The Impact of Sanctioning in the Nonprofit Sector

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Introduction

- U.S. nonprofit sector is large and difficult to monitor
 - Over 10% of the workforce
 - \$450 billion in donations annually
- Donors reliant on journalists and charity watchdogs to expose misconduct Headlines
- Charity Navigator publishes reports of potential or confirmed misconduct being investigated by the media or governmental agencies

Introduction

In this paper, I ask the following questions:

- How do donors respond to the publication of an advisory notice?
- 2 How do charities respond?

Related literature

- Firm scandals:
 - Eg. Bilicka and Traini (2023), Lewellen et al. (2021), O'Donovan et al. (2019), Chakravarthy et al. (2014), Hanlon and Slemrod (2009)
- Charity scandals:
 - ► Eg. Xu (2022), Lamonthe et al. (2022), Hungerman (2013)
- Donor and charity responses to information and incentives:
 - Eg. Mayo (2023), Babenko et al. (2021), Mayo (2021), Homonoff et al. (2020), Marx (2018), Calabrese and Grizzle (2012)
- Impact of taxpayer audits:
 - ► Eg. Advani, Elming and Shaw (2021), DeBacker et al. (2018), Gemmell and Ratto (2012), Kleven et al. (2011)

Preview of results

- No evidence of a donor response:
 - On average, advisories don't seem to have an impact on donations
- Charities take steps to "improve":
 - ► Increase in spending on program services ⇒ improvement in salient financial metric
 - Broader restructuring
 - Strategic fundraising decisions

Charities and the IRS Form 990

- All IRS Section 501(c)(3) organizations with gross receipts of over \$50,000 are required to file IRS Form 990 annually
- The form contains information on the charity's financials, as well as personnel and program service activities Form 990
- Outcomes of interest include:
 - Income
 - Expenses
 - Financial metrics
 - Labor market outcomes

Charity Navigator

- Since its founding in 2001, Charity Navigator has become the most-utilized evaluator of charities in the U.S.
 - ▶ 11 million unique users
- Provide ratings for c. 200,000 charities a year
- Rate charities according to their financial health, accountability and transparency
- Since 2014, also provide information on reported or confirmed charity misconduct

Charity Navigator Advisories

- Information comes from publicly available reporting
 - Google Alerts and Meltwater
- Active advisories clearly displayed on the website Active advisories
- Flags on charity information pages Flags
- 3 levels of advisories: Low, Moderate and High Concern
 - High Concern is proven or confirmed allegation against a charity or an employee that is serious both in nature and scope
 - Moderate Concern highlights allegations being made against a charity or an employee that have not yet been confirmed
 - Low Concern highlights actions or circumstances that should be regarded with caution due to their nature, seriousness, and scope
- Scrape data from Charity Navigator's website ⇒ final sample is the universe of advisories 2014 to date ◆ Distribution

Summary statistics

	Advisories (mean)	Rated (mean)	Advisories (median)	Rated (median)
Assets (\$ million)	86.52	37.63	7.63	6.87
	(323.58)	(210.48)		
Revenue (\$ million)	66.50	16.83	5.00	4.55
	(286.52)	(70.59)		
Contributions (\$ million)	45.80	13.21	3.50	3.45
	(157.43)	(63.15)		
Total expenses (\$ million)	50.96	15.51	4.60	4.18
	(257.27)	(64.97)		
Program expenses (\$ million)	59.05	13.24	3.90	3.36
,	(254.93)	(59.41)		
Fundraising expenses (\$ million)	3.71	0.979	0.380	0.337
	(17.01)	(3.77)		
Program expense percentage	0.779	0.804	0.823	0.814
	(0.168)	(0.099)		
Fundraising efficiency	0.126	0.120	0.073	0.099
	(0.165)	(0.107)		
Number of employees	300.54	126.36	45	40
-	(1,476.53)	(386.46)		
Observations	177	7855	177	7855

Notes: All dollars are constant (\$2010)

Summary statistics are reported for the year 2019

Standard deviations are in parentheses

 International, Religion-related and Animal charities are over-represented among advisories (relative to rated organizations)

Environmental, Food and Education charities are under-represented Sectors

or represented

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Donor responses to misconduct

- How do donors respond to the publication of an advisory?
- Estimating donation responses helps to quantify the cost of negligence, and predict how charities might respond
- Compare contributions of organizations that experience these events with those that do not:
 - Treated: Advisory notice already published
 - Not-yet-treated: Advisory notice not yet published
 - Never treated: Charities not subject to an advisory
- Events are not randomly assigned, but the timing is arguably random: advisory notices represent an exogenous shock to donors' information sets

Donor responses to misconduct

Event study design:

$$In(D)_{it} = \alpha_i + \gamma_t + \sum_{\substack{r \neq -1 \\ T < r < \bar{T}}} \mathbb{1}[R_{it} = r]\beta_{1r} + \varepsilon_{it}$$

- D is total contributions, and R_{it} are dummy variables for time relative to the publication of an advisory
- α_i and γ_t are charity and time fixed effects, respectively
- \bullet ε_{it} is clustered at the charity level
- β_{1r} estimates the difference in average donations r years after the advisory between those that are subject to a notice and those that are not

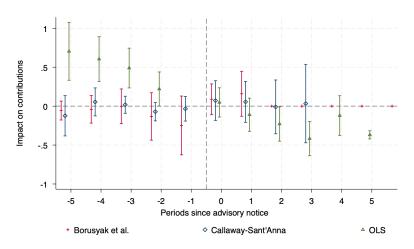
Heterogeneity

- Recent work has shown that β_{1r} may not represent a straightforward weighted average of treatment effects if there exists heterogeneity across time or charities
- Heterogeneity across charities:
 - Might think that the publication of an advisory notice has a different impact on donations depending on a charity's size or sector
- Heterogeneity across time:
 - Charity Navigator has increased in popularity over time advisory notices posted today likely have larger impacts on donations

 \implies "heterogeneity-robust" estimators that rely on generalized parallel trend and no-anticipation assumptions



Impact of an advisory on contributions



Exception: donations decline by 30% when media coverage increases



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Charity responses

- Same event study design as before
- Empirical challenge: even if an advisory notice is a shock to donors, it may not be to the charity in question ⇒ threat to generalized parallel trends assumption
 - Robustness check: Restrict attention to financial misconduct committed by individuals against the organization (33% of all cases), such as cases of embezzlement

Charity responses

Table: Effect of an advisory notice on charity behavior: Spending outcomes

	Program expenses	Fundraising	Program ratio	Fundraising efficiency	Admin ratio
Average ATT (pre)	-0.0404	-0.0701	-0.0068*	-0.0025	0.0003
	(0.0304)	(0.1158)	(0.0039)	(0.0042)	(0.0010)
Average ATT (post)	0.3190**	0.9025	0.0323**	-0.0004	-0.0035
	(0.1424)	(0.6182)	(0.0154)	(0.0194)	(0.0046)
Observations	1372	1372	1372	1028	1028

Notes: All dependent variables, except ratios, are transformed via inverse hyperbolic sine

Program ratio = Program service expenses | Fundraising efficiency = Fundraising expenses | Fundraising expenses | Admin ratio =

The control group are the not-vet treated organizations

All specifications are based on Callaway-Sant'Anna (2020) and control for total assets and sector Pre-(post-)treatment average ATTs average over 5 (4) years

Standard errors (in parentheses) clustered at the charity level

* p < 0.1, ** p < 0.05, *** p < 0.01

Program services > Fundraising (ihs) > Fundraising (intensive)

▶ Program ratio

Charity responses

Table: Effect of an advisory notice on charity behavior: Employment outcomes

	Number of paid employees	Number of volunteers	Total wage bill
Average ATT (pre)	-0.0116	-0.0060	0.0561
	(0.0258)	(0.0681)	(0.0505)
Average ATT (post)	-0.1980	-0.0364	-0.0054
	(0.1249)	(0.2897)	(0.3068)
Observations	1028	964	1028

Notes: All dependent variables, except ratios, are transformed via inverse hyperbolic sine

The control group are the not-yet treated organizations

All specifications are based on Callaway-Sant'Anna (2020) and control for total assets and sector

Pre-(post-)treatment average ATTs average over 5 (4) years

Standard errors (in parentheses) clustered at the charity level

*
$$p < 0.1$$
, ** $p < 0.05$, *** $p < 0.01$

Heterogeneity

- - Level of advisory
 - No differential spending or employment responses
 - Financial vs non-financial misconduct
 - Increase in program spending largely driven by financial scandals
 - Decline in number of employees (and subsequent decline in wage bill) entirely due to non-financial scandals
 - Individual vs organizational misconduct
 - Improved spending ratio and reduction in number of employees following organizational misconduct
 - National vs local coverage
 - Increase in program spending and decline in employment for scandals with national coverage
 - Amount of coverage
 - ★ Increase in program spending ratio for scandals with more coverage



Heterogeneity

- Heterogeneity analysis emphasizes:
 - Reputation building
 - Marginal effectiveness of fundraising
 - Restructuring

Conclusion

- Examine important accountability tool
- On average, donors are unresponsive to advisory notices
- BUT charities do respond:
 - Increased spending on program services
 improvement in the most salient financial metric
 - Strategic fundraising decisions
 - Broader restructuring
- Behavior consistent with reputation-building and strategic decision-making

Next steps

- Other outcomes of interest:
 - Government grants vs private contributions
 - Change in leadership
- Real responses vs manipulation
- General deterrence/spillover effects?

Thank you! jennifer.mayo@missouri.edu

Wounded Warrior Project Spends Lavishly on Itself, Insiders Say



After Public Crisis and Fall from Grace, Wounded Warrior Project Quietly Regains Ground

WWF accused of deceit, cover-ups and dishonesty in US Congressional Committee hearing

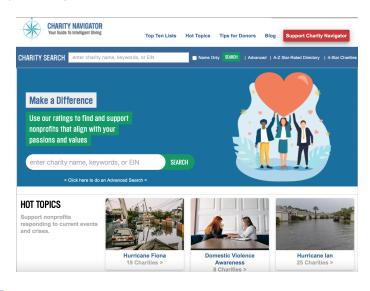
October 27, 2021

Secret recording from DIA board meeting reveals harsh findings about workplace culture

Inabelle Sousquette Special to the Detroit Free Press
Published 8:00 a.m. ET March 12, 2021 | Updated 8:04 p.m. ET March 12, 2021



Charity Navigator





Active advisories







Total: 58

Date †	Charity Name †
07/25/22	Pride Houston Inc.
07/22/22	Wayne Township Fin Department Inc.
07/22/22	Zoar Volunteer Fire Department Inc.
07/11/22	Lower Columbia Q

Center

07/01/22 Vietnam Veterans of San Diego

05/20/22 Longhouse Reserve 05/20/22 WOMEN FOR

AMERICA FIRST

Total: 227

Date †	Charity Name 1
08/19/22	Casa Ruby Inc.

08/19/22 Healthy Kids Running Series

08/19/22 Middle Farth

08/19/22 Sierra Nevada German Shepherd Rescue

07/29/22 ROMAN CATHOLIC CHURCH OF THE ARCHDIOCESE OF

THE NEW ORLEANS 07/25/22 American Health

Foundation Inc.

Total: 170

Date 1	Charity Name 1
08/03/22	Madison Square Boys

& Girls Club Sumter County 08/03/22 Commission on

Alcohol and Drug Ahuse 08/03/22 Western Alliance

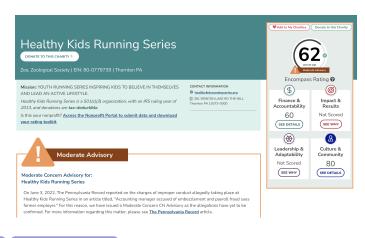
Emergency Services Inc

07/22/22 Enrichmond Foundation

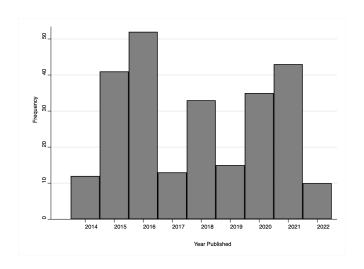
07/22/22 Lift Up Someone Today



Charity information page



Distribution of advisories





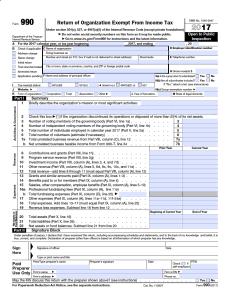


Summary statistics

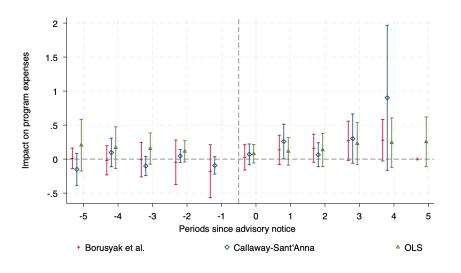
	Advisory charities
A: Arts, Culture and Humanities	27
B: Education	5
C: Environment	4
D: Animal-Related	16
E: Health Care	10
F: Mental Health and Crisis Intervention	0
G: Medicine and Voluntary Health Associations	4
H: Medical Research	2
I: Crime and Legal-Related	4
J: Employment	2
K: Food, Agriculture and Nutrition	2
L: Housing and Shelter	2
M: Public Safety, Disaster Preparedness and Relief	0
N: Recreation and Sports	4
O: Youth Development	10
P: Human Services	26
Q: International, Foreign Affairs and National Security	24
R: Civil Rights, Social Action and Advocacy	5
S: Community Improvement and Capacity Building	1
T: Philanthropy, Voluntarism and Grantmaking	6
U: Science and Technology Research Institutes	1
V: Social Science Research Institutes	0
W: Public and Society Benefit	5
X: Religion-Related	16
Y: Mutual and Membership Benefit	0
Total	177



IRS Form 990



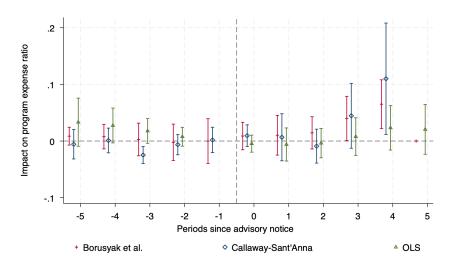
Impact of an advisory on program service expenses







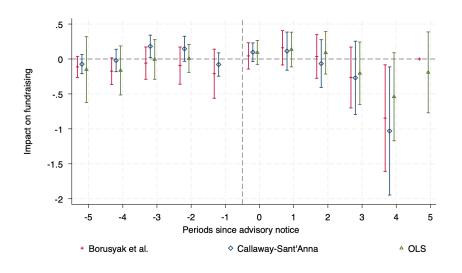
Impact of an advisory on program service ratio







Impact of an advisory on fundraising (intensive)







Impact of an advisory on fundraising (ihs)

