

Not-for-Profit Board Governance: Best Practices for CEO Review

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One of the many benefits of serving on the board of directors (board) of a not-for-profit organization is the opportunity to have an impact on the mission and direction of the overall organization. The nature of the board role is often transitory with many members serving only one or two terms. While changes in board membership bring new perspectives and ideas to the organization, they can also create significant challenges for the CEO as he or she tries to determine what is expected under constantly changing board leadership.

Many not-for-profit and for-profit organizations struggle with establishing a process for conducting the CEO's evaluation and determining appropriate rewards. With greater scrutiny by legislators, donors and the community at large, board members are carefully re-examining their responsibilities, including the process by which they evaluate the performance and compensation of the organization's CEO. Outlined below are key considerations and suggested steps for boards to follow.

Defining performance criteria

As simple as it seems, many boards fail to define the criteria by which CEO performance will be evaluated. Performance criteria, for the CEO or employees at any level, can be examined and evaluated within all or some of the following categories: day-to-day results, behavioral competencies and/or objectives.

Day-to-day results

Day-to-day results are the assigned job responsibilities or accountabilities that should be documented in the CEO's job description. The description should not represent a list of tasks and duties but major accountabilities that must be fulfilled in the CEO role. A job description must also comply with the Americans with Disabilities Act (ADA) requirements.

Behavioral competencies

Behavioral competencies are the "hows" of a job. This gives the board an opportunity to hold the CEO accountable for demonstrating the core values which support the mission of the organization. Behavioral competencies may include such areas as leadership, ethics, communication and relationships with the board. In order to help the CEO maintain focus, there should be no more than four or five competencies expected. They should include the behaviors that are most critical to achieving the results set forth by the board, as well as those that reflect the organization's desired values and culture. Competencies need to be clearly defined, not just listed on a form. For example:

- Acts as a role model for employees by demonstrating integrity and character in words and actions
- Empowers employees to resolve issues and problems and supports their decisions.

- Provides consistent and timely direction, and honest and constructive feedback to staff when needed
- Involves the right people in the decision-making process to get the best solution and build sufficient commitment

Objectives

Objectives can be developmental or strategic. Developmental objectives involve the acquisition or honing of knowledge, skills and abilities to enhance the CEO's job performance. Strategic objectives involve outcomes or results which are related to, but over and above, the CEO's day-to-day job. Typically, strategic objectives are focused on improving or maintaining the long-term viability of the organization.

Alignment with reward systems

Selecting criteria to evaluate CEO performance is only one step in the process. The board must also consider various reward systems and determine which performance criteria will be linked to which type of reward. For example, a competitive level of base pay may be provided in exchange for executing day-to-day responsibilities and demonstrating desired behavioral competencies. If additional compensation is provided in the form of an incentive or bonus, then this may be tied to the achievement of key strategic objectives. Without this type of clarity, the CEO and the board may be unclear about which results are linked to which reward system, and the board runs the risk of "double dipping." In other words, the board may be providing additional compensation for the same results that are already rewarded through some other reward system.

Review process

The CEO review process consists of three key steps: the performance review the salary review, and the determination of an incentive or bonus award (if applicable). Board size will typically determine who has responsibility for executing the CEO review process. A compensation committee is often formed when the board is large. Alternatively, the board chair or finance committee chair may be given this responsibility.

Performance review

The board should determine which individuals will provide input to the CEO's performance review. A 360-degree evaluation process provides a broad view of the CEO's performance when input is gathered from all board members and direct reports of the CEO. Some organizations include feedback from the CEO's indirect reports as well.

The form used to collect the feedback should be a reflection of the performance criteria selected (as described earlier). Today's technology provides access to Web-based instruments which can be easily customized to incorporate the selected criteria. Board

members can rate the CEO against the desired criteria but key executives tend to find the supporting comments as a particularly helpful part of the process.

The board should determine who will be responsible for compiling and analyzing the evaluation results. Many organizations use an outside consultant so that individual confidentiality is maintained and only aggregate results are reported.

Salary review

Determining a competitive level of compensation is an important part of the process, whether or not the results of the CEO's performance review impacts a salary increase decision by the board. A market study of comparable organizations should be conducted at least bi-annually to ensure the CEO's total cash compensation level remains competitive.

The definition of "comparable organizations" will vary depending upon the board's definition of the competitive market. In some cases the competitive market may be limited to other not-for-profit organizations of comparable size. In others, for-profit companies may also need to be considered. The board should consider the industry or industries where qualified replacement candidates would be found if recruiting for the position, as well as industries that may attempt to recruit their CEO. This will provide the best information for making a competitive market comparison.

Reputable salary survey sources should be used to gather market data. Internet sources are not recommended as they typically do not employ the rigorous quality control steps used by published sources. Salary surveys can be purchased or an outside consultant can be retained to conduct the market data research and analysis.

Incentive or bonus awards

Some not-for-profit organizations are opposed to bonuses or incentives because they believe it contrary to the mission of the organization. According to the *2009 Watson Wyatt Top Management Survey*, 37 percent of not-for-profits provide some form of variable pay to their top executives. If the incentive or bonus is intended to reward the CEO for organizational success, then it is imperative that the board establish and clearly communicate the results that must be achieved in order to earn additional compensation. It must be clear that these results are distinct from (or over and above) base pay expectations.

There should be a written document that outlines the provisions of the bonus or incentive plan. In addition to defining the performance criteria on which the award will be based, the document should address key issues such as termination and/or retirement, payout examples, and language specifying that the bonus or incentive plan is not part of a contract of employment.

Determining the appropriate bonus or incentive award becomes a streamlined and efficient process if all parties involved understand the expectations associated with base versus "extra" pay.

Process timeline

Boards will find it helpful to establish a performance and salary review timeline that can be followed each year. Every step in the process should be identified along with target dates for completion and responsibility assignments. This provides a common framework for board members as well as the CEO, and reduces the anxiety that board members and CEOs often experience around the entire process.

Governance responsibility

Government oversight (in the form of 990 reporting) and public scrutiny has resulted in greater responsibility to boards of directors of not-for-profit organizations. Establishing criteria and a consistent process by which the board will evaluate and reward the CEO will create better alignment between board directives and the CEO's efforts.

Additionally, a consistent process reduces risk to the organization and board members, eliminates the possibility of "double dipping" with the organization's reward system, and ensures consistency in process — regardless of who serves on the board.

About the author

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