RICE UNIVERSITY

Corporation Giving: An Investment in Goodwill

by

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The philanthropic activities of corporations provide an interesting economic problem because traditional economic theory appears to not allow for this type of behavior on the part of the firm. However, such activity does take place and economists have recently begun to investigate the philanthropic activities of corporate organizations.

Three main reasons are usually postulated to explain corporate giving. The first is that corporations make gifts and contributions for the same reasons individuals make them. When a corporation is considered in terms of an organization the above reason is no longer a good explanation of corporate philanthropic activity. The other common reasons offered for corporate giving are first, that gifts can achieve the same results as more common types of business expenditures and second, corporations give because society requires that they do so. Both of these reasons are useful in providing an explanation of why corporations undertake philanthropic activities.

In this paper corporate philanthropy is discussed in terms of an investment in a stock of goodwill. This investment in goodwill concept is used in order to provide a framework which will allow corporation giving to be studied with the same tools that are used to study other
business expenditures. The optimal quantity of goodwill from gifts is assumed to be related to the amount of goodwill the firm obtains from advertising, the amount the firm spends on employee fringe benefits, and the amount which society expects the firm to give.

A brief empirical study indicates the relationship between corporation giving and the factors mentioned above. Other questions such as the cost of the gift to the corporation and the relationship between corporation giving and economic efficiency are also discussed in separate sections.

The result of this paper is that corporation giving has been placed in an analytical framework which allows it to be studied by using the traditional tools of economic analysis. It also emphasizes the returns to the corporation from giving and allows the corporation to approach its giving decisions in a more rational manner.
Acknowledgements

I would like to thank Professors F.K. Levy and Charles McLure for their helpful comments and criticisms during the writing of this thesis.
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I. Introduction

Corporation gifts and contributions to charitable activities have concerned economists more in recent years than they did previously. Interest seems to have shifted somewhat from whether corporations should make gifts or contributions to why they make gifts. Recent studies have made detailed probes into some of the variables which appear to influence the decisions of firms concerning how much to give.

This paper sets forth a framework which would allow a corporation to come to a rational decision concerning its giving activities. In section II the possible reasons for corporate giving are discussed, and section III attempts to derive a reasonable framework within which a corporation could form its decision on giving. Section IV is a brief empirical examination of some of the variables discussed in sections II and III and in section V a brief note is made concerning the actual cost to the firm of a corporate gift. Section VI discusses corporate philanthropy and economic efficiency while section VII gives a brief summary of the paper and suggests some areas for future investigation.
II. Reasons for Corporate Giving

In most discussions of corporate giving three main views have been posited concerning why corporations would undertake any charitable activities. The first is that corporation giving represents a philanthropic act. Under this view, the corporation is not concerned with whether any direct benefits would accrue to the corporation, but instead it is just trying to act like a good citizen. The act of giving is assumed to involve direct "utility" to the corporation. From this viewpoint, corporate giving could be seen as corporate consumption. That is, the corporation, as an organization, can in some way obtain direct "utility" through the use of economic resources. This utility is assumed to be analogous to that derived by an individual who undertakes philanthropic activities.

The question of whether a corporation, as an economic organization, can derive satisfaction from giving as a form of consumption, makes this approach to corporate giving of

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2 The term "good citizen" means, in this context, that the corporation is attempting to meet the obligations which society expects it to fulfill. That is, it tries to perform the functions which society feels to be desirable for it to undertake. These functions do not necessarily have to fall into the scope of what is usually considered economic activity.
doubtful practical value. The corporation, thought of as an organization, cannot gain any type of utility from an activity except as the individuals who are members of that organization can derive utility from this activity. If the charitable acts of the corporation do affect the individual utility functions of the members of the organization, then the corporate act of giving could be analyzed as a form of compensation to the members of the organization for their participation in the organization. When this is the case, it would seem that a more reasonable approach to corporate giving would be to look at it as some sort of employee compensation or perhaps a dividend to the corporation's stockholders. In summary, because a corporation, when viewed as an organization, cannot gain utility from an act of direct corporate consumption, then the view of corporation giving as a purely philanthropic activity would appear to be an "empty box."

A second approach to corporate giving is to analyze it as a form of business expense. According to this view, a corporation can meet through its giving activities, some of the same objectives which it would normally achieve by allocating funds to the more traditional categories of business expenses. For instance, corporation giving could be looked upon as an additional form of employee compensation as was noted above. An example of this could be a donation by a firm to a local hospital which would improve the quality of the medical care in the community. This type of
donation might be a substitute for increased contributions by the firm to an employee health insurance plan. A well publicized gift to a popular charity would establish goodwill toward the firm among customers much as would expenditures usually included under advertising expense. Similarly, a contribution to an educational institution could be viewed as a form of employee training expense. A profit maximizing corporation would allocate resources to giving up to the point where the marginal cost of the gift to the firm would be equal to the marginal revenue product of the gift.

A third approach to corporation giving sees it as an informal tax imposed upon the corporation by public opinion. This tax is an expression of the view which the public has concerning the role of the corporation in society. From the viewpoint of the firm, the paying of the tax is one way of insuring the existence of the corporation as a legitimate institution. Because many of the services provided by private philanthropy are in some sense public goods which have traditionally been financed through private means rather than by the government, it seems reasonable to assume that the corporations would be expected to pay for part of these "philanthropic public goods" just as they do for the usual type of public goods. It is not unusual for a single institution to receive both private donations and grants made from public revenues, e.g., a new college science building financed by gifts from corporations and alumni as
well as grants made by the federal government. In such an example, the public good aspects of education are being paid for, not only by the government, but also by the philanthropic activities of individuals and corporations in the private sector. Because corporations presumably receive some type of benefit from these "philanthropic public goods" the public would expect them to help with their financing although there is no legal statute forcing the corporations to do so. The provision of a social climate favorable to the existence of corporations becomes increasingly important when the legitimacy of corporate power is being questioned as it is today by some people.

The above discussion of the results of private philanthropy in terms of "philanthropic public goods" may also indicate a possible reason why firms sometimes put pressure on their employees to give to a certain charity. One of the most serious obstacles to the optimal provision of public goods is the non-revelation of preferences for public goods by individuals in a society. This problem results from the non-exclusive nature of most activities considered to be public goods, e.g., defense expenditures, public health programs, etc. When a firm can put pressure on its employees to make charitable contributions it can force them to reveal their preferences for "philanthropic public goods". This allows everyone, both the firm and its employees, to benefit from the provision of a greater amount of the public good than would be obtained if the employees
were not encouraged to reveal their preferences.

The above discussion of the various approaches to analyzing firm giving suggests that the most useful approach is to look at it in terms of the benefits that can be expected to accrue to the firm as a result of its gift or contribution, i.e., to view giving in the same light as other business expenditures, but not as a philanthropic act. Richard Eells has noted that viewing giving as a purely charitable act can lead to an inefficient allocation of a firm's resources. By viewing giving as just another type of business expenditure it is hoped that better allocation of a firm's resources would be one of the results.

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III. Framework for Giving

Gifts and contributions by a corporation can be viewed as the building of a stock of goodwill toward the corporation. This stock of goodwill concept is similar to that used by Nerlove and Arrow in dealing with advertising. The concept of goodwill appears to be applicable in analyzing corporate giving because goodwill seems to be the major result of giving. There are few other benefits which could be obtained through giving, which could not be gained more efficiently in another manner. For example, spending money to send a person to school in a specified field of study and with the understanding that the individual will go to work for the firm financing his education would be a more efficient way to train an employee than just giving a grant to a university and then hoping to hire some of its graduates.

In the above example goodwill would be the major result of the grant to a university. This goodwill might lead the university to steer talented individuals in all fields toward the gift giving company and thereby reduce the


5 This point is related to the concept of "general" and "specific" training. General training increases the productivity of the worker to all firms while specific training increases the productivity of the worker only to the firm providing the training. In the example in the text the giving of the grant to a university would be a form of general training while aid given to a person with the understanding he will work for the firm providing the aid would be more closely related to specific training.
company's hiring expense. This steering activity might continue for a number of years in the future. Thus, the type of grant just mentioned could be discussed in terms of an investment in a stock of goodwill.

Why should giving be discussed as an investment rather than a current expense? The reason is that the stock of goodwill generated by a gift is expected to exist for more than one period. Casual empiricism would seem to suggest that a gift given during one time period would still affect the attitudes of people (customers, suppliers, and employees) toward the firm in following time periods. It also seems logical to assume that the influence of any one gift will decline as time passes, i.e., the stock of goodwill depreciates.

Another reasonable assumption would be that there should be some sort of optimal level for the stock of goodwill derived from gifts just as there should be of any other fixed asset employed by the firm. Nerlove and Arrow calculated the optimal level of goodwill from advertising in relation to a given level of sales during a period. With respect to goodwill from giving we shall let,

\[ G^*_t = G(A_t, e_t, v_t) \]

where,

- \( G^*_t \) = the optimal stock of goodwill from gifts in period \( t \),
- \( A_t \) = the optimal stock of goodwill from advertising in year \( t \),
- \( e_t \) = the amount spent on employee fringe benefits in year \( t \),
\[ v_t = \text{an informal tax imposed by society through public opinion in year } t. \]

Gifts are related to advertising when they give the company a good image in the eyes of the firm's customers. It would seem reasonable to expect that in order to obtain the maximum benefit from each dollar of giving, the advertising resulting from a gift should be combined in the proper proportion with other forms of advertising, e.g., a charitable contribution should be accompanied by a certain amount of publicity to let the public know about the gift. This expectation would lead to some optimal stock of gift goodwill being associated with each stock of conventional advertising goodwill.

Gifts are also related to that portion of employee compensation normally referred to as fringe benefits. An example of this would be the case described earlier in which a business firm makes a contribution to a local hospital. The donation of funds to build a public park available to the firm's employees in order that they might derive more pleasure from their leisure time might be another example. Any type of giving which would improve the prestige of the firm in the community in which its employees live should, according to March and Simon,\(^6\) make it more likely the employees will identify with the firm because such an identification is a means of gaining personal status.

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This should make the employees more receptive to the goals of the firm. Also, by giving to charitable activities which are important to the employees, the firm can help to combine its special goals with those of its employees.

The relationship between the optimal stock of goodwill and public opinion concerning the desirability of corporate giving is expressed by the informal tax rate. The penalty associated with not paying this unofficial tax liability could be the possible elimination of the corporation. The most likely way this would come about would be through a loss of business. Another possible, but unlikely to be used, method would be the elimination of the business through legal channels. This could occur if the public became aroused by the failure of the firm to meet what were considered to be its social obligations. Any public sentiment strong enough to elicit this type of response would probably result in the abolition of most private corporations. The amount of attention paid by the firm to this informal tax would depend on how the firm estimated the probability of the implementation of such a penalty.

The problem facing the firm is how much to allocate to gifts in any given year. The following expression gives one view of how much the firm should give in a given year

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7 Gifts may be made either in cash or in kind. We will assume here that we are referring to cash gifts because of their greater generality. The nature of a corporation's product could restrict its ability to make gifts in kind to a very limited range of donees. Some of the analytical differences between cash gifts and gifts in kind are discussed in section V.
when the factors discussed above are considered to be the most important determinants of corporation giving. Assume that gross giving in any year cannot be negative and that the goodwill derived from an expenditure will last beyond the period in which the expenditure is made. Then the amount to be given in any year, \( t \), can be represented by,

\[
\text{g}_t = \alpha \text{G}_{t-1} + h \left[ b_1 (a_t - JA_{t-1}) + b_2 (e_t - e_{t-1}) + b_3 (v_t - v_{t-1}) \right] + b_4 D_t
\]

where,

- \( \text{g}_t \) = the amount of giving in year \( t \),
- \( \text{G}_{t-1} \) = the stock of goodwill from giving existing in year \( t-1 \),
- \( a_t \) = the amount of advertising in year \( t \),
- \( A_{t-1} \) = the stock of goodwill from advertising in year \( t-1 \),
- \( \alpha \) = the rate of depreciation of the stock of goodwill from gifts,
- \( j \) = the rate of depreciation of the stock of goodwill from advertising,
- \( D_t \) = the total dividends paid to stockholders by the corporation in year \( t \),
- \( h \) = a partial adjustment coefficient, \( 0 < h < 1 \),
- \( b_1 = \frac{\partial G}{\partial a} > 0 \)
- \( b_2 = \frac{\partial G}{\partial e} > 0 \)
- \( b_3 = \frac{\partial G}{\partial v} > 0 \)
- \( b_4 = \frac{\partial G}{\partial D} > 0 \)

The expression \( (a_t - JA_{t-1}) \) represents the change in the stock of advertising goodwill during the preceding year and \( (e_t - e_{t-1}) \) is the change in the outlay for fringe benefits during the preceding year. \( b_1 \) and \( b_2 \) represent
the adjustment coefficients relating the changes in the two variables mentioned above to the optimal stock of goodwill. The informal tax variable, $v_t$, is defined as follows, \[ v_t = \frac{Z_t}{N_t} \eta_x \]

where,

$v_t =$ the informal tax imposed on the firm in year $t$,

$Z_t =$ national, non-corporate philanthropy in year $t$,

$\eta_x =$ before-tax profits of the firm in year $t$,

$N_t =$ national income in year $t$.

The assumption upon which this definition is based is that society expects the corporation to contribute an amount proportional to the amount given by the non-corporate sector of the economy.

$D_t$ is included in (2) to indicate a relationship between gifts which a corporation makes and the amount of dividends it pays to its stockholders. Members of the corporate organization other than employees, specifically the owners, can also be compensated for their participation in the organization by means of corporate giving. If a corporation's shareholders can receive the same type of utility from giving by the corporation as they do from their own individual acts of philanthropy, then the shareholders can increase the return on their shares of stock by allowing the corporation to act as an agent through which they carry on their philanthropic activities. Appendix A shows that for a given amount of pre-tax, pre-gift corporate income...
the sum of the stockholders' disposable income after giving and the total amount given is greater when the corporation is the agent doing the giving than when the stockholders themselves do the giving. This of course assumes that stockholders can achieve the same type of utility from a gift given for them by a corporation as they can gain by making the same contributions themselves. For this assumption to be valid the stockholders would have to play a large part in determining the magnitude and the direction of their corporation's charitable activities.

$D_t$ is included in (2) but not in (1) because gifts representing a dividend payment are not given for the purpose of contributing to a stock of goodwill. However, there is no reason why any particular gift would not be able to serve more than one purpose, i.e., as both a dividend payment and an addition to the stock of goodwill from giving.

The partial adjustment coefficient, $h$, represents a rational response on the part of the firm to the uncertainty it faces when making the decision on how much to give. The reason $h$ is less than one is that because of the uncertainty concerning future conditions, the firm would not wish to over-adjust its stock of goodwill from giving. If the optimal stock of giving goodwill were to decrease quite rapidly, the most rapid rate at which the actual stock could be decreased would be the annual rate of depreciation. It therefore seems reasonable to assume that the firm may not
fully adjust to changes in the parameters which determine the optimal stock of goodwill until it is sure that these changes will not be reversed in the near future.

The signs on $b_1$, $b_2$, and $b_3$ are all assumed to be positive. The reason for the sign of $b_1$ and $b_2$ is that giving is considered to be a complimentary expenditure with respect to both advertising and employee fringe benefits. The reason for the sign of $b_3$ is obvious. The larger the tax variable, the greater the amount of giving needed to meet the firm's obligations. The sign on $b_4$ is positive because it is assumed that the amount of charitable contributions which individuals desire to make from their dividend income increases (decreases) as their dividend income increases (decreases).

Equation (2) thus gives a rational description which firms follow in order to obtain the optimal quantity of goodwill from giving, relative to their other assets.
IV. Empirical Study

Schwartz, in his paper on corporate giving, has shown that there is a positive correlation between gifts and advertising expenditures. In the present paper a brief study was undertaken using data from consolidated income statements compiled by major industrial group. The three industrial groups chosen were selected because their relatively high expenditures on advertising seemed to indicate the awareness of the industries' members of the usefulness of goodwill and also, that the structure of these industries was such as to permit this type of non-price competitive behavior. First of all, many utilities, communications, and transportation firms are monopolistic in nature and are subject to many government controls and regulations. This would seem to give them an incentive to try to make public opinion concerning themselves as favorable as possible. This favorable image, which these firms try to foster through advertising and philanthropic activities, could affect the ease with which they receive favorable decisions on proposed rate changes, etc.

Similarly, the market structure of most manufacturing industries can be best described as oligopoly or monopolistic competition. Product differentiation is important under

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both types of market structure and manufacturing firms may look upon philanthropy as another type of product differentiation. Finally, the large amount of advertising done by retail firms suggests they know the importance of advertising goodwill. Because the structure of the retail industry obviously allows for non-price competitive behavior it seems reasonable to assume that it would also allow for philanthropic activities whose effects are similar to advertising in many ways.

The three expenditures, gifts, advertising, and employee fringe benefits were all computed as a percentage of total deductions and the movements of these ratios were compared over time. In general, the three ratios seemed to move together, particularly when considering the period investigated as a whole. During the ten year period, 1957-1966, all three of these deductions tended to increase as a percentage of total deductions. The only exception was the decline of fringe benefits as a fraction of total deductions in the Wholesale and Retail Trade Industry. Concerning the short-term year-to-year changes in these ratios, this study seems to indicate some relationship between the movements of fringe benefit and advertising ratios and the gift ratio.

With respect to the unofficial tax rate, \( v_t \), the data needed to compute the rate could be found only for three years, 1957-1959. In these three years the ratio of giving to total deductions was found to move in the same direction as the tax rate.
Chart 1.

% of total deductions

Source: Statistics of Income--Corporation Income Tax Returns
Chart 2.

% of total deductions

Source: Statistics of Income--Corporation Income Tax Returns
Chart 3.

Source: Statistics of Income--Corporation Income Tax Returns
In order to determine more precisely the relationship between the amount of gifts and contributions in any one year and the amount spent on advertising, employee fringe benefits, and the informal tax rate a regression was run using the yearly data used to compute the ratios discussed above. (In addition the variable $D_t$ was added to the regression equation because of the predicted relationship between stock dividends and giving discussed in section III.)

The two equations tested and the results of these tests are shown in Table 1. The equation was run without the tax variable (Equation B) because the difficulty of finding data with which to compute $v_t$ cast the accuracy of the figures used for $v_t$ in doubt. However, results showed that the presence of this variable did not significantly affect the results.

The signs on all of the regression coefficients are as expected however only the coefficients of the variables representing advertising expenditures and dividends are statistically significant. The advertising variable shows

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10 The data necessary to compute $v_t$ could be found only for the years up to 1959. From looking at the value of $v_t$ in years prior to 1957 a general upward trend was found. (Dickinson, The Changing Position of Philanthropy in the American Economy, p. 48.) Therefore, as a proxy for the actual value of $v_t$, a trend variable was used in the regressions. It is possible that using the actual values for $v_t$ during the period studied would have improved the results.

11 The coefficients of the variables representing advertising expenditures and dividends were statistically significant in both equations. The other coefficients were not statistically significant.
the strongest relationship with the amount of corporation giving and this would seem to lend support to the theory that the effects of advertising expenditures and gifts are similar in the eyes of the firm, i.e., they both result in a stock of goodwill.
Table 1. Regression Equations Relating Corporation Giving To Various Explanatory Variables\(^a\)

<table>
<thead>
<tr>
<th>Equation</th>
<th>Constant Term</th>
<th>Advertising Expenditures</th>
<th>Expenditures on Fringe Benefits</th>
<th>Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>(-12.206)</td>
<td>+0.036 (X_2)</td>
<td>+0.009 (X_3)</td>
<td>+0.009 (X_4)</td>
</tr>
<tr>
<td>B</td>
<td>(-5.318)</td>
<td>+0.036 (X_2)</td>
<td>+0.007 (X_3)</td>
<td>+0.009 (X_4)</td>
</tr>
</tbody>
</table>

T-Ratios

<table>
<thead>
<tr>
<th>Equation</th>
<th>(X_1)</th>
<th>(X_2)</th>
<th>(X_3)</th>
<th>(X_4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1.991</td>
<td>8.518</td>
<td>0.755</td>
<td>2.116</td>
</tr>
<tr>
<td>B</td>
<td>1.612</td>
<td>8.446</td>
<td>0.593</td>
<td>2.137</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equation</th>
<th>Tax Variable</th>
<th>Coefficient of Determination (R^2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>+1.087 (X_5)</td>
<td>.979</td>
</tr>
<tr>
<td>B</td>
<td></td>
<td>.977</td>
</tr>
</tbody>
</table>

T-Ratios

<table>
<thead>
<tr>
<th>Equation</th>
<th>(X_1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1.325</td>
</tr>
</tbody>
</table>

\(^a\)Based on time-series data for 3 industrial groups for the 10-year period, 1957-1966.

Definitions of the variables presented in the above table:

\(X_1\)= Total gifts and contributions of corporations in the industry. =\(g_t\)

\(X_2\)= Total advertising expense of corporations in the industry. =\(a_t\)

\(X_3\)= Total expenditures for employee fringe benefits by corporations in the industry. =\(e_t\)

\(X_4\)= Total dividends paid to stockholders by firms in the industry. =\(D_t\)

\(X_5\)= Informal tax variable facing the corporations in any given year. =\(v_t\)
V. The Price of Contributions

Past studies have used the marginal tax rate in order to calculate the real "price" per dollar given of contributions made by the firm. The line of reasoning followed is that if the firm did not make the gift or contribution, then the firm's profits would have been increased by just that amount and its income tax liability would also increase by the amount given multiplied by the marginal tax rate. The price of any gift of X dollars is \((1 - t_m)X\) dollars, where \(t_m\) is the firm's marginal income tax rate. This view of the "price" of giving is certainly consistent with the view that the giving of gifts is a form of investment. Schwartz's study indicated that the amount of giving was affected by the "price" of the gift and that giving is price elastic. A point that should be mentioned is that the "price" of gifts changes, given any marginal tax rate, when the amount of the contributions becomes greater than five per cent of the firm's pre-tax income because contributions exceeding five per cent of the firm's income are not deductible in the year in which the contribution is made. In this case the price facing the firm for each dollar given over the five per cent limit is one dollar just as for any other investment. However,

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12 Schwartz, "Corporate Philanthropic Contributions," p. 481.

13 Ibid., p. 496.
unlike most other investments, depreciation of gift goodwill cannot be written off as an expense in future periods for tax purposes when the goodwill results from a contribution exceeding five per cent of the firm's pre-tax income for the year in which the gift was made. Also, the firm must have made a profit in order for the "price" to be less than one hundred per cent of the contribution.

It should be noted that this analysis of the cost of a dollar of giving applies only when giving is considered an investment and does not apply if it is analyzed as a current expense. The cost of any elements of giving viewed as a current expense is equal to the cash outlay, just as for any other current expense. The marginal tax rate would not affect the cost of any giving which is considered a current expense.

The price per dollar of a gift made by a corporation also depends on whether the gift is made in kind or in cash. The advantage to giving in kind is that the gift can be deducted from taxable income at its fair market value which is equal to cost plus gross profits. Thus, for exactly the same cash outlay the corporation can increase its deductions from taxable income by the amount of gross profits included in the selling price of its gift and this results in higher after-tax profits. The result is that the price per dollar given by the corporation has been lowered.

14 For a more detailed discussion of gifts in kind see,
As long as gifts in kind are deductible at their market price it would be to a firm's advantage to substitute gifts in kind for cash gifts. However, as noted in footnote 6, such a substitution may not always be possible.

VI. Corporation Giving and Economic Efficiency

Another question which should be considered is the relationship between corporate philanthropy and economic efficiency. According to traditional welfare economics efficiency in the allocation of resources is achieved when the marginal social cost of an activity is equal to the marginal social benefit resulting from that activity. (MSC = MSB) In the case of corporate philanthropy the individual firm would attempt to equate marginal private costs with marginal private benefits. (MPC = MPB) An important question is how do MPC and MPB differ from MSC and MSB?

First, consider MPC and MSC. It seems reasonable to assume that MPC and MSC, measured in dollars, would be almost equal. Most activities which would usually be included under the heading of philanthropy do not seem to involve any major negative externalities which would make MSC significantly greater than MPC. Similarly, there does not seem to be any reason to expect MPC to be significantly greater than MSC.

When comparing MSB with MPB the situation appears to be quite different. It generally seems that the MSB from a charitable act is much greater than the MPB which is the reason charitable acts are "charitable". It is not difficult to think of charitable acts which would benefit many other people or firms besides the firm making the gift. This disparity between MSB and MPB provides the rationale for making many types of charitable gifts, by
both corporations and individuals, deductible under federal income tax laws.

If the above conclusions concerning MSC and MPC as well as MSB and MPB are valid, profit maximizing firms would undertake a less than optimum amount of philanthropic activity. A profit maximizing firm would undertake philanthropic activities until MPC was equal to MPB. Assuming MPC ≤ MSC and MPB < MSB, then when MPC = MPB, MSB would be greater than MSC and the activity would have been undertaken in a less than optimal amount from the standpoint of economic efficiency.

One way to encourage corporate philanthropy, which is already in use, is the deductibility of charitable contributions for income tax purposes. This tends to decrease the "cost" of the gift to the firm when the firm views the gift as an investment and encourages it to give more. Appendix A suggests that more total giving might result if corporations acted as agents through which stockholders could carry on their charitable activities. A third possible way to increase total philanthropic giving might be to encourage programs of matching gifts, i.e., a corporation might be willing to match a percentage of the gifts of a group of individuals to a particular charity. Each individual or firm not only receives a certain amount of benefit from its own gifts but also from the gifts its giving encourages others to make.
VII. Conclusions

This paper has provided a framework for corporate philanthropic giving. The idea that corporation giving can be analyzed as a purely philanthropic act was dismissed for two reasons. First, it is not certain that a corporation, being an organization, can carry out a purely philanthropic act as the term philanthropic is usually understood. Secondly, the resources a firm allocates to giving can generally be found to be achieving many of the same effects as resources allocated to more traditional categories of firm expenditures.

Studying corporation giving as an investment in a stock of goodwill was presented as a reasonable way to view the effects of giving on the corporation. This type of investment should probably be viewed as an extremely long-range one. The reason for this is the tax aspect of giving, the payment of which helps to enhance the firm's future prospects for existence. Because of the long-term nature of an investment in giving goodwill, one would probably expect it to be a more variable type of outlay than expenditures designated for more short-run objectives. That is, one would expect giving to be more price elastic and more income elastic (with respect to the firm's profits) than other types of investment. This is a question which should be looked into further.

Another question which needs to be investigated is how can the stock of goodwill from past and present giving be measured? Also, how can one accurately determine the
returns from goodwill built up from gifts? These questions both need to be studied before a corporation could make exact decisions concerning how much it should allocate to gifts and contributions.

In conclusion, the problem of corporation giving can be discussed in terms of the traditional tools used in analyzing the expenditures of a firm and there is no need to resort to some sort of hazy philanthropic goal to explain corporation giving. Because of this conclusion, a more efficient use of corporate resources should be one of the products of the approach to corporate giving discussed above.
Appendix A

This section will show, assuming a given level of pre-tax, pre-giving corporation income, that stockholders of a corporation can increase the total amount of money they give to charity and still maintain their total after-tax, and after-giving dividend income by allowing the corporation to do their charitable giving.

Assume,

(1) \[ D_t - t_p D_t - G_{st} + t_p G_{st} = D_{gt} - t_p D_{gt} \]

where,

- \( D_t \) = dividends paid to stockholders if the corporation did no giving for the stockholders in year \( t \),
- \( t_p \) = the personal income tax rate, \( 0 < t_p < 1 \),
- \( G_{st} \) = the amount of charitable giving by stockholders from their dividend income in year \( t \) if the corporation does not act as their giving agent,
- \( D_{gt} \) = the cash dividends paid to stockholders if the corporation did carry on some charitable activities as a form of compensation to the stockholders in year \( t \).

(2) \[ D_t = \pi_x (1-t_c) - R_t \]
(3) \[ D_{gt} = \pi_x (1-t_c) - R_t + g_t (t_c-1) \]

- \( \pi_x \) = the corporation's pre-tax, pre-giving income in year \( t \),
- \( t_c \) = the corporation income tax rate, \( 0 < t_c < 1 \),
- \( R_t \) = the retained earnings of the corporation from income in year \( t \),
- \( g_t \) = the charitable gifts made by the corporation as compensation to stockholders in year \( t \).

Substituting (2) and (3) into (1) we get,

(4) \[ \pi_x (1-t_c) - R_t - t_p [\pi_x (1-t_c) - R_t] + G_{st} (t_p-1) = \]
\[ \pi_x (1-t_c) - R_t + g_t (t_c-1) - t_p [\pi_x (1-t_c) - R_t + g_t (t_c-1)] \]
\begin{align}
(5) \quad & -t_p \left[ \pi_t(1-t_c) - R_t \right] + G_{st}(t_p-1) = s_t'(t_c-1) - t_p \left[ \pi_t(1-t_c) - R_t + s_t'(t_c-1) \right] \\
(6) \quad & -t_p \pi_t(1-t_c) + t_pR_t + G_{st}(t_p-1) = s_t'(t_c-1) - t_p \pi_t(1-t_c) + t_pR_t - t_p s_t'(t_c-1) \\
(7) \quad & G_{st}(t_p-1) = s_t'(t_c-1) - t_p s_t'(t_c-1) \\
(8) \quad & G_{st}(t_p-1) = s_t'(t_c-1)(1-t_p) \\
(9) \quad & G_{st} = \frac{s_t'(t_c-1)(1-t_p)}{(t_p-1)} \\
(10) \quad & -G_{st} = \frac{s_t'(t_c-1)(t_p-1)}{(t_p-1)} \\
(11) \quad & G_{st} = s_t'(1-t_c)
\end{align}

which implies,

\[ s_t' > G_{st} \]

If stockholders can receive utility from gifts made by a corporation acting as their agent similar to the utility they would receive from making the gifts themselves, it follows from the above that a corporation could increase the compensation paid to its stockholders by making gifts to charitable activities as part of a dividend payment.
BIBLIOGRAPHY


