

Constraining Managers without Owners: Governance of the Not-for-Profit Enterprise

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ABSTRACT

In the absence of owners, how effective are the constraints imposed by the state in promoting effective firm governance? This paper develops state-level indices of the legal and reporting rules facing not-for-profits and examines the effects of these rules on not-for-profit behavior. Stronger non-distribution constraints are associated with significantly greater charitable expenditures and foundation payouts while more stringent reporting requirements are associated with lower insider compensation. Instrumental variables analysis that employs state-level economic variables to generate predicted values of the governance variables confirms the relationship between legal and reporting requirements and not-for-profit performance. The paper also examines how governance influences an alternative metric of not-for-profit performance – the provision of social insurance. Stronger governance measures are associated with intertemporal smoothing of resources and greater activity in response to negative economic shocks.

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1. Introduction

In the absence of owners, how effective are the constraints imposed by the state on insiders in providing for effective governance of firms? The not-for-profit sector is characterized by the absence of owners but the presence of legal and reporting rules. Indeed, the differentiating characteristic of not-for-profits is the legal constraint on the non-distribution of earnings to insiders. Additionally, reporting of various kinds – mandated by the government rather than the owners – is also required. The strength of these legal and reporting rules vary by state within the U.S. creating the opportunity to analyze the efficacy of legal and reporting rules in a setting without owners and without the complicating features of cross-country studies.

This paper analyzes the influence of state-varying legal and reporting rules on the behavior of public charities and private foundations from 1987 to 2000. If these entities are motivated purely by altruistic motives or if the rules themselves are ineffective, these governance constraints may have no effect on not-for-profit outcomes. Alternatively, some aspects of these governance constraints might constrain not-for-profit managers from exploiting the latitude afforded by the absence of owners and thereby improve firm performance. In order to consider these alternatives, a state-level index of the legal and reporting constraints facing not-for-profits is constructed. For legal constraints, the index includes legal rules facing not-for-profits which is further subdivided into indices measuring explicit rules that strengthen the non-distribution constraint and more general enforcement mechanisms. For reporting rules, the index contains specific state mandated reporting requirements. Investigation of these separate indices allows for the consideration of the role of both legal rules and reporting requirements in influencing not-for-profit behavior.

In order to assess the relevance of the governance environment to not-for-profit firms, these indices are related to measures of operating performance and insider compensation for public charities. The paper also analyzes the degree to which payouts and insider compensation by nonoperating foundations also vary with these governance metrics. Finally, the paper provides an alternative test of not-for-profit performance – the degree to which not-for-profits provide social insurance by building stocks of reserves and responding to local negative income shocks – and examines the effect of governance on firm performance through this test. Much as the efficiency of private firms is measured by their responsiveness to investment opportunities,

this test capitalizes on the idea that not-for-profits should expand activity at times when their activity is most warranted – that is, do they help when helping helps the most.

The paper provides evidence that the governance environment of not-for-profits is associated with differential performance by public charities and private foundations on several different margins. For public charities, the analysis demonstrates that stronger non-distribution constraints and reporting rules are associated with a greater fraction of expenditures devoted to charitable activities and a lower probability of undertaking inefficient fundraising activity. In addition to these effects on public charity behavior, stronger reporting rules are also associated with lower insider compensation. With respect to private foundations, stronger non-distribution constraints and reporting rules are associated with larger payouts, while stronger reporting rules are associated with a lower probability of delaying required payouts. Stronger reporting rules are associated with lower officer compensation relative to total expenses.

This evidence is suggestive of a link between these legal and reporting rules and managerial behavior. In order to further examine the causal nature of this link, two further analyses are provided. First, rather than mapping general legal and reporting rules to general outcome measures, it is possible to examine the specific effect of a particular legal rule in deterring the activity that it targets. Analysis is provided on the degree to which asset sales are opportunistic and how legal rules targeted at such activity appear to deter that specific activity. Second, it is possible to instrument for the governance variables with state-level economic variables that are plausibly unrelated to the outcome measures being analyzed. This instrumental variables analysis has the advantage of addressing concerns related to other explanations for the link between the governance variables and the outcome measures. This IV analysis, while subject to some limitations, provides reassuringly similar estimates to the OLS estimates discussed above.

Finally, not-for-profits in states with stronger legal and reporting rules also intertemporally smooth resources more by attenuating the link between the raising of resources and charitable expenditures. This intertemporal smoothing appears to fulfill a social insurance objective as not-for-profits in states with stronger legal and reporting rules also respond to negative income shocks with greater activity. These results suggest that not-for-profits in states with stricter governance environments fulfill a social insurance objective more effectively.

In general, governance laws related to the non-distribution constraint and state level reporting requirements have the most influence on not-for-profit behaviors while more ambiguous legal rules associated with enforcement appear to have little effect. More specifically, disclosure and reporting rules are most effective in deterring excessive compensation while the non-distribution constraint is most effective in focusing activities toward charitable purposes. As hypothesized in the literature, these results suggest that the strength of the non-distribution constraint specifically is a critical factor in regulating the behavior of not-for-profit organizations and that disclosure requirements can also deter opportunistic insiders. In sum, stronger non-distribution constraints and reporting rules increase the fraction of overall expenditures dedicated to charitable causes, mitigate large expenditures on officer compensation, and help ensure the efficient provision and timing of not-for-profit activity.

The analysis in this paper relates legal rules and reporting requirements to managerial behavior. What evidence exists that the legal rules and reporting requirements studied here might impact managerial performance? Relative to the accounts of managerial malfeasance in for-profit firms, little is known about the illicit behaviors of not-for-profit managers. Fortunately, some exceptions exist. In the catalog of state level legal rules on which the legal variables employed in this paper are based, Fremont-Smith (2004) provides a number of historic examples of the abuses of not-for-profit managers and their links to the legal constraints under examination. In addition, Fremont-Smith and Kosaras (2003) have catalogued managerial abuses by not-for-profit managers from press reports for the period from 1995 to 2002. While necessarily anecdotal, the nature of the abuses, the manner in which they were discovered and the prosecuting agencies are all suggestive of how the rules and regulations studied here can prevent the behavior also under examination here.

Their compilation of 104 criminal cases are dominated by cases involving the theft of charitable funds for personal use and the pursuit of those cases by state (rather than federal) authorities. Their compilation of 54 breach of fiduciary duty cases largely feature claims of misuse of assets, self-dealing, excessive compensation and excessive expenditures and, again, are dominated by state authorities. Indeed, their review of these activities leads Fremont-Smith and Kosaras (2003) to conclude that “under appropriate circumstances, the states and the federal government are able to correct improper behavior on the part of charitable directors, officers, and trustees entailing not only violation of the criminal laws, but breaches of their civil duties.” As

such, the limited anecdotal evidence on not-for-profit managerial malfeasance is consistent with a methodology that relates legal and reporting rules to compensation patterns and the allocation of resources to charitable expenditures. Of course, laws and regulations are not the only mechanism for governing not-for-profits as donors can dominate boards and provide oversight and can also withhold funds. This paper emphasizes the constraints placed by laws and regulations on managers. In doing so, it leaves to future analysis the degree to which donors respond to these same laws and regulations and the degree to which the management responses analyzed here reflect these donor decisions.

The rest of this paper proceeds as follows. Section 2 reviews the related literature and motivates the empirical methodology. Section 3 discusses the data employed with particular emphasis on the indices of governance employed in the paper. Section 4 provides the results. The initial results employ data on not-for-profits and relate state-level variables on legal rules and reporting requirements to performance in Section 5 concludes.

2. *Related literature and empirical methodology*

This analysis of the governance of not-for-profits is related to the growing literature on the economic functioning of not-for-profits and the extensive literature on social insurance mechanisms.

2.1. *The Economics of Not-For-Profits*

Analyses of not-for-profit firms typically consider why particular economic activities are undertaken by not-for-profit firms. This literature emphasizes that not-for-profit firms are distinctive primarily because of the non-distribution constraint and that this constraint can lead to efficient provision by these entities in some sectors. The intuition of Hansmann (1980), as expressed in models of asymmetric information (Easley and O'Hara (1983)) or ex-post expropriation (Glaeser and Shleifer (2001)), suggests that sectors characterized by the inability to contract fully over quality will feature not-for-profit firms. The available evidence on the sectors where not-for-profits are most active is consistent with this interpretation.¹

These analyses are helpful in considering what types of activities are undertaken by not-for-profits but provide limited guidance on analyzing the degree to which not-for-profit firms are

¹ In an alternative vein, Fama and Jensen (1983a) argue that potential conflicts between donors and residual claimants necessitate the not-for-profit form.

characterized by agency problems and the mechanisms by which those agency problems are resolved. The nature of agency problems within not-for-profits has drawn the attention of several papers that emphasize that without owners and a traditional for-profit governance framework, not-for-profit organizations evolve into worker cooperatives where worker preferences, particularly elite worker preferences, determine activities. This view is framed within the context of not-for-profit hospitals in Pauly and Redisch (1973) and extended to other settings in Glaeser (2003).² This problem of constraining managers is precisely why Fama and Jensen (1983b) suggest that insiders should not sit on the boards of not-for-profits.³ This paper extends this emphasis on the problems created by the autonomy granted elite workers and managers in not-for-profits by emphasizing the role of legal rules and reporting requirements.

In addition to the relevant literature on not-for-profit firms, the analysis also frames not-for-profit firms within the larger literature on social insurance mechanisms. This large literature typically emphasizes programs that are explicitly designed to provide insurance, such as unemployment insurance (as in Hamermesh (1982) or Gruber (1997)), and their effects in allowing recipients to smooth consumption. The intuition of social insurance has been extended to the mechanisms that are operative between and within families (as in Hayashi, Altonji, and Kotlikoff (1996)) or through the progressivity of the tax code (as in Auerbach and Feenberg (2000) and Kniesner and Ziliak (2004)). While Cochrane (1991) alludes to the role of not-for-profits in smoothing consumption, there do not appear to be any empirical efforts that conceptualize not-for-profits in this way. This is surprising given the large literature, summarized in Rose-Ackerman (1996), on the altruistic motives behind the donations that fund most not-for-profits. As described below, one of the tests used to assess the quality of not-for-profit performance is their level of intertemporal resource smoothing and their responses to negative local income shocks.

² The public finance literature has emphasized the responsiveness of contributions to taxes rather than the nature of the entity-level treatment of not-for-profits. See Bittker and Rahdert (1976) for a history of the exemption of not-for-profit and Hines (1998) for a discussion of the tax treatment of taxable income earned by not-for-profits.

³ In parallel with this economics literature, a growing literature in the accounting field has examined the reporting behavior of not-for-profits. For example, Baber, Daniel, and Roberts (2002) find that not-for-profit managerial compensation is at least partially explained by variations in the relative performance of the not-for-profit suggesting that the pay-for-performance relationship documented in the for-profit sector is also present in the not-for-profit sector. Krishnan, Yetman, and Yetman (2004) find that not-for-profit managers opportunistically report their accounting results so as to attract higher levels of donations and to appear more “charitable” to regulators.

Finally, this examination of the governance environment of not-for-profits parallels the growing literature on the impact of legal and reporting rules on for-profit firm performance. As in La Porta et al. (1997, 1998) and subsequent work in the law and finance literature, these efforts can emphasize cross-country differences in legal rules or, as in Bushman, Piotroski and Smith (2004), differences in accounting procedures. As Shleifer and Vishny (1996) note, ownership patterns themselves can embody responses to weak legal rules; in this sense, examining not-for-profits where owners are absent allows the examination of how legal and reporting rules alone influence firm performance. In emphasizing within-country differences, this paper may be closest in spirit to Gompers, Ishii and Metrick (2003) who create firm-specific measures of governance and link these governance measures to subsequent firm performance. This effort can be considered an effort to import the emphasis on quantifiable measures of governance to the fields of not-for-profit enterprises. The most closely related paper on not-for-profits is Fisman and Hubbard (2003) that links several attorney general powers as measured in 1977 to the endowment characteristics of not-for-profits.

2.2. *Empirical Methodology*

Although there are approximately 30 different types of not-for-profit organizations recognized by the IRS, those exempt under section 501(c)(3) of the Internal Revenue Code account for well over 90 percent of the total assets and revenues of the not-for-profit sector. The nearly \$1 trillion in assets in the 501(c)(3) portion of the not-for-profit sector are deployed by two types of firms – private foundations and public charities – that, in aggregate, are equally sized. In addition to receiving relief from federal and state income, sales, and property taxes, contributions to these two types of not-for-profits are tax-deductible. There are five general types of public charities including churches, schools, hospitals, widely supported charities, and organizations that support any of the above. Since churches are not required to report their information to the IRS, they are not included in the analysis. Foundations are organizations that receive their support from a single person or a small group of (frequently related) persons and make grants to public charities. Public charity status is generally preferred to private foundation status as foundations are subject to mandatory payout requirements (i.e., 5 percent of assets) and are also subject to a tax on their net investment income. In part, the minimal payout requirement

for private foundations is designed to prevent the creation of foundations for purely tax-minimizing purposes.⁴

In order to assess the efficacy of these governance rules, the effects of the measures of state-level governance (described in detail below) are separately examined on public charities and private foundations. For public charities, the sample consists of approximately 52,000 firm-year observations from 1987 to 2000. The tests emphasize three margins on which poor performance within public charities may be measured— the focus on charitable activities, the efficiency of fundraising, and the level of insider compensation.⁵ In order to consider the degree to which public charities are focused on charitable purposes (rather than administrative or fundraising expenses), tests examine the relationship between legal and reporting rules and the ratio of charitable expenses to total expenses and the ratio of charitable expenses to total assets. The former ratio measures charitable expenditure efficiency, whereas the latter measure is comparable to a return on assets metric. Fundraising activities, rather than serving to effectively raise funds, can serve the interests of insiders through extensions of social networks and the consumption of perquisites. To measure inefficient levels of fundraising, an indicator variable is set equal to one if the ratio of fundraising expenses to donations is equal to 1.0 or greater, and zero otherwise. An average ratio in excess of 1.0 is suggestive of excessive or inefficient expenditures on fundraising. Insider compensation is the other margin of not-for-profit behavior emphasized in this analysis. In order to measure compensation of insiders controlling the public charity, the ratio of officer compensation to total expenses is employed.⁶ None of these measures are perfect measures of poor performance or excessive compensation but do serve to measure the degree to which elite workers within public charities are benefiting from firm resources through either direct compensation, inefficient fundraising or non-charitable expenditures.

Turning to private foundations, the sample consists of approximately 38,000 firm-year observations from 1994 to 2000. The analysis considers the relationships between governance

⁴ See Marsh (2002) for a discussion of the historic rationale for the distinction between private foundations and public charities.

⁵ Of course, these measures of performance are largely efficiency metrics. As such, these measures are subject to the criticism that they equate more compensation with inefficiency. This, of course, need not be the case. The social insurance mechanism outlined below provides a more nuanced notion of performance.

⁶ Officers compensation includes any amounts (wages, benefits, bonuses, etc.) paid to employees who have decision control over a not-for-profit's operations or finances.

and foundation payouts and foundation managerial compensation. The rationale for examining the compensation of foundation managers parallels that for public charity managers. Foundation payout policies are of particular interest as they capture the degree to which foundations distribute their assets relative to what is minimally required by rules. As the tax deduction for a contribution to a private foundation occurs when the foundation receives the funds rather than when it is eventually distributed to a public charity, rules requires minimal distribution amounts to ensure that foundations are not advancing purely tax avoidance through transfers of assets to foundations (Steuerle 1977). Prevailing rules require that foundations meet a minimum distribution requirement by spending at least five percent of their non-charitable use assets (i.e., those not directly employed in conducting the operating of the foundation such as buildings) on charitable grants or charitable administrative expenditures in the current or following year (§4942). The minimum distribution requirement has been the subject of considerable controversy, with public charity advocacy groups calling for increases in the percentage of assets that must be annually paid out while foundation groups defend the current rules.⁷

The first measure of foundation payout is the ratio of current year payouts to the required amount (i.e., five percent of assets). The current payout amount is line 8 of Part V of the IRS 990-PF, and the minimum required amount is line 7 of Part XI of the prior year's IRS 990-PF. The payout requirement is based on the prior year's amount as foundations can meet their payout obligations in the current year or in the following year (with any excess distributions carried forward to the subsequent year). Although many foundations distribute the legal minimum of five percent, some distribute more than is required.

The second measure of charitable payout is an indicator variable equal to one if the foundation delays its payout as long as possible (i.e., until the following year) and zero otherwise. Foundations can choose to disburse their required 5 percent either in the current year, or they may wait until the next year. By delaying disbursement, a foundation can retain use of its assets. This indicator variable is constructed on the basis of the ratio of the current year payout (line 8 of Part V of the IRS 990) to the amount of remaining undistributed amounts left over from the prior year that must be distributed by the end of the current year (line 2a Column C Part

⁷ See Cambridge Associates (2000) and Mehrling (1999). Brody (1997) examines the broader questions of whether the non-profit sector should even have an endowment, whether this endowment should be controlled by private foundations instead of public charities, and whether private foundations should be allowed to exist in perpetuity. Hansmann (1990) criticizes the accumulation of wealth by universities on grounds of inter-generational equity.

XIII of the IRS 990-PF). If this ratio is 1.0, the foundation has delayed its payout as long as is legally possible. If this ratio is less than 1.0 the foundation has violated the rules and will be subject to severe financial penalties and very few foundations fall into this category. If the ratio is larger than 1.0 the foundation has not only made up last years unpaid balances, but has made additional payments as well. A ratio of 1.0 (or slightly over 1.0) suggests that the foundation is attempting to delay its payout as long as is legally permissible. However, even those foundations that want to delay their payouts as long as possible will want to avoid the danger of being under the 1.0 cutoff, (lest they incur substantial penalties), so they typically pay out slightly more than is necessary. Accordingly, the indicator variable is set equal to one if the ratio is between 1.0 and 1.1 and zero otherwise.⁸

Finally, the conceptualization of not-for-profits firms as providing social insurance is tested using methods drawn from the financial economics literature. Typically, tests of the efficiency of investment, as in the setting of conglomerates, employ proxies for investment opportunities, typically industry q , to assess whether firm investment is responding to relevant opportunities. In the not-for-profit setting, the intuition of social insurance suggests that activity should increase in response to negative economic shocks when the marginal productivity of not-for-profit activities becomes greatest.⁹ Said another way, not-for-profits fulfilling their mission should disproportionately respond during distressed times as this is when their investment opportunities are the greatest. One way to test this is to determine if not-for-profits respond differentially to local economic shocks depending on their governance environment.

This test of the efficiency of not-for-profit activity has several advantages. First, it provides a measure of performance that is not entirely cost-driven in a setting where output is hard to measure. Second, the intuition of investment opportunities corresponds to the espoused goals of a variety of not-for-profits. This notion of social insurance is operationalized using two empirical tests. First, for insurance to be provided, there has to be some element of intertemporal smoothing where funds are gathered during some periods (typically economically robust ones) and saved for later periods when they are most effective. In order to identify the presence of intertemporal smoothing, the empirical analysis below examines how governance influences the

⁸ The results are not sensitive to increasing this cutoff up to 1.25.

⁹ Alternatively, the concavity of utility functions provides the same intuition. That is, not-for-profits that best internalize the utility functions of their customers will expand activity during periods when marginal utility is highest.

relationship between changes in total revenue sources (including donations, the sales of products and services, and other income) and changes in charitable expenditures. If well-governed firms are intertemporally smoothing, the governance variable should attenuate the relationship between the sources of funds and the disbursement of those funds.

Such intertemporal smoothing need not be for purposes associated with the needs of not-for-profit beneficiaries. In order to examine if this intertemporal smoothing has an insurance component, it is possible to test if measures of governance influence the relationship between changes in local economic conditions (such as disposable income, gross state product, and unemployment levels) and changes in charitable expenditures. Local positive income shocks may well increase resource flows to not-for-profits permitting them to increase their charitable outputs. However, an insurance objective would be fulfilled if a positive relationship between local economic conditions and charitable output would be mitigated in well-governed firms. Said another way, the intertemporal smoothing identified in the first test could be characterized as insurance if this second test demonstrates that negative shocks are associated with increased activity for well-governed firms.

3. *Data and Descriptive Statistics*

3.1 *Governance Measures*¹⁰

As is emphasized in the literature on not-for-profits, the governance of not-for-profits is split between federal and state authorities. At the federal level, the Internal Revenue Service is charged with overseeing not-for-profit organizations. Although the IRS has the ability to revoke a not-for-profits tax-exempt status in response to misbehavior, it rarely does so. As a practical matter, the majority of not-for-profit oversight is provided by various state-level agencies. Because there is substantial variation in state-level not-for-profit legal regulation, the tests can employ this variation in the empirical analysis.¹¹ Recent research identifies seven measures of a

¹⁰ This analysis of governance emphasizes legal and reporting rules. Of course, board structure and selection can also be a meaningful aspect of not-for-profit governance.

¹¹ Fisman and Hubbard (2003) also attempts to identify and measure state-level measures of not-for-profit governance. The measure of legal and reporting governance used in this paper differs from their measure in several respects. First, the current analysis emphasizes the non-distribution constraint given the literature's emphasis on this aspect of not-for-profits. Second, the measure is based on a recent re-evaluation of state level governance (Fremont-Smith 2004) that updates the 1974 laws, also characterized by Fremont-Smith, used by Fisman and Hubbard. Third, the measure includes several new state-varying governance measures included in the recent source that were not

state's legal power to regulate not-for-profits, which naturally subdivide – one rooted in preventing expropriation of charitable assets by managers and the other rooted in the mechanisms through which the enforcement of these powers take place (Fremont-Smith 2004). The expropriation rules are directly related to the non-distribution constraint. As noted by Hansmann (1980), the non-distribution constraint is designed to prevent asset expropriation and it is this constraint that distinguishes the not-for-profit form of business. Table 1a describes the construction of the indices and the precise powers that are characterized in these indices. Throughout the paper, increases in the indices are characterized as stronger governance environments. While necessarily imprecise, this follows the tradition in the financial economics literature to aggregate numbers of provisions on critical dimensions as a way of measuring the relative strength of rights or constraints.

In the absence of oversight by either stockholders or the capital market, not-for-profit managers can divert charitable assets toward themselves in many ways including non-arms-length sales of assets, consuming perquisites, or retaining charitable assets upon dissolution. To prevent expropriation, states have instituted four commonly used laws as outlined in Fremont-Smith (2004). First, a state can legally distinguish not for profits from for-profit firms. By applying a unique set of statutory law to not-for-profits, a state can more easily act to prevent the distribution of charitable assets (i.e., residual claims) to officers, directors, or other specific individuals other than recipients specifically included in the organization by-laws. Second, states can require that liquidating distributions be made by not-for-profits only to other not-for-profits. By requiring that only another not-for-profit can receive the liquidating distributions of another not-for-profit a state effectively limits the payment of liquidating distributions to insiders. Third, states can enact laws that require that the State Attorney General be notified of not-for-profit asset sales. Again, this law prevents not-for-profits from systematically disposing of their assets, particularly through below-market sales to officers or employees through so-called “slow liquidations.” The fourth and final component of the non-distribution metric is whether state law limits not-for-profits from re-incorporating as for-profit corporations. This law acts to prevent charities from paying out their assets as distributions to new “shareholders” that could be officers, directors or non-charitable corporations.

included in the prior version. Finally, a state-level measure of reporting requirements is also used. We thank Marion Fremont-Smith for providing an advance copy of her publication, Fremont-Smith (2004).

The mechanisms a particular state can employ to enforce its provisions over not-for-profits also vary across states. Some states make their enforcement authority explicit by instituting specific laws. The analysis employs the most common monitoring and enforcement laws as contained in Fremont-Smith (2004). First, a state can require that the Attorney General must be notified of any legal suits involving charities. In this way the Attorney General is able to determine if there is any enforceable action that should simultaneously be undertaken. Second, a state can empower parties other than the Attorney General (such as officers, directors, or other employees) the standing to bring legal action against a not-for-profit. This law has the effect of exposing the charity to multiple sources of legal challenge. Third, states may allow for *Cy pres*, or the authority of the courts to modify the incorporated purpose of the organization if that organization's purpose became obsolete, wasteful, or otherwise impracticable.

In addition to variation in legal rules, states are also characterized by distinctive reporting requirements. These reporting requirements are applicable to organizations that solicit donations within the state. Each state has from zero to nine distinct financial reporting requirements imposed by a registration authority. The registration authority varies across the states, sometimes being the Attorney General but often is a board of charities. The reporting governance metric is a linear combination of these nine different financial reporting requirements that are outlined in summary in Table 1b.¹² Because it is possible that some larger organizations solicit donations in multiple states, this measure (which is based on the state of incorporation) will contain some measurement error. To determine if this effect influences the results, these tests are replicated eliminating organizations that filed combined IRS 990s (combined 990s result when a parent organization reports the aggregated financial results of the various affiliated state organizations) with no change in the substance of the results.

The nine measures of reporting requirements fall into three general categories. The first category includes the two general reporting requirements of whether or not a state requires registration and if registration needs to be renewed annually. The second category includes five types of documents that a state could require to be included in the registration. These documents are the not-for-profits' financial statements, by laws, articles of incorporation, IRS tax-exempt determination letter (i.e., the IRS 1023), and any additional forms the state may require. The

¹² These measures of various state not-for-profit reporting requirements are from the Charitable Organization Multi-State Filing Project at www.multistatefiling.org.

final category contains two miscellaneous items. Some states require that a not-for-profit disclose the name of any paid professional fundraising organizations used. Professional fundraisers frequently retain a portion of donations as a fee and remit remaining funds to charities. By using professional fundraisers and reporting only net donations a charity can appear to be raising fewer donations in a state, perhaps drawing less regulatory attention. Finally, some states require that organizations that solicit donations in their jurisdiction undergo a financial statement audit by Certified Public Accountants.

Tables 2a, 2b and 3 provide these legal and reporting indices, respectively, and their components by state. The minimum value for the total legal index is 2 while the highest is 7 indicating substantial variation across states. The reporting index provides even more variation with some states requiring nothing and other states requiring all nine components of the reporting index. The governance sub-indices are correlated with each other as the correlation coefficient between the non-distribution sub-index and the enforcement sub-index is 0.37. Similarly, the correlation coefficient between the combined legal index and the reporting index is 0.32. In addition to including these three measures separately in the regression models, various combinations of them are used including grouping the two legal governance metrics into a single legal governance measure as well as grouping all three measures into a single governance metric.

3.2. Not-for-profit Organization Data

All public charities and foundations with revenues over \$25,000 must file an IRS Form 990 (or in the case of a foundation, a 990-PF) annually. To ensure the wide dissemination of Form 990 information the IRS Statistics of Income (SOI) division sponsors the Urban Institute to collect the data and make it freely available on the Internet at www.guidestar.org.¹³ The public charity dataset includes the years from 1987 to 2000. The most recent year of the sample (2000) contains 15,669 observations, while the oldest (1987) contains 8,357. Each of the annual public charity datasets includes all charities with assets over \$10 million plus a stratified random sample of charities with assets less than \$10 million. This database contains 160,140 observations of which 65,195 are not educational (i.e., private high schools or universities) or medical (i.e., hospitals and medical research institutes) not-for-profits.

¹³ Computer readable data is available from the National Center for Charitable Statistics directly at www.nccs.urban.org.

The sample is restricted to 65,195 "firm-years" for this analysis for two reasons. First, these types of organizations are subject to several additional sources of state-level governance that are not related to the measures of governance used for the analysis. For example, in addition to being subject to the typical powers of a state Attorney General, medical not-for-profits are subject to oversight by state licensing and medical boards. In contrast, charitable not-for-profits are regulated by a single state agency and their powers correspond to the governance metric. Second, many states exempt educational and medical not-for-profits from the reporting requirements that are employed. These exemptions are granted because medical and educational not-for-profits generally must file particular regulatory forms with the state agencies that oversee them. Unfortunately, there does not appear to be any reliable source that would permit the construction of a legal or a reporting governance metric for educational or medical not-for-profits. The sample of 65,795 charitable not-for-profits is further reduced to 51,917 by requiring that they receive donations of a least \$10,000. Charities that receive few donations are frequently not subject to state reporting requirements and are less likely to be subject to enforcement efforts by state oversight agencies. In the final sample of 51,917 observations there are 9,324 unique organizations.

The foundation dataset spans the years 1994 through 2000. The 1994 database includes the entire population of 50,914 foundations, while the 1995 to 2000 samples include approximately 8,000 observations for each year. The sample observations for 1995 to 2000 were compiled by the IRS and include all foundations with total year-end assets of \$10 million or more as well as a stratified random sample of smaller foundations. After removing private operating foundations (which operate charitable programs rather than make grants and face a different set of tax rules) as well as foundation-year observations with zero assets and missing data, there are 38,560 observations in the sample.¹⁴ In the final sample of 38,560 observations there are 10,242 unique foundations.

¹⁴ Zero asset foundations frequently act as little more than annual conduits where a donor provides funds to the foundation, which disburses those funds to a charity before the end of the year.

Descriptive statistics for the variables employed in the paper are presented in Table 4.¹⁵ Although the organization-specific characteristics examined vary from year to year, the governance metrics do not. To gain some understanding of the extent to which these various governance mechanisms have been stable over time, particularly during the sample periods, several individuals at various state not-for-profit regulating agencies were contacted. These individuals suggested that in general the existing rules have been in place for at least the past several years. Because the governance variables do not vary across time and the dataset is a panel, all standard errors are clustered at the entity level.¹⁶ An industry indicator is included to control for the diversity in the charitable sector. The IRS has created a National Taxonomy of Exempt Entities (NTEE) which include 18 major categories (and numerous sub-categories) of charitable not-for-profits.

4. Results

4.1. Public Charities

As previously discussed the empirical analysis is directed towards addressing two broad issues. First, does stronger governance induce not-for-profits to focus more on charitable activities? Second, does stronger governance attenuate payments (in the form of salaries) to insiders? Table 5 initiates the analysis with an examination of how the governance metrics influence the charitable payout and fundraising activities of public charities. Industry, size (total assets) and revenue controls are included in all regressions. All t-statistics are based on standard errors clustered at the firm level. Several variations of each model are presented in order to examine the independent and joint effects of the governance variables.

The measure of charitable payout in columns 1 through 4 of Table 5 is the ratio of charitable expenses to total expenses. This measure captures the relative proportion of total expenditures that are devoted to charitable causes rather than consumed as administrative

¹⁵ Because the foundation sector is diverse and the sample contains observations with extreme minimum and maximum values of many of the variables of interest the analysis attempts to mitigate the influence of extreme values on the analyses in several ways. First, all of the data is winsorized at the 1st and 99th percentiles. Second, extensive outlier testing is done in each regression model including examining residual plots and screening the data based on Cook's D statistics, leverage statistics, and standardized residual statistics.

¹⁶ Standard errors are clustered at the entity level to allow for the possibility that the residuals are not independent within organizations, but that they are independent across different organizations. See Froot (1989) for a discussion of the clustering technique.

expenses or spent on fundraising activities.¹⁷ The results in column 1 of Table 5 indicate that the combined governance variable is associated with a larger share of not-for-profit expenses being dedicated to charitable purposes. When the combined governance variable is partitioned into its three sub-indices (non-distribution, enforcement, and reporting) in columns 2-5 of Table 5, results suggest that the enforcement sub-index has no independent effect on public charity behavior. In contrast the non-distribution and reporting governance variables each has a statistically significant effect on public charity behavior. Columns 5 through 8 of Table 5 repeat this analysis using total assets as a scaling factor in order to capture the amount of total current resources relative to total assets that are devoted to charitable purposes. Scaling by total assets is a useful check on these results and is comparable to a return on assets figure. Results for this alternative measure of charitable payout find that the combined governance variable is associated with higher charitable spending per dollar of assets. Columns 6 through 8 disaggregate the governance variable into its components and show that the non-distribution sub-index is associated with payouts per assets.

In terms of economic magnitude the results suggest that increasing non-distribution governance from the 25th percentile to the 75th percentile (a change of 1.0) induces an approximately one-half percent increase in expenses dedicated toward charitable purposes. A similar change in reporting governance leads to a smaller effect, increasing charitable expenses relative to total expenses by approximately one-quarter percent.

Columns 9 through 12 of Table 5 employ a dependent variable that measures the efficiency of fundraising. As noted by Steinberg (1986), a not-for-profit will benefit financially by increasing its fundraising activities until the marginal cost of fundraising is equal to marginal donation revenues.¹⁸ The fundraising metric used is an indicator variable equal to one if the ratio of fundraising expenses to total donations is equal to or greater than 1.0 and zero otherwise. This average measure, although not identical to the underlying marginal metric, captures the notion of

¹⁷ Charitable expenses are those reported as “program expenses” in Part II of Page 2 of the IRS 990. On page 2 a charity must partition all of its expenses into one of three mutually exclusive categories; programs, administrative, and fundraising.

¹⁸ Rose-Ackerman (1982) provides a formal analysis of the issue of “excessive” fundraising and finds that donors (who favor a particular type of public good) gain from fundraising to the extent it attracts other donors to their charity and lose to the extent that donations are diverted away from their favored charity towards alternative competing charities. This substitution effect can cause waste to the extent it merely increases overall fundraising expenditures without increasing the amount of overall donations in the market.

“excessive” fundraising. These specifications employ a logit model.¹⁹ These results indicate that the combined governance variable is associated with a lower probability of incurring “excessive” fundraising expenses. When the combined governance variable is partitioned into its three sub-indices (non-distribution, enforcement, and reporting) results show that the enforcement sub-index has no independent effect but that the non-distribution and reporting governance variables each has a statistically significant effect on fundraising, consistent with the results found for charitable expenditures above. In terms of magnitudes, the results suggest that increasing non-distribution (reporting) governance from the 25th percentile to the 75th percentile induces an approximately 14 (6) percent decrease in probability that a public charity will engage in excessive fundraising.

The importance of the non-distribution laws and reporting laws relative to general enforcement variables is something that persists in the analysis. Given that the non-distribution constraint is, as noted by Hansmann (1980), the differentiating characteristic of not-for-profits, these results are reassuring. These laws act to prohibit specific activities such as self-dealing or indirect distributions. Similarly, the state level reporting laws are designed to lay bare the financial transactions of the not-for-profit. In contrast, state level laws regarding the enforcement powers of the state Attorney General do not correspond to specifically prohibited transactions or actual requirement but simply lay out what general powers the Attorney General has. These more general laws appear to have no effect on the behavior of not-for-profits.

Table 6 presents the results of tests intended to measure the effects of governance on insider compensation.²⁰ Results in column 1 show that the combined governance variable is not associated with the ratio of officers’ compensation to total expenses. The results in subsequent columns (2 to 4) suggest that higher levels of reporting governance attenuate the ratio of officers’ compensation to total expenses, but that neither of the legal sub-indices has any independent effect. These results suggest that laws regulating reporting requirements have the strongest effect on officer’s compensation. These results correspond to the intuition that excess

¹⁹ As the descriptive statistics in Table 4 indicate, only six percent of the sample has this indicator variable set equal to one. Alternative specifications that employ a cutoff of 0.8 instead of 1 reach similar conclusions.

²⁰ This figure is drawn from line 25 of Part II of the IRS 990 (line item description is “compensation of officers, directors, etc.”).

compensation is deterred in the presence of reporting requirements the force not-for-profit managers to report their financials in detail.²¹

4.2. *Private Foundations*

The analysis of private foundations parallels that conducted on public charities. Similar to public charities, foundations also make charitable payouts. An important distinction between foundations and charities is that foundations have a minimum payout requirement while charities do not. As with the examination of public charities, two basic issues are of primary concern; does stronger governance cause foundations to pay out more than the minimally required amount, and does stronger governance attenuate payments (in the form of salaries) to insiders? Columns 1 through 4 of Table 7 examine the effects of governance on the amount of foundation payouts relative to legally required minimum amount of five percent of assets.²² The results in column 1 of Table 7 show that the combined governance variable is associated with larger foundation payouts relative to the required amount. When the combined governance variable is partitioned into its three sub-indices (non-distribution, enforcement, and reporting) as in columns 2-4 of Table 7, results suggest that the non-distribution and reporting governance variables each has a statistically significant effect on foundation payouts while the enforcement sub-index has no independent effect on foundation payouts. These results suggest that an increase in non-distribution governance from the 25th percentile to the 75th percentile induces an approximately seven percent increase in foundation payouts relative to the required amount. A somewhat smaller magnitude (two percent) applies to reporting governance.

As discussed above, a foundation has discretion over the amount and timing of payouts. Because foundations are permitted to delay their payouts one year they can retain their assets one additional year by deferring their payouts. Columns five through eight of Table 7 present results using an indicator variable equal to one if the foundation delays the majority (i.e., at least 90 percent) of its payouts until the following year and zero otherwise. Results suggest that higher combined governance is associated with a lower probability of delay in foundation payouts.

²¹ One problem with using the ratio of compensation to total expense is that many not-for-profit employees, including officers, donate their services. To the extent that the donation of services is correlated with governance this test is not necessarily isolating the effects of governance on compensation per se. To overcome this potential weakness, the analysis in Desai and Yetman (2005) also considers the ratio of total officer's compensation to other employee compensation as an alternative dependent variable and finds similar results.

²² The payout amount is line 8 of Part V of the IRS 990, and the minimum required amount is line 7 of Part XI of the prior year's IRS 990-PF.

Neither the enforcement sub-index nor the non-distribution sub-indices have an independent effect but the reporting governance variable does have a statistically significant and independent effect on foundation payout delay. In terms of magnitude the results suggest that increasing reporting governance from the 25th percentile to the 75th percentile induces an approximately 3 percent decrease in probability that a private foundation will delay its payouts as long as possible.

With respect to foundation officers' compensation²³, results in the first column of Table 8 show that higher levels of combined governance are associated with lower ratios of officers' compensation to total compensation suggesting that stronger governance attenuates foundation officer's compensation. The partitioned results in columns 2 through 4 indicate that this effect stems from the non-distribution sub-index and that neither the enforcement sub-index nor the reporting governance measure are associated with the ratio of foundation officer's compensation to total expenses. In terms of magnitude the results suggest that increasing non-distribution governance from the 25th percentile to the 75th percentile induces an approximately 3 percent decrease in the ratio of officers compensation to total expenses.

The results for foundation payouts are generally similar to those for public charity expenditures and suggest that similar forms of governance laws have similar effects on not-for-profit behavior. This is somewhat surprising given that private foundations are more likely to have a significant donor who can exert significant control. Nonetheless, in both cases non-distribution laws and reporting requirements generally appear to be associated with higher charitable distributions in both types of not-for-profits. In part, this may be explained by the fact that the oversight of many foundations are provided by the families of donors and, more specifically, later generations of donors with less incentive to fulfill the charitable mission of the foundation. This link between the presence of an actual donor and foundation behavior is left for future work.

4.3 *Causality*

The preceding analysis provides evidence suggesting a link between these legal and reporting rules and managerial behavior. In order to further examine the causal nature of this link, two further analyses are provided. It is conceivable that the relationship between the

²³ This figures is taken from line 13a of the IRS 990-PF.

governance variables and these outcomes is related to some correlated omitted variables. Fortunately, it is possible to instrument for the governance variables with state-level economic variables that are plausibly unrelated to the outcome measures being analyzed. This instrumental variable analysis has the advantage of addressing concerns related to other explanations for the link between the governance variables and the outcome measures. To conduct this analysis, fitted values from first stage regressions of the governance variables on state population, state domestic product, and per-capita state income are employed in second stage regressions that parallel the preceding analysis. Specifically, the eight columns of Table 9 correspond to different dependent variables from the analysis in Tables 4 through 8 where the combined governance index is examined.

The first seven columns in Table 9 show that the instrumental variables analysis provides results that are broadly consistent with the preceding analysis. It is interesting to note that with respect to the ratio of officer's compensation to total expenses (in column 4) for public charities the fitted combined governance variable has a statistically significant effect, whereas in Table 6 the relationship was not statistically significant. Finally, column 7 of Table 9 shows that the fitted combined governance variable is not associated with the ratio of officer's compensation to total expenses for foundations. The results in Table 8, which used non-instrumented governance variables showed that although the combined governance variable was statistically significant, all of the effect was from the nondistribution sub-index. Column 8 of Table 9 presents the results for the instrumented nondistribution governance sub-index and finds a statistically significant effect. In summary, the instrumental variable analysis provides reassuringly similar estimates to the OLS estimates discussed above.²⁴

In addition to the instrumental variable analysis above, it is useful to consider a specific, rather than more general, mapping of legal and reporting rules to outcome measures by examining the specific effect of a particular legal rule in deterring the activity that it targets. In particular, the analysis in Table 10 examines the relationship between the sales of property, plant, and equipment assets and officer's compensation, and how that relationship is attenuated in the presence of a specific governance variable intended to mitigate the relationship. The

²⁴ Of course, such an analysis is premised on the assumption that these state characteristics only influence the outcome variables through their influence on the governance variables. As with most instrumental variables analyses, it is impossible to refute this claim entirely. With this caveat, the consistency of the results with the OLS results across the various dependent variables is reassuring.

purpose of the nondistribution constraint is to limit managements' ability to steal the organizations' assets. One way a nonprofit manager could pay themselves what amounts to a liquidating dividend is to sell the assets of the nonprofit and retain the proceeds as salary. A specific nonprofit law used by some (but not all) states is that the State Attorney General must be notified of asset sales. This particular law is specifically intended to curb a manager's ability to sell off the nonprofits' working assets and abscond with the funds. To investigate this hypothesis the log of officer's compensation is regressed on asset sales (i.e., the sales of property, plant, and equipment) as well as the interaction of the asset sales variable with the Attorney General notification indicator variable. Results in the first column of Table 10 show that asset sales are positively related to officer's compensation. Results in the second column of Table 10 show that this relationship is attenuated in the presence of the requirement that Attorney Generals be notified at the time of the asset sale. This analysis provides more direct evidence that a specific governance rule has a specific effect on nonprofit behavior.

In order to consider if these effects relate to the broader governance environment or the specific legal rule, this same analysis is replicated in column 3 but the Attorney General notification variable is replaced with the *Cy Pres* variable to perform a falsification test. It is difficult to connect *Cy Pres* regulation to inappropriate asset sales so it should have no effect on the relationship between asset sales and officer's compensation. Results in column 3 of Table 10 support this hypothesis. This result provides some comfort that the results in columns 1 and 2 were not driven by a more general governance effect but were a reflection of the specific governance variable.

4.4. *Not-for-Profits and Social Insurance*

The preceding analysis is useful in establishing empirical regularities between insider compensation, a focus on charitable purposes and the governance environment of the not-for-profit firms. This analysis, however, only emphasizes the cost-structure of not-for-profits without attempting to assess the degree to which not-for-profits are fulfilling their mission. In order to investigate further the importance of the governance environment on not-for-profits and to respond to these concerns, it is possible to examine if not-for-profit firms fulfill a social insurance objective. While no ready summary statistic is available to assess the performance of not-for-profits, it is possible to employ the panel nature of the data to assess the degree to which not-for-profits are intertemporally smoothing resources and if they are, indeed, helping when

helping helps the most. These tests, while novel in the setting of not-for-profits, employ the differential response to shocks to see if the relationship between resources and activities and between local economic conditions and not-for-profit activities is mediated by the governance environment.²⁵

A social insurance object would be fulfilled if not-for-profits both intertemporally smooth resources *and* if they expend more resources when local economies are hardest hit. The intuition for intertemporal smoothing arises from the fact that a well governed not-for-profit would opt to limit the expansion of its charitable expenditures in flush times in order to build a reserve that can be employed in future bad times.²⁶ In order to consider this possibility, Table 11 examines the relationship between not-for profit activities and the resources available to a not-for-profit, including donations, program revenues (from the sales of products and services) and revenues from the sales of assets. Revenue sources naturally fall into these three categories as they are very different. Donations are received from donors while program revenues are earned income. Asset sales are neither donated nor earned, but result from the organization disposing of a portion of its investment or plant assets. These three revenue categories comprise the vast majority (over 95 percent) of total organization revenues. To conduct this analysis all of the variables are percentage changes and the models include year and industry effects. The analysis is restricted to human services type public charities only in order to narrow the scope of the examination to a setting where social insurance is most likely to be operative.

The first three columns of Table 11 examine the link between these three resources and not-for-profit expenses for charitable purposes. Results in the second column show that revenues from programs (the sales of products and services) is positively related to charitable spending. Results in the first and third column of Table 11 show that revenues from donations and asset sales are not associated with increases in charitable expenditures. Of more interest than these main effects is the coefficient on the interaction of the governance variable and these resource variables. Results in Column 2 suggest that the presence of stronger governance attenuates the increase in charitable outputs as resources from programs rise. This finding is consistent with a social insurance effect in that charities in well governed states increase their charitable spending

²⁵ Because foundations are less subject to the effects of economy wide fluctuations (as they are predominantly funded by a single person) and typically pursue longer-term objectives, private foundations are excluded from this analysis.

²⁶ The implicit assumption of this analysis (that is borne out in the analysis) is that revenue sources are pro-cyclical.

less as resources increase, saving some resources for poorer economic conditions. Columns 4, and 5 of Table 11 combine the measures of economic resources into single equations. Column 4 presents the combined results excluding the main effect of governance while the results in Column 5 include the governance main effect. In both cases, the results show an insurance effect (as noted by a statistically negative sign on the interaction coefficient) for program revenues.

While these results indicate intertemporal smoothing of resources, particularly program revenues, it does not suggest that not-for-profits are increasing resources during economically difficult times. To consider this possibility, the analysis in Table 12 explores the relationship between several measures of local economic conditions and charitable expenses. As no single measure best captures local needs several measures are used including changes in disposable income, disposable income per capita, gross state product, and state-level unemployment rates. The results in columns 1, 3, 5 and 7 in Table 12 indicate that as the overall economic situation of a state improves (as measured by higher state disposable income, higher state disposable income per capita, higher gross state product, and lower state unemployment rates) the amount of charitable expenditures by public charities likewise increases. These results suggest that not-for-profits are expanding and contracting in tandem with local economic cycles. When these economic variables are interacted with governance, the results in columns 2, 4, 6, and 8 of Table 12 indicate that the increases in charitable expenditures in response to economic activity are attenuated in higher governance states. In other words, not-for-profits in states providing a stricter governance environment are more likely to attenuate the relationship between local economic conditions and charitable expenditures, enabling them to provide more resources during more difficult economic times.

These results can be viewed as supporting the view that good governance rules help not-for-profit entities fulfill a social insurance function. While the coefficients on the interaction terms are supportive of this intuition, the coefficients on the local economic variables are not consistent with not-for-profits, on average, providing an insurance function as conceptualized in this paper. While the direct test of the effect of governance on not-for-profit is on the sign of the interaction term, the coefficients on the economic variables alone indicate the degree to which not-for-profits remain tied to local economic conditions. Further analysis might usefully examine the other factors that allow not-for-profit firms to fulfill a social insurance function.

5. *Conclusion*

The not-for-profit sector, consisting of public charities and private foundations, is a significant part of the U.S. economy. Public charities face several important operating choices including how much financial resources to devote to charitable rather than administrative activities, how much to spend on fundraising, and how to compensate their officers. Private foundations likewise face important choices including how much of their assets to give away to charities annually, when to pay those gifts, and how much to compensate their officers. These choices are central and fundamental to the overall operating effectiveness of the charitable sector and are remarkably unconstrained by the usual mechanisms that constrain for-profit managers. In the absence of the governance normally provided by owners, not-for-profits are subject to oversight and monitoring by various state-level agencies. Although this situation is well known, what is not known is how effective these legal and reporting rules are in controlling the behavior of not-for-profit managers.

The governance environment facing not-for-profit firms appears to shape their emphasis on charitable activities, their compensation patterns, their willingness to engage in inefficient fundraising, and their willingness to smooth and time their activities most effectively. These findings are consistent with the notion that state-level laws and regulations constitute an effective governance environment in the absence of owners. The results further suggest that the more general enforcement provisions that outline the legal authority of state attorney generals have little or no effect on not-for-profit firm behavior while specific rules that strengthen the non-distribution constraint or mandate fuller reporting provide the largest effects on not-for-profit behavior. Finally, the analysis finds that strong governance rules also appear to enhance the willingness of not-for-profits to intertemporally smooth their activities and expand activities when local economic conditions worsen. This finding is suggestive of a social insurance function for not-for-profits as well-governed entities moderate their spending in good economic periods in order to expand their charitable activities in less robust economic periods.

This analysis also suggests several lines of further inquiry. First, the diffusion of funders of not-for-profits might usefully be analogized to the concentration of ownership to examine how not-for-profit firms respond to the presence of large funders. One possible avenue for this would be to consider the role of government grants, or large block grants received from feeder

organizations such as the United Way. Second, the effects of large liquid endowments on charitable behavior, analogous to the free cash flow problem encountered in for-profit corporations, is a relatively unexplored area. Third, the extent to which legacy effects alter private foundation payouts has not been examined. The payout philosophy of a foundation could be a function of whether or not the originating founder is still alive or a function of the influence of the founder's heirs on foundation payouts. Each of these questions could be analyzed within the framework of the governance environment articulated in this paper. These questions are left for future research.

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Table 1a
Description of legal governance measures

Non-distribution sub-index measures	
Variable	Description
Not-for-profits legally distinguished from for-profit firms	Some states have a unique set of statutory laws that apply specifically to not-for-profits. One common element of these separate laws is that they typically act to prevent the distribution of charitable assets (i.e., residual claims) to officers, directors, or other specific individuals other than recipients specifically included in the organizations' by-laws.
Liquidating distributions restricted to other not-for-profits	Some states require that charitable liquidating distributions be paid to other registered charities only. This prevents charities from paying assets to corporate officers or directors or other non-charitable organizations.
Attorney General must be notified of asset sales	Some states require charities to notify the Attorney General if it sells substantially all of its assets. This permits the Attorney General to enforce non-distribution rules on charitable liquidations.
Limitations on re-incorporating as a for-profit corporation	Some states prohibit or otherwise limit the extent to which charities can re-organize as for-profit corporations. This prevents charities from paying out their assets to new "shareholders", which could be officers or directors or non-charitable corporations.
Enforcement rights sub-index measures	
Variable	Description
Attorney General must be notified of any suits involving charities	Some states require the courts to notify the Attorney General of any legal action brought against a charity. One purpose of this requirement is that it permits the Attorney General to determine if there is any enforceable action it should undertake as well.
Parties other than Attorney General have standing to bring legal actions	Some states give parties other than the Attorney General (such as officers or directors) the right to bring legal suit against a charity. This exposes the charity to additional sources of legal enforcement.
Cy pres authority	Cy pres laws give the courts the power to modify the incorporated purpose of the organization if that organization's purpose became obsolete, wasteful, or otherwise impracticable.

Source: Fremont-Smith (2004).

Table 1b
Description of reporting governance measures

Variable	Description
Registration required	Most states exempt organizations that raise small amounts of donations (typically around \$10,000). Virtually all states exempt not-for-profit educational and medical organizations from registration as these types of organizations typically have their own state and frequently federal registration requirements.
Annual renewal of registration	For states that require registration the renewal period is generally either annually or never (once the charity is registered, it need never again register).
Fundraising organizations used	Some charities use professional fundraising firms, which raise donations and remit those donations, less a fee, to the charity.
Financial statement audit	Some states require the charity to undergo a financial statement audit by Certified Public Accountants
Financial statements included	In addition to the IRS 990 (which is required to be included in all state registrations), some states also require that financial statements be included.
Bylaws included	Are bylaws included as part of required reporting?
Articles of incorporation included	Are articles of incorporation included as part of required reporting?
Tax exempt determination letter included	The tax-exempt determination letter (the IRS 1023) is the formal document that exempts a charity from federal income taxation.
Other state specific information included	Some states have additional state-specific forms that must be included in the registration.

Source: Based on filing requirements as reported by the Charitable Organization Multi-State Filing Project. Further detail is available at www.multistatefiling.org.

Table 2a
 Legal non-distribution governance sub-index

State	Legally distinguished	Limitations on distributions	AG notice of asset sales	Reincorp. limits	<i>Total Non-distribution Sub-Index</i>
Alaska	0	1	0	1	2
Alabama	0	1	0	1	2
Arkansas	1	1	0	0	2
Arizona	0	1	0	1	2
California	1	1	1	1	4
Colorado	0	1	0	1	2
Connecticut	0	1	0	1	2
DC	0	1	0	1	2
Delaware	0	0	0	1	1
Florida	0	1	0	1	2
Georgia	0	1	1	1	3
Hawaii	0	0	0	1	1
Iowa	0	1	0	1	2
Idaho	0	1	0	1	2
Illinois	0	1	0	1	2
Indiana	1	1	0	0	2
Kansas	0	1	0	1	2
Kentucky	0	1	0	1	2
Louisiana	0	1	0	1	2
Massachusetts	0	1	1	1	3
Maryland	0	1	0	1	2
Maine	1	1	1	0	3
Michigan	0	1	0	1	2
Minnesota	0	1	1	1	3
Missouri	1	1	1	0	3
Mississippi	0	0	0	1	1
Montana	1	1	1	0	3
North Carolina	0	1	1	1	3
North Dakota	0	1	1	1	3
Nebraska	1	1	1	0	3
New Hampshire	0	0	0	1	1
New Jersey	0	1	0	1	2
New Mexico	0	1	0	1	2
Nevada	0	1	0	1	2
New York	1	1	1	0	3
Ohio	0	1	0	1	2
Oklahoma	0	0	0	1	1
Oregon	1	1	1	1	4
Pennsylvania	0	1	0	1	2
Rhode Island	0	1	0	1	2
South Carolina	1	1	1	1	4
South Dakota	0	1	0	1	2
Tennessee	1	1	1	0	3
Texas	0	1	0	1	2
Utah	0	1	0	0	1
Virginia	0	1	0	1	2
Vermont	1	1	1	0	3
Washington	1	1	1	0	3
Wisconsin	0	1	0	1	2
West Virginia	0	1	0	0	1
Wyoming	1	1	1	0	3

Source: Fremont-Smith (2004).

Table 2b
 Legal enforcement governance sub-index

State	AG notice of suits	Other party standing	Cy pres	<i>Total Enforcement Sub-Index</i>	<i>Total Legal Index</i>
Alaska	0	0	0	0	2
Alabama	0	1	1	2	4
Arkansas	0	0	1	1	3
Arizona	0	0	1	1	3
California	1	1	1	3	7
Colorado	0	1	1	2	4
Connecticut	1	1	1	3	5
DC	0	1	1	2	4
Delaware	1	1	1	3	4
Florida	0	1	1	2	4
Georgia	1	1	1	3	6
Hawaii	0	1	1	2	3
Iowa	1	0	1	2	4
Idaho	1	1	1	3	5
Illinois	1	1	1	3	5
Indiana	1	0	1	2	4
Kansas	1	0	1	2	4
Kentucky	0	0	1	1	3
Louisiana	1	0	1	2	4
Massachusetts	1	1	1	3	6
Maryland	0	1	1	2	4
Maine	0	0	1	1	4
Michigan	1	1	1	3	5
Minnesota	1	1	1	3	6
Missouri	1	1	1	3	6
Mississippi	1	1	1	3	4
Montana	1	1	1	3	6
North Carolina	1	1	1	3	6
North Dakota	1	1	1	3	6
Nebraska	1	1	1	3	6
New Hampshire	0	0	1	1	2
New Jersey	1	1	1	3	5
New Mexico	0	0	1	1	3
Nevada	1	1	1	3	5
New York	1	1	1	3	6
Ohio	1	1	1	3	5
Oklahoma	1	1	1	3	4
Oregon	1	1	1	3	7
Pennsylvania	1	1	1	3	5
Rhode Island	1	0	1	2	4
South Carolina	1	1	0	2	6
South Dakota	1	0	1	2	4
Tennessee	1	1	1	3	6
Texas	1	1	1	3	5
Utah	1	0	1	2	3
Virginia	1	0	1	2	4
Vermont	1	1	1	3	6
Washington	1	0	1	2	5
Wisconsin	1	1	1	3	5
West Virginia	0	0	1	1	2
Wyoming	1	1	1	3	6

Source: Fremont-Smith (2004).

Table 3
Reporting governance index

State	Register	Annual	Fundraiser	Audit	Financials	By-laws	Articles	1023	Addl.	<i>Total Reporting Index</i>
Alaska	1	1	1	1	1	0	0	0	0	5
Alabama	1	0	0	0	1	1	1	1	0	5
Arkansas	1	1	1	1	0	0	0	1	1	6
Arizona	1	1	1	0	0	0	0	0	0	3
California	1	1	0	0	1	1	1	1	0	6
Colorado	1	1	1	0	0	0	0	0	0	3
Connecticut	1	0	0	1	1	0	0	0	0	3
DC	1	1	1	0	1	1	1	1	0	7
Delaware	0	0	0	0	0	0	0	0	0	0
Florida	1	1	1	0	0	0	0	1	0	4
Georgia	1	1	0	1	1	0	0	1	1	6
Hawaii	0	0	0	0	0	0	0	0	0	0
Iowa	0	0	0	0	0	0	0	0	0	0
Idaho	0	0	0	0	0	0	0	0	0	0
Illinois	1	0	1	1	1	1	1	1	0	7
Indiana	0	0	0	0	0	0	0	0	0	0
Kansas	1	1	0	1	1	0	1	1	0	6
Kentucky	1	1	0	0	0	0	0	0	0	2
Louisiana	1	0	1	0	0	1	1	0	0	4
Massachusetts	1	0	0	1	1	1	1	1	0	6
Maryland	1	1	1	1	1	1	1	1	0	8
Maine	1	1	0	1	1	0	0	1	0	5
Michigan	1	1	1	1	1	1	1	1	0	8
Minnesota	1	1	1	1	0	0	1	1	0	6
Missouri	1	1	1	0	1	0	0	1	1	6
Mississippi	1	1	1	1	1	1	1	1	1	9
Montana	0	0	0	0	0	0	0	0	0	0
North Carolina	1	1	1	0	1	1	1	1	1	8
North Dakota	1	1	1	1	1	0	1	0	2	8
Nebraska	0	0	0	0	0	0	0	0	0	0
New Hampshire	1	1	0	0	1	1	1	1	1	7
New Jersey	1	1	1	1	1	1	1	1	0	8
New Mexico	1	0	1	1	1	0	1	1	0	6
Nevada	0	0	0	0	0	0	0	0	0	0
New York	1	0	0	1	1	1	1	1	0	6
Ohio	1	1	0	0	1	1	1	1	0	6
Oklahoma	1	1	1	0	1	0	0	0	0	4
Oregon	1	0	0	0	1	1	1	1	0	5

Table 3
Reporting governance index (continued)

State	Register	Annual	Fundraiser	Audit	Financials	By-laws	Articles	1023	Addl.	<i>Total Reporting Index</i>
Pennsylvania	1	1	0	1	1	1	1	1	0	7
Rhode Island	1	1	1	1	1	0	0	0	1	6
South Carolina	1	1	1	0	1	0	0	0	0	4
South Dakota	0	0	0	0	0	0	0	0	0	0
Tennessee	1	1	1	1	1	1	1	1	2	10
Texas	0	0	0	0	0	0	0	0	0	0
Utah	1	1	1	1	0	1	1	1	1	8
Virginia	1	1	1	1	1	1	1	1	0	8
Vermont	0	0	0	0	0	0	0	0	0	0
Washington	1	1	1	0	1	0	0	1	1	6
Wisconsin	1	1	0	1	1	1	1	1	0	7
West Virginia	1	0	1	1	0	0	0	1	1	5
Wyoming	0	0	0	0	0	0	0	0	0	0

Source: Based on filing requirements as reported by the Charitable Organization Multi-State Filing Project. Further detail is available at www.multistatefiling.org.

Table 4
Descriptive statistics for public charities and private foundations

Variables	Mean	Median	25%	75%	σ
Governance Variables:					
Non-distribution governance	2.51	2.00	2.00	3.00	0.76
Enforcement governance	3.43	4.00	3.00	4.00	0.83
Reporting governance	5.62	6.00	5.00	7.00	2.46
Charitable Not-for-profits:					
Charitable expenses / total expenses	0.79	0.84	0.73	0.90	0.20
Charitable expenses / total assets	0.74	0.10	0.28	0.71	1.43
Fundraising indicator	0.06	0.00	0.00	0.00	0.23
Officer compensation / total expenses	0.06	0.03	0.01	0.06	0.08
Total revenues (in \$millions)	13.26	4.18	1.11	11.43	47.79
Total assets (in \$millions)	29.09	11.29	2.48	25.77	86.46
Log of officer's compensation	12.05	11.22	12.10	12.98	1.38
Log of asset sales	2.94	0.00	0.00	7.31	4.89
Log of state population	15.84	15.39	15.91	16.49	0.94
Log of state disposable income per capita	3.00	2.86	3.02	3.15	0.21
Percentage changes in charitable expenditures	0.08	0.01	0.07	0.17	0.35
Percentage change in donations	-0.48	-0.31	0.07	0.40	2.91
Percentage change in program revenues	0.03	0.00	0.07	0.18	0.62
Percentage change in asset sales	-2.40	-0.39	0.30	0.86	13.61
Percentage change in state disposable income	0.06	0.04	0.05	0.07	0.04
Percentage change in state disposable income per capita	0.05	0.03	0.04	0.06	0.04
Percentage change in gross state product	0.06	0.04	0.06	0.07	0.05
Percentage change in state unemployment	-0.06	-0.15	-0.07	0.03	0.15
Private Foundations:					
Qualifying distributions / required distributions	3.16	1.13	0.97	1.65	9.58
Delayed distributions indicator	0.27	0.00	0.00	1.00	0.44
Officer compensation / total expenses	0.50	0.53	0.23	0.77	0.29
Total revenues (in \$millions)	23.98	1.76	0.28	11.68	232.87
Total assets (in \$millions)	3.16	1.13	0.97	1.65	9.58

Notes: The governance variables are described in Tables 1a and 1b. Charitable nonprofit data is from the IRS Statistics of Income files for the years 1987 to 2000. The Private foundation data is from the IRS Statistics of Income files for the years 1994 to 2000. Charitable expenses (line 13 of the IRS 990) are expenses directed towards accomplishing the charitable mission rather than for fundraising or administrative activities. Total expenses are line 17 of the IRS 990. Total assets are year end and are from line 59B of the IRS 990. The fundraising indicator is equal to one if the ratio of fundraising expenses (line 15 of the IRS 990) to donations received (line 1a of the IRS 990) is one or greater, and zero otherwise. Officers compensation is from line 25A of the IRS 990. Total revenues is from line 12 of the IRS 990. Asset sales (line 8 of the IRS 990) are the sales of property, plant, and equipment. State population, unemployment, product, and disposable income data are from the U.S. Census Bureau. Program

revenues (line 2 of the IRS 990) are those from the sales of goods and services. Qualifying distributions (line 6 part XII of the IRS 990-PF) are amounts paid by a foundation that qualify towards meeting the five percent payout minimum. Required distributions (line 7 of part XI of the IRS 990-PF) is five percent of total assets. The delayed distribution indicator variable is equal to one if the foundation makes at least 90 percent of its qualifying distributions in the following (rather than in the current) year and zero otherwise. Officer's compensation is from line 13 of the IRS 990-PF. Total expenses are from line 24 of the IRS 990-PF. Total revenues are from line 12 of the IRS 990-PF. Total assets are from line I of the IRS 990-PF.

Table 5
Effects of governance on charitable organization operating efficiency

Dependent variable:	Ratio of charitable expense to total expense				Ratio of charitable expense to total assets				Fundraising indicator variable			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Constant	0.657 (66.14)	0.657 (60.40)	0.671 (88.19)	0.654 (58.59)	0.481 (8.93)	0.412 (5.74)	0.551 (13.21)	0.424 (6.03)	-2.634 (-10.61)	-2.755 (-10.3)	-2.863 (-13.86)	-2.713 (-9.92)
Combined governance	0.003 (3.61)				0.009 (2.29)				-0.054 (-2.55)			
Legal governance		0.005 (3.17)				0.029 (2.60)				-0.074 (-1.80)		
Distribution sub-index				0.005 (1.89)				0.067 (3.13)				-0.143 (-2.04)
Enforcement sub-index				0.002 (0.65)				-0.009 (-0.51)				0.061 (0.91)
Reporting governance			0.003 (3.01)	0.002 (2.29)			0.007 (1.31)	0.004 (0.77)			-0.064 (-2.41)	-0.062 (-2.51)
No. of observations	51,756	51,756	51,756	51,756	51,756	51,756	51,756	51,756	24,050	24,050	24,050	24,050
R ²	0.06	0.06	0.06	0.06	0.16	0.16	0.16	0.16	0.07	0.07	0.07	0.08

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 unique observations in the year 2000 sample. The dependent variable in the first four columns is the ratio of charitable expenses (line 13 of the IRS 990) to total expenses (line 17 of the IRS 990). The dependent variable in the second four columns is the ratio of charitable expenses to total year end assets (line 59B of the IRS 990). The dependent variable in the final four columns is a dummy variable set equal to one if the ratio of fundraising expenses (line 15 of the IRS 990) to donations received (line 1d of the IRS 990) is one or greater, and zero otherwise. All regression employ industry effects, size controls (total assets) and revenue controls (total revenues). Models are restricted to observations with total donations greater than \$10,000. Governance variables are described in Tables 1a and 1b.

Table 6
Effects of governance on the ratio of charitable organization officers' compensation to total expenses

	(1)	(2)	(3)	(4)
Constant	0.078 (16.69)	0.071 (13.49)	0.078 (22.29)	0.073 (13.45)
Combined governance	-.001 (-1.39)			
Legal governance	0.000 (0.45)			
Distribution sub-index	0.001 (0.60)			
Enforcement sub-index	0.001 (0.73)			
Reporting governance	-.001 (-2.03)			
No. of observations	26,971	26,971	26,971	26,971
R ²	0.06	0.06	0.06	0.06

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 unique observations in the year 2000 sample. The dependent variable is the ratio of officer's compensation (line 25 of the IRS 990) to total expenses (line 17 of the IRS 990). All regressions employ industry effects, size controls (total assets) and revenue controls (total revenues). Models are restricted to observations with total donations greater than \$10,000 and non-zero officer's compensation. Governance variables are described in Tables 1a and 1b.

Table 7
Effects of governance on foundation payouts

Dependent Variable:	Ratio of qualifying distributions to required amount				Delayed payout indicator			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Constant	1.355 (28.30)	1.340 (20.27)	1.467 (47.52)	1.352 (19.90)	-0.874 (-10.85)	-1.025 (-9.55)	-0.920 (-18.09)	-1.011 (-9.30)
Combined governance	0.020 (4.84)				-0.015 (-2.16)			
Legal governance		0.041 (3.77)				-0.003 (-0.16)		
Non-distribution sub-index				0.071 (3.74)				0.006 (0.17)
Enforcement sub-index				-0.013 (-0.69)				0.028 (0.85)
Reporting governance			0.021 (4.11)	0.019 (3.47)			-0.023 (-2.62)	-0.026 (-2.76)
No. of observations	38,411	38,411	38,411	38,411	28,956	28,956	28,956	28,956
R ²	0.003	0.003	0.002	0.003	0.005	0.005	0.004	0.005

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all private foundations included in the IRS Statistics of Income files for the years 1994 to 2000. There were 7,513 unique observations in the 2000 database. The dependent variable in the first four columns is the ratio of qualifying distributions (line 6 part XII of the IRS 990-PF), which are amounts paid by a foundation that qualify towards meeting the five percent payout minimum, to the required amount (line 7 of part XI of the IRS 990-PF). The dependent variable in the second four columns is a delayed distribution indicator variable is equal to one if the foundation makes at least 90 percent of its qualifying distributions in the following (rather than in the current) year and zero otherwise. Total revenues (line 12 of the IRS 990-PF) and total assets (line I of the IRS 990-PF) are included as control variables in all models. Models are restricted to observations with total donations greater than \$10,000. Governance variables are described in Tables 1a and 1b.

Table 8
Effects of governance on the ratio of foundation officers' compensation to total expenses

	(1)	(2)	(3)	(4)
Constant	0.570 (50.45)	0.632 (41.10)	0.545 (75.70)	0.619 (40.07)
Combined Governance	-0.002 (-2.41)			
Legal Governance		-0.015 (-5.78)		
Non- Distribution Sub-index				-0.031 (-6.61)
Enforcement Sub-index				-0.003 (-0.51)
Reporting Governance			0.000 (-0.12)	0.002 (1.23)
No. of Observations	33,516	33,516	33,516	33,516
R ²	0.03	0.03	0.03	0.04

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all private foundations included in the IRS Statistics of Income files for the years 1994 to 2000. There were 7,513 unique observations in the 2000 database. The dependent variable is the ratio of officer's compensation (line 13 of the IRS 990-PF) to total expenses (line 24 of the IRS 990-PF). Total revenues (line 12 of the IRS 990-PF) and total assets (line I of the IRS 990-PF) are included as control variables in all models. Models are restricted to observations with total donations greater than \$10,000 and non-zero officer's compensation. Governance variables are described in Tables 1a and 1b.

Table 9
Effects of instrumented combined governance on various nonprofit behaviors

Dependent Variable:	(1) Ratio of charitable expense to total expense	(2) Ratio of charitable expense to total assets	(3) Fundraising indicator variable	(4) Ratio of nonprofit officers' compensation to total expenses	(5) Ratio of qualifying distributions to distributable amount	(6) Delayed payout indicator	(7) Ratio of foundation officers' compensation to total expenses	(8) Ratio of foundation officers' compensation to total expenses
Constant	0.624 (34.14)	0.293 (2.66)	-1.877 (-3.07)	0.081 (11.21)	1.230 (21.51)	0.053 (0.40)	0.515 (26.13)	0.629 (31.96)
Combined governance	0.005 (3.60)	0.021 (2.24)	-0.142 (-2.67)	-0.001 (-1.84)	0.026 (3.38)	-0.141 (-7.54)	0.002 (0.78)	
Nondistribution Sub- index								-0.019 (-5.00)
No. of Observations	51,756	24,050	51,756	26,971	38,411	28,956	33,516	33,516
R ²	0.06	0.09	0.08	0.06	0.002	0.01	0.03	0.03

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 (7,513) unique observations in the year 2000 sample of public charities (foundations). The governance variables (which are described in Tables 1a and 1b) are the fitted values from a first stage regression run at the state level. The first stage regression used 51 observations (50 states plus the District of Columbia) and regressed the governance variables on state population, state domestic product, and per-capita state income. Results are robust to various combinations of these regressors both in levels and per-capita. The first dependent variable is the ratio of charitable expenses (line 13 of the IRS 990) to total expenses (line 17 of the IRS 990). The second dependent variable is the ratio of charitable expenses to total year end assets (line 59B of the IRS 990). The third dependent variable is a dummy variable set equal to one if the ratio of fundraising expenses (line 15 of the IRS 990) to donations received (line 1d of the IRS 990) is one or greater, and zero otherwise. The fourth dependent variable is the ratio of officer's compensation (line 25 of the IRS 990) to total expenses (line 17 of the IRS 990). The fifth dependent variable is the ratio of qualifying distributions (line 6 part XII of the IRS 990-PF), which are amounts paid by a foundation that qualify towards meeting the five percent payout minimum, to the required amount (line 7 of part XI of the IRS 990-PF). The sixth dependent variable is a delayed distribution indicator variable is equal to one if the foundation makes at least 90 percent of its qualifying distributions in the following (rather than in the current) year and zero otherwise. The seventh and eighth dependent variables are the ratio of foundation officer's compensation (line 13 of the IRS 990-PF) to total expenses (line 24 of the IRS 990-PF). All regression employ industry effects (except for the foundation models 5, 6, 7, and 8), size controls (total assets) and revenue controls (total revenues). Models are restricted to observations with total donations greater than \$10,000.

Table 10
Effects of governance on the relationship between sales of property, plant and equipment and officer's compensation

	(1)	(2)	(3)
Constant	6.894 (22.82)	6.877 (22.21)	6.936 (22.53)
Asset sales	0.043 (15.02)	0.047 (13.61)	0.030 (1.67)
Notice to attorney general of substantial asset sales indicator		0.011 (0.29)	
Interaction of asset sales and attorney general notification		-0.012 (-1.94)	
Cy pres			-0.049 (-0.41)
Interaction of asset sales and cy-pres			0.013 (0.69)
No. of Observations	28,126	28,126	28,126
R ²	0.12	0.12	0.12

Notes: All specifications are OLS analyses with standard errors corrected for clustering at the firm level. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 unique observations in the year 2000 sample. The dependent variable is the log of nonprofit officer's compensation (line 25 of the IRS 990). Asset sales (line 8 of the IRS 990) are the log of sales of property, plant, and equipment. The notice to the attorney general of substantial asset sales is a governance mechanism employed by some states that is specifically intended to limit a manager's ability to inappropriately distribute a nonprofit's assets. Cy pres laws give the courts certain administrative powers as explained in table 1a. Cy pres administrative powers are not intended to limit inappropriate asset distribution. The sample is limited to observations with positive non-zero values for officer's compensation. So that observations with zero values could be used (other than officer's compensation), they were reset to a value of one prior to logging. All regression employ industry effects, size controls (log total assets) and revenue controls (log total revenues). The governance variables are from Freemont-Smith (2004). Models are restricted to observations with total donations greater than \$10,000.

Table 11
Effects of governance on the sensitivity of charitable expenses to charity-specific resources

	(1)	(2)	(3)	(4)	(5)
Intercept	0.121 (20.92)	0.100 (20.49)	0.114 (13.14)	0.094 (12.47)	0.104 (10.64)
Legal governance indicator variable					-0.002 (-1.81)
Percentage change in donations	0.001 (0.82)			-0.001 (-0.95)	-0.001 (-0.82)
Percentage change in donations * governance indicator	0.001 (1.07)			0.001 (0.68)	0.001 (0.44)
Percentage change in program revenue		0.089 (36.12)		0.071 (21.99)	0.071 (21.97)
Percentage change in program revenue * governance indicator		-0.021 (-5.59)		-0.016 (-3.10)	-0.017 (-3.22)
Percentage change in asset sales revenue			0.001 (1.02)	0.001 (0.89)	0.001 (1.00)
Percentage change in asset sales revenue * governance indicator			0.001 (1.28)	0.001 (0.11)	-0.001 (-0.14)
No. of Observations	26,693	21,658	13,750	9,376	9,373
R-Squared	0.01	0.10	0.01	0.08	0.09

Notes: All specifications are OLS regressions. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 unique observations in the year 2000 sample. The dependent variable is the annual percentage change in charitable expenses (line 13 of the IRS 990). The governance indicator variable is equal to 1 if the legal governance variable (the combination of non-distribution and enforcement governances) is greater than 6 (its median value) and zero otherwise. Donations (line 1a of the IRS 990) are the total donations from individuals and corporations. Program revenues (line 2 of the IRS 990) are those from the sales of products and services. Asset sales revenues (line 8d of the IRS 990) are from the sales of assets including investments and equipment. All regressions employ industry effects and yearly indicator variables. T-statistics based on robust standard errors are underneath the parameter estimates. The sample is limited to observations with donations over \$10,000 and that are classified as human service organizations. Human service organizations include the National Taxonomy of Exempt Entities industries (there are 26 industries as established by the IRS) J, K, L, M, N, O, P, S, T, and W. The primary exempt missions of these 10 industries are (respectively): employment, food and nutrition, housing, public safety, public recreation, youth assistance, general human services, public community assistance, philanthropy, and general public benefit.

Table 12
Effects of Governance on the Sensitivity of Charitable Expenses to Local Economic Shocks

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Constant	0.014 (3.43)	0.015 (3.63)	-0.045 (-5.96)	-0.044 (-5.80)	0.027 (6.72)	0.028 (7.00)	0.099 (26.24)	0.099 (26.39)
Percentage change in disposable income	1.227 (47.34)	1.245 (45.20)						
Percentage change in disposable income * governance indicator		-0.085 (-2.88)						
Percentage change in per-capita disposable income			1.380 (22.87)	1.429 (22.35)				
Percentage change in per-capita disposable income * governance indicator				-0.172 (-2.56)				
Percentage change in gross state product					1.127 (46.09)	1.161 (44.41)		
Percentage change in gross state product * governance indicator						-0.104 (-3.68)		
Percentage change in state unemployment level							-0.039 (-4.23)	-0.048 (-4.72)
Percentage change in state unemployment level * governance indicator								0.031 (2.24)
No. of Observations	29,786	29,788	31,120	31,120	29,790	29,788	29,755	29,755
R-Squared	0.08	0.08	0.02	0.02	0.07	0.07	0.01	0.01

Notes: All specifications are OLS regressions. The sample includes all public charities included in the IRS Statistics of Income files for the years 1987 to 2000. There are 7,028 unique observations in the year 2000 sample. The dependent variable is the annual percentage change in charitable expenses (line 13 of the IRS 990). The governance indicator variable is equal to 1 if the legal governance variable (the combination of non-distribution and enforcement governances) is greater than 6 (its median value) and zero otherwise. State population, unemployment, and disposable income data are from the U.S. Census Bureau. All regressions employ industry effects and yearly indicator variables. T-statistics based on robust standard errors are underneath the parameter estimates. The sample is limited to observations with donations over \$10,000 and that are classified as human service organizations. Human service organizations include the National Taxonomy of Exempt Entities industries (there are 26 industries as established by the IRS) J, K, L, M, N, O, P, S, T, and W. The primary exempt missions of these 10 industries are (respectively): employment, food and nutrition, housing, public safety, public recreation, youth assistance, general human services, public community assistance, philanthropy, and general public benefit.