NONPROFIT EXECUTIVE SALARIES

San Francisco Human Services Network
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The San Francisco Human Services Network has the following concerns with Supervisor McGoldrick's proposed legislation that would limit city expenditures for nonprofit Executive Director salaries and benefits to six times the level of the lowest paid employee.

(1) The legislation's method of comparing Executive Director compensation with entry-level workers is problematic:

*** A one-size-fits-all model is not appropriate.** The legislation sets an arbitrary level for reimbursement of executive compensation and creates an unrealistic measure of an Executive Director's value to the organization. For example, it does not account for the differences in responsibilities between large and small nonprofits. A reasonable salary review must consider many factors, such as the organization's budget size, the amount of fundraising required, and the funding mix of government and private funds; the number and complexity of programs, staff and clients; and the Executive Director's performance, years of service, and prior experience. While the Controller's report identifies a few agencies with above-average executive salaries, it omits any analysis of the reasoning behind those salaries or the amount of the compensation that the city actually pays.

*** The legislation will not have any effect on nonprofit salaries, either at the high or the low end.** Should this legislation take effect, those nonprofits whose executive compensation exceeds the ratio are unlikely to reduce executive compensation. Boards of Directors set salaries that they deem to be reasonable and necessary, and most organizations fund all or part of that salary with non-City funds. The real issue is the need to increase the salaries of the lowest-paid employees, which have been suppressed by years of inadequate cost-of-doing-business increases in nonprofit contracts and lack of city funding for an increase to nonprofit workers under the Minimum Compensation Ordinance.

*** The notion of an egalitarian six-to-one ratio is unfair and has not worked in practice.** Social justice advocates promulgated the concept of caps on executive/worker ratios several decades ago, and Ben and Jerry's became the most visible employer to adopt the concept with a five-to-one ratio. However, that model did not include executive compensation through stock options, and the company discarded the model after Ben and Jerry left the company in 1994 when they were unable to attract a qualified executive. Today, a few socially responsible companies have adopted similar concepts, but they typically link executive pay to that of the average worker rather than the lowest paid, and use much higher ratios. However, the range of nonprofit organizations in San Francisco is too diverse to be governed by a uniform rule. Nor does the city apply such a ratio to its own workers, or to its for-profit contractors.

*** Including benefits in the ratio unfairly distorts the comparison between executive and entry level workers.** Benefits, including payroll taxes, are typically about 20% of salary. Therefore, applying a 6-1 ratio on total compensation would require a 5-1 salary ratio. This would lead to a maximum salary of about $122,000 if a nonprofit has even one minimum wage employee, regardless of the circumstances of that agency, executive or employee. The comparison is distorted further by the likely age difference between executive and entry-level workers. Monthly health insurance premiums for younger workers are at the low end of the scale, while the Executive Director's premiums may be double or triple the cost for the same insurance benefits.

(2) The Controller's report finds that most nonprofit executives receive salaries that are well within the range for average California nonprofits: HSN disputes the assertion that many nonprofit executives receive extravagant pay at the expense of city taxpayers.

In general, nonprofit executive salaries are reasonable for the level of responsibility entailed in working with vulnerable people and sensitive issues, with tight budgets and high pressure to raise funds while maintaining unwavering attention to the organization's charitable mission. Nonprofits constantly struggle with economic uncertainty, increased demands for services, high expectations of accountability and excellent service, low retention rates for underpaid management and staff, and impending budget cuts.

Given these challenges and San Francisco's high cost of living, an artificial salary cap would impair recruitment and retention of qualified leadership. Nonprofits must provide a competitive salary to attract and retain executives who have the necessary years of experience and exceptional skills, and are willing to forgo the significantly higher pay and richer benefit packages (including pensions) available in the private sector.

Furthermore, the city already pays only a portion of those salaries, as government expects nonprofits to supplement city funds from donations and other sources. A Human Services Network study found that nonprofits raise $1.50 for every dollar they receive in city funding.

(3) State law already requires nonprofit boards of directors to ensure the reasonableness of executive compensation: A nonprofit's board of directors is charged with the fiduciary duty to review Executive Director performance and set the appropriate salary. The Nonprofit Integrity Act, enacted by the State in 2004, already requires that boards must review the compensation package (including all benefits) of the Executive Director to assure it is just and reasonable. This review and approval must occur upon hiring, when the executive's term is renewed or extended, and whenever the compensation is modified.

(4) The real issue is how efficiently the nonprofit uses its city funding, as measured by its successful achievement of outcomes and the organization's indirect rate: Contracts include the Executive Director's salary through two mechanisms. In some contracts, the Executive Director bills part of their time directly to the contract as part of the services performed and in furtherance of the contract's outcomes. In this case, the direct costs reflect the agency's actual cost of compensation for that time.

For many nonprofits, the Executive Director's salary is a component of the nonprofit's indirect costs, expenses that benefit all of the organization's programs. A low indirect rate indicates that the nonprofit is using its funds effectively to provide direct services. Costs are allocated to particular programs based on a best estimate of the actual benefit to that program from those services, as supported through objective criteria such as time studies. However, nonprofits contract with departments at a negotiated indirect rate, and departments already impose percentage caps on that rate. Thus, the city often underpays for the full executive salary.