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## Pay in Nonprofits

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# Pay in Nonprofits

In the U.S., April 21–27 is  
National Volunteer Week,  
a time to recognize all  
those who work without  
pay to support important  
missions or causes  
championed by nonprofits.

But what about those who work *for* pay in nonprofits? Is pay in nonprofit organizations like that in for-profit organizations? Yes and no. I am an economist and economists are well-known to say “On the one hand ... but on the other hand ...” This is a case where that is particularly salient. Many of the issues that come up when designing pay systems in for-profits (strategy, internal equity, performance, motivation, fairness, transparency, etc.) are as important to consider in nonprofits as they are in for-profits. But some of

the facts and issues differ. For example, pay levels and pay mix differ across the sectors; so does the way people think about performance and executive compensation.

## Pay Design Across Sectors

In my college courses, I am quite careful to avoid use of the words “company” or “firm” for weeks on end when I teach about the mechanics of basic compensation design. The students and I talk about business strategy, compensation strategy, job analysis, job evaluation, weighting, scaling, the market pay line, internal equity, surveys, the external market and on and on. Looking back, the students see that what they have learned is not applicable to only for-profit organizations.

There are, though, many important and interesting differences among nonprofit, for-profit and government organizational forms, as thoughtfully highlighted in Henry B. Hansmann’s “Ownership of Enterprise” (Harvard University Press, 1996). This classic book describes why organizations



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# Take Control of Your Pay Structure

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form as nonprofits, and it presents interesting examples of some organizations (e.g., daycare centers) that might have an advantage when organized as a nonprofit because the “residual claimant” (owner) can’t walk away with the profits; something Hansmann calls the “nondistribution constraint.” The owner of a for-profit day care could keep for himself or herself the money saved by serving less-fresh vegetables to the children, but the leader of a nonprofit could not.

Despite these interesting differences in organizational forms, the basic mechanics of pay systems — and the training of people in my classroom and your organization about those mechanisms — are really sector (nonprofit, for-profit, government) free.

## Do Those in Nonprofits Earn Less? Why?

Using a sample of data from the 2000 U.S. Census of Population about approximately 3 million people between the ages of 16 and 65 who worked full year and full time, I find that those working in nonprofits are paid less than in other areas. The data show that overall annual earnings for those working in nonprofits averaged about \$42,000. The pay for those in the for-profit sector was, on average, a few thousand dollars per year more.

Trying to estimate a wage gap is one thing, but figuring out why one group earns more than another is all together more difficult. (See, for example, my discussion of “Pay System Gender Neutrality” in the November 2011 issue of *workspan*.) One reason for the size of the for-profit/nonprofit pay gap could be because of the uniqueness of the sample (e.g., what if we also looked at part-time workers? What should we do about the incredibly interesting case of volunteers who work for no financial wage or salary?) or other statistical issues that I have discussed in the column on gender and elsewhere.


Academics have considered a diverse set of theoretical explanations for why those in nonprofits earn less (on average) than those in for-profits. I will only briefly mention three here. The first (attributed to Anne Preston, 1989, “The Nonprofit Worker in a For-Profit World,” *Journal of Labor Economics*, 3, 438-463) is known as “donating wages.” The idea is that employees are essentially donating back to the nonprofit for which they work the difference between what they would have earned in the for-profit sector and their actual wages in the nonprofit sector. A second idea is what economists call “compensating wage differentials.” Here, workers accept lower wages in exchange for a host of more pleasant working conditions (e.g., flexible hours, more stable job prospects). The third reason average pay is lower in the nonprofit sector, as suggested by some, is that that the skills of those in nonprofits may be more

usefully applied elsewhere or they are less appropriate for the for-profit sector, meaning there are fewer competing opportunities available to them. Testing these theories is extremely difficult given the existing data.

## Executive Compensation in Nonprofits

I first became interested in the study of compensation in nonprofits when I thought about nonprofit executive compensation. I reasoned that paying leaders in nonprofits may be even more complicated since the bottom line is less clear. To be sure, for-profit organizations have many constituents (e.g., customers, employees, suppliers, government and shareholders) and many nonprofits also have myriad constituents. But it has been argued that the bottom line is clearer in for-profit firms than it is in nonprofit organizations.

In “Managerial Pay and Governance in American Nonprofits,” (2002, *Industrial Relations*) I studied some of these ideas and found some interesting facts. Among them are that organization size and managerial pay are strongly linked in nonprofits (just as they are in for-profit firms), but other measures of performance are, too. For example, the ratio of program service expenses to total expenses in the nonprofit are also related to the manager’s pay (even after controlling for many other characteristics of the organization). That is, managers who lead organizations where a relatively higher share of budget is spent on programs and serving the mission (and relatively less on administration and fundraising) are, on average, paid more.

More research needs to be done on compensation in nonprofits, and I look forward to being involved in some of it (some colleagues and I are currently studying the pay of university presidents). Many general lessons from compensation research and practice in for-profits can be applied to nonprofits. Still, practitioners in for-profits should also look to learn from nonprofits. What lessons can be found in nonprofits for how employees may be willing to make trade-offs between rewards (broadly defined), like being paid through the love of working for a greater sense of purpose and mission (more often associated with nonprofits), and simply doing a job for cash? Or, if there is a for-profit/nonprofit pay gap, is there a pool of underpaid talent ripe for the picking by for-profit organizations? 



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