

5-2012

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Recommended Citation

Hallock, Kevin F. 2012. "Governance and Executive Compensation in Nonprofits." *Workspan* 55 (5) (05): 12.

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Governance and Executive Compensation in Nonprofits

Corporate governance has attracted much attention lately, justifiably many would argue.

But what about governance of nonprofits? In the past couple decades, important legislative changes and public pressure have driven rapid changes in board governance and reporting, much focused on executive compensa-

tion, in particular. Still, there seems to be less focus on these issues in nonprofit organizations. This despite the fact that more than one-quarter (26.8 percent) of Americans volunteered through or for an organization last year, with the likely majority of these organizations being nonprofits. (In a future column I will discuss the seeming oddity of people volunteering for for-profit companies.) Nonprofits in the United States account for roughly 10 percent of employment and 5 percent of GDP.

Reciprocally Interlocking Relationships and CEO Pay

I first began thinking about executive compensation from an interest in corporate governance. In one of my early academic publications, I analyzed the link between corporate board structure and the compensation of CEOs in large publicly traded U.S. companies. In particular, I was interested to know if CEOs, who experienced what I called reciprocally interlocking relationships, were paid more. I defined a reciprocally interlocking relationship being present if the CEO of Firm A sat on the board of Firm B at the same time the CEO of Firm B sat on the board of Firm A. ("Kevin F. Hallock, Reciprocally Interlocking Boards of Directors and Executive Compensation," *Journal of Financial and Quantitative Analysis*, 32(3), 1997).



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Using data on more than 9,800 directors at the largest U.S. firms, I showed that CEOs of interlocked firms earned more. By removing the effect of firm size (larger firms pay more (see the February 2011 Research for the Real World)) and other CEO characteristics, the pay advantage to being interlocked was reduced dramatically. However, when firms that were identified as interlocked through documented business relationships are considered not interlocked, the measured return to compensation of being interlocked was as high as 17 percent. Surely this gap is much smaller today. Given increased regulation and scrutiny, I suspect there are few if any remaining interlocking relationships in corporate America.

But what about in nonprofits? The lack of attention nonprofits receive related to this issue might suggest that most think nonprofits are immune to reciprocally interlocking management, but they are not. For example, according to the *Chronicle of Higher Education* some university presidents who serve on boards of corporations (and earn fees for doing so) simultaneously have members of the management teams of those same corporations serving on their university board. These kinds of situations, and other scandals over incidents of massive pay packages for heads of nonprofits with less than ideal oversight, are raising interest among some about the importance of governance in nonprofits.

Do Pay Levels Make the Difference?

Could it be that there is less scrutiny over governance of nonprofit organizations because pay levels for the heads of these organizations is so much lower? Adjusting for organization size, however, cash pay is not that different in for-profits and nonprofits (Kevin F. Hallock, "Managerial Pay in For-Profit and Nonprofit Organizations," in Sarah Smith-Orr and Ron Roggio, editors, *Improving Leadership in Nonprofit Organizations*, 2004). For-profit executives often receive stock and options, making their total compensation,


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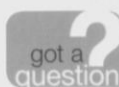
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Advancement and Change in the Near Future?

Resources exist for helping nonprofit boards govern effectively, and the good news is that this support is growing. I suspect that, compared to boards of for-profits, there is, on average, less business experience, less compensation experience and less onboarding of new members of nonprofit boards. As a result, members of nonprofit boards could always use additional resources for helping them serve their constituents effectively.

In one example, in my own state of residence, New York, the state attorney general has launched an initiative to revitalize nonprofits. Attorney General Eric T. Schneiderman's initiative includes a robust focus on improving training resources for nonprofit board members, with some particular focus on executive compensation. (This announcement came in February, just one month after a gubernatorial executive order that "[to] the extent practicable" limits to \$199,000 "state payments for executive compensation" in service-providing organizations).

Schneiderman is convening Cornell's Institute for Compensation Studies with other academic institutions (including Adelphi, Baruch, Binghamton, Columbia, The New School, NYU, University of Albany and Yale) to collaborate on an accessible, online Directors U library of resources to help board members understand their duties and responsibilities, increasing governance and accountability. Perhaps this will spur other organizations in the for-profit and nonprofit worlds to continue to further good governance practices on boards. 



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