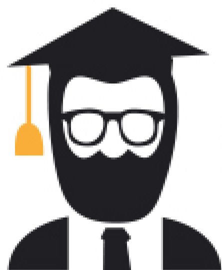

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Nonprofit Executive Compensation: How Much Is Too Much?

Case

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Region: Northern America | **State:**
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Abstract

The case focuses on the extravagant salaries that executives in nonprofit organizations earn. This is illustrated with examples ranging from the former chief executive of the Smithsonian Institution to the director of the Los Angeles County Museum of Art. The Internal Revenue Service has responded to an extent to restrict this type of behavior in nonprofits. This case study asks students to consider whether the response to this business problem has been sufficient and to assess how charities themselves should tackle the issue of excessive salaries for executives.

Case

Corporations aren't the only organizations accused of paying their executives too much and providing them with outlandish perks. Lawrence Small, the former chief executive of the Smithsonian Institution in Washington, D.C., saw his pay jump from $536,000 to $915,000 between 2000 and 2007. He traveled by private, chartered plane and took nearly 10 weeks of vacation a year. His deputy was absent from the Smithsonian one quarter of her workdays while serving on other boards, which earned her about $10 million in outside income. Combined compensation for executives at the National Veterans Business Development Corporation amounted to more than 22% of the money Congress appropriated to the organization to help veterans. The group's leaders also spent over $5,000 for two meals at a steakhouse. Senators criticized the Boys & Girls Clubs for paying its president nearly $1 million a year while spending over $4 million on travel expenses for 350 staff members. The president and CEO of Philadelphia public radio station WHYY earns more than the heads of the Public Broadcasting System, National Public Radio, and many commercial stations.

The Internal Revenue Service has tightened restrictions on nonprofits in light of the compensation scandals. Nonprofits are now required to reveal executive salaries greater than $150,000 and to disclose amounts spent on housing allowances, expense accounts, chauffeurs, bodyguards, and first-class air travel. Board members can be hit with penalties if pay packages are considered too generous. However, the IRS waives the penalties if the board can establish that the compensation package is comparable to those paid by other, similar charities.

It is easy to see why the IRS is increasing its oversight of nonprofit executive compensation. Money spent on salaries and travel often means less money available for helping the poor, educating children, supporting the arts, healing the sick and other causes. A number of Boys & Girls Clubs were also forced to close, for example, even as the parent organization's CEO took home $1 million in compensation. Then, too, tax-exempt organizations are supposed to serve the public good, not take advantage of the tax code to enrich their leaders. Society expects nonprofit executives to be motivated by service, not pay. According to the director of the Nonprofit Leadership and Management program at the University of San Diego, “There is a moral obligation for nonprofits to compensate their top staff in a way that is respectful of their mission” (Kosseff, 2004).· Some donors are fighting back, refusing to support organizations led by highly paid executives. Critics of WHYY distributed bumper stickers with a red circle and slash over WHYY with the words “Its CEO makes over $400,000. Do you?” (Davis, 2008).

Greater IRS scrutiny and donor protests will not end the debate over nonprofit executives' salaries. That's because more and more charities are adopting strategies traditionally associated with businesses, such as hiring MBAs, conducting market research, advertising, and jettisoning unproductive activities. Those groups that operate in a more businesslike fashion may experience a dramatic increase in revenues and programs, increasing their outreach and enabling them to better fulfill their mission. However, nonprofits that adopt a business model can end up bidding against businesses (and other nonprofits) when recruiting talented executives. For example, the Los Angeles County Museum of Art lured a new director from the Dia Art Foundation

in New York by offering him a $1 million annual compensation package. Said the museum's major donor, “We wanted him and we had to induce him to leave where he was, and the financial package was a major part of that inducement. It's a market. You've got to be competitive” (Pogrebin & Taylor, 2010).

Many board members argue that high-performing nonprofit executives deserve what they make. According to the chairman of the Museum of Modern Art in New York, which paid its director $2.7 million in salary, housing allowance, and other benefits in 2008, “If you are lucky enough to have the best executive in the field, you should compensate the person accordingly … because if you want your organization to be well run, you've got to find the person who can accomplish it” (Pogrebin & Taylor, 2010).

Discussion Questions

1. How much is too much when it comes to nonprofit executive compensation? What standards do you use to make this determination?
2. How should nonprofit pay levels be set?
3. Should managers at charities be expected to work for less than their colleagues in corporations? Why or why not?
4. Should nonprofit groups operate like businesses? What are some of the potential benefits of doing so? The potential dangers?
5. If you discovered that the leader of your favorite charity was receiving a very high salary and benefits package, would you stop supporting that group?

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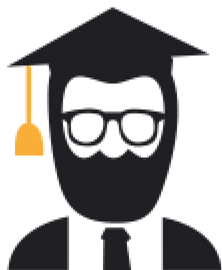

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