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From Cost-of-Living to Capability: Building Successful Performance Management in Tax-Exempt Organizations



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This is the eighth installment in our [Tax-Exempt Executive Compensation Essentials](#) series—a resource for boards, compensation committees, and management teams of tax-exempt organizations.

Performance management is still one of the least developed processes in tax-exempt organizations' talent practices. That isn't because it matters less in the nonprofit sector. Rather, mission-focused delivery, fundraising, and program execution tend to take priority, and performance management gets pushed down the list. Conversely, for-profit companies have spent decades refining goal-setting, evaluation, and calibration. A large share of tax-exempt organizations still run on a simpler model: most staff get the same cost-of-living adjustment each year, there's little differentiation, and formal bonus plans are rare.

This problem is common across the sector, and it's one of the more accessible places for a board or leadership team to improve talent outcomes without adding significant cost or complexity. What follows looks at where tax-exempt organizations tend to land on a maturity spectrum, what a well-built process includes, and why that process shapes decisions well beyond the annual review.

The Current Landscape: A Staged Maturity Model

Performance management sophistication varies widely across tax-exempt organizations, and the variation doesn't always correlate with size. A mid-size organization in a competitive talent market, or one running an ambitious strategic agenda, can have a more disciplined process than a much larger, more insulated peer. Maturity tends to track organizational complexity, culture, and leadership and board expectations.

Four stages of maturity are common across the sector, moving from organizations where performance management exists only on paper, to those where it's built into how talent and pay decisions get made.

Stage	Characteristics
1. Compliance-Only	■ Flat cost-of-living increases for all staff ■ Little to no differentiation ■ No bonus plan ■ The performance review, where one exists, functions largely as a formality with little bearing on pay or advancement
2. Informal Differentiation	■ Managers have some discretion over increases ■ No structured goal-setting ■ No consistent rating framework ■ Little documentation to support decisions
3. Structured but Siloed	■ Formal goal-setting and evaluation processes exist, but ratings aren't calibrated across departments or business units ■ Performance outcomes aren't yet systematically connected to other talent decisions
4. Integrated	■ Goal-setting, evaluation, and cross-organizational calibration function together ■ Supported by a structured bonus plan ■ Performance outcomes actively inform succession, promotion, and development decisions

A few factors tend to keep organizations stuck at Stage 1 or Stage 2. HR staffing and budget are often limited relative to what it takes to build and run a more rigorous process. Boards and executive directors may be uncomfortable openly differentiating pay in a mission-driven culture. There's often concern—not always well-founded—about legal or morale risk from more rigorous evaluation. And in some cases, organizations still compare themselves to government or civil-service pay norms, where uniform increases are the default. None of these concerns rule out moving to a more mature process. They just call for a process built around those constraints, not one copied from a very different kind of

employer.

Best Practices for the Performance Management Process

Moving up the maturity curve doesn't require copying a large public company's performance management program. Four fundamentals can guide organizations as they mature their programs.

Set individual, role-specific goals

Goals tied to a person's role and the organization's strategy are more useful than generic, department-wide objectives, and are easier to defend later. They should be set at the start of the performance period, understood by both employee and manager, and specific enough to support an honest evaluation at year-end.

Build a credible evaluation structure

A regular review cadence, a clear rating framework, and manager accountability for the quality of the evaluation are the backbone of a credible process. Evaluation should not be treated as an HR compliance task; it's a management responsibility. Changing that expectation usually matters more than the specific rating scale or form being used.

Calibrate across the organization

Calibration is the piece most tax-exempt organizations skip, and it's probably one of the most valuable improvements organizations can make. Without some way to compare ratings across managers throughout the organization, ratings may become less reliable and valid, eventually causing employees to question the integrity of the process. "Meets expectations" can mean different things depending on who wrote the review. Calibration is what keeps the process honest over time.

Link outcomes to pay

A modest, well-governed bonus or differentiated merit pool sends a different signal than flat, across-the-board increases. It signals that the organization takes performance seriously and will act on it. This doesn't take a large incentive opportunity. It requires differentiation tied to documented performance, not tenure or impression.

Performance Management as an Input to Downstream Talent Decisions

The case for investing in performance management goes beyond the review conversation itself. A credible process provides the foundation for several other decisions an organization makes over time, from identifying future leaders to determining where development resources will have the greatest impact, regardless of size or mission.

Succession planning

Identifying future leaders requires an ongoing read on current performance and potential, not something cobbled together when a vacancy opens. Without documentation,

succession planning is guesswork and does little to support organizational strategy.

Promotion and advancement

Without documented performance history, promotion decisions look subjective and sometimes are. A working process gives both the organization and the employee a defensible basis for advancement, which cuts down on perceptions of favoritism.

Leadership development investment

Performance data also helps organizations make better decisions about leadership development. Coaching and training budgets are limited, and performance data should help decide where they go. Relying on which leaders “seem ready” instead of on documented evidence of performance and potential tends to reinforce existing biases rather than correct them.

Hiring decisions

The same performance and competency data can support decisions on whether to hire internally or externally, and give interview panels a benchmark for what success looks like in a role, rather than relying on interview impressions alone.

Long-term incentive design

Where long-term incentive arrangements exist, or are being considered, individual performance data can help support more defensible decisions about eligibility, award levels, and differentiation. These are all topics a board, donor, or regulator may eventually ask about.

Retention and difficult conversations

A documented process gives managers a clearer basis for both recognition and development plans. For employees, documentation provides transparency and understanding about how their performance is evaluated as they navigate their career decisions.

Performance management isn't a standalone HR exercise. It's upstream of nearly every other talent and pay decision an organization makes.

Governance and Reasonableness Considerations

Tax-exempt organizations also have a governance angle to consider. Boards approving any form of pay differentiation need documented performance criteria and outcomes to support that differentiation under the reasonableness standard that governs tax-exempt compensation. A weak or informal process undercuts that case, even for modest pay decisions. Investing in the process is also an investment in the defensibility of all downstream decisions and outcomes.

Looking Ahead: Deliberate, Not Elaborate

Performance management in the tax-exempt sector doesn't need to look like a large public company's program. It needs to be deliberate: defined goals, calibrated evaluations, and outcomes that inform pay and talent decisions. Organizations that make this investment build a foundation for succession, promotion, development, hiring, and incentive decisions, making those decisions more consistent and defensible.

Before the next review cycle, it's worth asking: if a board member, donor, or regulator asked why someone was promoted, got a bonus, or didn't, could the organization produce a documented answer? Many tax-exempt organizations struggle to provide a response that inspires confidence. A more structured performance management process can help ensure those decisions are grounded in clear expectations, consistent evaluations, and documented results.

About the Authors

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