The Impact of Public Scrutiny on Corporate Philanthropy

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I. Introduction

Philanthropy, by its definition and in its early forms, assumes a certain degree of altruism and magnanimity. The Greek roots of the word suggest "love of mankind." The early philanthropists were described as propelled by a vision to "apply their wealth to the discovery of the underlying causes of personal distress, and to the formulation of strategies to rid the world of such systemic scourges" (Katz, 2004). While many wealthy individuals and private foundations are still motivated by altruism to work towards such lofty and noble goals, few today will believe that pure altruism is the driving force behind *corporate* philanthropy. Corporate donations totaled $13.5 billion in 2003, according to *Giving USA*, an annual report on the state of philanthropy published by the American Association of Fundraising Counsel. While this is a mere fraction of the $240.7 billion raised by all charities nationwide, it is nonetheless a considerable amount with significant potential to do much good for those in need of help.

Today, the issue of whether corporations should be engaged in philanthropy at all, for charitable or selfish reasons, is a point of contention. From a traditional economic perspective, the theory of the firm holds the corporation responsible only to its shareholders; that is, the sole objective of the firm is to maximize shareholder value. Under this framework, the corporation has no business giving away shareholders' money for purely altruistic reasons. In Milton Friedman's view, corporate philanthropy is tantamount to managers of a firm stealing from shareholders. From an ethical perspective, however, corporations, as

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powerful entities that reach into every sphere of society, arguably have an obligation to be socially responsible and to conduct their business activities with society's interests at heart. While keeping its eye on the bottom line, the corporation must also do right by its employees, its customers, the environment, the local community, etc. This view is best expressed through the stakeholder theory developed by Freeman (1984). Corporate philanthropy, under this framework, is but one of the many duties that are expected of the upstanding corporate citizen.

As it exists today, corporate philanthropy is in many ways a compromise or, perhaps more accurately, a conflicted synthesis of the two points of view. Companies may make charitable donations, but they do so under profit-maximizing constraints. This impurely altruistic donation of corporate resources "to address non-business community issues that also benefit the firm's strategic position and ultimately, its bottom line" is known in the literature as "strategic philanthropy" (Saiia et al., 2003). Strategic philanthropy satisfies some of the company's ethical obligations to stakeholders. At the same time, it is justified to shareholders because it is treated as yet another business avenue to be judged "by the profit it generates rather than the social benefit it creates" (Buchholtz et al., 1999).

How exactly does this peculiar business avenue operate? Managers and economists have cited the potential for philanthropy to "enhance consumer name recognition and/or employee productivity, reduce R&D costs, or overcome regulatory obstacles, among other uses" (Smith, 1994). All companies stand to gain from these benefits. However, they are especially crucial to companies that have high visibility and are subject to high degrees of scrutiny.

This paper proposes that vulnerability to public scrutiny drives corporate philanthropy. The company can be impacted by public scrutiny in several ways. The government may impose regulations on an industry and thereby inflict compliance costs on the company. The public may form interest groups to take legal or economic action against the company. The media may report on the company's operations and behavior, occasionally in negative ways.

Under conditions of high public scrutiny, corporate philanthropy can come to the rescue. Donations can create goodwill and buy influence. Charitable contributions can arguably be classified as a form of political activity (Useem, 1984). Indeed, the motivations behind corporate political donations and corporate philanthropic donations can be very similar. Donations can serve as public relations gestures to help cultivate a positive, socially responsible image in the eyes of the consuming and judging (and potentially protesting) public. The more likely a company is to run up against legislation, the greater its need to chalk up a store of "brownie points" with the public in order to retain their goodwill. In addition, the donations establish direct links between the for-profit company and the non-profit foundation recipients, which may transform into useful relationships with political leverage to maneuver around regulation. Political opposition from non-profit organizations is arguably more persuasive in the eyes of legislators and the general public than corporate opposition, which is backed usually by a mercenary motive. To that end, the greater the need for political influence over the government or the general public, the more companies will tend to donate to charity.

In contrast to its altruistic roots, this framing of corporate philanthropy lends it a rather commercial, self-serving, and even sinister tone. In this way, however, strategic

corporate giving can be both beneficial to shareholders, since it improves the corporation's standing, as well as public-regarding, since the corporation is doing good in response to the pressures of the public. By meeting the demands on both sides, perhaps corporate philanthropy has moved society up the social welfare function after all.

This paper expands the limited literature on corporate philanthropy in the following ways. First, this paper runs the horse race between two broad, plausible reasons for giving: altruism vs. strategic motives. Second, previous studies tend to look at corporate giving as an isolated function that is separate from the main purpose of the firm, which is to generate profits. This study corrects this by constructing a model of corporate giving that is based on profit maximization. Third, rather than rely on subjective survey data, this paper uses quantitative measures for the determinants of giving.

This study tests the hypothesis that companies donate for strategic motives against the alternative that they do so for altruistic reasons. Giving strategically implies that companies respond to external pressures imposed by the government and the general public in the form of lawsuits and media attention. Giving altruistically implies that companies react to the degree of need experienced by recipients of charitable help, by gauging the state of the economy and the level of giving by other donors. Through examining the philanthropic behavior of 40 Fortune 500 companies over the course of 7 years, this paper finds that companies are *both* strategic and altruistic in their giving; the two are not mutually exclusive. Moreover, results indicate that more court case involvements and more news coverage increase the rate of giving in statistically and economically significant ways. Results also show that companies tend to give more when macroeconomic variables are weak, signifying times of greater need.

This paper is organized as follows. Part II discusses the relevant existing literature on corporate philanthropy by drawing from the work on philanthropy, as well as from the literature on political donations. Part III explains the theoretical framework used to analyze how corporate philanthropy enters into the firm's profit-maximizing function, and how public scrutiny then interacts with corporate philanthropy. Part IV describes the data used for the empirical analysis in Part V, which reveals the results of this study. Part VI concludes with the implications of these findings on corporate philanthropic behavior.

II. Literature Review

While the altruistic motive does not immediately spring to mind when one speaks of corporate philanthropy, motivations based on altruism are nonetheless an instructive place to start, since philanthropy is at least ostensibly intended to do good. This paper starts with the literature on private philanthropy, which illustrates the possible range of reasons for making donations, from purely other-directed to wholly self-interested. Through this, strategic corporate philanthropy can be placed in a broader context and compared against other plausible rationales for giving. Such analysis can help to reveal the possible nuances of a philanthropic gesture.

By beginning with the individual donor, Andreoni (1990) models giving that is driven by mixed motives, or impure giving, in the following way: $U_i = U_i(x_i, G, g_i)$, where x is the private good consumed by the individual, g is the individual's gift (donation) to the public good G, and finally $G = \Sigma g_i$. Hence, g enters twice into the utility function. In the purely altruistic case, $U_i = U_i(x_i, G)$; that is, the individual cares about his own consumption and the overall amount of the public good, but does not care about how much he personally contributes. In the purely egoistic case, $U_i = U_i(x_i, g_i)$; that is, the individual cares about the

size of his contribution, and does not care about the overall amount of the public good. Andreoni calls the latter case "warm-glow giving." Harbaugh (1998) extends this work by suggesting that donations are made on the basis of "prestige and warm glow". "Warm glow" giving mixed with an appetite for prestige implies that the donor cares about his donation relative to that of other donors and likes receiving public recognition for his generosity. Duncan (2004) builds a model of "impact philanthropy", whereby the donor cares that his contribution makes a more significant impact relative to other donors and that he is the most important donor in the eyes of the recipient. The donor, oddly enough, hopes to induce a moral hazard problem and cause the recipient to become perpetually dependent on him. Indeed, even in the realm of private philanthropy, pure altruism is rarely assumed.

From the private income transfers literature, Bernheim, Shleifer and Summers (1985) develop a model of strategic bequests in which a person influences the behavior of his/her beneficiaries by conditioning the allocation of bequests on the beneficiaries' actions. The paper finds that bequests are often used as compensation for services rendered by beneficiaries. This highly impure, self-interested model of giving that has some regard for the recipients' welfare closely mirrors the structure of strategic philanthropy.

Moving on to the work on corporate philanthropy, most studies seek to question the presumably altruistic motive of donations by testing hypotheses which suggest donations are made strategically. To examine the possibility that philanthropy is strategic in the broadest sense in that it reaps returns, economists have studied the correlation between the size of donations and financial performance. Griffin and Mahon (1997) find no correlation between philanthropic generosity and financial performance. Seifert, Morris and Bartkus (2003) conduct a study of matched pairs of generous and less generous companies within the same

industry and also fail to find a significant relationship between corporate philanthropy and financial performance.

In a more comprehensive study that attempts to examine the combined impact of several factors that determine corporate giving, Buchhholtz, Amason and Rutherford (1999) develop an integrated model of several core motives. They find that the more discretion a manager has over decision-making and the more highly the manager values "service to community", the more generous the corporate donation. The variables in this study were measured through surveys of managers.

Saiia, Carroll and Buchholtz (2003) also employ the survey method and find that managers believe that their firms are becoming increasingly strategic in their philanthropic activities. More intriguingly, they find that higher levels of "business exposure", defined as "the extent to which a firm is open and vulnerable to its social environment", are associated with higher levels of strategic philanthropy. The "business exposure" variable is measured through the manager's perception in a questionnaire.

Moving closer to measuring the extent to which philanthropy brings tangible benefits, Williams and Barrett (2000) show that philanthropy can ameliorate the adverse side effects caused by other corporate activities. They find that firms that violate regulations suffer a decline in their reputations, while those that contribute to charitable causes enjoy positively enhanced reputations. Hence, in combining the two propositions, the authors conclude that, "the extent of the decline in reputation [caused by violations] may be significantly reduced through charitable giving" (ibid.). Reputation was measured through *Fortune* surveys, while violations were measured through citations.

Oddly enough, despite the extensive descriptive literature on strategic donations (Mescon and Tilson, 1987; Kramer and Porter, 2002; O'Hagan and Harvey, 2000; Smith, 1994), the studies have not focused on quantifying or testing strategic hypotheses. Many of the studies cited above explicitly state the strategic rationales behind corporate philanthropy but fail to test them. For instance, Buchholtz et al. (1999) write, "Philanthropy has become one of the strategic tools a manager has for improving profits, instilling customer loyalty, enhancing employee morale, and building community relations." However, their study, like so many others, falls short of measuring these links. The studies tend to rely on survey methods rather than tangible indicators. Furthermore, the studies tend to focus on factors that enable or mitigate corporate giving (such as firm resources), but do not investigate the relation between the rationales cited for strategic giving and the actual amount of giving. While this paper does not go so far as to establish whether corporate giving meets the strategic goals it is purported to serve, it makes the first step in examining whether corporations do in fact make donations in response to the factors (such as public scrutiny) that demonstrate strategic (vs. altruistic) giving.

Interestingly, these strategic links are most developed in the literature on the determinants of corporate *political* activity. If one believes that donations to Political Action Committees (PACs) and political parties are strategically motivated and intended to buy influence, then the links found between motivations and money in the political donation literature can also apply to the work on strategic philanthropic donations. Grier, Munger, and Roberts (1994) study industrial political activity as a collective action problem. They find that PAC contribution by industry is positively driven by the cost-benefit analysis of factors including degree of regulation, geographic concentration, less diversity of products, firm

sales, and sales from government contracts. Hansen and Mitchell (2000) analyze corporate political activities, which include PAC contributions, lobbying and charitable giving, in terms of strategic behavior. They focus on the behavior of individual firms and find that the level of activity is correlated with industry concentration, government contracts, firm size, foreign ownership and regulation. This research in the political sphere has made significant inroads in measuring and linking strategic motivations to political donations. This paper will apply their ideas and techniques to further the work on philanthropic donations.

III. Model

To develop the theoretical perspective of corporate giving, this paper first allows for the possibility that philanthropy by corporations may be altruistic, in recognition of philanthropy's benevolent origins. This can be represented as:

$$g_{i,t} = D_i(D) \tag{1}$$

where g is the amount of corporate giving by each company and therefore a private good; and D is the total amount of donations received by charities, a public good. If corporate giving is altruistic, g and D should have an inverse relationship. The corporation will donate more when D is low and donate less when D is high.

$$dg/dD < 0 \tag{2}$$

As an alternative to altruism, philanthropy may be strategic. In this scenario, the firm's objective is to maximize profits and will conduct its philanthropic work in accordance with this goal. Let us assume that the firm uses inputs capital (K) and labor (L) to produce its output (Q). In addition to producing goods, the firm's activities also engender a public

reputation (R), which is influenced by the varying levels of both the public scrutiny the firm attracts and the goodwill it creates.

$$R = R(S, g) \tag{3}$$

The firm's bad activities (s), an endogenous variable, predispose it to receiving negative attention. However, these bad activities may or may not be noticed by the general public. When the general public does detect s and does respond negatively, public scrutiny (S) is exogenously produced. Public scrutiny hurts reputation. Increasing amounts of scrutiny tend to snowball and inflict an increasingly adverse effect on reputation.

$$dR/dS < 0 \; ; \; d^2R/dS^2 > 0 \tag{4}$$

To counteract such adverse effects on reputation, the firm can choose to endogenously increase its good activities (g), in this case specified as corporate philanthropy, to generate goodwill and thereby provide a boost to its reputation. The positive effects of giving, however, are likely to be subject to decreasing returns.

$$dR/dg > 0 \; ; \; d^2R/dg^2 < 0 \tag{5}$$

Now, the firm produces to expected demand:

$$F(K, L) = Q(P, R) \tag{6}$$

where K = capital; L = labor; Q = output; P = price; R = reputation. Higher R leads to higher sales (or ability to charge premium prices) for given levels of capital and labor inputs.

$$dQ/dR > 0 \; ; \; d^2Q/dR^2 < 0 \tag{7}$$

The firm faces the following profit-maximizing function:

$$\max \Pi = P*Q(P, R(S,g)) - wL - rK - cg \tag{8}$$

where Π = profits; P = price of output; Q = quantity of output; R = reputation; S = public scrutiny; g = corporate giving; w = wage; L = labor; r = cost of capital; K = capital; and c = per unit cost of corporate giving.

Ideally, this paper would derive the optimal corporate giving function, $g^* = f(\ldots)$. However, as there is no specific functional form, g^* cannot be found explicitly. Instead, the first derivative of the profit function with respect to g (maximizing profits with respect to giving) gives an implicit function that defines g^*.

$$g^*: d\Pi/dg = P^*(dQ/dR)^*(dR/dg) - c_g = 0 \qquad (9)$$

Then, the implicit function theorem can be used to find the partial derivative of g with respect to S, the central relationship of interest.

$$\delta g/\delta S = - [\delta/\delta S \ (d\Pi/dg)] \ / \ [\delta/\delta g \ (d\Pi/dg)] \qquad (10)$$

Solving for the components of (10),

$$\delta/\delta S \ (d\Pi/dg) =$$

$$P^*[(\delta^2 Q/\delta R^2)^*(\delta R/\delta S)^*(\delta R/\delta g) + (\delta^2 R/\delta g \delta S)^*(\delta Q/\delta R)] \qquad (11)$$

where $\delta^2 Q/\delta R^2 < 0$ since an increase in g raises the firm's R to relatively high levels, which implies that further increases in R will have a relatively diminished impact on Q. $\delta^2 R/\delta g \delta S > 0$ since an increase in S again weakens the firm's reputation, which magnifies the potential for increases in giving to significantly improve reputation. Since $\delta R/\delta S < 0$ from (4), $\delta R/\delta g > 0$ from (5), $\delta Q/\delta R > 0$ from (7),

$$\delta/\delta S \ (d\Pi/dg) > 0 \qquad (12)$$

Similarly,

$$\delta/\delta g \ [d\Pi/dg] =$$

$$P*[(\delta^2 Q/\delta R^2)*(\delta R/\delta g)^2 + (\delta^2 R/\delta g^2)*(\delta Q/\delta R)] \tag{13}$$

Since $\delta R/\delta g > 0$ and $\delta^2 R/\delta g^2 < 0$ from (5), while $\delta Q/\delta R > 0$ and $\delta^2 Q/\delta R^2 < 0$ from (7),

$$\delta/\delta g \ [d\Pi/dg] < 0 \tag{14}$$

Hence, by applying (12) and (14) to (10),

$$\delta g/\delta S = - \ [\delta/\delta S \ (d\Pi/dg)] \ / \ [\delta/\delta g \ (d\Pi/dg)] > 0 \tag{15}$$

This result shows that an exogenous increase in the level of public scrutiny leads to endogenous decisions within the firm to increase the amount of corporate giving, the central hypothesis of this paper.

This model also can be represented in a diagram:

Good activities (g) → actual goodwill (G) → R ↑ → Π ↑

Corporate activities

Bad activities (s) → actual public scrutiny (S) → R ↓ → Π ↓
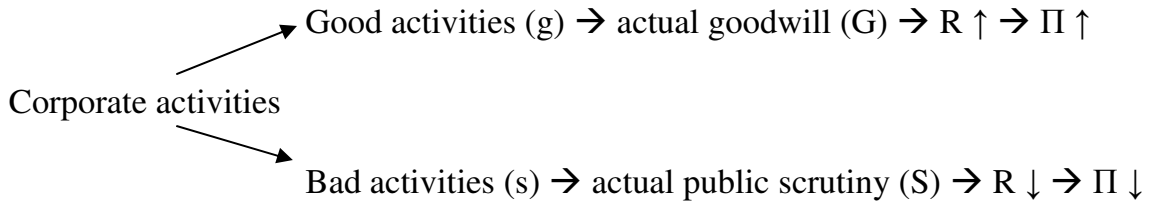
Figure 1.

The effects of corporate activities on profit levels feed back into corporate activities, as the managers of the firm adjust the mix of g and s to achieve the R and therefore the Π_{max} that is their goal. If bad activities (s) invite public scrutiny (S) and hurt the firm's reputation (R), profits (Π) will fall. This negative outcome creates a derived demand for g, since managers will want to restore the firm's reputation and improve profits. Hence, the rise in public scrutiny drives the demand for corporate giving.

IV. Data

The central variable of the model, **g**, the amount of corporate giving, comes from *The Chronicle of Philanthropy.* The journal conducts an annual survey where the largest 150 companies of the Fortune 500 are asked to provide figures on their philanthropic donations. The numbers include cash and in-kind giving but not time volunteered or money raised by employees personally. Each year, approximately 50 companies will decline to state figures, leaving 90-100 companies that provide disclosure. The data span from 1997 to 2003. By filtering for companies that make the corporate giving list for all 7 years and by accounting for mergers and acquisitions, there are data points for 40 companies. The average annual donation for the set of companies is $36 million.

Larger firms have more financial resources available and will tend to give more in absolute dollar amounts. To correct this, a measure of the size of a firm, **II**, is needed to adjust g in order to make it comparable across companies. Sales is selected as an appropriate proxy for firm size, as it has relatively stable growth and serves as a good indicator for the depth of a firm's resources. Sales figures were compiled through Compustat for the set of 40 companies. The annual sales figures range from $2.3 billion to $257 billion. Mean annual sales over the time period is $44 billion, while the median is $27 billion.

Hence, for the regressions, the dependent variable used is **GIVERATE** = amount of corporate giving, g / sales.

The crucial variable for testing altruism, **D**, the total amount of public donations received by charities, can be found in *Giving USA*, an annual report on philanthropy by the American Association of Fundraising Counsel. The data for the years 1997-2003 are obtained from the 2003 report, which gives total funds received by charities, as well as a

breakdown by donor categories: individual, foundation, bequest, and corporate. This variable is used for regressions is **GUSA**, the aggregate measure for all contributions in a given year. It includes corporate giving which accounts for about 5% of the total.

In addition to D, various macroeconomic variables can test how corporate decisions to donate respond to economic need. If corporate giving is compensatory, then weaker economic conditions should correspond with higher giving. Gross domestic product, **GDP**, offers the broadest, most all-encompassing measure of how the economy is performing. Personal consumption expenditures, **CNEXP**, are indicative of the disposable income available to consumers and their willingness to spend it. These numbers are available through the Bureau of Economic Analysis. The Index of Consumer Confidence, **ICS**, from the University of Michigan measures the outlook of consumers through a survey of five questions about their expectations for economic conditions. The level of the S&P 500, **SPX**, may be worth observing as well since it is a leading indicator of market sentiment. These data are available from Compustat. Finally, poverty rates, **POVPER**, which behave in reverse, are included; they increase as the economy worsens. They specifically capture the economic situation of people who are most in need of help. People in this income bracket are most likely to be affected by philanthropic decisions, while (altruistic) donors are likely to be most concerned about the circumstances of people in this demographic. Data on the poverty rates, as measured by the percentage of U.S. population living below the defined poverty line, were compiled from the U.S. Census. These macroeconomic variables are by no means exhaustive in describing the state of the economy or the degree of need. However, by identifying a range of variables, which target different aspects of the big picture, this paper hopes to establish the stability of results found under the altruistic hypothesis.

The most important other variable, public scrutiny, cannot be measured directly. The challenge is to select appropriate proxies. Conceptually, this paper is interested in the economic impact of scrutiny on the company's bottom line. After all, if profits are the corporation's primary objective, the corporation will react to scrutiny (by increasing giving or otherwise) only if it believes that scrutiny will affects profits. Hence, the ideal measure would quantify the cost inflicted by all kinds of scrutiny, whether they involve a loss in revenue, higher compliance costs, or the cost of settling lawsuits. However, given that such dollar figures cannot be obtained, the search for proxies goes one step back in the causal chain to the forms of scrutiny that pose a threat to profits and are likely to induce a firm to do good - or least appear to do better.

With that in mind, the degree of government regulation, as expressed by the number of court cases faced by a company, is a good starting point for measuring government scrutiny. Hansen and Mitchell (2000) construct an index by logging the number of corporate interactions of a company with the federal courts in regulatory cases and with 8 major regulatory agencies: EPA, OSHA, CPSC, FERC, NLRB, FDA, FTC, and the Antitrust Division of the Department of Justice. While the Hansen and Mitchell study simply counts the number of interactions, the Mitchell, Hansen and Jepsen (1997) study creates a measure that captures intensity and range of regulation by multiplying the number of interactions by the total number of agencies (0 to 7 in the study) with which the firm interacted.

This paper selects as its proxy the number of interactions that a company has with court cases at the federal level. **GOVREG** takes a page from the Hansen and Mitchell study and tallies the number of mentions of the company name in the title of a court case with any of these 7 regulatory agencies: EPA, OSHA, CPSC, FERC, NLRB, FDA, and FTC. This was

done by running a search string in the Westlaw database for the company name and any of the 7 agencies in the case title, for each of the 40 companies for each of 7 years.[1]

GOVREGUS captures the number of mentions of the company name in the title of a court case that involves the United States government. (E.g. Antitrust cases of U.S. vs. Microsoft.) These data were collected through Westlaw by searching for the company name and "United States" in the case title, again for 40 companies over the time span. It should be noted that these data face a lower limit of 0 and cannot go negative even if a company has flawless legal conduct. For GOVREG, 22 companies out of 40 are found to have no interactions with the agencies for the time span considered. For GOVREGUS, 7 out of 40 companies have no court interactions with cases where the United States government is a party. The maximum number of GOVREG cases per year for a single company is only 6, while the maximum for GOVREGUS is 18. In a year, the average company faces merely 0.23 GOVREG cases and 0.92 GOVREGUS cases.

As for non-governmental public scrutiny, **TOTALREG**, the total number of court cases that involve a company, is used. This was found by running search strings in Westlaw for simply the company name in the case title, and then subtracting the GOVREG and GOVREGUS numbers compiled previously to keep the measures mutually exclusive. The data face a similar "floor" of 0 case mentions, but now all 40 companies have at least one case mention in the seven-year span. The average number of TOTALREG cases per year is 23.9, with as many as 158 cases for a company in a single year.

Scrutiny from the general public is further measured through the amount of news coverage, **NEWS**. LexisNexis was used to count the number of times a company name

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[1] The Mitchell, Hansen, and Jepson (1997) method of multiplying interactions by number of agencies was not used, because most of the companies faced 0 interactions with most of the agencies in any 1 year. So multiplying them to capture intensity would have resulted in a string of 0s for the majority of companies.

appears in the headline, lead paragraph or terms of articles in the major newspaper file (which includes the *New York Times* and the *Wall Street Journal*). This variable does not separate negative coverage from the neutral or positive. However, by the nature of what makes news sell, negative mentions are likely to exceed positive ones. NEWS gauges the level of public attention and can capture the magnifying effect that a higher level of visibility can have on a company's actual (bad) behavior. The latter effect makes greater NEWS counts a cause for concern as a company reviews its reputation. The average company receives 900 NEWS mentions in a year. The minimum number of mentions is 0, while the maximum is 15000.

Data Specification Summary Table

Dependent variable:

GIVERATE = g / Π

Variable	Definition	Data Source	Description
G	Corporate giving	*The Chronicle of Philanthropy*	40 companies (incl. industry labels); 1997-2003.
Π	Sales	Compustat	For 40 companies; 1996-2003.

Independent variables:

Altruistic -

Variable	Definition	Data Source	Description
GUSA	Total public donations to charities	*Giving USA*	1996-2003; breakdown by individual, foundation, bequest, corporate.
GDP	Gross domestic product	Bureau of Economic Analysis	Levels for 1996-2003.
CNEXP	Personal consumption expenditures	Bureau of Economic Analysis	Levels for 1996-2003.
ICS	Index of Consumer Sentiment	University of Michigan	Annual index from survey of 5 questions; 1996-2003.
SPX	S&P 500 Index	Compustat	Historical prices; 1996-2003.
POVPER	Poverty rates	U.S. Census	(Number of people below poverty level)/(total population). 1996-2003.

Strategic -

Variable	Definition	Data Source	Description
GOVREG	Court case interactions with government agencies	Westlaw	Number times company name is mentioned in case title with EPA, OSHA, CPSC, FERC, NLRB, FDA, FTC; for 40 companies; 1996-2003.
GOVREGUS	Court case interactions with federal government	Westlaw	Number times company name is mentioned in case title with United States; for 40 companies; 1996-2003.
TOTALREG	Total court case interactions	Westlaw	Number of times company name is mentioned in case title excluding GOVREG and GOVREGUS; for 40 companies; 1996-2003.
NEWS	News coverage	LexisNexis	Number of times company name appears in article title, lead paragraph, or terms of major newspapers; for 40 companies; 1996-2003.

V. Empirical Specification and Results

This paper employs a linear regression model to examine the impact of public scrutiny on corporate giving. Regressions are performed on pooled cross-sectional time series data spanning 40 companies and the years 1997 through 2003. The primary specification is as follows:

$$GIVERATE_{ij} = \beta_{0i} + \beta_1 TOTALREG_{ij} + \beta_2 GOVREG_{ij} + \beta_3 GOVREGUS_{ij}$$
$$+ \beta_4 NEWS_{ij} + \beta_5 GUSA_j + \beta_6 CNEXP_j + e_i$$

where i = company; j = year

Panel data is characterized by tracing the same individual units, companies, over time. This method is appropriate for this paper given the limited number of data points available; n and t are relatively small. In addition, panels offer the benefit of studying the effects of public scrutiny as it varies across a diverse set of companies and as it varies across time. Panel data can control for some omitted variables, even if these variables are not observed, by focusing on the changes in the dependent variable over time. In particular, fixed effects regressions control for omitted variables by eliminating the unobserved effects that differ between cases but remain constant over the years. For this paper, this implies that fixed effects can control for individual traits that are specific to each firm, which is useful in light of the variations in their industries, firm size, etc. Fixed effects intercepts have been chosen for the regressions, which means that each firm is assigned a separate intercept in the regressions. This is equivalent to eliminating the general intercept term and constructing dummy variables to represent each of the 40 companies.

Considering the wide range of companies in the sample, the problem of heteroskedasticity is likely. Its effects are countered by calculating GIVERATE as the dependent variable instead of simply giving. Larger companies tend to have more cash

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available for discretionary spending on causes such as philanthropy. Taking giving as a percentage of sales corrects for the differentials in their spending power and puts their charitable acts on a comparable scale. White's test for heteroskedasticity is also used to control for variance.

A preliminary levels estimation of the specification above gives these results:

Table 1

Variable	Coefficient		Std. Error	t-statistic
TOTALREG	4.77E-06	***	(4.43E-07)	10.77
GOVREG	1.05E-05	***	(3.55E-06)	2.95
GOVREGUS	1.39E-06		(2.91E-06)	0.48
NEWS	3.62E-08	***	(7.08E-09)	5.11
GUSA	2.10E-06	***	(2.5E-07)	8.39
CNEXP	-4.18E-08	***	(1.57E-08)	-2.67
R-squared	0.97			
Adj. R-squared	0.97			
Durbin-Watson	1.31			

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

The very high R-squared values and the low Durbin-Watson figure suggest that serial autocorrelation exists. This trending problem seems to be present in the data despite the fact that the time period covered is only 7 years and includes the dot-com boom/bust cycle. Spurious correlation compromises the validity of the above results.

To address this, first differencing is applied to all variables, so that this study compares relative changes in levels rather than absolute levels.

$$XCHG = X_t - X_{t-1} \qquad \text{where X represents all variables}$$

First differencing implies that the focus is not on what determines the initial level of giving. The initial giving rate is assumed to be endogenously determined by the firm or by other external factors. Instead, a first differenced equation focuses on the drivers of change. Assuming a certain giving rate, changes in the independent variables affect the magnitude of change in the dependent variable.

Note that first differencing reduces the number of time periods to 6. This is the new estimation and its accompanying results:

$$\text{GIVERATECHG}_{ij} = \beta_{0i} + \beta_1\text{TOTALREGCHG}_{ij} + \beta_2\text{GOVREGCHG}_{ij} + \beta_3\text{GOVREGCHGUS}_{ij} + \beta_4\text{NEWSCHG}_{ij} + \beta_5\text{GUSACHG}_j + \beta_6\text{CNEXPCHG}_j + e_i$$

where i = company; j = year

Table 2

Variable	Coefficient		Std. Error	t-statistic
TOTALREGCHG	4.75E-07	**	(2.3E-07)	2.11
GOVREGCHG	-1.11E-05	***	(1.1E-06)	-10.21
GOVREGUSCHG	4.98E-06	***	(1E-06)	4.92
NEWSCHG	2.69E-08	***	(4.9E-09)	5.55
GUSACHG	2.71E-06	***	(2.5E-07)	10.70
CNEXPCHG	-4.84E-07	***	(4.9E-08)	-9.92
R-squared	0.30			
Adj. R-squared	0.14			
Durbin-Watson	2.46			

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

All independent variables are significant at the 95% confidence level, with all but TOTALREGCHG significant at the 99% confidence level. The lower R-squared values are to

be expected on a first-differenced equation and suggest that serial correlation has been corrected.

A. The Strategic Hypothesis

The positive signs and significant coefficient on TOTALREGCHG matches what intuition and this paper's hypothesis predict. Greater public scrutiny in the form of more TOTALREG cases encourages corporations to give more. Using the average sales figure of the 40 companies of $44 billion, the coefficient on TOTALREGCHG shows that for every 1 unit increase in the number of TOTALREG case mentions, giving increases by $21,000 for the average-sized firm in the sample.

The conflicting signs on the GOVREG and GOVREGUS coefficients pose a conundrum. The positive sign on GOVREGUS confirms this paper's hypothesis, while the negative sign on GOVREG's coefficient contradicts expectations. Both variables concern lawsuits which involve the government, but GOVREGUS case mentions are likely to be more serious, as these charges involve the United States government rather than one its agencies. On average, they probably are more costly to fight or settle and receive greater prominence in the media. Sufficiently negative media coverage may hurt sales. This will induce a greater need for improving the company's reputation, which can be achieved through more generous giving. In economic terms, 1 more GOVREGUS case mention corresponds to $220,000 more in donations.

As for the negative coefficient on GOVREG, it perhaps can be explained by a combination of factors. On the one hand, these cases represent entanglements with a government agency and are likely to lead to costly legal procedures. On the other hand, most

of these cases generate little media interest. From the company's perspective, it may be prudent to cut back on discretionary philanthropic spending to increase the funds available for combating lawsuits. However, as there is little adverse fallout with the general public due to low levels of publicity, there is no need to increase philanthropic efforts.

Granted, some GOVREG cases may receive more media attention and become more widely publicized than other cases. To test this effect, an interaction term, GOVREGCHG*NEWSCHG, is introduced into the specification. The coefficient on this term is notably positive and significant. This suggests that with high profile GOVREG cases, the concern for public backlash exceeds the legal/financial concerns and induce companies to increase giving. This supports the idea that it is scrutiny, and not simply regulation, that drives giving.

Table 3

Variable	Coefficient		Std. Error	t-statistic
TOTALREGCHG	6.83E-05	*	(3.6E-05)	1.88
GOVREGCHG	-9.31E-04	***	(0.00023)	-4.06
GOVREGUSCHG	3.44E-06		(0.00016)	0.02
NEWSCHG	2.67E-06	***	(6.1E-07)	4.41
GOVREGCHG*NEWSCHG	2.45E-06	***	(1E-06)	2.38
GUSACHG	2.76E-04	***	(2.8E-05)	9.81
CNEXPCHG	-3.92E-05	***	(5.2E-06)	-7.48
R-squared	0.25			
Adj. R-squared	0.07			
Durbin-Watson	2.45			

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

Does NEWS have a similar amplifying effect on GOVREGUS? To test this, the interaction term, GOVREGUSCHG*NEWSCHG, is introduced into the specification. The results in Table 4 show that the coefficient on the new term is interestingly negative. This variable is, however, is weakly significant with a p-value of 0.12. The reversal of signs from the component variables, GOVREGUS and NEWS, can perhaps be explained by a company's attempts to effectively use limited discretionary funds. If the average GOVREGUS case is already an expensive matter, the combination of a GOVREGUS case with high levels of NEWS may imply an extremely costly legal case. At this point, it may be more prudent to cut back on philanthropic spending in order to increase the funds available for dealing with the courts. While negative media coverage can hurt reputation, the company may decide that expenditures on philanthropy reap lower marginal benefits than further legal spending.

Table 4

Variable	Coefficient		Std. Error	t-statistic
TOTALREGCHG	4.81E-07	**	2.28E-07	2.11
GOVREGCHG	-1.07E-05	***	1.06E-06	-10.08
GOVREGUSCHG	4.62E-06	***	1.10E-06	4.20
NEWSCHG	3.20E-08	***	5.05E-09	6.34
GOVREGUSCHG*NEWSCHG	-1.62E-09		1.04E-09	-1.56
GUSACHG	2.86E-06	***	2.64E-07	10.81
CNEXPCHG	-5.07E-07	***	5.09E-08	-9.96
R-squared	0.30			
Adj. R-squared	0.14			
Durbin-Watson	2.46			

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

The NEWS variable in Table 2 has a positive and significant coefficient as theory predicts. Its economic significance is considerably smaller than that of the _REG variables. For every unit increase in the number of NEWS mentions, there will be a $1,190 increase in giving. A unit of this variable has the smallest economic impact by far. The average news article is capable of inflicting far less damage than a typical court case.

A comparison of the relative magnitudes of the strategic variables illustrates some interesting relationships. A single TOTALREG court case mention has an impact on giving 18 times that of a news mention. One expects a lawsuit or court-related interaction to cause a more severe impact on a company's reputation than a news article, and hence create a greater need for manufacturing goodwill. Companies may also be mentioned in news articles for neutral, innocuous or even positive reasons. Thus, the average news mention is understandably less likely to generate a need for goodwill.

A GOVREGUS case presents the harshest form of scrutiny. A company name mention with a GOVREGUS case has an impact on corporate giving that is 10 times that of TOTALREG, or 185 times that of NEWS. This points to the severity of charges involving the United States government. The public regard for these cases may mean that they constitute scrutiny from both the government and the general public, a double effect which helps to explain their ability to strongly affect giving.

While GOVREGUS may seem to have a greatest *per unit* impact on giving, it does not necessarily have the greatest influence on giving rates as an overall category. In order to examine the relative importance of the different forms of public scrutiny, their average total impacts on giving must be compared. Table 5 below shows the assessment.

Table 5

	GOVREGUS	TOTALREG	NEWS
MEAN (UNITS)	0.925	23.9	900
PER UNIT IMPACT ON GIVERATE	**$220,000**	$21,000	$1,190
AVERAGE TOTAL GIVERATE IMPACT	$203,000	$502,000	**$1,070,000**

The second row shows the relative per unit impact, where GOVREGUS clearly has the lead at an increase of $220,000 per unit. However, for a comparison of the average total impact, the average number of occurrences matters. The average company has 900 NEWS mentions, a far smaller number of TOTALREG cases, and less than 1 GOVREGUS case per company per year. Multiplying numbers in the first two rows gives the results in the third row, which shows the average total impact on giving, when each form of scrutiny is taken as a category. While GOVERGUS has the highest per unit impact, it is the category of NEWS that has the highest average total impact. At an increase of $1,070,000 in giving on average for the category, NEWS mentions show that media coverage as a form of public scrutiny has the greatest economic significance for corporate giving.

The figures from the strategic variables demonstrate that public scrutiny through the courts and through the media exert statistically and economically significant pressure on companies to increase their giving. However, the argument that companies give strategically does not preclude the possibility that there may be an altruistic element in their giving as well.

B. The Altruistic Hypothesis

The remaining two variables in the regression test for altruism. Both GUSA and CNEXP display statistical significance, but their signs tell a conflicted story. The positive

coefficient on GUSA opposes the altruistic hypothesis. When overall giving falls, the public need for charitable funds will increase. If companies are other-regarding, then they should respond by increasing giving. However, the positive coefficient on GUSA shows that they follow general giving trends, instead of seeking to counteract them in order to achieve an optimal amount of total giving. In contrast, the negative coefficient on CNEXP supports the idea that altruistic motives are at work. When consumer spending falls, which happens in times of a weaker economy, corporations tend to ameliorate public need by increasing giving.

To further test these contradictory results, the basic regression is repeated with other macroeconomic variables in place of CNEXP to give the results in Table 6.

Table 6

	CNEXP	GDP	SPX	ICS	POVPER
TOTALREGCHG	4.75E-07 **	4.76E-07 **	7.38E-07 ***	6.91E-07 ***	5.76E-07 ***
GOVREGCHG	-1.11E-05 ***	-1.18E-05 ***	-1.46E-05 ***	-1.01E-05 ***	-1.44E-05 ***
GOVREGUSCHG	4.98E-06 ***	5.71E-06 ***	5.17E-06 ***	2.74E-06 **	5.14E-06 ***
NEWSCHG	2.69E-08 ***	2.73E-08 ***	2.26E-08 ***	2.26E-08 ***	2.55E-08 ***
GUSACHG	2.71E-06 ***	1.70E-06 ***	1.55E-06 ***	1.52E-06 ***	3.98E-06 ***
CNEXPCHG	-4.84E-07 ***				
GDPCHG		-1.49E-07 ***			
SPXCHG			-6.28E-05 ***		
ICSCHG				-2.58E-06 ***	
POVPERCHG					6.69E-05 ***
R-squared	0.30	0.30	0.27	0.29	0.32
Adj. R-squared	0.14	0.14	0.10	0.13	0.16

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

The first four altruistic variables, which are expected to be negative, all do in fact carry negative signs. The poverty rate variable, POVPER, should have the reverse effect and increase in tandem with giving. Its positive sign shows that it does. The agreement of these variables lends strong credence to the altruistic hypothesis.

The ambiguity introduced by GUSA's unexpected positive sign may be accounted for by the fact that the variable does not measure public charitable need directly. It measures total donations, rather than need. A negative sign on GUSA will only support the notion of altruism if it is assumed that total need is constant. If that is case, altruistic corporate donations should compensate shortfalls in the total donations pool by increasing when GUSA falls. However, charitable need is not constant. When the economy is weak and charitable need increases, donors should increase their contributions if they are acting altruistically. Even as total giving is rising in times of recession, the need for donations may surpass that increase. A corporation that gives more when everyone else is also giving more may be addressing that additional need. Thus, a positive sign on GUSA can in fact support the altruistic case.

To further investigate these possibilities and clarify the above results, an interaction term, GUSACHG*CNEXPCHG, is included in the regression. Results can be found in Table 7. The coefficient on CNEXP is now unexpectedly positive; it was negative in Table 6. However, the significant coefficient on the new interaction term sheds some light on the altruistic motives at work. The negative coefficient suggests that when the economy is performing well and total donations are high, companies tend to cut back on giving. Conversely, if the economy is weak and total donations are low, companies will tend to increase giving. These philanthropic patterns signify altruistic behavior.

Table 7

Variable	Coefficient		Std. Error	t-statistic
TOTALREGCHG	4.99E-07	**	2.11E-07	2.37
GOVREGCHG	-8.19E-06	***	1.05E-06	-7.82
GOVREGUSCHG	4.34E-06	***	1.05E-06	4.15
NEWSCHG	2.64E-08	***	5.11E-09	5.18
GUSACHG	2.31E-05	***	2.39E-06	9.65
CNEXPCHG	5.59E-07	***	1.19E-07	4.69
GUSACHG*CNEXPCHG	-7.80E-08	***	8.89E-09	-8.77
R-squared	0.34			
Adj. R-squared	0.18			
Durbin-Watson	2.44			

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

As a robustness check, one concern is that, because of the first differencing, the changes in sales may be driving the regression rather than the changes in giving. Since GIVERATECHG = $[g_t / \text{sales}_t] - [g_{t-1} / \text{sales}_{t-1}]$ is used as the dependent variable, and sales is much larger in magnitude than giving, dramatic changes in sales may be captured by the estimation instead of the changes in giving. To investigate this possibility, a new term is introduced:

GIVERATE1 = g_{ij} / (average total sales over 7 years)$_i$

This holds the sales denominator constant over the 7 years for each company, but allows the sales factor to vary across the companies. The new term controls for the differences in financial resources across companies, but no longer differentiates between the increases or

decreases in the resources of a particular firm over time. Repeating Table 6's regressions with the GIVERATE1 adjustment gives these results:

Table 8

	CNEXP	GDP	SPX	ICS	POVPER
TOTALREGCHG	7.82E-07 ***	7.76E-07 ***	7.89E-07 ***	8.14E-07 ***	7.85E-07 ***
GOVREGCHG	-3.39E-06 **	-3.84E-06 **	-2.90E-06 *	-2.05E-06	-3.64E-06 **
GOVREGUSCHG	2.29E-06 **	2.46E-06 **	2.24E-06 **	1.74E-06	2.74E-06 **
NEWSCHG	1.32E-08 ***	1.14E-08 ***	1.05E-08 ***	1.53E-08 ***	1.53E-08 ***
GUSACHG	2.45E-06 ***	2.37E-06 ***	1.96E-06 ***	2.96E-06 ***	2.82E-06 ***
CNEXPCHG	9.12E-08 *				
GDPCHG		7.85E-08 ***			
SPXCHG			7.68E-05 ***		
ICSCHG				-7.70E-07 ***	
POVPERCHG					3.91E-07
R-squared	.31	.32	.32	.31	.31
Adj. R-squared	.15	.16	.16	.15	.15

* indicates .10 significance
** indicates .05 significance
*** indicates .01 significance

The scrutiny variables generally maintain their signs and significance levels, further supporting the strength of the strategic hypothesis. However, the first three macroeconomic variables have switched signs: they have become positive and now discredit the altruistic hypothesis. This result may be explained by the fact that, dividing giving by a constant average total sales figure for each company makes GIVERATE insensitive to the changes in the financial resources of a firm, which can vary significantly over 7 years. Thus, the estimation may be prejudiced against altruism.

A closer examination of the changes in g and in sales reveals that this prejudice is likely, while the concern about sales driving the regression is unwarranted. The percentage

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changes in g and in sales are both comparable. On average, both data series change by about 10% from year to year. Over the course of 7 years, these annual 10% changes accumulate considerably. To that end, holding the denominator of GIVERATE constant with an average figure necessarily distorts the results. GIVERATE will appear to fluctuate more than it should, while the growth in the financial resources of the firm goes ignored. Since both sales and giving grow significantly and comparably over 7 years, the original GIVERATECHG (and not GIVERATE1CHG) is the most appropriate dependent variable to use. These numbers also suggest that when firms approach their budget for giving, they focus on giving as a fraction of their available resources, rather than on its absolute level.

The general conclusion to be drawn from Table 6 is that the scrutiny variables withstand the robustness check and back this paper's central claim that public scrutiny drives corporate giving.

VI. Conclusion

This paper offers insight into the effectiveness of public scrutiny in influencing the behavior of corporations. Governmental scrutiny, in the form of court case interactions with companies, has substantial leverage over increasing the giving rate of companies. Court cases that implicate a company and involve the United States government or other non-governmental parties have statistically and economically significant effects on increasing giving. However, court cases involving select government agencies seem to have a reverse impact on giving, arguably because they are less publicized.

News coverage is a significant driver of corporate giving in and of itself. When it occurs in tandem with government agency court cases, it has a further amplifying and

positive impact on giving. These results suggest that the general public is able to exert credible pressure on corporations in ways beyond what government regulation can achieve. The relative impact of the various forms of public scrutiny show that cases involving the federal government are most severe. However, overall, it is media attention that has the greatest average total impact on giving rates.

Interestingly, altruistic reasons for giving were discovered alongside the strategic motives. Macroeconomic indicators, including gross domestic product, a consumer sentiment index, and the poverty rate, all consistently demonstrate that companies give more in times of greater need. These results all corroborate to make a convincing case that corporate giving is indeed strategic *and* altruistic.

The fact that the variables of interest in this paper are measured through proxies points to the potential areas for future research. As mentioned in the data section of this paper, there are many ways in which to proxy for public scrutiny. Future studies may wish to explore the realm of possibilities, perhaps by considering measures such as the compliance costs faced by companies, the actual amount spent on dealing with lawsuits, or by employing survey methods which capture the public perception of a company's reputation when it behaves badly.

On the altruistic side, it may be worthwhile to investigate the giving relationship between corporations and the specific beneficiaries of their giving. Matching donors and recipients will allow for a closer study of the extent to which altruistic motives dominate. In addition, it may be useful to gather data on the number of requests for donations or the number of applications for grants as proxies for altruism. Companies are more likely to use such variables to gauge the degree of public need than a generic macroeconomic variable.

With better proxies, research can go so far as to compare meaningfully the relative degrees of altruism and strategic motives.

The story behind corporate philanthropy is a mixed one with double-edged motives. This dovetails nicely with the broader story of corporate social responsibility. Many public intellectuals and interest groups have argued for the need to be socially responsible corporate citizens from a normative, ethical perspective. Economists have tended to focus on whether it is profitable to be socially responsible, and whether it is possible to realign incentives to make corporate social responsibility a profitable, and even necessary, venture. This paper suggests that to a considerable extent the government and the general public do have the credibility and capacity in the marketplace to impose their values on corporations. While much has been written about the all-powerful multinational company that can bend the will of governments to its agenda and hold the future of entire economies at its mercy, this study argues that corporations, particularly large and powerful ones, are still subject to the preferences and opinions of the public at large. Public perception may not be powerful enough to override all bad corporate behavior, but it can nonetheless be a persuasive force in fostering some social concern and some good work from corporations.

As for altruism, perhaps corporations behave altruistically within constraints. They help out to the extent that they can. After all, they do not make philanthropic decisions in a vacuum but instead have to weigh philanthropy against other competing claims (by all-important shareholders, for instance). Alternatively, perhaps what is perceived as altruism is really a well-calculated attempt to project an image of altruism. Companies do good to do well. The reputational benefits from making the same donation in hard times may be better appreciated and applauded than if made in good times. If it benefits the corporate reputation

to make donations regardless of motive, the perception that donations are made with all good intention must be that much more well-regarded.

Cynicism aside, $13.5 billion donated is $13.5 billion benefiting education or health care or the arts. The conclusions of this paper highlight the possibility of persuading corporations to think beyond their conventional notions of the bottom line. Even if corporations always operate strategically with an eye on profits, they can be convinced to make investments towards objectives on which they cannot easily evaluate returns. The question then is, how else would we like corporations to behave better?

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