04	15,977.50	

Source: Authors' tabulations of the 1998 and 1999 National Nonprofit Databases, National Center for Charitable Statistics, The Urban Institute

N=1,327 R-squared=0.267

** p<=0.01

* p<=0.05

Table 6. Determinants of Total Executive Compensation at Human Services Nonprofits

Variable	Coefficient	Standard Error	Significance
Equity balance (per \$10,000)	-9.10	3.60	*
Margin (per \$10,000)	-51.50	14.80	**
Growth in donor support (per \$10,000)	24.70	5.90	**
Total assets (per \$10,000)	21.10	3.00	**
Market share	2,255.06	351.05	**
Donor support (per \$10,000)	15.20	1.80	**
Children and youth services	-528.75	3,129.66	**
Emergency services	-3,154.16	4,402.24	
Family and personal services	3,585.21	3,187.46	
Housing	1,714.20	3,284.42	
Job and vocational training	15,750.80	3,717.70	**
Substance abuse	8,210.53	3,691.06	*
Multipurpose human services	4,880.03	3,414.53	
Growth rate	1,198.96	391.13	**
Organizational density	3,409.70	1,546.98	**
Percent of residents in poverty	703.08	1,395.90	
Unemployment rate	7,130.60	2,392.16	*
Median household income	0.60	0.21	**
Intercept	-13,610.08	17,490.58	

Source: Authors' tabulations of the 1998 and 1999 National Nonprofit Databases, National Center for Charitable Statistics, The Urban Institute

N=1,327 R-squared=0.285

** p<=0.01

* p<=0.05

But tables 5 and 6 hint at an important factor in the human service field. The data show negative and significant relationships among wages and total compensation and two performance measures—equity balance and operating margin. It is unlikely that human service managers are being punished with relatively low compensation for strong fiscal performance. It is probable, however, that boards of directors of human service agencies more heavily value the ability of their chief executives to expand their connections with local donors than to grow the assets or operating margins of their organizations. This important finding reveals that common fiscal health measures in the nonprofit literature may be inapplicable to particular industries, such as the human service field. It also may suggest, however, that some boards lack the information to adequately assess their organization's fiscal vitality and vulnerability along multiple dimensions, limiting their ability to tie multiple financial measures to executive wage setting. If a board operates with inadequate information or even disregards signs of fiscal trouble, then executive compensation may be set without regard to the financial position of the organization.

A particularly strong finding is the effect of organizational size on setting executive wages at community-based human service nonprofits. As predicted above, organizational size is strongly and positively related to pay for the top officials at human service agencies. Chief executives receive an additional \$1,900 in annual wages for every one percent increase of market share held by the organization (table 5). Fixed assets also significantly relate to executive wages, with chief executives earning roughly \$18 more in pay for every \$10,000 in assets. Not surprisingly, market share and assets are also critical determinants of total compensation for chief executives. Table 6 shows that top officials in the sample receive roughly \$2,300 more in total compensation for each percent of their organization's market share, and approximately \$21 more in wages and benefits for every \$10,000 in asset holdings.

Receipt of donor support is also a significant predictor of chief executive compensation at human service nonprofits, confirming the third hypothesis of the study. Holding constant other factors, executive directors of human service providers receive roughly \$13 in wages (table 5) and \$15 in total compensation for every \$10,000 in donor contributions. This finding likely points to the value that governing boards place on individuals who can support their organizations through charitable donations.

External Determinants of Executive Compensation

Possibly the most striking finding is the extent to which organizational competition in the nonprofit human service field impacts chief executive compensation in metropolitan areas. Per capita density of the human service nonprofits and the growth in the number of providers overwhelming relate to higher wages and benefits among nonprofit leaders. In fact, table 5 shows that for each percentage increase in organizational density, chief executives earn \$2,900 annually in additional wages. When controlling for certain factors, every percent of growth in the number of human service groups yields nearly \$1,000 in salary for chief executives. The relationships among competition, growth, and total compensation are also positive and significant (table 6). Competition for talent employees can drive up labor costs, an economic circumstance that is apparent in the sample metropolitan areas.

The analysis also provides some support for the hypothesis that wage setting in the human service field is linked to local economic stress. Tables 5 and 6 show that higher wages and total compensation are significantly linked to higher metropolitan unemployment rates. This finding in part relates to the relatively high wages paid to chief executives of job training providers – organizations that often provide formal services to the unemployed. Poverty is also positively related to wages and total compensation for human service executives, although the tests do not meet standard significance levels ($p < 0.05$). Nevertheless, the finding suggests that in economically distressed areas, nonprofit executives may insist on – and appear to receive – higher compensation than top officials in metropolitan regions with better economic climates. Because the models in the study control for organizational size, regional cost of living and other factors, it appears that governing boards may reward chief executives for leading their nonprofits in areas characterized by relatively high levels of need.

Summary and Implications

This study attempts to add to the growing theoretical and empirical research on nonprofit executive compensation by testing several hypotheses through two empirical models to assess the influence of internal and external conditions on chief executive compensation at human service charities. Substantial empirical support was provided for

most of the hypotheses in the regression models, demonstrating that these organizations use a mix of factors to set executive wages and benefits. More specifically, consistent with the existing theory on nonprofit executive wage setting, the models show that bigger organizations provide higher compensation to their top officials than smaller groups.

The analysis also illustrates that governing boards may link compensation levels to certain fiscal health measures, but discount or consider inapplicable in human service provision other factors such as equity balances or fiscal margins. It is possible that human service leaders are compensated by boards not only for their ability to increase donor support, but also for the *amount* of goods and services produced, rather than their ability to “turn a profit” in which revenues exceed expenses during the year. In fact, the nature of nonprofit service delivery suggests that to meet community needs, local human service groups often attempt to generate as much output as possible, even if it places them in some fiscal jeopardy. Another possible explanation for these results, unexplored in this analysis, is the extent to which poorly performing community-based providers changed chief executives between 1998 and 1999. Taken together, these considerations serve as a starting point for additional research.

Perhaps most importantly, the study provides a new wrinkle to our understanding of nonprofit executive compensation by revealing the significant role of environmental factors in nonprofit executive wage setting. Indeed, the analysis demonstrates that community-based providers relate executive wages and total compensation to local organizational competition and community needs, suggesting that boards of directors may be aware of the changing nature of their local human service sectors and may set wages for their chief executives accordingly. More competition means higher wages. Less competition produces lower salaries. But the findings also reveal an important avenue for future research on nonprofit wage setting, and the charitable labor market more generally. That is, despite the evidence by Weisbrod (1983) and others of a charitable wage penalty, that is, the willingness by nonprofit employees to forgo higher wages at for-profit firms to work in the charitable sector, one may question the extent to which executive directors of human service groups use the threat of “exit” (Hirschman, 1979) to raise their compensation in metropolitan areas. In other words, one should consider that in metropolitan regions characterized by the strong availability of

opportunities for chief executives, whether nonprofit managers are more reactive to labor market cues and less “charitable” than nonprofit scholarship has traditionally assumed.

References

- Anheier, H.K., & Toepler, S. (1998). Commerce and the Muse: Are Arts Museums Becoming Commercial? In B.A. Weisbrod (Ed.), *To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector*. New York, NY: Cambridge University Press.
- Brody, E. (1996). Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms. *New York Law School Law Review*, 40(3): 457-536.
- Chang, C.F., & Tuckman, H. (1990). Why Do Nonprofit Managers Accumulate Surpluses, and How Much Do They Accumulate? *Nonprofit Management and Leadership*, 1(2): 117-135.
- DuMond, J.M. (1997). *Wage Tradeoffs: An Analysis of the Nonprofit Sector and Local Amenities*. Unpublished Ph.D. thesis, Florida State University.
- Frank, R.G., & Salkever D.S. (1994). Nonprofit Organizations in the Health Sector. *Journal of Economic Perspectives*, 8(4): 129-144.
- Frumkin, P., & Keating, E.K. (2001). *The Price of Doing Good: Executive Compensation in Nonprofit Organizations*. Working Paper, Harvard University, The Kennedy School of Government.
- Hallock, K.H. (2000). *Managerial Pay and Governance in American Nonprofits*. Working Paper, University of Illinois, Champaign-Illinois.
- Hansmann, H. (1980). The Role of Nonprofit Enterprise. *The Yale Law Journal*, 89 (5): 835-901.
- Hirschman, A.O. (1979). *Exit, Voice, and Loyalty: Responses to decline in Firms, Organizations, and States*. Cambridge, MA: Harvard University Press.

Jensen, M.C., & Murphy, K.J. (1990). Performance Pay and Top Management Incentives. *Journal of Political Economy*, 98(2): 225-255.

Murphy, K.J. (1998). Executive Compensation. In O. Ashenfelter & D. Card (Eds.), *Handbook of Labor Economics, Volume 3*. New York, NY: North-Holland.

Oster, S.M. (1998). Executive Compensation in the Nonprofit Sector. *Nonprofit Management and Leadership*, 8(3): 207-221.

Preston, A. (1989). The Nonprofit Worker in a For-Profit World. *Journal of Labor Economics*, 7, 438-463.

Roomkin, M., & Weisbrod, B.A. (1999). Managerial Compensation and Incentives in For-Profit and Nonprofit Hospitals. *The Journal of Law, Economics and Organization*, 15(3): 750-781.

Rose-Ackerman, S. (1986). Charitable Giving and Excessive Fundraising. In S. Rose-Ackerman (Ed.), *The Economics of Nonprofit Institutions*. New York: Oxford University Press.

Ruhm, C.J., & Borkoski, C. (2000). *Compensation in the Nonprofit Sector*. National Bureau of Economic Research, Working Paper 7562, Cambridge, MA.

Scott, W. R. (1995). Introduction: Institutional Theory and Organizations. In W.R. Scott (Ed.), *The Institutional Construction of Organizations*. Thousand Oaks, CA: Sage.

Steinberg, R. (1990). Profits and Incentive Compensation in Nonprofit Firms. *Nonprofit Management and Leadership*, 1(2): 137-152.

Trussel, J.M. (2002). Revisiting the Prediction of Financial Vulnerability. *Nonprofit Management and Leadership*, 13(1): 17-31.

Tuckman, H.P. (1998). Competition, Commercialization, and the Evolution of Nonprofit Organizational Structures. In B.A. Weisbrod (Ed.), *To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector*. New York, NY: Cambridge University Press.

Twombly, E.C., & Gantz, M. (2001). Executive Compensation in the Nonprofit Sector: New Findings and Policy Implications. Policy Brief No. 11 in the *Charting Civil Society* series of the Center on Nonprofits and Philanthropy, The Urban Institute.

Weisbrod, B.A. (1983). Nonprofit and Proprietary Sector Behavior: Wage Differentials Among Lawyers. *Journal of Labor Economics*, 1(3): 246-263.

Weisbrod, B.A. (1989). Rewarding Output That is Hard to Measure. *Science*, May, 541-546.

Weisbrod, B.A. (1998). The Nonprofit Mission and Its Financing: Growing Links Between Nonprofits and the Rest of the Economy. In B.A. Weisbrod (Ed.), *To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector*. New York, NY: Cambridge University Press.

Young, D.R. (1986). Entrepreneurship and the Behavior of Nonprofit Organizations: Elements of a Theory. In S. Rose-Ackerman (Ed.), *The Economics of Nonprofit Institution*. New York: Oxford University Press.