Greed is Good: The Agency Costs of Blockholder Philanthropy

Roger White

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Georgia State University | J. Mack Robinson College of Business

Current State of Literature

- **General Theme: Firms can do well by doing good.**
- Almost all literature examines manager-driven CSR using shareholder resources.
  - What about other sources of CSR?
  - Coase approach: firm as a nexus of contracts.
- Individuals contribute 15x more to charity than corporations in the US on an annual basis.
  - Many of these donors are corporate stakeholders. How does this CSR affect the firm?
  - Experimental research suggests that charitable owners inspire agents to contribute more to the firm [Cox (2004), Balakrishnan et al (2011)].

My Setting and Research Question

- Examine market reaction to major shareholders (blockholders) making large charitable pledges.
- Specifically: Joining The Giving Pledge
  - Originated by Bill Gates and Warren Buffet.
  - Signatories (mostly billionaires) pledge to give or bequeath at least half of their wealth to charity within their lifetime (or upon their death).
  - Does not involve firm resources.
  - Not (generally) done with corporate goals in mind.

Sample Blockholders: Excerpt of Table 1 (p. 26)

	Name	Major Holdings (Greater than 5%) at time of signing The Giving Pledge	Date signed The Giving Pledge	Age at Pledge	Net Worth ($ Billion)
1	Nicolas Berggruen	1	8/25/2010	49	$ 2.3
2	Warren Buffett	10	8/4/2010	80	$ 46.0
3	Steve Case	1	12/9/2010	52	$ 1.7
4	Lee Cooperman	4	9/27/2010	67	$ 2.2
5	John Doerr	2	8/4/2010	59	$ 2.5
6	Larry Ellison	3	8/3/2010	66	$ 41.0
7	Phillip Frost	6	4/28/2011	76	$ 2.4
8	Bill Gates	12	6/6/2010	55	$ 66.0
9	Harold Hamm	1	4/19/2011	66	$ 9.7
10	Jon Huntsman	1	6/18/2010	73	$ 0.9
11	Carl Icahn	3	9/21/2010	74	$ 14.8

Main Hypotheses

- Stakeholders have preferences for altruism (firms engaging in CSR trade at a premium).
  - *H1P: A firm will experience a positive market reaction to the news that a blockholder has made a major charitable pledge.*
- Shareholders expect blockholders to act as monitors of the firm in their own self-interest. Charitable contributions by blockholders suggests that they are not self-interested(firms with blockholders trade at a premium).
  - *H1A: A firm will experience a negative market reaction to the news that a blockholder has made a major charitable pledge.*

Event Study Results: Table 2A (p.27)

Window	Firm Events	Mean Abnormal Return	Mean Abnormal Return Z Score	Median Abnormal Return	Median Abnormal Return Z Score	Predicted Sign
(-45,-1)	124	-6.29%	-2.64***	-5.05%	-1.63	H1A(-) H1P(+)
(-30,-1)	124	-4.58%	-2.90***	-4.39%	-2.72***	H1A(-) H1P(+)
(-15, -1)	124	-3.27%	-3.26***	-2.96%	-2.72***	H1A(-) H1P(+)
(-1,+1)	124	0.07%	0.03	-0.19%	0.01	H1A(-) H1P(+)

- Focus on run-up windows.
  - News leaks before the announcement is made.
- Negative, statistically significant reaction in the run-up to the announcement that a blockholder has joined The Giving Pledge.
  - Median firm market cap. 3 months before announcement: $450 million.
  - 3% reduction in median firm value = $13.5 million in shareholder value destroyed.
- Costs of blockholder CSR outweigh any benefits.

Agency Cost Hypotheses

- H2P: The charitable pledges of director blockholders will elicit a higher market reaction than the charitable pledges of blockholders who do not serve on the board.
- **H2A**: The charitable pledges of director blockholders will elicit a lower market reaction than the charitable pledges of blockholders who do not serve on the board.

- H3P: The charitable pledges of the principals of institutional blockholders (hedge fund managers) will elicit a higher market reaction than the charitable pledges of blockholders who are unaffiliated with an institution.
- **H3A**: The charitable pledges of the principals of institutional blockholders (hedge fund managers) will elicit a lower market reaction than the charitable pledges of blockholders who are unaffiliated with an institution.

Table 4A (p. 29)

	DV: Charitable Pledge Announcement Run-up CAR (-30, -1); Value Weighted Index					
	Model 1	Model 2	Model 3	Model 4	Model 5	Predicted Sign
Director	0.0055 [0.7609]	-0.0720*** [-4.4567]			-0.0860*** [-3.7297]	H2A(-) H2P(+)
Institutional Shareholder Principal			-0.0514*** [-7.7481]	-0.0109 [-0.6930]	-0.0345*** [-11.7747]	H3A(-) H3P(+)
Ln(Net Worth)		0.0223*** [6.4884]		0.0278*** [7.5316]	0.0211*** [4.3843]	
Percent of Wealth Invested		0.0757** [2.1154]		0.0603* [1.8141]	0.0649* [1.9531]	
Controlling Shareholder (Dummy)		0.0657*** [8.6485]		0.0321*** [4.5584]	0.0545*** [4.0529]	
Prior Charitable Foundation (Dummy)		-0.1002*** [-3.1875]		-0.0931* [-2.0121]	-0.0969** [-2.5833]	
Ln(Charitable Shareholder Age)		0.0446 [0.4887]		0.0685 [0.6455]	0.0669 [0.8104]	
Multiple Segments (Dummy)		0.0284*** [2.8099]		0.0176 [1.6564]	0.0281*** [3.1581]	
Foreign Income (Dummy)		-0.0236* [-1.8123]		-0.0235*** [-4.3037]	-0.019 [-1.4393]	
Leverage		0.0132* [1.9556]		0.0071 [0.6788]	0.0253** [2.4381]	
Size		0.0124*** [5.5052]		0.0076*** [4.0474]	0.0120*** [3.8990]	
Constant	-0.0491*** [-16.0397]	-0.4506 [-1.1904]	-0.0199*** [-28.4057]	-0.4705 [-1.0261]	-0.5145 [-1.5426]	
Observations	124	124	124	124	124	
R-squared	0.04%	21.17%	4.09%	18.05%	22.14%	
F-Statistic	0.04	**5.46**	**4.64**	**6.33**	**9.29**	

Results

- Blockholder charity destroys firm value (H1A).
- Cross-sectional results (support for H2A and H3A) suggest that agency costs drive this value destruction.
  - H2A: Director blockholder charity leads to more value destroyed.
  - H3A: Hedge fund blockholder charity leads to more value destroyed.

Implications

- Shareholders rely on monitors' (blockholders, in this case) self-interest to police their shared investment. When these monitors engage in selfless CSR, shareholders react negatively, as they are less able to rely on the self-interest of the monitors to protect their investment.
  - In this case, the benefits of altruism are clearly outweighed by agency costs.
  - Managers are also monitors of shareholder wealth. If manager-driven, shareholder funded CSR reduces managers' wealth, it could create a similar agency cost.
- Agency problems can present economically significant, largely unexplored costs to CSR.
  - Future studies should try to account for this agency cost when evaluating costs and benefits of CSR.