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Developing Compensation Peer Groups for Tax-Exempt Organizations



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PRINCIPAL

This is the fifth installment in our Tax-Exempt Executive Compensation Essentials series.

When considering the foundational elements of an effective and market-competitive executive compensation program, it's critical to identify appropriate sources for gathering relevant pay data.

One of the most common approaches is identifying a custom compensation peer group (or groups) composed of similar organizations. This peer group must be defensible and a reasonable representation of the competitive market for executive talent. Most often, relevant data on peers is drawn from Form 990 filings or insurance filings, allowing for detailed comparisons to executives at these named peers. In other cases, peers may be identified from existing surveys in which the survey provider can provide a "custom" cut specific to those peers included in their survey.

While developing an appropriate peer group is both an art and a science, this article outlines the key components of identifying appropriate peers and typical factors used to do so.

Why a Defensible Compensation Peer Group Matters

To establish the rebuttable presumption of reasonableness under IRC Section 4958, a tax-exempt organization needs to rely on comparable market data, which is often accomplished by using either an established peer group or survey data provided by an independent advisor, or both, when making executive pay decisions. The goal of developing a compensation peer group is to identify organizations that are comparable to your organization to not only ensure defensibility, but also to deliver reliable and relevant market compensation levels.

In some cases, there will be many organizations that are comparable based on mission, operations, and size, leading to the primary issue of selecting the most appropriate peers from a considerable pool of comparables. In other cases, there are very few direct or clear

comparables, which then requires greater judgment in identifying entities that are somewhat comparable and represent a reasonable competitive market for executives.

Documenting Peer Group Development Factors

The parameters used to determine appropriate peers are predominantly governed by a compensation philosophy that supports effective governance. Participants in compensation programs also receive clarity on how the organization approaches pay decisions and how it benchmarks compensation against the market.

Core Metrics for Building a Compensation Peer Group

A peer group should consist of organizations that are truly comparable and appropriate for benchmarking executive pay, incentives, and other ancillary benefits. Whether a tax-exempt organization, a privately held company, or a publicly traded company, the key factors in developing a compensation peer group are generally similar:

- Organization Size (typically by operating expenses or revenue): Usually the single most important factor, as executive compensation levels are highly correlated with the size of an organization.
- Industry/Mission Similarity: Organizations should ideally operate in the same or similar space and compete for like talent.
- Complexity of Operations: Equal revenue does not always equal similar complexity.
- Talent Market: Peers may also be identified using a talent market approach, with peers chosen based on overlap of recruitment, shared executive talent pools, and similar leadership roles.
- Financial Health: Especially important in non-profit and tax-exempt benchmarking.
- Geographic Labor Market: While geography matters less for executive roles than lower-level positions, local market comparisons may still be a relevant consideration.

A Clear Process for Developing a Compensation Peer Group

Taking a structured approach to development helps organizations support good governance and provide transparency to program participants when considering pay decisions.

Phase	Objective	Key Activities/Analyses
1. Stakeholder Input	Understand the organization (e.g., mission, strategy), desired pay positioning, and talent market considerations	Input gathered from the Board/Committee, senior management, advisors, and other key stakeholders

2. Define Peer Group Parameters	Establish the parameters used to identify peers (e.g., size, mission, industry)	Define methodology and identify preliminary peers
3. Test Against the Philosophy	Confirm alignment with the guardrails defined in the philosophy	Ensure alignment between the philosophy and the proposed peer group
4. Identify Specific Peers Using the Criteria	Generally, 15–25 peers comprise the peer group	Too many peers can lead to diminished returns, while too few can distort results and potentially lead to volatility in year-over-year market compensation levels
5. Board Approval	Ensure formal governance oversight and accountability	Present the peer group for review and obtain approval from the Board or designated committee
6. Ongoing Review	Maintain alignment over time	Conduct regular review to ensure continued comparability and appropriateness of peers

How to Ensure a Size-Appropriate Peer Group

Ideally, organizations will identify similar organizations that fall within a range of 0.5x to 2x revenue or annual budget. However, often that range needs to be expanded (e.g., 0.25x to 4x revenue or annual budget) in order to identify enough peers to gather reliable compensation data.

In more rare cases, where there are not enough similarly-sized peers, a regression model can be used to “right-size” compensation levels of a peer group of organizations that are either too small or too large, from a size perspective, relative to your organization. This approach is more sophisticated and may be challenging to understand and articulate.

Implementation Considerations and Practical Guidance

Ensure that the peer group has continuous alignment with the organization’s compensation philosophy, regularly assess market comparability, and update as necessary to reflect any relevant changes in the organization (e.g., growth or diversification) or in the talent market.

As mentioned above, data gathered from a compensation peer group is often supplemented by data from other common sources of data, including relevant salary surveys, industry association surveys, and/or public company proxy statements (generally only for very large, complex tax-exempt organizations).

By following a structured process and committing to regular review, organizations can effectively establish a robust and defensible peer group with which to benchmark pay

decisions.

The next piece in our Tax-Exempt Executive Compensation Essentials series will focus on evaluating the use of annual incentives.

About the Author

Tim partners with boards and senior leaders to design executive compensation programs aligned with business strategy, supporting talent attraction and retention through competitive pay and incentive design.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.