talent exchange

CEO pay in the voluntary sector
How much is enough?

January 2019

The pay of chief executives (CEOs) in the voluntary sector is a matter of regular public scrutiny, and often reported when it is considered ‘too high’. But how much is enough? Whilst there is guidance on the process for determining CEO pay, there is limited guidance on the value that should attributed to a particular job. This paper seeks to address a few of the questions facing trustees when determining CEO pay. In particular:

- How are CEOs in the voluntary sector paid relative to other sectors?
- How are CEOs paid relative to the workforce they lead?
- What factors seem to determine why one CEO in the sector may be paid higher than another?

Whilst this paper considers the rationale for pay from the perspective of the job it is not concerned with the personal factors that determine pay levels (e.g. qualifications, competence or performance), nor the process for determining CEO pay, nor the principle of transparency nor questions about the structure of the total package.

This analysis relies heavily on a variety of market data sources for salaries in the private, public and voluntary sectors. It analyses the progression of pay in these sectors, the comparisons of levels of pay between these sectors and, importantly, the contextual factors that determine levels of pay within the voluntary sector.

Context

The setting of CEO rewards is an important trustee responsibility. A CEO’s package needs to be sufficiently attractive to ensure that the right candidates are attracted to the role and motivated to perform, but not be excessive so as to appeal to the wrong people/motivations, reduce the funds for beneficiaries, nor attract adverse public attention.

All the major sectors are ‘guided’ to the appropriate outcome without dictating the formula for determining the quantums given to the package elements.

In the ***private sector*** various sources of guidance are available, largely in the context of shareholder interest in the executive remuneration of publicly listed organisations. These are contained in The Financial Reporting Council (FRC) UK Corporate Governance Code (2016), The Institute of Chartered Secretaries and Administrators (ICSA) terms of reference for the remuneration committee (2013), as well as The Association of British Insurers (2013) and the Investment Association (2015) principles of remuneration, which mirror each other. Collectively these offer similar guidance on the level and components of director remuneration, including:

- The need to align the reward framework with the interests of the investors, emphasising sustainable performance in an efficient, simple and cost-efficient manner,
- A preference for a mix of fixed and variable rewards. Variable rewards should recognise performance in relation to different time horizons and appropriate performance measures,
- Remuneration levels should be sufficiently attractive to attract talented individuals, recognising the role and responsibilities, and be affordable in accordance with the aims of the organisation,
- The remuneration committee should benchmark these rewards to comparable organisations but be wary of the ratchet effect that results from paying over market median,
- Penalties for failure. A recommendation for mechanisms that allow for retrospectively adjusting bonus awards ('malus'), or recover previously paid sums ('clawback') should long-term performance targets be missed.

Despite these measures the High Pay Commission (2016) held that executive pay is out of control, recommending the publication of pay ratios, increased employee representation on remuneration committees and the establishment of a mandatory shareholder vote.

In the ***public sector*** decisions are informed by guidance from HM Treasury (2018). This recognises the value contributed by leaders in the sector but identifies controls over the determination of pay for anyone paid more than the prime minister (over £150,000) or who might have a bonus opportunity over £17,500. The guidance is heavy on process but light on direction. It acknowledges that the pay for staff at these levels should consider the influence and impact of the role (including the size of the organisation, the criticality of the role, the need for income generation or exposure to risk), the skills and experience required where the role needs high calibre candidates, labour market considerations (especially where there is a limited pool and a market premium applies) and the package of the previous incumbent. The guidance also suggests that pay should be set with reference to the principles of value for money, the ability to recruit, retain and motivate the best people and ensure fairness between grades and across the public sector.

In the ***voluntary sector*** the matter gained prominence in 2013 when various CEOs were identified in the media as being overpaid. This led to the NCVO (2014) setting up an inquiry to explore the arguments regarding appropriate levels of pay for senior executives in the sector, consider the relationship between executive pay and public trust, and produce clear guidelines for trustees on salary setting. The report of the inquiry holds/recommends:

- Charities undertake a range of activities and are organised differently. Ultimately they exist for the public benefit, and should recognise the interests of all stakeholders,
- Only 9% of charities employ staff. Charities, like other sectors, need to attract specialist skills (including leadership skills), and this may be best achieved by employing paid professionals rather than volunteers, and this may come at a price,
- Charities should maintain a pay policy that enables them to attract and retain the appropriate calibre of leader (and other employees), consistent with the charity’s purpose and services, particularly the volunteer ethos, and intangible benefits of working for a charity – including the ability to make a positive social impact. As a result pay should be at a discount to similar roles in most others sectors,
- Charities should consider the business plan, the skills required to achieve it and their ability to pay (now and in the future). Leadership pay should reflect the performance expectations and outcomes (in the short and long-term),
- Consideration should be given by the trustees to the views of beneficiaries, donors, funders, employees and volunteers,
- Leadership pay should be coherent with pay for other staff , and that charities might measure this through ‘ratios’, such as the ratio between CEO and median organisation pay.

And there is evidence that these recommendations should result in greater trust from the relevant stakeholders. Trust in charities correlates with views on leadership pay (Gaskin, 1999). There is evidence that the top public concern is that executive salaries are too high (42% of those polled, rising to 49% of those who have become increasingly sceptic about charities overall) (Wixley and Noble, 2014). And it would appear that attitudes to high pay correlate with trust in the charity to a) make independent decisions for the cause they support,

b) ensure a reasonable proportion of donations makes it to the end cause, c) fundraisers are honest and ethical, and d) be well managed (IPSOS MORI, 2012).

Evidence from the Charity Commission (in NCVO, 2014) suggests that only 1.2% of people employed in the sector earn over £60,000 (and 0.2% earn over £100,000), and that two thirds of these high earners are employed in charities with annual income in excess of £10 million. Their evidence also suggests that those people in the sector earning more than £60,000 are more likely to be employed in certain sub-sectors than others (see chart 1) suggesting that there are dynamics other than size that might affect earnings levels.

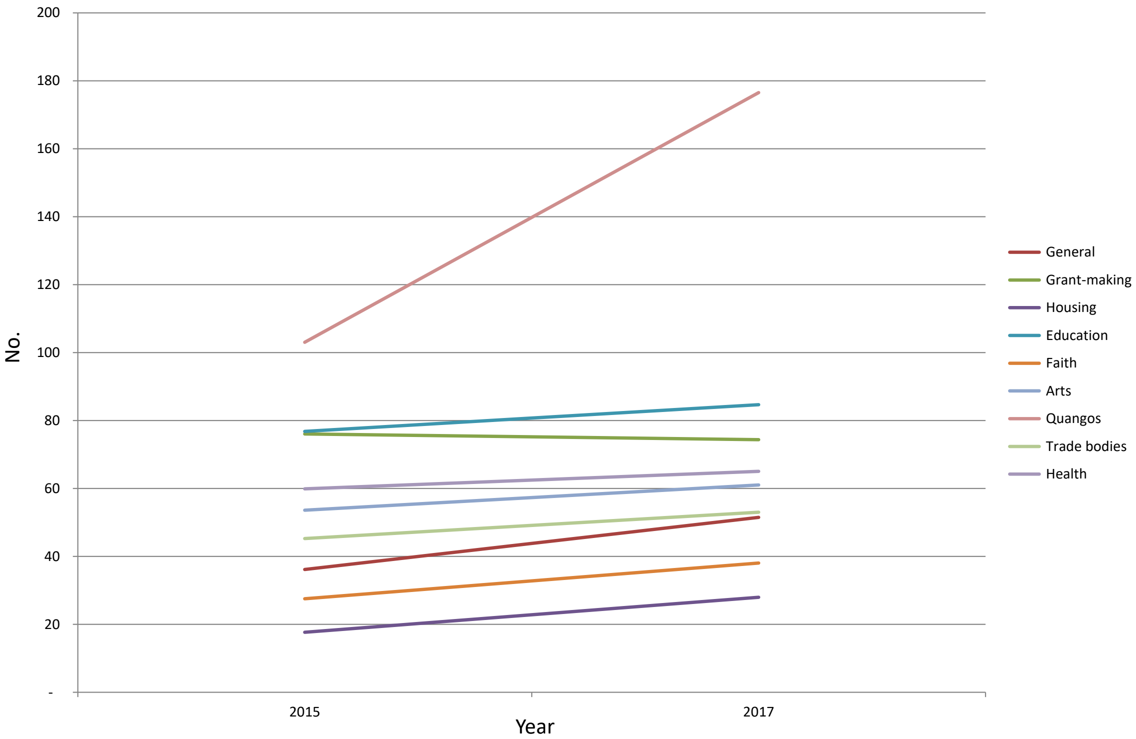

Chart 1 – The average number of people earning over £60,000 by sub-sector in the sector's largest organisations (and the change over time)

The nature of the charity also appears to impact the extent of the differential in pay (the 'charity discount'). This is greatest in general charities or those with a volunteering ethos and those funded through public donations according to Charity Commission data (see chart 2).

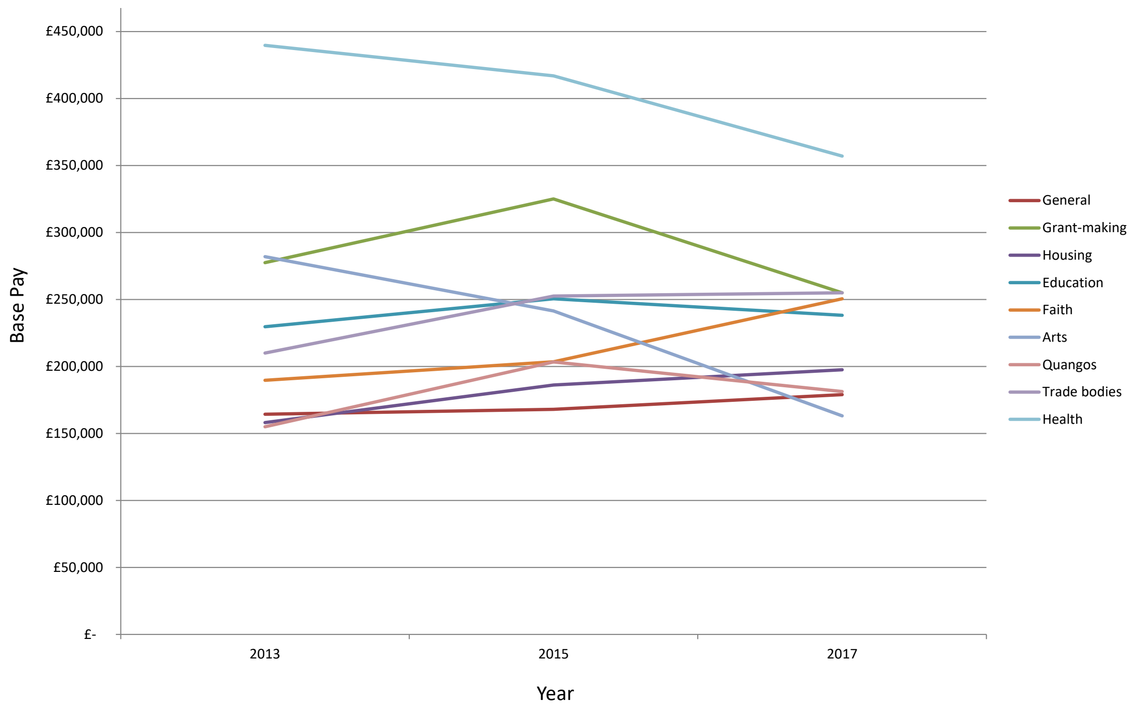

Chart 2 – The average CEO pay by sub-sector in sector's largest organisations (and the change over time)

Of course it's more than just pay. The constitution of the rewards offered to CEOs/leaders will vary by sector, for a number of reasons. The nature of the proposition is a product of the 'identity' of the organisation (Mercer, unpublished, see appendix 1) and the reward programmes that are available to recognise the contribution of the job holder. For the purposes of this assignment the focus is pay and whether there are clear factors that determine the level of pay offered to CEOs.

Methodology

This is fundamentally a benchmarking review that attempts to look objectively at the factors that drive CEO pay. A summary of the methodology used to address each hypothesis is included in the appendix.

Hypothesis 1 – CEO pay in the voluntary sector is at a discount to other sectors

The following chart plots the nature of pay progression as job size increases, comparing some major sectors. The information is drawn from a variety of different data sources and calibrated using a common job evaluation methodology.

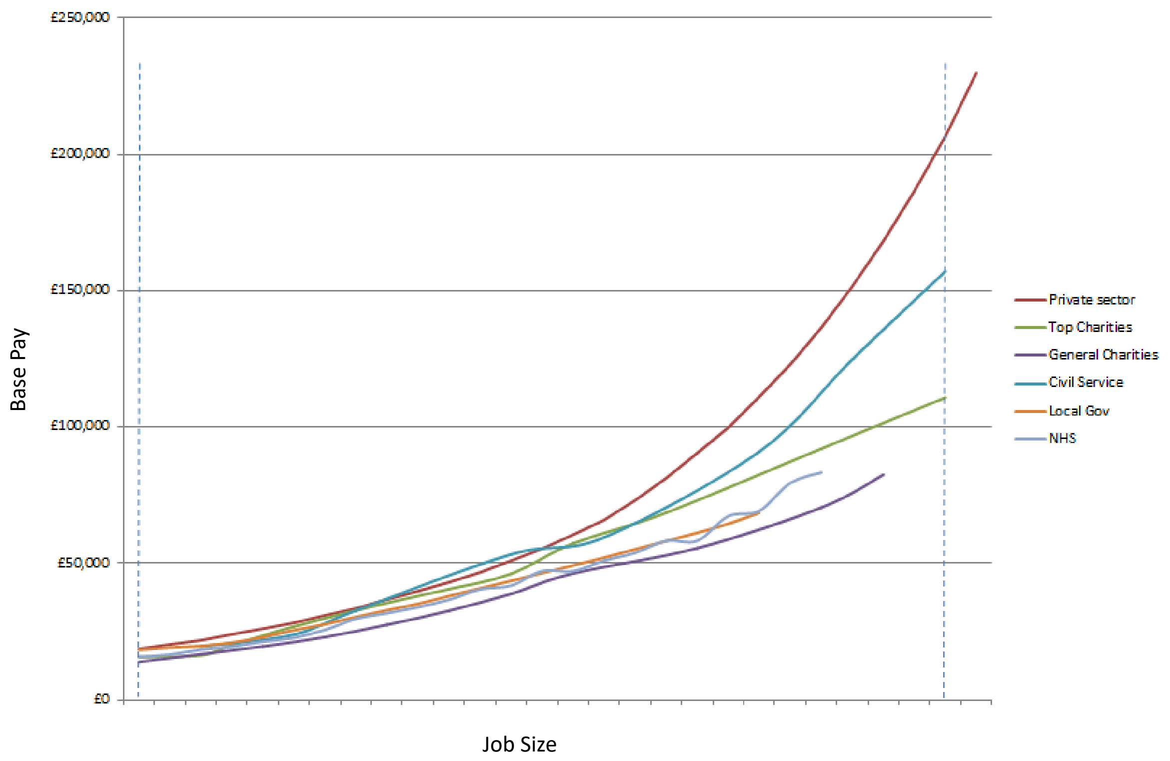

Chart 3 – Pay progression (as job size increases) by sector

The results are consistent with other studies that have found that there is a discount applied to charity employees and that this is at its greatest for senior positions (and almost immaterial when comparing the smallest jobs). At these levels a CEO might be paid half their counterpart in the private sector. Interestingly this research found that 'top' charities are more likely to offer steeper pay progression than general charities such that pay for similar roles will be higher in the larger charities. As a result pay in the larger charities may be at a premium to local government and the NHS but pay in the smaller charities will be at a discount. For instance a CEO in a top charity might be paid 10-15% more than an NHS or local government leader but a general charity CEO will be paid 5-10% less.

Hypothesis 2 – The ratio between CEO pay and low pay varies by sector

As a result of the different progression profiles (and similar entry level salaries) of the sectors it is fair to conclude that the ratios between CEO pay and low pay will also vary. Considering the positions indicated on chart 3 (the dotted lines) it is possible to determine the multipliers that apply in these sectors:

Sector	Multiplier
Private Sector	11.2
Civil Service	9.8
Top Charities	7.1
General Charities	6.5
NHS	6.4
Local Gov	5.2

These ratios might be helpful for organisations that are concerned more about internal relativities than they are by external competitiveness. Or might be helpful in conjunction with other benchmarking activities.

Hypothesis 3 – The size of the charity is an important determinant of CEO pay

The data above suggests that pay in larger charities will be higher than in smaller charities. The chart below aggregates data from three prominent sector salary surveys and plots average CEO pay by organisation income. The data points represent median market practice, although it is also possible to identify the interquartile range.

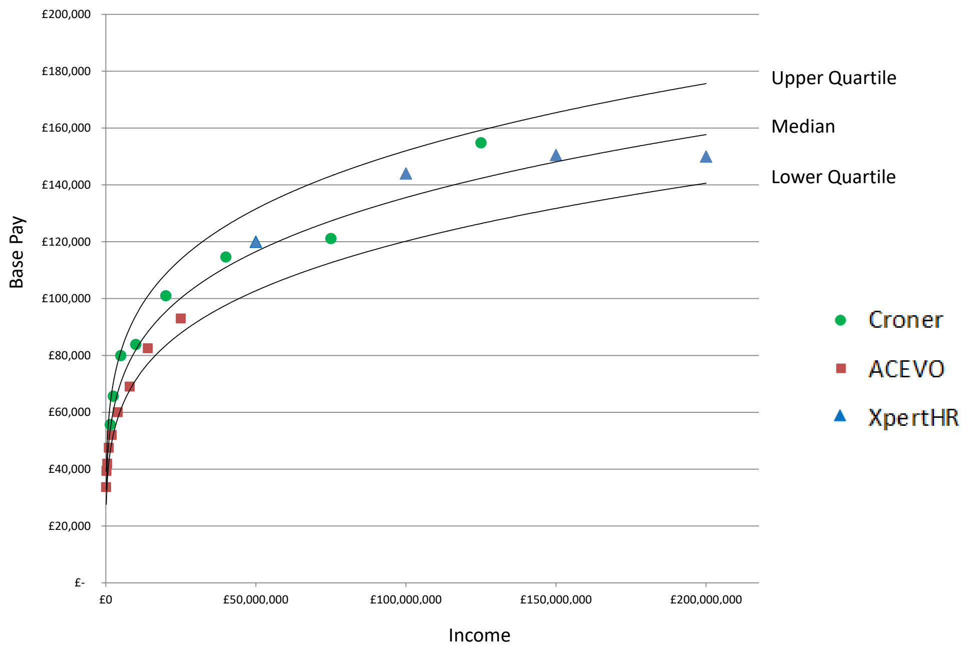

Chart 4 – CEO pay in voluntary sector organisations relative to organisation income

This analysis shows that there is a strong correlation between organisation size (by income level) and CEO pay. Base pay progresses quite steeply as organisation size increase then has a diminishing impact.

Hypothesis 4 – The nature of funding moderates CEO pay

The data above also suggests that there are other factors that moderate pay by +/- 15-20%. We know that median CEO pay does vary by sub-sector so this analysis looked at funding type as a potential moderating factor. In particular it considered the proportion of funding from voluntary sources (relative to overall funding) and the potential for this to moderate pay. This was based on the evidence (above) that charities who receive high levels of voluntary funding (either as donations, legacies or grants) are more likely to wish to see that funding reach the beneficiaries and/or are more likely to be aware of the reputational issues associated with high levels of leadership pay.

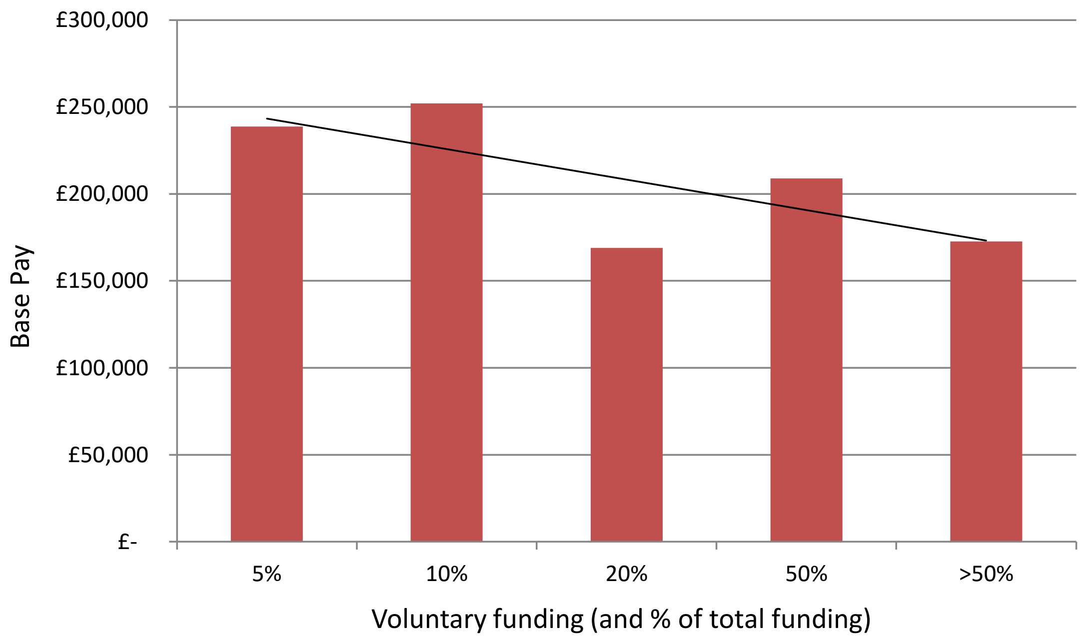

Chart 5 – Average CEO pay as a product of levels of voluntary funding

The evidence suggested that the proportion of voluntary funding did appear to correlate with leadership pay with those organisations receiving higher levels of such funding tending to pay their CEOs less than others.

A possible model for explaining CEO pay in the voluntary sector

It is proposed that these factors (size: measured by income, and identity: measured by the proportion of voluntary funding) can be used together to explain the levels of pay provided to CEOs in the voluntary sector. The following table considers market average pay then weights these values according to the factors determined from the funding analysis.

		Funding (voluntary as % of total)				
Income	**Average pay**	**<5%**	**5-10%**	**10-20%**	**20-50%**	**>50%**
£100,000	**£29,977**	£34,173	£31,476	£28,478	£25,780	£23,682
£200,000	**£34,876**	£39,759	£36,620	£33,132	£29,993	£27,552
£500,000	**£42,603**	£48,567	£44,733	£40,473	£36,638	£33,656
£1,000,000	**£49,566**	£56,505	£52,044	£47,088	£42,627	£39,157
£2,000,000	**£57,667**	£65,741	£60,550	£54,784	£49,594	£45,557
£5,000,000	**£70,443**	£80,305	£73,965	£66,921	£60,581	£55,650
£10,000,000	**£81,956**	£93,430	£86,054	£77,859	£70,483	£64,746
£20,000,000	**£95,352**	£108,701	£100,119	£90,584	£82,002	£75,328
£50,000,000	**£116,477**	£132,783	£122,300	£110,653	£100,170	£92,016
£100,000,000	**£135,514**	£154,486	£142,289	£128,738	£116,542	£107,056
£200,000,000	**£157,662**	£179,735	£165,546	£149,779	£135,590	£124,553
£500,000,000	**£192,592**	£219,555	£202,222	£182,962	£165,629	£152,148

Table 1 – Average CEO pay determined by organisation income and funding source

Whilst the principle of using ratios has mixed support as a basis monitoring CEO pay (Wells, 2014) this is largely as a result of the fact that these ratios are the product of other organisational dimensions and design, such as the extent to which low paid jobs are outsourced. However as an alternative to using internal measures this analysis also considers CEO pay with reference to an external measure of low pay – the Living Wage Foundation's recommended rate. The analysis below presents the multipliers that might explain CEO pay when the outside London rate (£8.75 per week or £16,835 per annum) is considered as the base unit.

	Funding (voluntary as % of total)				
Income	**<5%**	**5-10%**	**10-20%**	**20-50%**	**>50%**
£100,000	2.03	1.87	1.69	1.53	1.41
£200,000	2.36	2.18	1.97	1.78	1.64
£500,000	2.88	2.66	2.40	2.18	2.00
£1,000,000	3.36	3.09	2.80	2.53	2.33
£2,000,000	3.90	3.60	3.25	2.95	2.71
£5,000,000	4.77	4.39	3.98	3.60	3.31
£10,000,000	5.55	5.11	4.62	4.19	3.85
£20,000,000	6.46	5.95	5.38	4.87	4.47
£50,000,000	7.89	7.26	6.57	5.95	5.47
£100,000,000	9.18	8.45	7.65	6.92	6.36
£200,000,000	10.68	9.83	8.90	8.05	7.40
£500,000,000	13.04	12.01	10.87	9.84	9.04

Table 2 – CEO pay, determined by organisation income and funding source, as a multiplier of Living Wage Foundation rates

Conclusions

UK charities are often criticised by the press for overpaying their CEOs. And the level of CEO pay does appear to influence donor decisions. Whilst there is guidance in all sectors on the process of setting leadership pay there is limited advice on how much is enough. This paper considers various existing data sources and seeks to evaluate whether there is a basis for explaining what is reasonable. Specifically it identifies that:

- CEO pay is typically at a discount to other sectors. This is certainly true when compared to the private sector. However, larger 'top' charities tend to pay more (than other charities) and the evidence suggests that these charities pay well when compared to various public sector peer groups, such as local government or the NHS. Smaller 'general' charities tend to pay less than all other sectors.
- The discount for the 'warm glow' diminishes down the organisation and has largely gone when comparing entry level roles. As a result there are also significant sector differences when comparing the ratios of CEO pay to entry level pay. In the voluntary

sector CEO pay would appear to be around 6.5-7 times entry level pay (as compared to 11 times in the private sector).

- Organisation size is an important determinant of CEO pay in the voluntary sector. Pay correlates highly with income level, initially having a big impact, then tapering.
- It is clear there are other moderating factors. The source of funding would appear to be an important ‘other’ factor, especially the proportion of funding that comes from voluntary donations. This may be because of the objectives of charities to maximise the impact on beneficiaries and/or may reflect the reputational impacts of over-paying senior staff.

Finally, a model is proposed to explain these influences and determine a value that might be given to a CEO’s pay. And, considering the interest in the use of ratios, a model is proposed that addresses some of the concerns about their relative nature, by considering CEO pay as a multiple of the living wage. Organisations might consider such an approach when reviewing CEO such they can feel confident that they are ‘paying enough’.

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Appendix 1 – Methodology

Chart 1

- Data is taken from accounts published on the Charity Commission website
- Data was aggregated and reported by Third Sector magazine and reflects the highest paying charities in each subsector

Chart 2

- Data source as above
- For the purposes of a richer data set the 2013 and 2015 charities not reported in 2017 were aged and included in the analysis

Chart 3

- Data was taken from a variety of sources, including salary surveys and public sources (largely for the public sector data)
- These surveys and sources report data with respect to their individual career frameworks. These frameworks were evaluated using Mercer's job evaluation methodology – IPE, to ensure that the data was comparable
- The ratios were based on a comparison between the smallest jobs and an executive position of a common size

Chart 4

- The analysis relies on three salary surveys (ACEVO, XpertHR and Croner). Each reports data by organisation size (income/revenue)
- Where ranges are used then the midpoint is typically taken as the reference value
- In the analysis the different sources have been identified

Chart 5

- The data used for chart 2 was supplemented with funding source data taken from the accounts registered for each charity in the Charity Commission website
- The scale for the funding axis was chosen because this resulted in an even distribution of charities across the axis (the majority of large charities have little voluntary funding)

Table 1

- The formula for the median line on chart 4 was used to determine average pay (column 2 of the table)
- The formula for the trend line on chart 5 was used to moderate this value based on the level of voluntary funding
- These factors mathematically determined the values in the table

Table 2

- This table relies on the values in table 2
- As stated these values were divided by the annualised value for the Living Wage Foundation's proposed rate for outside London (£8.75)
- The annual value assumed that the hourly rate would be paid for 37 hours per week and 52 weeks per year - £16,835

Appendix 2 – Mercer's 'identity' model

	Theme	Fundraising Charity	Public sector	Membership organisation	Social enterprise	Private sector/Commercial
Organisation	**Exist for**	Beneficiaries	The public	Members	Beneficiaries (and customers)	Shareholders (and customers)
	Funding	Donations, legacies (some government funding and commercial revenue)	Exclusively Government funding	Subscriptions	Government funding and commercial revenue (some donations)	Commercial revenue
	Competition	Not relevant	Not relevant	Less relevant	Other commercial enterprises	Other commercial enterprises
Talent	**Talent pool**	Other charities (some commercial peers for functional roles)	Mixed – but largely home-grown	Other membership bodies Membership Public sector Private sector	Mixed	Competitors
	Employee Value Proposition focus	Purpose (rewards as hygiene). Often talent frameworks are lacking	Purpose	Balanced (purpose, careers and rewards)	Balanced (purpose, careers and rewards)	Reward and careers
	Performance orientation	Collaborative	Collaborative	Collaborative	Collaborative whilst recognising individual contribution	Individual contribution, trending to behaviours (often collaboration)
	Reward approach	Lacks definition, often collective	Very structured	Structured	Reactive	Aim for individual, resist collective
	Segmentation	Would be divisive	Some	Rarely	Unlikely	In a targeted manner
	Leadership	Passionate (sometimes chaotic)	Institutionalised	Institutionalised	Strategic	Visionary/commercial
	Communication	Usually immature	Very mature	Reasonably mature	Mature	Becoming sophisticated/interactive
	Careers	Often unclear, built around the individual	Very structured	Not very structured	Becoming structured	Structured, invested
	Talent and reward programmes	Disconnected	Connected, integrated	Disconnected	Becoming connected	Starting to be integrated
	Talent acquisition	Predominantly build	Predominantly build	Predominantly build	Buy and build	Predominantly buy
Reward	**Reward quantum**	Modest	Moderate – valuable pension	Moderate	Moderate	Competitive
	Reward mix	Base (and some gain share)	Base and benefits	Base and benefits	Base and bonus	Base, bonus and LTI
	Differentiation	Low	Low	Low	Low-Medium	Medium-High
	Governance	Structure decides	Set by Government / LG	Limited flexibility	Discretionary within frameworks	Discretionary within frameworks
	Reward drivers **a) Pay** **b) Variable**	a) Competence (or service as a proxy) b) Group success	a) set centrally by grade b) if any, low level	a) set centrally by grade (some service-relate) b) if any, low level	a) Contribution (=individual performance + competence) b) Individual performance (=outcomes and behaviours)	a) Contribution (=individual performance + competence) b) Individual performance (=outcomes and behaviours)