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## The design of charitable fund-raising schemes: Matching grants or seed money

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### ABSTRACT

For a fixed large donation a matching scheme that simply uses a one-for-one match ratio can actually raise less money than a seed money scheme. But when the match ratio is chosen to reflect the characteristics of the small donor base so as to exhaust the large donor's willingness to give, matching schemes always raise more money and are preferred by both charities and large donors. However, when the large donor chooses the size of her donation, a conflict can arise. The large donor can prefer a smaller leadership gift and more reliance on small donor matching while the charity can prefer seed money.

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### 1. Introduction

Consider a business school in the early stage of a fund-raising campaign that has been approached by a wealthy alumnus interested in donating a large sum. Should the school accept the donation as seed money or persuade the benefactor to agree to give her donation as a matching grant? What should the match ratio be? What will the large donor prefer? This paper provides the answers. We show that unless the match ratio reflects the characteristics of the small donor pool, a matching scheme could raise less money than if the large donation were treated as seed money. But when the match ratio is selected to exhaust the large donor's willingness to give (and not simply as a default of one-for-one), then for a fixed large donation a matching scheme will always raise more money and will be preferred by both the school and the large donor. However, when the large donor chooses the size of her donation, a conflict can arise. The large donor can prefer a smaller leadership gift and more reliance on small donors' matching while the school can prefer seed money.

Matching grants are grants offered as challenges. A large donor offers her grant with the stipulation that the recipient organization must raise funds from other sources to match the offered amount. A matching grant is therefore conditional on the amount raised from smaller donors. For each dollar raised, the large donor will match with  $h$  up to some maximum total amount.<sup>2</sup> The crucial difference between a matching gift and lump-sum seed money lies in the effect of the large donor's

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<sup>2</sup> An example is a \$113 m pledge by the William and Flora Hewlett Foundation to create 100 endowed faculty chairs at U.C. Berkeley. The challenge grant will match other private donations dollar-for-dollar up to \$110 million, resulting in \$220 million in new endowments once the challenge is met. The additional \$3 million will be used for managing those endowed funds. [http://www.berkeley.edu/news/media/releases/2007/09/10\\_hewlett.shtml](http://www.berkeley.edu/news/media/releases/2007/09/10_hewlett.shtml).

contribution on small donor contributions: A matching gift is “multiplicative” while seed money is “additive” and hence small donor incentives are affected. Matching schemes are used widely in fund-raising and are endorsed by professional fund-raisers: *Dove (2001, p. 21)* states that one should “[n]ever underestimate the power of a challenge gift. North Americans love the ‘buy one, get one free’ concept, and the ability to leverage a gift is an irresistible temptation for many.” Organizations as diverse as Rotary International, the Arkansas Humanities Council, Sara Lee and IBM use matching grants to support either small donor or employee contributions to an approved list of charities.

There is a large body of literature on charitable giving surveyed in *Andreoni (2006a)*, *List (2011)*, and *Andreoni and Payne (2013)*. The incentive effects of matching in mitigating free-rider problems have been well recognized; see *Guttman (1978, 1985, 1986, 1987)*, *Danziger and Schnytzer (1991)*, *Varian (1994)* and *Boadway et al. (2007)*. Other papers address the role of lump-sum seed money in fund-raising in signaling the quality of the project and mitigating information asymmetries thereby increasing donations from small donors (*Vesterlund, 2003; Andreoni, 2006b*). Large donors are likely to have carefully scrutinized the management and goals of a charity before making a large donation. *Fama and Jensen (1983)* point out, and *Callen et al. (2003)* document, that major donors play an important role in the governance of non-profits, often by their presence on non-profit boards.<sup>3</sup> Seed money can also assure potential small donors that sufficient funds could be raised to undertake a large project with significant fixed costs, see *Andreoni (1998)*. Consistent with the certification role of large donor gifts, *List and Lucking-Reiley (2002)* provide experimental results showing that seed money increases both the participation rate of donors and the average gift received from participating donors.<sup>4</sup>

Our paper makes three contributions to the theory of charitable fund-raising. First, the literature to date has primarily focused on the game played by potential donors without discussing the role of the recipient charity. In contrast, we focus on the role that large donors and charitable organizations play in the design of fund-raising strategies when each party seeks to maximize their own objective. To this end, we directly examine the choice between matching grants and seed money from both the charity’s and large donor’s points of view. We consider the potential conflict between the objectives of charities and those of lead donors and show that whether a conflict arises depends on how small donors respond to changes in the match ratio.

A further theoretical contribution is to extend existing work which shows that matching mitigates free-riding and determine the match ratio that maximizes total contributions to the charity for a given leadership gift. This provides the theoretical basis necessary for the correct interpretation of recent experimental work whose authors conclude that matching schemes raise less than seed money schemes. Our third contribution is to recognize the importance of the converse of the usual signaling model in which small donors seek to learn from the lead donor’s behavior in the choice between seed money and matching grants. We observe that the design of the fund-raising can be important if the lead donor wishes to gauge how highly others, in particular small donors, value the charity’s mission.

Our comparison of matching schemes and lump-sum seed money is based on a model of the private provision of public goods. To crystallize the difference between the two fund-raising methods, there is assumed to be no information asymmetry about the quality of the provider of the public good. In the initial analysis, the size of the large donation is given—only its packaging is to be determined. We show that for a given leadership gift, the matching approach will raise more money in total *provided* the matching scheme is designed to reflect the characteristics of the small donor pool and exhaust the large donor’s willingness to give. Since for a given potential leadership gift, a matching scheme that exhausts the large donor’s willingness to give will raise more money in total, both the charity and the large donor should prefer matching whenever the leadership gift is fixed.

The conclusion that appropriately designed matching schemes raise more money than seed money schemes seems inconsistent with recent experimental results. For example, *Huck and Rasul (2011)* conclude that charities will maximize the donations they receive by treating leadership gifts as seed money. In fact, they emphasize that their results “beg the question of why fundraisers are so often observed employing matched fundraising” (*Huck and Rasul, 2011, p. 360*). Similarly, *Karlan and List (2007)* conclude that their experimental result “. . . directly refutes the integrity of using larger match ratios, and stands in sharp contrast to current fundraising practices.” The experimental results may well call into question the common practice of employing a one-for-one match ratio as a default, but they do not contradict the fund-raising recommendations of this paper. Rather the experimental outcome is shown to be a result of experimenting with match ratios far below the level that would exhaust the large donor’s willingness to give. In fact the results of the experiments can be interpreted as demonstrating that matching schemes, if designed appropriately, could well have succeeded in raising more money than was raised by the seed money at the same cost to the large donor.

We also consider the choice between matching and seed money when the leadership gift is not fixed. When the large donor can choose both the size of her gift and the method of fund-raising, matching is always her preferred option. But the charity may disagree. A necessary condition for disagreement to occur is that small donor gifts are decreasing in the match

<sup>3</sup> In *Callen et al. (2003)*, the definition of “major” donors is left to the discretion of the organization staff member who completed the survey. They find that major donors constitute 26% of the board on average. The greater the proportion of major donors on the board is, the lower the organization’s administrative expenses as a proportion of total expenses.

<sup>4</sup> This finding shows that the leadership gift can have a “crowding-in” effect. A “crowding-out” effect will occur when the leadership gift does not signal higher quality. The *Roberts (1984)* analysis of the crowding-out effect of government spending on the provision of public goods has been extended in *Bergstrom et al. (1986)* and *Andreoni (1988, 1989)*, and tested in *Andreoni (1993)* and *Andreoni and Payne (2003)*.

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