'A Vow of Moderation': Public Service and Leadership by Example

Tom Pollak, The Urban Institute, Nov. 2009

> Compensation in nonprofit organizations attracts a regular flow of press reports and policy discussions. Much of what has been written in the past ten years by leaders in the nonprofit sector focuses on the importance of raising pay levels to compete for talent with the private sector. They focus on the low salaries of small nonprofit organizations and “gloom and doom” scenarios about an impending workforce shortage. It's not fair, they argue, that people who want to work in the nonprofit sector should get paid less than those in regular jobs in the for-profit sector.

At the other end of the spectrum, stories in the general interest press often mention the salaries of the "superstars" -- the executive directors or CEOs of major hospitals, universities, private foundations, or other large nonprofit organizations. Others have focused on Senator Grassley's investigation of the compensation of high-profile televangelists. Still others have focused on the multimillion dollar salaries paid to the most successful college coaches.

Reality lies somewhere in between. Thousands of executives at organizations that many of us think of as the “good guys” are paid quite handsomely. The number of organizations paying key employees (CEOs, executive vice presidents, etc.) more than $200,000 probably exceeds 10,000 (NOTE: need to confirm). From the perspective of the typical American – the median family of four had income of only $67,000 in 2005 (http://www.census.gov/hhes/www/income/4person.html)-- this is a rich person’s salary.

From a practical perspective, you might be thinking, what's $200,000 when some for-profit CEOs are making hundreds of millions? Even if all of your 10,000 well-paid nonprofit leaders had their salaries cut to $100,000, the added money available for charity would be maybe $1 billion – a mere drop in the bucket, less than one percent of charitable contributions last year.

But it's not that simple.

Aspirations and Reality

The basis for the nonprofit sector's exemption from taxes and, a bit more abstractly, for its moral leadership, is its commitment to the public good. Independent Sector, the umbrella association for the major foundations and charities, defines it's mission and vision as “advanc[ing] the common good by leading, strengthening, and mobilizing the charitable community” to create a “just and inclusive society and a healthy democracy of active citizens, effective institutions, and vibrant communities.” Inspiring words.

Yet public confidence in nonprofit organizations is middling. "The poll, commissioned by New York University's Organizational Performance Initiative, found that 64 percent of Americans have a "great deal" or "fair amount" of confidence in charitable organizations, down from 69 percent in 2006." (http://philanthropy.com/premium/articles/v20/i12/12001201.htm) One-third of the American public has a less than favorable view of charitable organizations. Not horrible, but hardly the numbers one would expect of a sector that often fancies itself providing above-the-fray moral leadership.

How do charities compare to other institutions? It depends on which number one chooses to focus. To stress the point that confidence in charities is not where I believe it could be, I will zero in on the percentage of people who said they have a “great deal” of confidence in charitable organizations—a mere 16 percent. Harris Interactive asks a similar set of questions about the leaders of various “institutions.” It's not a perfect comparison, but useful nonetheless. NYU's numbers for charities fall more or less in the middle of the pack, dramatically lower than the 51 percent of people who have a great deal of confidence in the military or the 47 percent who feel the same way about small business leaders. Instead, charities are in the same range as “the courts and the justice system” and “television news,” and only slightly ahead of “The White House” and “major companies.” Hardly the numbers one would expect from the nation's civic leadership. (http://www.harrisinteractive.com/harris_poll/index.asp?PID=876)

Why the large gap between the sector's aspirations and its performance as judged by its “customers,” the American public? One explanation is that periodic well-publicized scandals have tainted public opinion. There's probably a good measure of truth there. But that misses a deeper problem.

Assessing integrity is not always an easy task. People do tend to follow the old maxim that actions speak louder than words. The captain of the sports team or the officer leading his troops into battle is expected to lead by example, to play with heart, to be the first man over the wall. We are accustomed to seeing founders and founding members of nonprofits and nonprofit movements as self-sacrificing and even heroic. Think Martin Luther King or John Lewis; more recently, Greg Mortenson’s story of his labors to create schools in Pakistan and Afghanistan has sold more than a million copies. Initially, he lived out of his van so he could put his rent money toward a school.

So what does this mean for the average mature nonprofit organization? That’s the question, we will explore.

Our Mental Models

How do we think about compensation of top staff in mature organizations today? Three models leap readily to mind.

IRS regulations. In the 1996 Taxpayer Bill of Rights II (http://www.law.cornell.edu/uscode/26/usc_sec_26_00004958----000-.html; summary at http://www.irs.gov/pub/irs-utl/doc7394.pdf, p.19), Congress created a penalty (aka, "intermediate sanctions") for nonprofit "excess benefit transactions." These are defined by the IRS as transactions in which a "disqualified person engages in a non-fair-market-value transaction with an organization or receives unreasonable compensation."

Compensation is based on "fair market value." The IRS went on to define the market as including both for-profits and nonprofits. Thus, a college football or basketball coach may be paid several million dollars a year since the pay is comparable to what the coach could get in the pros. The president of the University of Mississippi, for example, raised private contributions to cover the $7.5 million salary for his new football coach. (New Yorker, May 19, 2008)

Public service. "Public service" is mostly used to refer to work in the government, although work for the nonprofit sector is occasionally included. The 2003 report by the National Commission on the Public Service ("Volcker Commission") provides the “consensus” perspective: "What are the relevant markets for most federal employees? The Commission does not believe that the federal government needs to match salaries of corporate managers in most instances to ensure a quality workforce. The proper marketplace comparisons will more often be with the independent sector: with universities, think tanks, and nonprofits rather than with business..." Unlike the IRS regulations, this makes clear that the nonprofits and government are to be thought of separately from for-profit organizations.

And the salaries for “civil servants,” even those running very large bureaucracies, tend to be lower than that of major nonprofit organizations. Cabinet-level officials made $180,000 in 2005. Congressmen and Senators made $162,000.

The image of “public service” is a mixed one in the American mind. There’s the idealism of the young men and women who flocked to Washington to join the New Deal or the Kennedy Administration. Why do we think of them as idealistic? We think of their actions, their willingness to sacrifice potentially lucrative careers in law and business for the modest salaries of the federal government.

But we also think of “bureaucracy,” of rule-bound and unimaginative functionaries who stymie innovation. The ideal of nonprofit service, however, bonds the idealism of those public servants with the flexibility and innovation of business.

Other Perspectives

Stepping back and thinking more broadly about the roles of the nonprofit sector leads to other models.

Military service. If one focuses on the role of nonprofits as providing service to the nation, why not look at compensation and organizational culture in an institution with a similar mission, the U.S. military, to see how it deals with compensation?

Let me first offer a few admittedly selective snippets:

- How many organizations, nonprofit or otherwise, emphasize selfless service as one of their core values? The U.S. Army may be unique in this regard.
- "Taking care of [employees] treating them fairly, refusing to cut corners, sharing their hardships [italics added], and setting a personal example are critical." (U.S. Army Leadership Manual 2006)
- "I held to the old-fashioned idea that it helped the spirits of the men to see the Old Man up there, in the snow and the sleet and the mud, sharing the same cold, miserable existence they had to endure." (Hesselbein 2004, quoting “Leading from the Front: Ridgeway in Korea”)

Arguably, the rhetoric of sacrifice is moving, but does it reflect the reality of military life, let alone offer any guidance on nonprofit compensation? I would argue that it does—but more on that later.

At a more practical level, it is also useful to look at actual compensation of military personnel. Three features stand out. First, the military compensation system relies on special allowances related more to need than to rank. For example, the “Basic Allowance for Housing” provides the lowliest enlisted person with dependents with a subsidy equal to “the midpoint between the average rental cost of a 2 bedroom apartment and a 2 bedroom townhouse” while a single person would receive “the average rental cost of a one-bedroom apartment.” These allowances are also adjusted for local housing costs. Second, while base salaries are modest, “collective goods” such as recreational facilities and discounted “PX” shopping are available to all. Third, the salary structure is relatively flat. Even the highest paid general or admiral makes less than $200,000 per year.

"It's a Wonderful Life." Even in the for-profit sector, there are models of moderation, albeit fictional. The iconic image of service to the community is George Bailey (Jimmy Stewart) in Frank Capra’s "It's a Wonderful Life." A young man with great prospects and desperate to escape the confines of his small town, he nevertheless accepts his lot as the financially strapped head of the local “building & loan” after his father’s unexpected death.

Artists. The long-serving head of the innovative Wooster Group theater company, based in New York City, makes only $30,000, more or less the same amount as the other seventeen members of the company. But as Oscar-winning actress Francis McDormand put it, ""I was a middle-aged actress, and to get to work with Liz, with the only company I know with a real mission to entertain and subvert—it was like being reborn into a new life. I loved it." (New Yorker, Oct. 8 2007)

Social movements. Some mission-driven "progressive" organizations have consciously chose to limit their salaries. The executive director of ACORN Housing Corp., with more than $7 million in gross receipts, received approximately $66,000 in salary and other benefits in FY 2006, far below typical levels for organizations of this size. (ACORN Housing, as far as I can tell, is a separate entity from its former parent, recently the subject of a disturbing article by the NY Times.)

The vow of poverty. There's a tradition of compensating the heads of some major nonprofits at rates that are far lower than market. Historically, but perhaps less so today, heads of many Catholic hospitals and schools and the Salvation Army accepted compensation that was many times smaller than their secular counterparts.

The Team. There's also a parallel in the world of sports that has been adopted in the business management press. That's the concept of the team. In a team, all players are focused on the success of the team as a whole, not on their personal advancement.

Although most nonprofit and business leaders talk the language of teams, few dare extend the implications to compensation.

What Should a Board Do?

I am not arguing that every organization should rush out and drastically change its compensation structure. The issues are complex. The case for compensating line staff at market rates is stronger than for compensating top staff. A nonprofit hospital, for example, competing against a for-profit in the same town probably has little choice but to pay close to market wages to its nurses, given the demanding nature of nursing jobs in the modern hospital and the limits of what even the best hospital managers can accomplish.

Tying pay to performance is increasingly popular in both the for-profit, nonprofit and governmental sectors. The adoption of any of the alternative models discussed earlier does NOT necessarily conflict with this practice. For example, an organization with a flat compensation structure that pays everyone from the janitor to the executive director base pay ranging from $30,000 to $60,000 per year could still provide, say, $5,000 to each team member who meets key performance targets for the year. (This will be the subject of a different article.)

Those cautions aside, I am recommending that boards think seriously about some of the deeper implications of their compensation structures and the potential for either matching compensation structure to the existing values of their organizations or--more challenging-- reorienting the culture of their organizations to reflect one of the great promises of the nonprofit organizations and associations: They provide an ideal structure for people to come together as equals to work together for the common good.

Develop a "Seal of Modest Compensation" approval and publicize it. Assess impact it has on giving.

- Use military pay approach: Geographic adjustments; housing allowance; GI Bill/education benefit.
- Recruit from within.
- Recognize that measuring results in many areas of nonprofit activity is fraught with difficulty. But we can measure inputs and compensation, a proxy for integrity.
- Also need to show effectiveness.

Arguments and Counterarguments

It's easy to find sound reasons to dismiss the "vow of moderation." Let me offer a number of them and a response.

The Recruitment Argument. We won't be able to find anyone to serve as CEO if we don't offer market wages.

Pay People What They Are Worth. It's the American way: Pay people what they are worth. Let's face it; there are irreplaceable social entrepreneurs out there who do a great deal of good. They make their organizations great.

Fairness. It's only fair to a CEO who brings in $1 million per year from her wealthy corporate friends to pay her what she is worth.

Implementation and Staff Morale. We can't move from our current structure to what you recommend. Staff would rebel.

Long-Term Staff Retention. We must reward longevity of service. That means we must have a highly unequal compensation structure.

All of these arguments have merit. I would not recommend legislation to prevent boards of doing what they need to do to maintain their organizations. But cultures can change, within organizations as well as within nations. One can fill bookshelves with the business literature on "change management" and building an organizational culture that rewards excellence.

Examples of change at the national level are harder to find, but there are encouraging signs that we are entering a period of public-spiritedness. Whatever one may think of Barack Obama's policies or readiness for higher office, the dramatic increases in voter turnout and volunteering bode well for the capacity of Americans to switch their focus away from private gain toward a focus on the health of the commonweal. Threats of massive climate change, nuclear terrorism, and mounting federal budget deficits help focus our attention on the need for public action.

The bottom line is that organizations that choose to move toward a "vow of moderation" might have new challenges in the short run, but I'd bet that, in the long run, staff will rise to the challenge and new resources – staff, volunteers, donors – will be found and the organization will be the stronger for it.

The Long View

Imagine if the nonprofit executives of all the major foundations and public charities announced at the next Independent Sector meeting that they were taking a voluntary reduction in their pay to $100,000 (plus reasonable allowances for health care, college tuition for kids, cost of living adjustments for major cities, and retirement). I'd wager that there would be an outpouring of positive commentary from the mainstream news media and that the public's opinion of charitable organizations would be measurably improved. No longer would we hear about the "leadership shortage" in the nonprofit sector. Talented and idealistic young people would look with renewed enthusiasm at nonprofit opportunities. The nonprofit sector's role as moral leader would be renewed.

Environmental organizations could once again capture the energy of the "environmental movement." Donations would increase, and, with them, the capacity for major nonprofits to provide the sorts of services in low-income neighborhoods that are so desperately needed.

Moving to a model of moderate compensation is no panacea. One must still ensure that small nonprofits can pay adequate, living wages; that work in large nonprofits isn't unnecessarily hampered by bureaucracy; that enlightened team- and mission-oriented leadership becomes the norm in organizations large and small.

But it sends an important signal to the general public that these organizations' leaders "walk the walk," that they are truly committed to serving the public at a time when a more civic-minded focus seems critical to addressing problems of climate change, persistent poverty at home and abroad, and America's weakened position as a force for good in the world.