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Paying for Performance in Not-for-Profits

KEY TAKEAWAY

There are several key factors why companies should utilize incentive plans. Incentive plans are correlated to better-performing companies, they tie compensation expenses to financial results and enhance the competitiveness of your compensation program, among other benefits.

With the passage of the 2017 Tax Act, more scrutiny continues to be applied to not-for-profit organization compensation. This follows recent actions from various state and federal agencies upping the ante on not-for-profit compensation. As such, we believe there will be more pressure for not-for-profit organizations to prove pay for performance.

Not-for-profits have generally not utilized incentive plans like their for-profit counterparts. Some of the reasons for this are:

1. They don't want to compromise their "mission"
2. Their not-for-profit peers don't generally provide incentive plans
3. They didn't start with an incentive plan, and those compensation cultures continue status quo
4. It can require additional resources to track and administer the plan

However, there has been a steady increase in the adoption of incentive plans that suggests not-for-profit organizations are thinking outside the box to drive performance by attracting, motivating and retaining key talent through said plans.

Why Utilize an Incentive Plan in a Not-for-Profit?

Whether not-for-profit incentive plans continue to trend up because of government agency pressures, legislative pressures, market trends, or other ancillary reasons, there are several key factors why companies, including not-for-profits, should utilize incentive plans as explained below:

- Incentive plans are correlated to better-performing companies. Analyzed another way, a study of incentive plan practices in for-profit companies indicates the lack thereof produces bottom quartile performance.
- Incentive plans tie compensation expenses to financial results.
- Incentive plans enhance the competitiveness of your compensation program without increasing fixed costs.
- Incentive plans can focus employees on the goals of the company, and drive behavior and performance towards those goals.
- Incentive plans are proven to attract star performers.

What are Not-for-Profit Incentive Plan Guidelines?

The following provides some not-for-profit incentive plan best practices to consider:

- **Incentives should be tied to organization-related metrics.** What is measured can include financial and fundraising goals, but this is tricky. Organizations should include some measures that are preconditions for success rather than measures of success already achieved. In short, tie to key annual strategic goals that support the mission and annual targets of the organization, but make sure these goals are clearly defined, understood, and measurable.

- **Incentive targets should be market competitive.** While for-profit organizations set much larger incentive targets, not-for-profit incentive targets for senior management are typically in the range of 20-40% of base salary, but size and industry play an important role in this.
- **Discretion is as important as formula.** Do not rely on a fully formulaic approach. Measuring an organization's effectiveness over a year is always difficult, especially in the non-profit world. Incentive goals should be a combination of goals that can be measured by clear metrics, as well as subjective goals which are equally important. Set three to five goals that will be used to fund the bonus pool (the amount that will be paid in relation to total target bonuses). These goals should relate to the strategic plan, represent significant accomplishments, and include both operational and organization-based goals. In short, a good board member knows what was positive performance at the end of the year better than a spreadsheet would at the beginning of the year.
- **Participation.** While incentive plans are reported to be the most effective when designed for the senior management group, or specific groups of employees, we believe the concept of "one team, one dream" should permeate to incentive plans going down the organization.
- **Pay annually or semi-annually.** Short-term incentives continue to be the most prevalent among nonprofits, with formal annual incentive plans and spot awards being the most common. Other types of short-term incentives include discretionary bonus plans and profit-sharing plans. Long-term incentive plans are less common and are usually reserved for top management executives.
- **Total compensation – including amounts paid under the bonus plan, plus all other forms of compensation – should be reasonable.** The IRS wants to see compensation in line with what would ordinarily be paid for similar services by a similar enterprise under similar circumstances. By the way, this doesn't mean just not-for-profit organizations.
- **An incentive plan should be established and implemented with an independent board of directors or Compensation Committee members.** This helps with regulators and is generally a good practice to ensure independence when establishing goals and metrics.

Conclusion

Whether legislative changes or market best practices drive the adoption of a new incentive plan in your not-for-profit organization, NFPCC is here to help. Our not-for-profit compensation consultants have designed hundreds of short and long-term incentive plans in small (local), medium (regional), and large (national) organizations. NFPCC has traversed the regulatory environment to ensure a well-developed plan preserves the organization's tax status and intermediate sanction avoidance. If you are looking to help take your not-for-profit to the next tier, or just want an added measure of insurance for not-for-profit regulators, incentive plans could be your next best step and NFPCC is ready to assist you.