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Board Chair–CEO Relationship, Board Chair Characteristics, and Nonprofit Executive Compensation

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We examine the associations between board chair–CEO relationship, board chair characteristics, and top executive compensation in U.S. nonprofit organizations. Using a sample of 2,153 organization-year observations in our empirical tests, we find a significant positive association between board chair–CEO relationship and top executive compensation. We find that board chair characteristics such as tenure and gender are not significantly associated with top executive compensation. The supplementary analyses suggest that board chair–CEO relationships are positively associated with executive compensation but for only organizations with larger revenues, a bigger board, and a lower change in percentage of program expenses. The findings should be helpful in enhancing the understanding of influencing factors on nonprofit executive compensation.

Keywords: Governance, Executive Compensation, Nonprofit, Board Chair

Introduction

Executive compensation is a well-researched area. Studies in both the for-profit setting (e.g., Bebchuk & Fried, 2004; Fama & Jensen, 1983; Jensen & Meckling, 1976; Jensen & Murphy, 1990; Murphy, 1985; Murphy, 2013; Tosi et al., 2000) and the nonprofit setting (e.g., Aggarwal et al., 2012; Baber et al., 2002; Balsam & Harris, 2018; Brickley & Van Horn, 2002; Brickley et al., 2003; Frumkin & Keating, 2010; Gibelman, 2000; Grasse et al., 2014; Gray & Benson, 2003; Hallock, 2002; Jobome, 2006) have shown evidence of either pay-for-performance or the associations between governance and executive compensation. The board chair and the CEO are the two main actors in an organization's governance.[1] Anecdotal evidence suggests the relationship between the board chair and chief executive plays an important role in setting the chief executive's compensation. For example, a critique of the compensation package paid to the CEO of the Rhode Island Foundation suggested that the board chair's relationship with the CEO influenced the size of the pay package awarded to the CEO (GOLOCALProv, 2021). Survey data found that the board chair's leadership plays an important role in evaluating the CEO (Van Puyvelde et al., 2018). Yet, to our knowledge, no prior research has examined the association between board chair–CEO

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relationship, board chair characteristics, and executive compensation. This study intends to fill the literature gap.

The efficient contracting theory suggests that executive compensation could be optimal given a competitive equilibrium in the market for executive talent (Murphy, 2013). The board chair–CEO relationship can promote synergy between the two major actors in nonprofit organizations and thereby enhance organization performance. According to the efficient contracting theory, better organization performance leads to better executive compensation. In addition, the board chair–CEO relationship may also offer executives more opportunities to influence the board chair and board for higher compensation, which is consistent with the managerial power theory for executive compensation (Murphy, 2013).[2] In a nonprofit study, Jäger and Rehli (2012) analyze cases where organizations experience a replacement of the board chair and the executive director and find that the power relationship characterized by the two actors' equivalent capabilities and complementary preferences enhances checks and balances between the board chair and the executive director. Whether the board chair–CEO relationship plays a significant role in determining executive compensations in nonprofit organizations remains an open empirical question, which motivates this research.

In this study, we measure the board chair–CEO relationship by whether the two individuals have previously worked together in their respective roles for the current organization.[3] Our goal is to examine whether the work experience and familiarity between the two main parties have an impact on CEO compensation. Many CEOs act as board chair in for-profit firms. In contrast, in the nonprofit sector, it is typical for the board chairs to serve independently from the executive function (Price, 2018).[4] This unique setting provides us a relatively clean testing opportunity to investigate the role of board chair and whether board chair characteristics are associated with CEO compensation.

Besides the board chair–CEO relationship, this study also examines whether board chair tenure and gender affect CEO compensation. Several nonprofit studies (Brickley et al., 2003; Gibelman, 2000; Jobome, 2006) have examined the association between CEO tenure and executive compensation. As far as we know, no prior research has investigated the association between board chair tenure and executive compensation. Based on several for-profit studies (Cook et al., 2019; Elkinawy & Stater, 2011; Gilley et al., 2019; Kesner, 1988) that provide some evidence for the role of board director gender on committee membership and executive compensation, we expect that board chair gender may influence executive compensation in the nonprofit setting.

Using a sample of 2,153 organization-year observations, we find a positive association between board chair–CEO relationship and CEO compensation. Our results show that if the board chair and CEO have previously worked together for the same nonprofit, the CEO's compensation is 5% higher than if they have no previous cohort experience. However, there is no consistent supporting evidence that board chairs tenure and gender are associated with the level of CEO compensation. The supplementary analyses indicate that the positive association between board chair–CEO relationship and executive compensation exists for only the larger organizations (measured by total revenues), those with a bigger board, and those with a lower percentage change in program expenses.

Our study makes the following contributions to the executive compensation literature. First, while practitioner and academic sources suggest the board chair plays an important role in evaluating the CEO and setting their compensation, our study is, to our knowledge, the first to empirically test the proposition. Second, our results show that the relationship between board chair and CEO increases CEO compensation, thus furthering our understanding of the determinants of CEO

compensation. Finally, we add to the literature on the role gender and tenure of board chair play in setting CEO compensation.

The next section reviews related literature and develops our hypotheses. The following three sections discuss our research model and results. The last section summarizes our findings and presents our conclusions.

Literature Review and Hypothesis Development

Executive compensation has been long studied in the for-profit world. The mainstream of this literature is based on agency theory, developed by Jensen and Meckling (1976). Executive compensation, such as bonuses, stocks, and stock options, can be arranged to reward executives for better firm performance (Fama & Jensen, 1983; Jensen & Meckling, 1976). Another strand of executive compensation research (e.g., Bebchuk & Fried, 2004) has viewed executive compensation as the result of either managerial power or rent extraction. Research has also empirically examined the determinants of executive compensation (Jensen & Murphy, 1990; Murphy, 1985; Tosi et al., 2000). Murphy (2013) has reported that executive compensation may be determined by the efficient contracting theory, managerial power theory, and other related factors.

In the nonprofit sector, research on executive compensation was sparse in the past and has increased in recent years due to data availability. Several nonprofit studies (Baber et al., 2002; Balsam & Harris, 2018; Brickley & Van Horn, 2002; Frumkin & Keating, 2010; Gray & Benson, 2003; Hallock, 2002) have investigated the association between pay and performance in nonprofit organizations. For instance, Baber et al. (2002) have found that accounting performance measures (e.g., changes in program spending) play a role in determining executive compensation in nonprofit organizations. Gray and Benson (2003) have used a sample of 114 directors of small business development centers and documented the supporting evidence for a significant pay-for-performance relationship. Furthermore, they reported that human capital (i.e., education and experience), organizational size, and organizational affiliation are significantly related to executive compensation. Controlling for education, tenure, size, performance, and affiliation, they also found that female executives receive significantly lower compensation than male executives. Aggarwal et al. (2012) have investigated the relationships between board size, managerial incentives, and enterprise performance in nonprofit organizations. They provided evidence of a negative association between board size and management incentives.[5]

The nonprofit sector offers a unique setting to examine executive compensation based on a non-distribution constraint on the payout of profit to managers. In the for-profit world, firms have ownerships, which nonprofit organizations generally lack. The agency theory may apply differently to executive compensation in the nonprofit sector. Without shareholders and the threat of takeovers, nonprofit managers could be under less compensation oversight than their for-profit counterparts. Furthermore, nonprofit boards cannot utilize equity compensations to mitigate agency conflicts. Fama and Jensen (1983) point out that, given this unique feature, nonprofits rely more on governance mechanisms such as self-perpetuating boards that are distinctly different from those of for-profit corporations to mitigate agency problems. However, there is still potential for agency conflicts because nonprofit officers may serve on the boards as voting members (Ostrower, 2007). In this paper, we utilize the efficient contracting and managerial power frameworks discussed by Murphy (2013) to study how nonprofit board chair–CEO relationship affects executive compensation.

The chairperson of the board of directors at a nonprofit plays a pivotal governance role. The board chair acts as the primary point of contact between the executives and the board, focuses on high level strategic planning, and is typically responsible for ensuring evaluating the chief executive on an annual basis (Boardable, 2021). Prior academic works support the integral role the board chair plays in the governance of the nonprofit organization (Jäger and Rehli, 2012). The board chair is generally perceived as playing a highly influential role for the nonprofit organization (Harrison et al., 2013; Hiland, 2008). The relationship between the board chair and chief executive is not static and evolves over time (Cornforth & Macmillian, 2016). Independent board chairs have been found to be an important factor in whether an organization adopts a formal process for evaluation the performance of the CEO (Young et al., 2000).

In terms of setting the chief executive's compensation, the board chair can exert influence in several ways. First, the board chair takes a leadership role in creating and staffing committees, thereby influencing the process for evaluating the executive director and setting their compensation (MissionBox, 2021). Second, the board chair generally leads the executive committee, which may be charged with evaluating the chief executive's performance (BoardSource, 2021). Finally, as the leader of the board, the board chair may leverage their considerable influence to direct board level discussions on the chief executive's compensation. Prior academic research finds the leadership of nonprofit board chairs is perceived as an important factor in the effective evaluation of CEOs (Van Puyvelde et al., 2018).

As the board chair and CEO develop longer tenure together in the current nonprofit, the level of familiarity between the two parties increases. The board chair and CEO could work more efficiently with each other as they both build more industry expertise (Kesner, 1988). The synergy between the organization's two major actors can lead to better performance and thus higher executive compensation, which is consistent with the efficient contracting theory (Murphy, 2013). At the same time, the board chair–CEO relationship could also raise the risk of entrenchment (i.e., executives may influence the board chair in the process of determining executive compensation). In this case, the board chair becomes the CEO's advocate, and the CEO could use this relationship to their benefit (Byrd et al., 2010), which is consistent with the managerial power theory (Murphy, 2013). Therefore, we expect a positive association between board chair–CEO relationship and executive compensation. Based on the above discussion, our first hypothesis is as follows:

H1: Board chair–CEO relationship is positively associated with executive compensation.

Prior nonprofit research has examined the association between CEO tenure and executive compensation (Brickley et al., 2003; Gibelman, 2000; Jobome, 2006). In a for-profit study, Deschenes et al. (2015) has found that top management compensation is positively associated with the average tenure of outside board members. Board chair and CEO are two significant actors in organizations and play an important role in organization governance. However, no existing research has investigated the association between board chair tenure and executive compensation. Thus, we expect that board chair tenure may play a role in determining executive compensation. On the one hand, when the board chair's tenure is short, the board chair may have less power in influencing decision-making on executive compensation. On the other hand, when the board chair's tenure is short, they are more likely to be objective in assessing executive compensation and making recommendations for necessary adjustments on executive compensation. It is unclear which direction board chair tenure affects executive compensation. Thus, our second hypothesis is as follows:

H2: Board chair tenure is not associated with executive compensation.

In a for-profit study, Kesner (1988) has found evidence that the gender of board directors affects their membership on board committees, including the compensation committee. Cook et al. (2019) have found no evidence that adding women to the board of directors and the compensation committee reduces the compensation gap within the top executive team. However, they report that if a woman takes the chair role of the compensation committee, the top executive compensation gap diminishes. Elkinawy and Stater (2011) have documented that female executives receive salaries that are about 5% lower than those of their male counterparts and the gender difference in salary is larger in firms with more male-dominated boards. Gilley et al. (2019) have found that boards with a higher proportion of women emphasize corporate social performance more than other types of social performance when setting CEO compensation. Given the evidence that gender difference matters, we expect that board chair gender may have an impact on determining executive compensation. Nevertheless, we do not have a specific directional prediction on how board chair gender affects executive compensation. Thus, we state our third hypothesis in the null form as follows:

H3: Board chair gender is not associated with executive compensation.

Research Design

Based on our discussion in the previous section, we estimate the following specifications to test our hypotheses:

$$\begin{aligned}\text{Ln(CEOComp}_{it}) = {} & \beta 0 + \beta 1\ \text{BoardChairCEORelation}_{it} + \beta 2\ \text{BoardChairTenure}_{it} + \beta 3\ \text{BoardChairGender}_{it} + \beta 4\ \text{BoardCoChairs}_{it} + \beta 5\ \text{CEOTenure}_{it} + \beta 6\ \text{CEOGender}_{it} + \beta 7_{it}\ \text{BoardSize}_{it} \\ & + \beta 8\ \text{BoardIndependence}_{it} + \beta 9\ \text{ProgramRatio}_{it} + \beta 10\ \text{Ln(Revenue}_{it-1}) + \beta 11\ \text{Ln(UnrestrictedCash}_{it-1}) + \beta 12\ \text{Ln(CEOComp}_{it-1}) + \text{Year fixed effects} + \varepsilon\end{aligned}$$

where

Ln(CEOCompt): the natural logarithm of CEO (highest-paid executive) compensation in year t;
BoardChairCEORelation: 1 indicates neither the board chair nor the CEO are new to their roles in year t, 0 otherwise;
BoardChairTenure: the tenure of the board chair;
BoardChairGender: 1 indicates female and 0 indicates male;
BoardCoChairs: 1 indicates board with co-chairs;
CEOTenure: number of the years in the CEO position before year t. 0 indicates the first year as CEO; Tenure goes from 0–5;
CEOGender: 1 indicates female and 0 indicates male;
BoardSize: number of board members in year t;
BoardIndependence: number of independent board members / the total number of board members;
ProgramRatio: program expenses / total expenses;
$\text{Ln(Revenue}_{t-1})$: the natural logarithm of total revenue in year t-1; and
$\text{Ln(UnrestrictedCash}_{t-1})$: ln((Cash+saving)*(unrestricted net assets/total net assets)) for year t-1.

Our variables of interest are BoardChairCEORelation, BoardChairTenure, and BoardChairGender. Next, we provide justifications for the control variables included in our model.

Garner and Harrison (2013) have reported that the negative relationship of CEO pay to performance exists for firms with only one executive, the CEO. The evidence suggests that a powerful CEO with autonomy can harm firm performance, but other executives can mitigate agency problems. We posit that a board with a single chair may suffer similar negative consequences because of the autonomy possessed by a powerful board chair and expect that co-chairs may mitigate agency problems. Thus, we control for board co-chairing in our regression.

Iliev and Vitanova (2019) have documented that the increase in CEO pay resulting from the Dodd-Frank Act is larger for CEOs with higher ownership and longer tenure. Hill and Phan (1991) have reported that the likelihood that CEO compensation packages reflect their preferences increases with CEO company tenure perhaps because over time CEOs can strengthen their positions and circumvent monitoring and incentive alignment mechanisms. Thus, we use CEO tenure in the model to control for CEO experience, skill, and possible entrenchment.

Oster (1998) has found that CEO gender is insignificant in deciding executive compensation. In contrast, after controlling for education, tenure, size, performance, and affiliation, Gray and Benson (2003) have reported that female executives received significantly less compensation than male executives. Given the mixed results on CEO gender in prior research, we control for CEO gender in the model.

Prior research examines the influence of governance factors such as board size and board independence. For instance, the for-profit literature (Hermalin & Weisbach, 1998) has reported that independent directors are likely to provide better monitoring. The results on whether larger boards are better at monitoring are mixed (Boone et al., 2007; Coles et al., 2008; Linck et al., 2008; Yermack, 1996). In a nonprofit study, Aggarwal et al. (2012) have investigated associations between board size, managerial incentives, and enterprise performance in nonprofit organizations. They provided evidence of a negative association between board size and management incentives. We include board size and board independence as control variables in our model.

Studies (Baber et al., 2002; Balsam & Harris, 2018; Brickley & Van Horn, 2002; Frumkin & Keating, 2010; Gray & Benson, 2003; Hallock, 2002) have provided supporting evidence for pay-for-performance in nonprofit organizations. For instance, Gray and Benson (2003) have analyzed a sample of 114 directors of small business development centers and found supporting evidence for significant pay-for-performance relationship. More specifically, after controlling for education, tenure, size, performance, and affiliation, they have reported that human capital, organizational size, and organizational affiliation are significantly related to executive compensation. In a nonprofit study, Grasse et al. (2014) have found evidence that organization performance (measured by the program ratio) affects executive compensation. Given that prior compensation literature has supported a pay-for-performance relationship, we control for organizational performance (measured by program ratio and by total revenue) in our model.

Aggarwal et al. (2012) and Hallock (2002) have provided supporting evidence that organization size, a proxy for organizational complexity, is an important determinant of executive compensation. More complex organizations, compared with simpler organizations, demand more skill and experience of executives, which leads to a compensation premium. Oster (1998) has also found evidence that organization size is a strong predictor of executive compensation. Thus, we control for organization size measured by total revenue in our model.

Frumkin and Keating (2010) have found CEO compensation is significantly higher when organizations have free cash flow, which is inconsistent with the principle of not distributing

Table 1. Sample Selection

Sample Description	Observations
From GuideStar in April of 2019 we obtained a list of independent arts organizations with at least $2 million in total revenue, total assets, and total expenses. Organizations were also required to have achieved at least a bronze level of transparency.	705
Downloaded 5 years of officer and board data directly from GuideStar.	3,525
Less organizations missing officer/board data, or data necessary for the models.	(1,372)
Total Sample	2,153

profits. Consistent with Balsam and Harris (2018) and Core et al. (2006), we expect that when organizations have more free cash flow, it is easier for top management to distribute and increase their own compensation. To control for the impact of 'free cash flow,' we add unrestricted cash in our model.

A GuideStar report in 2013 highlighted the economy's significant impact on nonprofit CEO compensation. Thus, we include fixed year effects to control for the economic condition at different periods. To control for autocorrelation and any other organization-specific factors, we include executive compensation from the previous year in our regression.

Main Analyses

Sample Selection

The sample is drawn from all independent arts organizations (NTEE code A) that have at least $2 million in assets, total revenues, and total expenses. The focus on one nonprofit sector allows us to analyze a representative charitable sector in depth while increasing the analysis' internal validity.[6] We also required organizations to have at least a bronze level of transparency (i.e., report at least minimum levels of financial information on their GuideStar profile). The filters resulted in a sample of 705 nonprofit organizations (Table 1). For each sample organization, we downloaded five years of board and CEO data resulting in a total of 3,525 organization-year data.[7] We then merged this dataset with Form 990 financial data obtained directly from the IRS website (SOI data). Because of the need for lagged data for some models, as well as missing data, the final sample consists of 2,153 organization-year observations.

Univariate Results

All the variables used in this study are listed in Table 2.

In Table 3, we present the descriptive statistics. During our sample period, the average CEO compensation for independent arts organizations with at least $2 million in revenue, assets, and expenses is $232,028. The organization-years that the board chair and the CEO have previously worked together for the same nonprofit account for 57% of our sample. During the 5-year sample period, the average board chair tenure is 1.22 years, 32% of our sample board chairs are female, and 4% of the boards have co-chairs. On the CEO side, the average CEO tenure is 1.83 years and 39% are female. In terms of board governance features, the average board size of our sample is 28, and on average 93% of board members are independent. The mean program expense ratio for our sample is 77%. Because we study large arts institutions, it is no surprise that the average total

Table 2. Variable Definitions

Variable	Definition
CEOComp	Total compensation for the CEO identified by GuideStar as the principal officer.
BoardChairCEORelation	1 if neither the board chair nor the CEO are new to their roles.
BoardChairTenure	The tenure of the board chair.
BoardChairGender	1 if the board chair is female; 0 if male.
BoardCoChairs	1 if the organization had board co-chairs.
CEOTenure	The tenure of the CEO.
CEOGender	1 if the CEO is female; 0 if male.
BoardSize	Total number of voting board members.
BoardIndependence	Number of independent board members divided by total number of board members.
ProgramRatio	Ratio of program expenses to total expenses.
LagRevenue	Lag of total revenue.
LagUnrestrictedCash	Lag of unrestricted cash. Unrestricted cash is defined as the total cash balance multiplied by the % of net assets that are unrestricted.
LagCEOComp	Lag of CEO compensation.

revenue is over $12 million, and the unrestricted portion of the nonprofit's cash holding is around $1.7 million.

In Table 4, we present the correlation table among all our variables. Our main interest is the correlation between CEO compensation and board characteristics. Interestingly, all the variables used in our model are significantly correlated with CEO compensation. More specifically, the board chair–CEO relation, board chair tenure, board co-chair, CEO tenure, board size, program expense ratio, total revenue, and unrestricted cash are all positively correlated with CEO compensation, whereas board chair gender (1=female), CEO gender (1=female), and board independence are negatively correlated with CEO compensation. The results suggest that our main variable of interest, that the board chair and CEO have worked together before for the current nonprofit, is associated with higher CEO pay. In the next section, we investigate whether this still holds with multivariate regressions.

Multivariate Results

In this section, we test the impact of board characteristics on CEO compensation in a multivariate setting. In our hypotheses, the main variables of interest are the board chair–CEO relationship, board chair tenure, and board chair gender. In Table 5, we run OLS regressions of the CEO compensation on board characteristics and other firm variables. We use the natural logarithm of all dollar amounts (including CEO compensation, revenue, and unrestricted cash) to reduce the influence of outliers. We control for year fixed effects, and because we focus only on the independent arts organizations, there is no need to include any industry fixed effects. In column (1) and (2) of Table 5, we present the results when the lag CEO compensation is not included as one of the independent variables. When we include the lag CEO compensation under column (3) and (4), the R^2 increases from 0.549 to 0.824, suggesting that the independent variables in the last two columns capture most of the cross-sectional variations of CEO compensation.

Using the results under column (2) of Table 5, when the lag CEO compensation is not included, we find that the board chair–CEO relationship has a significant positive impact on CEO

Table 3. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
CEOComp	2,153	238,028	193,953	7,615	3,750,670
BoardChairCEORelation	2,153	0.57	0.50	0.00	1.00
BoardChairTenure	2,153	1.22	1.16	0.00	4.00
BoardChairGender	2,153	0.32	0.46	0.00	1.00
BoardCoChairs	2,153	0.04	0.19	0.00	1.00
CEOTenure	2,153	1.83	1.27	0.00	5.00
CEOGender	2,153	0.39	0.49	0.00	1.00
BoardSize	2,153	28.44	17.32	2.00	260
BoardIndependence	2,153	0.93	0.11	0.00	1.00
ProgramRatio	2,153	0.77	0.10	0.00	0.99
LagRevenue	2,153	12,300,000	24,700,000	169,993	607,000,000
LagUnrestrictedCash	2,153	1,742,826	3,216,220	325	44,100,000

Note: This table reports the summary statistics of board characteristics and firm-specific variables used in the analysis. The sample includes large independent arts organizations from 2012 to 2018. All the variables are described in Table 2.

compensation. More specifically, if the board chair and CEO have previously worked together for the same nonprofit, the CEO has 7.75% higher compensation than if they have not worked together previously. The results are weakened if we control for lag CEO compensation, but the significance still holds. The findings are consistent with our first hypothesis. As discussed previously, there are two potential explanations for our results. First, the board chair–CEO relationship variable might reflect the synergy created during the board chair and CEO's tenure together. Consistent with the efficient contracting theory, the synergy would lead to superior performance, which then leads to higher CEO compensation. Alternatively, consistent with the managerial power theory, the board chair–CEO relationship could raise the risk of entrenchment as CEOs could use their ties with the board chair to negotiate higher levels of payment, which would negatively affect the value of other organization stakeholders. The relationship between board chair tenure and CEO compensation is no longer significant after we control for other board chair and firm characteristics, which supports our second hypothesis. In terms of board chair gender, we find that female board chairs are associated with lower CEO compensation in all four regressions, but the coefficient is not significant after we control for other variables, which provides support for our third hypothesis as well. As a control variable, the positive coefficient in front of co-chairing loses its significance after we include lag CEO compensation in our regression.

In terms of CEO characteristics, consistent with the evidence from the for-profit literature, we find that CEO tenure is positively associated with CEO compensation, suggesting that longer serving CEOs in our sample enjoy higher compensation than CEOs with a shorter tenure.

Regarding board characteristics, in column (2) we find that larger boards are associated with higher CEO compensation. However, board size loses its significance when we include the lag CEO compensation in column (4). Interestingly, the board independence variable is not significant in any of the multivariate regressions. These results show that, compared with board chair and CEO characteristics, board size and independence are less important considerations for CEO compensation.

Table 4. Correlation Table

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
CEOComp (1)	1.00											
BoardChairCEORelation (2)	0.13*	1.00										
BoardChairTenure (3)	0.13*	0.60*	1.00									
BoardChairGender (4)	-0.07*	-0.02	-0.02	1.00								
BoardCoChairs (5)	0.09*	0.02	0.02	0.03	1.00							
CEOTenure (6)	0.14*	0.33*	0.23*	-0.02	0.04	1.00						
CEOGender (7)	-0.08*	-0.01	0.00	0.00	-0.02	0.00	1.00					
BoardSize (8)	0.31*	-0.02	-0.02	-0.01	0.01	0.01	-0.06*	1.00				
BoardIndependence (9)	-0.06*	0.01	-0.01	0.04	-0.01	0.02	-0.04*	-0.16*	1.00			
ProgramRatio (10)	0.06*	0.02	0.01	0.00	0.02	0.04*	0.02	0.07*	0.02	1.00		
LagRevenue (11)	0.56*	0.03	0.10*	-0.07*	0.06*	-0.01	-0.04	0.23*	-0.06*	0.09*	1.00	
LagUnrestrictedCash (12)	0.47*	0.04	0.06*	-0.06*	0.05*	0.02	-0.04	0.11*	-0.05*	0.10*	0.54*	1.00

Note: This table shows the Pearson correlations among the board characteristics and firm-specific measures. Figures followed by '*' indicate that they are significant within the 5% significance level. The sample includes large independent arts organizations from 2012 to 2018. All the variables are described in Table 2.

In terms of nonprofit performance, we find that firms with a lower program expense ratio, that is, firms that devoted a lower percentage of expenses to programs, have higher CEO compensation. This might be attributable to the inverse relationship between the program expense ratio and the administrative expense ratio, where a significant portion of CEO compensation should be allocated.

The results of other control variables are consistent with the previous literature. More specifically, nonprofits with higher lagged revenue and unrestricted cash have higher CEO compensation. Finally, higher past CEO compensation also leads to higher future compensation. In summary, in Table 5 we find supportive evidence that the board chair–CEO relationship contributes to higher CEO compensation.

Table 5. Regression Analysis

Dependent variable: Ln(CEOComp)	(1)	(2)	(3)	(4)
BoardChairCEORelation	0.0775***	0.0775***	0.0462***	0.0462***
	-3.19	-3.89	-3.03	-2.75
BoardChairTenure	0.00497	0.00497	-0.00763	-0.00763
	-0.5	-0.39	(-1.21)	(-1.05)
BoardChairGender	-0.0178	-0.0178	-0.00878	-0.00878
	(-0.95)	(-0.71)	(-0.75)	(-0.85)
BoardCoChairs	0.145***	0.145***	0.02718	0.02718
	-3.22	-2.75	-0.96	-1.05
CEOTenure	0.0699***	0.0699***	0.0131**	0.0131**
	-7.95	-6.58	-2.31	-2.02
CEOGender	-0.0274	-0.0274	-0.0149	-0.0149
	(-1.53)	(-0.95)	(-1.33)	(-1.26)
BoardSize	0.00457***	0.00457***	0.000779**	0.000779*
	-8.45	-3.62	-2.28	-1.85
BoardIndependence	0.0847	0.0847	0.01047	0.01047
	-1.08	-0.7	-0.21	-0.2
ProgramRatio	-0.441***	-0.441***	-0.199***	-0.199***
	(-4.97)	(-2.85)	(-3.50)	(-3.33)
LnLagRevenue	0.382***	0.382***	0.0942***	0.0942***
	-33.81	-18.3	-10.67	-4.93
LnLagUnrestrictedCash	0.0401***	0.0401***	0.0134***	0.0134***
	-6.37	-3.94	-3.37	-3.48
LnLagCEOComp			0.750***	0.750***
			-56.65	-18.62
_cons	5.655***	5.655***	1.554***	1.554***
	-30.89	-16.49	-11.44	-6.37
Year Fixed Effect	YES	YES	YES	YES
Clustered by EIN		YES		YES
N	2,153	2,153	2,102	2,102
Adj. R^2	0.549	0.549	0.824	0.825

Note: This table reports the OLS regression results of total CEO compensation on board characteristics and other firm-specific variables. '***', '**', and '*'represent significance at 1%, 5%, and 10% levels, respectively. We control for year fixed effects. The sample includes large independent arts organizations from 2012 to 2018. All variables are described in Table 2. T-statistics are reported in parentheses. Columns (2) and (4) cluster standard errors by EIN.

Additional Analyses

Subsample Tests Based on Total Revenue and Board Size

Oster (1998) and Grasse et al. (2014) find organization size affects executive compensation. Board chair–CEO relationship and board chair characteristics may have different levels of influence on executive compensation for different size groups of nonprofit organizations.

Consistent with both the efficient contracting and managerial power theories, larger nonprofits might be better equipped to reward CEO with higher compensation. Therefore, we expect to find more support for our first hypothesis among larger nonprofits. Correspondingly, we conduct a supplementary analysis based on organization size, measured by total revenues. We divide our sample into two groups based on total revenue and then repeat our main regression within each group. In our regression, we include the previous year's CEO compensation and control for year fixed effect. The results are presented in columns (1) and (2) of Table 6. We find that the board chair–CEO relationship is only positively associated with CEO compensation in the top half of our sample (at the 5% level). More specifically, for nonprofits whose total revenue is above the median, if the board chair and CEO have previously worked together in the current nonprofit, the CEO compensation is 6% higher than if they have not previously worked together. The coefficient in front of the board chair–CEO relationship is not significant in the bottom half of our sample.

Based on the results from our main regressions, board size has a significantly positive impact on executive compensation. Board chair–CEO relationship and board chair characteristics may affect executive compensation differently based on board size. With results similar to those of our subsample test based on total revenue, we expect firms with larger boards to be better financially equipped and thus have a stronger association between CEO compensation and board chair–CEO relationship. Therefore, we rerun our main regressions based on board size, measured by the number of board members. We divide our sample into halves based on the size of the board and repeat the main regression within each group. The results are reported in column (3) and (4) of Table 6. We find that the positive association between the board chair–CEO relationship and CEO compensation only holds in the top half of our sample in terms of board size.

Our subsample tests results based on total revenue and board size suggest that the positive association between board chair–CEO relationship and CEO compensation (Hypothesis 1) is significant only for large nonprofits that are better equipped to provide competitive pay to their CEOs. These results are potentially consistent with both the efficient contracting and managerial power theories, given that large nonprofits with extra financial recourse are more likely to reward their superior performing CEOs with higher pay and/or engage in entrenchment activities.

Subsample Test Based on the Percentage Change of Program Expense

Next, to disentangle the efficient contracting and managerial power theories, we conduct another subsample test based on the percentage change of program expenses from the previous year. Change of program expense is used as a performance measure in Aggarwal et al. (2012). This variable fits into our analysis since if managerial entrenchment is behind the positive association between CEO compensation and board chair–CEO relationship, these nonprofits could potentially reduce (or not increase as much) their investments in programs, which would negatively affect other stakeholders (clients). However, if superior CEO performance is the driving force behind the positive association, we should observe the positive association among the nonprofits with higher increases in program expenses. Thus, we divide our sample into halves based on the percentage change of program expenses and rerun our main regression. The results are presented in column (5) and (6) of Table 6. The results suggest that the positive association between CEO compensation and board chair–CEO relationship (Hypothesis 1) is significant only for firms with a lower percentage change in program expenses. This evidence suggests that higher CEO compensation is more likely to result from managerial entrenchment. Consistent with Hypothesis 2 and 3, board chair tenure and gender are not associated with CEO compensation in any of the subgroups.

Table 6. Partitioned Analysis

Dependent variable: Ln(CEOComp)	Total Revenues Above Median (1)	Total Revenues Below Median (2)	Total Board Size Above Median (3)	Total Board Size Below Median (4)	% Change Program Expense Above Median (5)	% Change Program Expense Below Median (6)
BoardChairCEORelation	0.061***	0.038	0.046**	0.04	0.040	0.041*
	(3.47)	(1.42)	(2.57)	(1.43)	(1.17)	(1.80)
BoardChairTenure	-0.011	-0.007	-0.012	0.0003	-0.014	-0.006
	(-1.52)	(-0.59)	(-1.49)	0.02	(-1.20)	(-0.66)
BoardChairGender	0.004	-0.02	0.0007	-0.02	0.015	-0.002
	(0.36)	(-1.17)	(0.05)	(-1.05)	(0.76)	(-0.16)
BoardCoChairs	0.033	0.028	0.033	0.023	-0.002	0.048
	(1.05)	(0.85)	(0.90)	(0.79)	(-0.08)	(1.13)
CEOTenure	0.013	0.015	0.026***	0.002	0.015	0.007
	(1.61)	(1.46)	(2.62)	(0.25)	(1.35)	(0.88)
CEOGender	-0.008	-0.019	-0.0004	-0.038*	-0.066***	0.004
	(-0.65)	(-0.98)	(-0.03)	(-1.92)	(-3.09)	(0.24)
BoardSize	0.0001	0.002**	-0.00001	0.003	0.0003	0.00002
	(0.42)	(2.29)	(-0.03)	(1.40)	(0.37)	(0.05)
BoardIndependence	-0.043	0.105	0.039	-0.05	0.060	-0.135
	(-0.72)	(1.32)	(0.60)	(-0.63)	(0.75)	(-1.43)
ProgramRatio	-0.197**	-0.284***	-0.082	-0.292***	-0.215*	-0.148**
	(-2.14)	(-3.03)	(-1.12)	(-3.33)	(-1.93)	(-2.11)
LnLagRevenue	0.050**	0.081***	0.072***	0.098***	0.061**	0.079***
	(2.54)	(2.75)	(4.76)	(3.23)	(2.04)	(5.14)
LnLagUnrestrictedCash	0.004	0.019***	0.011**	0.016***	0.014*	0.021***
	(1.01)	(2.74)	(2.18)	(2.71)	(1.82)	(3.01)
LnLagCEOComp	0.877***	0.627***	0.822***	0.689***	0.832***	0.794***
	(22.26)	(10.99)	(23.85)	(11.25)	(15.59)	(24.47)
_cons	0.844***	3.047***	0.939***	2.28***	0.994***	1.278***
	(3.25)	(6.11)	(3.44)	(6.03)	(3.26)	(4.05)
Year Fixed Effect	YES	YES	YES	YES	YES	YES
Clustered by EIN	YES	YES	YES	YES	YES	YES
N	1,061	1,041	1,042	1,060	751	754
Adj. R^2	0.851	0.614	0.857	0.747	0.818	0.865

Note: This table reports the OLS regression results of total CEO compensation on board characteristics and other firm-specific variables for various partitions. '***', '**', and '*'represent significance at 1%, 5%, and 10% levels, respectively. We control for year fixed effects. The sample includes large independent arts organizations from 2012 to 2018. All variables are described in Table 2. T-statistics are reported in parentheses. Standard errors are clustered by EIN.

Robustness Tests

We also conducted several robustness tests. First, we replace our main variable, board chair–CEO relationship, with the number of years the board chair and CEO have previously worked together. The purpose of this procedure is to replace a binary variable with a semi-continuous variable that is linked to the duration of the board chair's and CEO's tenure together. The untabulated results show that as the board chair and CEO accumulate longer tenure together, the CEO enjoys higher compensation. More specifically, one more year of cohort experience between the board chair and CEO leads to an 3.78% increase in CEO compensation, even after we control for the previous year's compensation. The result is consistent with our first hypothesis and reinforces the main finding of this paper.

In our second robustness test, we added two additional control variables, a dummy variable that equals to 1 if the board chair gender and CEO gender are aligned, and a dummy variable that equals to 1 if the CEO's title includes the phrase "artistic."[8] The rationale for the first variable is that gender alignment could further reinforce both the synergy created by the board chair and CEO's tenure together and the entrenchment risk associated to prior relationships. Thus, we predict that board chair and CEO gender alignment will contribute to higher compensation. The rational for the second variable is unique for our nonprofit sample. In large arts organizations, it is not uncommon to have both an executive director and an artistic director. In our study, we focus on the highest-paid individuals, irrespective of title. However, in the robustness test, we are interested to see if having a certain type of title, in this case including the phrase "artistic," would have any impact on CEO compensation. Our data suggests that in 53% of our sample nonprofits the CEO gender and board chair gender are aligned, and about 10% of the CEOs have the term "artistic" in their titles. The untabulated results confirm that gender alignment is positively associated with CEO compensation, while having "artistic" in the title is not significantly associated with CEO compensation.

In our last robustness test, instead of using the level compensation and including the previous year's compensation in the regression, we use the percentage change of the CEO compensation from the previous year as our dependent variable.[9] We keep all the other independent variables in our main model intact. Our unreported robust regression results suggest that the positive relationship between board chair–CEO relationship and CEO compensation is still significant.

Conclusions

To our knowledge, the current study is one of the first to specifically consider the role the board chair plays in setting the compensation of the CEO in the nonprofit sector. Unlike the for-profit sector, where many CEOs act as board chair and CEO, in the nonprofit sector almost all board chairs serve independently from the executive function. This allows us to isolate the board chair role and test whether board chair characteristics are associated with level of CEO compensation.

We find a nuanced relationship between board chair–CEO relationship and CEO compensation. Univariate results suggest the gender of the board chair, the size of the board, whether the board has co-chairs, the tenure of the board chair, and whether the board chair and CEO have previously worked together are all associated with the total CEO compensation. However, once we run the multivariate analysis, a few key determinants rise to the top. We find a strong association between the board chair and CEO having a prior working relationship and higher levels of CEO pay. Again, this is consistent with both the efficient contract theory where concurrent board chair and CEO tenure indicates the synergy created from the pair's past working experience and better CEO performance, and the managerial power theory where the board chair (and by extension the board) loses some objectivity once a level of familiarity

exists between the board chair and CEO. Once other known determinants of compensation are controlled for, we find CEO compensation is not associated with board chair tenure or gender. The supplementary analyses indicate that the positive association between the board chair–CEO relationship and CEO compensation is prominent only for larger nonprofit organizations, those with a bigger board, and nonprofits with lower percentage change in program expenses from the previous year. In all, our evidence leans towards CEO entrenchment and the managerial power theory.

Overall, our finding contributes to the understanding of the important role played by the board chair and the board chair–CEO relationship as a determinant variable for CEO compensation. Our results suggest that stewards of nonprofit organizations should exercise increased care in setting CEO compensation in the presence of governance indicators that might indicate relatively lax oversight. Specifically, organizations with large boards and more revenues (and unrestricted cash) and those whose board chair and CEO have a cozy relationship should be diligent in ensuring that their CEO compensation-setting practices are well documented and reasonable and that they can be defended upon scrutiny. A formal CEO performance evaluation process conducted on an annual basis might be particularly helpful for nonprofits currently evaluating their CEO on a more informal basis. Future studies with a longer time series could continue to examine the compensation-setting practices at nonprofit organizations and determine what characteristics of the board best ensure a just and reasonable CEO compensation package.

Notes

1. In the nonprofit setting, the chief executive could be named as CEO, executive director, general manager, or other similar titles. In this paper, we use the term 'CEO' to capture the role played by the chief executive.
2. In the managerial power theory framework, power is defined as the ability of the executives to influence the level and composition of their own compensation package (Murphy, 2013).
3. We understand this measure does not capture all aspects of board chair–CEO relation (such as their social connections outside the nonprofit organization). Nevertheless, we believe the years served together by the pair plays a significant role in shaping their power dynamics and thus has an influence on CEO compensation.
4. In our sample, only one out of the 705 nonprofit organizations included in our study has the same person acting as both board chair and CEO.
5. Aggarwal et al. (2012) use two proxies for managerial incentives. The first is the sensitivity of compensation to financial performance. The second is the coefficient of variation of executives' compensation.
6. Our sample is representative of the general nonprofit population in terms of the composition of total revenue. In our sample, the percentages of total revenue from donations and program income are 55.9% and 32.8%, respectively. Among the nonprofits that filed Form 990 in 2017, the percentages of donations and program income are 52.6% and 36.8%, respectively. We would also note that prior studies have focused on arts organizations in part based on their familiarity (Grasse et al., 2016).
7. At the time the sample was downloaded, April 2019, GuideStar Premium allowed registered users to download the most recent 5 years of board and officer data.
8. We thank the anonymous reviewers for the suggestions of both variables.
9. We thank the anonymous reviewers for this suggestion as well.

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The authors declare that there are no conflicts of interest that relate to the research, authorship, or publication of this article.

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