7th Annual Conference Risk Governance

Risk Governance and Sustainability

The gift that keeps on giving: Corporate giving and excessive risk taking

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Motivation

Federal Reserve
Chairman
Ben S. Bernanke

*"Compensation practices at some banking organizations have led to **misaligned incentives** and **excessive risk-taking**, contributing to bank **losses** and **financial instability**."*

*"The Federal Reserve is working to ensure that compensation packages appropriately tie rewards to **longer-term performance** and do not create undue risk for the firm or the financial system."*

- **Unsustainable culture and reward systems (e.g., tournaments or stock options) encourage employees at all levels to make investments, rather than 'good investments'**

- **Our study explores a potential incentive system that may discourage employees from taking excessive risk.**

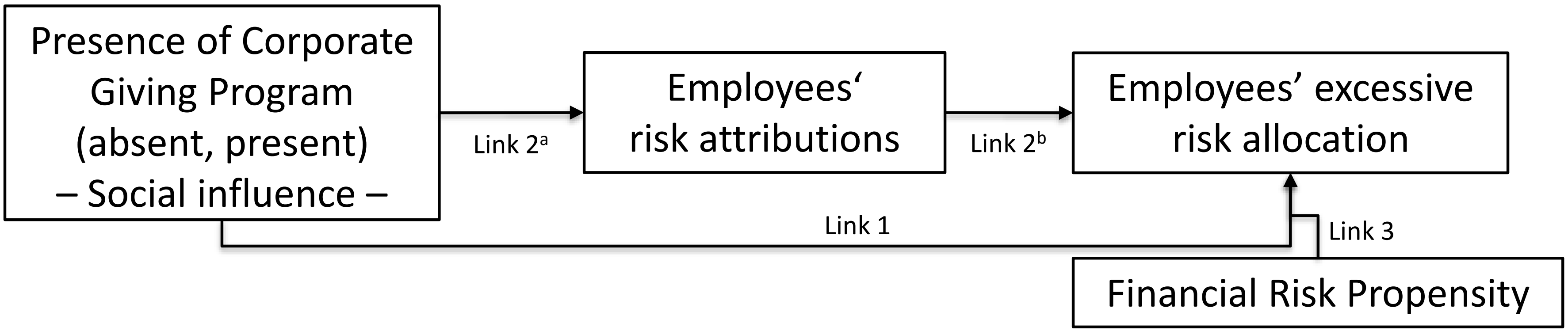
Relevant Research

Performance = f(effort, risk taking, controls)

- What is the effect of corporate giving on employees' **excessive risk taking behavior**?
- How do people take excessive risk benefitting a **charity**?
  (≠ strangers vs. group members)

Prosocial behavior	Risk taking on behalf of others
» What is the effect of charitable giving on employees' **effort** or **performance**? (e.g. Ariely et al. 2009; Tonin & Vlassopoulos 2010; Imas 2014; Gerhards 2015; Douthitt et al. 2019) » Which factors determine giving size + frequency? (e.g., audience effect: Andreoni & Bernheim 2009; Ariely et al. 2009; monetary rewards: Chao 2017; other-regarding preferences: Deb et al. 2014; recognition: Winterich et al. 2013)	» How people take risks on behalf of others (strangers *vs.* **group members**). » Mixed results: cautious shift (e.g., Charness & Jackson 2009; Bolton & Ockenfels 2010; Eriksen & Kvaløy 2010; Pahlke et al. 2015) *vs.* random behavior (e.g., Eriksen et al. 2017) *vs.* risky shift (Chakravarty et al. 2011; Agranov et al. 2014; Pollmann et al. 2014)

Causal Mediation Model for H1



Model of risk behavior

[Sitkin & Pablo 1992]

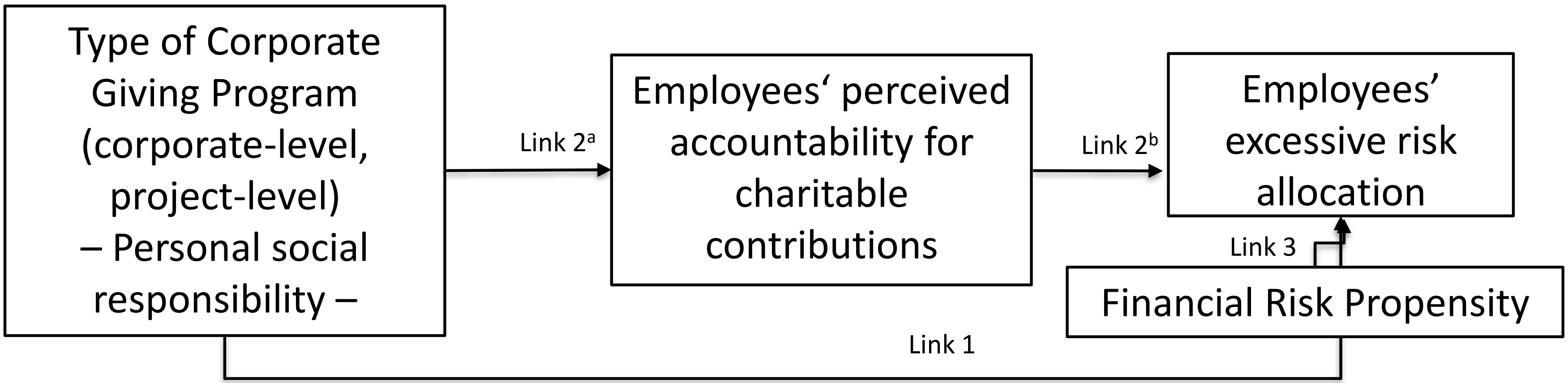
- A firm's practices, its cultural risk values and its leaders influence the risk perceptions and the risk-taking behaviors of employees
- "Bet-your-company" culture vs. "social-responsibility" culture

Social norm activation theory

[Bicchieri 2006]

- To *activate* a norm means that the employees infer from some situational cues what the appropriate behavior is, what they are expected to do, and act upon those cues
- Corporate-level giving activates a norm of other-regarding behavior, i.e. taking less excessive risk, thereby helping the firm and the charity.

Causal Mediation Model for H2



Accountability theory

[Simonson 1989; Lerner & Tetlock 1999]

- People want to justify their decisions to others and to themselves
- Selection of excessively risky investments is irrational and harder to justify

Responsibility effect

[Latane & Nida 1981; Charness & Jackson 2009]

- Under project-level giving the norm of other-regarding behavior is more meaningful to employees: they feel directly responsible for project outcome tied to charitable giving
- Project-level giving motivates more excessive risk aversion than comparatively vague corporate-level giving

Theory for H3 – Charity Selection

» Research setting: Employees participate in choosing the charitable organization

"Employees not only value their companies' social […] commitments, but also want to actively get involved in these efforts" [Giving USA 2017 citing the 2016 Cone Communications Employee Engagement Study]

Social distance

[Small & Simonsohn 2008]

» Strong identification with the charity and its objectives
» Greater motivation to decide in the best interest for a socially close charity, i.e. less excessive risk decisions

Motivated reasoning

[Kunda 1990]

» Motivated reasoning = People tend to access and interpret available information in ways consistent with their preferences and expectations, especially when they have a strong emotional stake in the decision.
» Motivation to reach a desired investment outcome for their selected charity, i.e. stronger focus on the profit potential

Summary of Hypotheses

H1a and b (short- and long-term)

Excessive risk-taking behavior (corporate-level giving) < Excessive risk-taking behavior (no giving)

Model of risk behavior

Social norm activation theory

H2a and b (short- and long-term)

Excessive risk taking behavior (project-level giving) < Excessive risk-taking behavior (corporate-level giving)

Accountability theory

No diffusion of personal responsibility

H3 (null form)

Excessive risk taking behavior (project-level giving) ≡ Excessive risk-taking behavior (project-level giving with charity selection)

Social distance

Motivated reasoning

Experiment (1 x 4 x 10 mixed design)

Manipulated variables and participants

» Employees' task: Making investments

» 10 independent rounds – *round* manipulated within-subjects

» 4 treatment conditions – *presence/type of the corporate giving program* manipulated between-subjects

No Giving	Corp.-level Giving	Project-level Giving	Charity Selection
			
• 90% - shareholder • 10% - own	• 80% - shareholder • 10% - own • 10% - ARC (**overall firm** profit)	• 80% - shareholder • 10% - own • 10% - ARC (**project** profit)	• 80% - shareholder • 10% - own • 10% - charity of choice (**project** profit)

Experiment (1 x 4 x 10 mixed design)

Incentive scheme and task

Incentive scheme

» **Monetary compensation** ➕ **Prosocial incentive**, i.e. Ø = $3.57 donation (10% of the investment payoff) in condition #2, #3 and #4

- $4.80 appearance fee
- $8.52 to $9.84 flat payment for answering survey questions
- $0 to $10 performance-based payment (always 10% of the investment payoff)
- Ø = $17.82, min = $14.86 and max = $21.17 for approx. 100 min of attendance

Experimental task

» One **single investment task**: **Gneezy and Potters' (1997**) risky lottery

- 100 points per round split between risky and riskless investment alternatives
- No carry over to the next round
- Dependent variable = **excessive risk taking** (EV < 1)
- Investment alternatives A and B remain the same over ten rounds

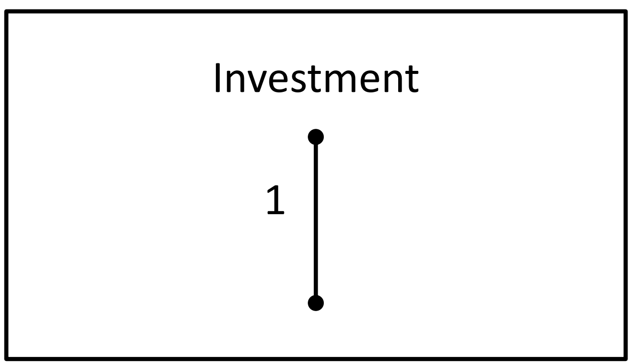
Experimental (1 x 4 x 10 mixed design)

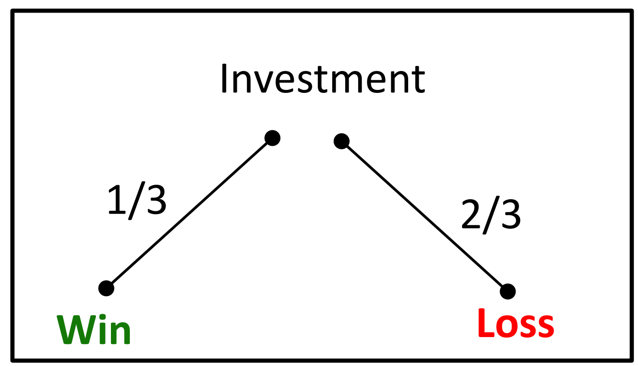
Experimental task

Endowment:
100 points

Expected Value =
1/3 · 2.5 + 2/3 · 0 = 0.8333 →
below 1, i.e. measure of
excessive risk taking

Investment alternative A	Investment alternative B





» Payoff:	Investment · 1	Investment · 2.5	Investment · 0

Results

Descriptive statistics

	No Giving	Corporate-level Giving		Project-level Giving	Charity Selection	**Project-level Giving Total**	**Giving Total**	**Total**
n	29	21		24	25	**49**	**70**	**99**
1st Half Rounds 1–5	42.80 [28.99]	46.51 [31.19]	>	37.59 [27.12]	40.58 [30.85]	39.12 [29.06]	41.34 [29.87]	41.77 [29.59]
2nd Half Rounds 6–10	51.66 [34.36]	50.90 [30.09]	>	34.91 [31.69]	43.49 [35.97]	39.29 [34.14]	42.77 [33.37]	45.37 [33.87]
Total	47.23 [32.05]	48.71 [30.65]	>	36.25 [29.47]	42.04 [33.47]	39.20 [31.67]	42.05 [31.65]	43.57 [31.84]

Excessive risk allocation – MC sample (Mean [Standard Deviation])

» Marginal difference between *no giving* and *corporate-level giving*

» Excessive risk allocation is substantially lower under *project-level giving* relative to *corporate-level giving*, with *charity selection* in between

Repeated-Measures ANCOVA results

Hypotheses Tests

Dependent variable: Excessive Risk Allocation (n = 99)

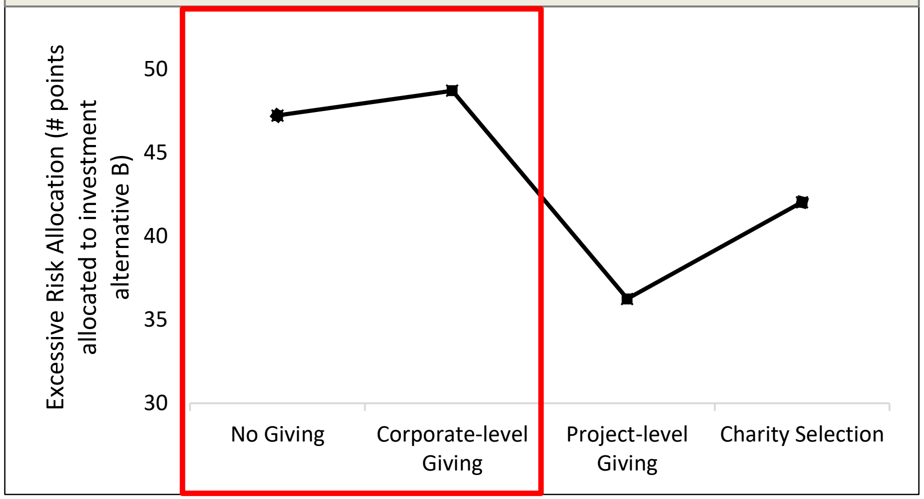
Source of Variation	*df*	MS	*F*-Statistic	*p*-Value
Between subjects				
Giving	3	8,038.30	8.14	<0.001***
Financial Risk Propensity	1	11,732.40	11.87	<0.001***
Altruism	1	4,423.11	4.48	0.0346**
Within subjects				
Round	9	1,211.10	1.23	0.2751
Giving x Round	27	512.47	0.52	0.9804

» Highly significant treatment effect ("Giving")

» Both financial risk propensity and the level of altruism, our covariates, are significantly related to participants' excessive risk allocation

Hypotheses Tests

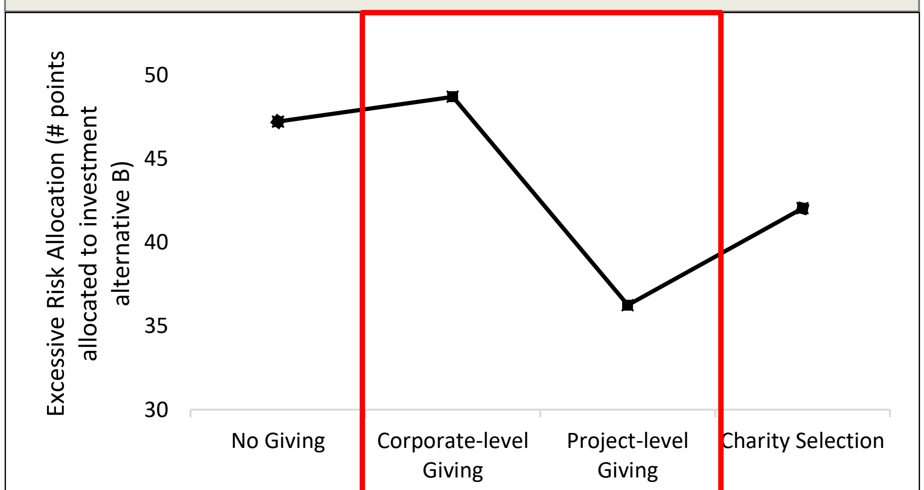
H1: # points B (no giving) > **# points B** (corporate-level giving)



H1: Test of hypothesis

- Contrast analysis: *F* = 0.15; *p* = 0.69
- Adjacent contrast = -1.13
- Interaction *Corporate-level Giving* vs. *No Giving × Round*: *F* = 1.19; *p* = 0.28
- Effect of *Round* (i.e., linear trend)
  - within *No Giving*: *F* = 6.20; *p* = 0.01
  - within *Corporate-level Giving*: *F* = 0.43; *p* = 0.49

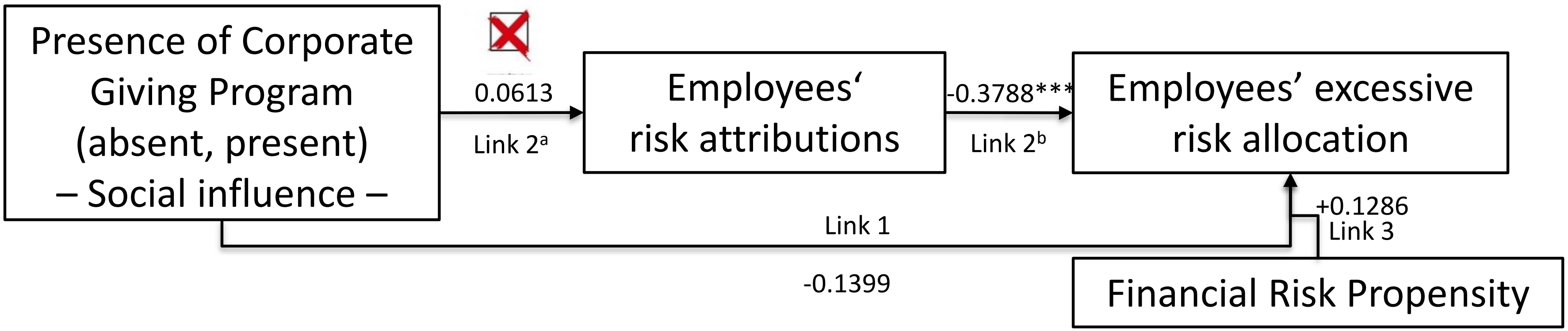
H2: # points B (corp.-level giving) > **# points B** (proj.-level giving)

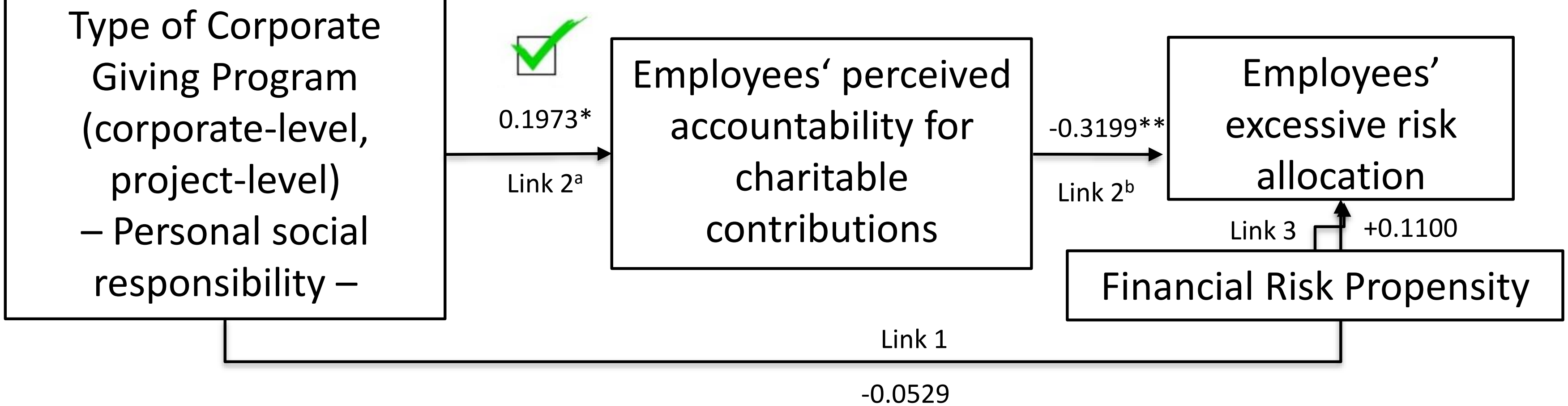


H2: Test of hypothesis

- Contrast analysis: *F* = 17.38; *p* < 0.01
- Adjacent contrast = 12.38
- Interaction *Project-level Giving* vs. *Corporate-level Giving × Round*: *F* = 0.56; *p* = 0.46
- No Effect of *Round* (i.e., linear trend)
  - both: *p* > 0.1

Mediation Analyses for H1 and H2

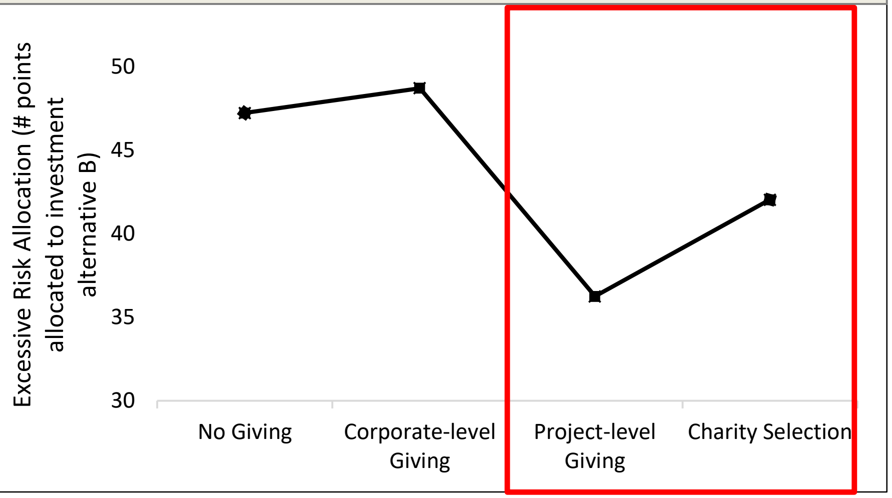




*, **, *** significant at the 0.10, 0.05, and 0.01 levels, respectively.
The numbers on the arrows represent the standardized path coefficients.

Hypotheses Tests

H3: # points B (project-level giving) ≡ **# points B** (charity selection)



H3 (stated in the null): Test of hypothesis

- Contrast analysis: $F = 2.87$; $p = 0.09$
- Adjacent contrast = -4.84
- Interaction *Charity Selection* vs. *Project-level Giving* × *Round*: $F = 1.43$; $p = 0.23$
- No Effect of *Round* (i.e., linear trend)
  - both: $p > 0.1$

Discussion and Conclusion

Wrap-up

- CSR programs like project-level giving can be an effective component in an incentive contract [see also Balakrishnan et al. 2011].
- Charitable contributions diminish excessive risk taking by employees only when they are implemented at the project-level.
- Project-level giving programs' increased accountability persists over time, i.e., no one-time effect.

Policy implication: Prosocial workplace activities should be tied to project-level outcomes.

- Under project-level giving, excessive risk taking is lowest when senior management determines the beneficiary charity.

Policy implication: At the project-level, the charitable recipient should be selected by the firm's senior management.

Limitations and Future Research

Wrap-up

- Assumption that charitable incentives have a positive signaling value, i.e. negative intentions for doing good have been left out
- No alteration of the payoff structure (e.g., low-probabilities & high outcomes, "good" risks)
- Personal monetary incentives held constant
- Other workplace giving forms not considered (e.g., non-cash ones like volunteerism)

> "The Giving USA Special Report 2018 emphasizes that effective communication, through a wide range of platforms, **empowers employees to become donors** and advocates for their causes in and **through their workplaces**, which is not only **advantageous** for the nonprofit, **but for the corporation as well**."
>
> (Rick Dunham, chair of Giving USA Foundation)

Thank you for your attention!

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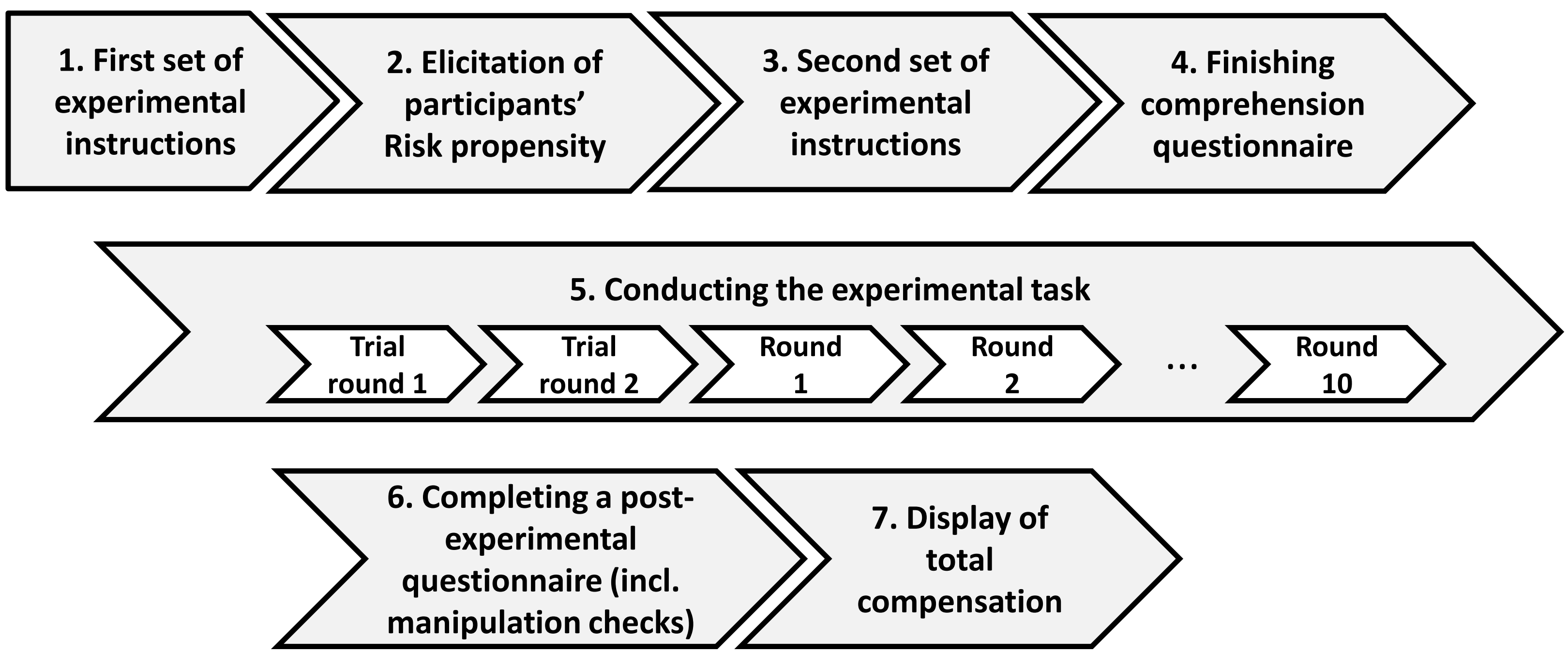
Back-up

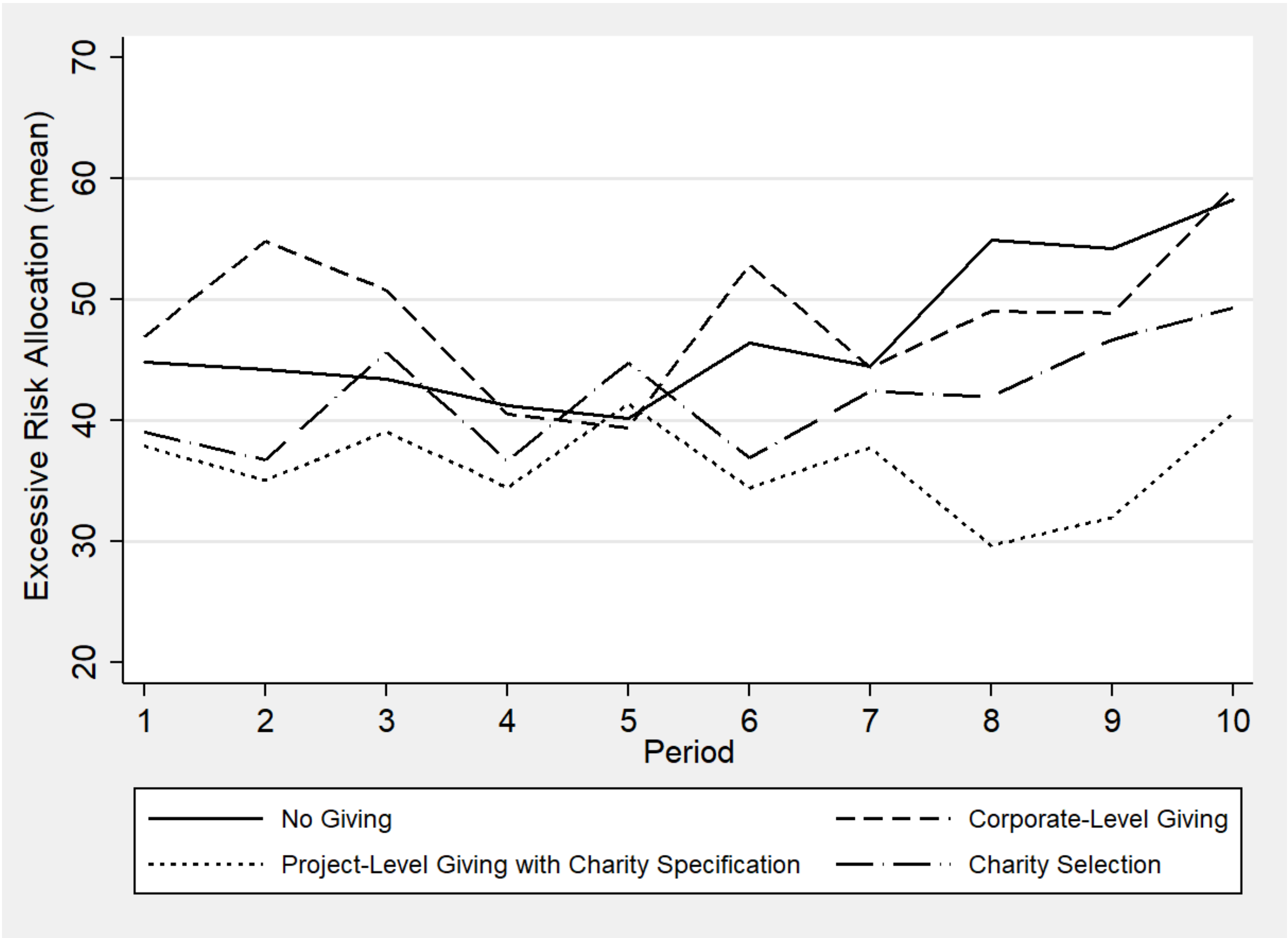
Participants and experimental procedure

- » 99 (under-)graduate students (MC sample)
- » Mean age: 22.45 years, 48 % female, 52% male
  - Academic major: 44% accounting, 27% finance, 18% marketing, 11% other



Back-up

Descriptive statistics



Back-up

Additional analysis