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## **Governance and managerial pay in charities: Evidence from the Netherlands**

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**Abstract:** We investigate the relationship between governance characteristics, managerial pay disclosure, and ‘excessive’ managerial pay in Dutch charities. ‘Good governance’ is argued to have several potential benefits, including increased managerial accountability (i.e., disclosure of managerial pay) as well as reduction of ‘excessive’ managerial pay. We investigate these claims empirically in a sample of charities in the Netherlands. Our results indicate that governance characteristics have an impact respectively on managerial pay disclosure and managerial compensation levels. First, we find that, after controlling for several organizational characteristics, charities with large boards are less likely to disclose information about managerial pay in their annual report. Second, we find that charities with more board meetings have lower managerial pay, controlling for other intervening variables. Our results provide insights in the complex patterns of governance arrangements in non-profit organizations.

**Keywords:** public sector; charities; governance; executive pay.

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# 1. Introduction

The importance of ‘good’ governance in charities has been recognized as a prerequisite for ensuring them to meet effective and efficient performance. Yet empirical evidence relating to governance in charities has been fragmentary and do not allow to formulate general conclusions (Hyndman & McDonnell, 2009). Recent calls for research claimed for further studies to improve understanding, evaluation and practice in the context of charity governance (Eldenburger, Hermalin, Weisbach, & Wosinska, 2004; Jegers, 2009). In terms of managerial and policy implications, particularly the issues surrounding remuneration mechanisms in charities remains open to debate as to how managers in this sector should be rewarded and which governance structures should be put in place to increase accountability towards the taxpayers, donors and beneficiaries (Steinberg, 2010).

In this paper, we investigate the relationship between governance characteristics, managerial pay disclosure, and ‘excessive’ managerial pay in Dutch charities. Building upon corporate governance literature, we explore whether a charity characterized by having adopted ‘good’ governance guidelines and other governance characteristics affect the likelihood of disclosing information about managerial pay and eventually affects managerial pay level. We draw mainly on agency theory to examine such relationships controlling for a charity’s past performance measured with three ratios (program expenditure, fundraising expenditure and administrative expenditure).

Our data is based on publicly available information and is hand-collected from the website of the Dutch accreditation program (CBF) and charities’ websites. Data is gathered over the years 2005 until 2008, with a sample of 521 observations from 139 different charities. Our results indicate that governance characteristics have an impact on managerial pay disclosure, as well as managerial compensation levels. We document that, after controlling for several organizational characteristics and past performance levels, charities with large boards are less likely to disclose managerial pay in their annual report. In addition, we find that charities with a higher frequency of board meetings have lower managerial pay, controlling for other confounding variables. We supplement our analysis with robustness checks.

The present study is most closely associated with Jobome (2006) in examining the interplay between various governance dimensions on the disclosure and levels of managerial pay in charities. In comparison to Jobome (2006), the contribution of our paper is threefold (cf. Baber, Daniel, & Roberts, 2002; Helmig, Jegers, Lapsley, & Panozzo, 2009; Hyndman & McDonnell, 2009). First, we examine an enlarged set of explanatory factors concerning governance characteristics that combine prior evidence from various literature streams (finance, accounting, economics and management of non-profit organizations). Second, our empirical analysis explores data collected across four consecutive years with the objective to tackle the issue of causality. Third, our study attempts to enhance comparative research on this theme by enlarging the scope of research and allowing insights on institutional contingencies outside the United States, where most of prior data has been collected.

The remainder of the paper is structured as follows. The next section presents the literature review and develops the hypotheses. Section 3 describes the sample and the methodology applied. Section 4 highlights the descriptive statistics, the univariate and multivariate analyses, and robustness checks. The concluding section summarizes the main findings, discusses the limitations of this study and advances ideas for further research.

## 2. Literature review and hypotheses

### 2.1 Background about the Dutch charity sector

The charitable sector in The Netherlands is on the rise, showing total fundraising revenue of approximately 775 million Euros in 2008 and enhanced requirements in terms of financial reporting quality, oversight committees, (improved) regulations, and transparency. Questionable compensation policies in a few charities recently attracted media attention (NRC, 2009, Volkskrant, 2009). For instance, the ‘Nederlandse Hartstichting’ received harsh criticism from donors regarding the high salary of their medical director (Volkskrant, 2005), while Plan Nederland experienced a huge comedown in the 1990s when the salary of the interim manager and the non-existing charity’s beneficiaries were discovered (Algemeen Dagblad, 2009).

Concerns regarding the accountability of charities forced the Dutch government to implement guidelines of ‘good’ governance for the sector. In 2005, the Commission Wijffels initiated by the VFI in 2004, presented a code (Code Wijffels), which advises charitable foundations in their governance arrangements. Members of VFI are obliged to either adhere to this code, or explain why it was not executed. This code provides instructions for showing responsibility regarding all actions taken by the organization. In their advice on good governance, the VFI recommends charities to segregate decision making tasks from supervising and monitoring. Four types of board models have been envisaged. The first three models do not use independent supervision. Model IV uses independent supervision by a separate oversight board.

Another advice presented by the VFI to establish ‘good’ governance mechanisms, relates to the level of manager compensation within charities (VFI, 2005b). In 2008, the maximum level of managerial pay was set on 149.283 Euros on a yearly basis including full time gross salary, holiday benefits, end-of-year benefits, thirteenth month payment, variable pays, and bonuses (VFI, 2007). This amount is aligned with the maximum pay stated in the collective agreement for the Dutch Government<sup>1</sup>. Based on four criteria, each charity can determine what level of managerial compensation is acceptable. These criteria comprise organizational size, complexity of the organization, organizational context, and type of governance structure. Organizational size is measured through fundraising revenues, expenditures on purpose, and number of employees. Complexity of the firm is a proxy for diversity of activities and fundraising revenue structure (reliance on institutions and/or donations). Organizational context is based on (in)dependence on an (international) parent organization and division of organizational tasks, namely policy determination and policy execution. The final criterion is governance structure, which is determined by the number and tasks of managers and the board chairman respectively.

The Code Wijffels has currently been incorporated in the CBF-Seal of approval (in this paper referred to as CBF accreditation). The CBF pursues the objective to monitor and improve trustworthy fundraising and reporting activities. In order to obtain the CBF accreditation, charities need to meet certain criteria in areas of governance, policy, fundraising, expenditures, communication and transparency. As for transparency, annual reporting is only statutory for large charities. However, for societal confidence it is important that all charities are transparent and that the donors can rely on reports that reflect fundraising and expensing activities correctly. Therefore, charitable foundations are required to follow the Guideline 650 for Fundraising Organizations (RJ, 2008; CBF, 2009). Further, the Transparency Prize, initiated by PricewaterhouseCoopers, is an initiative to enhance transparency under charities (PWC, 2008).

## 2.2 Prior research on governance in charities

Few studies have focused on governance in charities. In the Accounting literature the largest stream of research on charities examines transparency and quality of reporting of charities. Previous research has identified several issues which can significantly influence the quality of reporting in the charity sector, namely misreporting and transparency concerns. In examining charities in the United States, Krishnan *et al.* (2006) found that a significant amount of charities report zero fundraising expenses, even though these charities receive donations and undertake fundraising activities. Another study in the US also found similar managerial dysfunctional behavior. Managers use the joint costs allocated to program expenses to manage their program spending ratio (Jones and Roberts, 2006). An incentive for managers to misreport these expenses could be to obtain higher compensation and donations. Trussel (2003) was actually able to develop a model where he defined six financial indicators that could possibly signify an accounting manipulator, the latter being a charity with a higher than expected program-spending ratio. Due to these results, users of annual reports of charities should be cautious of potential manipulation of financial information.

A different stream of research focuses on the transparency of charities, referring to the public disclosure practices towards stakeholders. This type of research mainly results from the increased media attention of charities on issues such as excessive managerial salaries and organizational inefficiency. Charities need to be transparent on how they spend their funds as to restore public trust and confidence. In a recent research in the UK, Dhanani and Connolly (2009) found that charities have improved their communication with stakeholders through non-financial narrative information in their reports. However, they find a weakening in charitable accountability over time. In addition, they conclude that charities are more transparent in relation to fiduciary accountability (control and good governance) than managerial accountability (effectiveness in financial and non-financial terms/organizational success), the first being the main interest of this research.

Another stream of research examines governance characteristics and structure in non-profit organizations. For instance, Callen *et al.* (2003) examined the relationship between board composition and organizational efficiency in non-profits in the US. They found that the ratio of program expenses to total expenses is negatively related to higher donor representation on boards. In addition, they found different factors affect the administrative and fundraising ratio. When examining board committees, they found that the percentage of major donors on the finance committee was negatively related to the administrative expense ratio. Moreover, they found the fundraising ratio to be positively related with board size, but not with the proportion of major donors on the board. Andrés-Alonso *et al.* (2006) also focused on the relationship between board composition and performance in non-profits, but then in Spain. They found that the board size and number of meetings is negatively related, and the relative number of outsiders on the board is positively related to a non-profits allocative efficiency (program expense/total donations). However, these effects do not hold when focusing on technical efficiency (administrative efficiency). In addition, they also found that large institutional donors can positively affect an organization's performance.

A limited amount of paper explicitly investigated governance structure or mechanisms in charities, focusing in particular on managerial pay. Baber (2002) performed a research in the US in order to investigate the relation between fundraising and compensation, and the relation between program spending ratios and compensation. He found evidence that manager compensation schemes are positively

related to their program spending patterns. He also highlights the importance of subjective and nonfinancial performance measures in nonprofits where objectives are more qualitative. As mentioned, Krishnan *et al.* (2006) confirm that financial misreporting and manager compensation are associated. By testing compensation sensitivity and donor sensitivity to performance, they find that expense misreporting (under-report fundraising expenses and over-report program spending) is associated with managerial incentives to increase manager compensation and donations.

An important contribution to literature on governance within charities is made by Jobome (2006). He tackled the issue of intrinsic motivation, a supposed characteristic of managers in charities, being complemented by extrinsic rewards. His investigation concerned governance within charities in the UK addressing management compensation, generally relying on agency theory. His study played an important role in the design of the current framework. However, he was not able to confirm that charity managers are extrinsically motivated due to a negative pay-for-performance link, the fact that manager compensation consists of a significant fixed part, and insignificant relations between governance mechanisms and manager pay.

In this paper we draw upon Jobome (2006) and test empirically a series of hypotheses with twofold objectives. First, we examine the determinants of managerial pay disclosure, arguing that making information about managerial pay enhances the transparency of a charity organization. Second, our focus within the charities that disclose managerial pay is to explain which governance aspects are significantly associated with compensation levels. In the next section, we develop hypotheses accordingly.

### **2.3 Hypotheses on the determinants of managerial pay disclosure**

When considering organizational structure as a governance mechanism, the Dutch institutional environment is of main importance. Dutch organizations operate under a ‘two tier’ board model. This means the board of directors and supervisory board are legally separated. The board of directors is charged with daily management. The supervisory board supervises the board of directors from a distance, and controls the followed strategy. This model is in contrast to the ‘one-tier’ board model (the Anglo-Saxon model), which is common in the US and the UK, where management and the oversight board are integrated in one board. The supervisory board is then thus much more closely involved with the organization’s policy.

The most important distinction in functions from the Code Wijffels of 2005 that has to be made is between, daily execution, management, and supervision. Organizations in which all functions are separated can be viewed as more complex. Code Wijffels states that larger organizations *must*, and smaller organizations *can* have different bodies for the supervising and managing function. In this code a large organization is defined as an organization with either 15 fte or €2.5 million revenues per year. This distinction in functions is consistent with the two-tier model. Although previous studies in the profit-sector are somewhat contradicting, most empirical studies find that corporate performance is enhanced when the functions are separated (two-tier) (Dehaene *et al.*, 2005). It can be expected that the two separate bodies provide the best guarantee for independent and objective supervision by the supervisory board on management. In addition, when separating the control of decisions from the management of decisions, agency problems can be reduced to a minimum (Fama and Jensen, 1983). Model IV of Code Wijffels thus seems thus most desirable as here the three organizational functions are installed in different

bodies. This model makes sure that operations and monitoring activities are segregated. Having an independent subject supervising the actions and decisions made by the board of directors would hamper the incentive that boards in a board model could have by not disclosing manager compensation (for whatever reason). Therefore, we propose the following hypothesis:

H1: The likelihood of disclosing managerial pay information is lower for charities with a simple governance structure without independent oversight committee.

We refrain from hypothesizing additional governance determinants in absence of prior evidence. It can be nevertheless expected that the likelihood of disclosure is higher for charities with a smaller board size and lower board meeting frequencies. Our model specification will include these board characteristics and control for additional charities features (among others related to organizational performance).

## **2.4 Hypotheses on the determinants of managerial pay level**

For boards being independent and function as a supervising unit, the VFI require charities to implement the oversight board model (model IV). From a logical point of view, organizational structure and size would go hand in hand. So, a large organization, involving more risks, would have a more complex organizational structure than a small organization. However, referring to the different models that the VFI presents in Code Wijffels, all charities need an oversight board model in order to have an independent monitoring unit and to comply with 'good' governance. Previous research (Alper *et al.*, 2009) shows that many charities have not (yet) implemented an oversight board model, suggesting that charities lacking an oversight board model will apply higher manager compensation as they also lack strictly independent supervision.

H2: Charities with a simple governance structure without independent oversight committee have higher managerial pay level.

The board of directors monitors the charitable organization and oversees, among others, expenditures. Thus, the board could have an effect on manager compensation as they pursue efficiency of the organization. On one hand, it could be argued that large boards would limit manager compensation in terms of preferring an efficient organization. On the other hand, large boards could mean that the charity encounters a higher level of monitoring which makes a high-quality and highly paid manager unnecessary. Boards that are too large could lead to inefficient boards that dysfunction in their role as supervisors, which lead to loss of monitoring power (Hyndman & McDonnell, 2009). Nevertheless, Hallock (2002) finds a positive relation between the number of (unpaid) board members and the level of executive pay in U.S. nonprofits. As observed in annual reports, board members of charities are often unpaid and, keeping in mind that board size might be correlated to the size of the charity, we expect that board size and pay level are positively related. Further, board meeting frequency also provides an indication on monitoring level within a charity. It can be posited that, the more board meetings per year, the higher monitoring level and the less entrenched the managers. Hence our hypotheses:

H3: Charities with a larger board size have a lower managerial pay level.

H4: Charities with a higher frequency of board meetings have a lower managerial pay level.

### 3. Methodology

#### 3.1 Data sources and sample

Our data is based on publicly available information and is hand-collected from the CBF website and charities' websites. Data on these charities is gathered over the years 2005 until 2008. Providing financial statements is not mandatory for all charities in the Netherlands; as a result, not all charities provide annual reports. Our final sample holds 521 observations, from 139 different charities. Compared to the total number of charities in the Netherlands, our sample is biased towards larger charities. Table 1 provides details of the construction of the sample.

#### 3.2 Variables

##### 3.2.1 Dependent variables

We include two dependent, and a number of independent variables in our study. Our first dependent variable relates to the disclosure of managerial compensation; we use a dummy variable (dCOMP) that indicates whether management compensation is disclosed (coded 1) or not (coded 0). In addition, we use managerial compensation. Managerial compensation has been measured differently within previous studies; some use (percentage) change of manager compensation level (Baber *et al.*, 2002), others use actual levels (Frumkin & Keating, 2001; Jobome, 2006) that sometimes are transformed into a natural logarithm variable (Oster, 1998; Brickley *et al.*, 2003), and a third line of research uses excessive pay (Jobome, 2006). In this study, we will use actual levels of manager compensation standardized by the number of hours that the manager works<sup>1</sup> (labeled COMPFT). In our robustness checks, we will use alternative specifications.

##### 3.2.2 Independent variables

We use a number of independent variables relating to governance characteristics (see also Table 1 for a specification of the variables). We include 4 independent variables: governance structure, board size, number of board meetings and auditor quality. Based on the organizational structures set up by the VFI in Code Wijffels (VFI, 2005a), we use a dummy variable for governance structure (dGSTRUCT). It is coded one when model IV from the Code Wijffels is used (the most advanced governance structure), and a 0 for charities that use model II or III. Board size is measured by taking the number of board members at the end of the financial year; we use the log of board size (LGBRDSIZE) in our analysis for statistical reasons. Another measure for governance is the number of board meetings in which decisions, performance and contracts are discussed and monitored. We use the log of the number of board meetings (LGBRDFREQ) in our regression analyses. Finally, we use a measure (AUDITOR) which indicates whether the auditor is a Big 4 firm (coded 1) or a non-Big 4 firm (coded 0).

---Insert Table 1 and Table 2 about here---

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<sup>1</sup> In the Netherlands, managers can opt to work part-time (for example, for one day a week). This is a quite pervasive characteristic in non-profit settings; therefore, we standardize the compensation by calculating a full-time equivalent pay.

### 3.2.3 Control variables

Our first control variable relates to charity performance. In general, performance is difficult to measure in nonprofit organizations as it is difficult to quantify. We include performance as a determinant of both disclosure as well as managerial compensation. Previous literature (e.g. Islam & Deegan, 2010) suggests that well-performing organizations may feel obligated to disclose more information to companies may have to explain that they operate within the (explicit or implicit) norms of society, as they will find it costly to be associated with actions that breach society's expectations. Charities may also link managerial compensation to organizational performance to achieve goal alignment. Referring to the CBF and VFI criteria, charities need to disclose information on fundraising, program spending and administrative expenses in order to obtain the accreditation of "good" governance. In addition, fundraising revenues, program expenditures and administrative expenses are frequently used proxies for (managerial) performance. For example, Frumkin and Keating (2001) use fundraising results and administrative efficiency while Baber *et al.* (2002) used program spending and results to measure CEO performance. Krishnan *et al.* (2006) used fundraising expenses and program expenses in order to test misreporting and the effect on manager pay. We note, however, that these measures do not tell us anything about the effectiveness of the charity (i.e., are the goals of the charity achieved). Fundraising ratio (FUNDRAIS) provides information on the charity's fundraising efficiency as it relates fundraising expenses to fundraising revenues. The program spending ratio (PROGSPEND) measures the fraction of revenues that is spent on program purposes. The administrative efficiency ratio (ADMEFF) is a measure on administration costs in relation to total costs.

Three variables have been computed for measuring donor dependency, another key variable for charities. According to Ullman (1985), a stakeholder's power to interfere with organizational management is measured through the degree of input over resources. In line with Ullman (1985), the variable LGDONORS is measured by the log of the number of donors of the charity. Private donations generally include contributions of members of the charity and private donations and gifts. Institutional donor dependency (INSTIT) relates to the charity's dependency on institutional subsidies, for example from the government. This variable is also measured relative to total fundraising revenues.

We include a number of control variables to proxy for organizational complexity. First, size is generally used as a proxy for external visibility of the organizations (which should increase disclosures) as well as for organizational complexity (which may increase managerial pay). Organizational size (LGSIZE) is measured through the log of fundraising revenues.

Another organizational variable that probably correlates with the size of the charity is their age, assuming that charities start small and grow over the years. We use the log of their age (LGAGE) to control for age effects. Another potentially confounding factor is the sector in which the charity operates. The VFI (VFI, 2008) recognizes 4 segments, namely international aid (INT\_AID), health (HEALTH), social welfare (SOCIAL) and nature and environment (NATURE). Finally, a dummy variable is included that indicates whether charities have an international parent (INTER).

We further control for charities that have an external auditor from a Big-4 financial audit firm (AUDITOR). In our model specification, we include dummy variables for the years 2005, 2006 and 2007 to control for time effects.

## 4. Results

### 4.1 Descriptive statistics

Table 3 provides the descriptive statistics of our sample. Table 3 indicates that about 80% of the charities in our sample discloses managerial pay. On average, managerial pay is approximately 95,000 euros. Approximately 4% of the charities in our sample pays more than the norms set by the VFI. About 27% of the organizations has an independent supervisory board, as recommended by the VFI (DGSTRUCT, which reflects the model IV as described by VFI). Charities have on average about 16 mln euros in annual revenues, and more than 100.000 donors. Approximately 18% of the revenues is from institutional donors. All sectors are represented in our sample, with the most charities coming from the international aid sector. Finally, 23% of the organizations belong to an international parent.

Table 4 provides the correlations of the main variables in our sample. Table 4 indicates that disclosure decisions are associated with governance structure, size and sector. In additions, over time charities have started to disclose more information about managerial pay, potentially due to (non-mandatory) regulation. The effect of regulation is also visible in the adoption of more independent governance structures over time. Managerial pay levels are associated with governance structure (organizational structure, board size and auditor choice), size, number of donors, age and sector.

---Insert Table 3 and Table 4 about here---

### 4.2 Regression analysis

We test our predictions through the following regression equations:

$$dCOMP = \alpha + \beta_1 * DGSTRUCT + \beta_2 * LGBRDSIZ + \beta_3 * LGBRDFR + \beta_4 * AUDITOR + \sum \beta_n * CONTROLS + \varepsilon \quad (1)$$

Respectively

$$COMPFT = \alpha + \beta_1 * DGSTRUCT + \beta_2 * LGBRDSIZ + \beta_3 * LGBRDFR + \beta_4 * AUDITOR + \sum \beta_n * CONTROLS + \varepsilon \quad (2)$$

Where:

dCOMP = Disclosure of managerial disclosure (1= disclosure, 0 = nondisclosure);

DGSTRUCT = Governance structure (1= independent oversight board, 0 = dependent oversight board);

LGBRDSIZ = Log of board size (number of people in the board);

LGBRDFR = Log of number of board meetings during the year;

AUDITOR = Auditor (1= non-Big 4, 0= Big 4 firm);

COMPFT = Managerial compensation (in euro's, per full time equivalent);

CONTROLS = control variables (including organizational performance, number of and dependency on donors, size, age, international parent, and sector in which the charity is operating)

Table 5 and 6 present our results. Contrary to our hypotheses is that Table 5 indicates that charities with large boards (LGBRDSIZ) tend to be associated with a lower chance of *disclosure* of managerial pay. One potential reason for this finding is that board members in charities are appointed to obtain access to additional funds rather than for monitoring reasons (cf. Callen *et al.*, 2010); however, the correlation analysis (see Table 4) indicates that board size is negatively associated with fundraising. The results for the control variables indicate that larger organizations are more likely to disclose managerial pay. This finding is consistent with the political cost hypothesis that suggests that more visible organizations tend to disclose more information to prevent or reduce the likelihood of adverse political or societal actions and the resulting costs. Charities that rely more on institutional donors are less likely to disclose managerial pay levels; one potential reason is that these institutional donors have access to managerial pay levels through other information sources. Finally, over the years, charities are more likely to disclose managerial pay, potentially as a result of political and societal pressure and increasing (voluntary) regulation.

---Insert Table 5 and Table 6 about here---

The results regarding the *level* of managerial pay suggest that governance characteristics are important in reducing ‘excessive’ managerial pay. That is, charities with more board meetings over the year (LGBRDFR) tend to have lower managerial pay levels. One potential reason is that charities with more board meetings tend to discuss managerial pay levels to a larger extent than charities with a few board meetings. The results for the control variables indicate that managerial pay is tied to organizational performance characteristics (fundraising, program spending and administrative efficiency). Organizations with more institutional donors appear to have lower managerial pay levels; apparently, these institutional donors do succeed in reducing managerial pay. Older organizations tend to have higher managerial pay levels, which may be due to the fact that these organizations have developed towards more professional organizations relative to their younger counterparts. Charities in health care also have higher pay levels; this may be explained by the fact that charities in health care tend to be headed by a former medical practitioner. These managers may want to hold on to the salary that they previously earned in medical practice.

### 4.3 Robustness checks

We perform a number of robustness checks to investigate whether our models are sensitive to alternative specifications. First, we use alternative binary logistics models (LOGIT- respectively Extreme value models) to test whether our disclosure model is sensitive to alternative underlying assumptions; we find similar effects and significance levels compared to the results presented in Table 5. In addition, we test whether our results are robust for alternative managerial compensation level variables. In a first step, we use the log of the absolute compensation level; our findings are similar to the results presented in Table 6.

---Insert Table 7 about here---

Subsequently, we follow the procedure outlined by Jobome (2006) and label managerial pay levels which are above the mean in the industry as ‘excessive’. Subsequently, we rerun our regression model to see which variables are associated with ‘excessive’ managerial pay levels; Table 7 presents our results. We find that larger boards (rather than board meeting frequency) tend to be associated with lower ‘excessive’ compensation; the effect for board frequency is negative, yet not significant. Finally, we follow a procedure similar to Core *et al.* (1999). First, we estimate a model with managerial compensation

(COMP\_FT, model 1, respectively LGCMPFT, model 2) as the dependent variable, and all organizational characteristics excluding the four governance variables (DGSTRUCTURE, LGBRDSIZE, LGBRDFR, AUDITOR). We assume that these organizational characteristics (including organizational performance, size, donor characteristics, and sector) provide an economic explanation for managerial compensation levels. We save the residual from this regression, and assume that it represents excessive pay (labeled EXCOMP1 respectively EXCOMP2). We run a regression with the four governance variables as independent variables, and the excessive pay variables as the dependent variables (controlling for the different years). Our results (presented in Table 7) indicate that LGBRDFR is negatively associated with managerial pay levels. These results indicate that the definition of ‘excessive’ pay has an impact on the results, even though governance characteristics still determine managerial pay levels.

## **5. Summary and conclusion**

In this study we investigate empirically whether governance characteristics affect managerial pay disclosure, as well as managerial pay levels empirically in a sample of charities (N=234) in the Netherlands. Our results indicate that governance characteristics have an impact on managerial pay disclosure, respectively managerial compensation levels. First, we find that, after controlling for several organizational characteristics, charities with large boards are less likely to disclose managerial pay in their annual report. Factors like institutional donor dependency, sector classification, size, and age also appear to capture the likelihood that charities publish compensation figures in their annual report. We also investigate what factors determine managerial pay level among the charities that disclose this type of information. We find that charities with more board meetings have lower managerial pay, controlling for other intervening variables. Our results provide mixed evidence about the hypothesized positive effect of past performance levels as explanatory variable of future remuneration. Similarly to the analysis about disclosure, our results indicate that a charity’s size, age and sector are significant drivers of managerial pay.

The exploratory results of this study add to prior attempts of explaining why disclosure of compensation schemes varies across non-profit organizations. They also contribute to the current debate as to whether economics-based theory can be applied to a non-profit environment.

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**Table 1: Characteristics final sample**

	2008	2007	2006	2005
Initial sample	282 (100%)	245 (100%)	245 (100%)	245 (100%)
Foundation with split financial years	-10	-9	-9	-9
Foundation is branch of other charity	-11	-10	-10	-10
Annual reports not available	-91	-29	-29	-29
<i>Sub sample</i> <sup>a</sup>	<b>170</b> (60%)	<b>197</b> (80%)	<b>197</b> (80%)	<b>197</b> (80%)
Management compensation not disclosed	-51 (18%)	-78 (32%)	-78 (32%)	-78 (32%)
<i>Final sample</i> <sup>b</sup>	<b>119</b> (70%)	<b>119</b> (60%)	<b>119</b> (60%)	<b>119</b> (60%)

**Note:** Count in numbers of charitable organizations. Percentages are relative to the initial sample of that year, except for final sample percentages: they are relative to the sub-sample.

**Table 2: Research variables**

	<i>Expected sign</i>	<i>Variable name</i>	<i>Explanation</i>
<b>Dependent variable</b>			
<i>Manager compensation disclosure</i>		dCOMP	Manager compensation disclosed: 0 ( <i>no</i> ), 1 ( <i>yes</i> )
<i>Manager compensation level</i>		COMP_FT	Total manager compensation
<b>Independent variables</b>			
<i>Governance characteristics</i>	+	dGSTRUCT	Governance structure: 0 ( <i>model II and III</i> ), 1 ( <i>model IV</i> )
	+	BDSIZE	Board Size
	-	BFREQ	Number of board meetings per year
<b>Control variables</b>			
<i>Organizational performance</i>		FUNDRAIS	Fundraising efficiency ratio: <i>fundr. expenses / fundr. revenues</i>
		PROGSPEND	Program expenditure ratio: <i>program expenses / total revenues</i>
		ADMEFF	Administrative efficiency ratio: <i>admin. expenses / total expenses</i> .
<i>Donor dependency</i>		DONORS	Number of private donors
		INSTIT	Institutional donor dependency: <i>Instit. donations / tot. fundr. rev.</i>
<i>Organizational characteristics</i>		SIZE	Size of organization (revenues)
		AGE	Age of organization in years
		INT_AID	International aid charity
		HEALTH	Health care charity
		NATURE	Nature/environmental charity
		SOCIAL	Social welfare charity (benchmark in regressions)
		INTER	0 ( <i>no international parent</i> ), 1 ( <i>international parent</i> )
		AUDITOR	0 ( <i>Big Four</i> ), 1 ( <i>non-Big Four</i> )

**Note:** For some variables, a recalculation is made by the natural logarithm as data turned out to be very skewed (e.g. LGDONORS, LGSIZE, LGAGE).

**Table 3: Descriptive statistics**

	N	min	max	mean	std.dev
dCOMP	516	0.00	1.00	0.81	0.39
COMP_FT (thousand)	382	23.51	199.00	95.36	29.99
dGSTRUCT	521	0.00	1.00	0.27	0.45
BDSIZE	521	3.00	35.00	7.48	3.14
BFREQ	427	1.00	13.00	5.16	2.01
AUDITOR	521	0.00	1.00	0.65	0.48
ADMEFF	517	0.00	0.89	0.10	0.10
FUNDRAIS	496	0.00	0.86	0.16	0.10
PROGSPEND	521	-1.02	2.65	0.90	0.26
SIZE (mln € revenues)	521	0.21	239.00	15.75	33.67
DONORS (thousand)	330	0.00	935.00	115.87	200.38
INSTIT	521	0.00	0.94	0.18	0.25
AGE	521	1.00	194.00	44.10	35.71
HEALTH	521	0.00	1.00	0.23	0.42
INT_AID	521	0.00	1.00	0.37	0.48
SOCIAL	521	0.00	1.00	0.23	0.42
NATURE	521	0.00	1.00	0.17	0.37
INTER	521	0.00	1.00	0.23	0.42
YEAR05	521	0.00	1.00	0.22	0.42
YEAR06	521	0.00	1.00	0.24	0.43
YEAR07	521	0.00	1.00	0.27	0.44
YEAR08	521	0.00	1.00	0.27	0.44

**Table 4: Correlations**

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1 dCOMP																	
2 COMP_FT	.a																
3 dGSTRUCT	.215**	.256**															
4 lgbrdsize	0.004	.200**	-0.053														
5 lgbrdfr	0.062	0.029	-0.080	0.013													
6 AUDITOR	0.070	.312**	.164**	-0.061	.169**												
7 ADMEFF	-.100*	-.187**	-.099*	-0.053	0.031	0.011											
8 FUNDRAIS	0.005	0.068	0.087	-.141**	-0.015	0.013	0.059										
9 PROGSPEND	-0.065	0.003	-0.003	-0.025	-0.010	0.013	-0.078	-.212**									
10 lgsize	.168**	.634**	.332**	.251**	.290**	.295**	-.305**	0.028	-0.023								
11 lgdonors	0.055	.483**	.199**	.125*	.287**	.185**	-.203**	.310**	-0.068	.674**							
12 INSTIT	-0.020	0.055	.174**	.211**	-0.001	-0.046	-.126**	-0.004	0.062	.356**	0.055						
13 lgage	-0.019	.200**	0.023	.215**	.184**	0.053	-0.041	-0.014	0.031	.229**	.285**	-0.031					
14 HEALTH	0.021	.263**	0.082	-.144**	-0.090	0.055	0.050	.145**	-0.030	-0.021	.242**	-.291**	0.022				
15 INT_AID	.109*	-.208**	-0.003	-0.002	-0.032	-0.002	-.120**	-.134**	0.064	.087*	-.269**	.245**	-.106*	-.420**			
16 NATURE	-0.067	-0.054	0.053	0.023	0.084	-.137**	0.048	0.029	0.021	-0.079	0.104	.104*	.109*	-.245**	-.340**		
17 SOCIAL	-0.086	0.020	-.125**	.126**	0.052	0.067	0.045	-0.018	-0.062	-0.009	-0.037	-0.080	0.003	-.304**	-.422**	-.246**	
18 INTER	0.079	0.035	-0.023	0.053	-0.049	-0.009	-0.044	-0.040	0.053	.160**	.275**	-0.001	.152**	-.218**	.160**	-0.051	0.080
19 YEAR05	-.196**	0.008	-.154**	-0.007	0.000	-0.035	.118**	0.024	.096*	-0.027	0.087	-0.018	-0.054	0.020	-0.030	-0.004	0.017
20 YEAR06	-0.069	-0.080	-0.014	-0.015	-0.018	-0.005	.141**	0.013	.177**	-0.036	0.003	0.014	-0.026	0.008	-0.004	0.002	-0.005
21 YEAR07	-0.002	0.020	0.028	0.015	0.019	0.013	-.112*	-0.017	-.186**	0.032	-0.051	0.010	0.024	-0.016	0.013	0.010	-0.008
22 YEAR08	.244**	0.045	.128**	0.004	-0.002	0.019	-.136**	-0.017	-0.074	0.021	-0.018	0.000	0.053	-0.013	0.016	0.001	-0.006

.a cannot be computed because at least one of the variables is constant.

\*,\*\* correlation significant respectively at the 5% and 1% level

**Table 5: Regression results for Disclosure of Managerial compensation**

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Dependent variable:	COMPDISC		
Method:	Maximum Likelihood - Binary Probit (Quadratic hill climbing)		
	QML (Huber/White) standard errors & covariance		
<i>Variable</i>	<i>Expected sign</i>	<i>Coefficient</i>	<i>Prob.</i>
Constant		0.26	
DGSTRUCT	+	0.31	
LGBRDSIZ	+	-2.27	**
LGBRDFR	+	0.78	
AUDITOR		-0.33	
ADMEFF		-0.67	
FUNDRAIS		1.21	
PROGSPEN		-0.38	
LGSIZE		0.75	**
LGDONORS		-0.13	
INSTIT		-1.51	**
LGAGE		-0.37	
HEALTH		-0.40	
INTER		0.27	
INT_AID		0.00	
NATURE		-0.46	
YEAR05		-1.16	***
YEAR06		-0.55	
YEAR07		-0.85	**
N		268	
Akaike info criterion		0.69	
LR statistic (18 df)		32.69	
Probability(LR stat)		0.02	
McFadden R-squared		0.18	

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\*\*\* significant at 1% level; \*\* significant at 5% level; \* significant at 10% level.

**Table 6: Regression results for Managerial compensation**

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Dependent Variable:	COMP_FT	
Method:	Least Squares	
Newey-West HAC Standard Errors & Covariance (lag truncation=4)		
<i>Variable</i>	<i>Expected sign</i>	<i>Coefficient Prob.</i>
Constant		-201059.2 ***
DGSTRUCT	-	1340.740
LGBRDSIZ	-	6175.826
LGBRDFR	-	-24523.50 ***
AUDITOR		6073.909
ADMEFF		11431.43
FUNDRAIS		97733.37 ***
PROGSPEN		15723.13 ***
LGSIZE		40587.05 ***
LGDONORS		-3758.691
INSTIT		-22208.13 ***
LGAGE		12170.92 **
HEALTH		10155.13 **
INTER		-3896.149
INT_AID		-6470.357
NATURE		-4985.171
YEAR05		-1974.416
YEAR06		-7984.742 ***
YEAR07		-1912.940
N		234
R-squared		0.676396
Adjusted R-squared		0.649303
Akaike info criterion		22.44929
F-statistic		24.96622
Prob(F-statistic)		0.000000

---

\*\*\* significant at 1% level; \*\* significant at 5% level; \* significant at 10% level.

**Table 7: Robustness checks**

Dependent Variable:	EXCCOMP	ECXCOMP1	EXCCOMP2
<i>Variable</i>	<i>Coefficient Prob.</i>	<i>Coefficient Prob.</i>	<i>Coefficient Prob.</i>
Constant	-19.22617 ***	470.9079	0.007016
DGSTRUCT	-0.148057	1792.775	0.014983
LGBRDSIZ	-1.800366 ***	8042.522	0.027821
LGBRDFR	-0.631448	-19874.26 **	-0.093847 *
AUDITOR	0.564824 *	6542.867 *	0.032365
ADMEFF	0.224434		
FUNDRAIS	7.087368 ***		
PROGSPEN	0.237489		
LGSIZE	3.013223 ***		
LGDONORS	-0.629439 ***		
INSTIT	-1.216291		
LGAGE	1.204249 ***		
HEALTH	0.088267		
INTER	-0.456700		
INT_AID	0.378050		
NATURE	0.611343		
YEAR05	-0.513161	5703.672	0.029077
YEAR06	-0.503665 *	3108.790	0.019483
YEAR07	-0.145251	1295.228	0.006299
N	234		
Akaike info criterion	0.899581		
LR statistic (18 df)	151.7371		
Probability(LR stat)	0.000000		
McFadden R-squared	0.467979		
R-squared		0.065741	0.061240
Adjusted R-squared		0.036804	0.032163
Akaike info criterion		22.37055	-1.891410
F-statistic		2.271839	2.106152
Prob(F-statistic)		0.029702	0.043906

\*\*\* significant at 1% level; \*\* significant at 5% level; \* significant at 10% level