

## Incentive Compensation in a Not-for-Profit Organization

**Q:** How could we develop and implement an incentive compensation plan for our not-for-profit organization? We aren't sure it even makes sense to do this, but are mulling whether it would be more effective than paying people only with salaries. Advice?

--- Clamoring for Insight, budget director, nonprofit, West Kingston, Rhode Island.

**A:** Just because you are a not-for-profit organization, don't make the assumption that an incentive program won't work. All not-for-profits, including charitable organizations, must operate as any other business in some very basic ways. Recruiting and retaining effective employees is a good example. This is a fundamental business need that will significantly affect decisions, such as whether to implement an incentive program.

Your organization should consider two parallel approaches in determining this need. First, assess the demands of the specific labor market in which you operate. A not-for-profit organization that recruits talent from, or loses talent to, for-profit companies will need to make sure that employees are paid competitively. Use the data from any labor-market or pay evaluation to analyze both base pay and total cash compensation for all positions. It does not necessarily mean that you have to provide incentive pay to employees (or even to all levels of employees), but you will need to make sure that your pay levels are within striking distance of total cash compensation in the labor market. Otherwise, you risk losing talented employees.

A second approach will consider your organization's mission, culture, business strategy and human resources strategy. For example, many not-for-profit organizations today use balanced scorecards to manage business success. Scorecards are an ideal device for supporting incentive programs, since they are predicated on achieving specific performance goals in four critical areas of business performance: customer service, financial, operational, and learning and development. If pay for performance is a part of that strategy, incentive pay may be a vital part of how your organization achieves business success. In any case, it is critical to ensure that an incentive program makes sense within the context of your organization's business strategy.

Once you decide to implement an incentive strategy, your work is only beginning. In terms of plan design, there are a large number of factors to consider, including performance measures, levels of participation/payout, alignment and weighting of various performance measures, measurement systems and others. Alternative designs should be examined and tested before implementing the full program. Employees should understand why the plan is necessary, how it works, and what they must do to succeed. These decisions are more easily made in light of a sound and well-defined business rationale that combines your findings from the two approaches outlined above.

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Originally published by Workforce Management on February, 2008. Workforce Management delivers the latest news, trends and tools for managing your workforce. Please go to [www.Workforce.com](http://www.Workforce.com) for information and subscriber access.