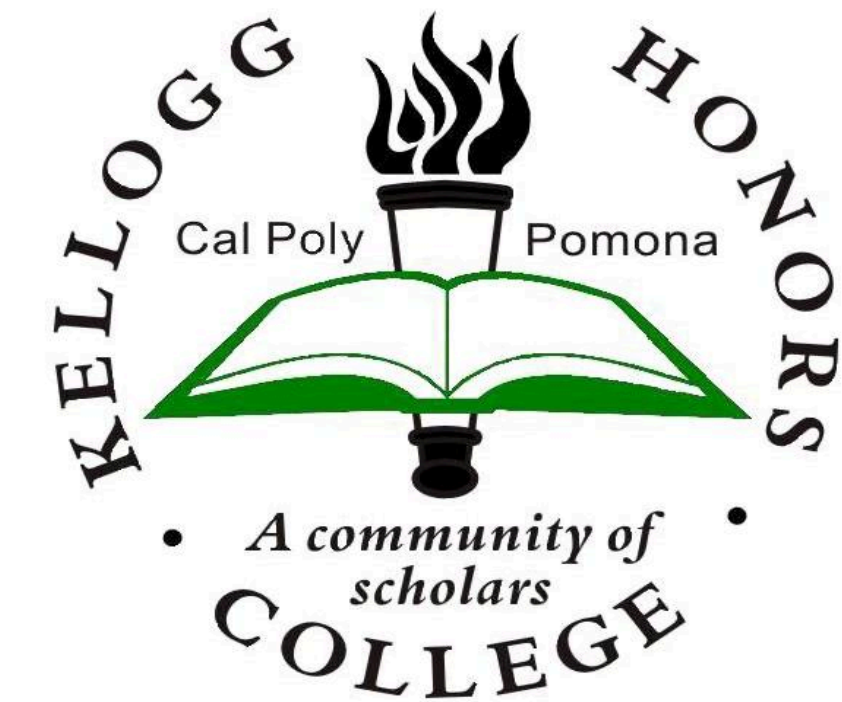


Impact of Nonprofit CEO Compensation on Organization Effectiveness



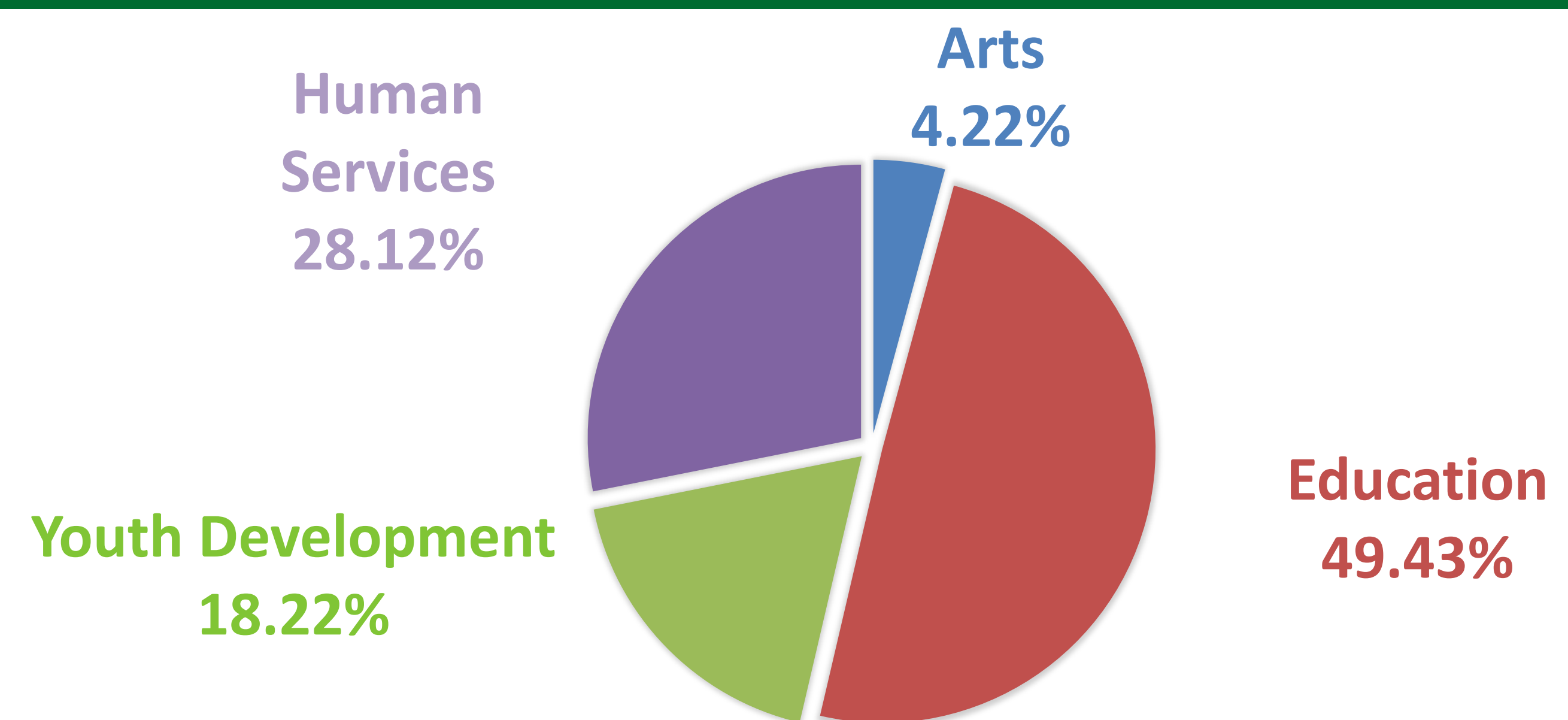
Brendan Lam, Accounting
Mentor: Dr. Mary Im
Kellogg Honors College Capstone Project



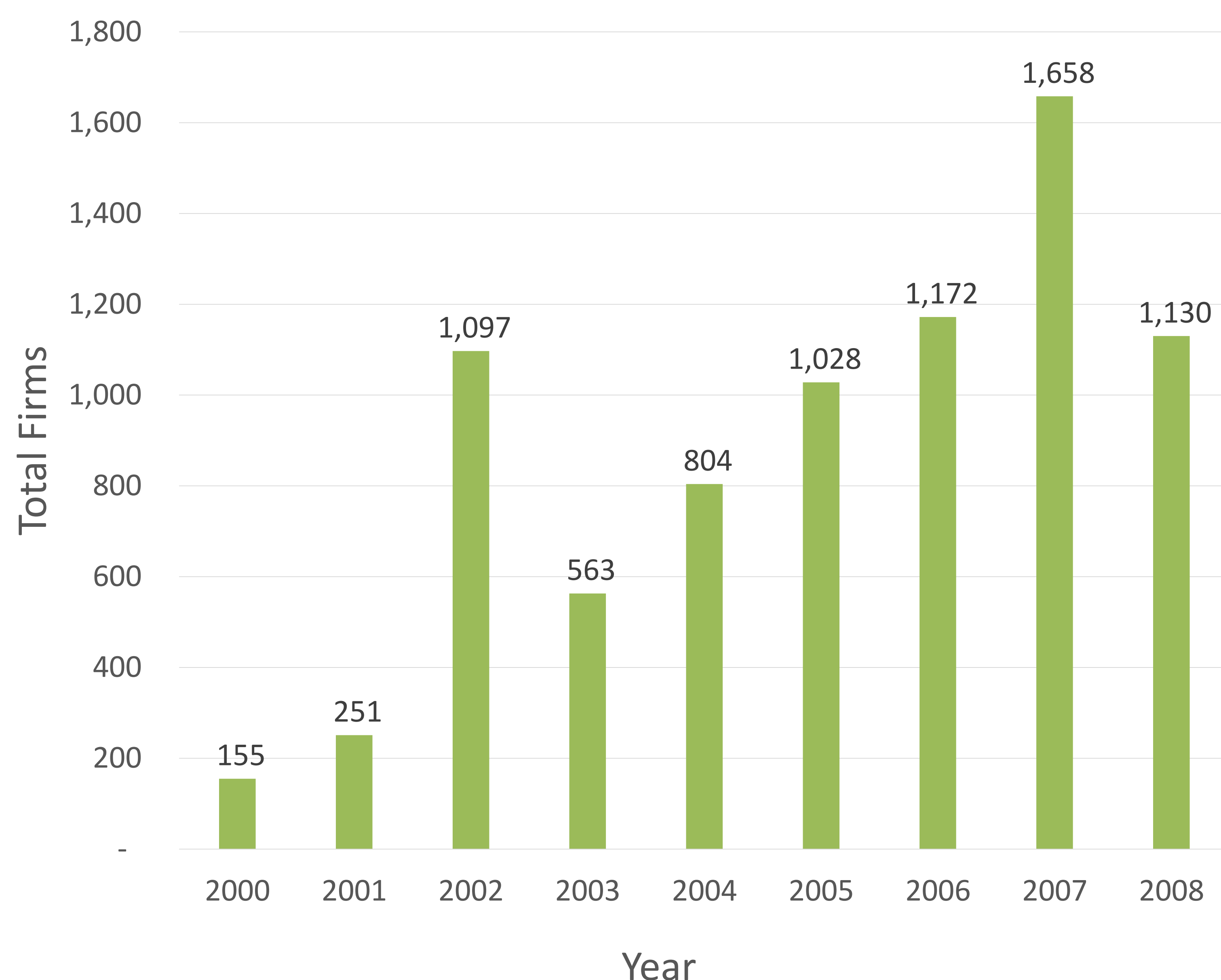
Abstract

In this study we examine whether nonprofit CEO compensation has a direct impact on the efficiency ratio of their organizations. Using the financial data samples of 3,555 observations taken from the years 2000 to 2008, we find that there exists a negative association between CEO compensation and the organization's efficiency; efficiency, in this case, can be examined through their program expense ratio. Past research has indicated that employees of the not-for-profit sector are those who are motivated by intrinsic rewards rather than extrinsic. Based on this description, in theory, the effectiveness of the CEO, and their organizations accordingly, should not be impacted by the amount the CEO is compensated. However, further research into this topic continues to reveal the opposite. By controlling several variables that may also affect the efficiency ratio, such as organization size, our findings show that efficiency is indeed negatively affected by higher CEO compensation.

Nonprofit Sectors Included



Aggregate Count of Nonprofit Firms



Sample Statistics (\$ in thousands)

Stats	Efficiency Ratio	CEO Compensation	Total Revenues	Total Contributions
MIN	0.108	\$55.70	\$1,747.18	\$0.00
MEAN	83.151	\$717.91	\$123,000.00	\$27,600.00
MAX	100	\$4,528.70	\$1,980,000.00	\$520,000.00

Variable	Expected Sign	Coefficient	p-value
CEO Compensation	0	-2.929	<0.01
Size (Total Revenue)	+	2.880	<0.01
Total Contribution	+	0	Not significant
Low Audit Risk	+	1.191	<0.01
Federal Expenditures	+	0.390	<0.04

$$\text{Efficiency} = 55.191 - 2.929 * \ln(\text{CEOcomp}) + 2.880 * \ln(\text{Size}) + 1.191 * \text{LowAuditRisk} + 0.390 * \ln(\text{FederalExp})$$

Model & Equations

$$\text{Efficiency} = \beta_0 + \beta_1 * \text{CEOcomp} + \beta_2 * \text{Size} + \beta_3 * \text{TotalContribution} + \beta_4 * \text{LowAuditRisk} + \beta_5 * \text{FederalExp} + \beta_6 * \text{Industry} + \beta_7 * \text{State}$$

$$\text{Efficiency Ratio} = \frac{\text{Program Expense}}{\text{Total Expenses}} * 100$$

Results

The nonprofit sector is often characterized by altruism leading to the belief that extrinsic rewards, such as compensation, does not influence the effectiveness of a nonprofit employee. However, our results reveal a negative correlation between a nonprofit CEO's compensation with their organization's effectiveness. With all other variables constant, the relationship can be depicted as for every 1% change in a CEO's compensation, there is a -0.029 change in efficiency. This numerical conclusion can be interpreted in different ways. Our conclusion realizes the need for the CEO to focus their efforts and resources less on administrative and funding functions and more toward the organization's mission.