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THE RELATIONSHIP BETWEEN CORPORATE PHILANTHROPY AND SHAREHOLDER WEALTH: A RISK MANAGEMENT PERSPECTIVE

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I present a complex theoretical explanation that draws on multiple bodies of literature to present an academically rigorous version of a simple argument: good deeds earn chits. I advance/defend three core assertions: (1) corporate philanthropy can generate positive moral capital among communities and stakeholders, (2) moral capital can provide shareholders with insurance-like protection for a firm's relationship-based intangible assets, and (3) this protection contributes to shareholder wealth. I highlight several managerial implications of these core assertions.

Should rational, profit-maximizing managers[1] engage in corporate philanthropy? Business and society scholars have theorized about and studied this question, as have accountants, economists, lawyers, philosophers, political scientists, strategists, and theologians. The relationship between philanthropic activity and shareholder wealth represents one facet of a larger debate over the link between corporate social responsibility (CSR) and corporate financial performance (CFP); this debate has generated substantial theoretical argument for over seven decades (e.g., Berle, 1931) and substantial empirical research contributions over the last three. Margolis and Walsh (2001) reviewed ninety empirical studies conducted since 1970 of the CSR-CFP relationship, and their analysis presents a decidedly mixed picture. Forty-eight studies show a positive link between CSR and CFP; however, closer examination of these studies reveals a number of concerns around data sources, the type and variety of measures used as both independent and dependent variables, and control variables (or lack thereof). The lack of theoretical grounding for many of the studies noted by Margolis and Walsh echoes Ullman's claim that this area of inquiry represents "data in search of a theory" (1985: 540).

Other meta-analytic work corroborates the unsettled state of empirical analysis. Griffin and Mahon (1997) and Roman, Hayibor, and Agle (1999) analyzed the same fifty-one studies and reached markedly different conclusions about the overall strength of a CSR-CFP relationship. The marked inability of scholars to reach an empirically grounded resolution to this debate indicates that the relationship between CSR and CFP, if one exists, may be quite complex (Rowley & Berman, 2000; Ullman, 1985). If such a relationship exists, the principle of requisite variety implies that such a complex relationship requires a suitably complex theoretical explanation.

In what follows, I present a complex theoretical explanation that draws on the business ethics, social psychology, law, microeconomics, and strategic management literature to present an academically rigorous version of an intuitively simple argument: good deeds earn chits. I hope to establish three core assertions: (1) that corporate philanthropy can generate positive moral capital among communities and stake-

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[1] Although I use the terms *rationality* and *profit maximizing*, I recognize and accept the boundaries on rationality suggested by Williamson, who notes that managers are "intendedly rational but only limitedly so" (1985: 45). Managers may in fact *intend* to maximize shareholder wealth; however, cognitive limits on their ability to consider all possible strategies and outcomes constrain their ability to maximize. I use the base terms *rationality* and *profit maximizing* for literary ease of use, but also because these pure assumptions underlie scholarship that emphatically holds that rational, profit-maximizing managers should not engage in philanthropic activity (e.g., Friedman, 1970).

holders, (2) that moral capital can provide shareholders with "insurance-like" protection for many of a firm's idiosyncratic intangible assets, and (3) that this insurance-like protection contributes to shareholder wealth. These three assertions and the constructs and relationships they embody constitute one pathway that leads from philanthropic activity (a manifestation of CSR) to shareholder wealth (a measure of CFP).

Philanthropic activity anchors one end of the pathway, shareholder wealth the other. Shareholder wealth is the expected discounted value of a firm's anticipated cash flow stream from the employment of its tangible and intangible assets, consistent with the prescriptions of the Capital Asset Pricing Model (Brealey, Myers, & Marcus, 1995). I use philanthropic activity as a construct for several reasons. Researchers (Carroll, 1979, 1999), research data bases (the Kinder, Lydenberg, Domini [KLD] social ratings include philanthropic activity in their variable "community relations"), teachers in the business and society field (Waddock, 2001), and practitioners (the Conference Board produces an annual industry-level survey of philanthropic donations) all consider philanthropic activity an important dimension of CSR. Further, a robust operational definition of philanthropy can be drawn from the accounting literature: philanthropy is "an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary **nonreciprocal transfer** by another entity acting other than as an owner" (Financial Accounting Standards Board [FASB], 1993: 2). The nonreciprocity condition becomes the acid test of philanthropic activity; it is not an explicit exchange of value between two parties such as cause-related marketing but, rather, a transfer of wealth from one party to another.[2]

Finally, philanthropy represents a discretionary manifestation of CSR that differs in kind (not merely in degree) from the obligatory conformance with economic, legal, or moral/ethical dimensions of CSR (Carroll, 1979). As a discretionary action by a firm's management, philanthropy can, under certain conditions, generate approbation and imputations of exemplary values or character to the firm from its various publics. Adherence to known and explicit requirements (economic and legal) and obligations (ethical) may generate satisfaction and imputations of responsibility among a firm's stakeholders; however, the voluntary and discretionary nature of philanthropic activity (doing good above and beyond what is expected) may lead to imputations of exemplary, as opposed to merely good, behavior (Wood & Logsdon, 2002).

The logic I outline below that links philanthropic activity with shareholder wealth may be applied a fortiori to other manifestations of discretionary social investments or activities by firms, where CSR is defined as actions that are not required by law but that appear to further some social good and that extend beyond the explicit transactional interests of the firm (McWilliams & Siegel, 2000). Simply put, if philanthropy can create wealth for shareholders, other discretionary corporate social initiatives should create wealth by the same basic mechanism.

The model I present focuses on two groups of actors: (1) managers, who make allocation decisions regarding philanthropic activity, and (2) stakeholders, who interact with the firm in their area of interest and as members of communities[3] affected by philanthropic activity

[2] Cloaked within the FASB standard is a fairly large measure of discretion and judgment in classifying individual cases as philanthropy or marketing expenses. Consider three examples: (1) a donation by a corporation to fund a new private school building; (2) support of the local symphony orchestra by the local utility company, where support is at a predefined "gold" level by the symphony and the firm receives recognition for its activities in the symphony program; and (3) a donation by a corporation to construct a sports arena that carries with it exclusive naming rights for the arena. The first case qualifies as philanthropic since no exchange has occurred, while the third does not because of the materiality of the donation, the explicit exchange of objects of value, and the exclusivity granted in exchange. The second case could be interpreted a number of ways; however, the donation most likely qualifies as philanthropic because (1) the level of materiality may be significant to the symphony but likely not to the utility company, and (2) the benefit exchanged for the donation (being a "gold" supporter) represents a nonexclusive benefit available to all who donate at that level. Materiality (on both sides of the transfer) and exclusivity of the exchange become useful guidelines to categorize ambiguous cases.

[3] A community can be "1. A neighborhood, vicinity, or location; 2. A society or group of people with similar rights or interests; or 3. A collection of common interests that arise from an association" (*Black's Law Dictionary,* 1999). Communities have been modeled in the literature as "stakeholders" of the firm (Freeman, 1984; Wood & Jones, 1995), usually construed under the first definition concerning geographic proximity. Definitions 2 and 3 move beyond this notion, how-

(Freeman, 1984). I assume that managers act rationally and intend to maximize shareholder wealth through their decisions; agency problems either do not exist, or adequate control systems and governance mechanisms can be installed to minimize the presence and severity of agency problems. Stakeholders construct reputational assessments and evaluations of the firm's various activities that generate positive or negative reputational capital (Fombrun, 1996). Both managers and stakeholders can be characterized as reasonable—that is, they will modify and change their decisions and positions in the face of reasons and reasonable argument.

The stakeholder world is pluralistic, which means that society consists of several "competing comprehensive doctrines" (philosophies, religions, etc.) that provide individuals and groups with final and intermediate definitions of what constitutes, for them, a good society (Rawls, 2000); an alternative formulation is that pluralism means stakeholders (as individuals and groups) hold differing moral preferences, and they belong to communities that are defined by the shared moral preferences of their members (Donaldson & Dunfee, 1999). Put simply, a firm's "public" consists of multiple communities, each representing different ethical values and value systems; few ethical values will be common across all communities, some will be common across many communities, many will not overlap, and some ethical values will conflict with values or complete value systems held by other communities.

LITERATURE REVIEW

Table 1 presents an overview of the main themes in the CSR-CFP debate. I make no claim that Table 1 presents an exhaustive review of the theoretical work in this area; the scholarship cited here provides the reader with the basic contours and distinctive flavor of each position described. The table outlines the asserted relationship between CSR and CFP, the essential arguments advanced, strengths and weaknesses as evaluated by opponents in the debate, and representative (primarily) organizational[4] scholarship in each area. The arrow at the top of the table indicates the level of social involvement tolerated or called for by the three major positions; the clear break in the arrow captures the idea that, for business citizenship advocates, the rationale for corporate social involvement can never adequately devolve into a mere economically profitable relationship among the firm, stakeholders, and communities. Rather, CSR must be viewed as a citizenship duty, whether an ethical or political conception of citizenship is used (Logsdon & Wood, 2002; Wood & Logsdon, 2002).

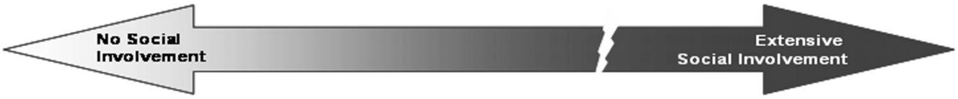
Proponents of one pole in the debate (strict capitalism) hold that there is no relationship between CSR and CFP and, consequently, that there should be no involvement in social issues; proponents of the other pole (business citizenship) argue for deep social involvement based on citizenship obligations, irrespective of any economic gain. Scholars in various disciplines have created intermediate positions that adhere to major tenets of the polar positions but attempt to move toward some middle ground. For example, marketing scholars advance the position of cause-related marketing as a method for combining adherence to strict capitalism with some level of social involvement (Deshpande & Hithon, 2002; Drumright, 1996; Mohr, Webb, & Harris, 2001; Varadarajan & Menon, 1988). On the other side, stakeholder theorists such as Freeman (1984) or strategy scholars such as Hart (1997) craft a position that shares a duty-based foundation with business citizenship but falls short of the latter's call for broad involvement in social, political, and humanitarian issues.

Strategic philanthropy, a term coined by Post and Waddock (1995), appears to be an oxymoron; however, the term adequately captures a compromise view that links CSR and CFP. How can a firm further its strategic interests (i.e., engage in activities that create wealth) while giving away resources with nothing apparent in return? Strategic philanthropy adherents hold that although the firm receives no tangible, explicit, or discrete exchange value, philanthropic and other CSR activities generate intangible strate-

ever, and imply that communities may have their own stake in the firm, but are also composed of individuals with other stakeholder interests.

[4] The table does not include scholarship from the disciplines of accounting, economics, finance, law, philosophy, political science, and theology that takes up this important conversation.

TABLE 1
Major Themes in the CSR-CFP Literature



Dimension	**Shareholder Capitalism**	**Strategic Philanthropy**	**Business Citizenship**
CSR-CFP relationship	Negative	Positive	Positive or negative but not the basis for action
Moral premise: shareholder property rights	Shareholders provide the capital for the firm and have a property claim on the residual earnings of the firm; it is unjust to dispose of that property without the consent of the owners	Enhancing public goods and social welfare increases the value of shareholders' residual claims	Shareholder property rights only meaningfully exist within an overarching framework of community institutions, basic human rights, and concern for human dignity
Moral premise: social welfare	Corporations contribute most to social welfare through the production of economic goods (e.g., products, services, jobs, tax revenues)	Corporate contributions can have a direct and measurable impact on both social welfare and a corporation's "strategic balance sheet" (e.g., increased trust, loyalty, goodwill)	As citizen agents of a larger community, firms have an obligation to contribute to social welfare in a broad-based way (e.g., policies, strategies, technologies, philanthropy)
Representative scholarship	Easterbrook & Fischel (1991); Friedman (1970); McWilliams & Seigel (2000)	Fombrun (1996); Fombrun Gardberg, & Barnett, (2000); Jones (1995); Keim (1978)	Korten (1996); Logsdon & Wood (2002); Waddock (2001); Wood & Logsdon (2002)
Strengths	● Creates a clear stopping rule for managerial discretion, investments, and moral obligations ● Holds managers strictly accountable to shareholders for outcomes ● Mitigates agency problems related to corporate contributions	● Presents a broad vision of a firm's roles and opportunities within society while retaining focus on shareholder wealth ● Fosters broader (more constituencies) and deeper (longer-term) commitments by firms to stakeholders	● Models the firm as a citizen, deeply embedded in a global society of communities and institutions ● Offers a broad agenda for meaningful corporate contributions to social welfare
Weaknesses	● Firms are independent/autonomous within the larger society, with no obligations beyond shareholder wealth ● Limited view of business contribution to social welfare; many opportunities for social contributions may be unrealized	● Many pressing social issues, and problems may not fit a firm's "strategic objectives" ● What is "strategic" is difficult to measure, thus open to abuse of agency relationship and providing a fuzzy stopping rule for investment	● No stopping rule (in theory or practice) to limit managerial decision making, investments, and moral obligations in social issues ● Business, run by private interest, assumes a larger public policy role, with no political accountability to check managerial discretion

gic assets like reputational capital (Fombrun et al., 2000), employee commitment (Turban & Greening, 1996), trust (Frank, 1996; Zucker, 1986), positive action (Neihesiel, 1994) or acquiescence (Jenson, 2002; Jenson & Murphy, 1990) among key regulatory institutions or legislative bodies, or the development of the firm's business and institutional environments (Porter & Kramer, 2002).

Strategic philanthropy has been the subject of empirical research, as well as theoretical development. Fry, Keim, and Meiners (1982) used IRS statistics of income for thirty-six industry groups from the years 1946–1973 to examine the potential strategic motivations and implications for corporate giving. They found that contributions were positively related to advertising expenses and that "firms with higher levels of public contact spend more on contributions than do firms with little public contact. This, too, is consistent with the notion that contributions are a profit motivated expenditure" (Fry et al., 1982: 103). Saiia, Carroll, and Buchholtz (2003) recently surveyed corporate giving managers among the largest public contributors to investigate the degree to which these individuals perceived their organizations as engaged in strategic philanthropy. Their results indicate that those in control of corporate giving see the activity as becoming increasingly strategic and that organizational leaders expect a link between philanthropic activity and corporate goals or strategies.

The scholarship of strategic philanthropy seeks a compromise position between the two extremes—arguing for a significant level of social involvement by firms, but limiting that involvement to the strategic interests of the firm, thereby increasing shareholder wealth. For all the effort invested by scholars in articulating a compromise position, two groups of essential questions reveal the difficulties in the current state of such a compromise. The first set of questions revolves around the notion of *strategic philanthropy,* considering how and under what conditions philanthropy will contribute to shareholder wealth: *why* and *when* will philanthropy be strategic? The second set of questions considers the implications for managers attempting to develop a *philanthropic strategy* and takes up *where* and *how* their firms should engage in philanthropic activity to create strategic value.

Strategic Philanthropy

What is the pathway that leads from philanthropic activity to shareholder wealth? Critics of strategic philanthropy note that, for all the theoretical and empirical effort in the area, no clearly specified mechanism has been described and defended. Margolis and Walsh note "a need for a causal theory to link CS[R] to CSP" (2003: 278). The work of Fombrun et al. (2000) exemplifies the problem. While their work establishes potential connections between social and financial performance, their reliance on anecdotes rather than research and on specific stakeholder relationships rather than general theoretical principles and constructs makes their argument associational rather than causational. Rowley and Berman (2000) and Wood and Jones (1995) outline criteria that such a causal mechanism must satisfy: such a mechanism must account for industry and competitive context differences between firms (Rowley & Berman, 2000) and must account for the diverse variety of stakeholder interests and divergent stakeholder perceptions and assessments of the firm (Wood & Jones, 1995).

In the first major section of what follows, I seek to strengthen existing work in strategic philanthropy by providing a detailed theoretical explanation of one pathway linking social and financial performance. There may be other paths; I do not imply that philanthropy creates value only in the way I specify. I argue that philanthropic activity can, under certain circumstances, generate positive moral capital, which provides the firm with insurance-like protection for its relationship-based intangible assets. The model attempts to account for diverse and divergent stakeholder interests and assessments of philanthropic activity, and the focus on the risk management value of positive moral capital provides a mechanism to accommodate industry, competitive, and firm-level differences that contour the economic landscape.

How much should a firm invest in philanthropic activity? The strength of the strict capitalism position lies in its clear delineation of a stopping rule for managerial investment and activity: only invest in those activities that create tangible and explicit value for shareholders (Berle, 1931; Easterbrook & Fischel, 1991). Such a stopping rule creates clear accountability to shareholders for all investments and provides clear direction for managers facing competing demands for resources. These scholars impale the strategic philanthropy perspective for not providing a clear stopping rule: "strategic" or "stakeholder" interest proves difficult to define and provides a nebulous and fuzzy stopping rule at best. Because my argument draws on risk management principles and insurance theory, I am able to strengthen the strategic philanthropy perspective by specifying a conceptually clear stopping rule for philanthropic activity and to define when continued investments in philanthropic activity yield no additional protection to the firm's expected cash flow stream.

Philanthropic Strategy

Where should a firm target its philanthropic activities? The strength of the business citizenship position lies in its vision of the corporation as tightly integrated into the larger social and institutional system; this tight coupling between business and society generates the citizenship mandate of corporate involvement in building the "good society" (Korten, 1996; O'Toole, 1993). Advocates wish to see business assets, skills, capabilities, talents, and resources employed to combat many of humanity's most pressing social and political problems, from poverty eradication concerns such as clean drinking water and adult literacy to the political guarantee of basic human rights for all citizens (Logsdon & Wood, 2002; Wood & Logsdon, 2002). Their dissatisfaction with the strategic philanthropy perspective stems from its inability to motivate social involvement beyond voluntarism and the "strategic interest" criteria of the donor firms. Philanthropic voluntarism will never, in the view of business citizenship adherents, lead to the sustained commitments necessary to tackle such broad social and political issues, and strategic interest may never motivate involvement in areas such as literacy or strengthening human rights. In the second major section of the article, I hope to accommodate the vision of business citizenship by arguing that a risk management view of philanthropy encourages a broad rather than narrow conception of activity: philanthropic activity in the broad social and political arenas advocated by business citizenship scholars may indeed generate value for shareholders, even though such activity does not appear to further the strategic interest of a firm.

How should a firm manage the processes of philanthropic activity to maximize its gains? Saiia et al. (2003) describe and Porter and Kramer (2002) prescribe a world of corporate giving dominated by rational economic decision making designed to isolate and exploit the strategic value of philanthropic activities. Porter and Kramer, for example, present a series of screens for contribution managers to use in evaluating the potential strategic leverage and opportunities available through philanthropic activity—the goal being to move managers beyond notions of communal obligations, past mere goodwill generation, and on to effective "strategic giving" (2002: 67). The argument I present below holds that adherence to communal obligations and goodwill generation represent important sources of the strategic value of philanthropy. Further, while the emphasis on rational economic decision making provides managers with solid foundations, philanthropic activity perceived as purely economic in its motivation is unlikely to generate the type or degree of moral capital that provides insurance-like value.

With these questions clearly articulated, I proceed to lay out the theoretical argument. In the first section that follows, I outline how philanthropy creates positive moral capital and how that capital provides insurance-like protection for the firm, and I specify an optimal level of philanthropic activity. In the second section I consider the managerial implications of the first section regarding the targeting of philanthropic activity among the firm's many stakeholders, stakeholder groups, and communities, as well as implications for organizational contexts and processes for managing philanthropic activities and allocating resources in this area.

STRATEGIC PHILANTHROPY: CREATING SHAREHOLDER WEALTH

This section marks the pathway from corporate philanthropy to moral capital, and then on to the creation of shareholder value. In the first subsection I argue that philanthropic activity will generate positive moral capital when both the acts themselves and the imputations about the organization and its actors receive positive evaluations from affected communities and others. In the second subsection I argue that positive moral capital can protect many of the firm's relationship-based intangible assets as it works to mitigate negative assessments and the resulting sanctions meted out by stakeholders consequent to actions by the firm that adversely impact stakeholder interests. In the final subsection I draw on standard notions in the economics of insurance literature to identify the optimal level of philanthropic activity for a firm.

From Philanthropic Activity to Moral Capital

Fombrun (1996) models reputational capital as the outcome of the process of assessments and evaluations of the firm's publics that constitute a reputation (Rindova & Fombrun, 1998); a reputation in and of itself has no cash value, but reputational capital—positive or negative—has economic value because it disposes stakeholders to hold beliefs and/or engage in actions that potentially create (or destroy) wealth for shareholders.[5] A firm's *global reputation* is "the overall estimation of a company held by its constituents" (Fombrun, 1996: 37). A global reputation is itself some function of reputational assessments of various *attributes* of the firm (e.g., a firm's finances, product, innovation, or brand), including the moral dimension of a firm's performance.

The notion that stakeholders will impute values—some of them moral—to organizational action can be traced back to some of the earliest scholarship in the field of management (e.g., Barnard, 1938; Selznick, 1957). Goffman (1997; originally published in 1959) explains that, in an attempt to ascertain the complete "social data" involved in any interaction, individuals judge not only the tangible and perceivable facts at hand but also impute intentions, motivations, feelings, and so forth to the others involved in the interaction, based on the tangible and perceivable facts and the *overall context* of the interaction. The action and context provide "cues, tests, hints, expressive gestures, etc." that form "the impressions that the others give"; these impressions have a moral component, since they "tend to be treated as claims and promises they have implicitly made, and claims and promises tend to have a moral character" (Goffman, 1997: 21).

Jones (1995) offers an account of a firm's moral reputation—one attribute-based reputational area—consistent with this notion. Stakeholders assess interactions between the firm and stakeholders and the overall context—its visions, strategies, policies, systems, etc.—that reflect some degree of "moral coloration" by individual actors, managers, and leaders within the firm; from these morally colored activities and contexts, stakeholders impute moral values, principles, and character elements that compose a moral reputation.[6]

Philanthropic moral reputational capital represents the outcome of the process of assessment, evaluation, and imputation by stakeholders and communities of a firm's philanthropic activities; thus, it is, at the core, a perception-based construct.[7] Philanthropic moral reputational capital has value, as I outline below, because it disposes stakeholders to hold beliefs about the firm that can influence the types of actions those stakeholders engage in. *Activity*-based philanthropic moral reputational capital becomes a part of the larger *attribute*-based construct of moral reputational capital, which, in turn, contributes to a firm's global reputational capital. For convenience, I refer to philanthropic moral reputational capital as simply *moral capital*.

That philanthropic activity generates a positive reputation and subsequent positive moral capital is, prima facie, true; good and beneficent acts that go above and beyond the call of duty *should* result in approbation rather than condemnation, for one *definiens* of a good act is that it engenders approbation among observers (Ar-

[5] The potential economic value becomes actual when two conditions occur: (1) when stakeholders act on their dispositions and (2) when the economic value created exceeds the cost of creating those dispositions.

[6] An explication of the calculus stakeholders or other assessors use to derive reputation is beyond the scope of this paper; however, plausible alternatives exist. For example, consider four alternatives: first, "netting," or taking some average score across various areas of activity and context; second, a "minimalist" approach that equates the overall score with the minimum assessment in any area; third, a "maximum" approach, where reputation equals the overall score with the maximum assessment in an area of most concern to a constituent; fourth, a "juridical" approach, where assessments of various activities are balanced and weighted on a case-by-case basis.

[7] The perceptual nature of the construct suggests that research methodologies and measurement techniques used in psychology (attribution theory research) and marketing (product attribute research) may empirically capture the type, level, and intensity of moral capital stakeholders hold toward a firm.

istotle, 1941). For philanthropic activity to qualify as a good act, it must be consistent with some underlying ethical value; hence, supporting Second Harvest, a Pacific Northwest food provider, is good, because alleviating hunger is an ethical value held by many people. However, counterexamples, such as AT&T's involvement with Planned Parenthood, show that philanthropic activity sometimes generates negative moral capital. AT&T had been a long-time donor to Planned Parenthood, but in 1990 pro-life groups pressured AT&T to abandon its philanthropic support of the organization. The company's support of Planned Parenthood generated negative moral capital among prolife communities, and in the ensuing cancellation of support, the firm lost its positive moral capital among pro-choice groups. Instead of earning chits, AT&T burned chits with everyone involved.

Pluralism implies a number of "comprehensive doctrines" by which people and communities order their lives and their conception of the good (Rawls, 2000). These comprehensive doctrines or value systems will contain values that overlap other comprehensive doctrines, as well as values that conflict with other systems. Philanthropic activity, and the ethical value or values underpinning such activity, will receive varied assessments and evaluations, because stakeholders and communities adhere to different ethical values; determinations of the "goodness" of philanthropic activity will be based on the consistency or agreement of the activity with the ethical values of those stakeholders and the communities affected by philanthropic activity.

For philanthropic activity, then, goodness is in the eye of the beholder. Philanthropic activity, and its associated ethical value, can be consistent with community values, leading to positive moral evaluations; the activity can be not consistent (but not opposed to) community values, resulting in apathy, indifference, and a neutral evaluation; or the activity can be opposed to values held dear by the community, leading to a negative moral evaluation. The relationship between philanthropic activity and subsequent moral evaluations can be captured in the following propositions.

> *Proposition 1a: The greater the level of consistency between philanthropic activity and a community's ethical values, the greater the positive moral evaluation among that community.*

> *Proposition 1b: The greater the level of opposition between philanthropic activity and a community's ethical values, the greater the negative moral evaluation among that community.*

> *Proposition 1c: Philanthropic activity that is neutral toward (neither consistent with nor opposed to) a community's ethical values will generate a neutral moral evaluation among that community.*

Consistency between philanthropic activity and a community's ethical values yields an *act-based* positive moral evaluation, which becomes the necessary condition for the generation of moral capital. The sufficient condition arises from the evaluations the community members impute to the firm's (and perhaps its managers') motives. Because philanthropy is discretionary, motives cannot be economic, legal, or even moral obligation; thus, the question of motive and intent becomes salient for communities and evaluators. Imputations of motivation turn on one simple question: Does the philanthropic activity at hand represent a genuine manifestation of the firm's underlying intentions, vision, and character, or is the activity designed to *ingratiate* the firm among the impacted community?

I use ingratiation in its negative and restrictive formulation: "a class of strategic behaviors illicitly designed to influence a particular other person [or group] concerning the attractiveness of one's personal qualities" (Jones, 1964: 4). Gordon (1996), in a meta-analytic review of empirical studies of ingratiation, notes that a consistent finding across studies is that attempts at gaining favor judged as ingratiating rather than genuine manifestations of identity actually diminish rather than enhance the actor's attractiveness in the eyes of those perceiving. Ingratiation is illicit and morally negative because it involves deception; honorable acts belie dishonorable motives, and the goal of the ingratiator is to be *seen* as good without actually *being* good.

> *Proposition 2a: The greater the extent to which philanthropic activity is viewed by a community as a genuine manifestation of the firm's intentions,*

motivations, and character, the greater the positive moral evaluation will be among that community.

Proposition 2b: The greater the extent to which philanthropic activity is viewed by a community as an ingratiating attempt to win favor, the greater the negative moral evaluation will be among that community.

Imputations of motive and character by a community yield an *actor-based* moral evaluation. Figure 1 represents the four possible combinations of the necessary (act-based) and sufficient (actor-based) conditions for moral capital generation. The logic of moral capital generation follows the simple arithmetic rule that one negative assessment ensures a negative result. The diagonal cells in Figure 1 capture this logic: negative moral capital arises either when the act or the actor receives a negative evaluation from the target community. The lower lefthand cell violates the arithmetic logic, however, since two negatives do not yield a positive; actions by a firm may be opposed to a community's values and still be perceived as ingratiating, thus yielding an extremely negative evaluation. The pathway from philanthropic activity to moral capital can be summarized as follows.

Proposition 3: The greater the act-based positive moral evaluation and the greater the actor-based positive moral evaluation by a target community, the greater the positive moral capital generated by the philanthropic activity will be.

With these propositions in place, I revisit the AT&T example. Hess, Rogovsky, and Dunfee (2002) argue that AT&T's problems with Planned Parenthood stemmed from the lack of consistency between the firm's philanthropic activity and overall firm strategy; these authors imply that AT&T's failure arose from an *internal* lack of consistency. The analysis underlying Proposition 1 suggests an additional, *externally based* error by decision makers. AT&T executives failed to see that actions designed to gain positive moral capital among one group (generally speaking, those characterized as pro-choice) meant generating negative moral capital among another group (generally speaking, those characterized as pro-life). They failed to see that picking up one end of a stick entailed picking up the other end as well.

The logic of Proposition 2 helps explain why AT&T ended the episode having burned its chits all around. The shift in contribution policy could be viewed by pro-choice groups as evidence that AT&T's motives were never pure; the support did not reflect acceptance of the pro-choice cause among AT&T decision makers but, rather, a donation seeking to win favor. Pro-life groups,

FIGURE 1
Acts, Actors, and Moral Capital

		Evaluation of actor	
		Ingratiating	**Genuine**
Evaluation of act	**Positive**	Actor-based negative moral capital	Positive moral capital
	Negative	Act- and actor-based negative moral capital	Act-based negative moral capital

however, had little reason to believe that AT&T decision makers were motivated by a sincere commitment to their cause; the donations to Planned Parenthood only stopped after they exerted vocal and sustained pressure.

In this subsection I specified the conditions under which philanthropic activity will generate positive moral capital. This model accounts for diverse and divergent stakeholder assessments and perceptions of a firm's activities—a criterion outlined by Wood and Jones (1995) as essential in developing a robust theory linking CSR activities with CFP. I now continue the journey and complete the pathway as I argue that moral capital provides insurance-like value to shareholders.

Positive Moral Capital As Insurance

Positive moral capital acts as insurance as it protects relational wealth against loss by mitigating negative stakeholder assessments and related sanctions when bad acts occur. To establish this thesis, I first identify the features and attributes of relationship-based intangible assets that preclude their protection through traditional insurance instruments. To further this argument, I next make a brief but necessary digression into the theory of law; law provides a cognitive template or recipe for how individuals and groups may make assessments of guilt and mete out punishment (Friedland & Alford, 1991; Nagel & Swenson, 1993; Scott, 1995).

This cognitive template is found in the doctrine of mens rea—the bad mind condition. I outline how positive moral capital creates economic value by influencing stakeholder perceptions regarding the mens rea. I consider when this value will most likely be effective and conclude by showing how this mens rea value contributes to shareholder wealth.

Relational wealth and the lack of insurability. The resource-based view of the firm asserts that a firm's competitive advantage in its markets derives from its possession of valuable and rare assets that are difficult for competitors to imitate or customers to substitute for (Barney, 1991; Ghemawat, 1991). Some of these resources will be intangible and idiosyncratic to the firm, and may have been developed over a number of years (Dierickx & Cool, 1989). Many of a firm's resources are relationship based, because the earning potential of these assets depends on the relationships a firm has with its stakeholders and the related assessments these stakeholders make regarding some (or all) elements of the firm's activities (Wood & Jones, 1995). These relationship-based intangible assets are termed *relational wealth* in the Clarkson Principles of Stakeholder Management (*Business Ethics Quarterly,* 2002), and, for convenience, I adopt this term throughout. A representative but *non-comprehensive* list of relational wealth among different stakeholders drawn from the academic literature includes the following:

- *Employees—Affective Commitment:* "Affective commitment refers to the employee's emotional attachment to, identification with, and involvement in the organization. Employees with a strong affective commitment continue employment with the organization because they *want* to do so" (Meyer & Allen, 1997: 11).
- *Communities and Regulators—Legitimacy:* "A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995: 574).
- *Suppliers and Partners—Trust:* "The willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party" (Mayer, Davis, & Schoorman, 1995: 712).
- *Customers—Brand:* "A brand is nothing but rich, product-specific information acquired, retained, and believed by the consumer independent of any particular act of consumption" (Evans & Wurster, 2000: 162).

Relational wealth cannot be protected through traditional insurance markets and contracts, because the underlying assets do not meet the criteria for the formation and maintenance of a functioning insurance market. Rejda (1992: 24) outlines six criteria necessary for a functioning insurance market to exist: (1) there must be a large number of homogeneous exposure units (objects to be insured), (2) the loss must be accidental and unintentional, (3) the loss must be determinable and measurable, (4) the loss should not be catastrophic (to the insurer), (5) the chance of loss must be calculable, and (6) the premium must be economically feasible.

Relational wealth is idiosyncratic to a particular relationship between a given firm and a given set of stakeholders. Relational wealth, like trust or brand, is not homogeneous among firms but, rather, is heterogeneous between firms and idiosyncratic to specific firm-stakeholder relationships (Zucker, 1986).[8] This heterogeneity violates the first condition for a functioning insurance market.

While some events that cause loss to the value of relationship-based intangible assets may be accidental or unintentional (e.g., an oil spill by an energy company or product contamination in a food products company), many of the events that negatively impact firm-stakeholder relationships are conscious and deliberate decisions (e.g., closing a plant, discontinuing a product or product line, stretching out suppliers' payment terms beyond reasonable limits, cutting philanthropic activity in a community). The presence of deliberate behavior in causing some losses violates the second condition for a functioning insurance market.

The magnitude of loss to relational wealth is difficult to ascertain. Unlike tangible assets, relational wealth cannot be valued ex ante with certainty—no original invoice exists from which to benchmark the loss of brand equity, customer loyalty, employee motivation, or any other manifestation of relational wealth. Ex post valuation proves a severe problem as well. Managers and investors cannot know exactly how much relational wealth has declined, because, unlike losses to tangible assets, losses to relational wealth may occur over a broad space (e.g., damage to a global brand may be textured in each local market) and may extend over a long horizon (e.g., some stakeholders have extremely long memories about past events and actions). Interaction effects between relational wealth and other assets may magnify losses from bad acts (e.g., diminishing employee commitment decreases willingness to innovate in new areas). Because losses are not determinable and measurable, relational wealth fails the third test for a functioning insurance market.

Because managers cannot insure the firm's relational asset base through traditional financial insurance contracts, I argue that philanthropic activity, through the positive moral capital it generates, provides insurance-like protection for a firm's relational wealth. Positive moral capital helps perform the core function of an insurance instrument—to protect the firm's assets from losses arising from business operations (Trieschmann & Gustavson, 1998). Positive moral capital can perform this insurance-like function as it generates mens rea value, which I now outline.

The mens rea doctrine. The theory of offense,[9] guilt, and punishment laid out in the common law tradition of criminal law provides a template for understanding the basis for stakeholder assessments of liability for offenses and the resulting punishments. Under the common law tradition, two elements must be present for an offense to occur: a bad act and a bad mind (LaFave, 2000).[10] A bad act requires that some action or conduct be performed that creates harm or adverse impact on another, be it an individual, group, or community. Bad acts must be accompanied by a bad mind in order to constitute an offense, for "actus not facit reum nisi mens sit rea (an act does not make one guilty unless his mind is guilty)" (LaFave, 2000: 225). This is the doctrine of mens rea.

The principle of corporate mens rea has been debated in the law since the modern corporate form began to dominate the economic landscape. On the one hand is the realization that a corporation has no mind of its own; it exists as a legal fiction (Khanna, 1999) and cannot, ontologically speaking, have a bad mind. On the other hand lies the social reality that corporations as organized groups of individuals formally espouse certain moral and social values

[8] Indeed, the relationship may be idiosyncratic to individuals within the firm and corresponding individual stakeholders. Thus, when a particular executive leaves a company, relational wealth may decline because the anchor of the relationship was an individual and not the firm in general. I thank an anonymous reviewer for highlighting this insight.

[9] Offenses are synonymous with crimes. The common law and statutory legal traditions speak of crime and punishment; I use the term *offense* deliberately, however, because corporate actions may offend stakeholder interests and concerns without constituting a criminal breach of the corporation's duties and obligations to society. For example, layoffs by a firm may prove offensive and adverse to the interests of several stakeholder groups (e.g., political communities, employee groups); however, layoffs do not constitute a criminal activity as defined by common law or by statute.

[10] Statutory law creates offenses without the mens rea criteria. Liability for an offense is founded on commission of the act, without regard to the state of mind. Simple laws such as running red lights and sophisticated crimes such as treason exist as statutory offenses. Mens rea may still come into play in a statutory offense when the issue of punishment is before the court.

(Barnard, 1938; Selznick, 1957), exert pressure and influence on individuals to define moral behavior in specific ways (Mitchell & Gabaldon, 2002), and create a context for individual moral choice and action (Jones & Ryan, 1997, 1998). Despite the apparent contradiction of granting a fictional entity a mind, the principle of corporate mens rea is well established in United States case law (Khanna, 1999), and the logic of corporate mens rea parallels organizational scholarship in which corporations are viewed as secondary moral agents (Werhane, 1985) or as moral agents but not moral actors (Werhane, 1985; Wood & Logsdon, 2002). For example, while the 1991 United States Sentencing Guidelines define offenses statutorily, the guidelines contain criteria to impute a level of corporate mens rea that play a significant role in the sanctioning phase of the judicial process. Khanna (1999) argues that such a use of mens rea is consistent with legal doctrine, common sense, and decision-making efficiency in dealing with corporate misdeeds.

Mens rea proves challenging and problematic to establish in a legal proceeding, because the actor's (individual or corporate) state of mind before and during the commission of a bad act can rarely be known with certainty; in most cases it can only be imputed after the act or conduct has occurred. Establishing the mens rea in individual circumstances requires one of four elements: (1) intentionality, (2) knowledge of harm, (3) negligence, or (4) recklessness (LaFave, 2000). The United States Sentencing Guidelines create a separate measure for corporate mens rea—a corporate "culpability score" (Nagel & Swenson, 1993). The answers to several investigative questions provide the culpability score and provide evidence of corporate mens rea (or lack thereof). Did the organization take all appropriate steps to remedy the harms created by the offense? Did the company have an institutionally rigorous (as opposed to superficial) compliance program that communicated antipathy toward wrongdoing? Did the organization voluntarily disclose the offense and cooperate in resulting investigations? What is the organization's prior history of offenses and moral behavior?

The mens rea value of moral capital. Some organizational acts adversely affect stakeholder groups and the communities to which they belong; organizational action or conduct that has an adverse impact on a stakeholder group constitutes the bad act element of an offense. Ongoing operations may create adverse impacts on the natural or social environment that are considered offensive to certain stakeholder groups. For example, extractive, mining, or manufacturing operations may generate environmental pollution or blight that adversely impacts certain stakeholders (e.g., those concerned with protection of the natural environment), business decisions such as facility closings or downsizing create adverse impacts on employees and local communities, and certain business practices such as product churning or preferential treatment for certain customer groups (such as the spinning of IPO shares to preferred clients) adversely affect other customers and regulatory agencies.

When bad acts occur, it is reasonable to assume that stakeholders invoke the cognitive template suggested by the mens rea doctrine to help determine appropriate sanctions.[11] As stakeholders consider possible punishments and sanctions, positive moral capital acts as character evidence on behalf of the firm. Positive moral capital provides counterfactual evidence to mitigate assessments of a bad mind; it reduces the probability that the firm possessed the evil state of mind that justifies harsh sanctions (Strong, 1999). Positive moral capital encourages stakeholders to give the firm the benefit of the doubt regarding intentionality, knowledge, negligence, or recklessness. Positive moral capital also addresses the relevant issue of a firm's history of moral behavior.

If stakeholders follow the mens rea template found in the United States Sentencing Guidelines, then the nature and severity of punishments for bad acts will be significantly influenced by stakeholder assessments of a bad mind. Negative sanctions may aim to remedy the causes or consequences of adverse impacts, they may seek compensation for adverse impacts, or they may aim to punish the firm and deter future adverse impacts. Remedial sanctions may include new regulations or laws aimed at limiting behavior or establishing future liability, or simply increased scrutiny and monitoring by affected stakeholder groups.

[11] Stakeholders may also look for and use evidence of character (good or bad) in their ongoing assessments of a firm; these assessments may help shape any consequent feelings toward or dealings with that firm.

Compensatory sanctions may include fines, lawsuits, or other actions aimed at financially compensating impacted groups. Punitive sanctions may include fines, incarceration for key individuals, negative publicity campaigns, or boycotts of the firm's products or services.

Moral capital provides insurance-like protection for relational wealth because it fulfills the core function of an insurance contract: it protects the underlying relational wealth and earnings streams against loss of economic value arising from the risks of business operations (Trieschmann & Gustavson, 1998).[12] *Moral capital insures the firm's relational wealth because it mitigates assessments of bad mind and creates a compelling case for leniency in punishment.* The firm gains insurance-like benefits in two ways: (1) the *degradation* of relationship-based intangible assets will be tempered by positive moral capital (less trust is violated, reputation is not tarnished as much, loyalty suffers but remains, etc.) and (2) *punishments and sanctions* by stakeholders will be mitigated (stakeholders may forego sanctions altogether or they will impose less severe sanctions than in the absence of positive moral capital). Positive moral capital provides a reservoir of positive attributions that can be drawn on to "indemnify" relational wealth against loss of value when stakeholders are adversely affected. This logic gives rise to the following.

> *Proposition 4: Positive moral capital will mitigate the degradation in value of the firm's relational wealth when bad acts occur.*

> *Proposition 5: Positive moral capital will mitigate stakeholder propensities for negative sanctions against the firm when bad acts occur. Specifically, higher levels of positive moral capital will result in fewer or less severe remedial, compensatory, or punitive sanctions against a firm by stakeholders.*

Positive moral capital should provide the most insurance-like protection when it provides the clearest signal of a firm's underlying moral character, which occurs when other benchmarks for character evaluation are unclear, underdeveloped, or contradictory. As stakeholders consider organizational mens rea in light of any bad act, they will most likely consider the firm's stock of moral reputational capital in toto; that is, they will consider a firm's moral performance across several dimensions of organizational activity (Jones, 1995).

When the moral capital generated by philanthropic activity conflicts with other readily salient examples of the firm's moral behavior (e.g., violations of law or regulations, disregard for ethical norms and customs), philanthropic moral capital will be unlikely to change the composite view and provide compelling evidence of good character; indeed, the situation may, in fact, worsen, since stakeholders will view philanthropy as an ingratiating act of hypocrisy. Not even a sterling record of philanthropic activity could dissuade stakeholders from harsh punishments of Enron and Arthur Andersen, since both firms violated fundamental ethical obligations and expectations. When philanthropic moral capital parallels the firm's other moral capital accounts (e.g., compliance with laws and regulations, adherence to ethical norms, respect for ethical customs), philanthropic moral capital will reinforce the overall assessment of good character.

Philanthropic moral capital should have the greatest impact when other behaviors and actions send unclear signals about a firm's overall moral values, ethical principles, or character. Clear moral assessments cannot be made in some areas of organizational activity because the underlying bases on which judgment rests are ill defined, ambiguous, fuzzy, or unclear. Lack of clarity arises from situations where there are underdeveloped legal standards (e.g., e-Bay's restriction of firearms sales on its web-

[12] The risk and insurance literature quantifies the contribution of insurance to shareholder value. Insurance protects shareholders against severe financial distress that impedes their ability to diversify away specific risks. Stultz (1996) estimates the value of insuring against the financial distress caused by bankruptcy according to the following formula:

$$\text{Equity Value of Insurance} = \text{Bc} \times \alpha\text{BU} - p,$$

where Bc = bankruptcy costs, αBU = the probability of bankruptcy for the uninsured firm, and p = the cost, or premium level, of purchasing insurance. In this case Bc represents the value of the relational wealth at risk of loss and αBU represents the probability the firm will engage in bad acts; p represents the cost of philanthropic activity that generates corresponding positive moral capital.

site or other areas of internet content where legislative mandate and case law have yet to evolve) or situations where ethical norms vary widely or are contested, meaning that consensus has yet to form at the level of broad communities or nation states (e.g., the limits of a firm's responsibilities vis-à-vis sub-subcontractors in foreign operations, or particular practices regarding the use of animals in product testing or meat products). When there is a dearth of other reliable judgments of morality on hand, philanthropic moral capital may provide stakeholders with the clearest and most unambiguous anchor on which to base mens rea assessments.

> *Proposition 6a: Philanthropic moral capital will have the lowest mens rea value when it contradicts moral capital and assessments based on the firm's behavior in other activities.*
>
> *Proposition 6b: Philanthropic moral capital will have moderate mens rea value when it reinforces moral capital and assessments based on the firm's behavior in other activities.*
>
> *Proposition 6c: Philanthropic moral capital will have the highest mens rea value when moral capital, assessments, or evaluations of the firm's behavior in other areas are ambiguous or unclear.*

Unocal's philanthropic activities in Burma (Myanmar) illustrate the attempt to use philanthropic activity to generate positive mens rea value. Critics and activists charge Unocal and its business partners with repression of indigenous peoples, support of a totalitarian regime, and environmental degradation in connection with a natural gas pipeline in the Yadana region of Burma. Unocal directly counters the claims, but the company also points to its charitable activity in the Yadana region. The company and its partners have made substantial investments designed to improve education, health care, sustainable community development, and improved infrastructure (Unocal, 2003)—all discretionary activities that go "above and beyond" wage rates or environmental remediation around the pipeline.

The company produces an annual report to show that (1) the overall project produces clear social, in addition to economic, gains for the region and that (2) such philanthropic efforts are inconsistent with acts of repression and brutality. This evidence may prove particularly valuable since other signals regarding Unocal's moral values communicate mixed messages to stakeholder groups. The company operates in nondemocratic nations, including Burma, yet the company is also rated among the best companies to work for in America for minorities and working mothers, and it has a nondiscrimination policy that includes sexual orientation (Stanford SICD, 2003). Unocal implies a mens rea argument in their literature: if philanthropic activity (evidence of a good mind) is inconsistent with knowingly violating human rights (a bad mind leading to a bad act), then, in the face of evidence of the former, the veracity of claims regarding the latter should be tempered and discounted. The effectiveness of those mens rea claims ultimately will be decided by stakeholders; however, a key component should be the juxtaposition of philanthropic mens rea evidence with evidence surrounding other activities, both in Burma and in the firm's general operations.

In this subsection I laid out and detailed the core assertion of the article: philanthropic activity creates shareholder wealth by generating insurance-like positive moral capital. Having established this argument, I now turn to the question of how much philanthropic activity a firm should engage in to garner the appropriate level of "insurance coverage."

The Optimal Level of Philanthropic Activity

The conceptual identification of the optimal level of philanthropic activity comes from the economics of insurance.[13] Consider a firm with two value-creating assets, A and L. A is immune

[13] Some may argue that the mathematical models of managerial behavior seem detached from the real processes managers use to make decisions. Friedman provides a response to this concern:

> The relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic,' for they never are, but whether they are sufficiently good approximations for the purpose in hand. And this question can be answered only by seeing whether the theory works, which means it yields sufficiently accurate predictions (1953: 15).

Within the risk management literature, the equations in the text have been shown to provide accurate predictions about the pricing and purchasing decisions of insurance products.

to loss (e.g., U.S. Treasury bonds); L, however, is at pure risk of loss, represented by α, owing to several factors (e.g., natural disaster, theft, fire). The presence of risk means that the firm's wealth function must be expressed as a function with two potential outcomes: $W_1 = A + L$, with probability $1 - \alpha$, or $W_2 = A$, with probability α (Mossin, 1968), which can be written as an expected value—$E(W) = \alpha W_1 + (1 - \alpha)W_2$.

Let p equal the investment (premium) required for the firm to fully insure L against loss. With such insurance the firm's wealth function can be described with certainty: $W_3 = A + L - p$. Rational managers will purchase insurance at premium level p such that wealth under certainty equals expected wealth under uncertainty: $E(W) = \alpha W_1 + (1 - \alpha)W_2 = W_3$. The optimal[14] insurance coverage, p^*, occurs at the level where the two wealth functions are equivalent:

$$E(W) = \alpha W_1 + (1 - \alpha)W_2 = W_3 = \alpha A + (1 - \alpha)(A + L) = A + L - p$$

In the current context, the optimality equation indicates that managers should engage in philanthropic activity that generates an optimal level of moral capital, p^*. Beyond p^*, additional philanthropic activity imposes additional costs on the firm, without generating any corresponding value; below p^*, the firm leaves relational wealth not fully covered. The equation provides managers with a clear conceptual stopping rule in decisions regarding philanthropic activity.

While this may prove an elegant and succinct economic conceptual stopping rule for philanthropic activity, the deep value of the equation comes as it reveals the factors that determine the optimal level of philanthropic activity: the level of wealth at risk (i.e., L, the level of a firm's relational wealth) and the risk of loss (i.e., α, the probability a firm will commit bad acts).

The relationship between the level of philanthropic activity (p) and the value of the relational wealth stock (L) is $dp/dL > 0$ (Mossin, 1968). Put simply, as the level of the firm's relational wealth increases, shareholders will both tolerate and encourage higher levels of philanthropic activity to accrue more insurance-like protection. This value can be measured in absolute terms, such as the economic value of brand affinity, or in relative terms, such as the economic value of brand affinity as a portion of shareholder wealth. As trust, brand, or employee commitment provide larger contributions to earnings, or as that contribution constitutes a higher percentage of shareholder wealth, the optimality equation leads rational managers to increase the firm's level of philanthropic activity.

> *Proposition 7: The optimal level of philanthropic activity will be higher for firms with higher levels of relational wealth (in absolute or relative terms) than for firms with lower levels of relational wealth.*

The relationship between the level of philanthropic activity and the risk factor (α) is given as $dp/d\alpha > 0$ (Mossin, 1968). In the current context, the risk of loss (α) to relational wealth has two components: a firm-specific and an industry-specific component. Firms are not homogeneous in the risk profiles of their relational wealth, and what constitutes a bad act by firms may depend on certain characteristics of the firm. For example, large firms, with very public brand profiles or other iconic social positions, may be held to higher standards of behavior than smaller, lower-profile firms. For example, Sears Auto Centers were targeted by California regulators in the early 1990s for consumer fraud in an industry filled with over 11,000 small, local, privately held competitors, most of whom were not targeted. Risk also differs by industry. The nature of the production process and technologies means that industries carry different risks of social damage, from environmental degradation in mining to product safety and human liability in manufacturing, to fraud and deceit in service and finance industries.

> *Proposition 8: The optimal level of philanthropic activity will be higher for firms with higher firm-specific risk profiles than for firms with lower firm-specific risk profiles.*

> *Proposition 9: The optimal level of philanthropic activity will be higher for firms with higher industry-specific*

[14] There exists an optimal level of insurance, p^*. If managers underinsure at a level $p^{**} < p^*$, then $W_3 < E(W)$, because L is not fully covered. If managers purchase coverage p^{***} in excess of p^*, then $W_3 < E(W)$, because the amount $p^{***} - p^*$ is simply excess cost, with no additional coverage created, since L is fully insured at p^*.

risk profiles than for firms with lower industry-specific risk profiles.

In this section I have offered an answer to the strategic philanthropy questions raised at the outset—namely, *what* the pathway is that leads from philanthropic activity to shareholder wealth and *how* much a firm should invest in philanthropic activity. I have presented one detailed conceptual path that connects philanthropy and shareholder wealth: philanthropic activity generates moral capital, which, in turn, provides insurance-like protection for a firm's relational wealth. I have also provided a conceptual optimal point for the strategic value of philanthropic activity and have identified the key drivers of the level of such activity: the value of a firm's relational asset base and the firm- and industry-specific risk profile facing the firm.

PHILANTHROPIC STRATEGY: OPTIMAL PHILANTHROPIC ACTIVITY

With the strategic value of philanthropic activity now clearly articulated, I turn to the implications of the above models for the practice of philanthropy by a firm's managers—what Post and Waddock (1995) refer to as a firm's *philanthropic strategy*. I consider here two elements of that strategy implied by the necessary and sufficient conditions for generating moral capital from philanthropic activity: (1) *where* a firm should target its activities to generate the maximum amount of positive moral capital and (2) *how* a firm should manage the organizational context surrounding philanthropic activities to minimize the potential for such activities to be viewed as attempts at ingratiation by target communities and other observers. The critical logic underpinning this discussion is the relationship between philanthropic activity and moral capital: negative evaluations of either the act or the actor will result in negative moral capital. Thus, managers seeking to optimize the value of their philanthropic portfolio should attend to creating positive evaluations based on the activities themselves and to establishing and managing organizational contexts and decision processes that avoid evaluations of ingratiation.[15]

The Optimal Portfolio of Philanthropic Activity

The optimality equation holds that the level of insurance will be determined by the firm's idiosyncratic risk factors (α) and by the nature and composition of its relational wealth component (L); an optimal portfolio of philanthropic activity for a firm depends on too many idiosyncratic factors (such as those identified above) to make any definitive theoretical statements about optimal targeting. The optimality equation and other arguments made earlier in the article can at least help identify some relevant factors and help define the contours of an optimal portfolio of philanthropic activity.

Two implications are fairly straightforward. First, the relationships among relational wealth, risk, and the need for moral capital that determine the optimal level of philanthropic activity also suggest that managers should carefully consider which stakeholder relationships significantly contribute to the firm's stock of relational wealth and should target philanthropic activity in ways that enhance the level of positive moral capital among those stakeholders. Mitchell, Agle, and Wood (1997) classify such stakeholders as dominant: those stakeholders possessing the power to negatively affect relational wealth, having the legitimacy to exercise that power, and lacking only a sense of urgency to do so. Second, the equation suggests that managers engage in a thorough and detailed analysis of the risks to relational wealth arising from idiosyncratic firm-level or industry and competitive contextual factors and that they target philanthropic activity toward both, reducing those risks and generating positive moral capital among those most likely to be affected by likely bad acts.

While the equation yields these straightforward implications, a problem arises because philanthropic activity does not target stakeholders per se but, rather, communities, be they communities of interest, such as the arts community, or geographic communities, such as cities, individual schools, or school districts. Whether or not firms can target specific stakeholder

[15] By "optimal" I mean the targeting of philanthropic activity to maximize shareholder wealth. This may or may not be consistent with some social optimal distribution of philanthropic activity. Because of a focus on shareholder wealth, my model, like all strategic philanthropy models, cannot cross the divide illustrated in Figure 1 to focus on social welfare optimization at the expense of shareholders.

groups for philanthropic activity depends on the alignment between stakeholders and identifiable communities. When tight alignment exists—stakeholders map cleanly onto a community—managers can target activity to generate *specific* moral capital in that group. For example, the customer base of Thule, a Swedish maker of bike and ski racks for automobiles, maps fairly cleanly onto the wilderness protection community of interest. When loose or little alignment exists—stakeholders belong to multiple or diverse and divergent communities—managers should concentrate on creating *general* moral capital among the relevant communities. AT&T's customer base, in contrast to Thule's, lives in diverse geographic locations and belongs to varied and diverse communities of interest; targeting specific communities for philanthropic activity will generate specific goodwill among some customers but likely will exclude a greater portion.

Proctor and Gamble represents a hybrid, since it sells its products to both a broad base of consumers but also enjoys strong customer niches among identifiable communities of interest—for example, mothers who buy Pampers. For these hybrid companies, efforts to create both specific moral capital within the relevant niche and general moral capital in the larger customer base should result in a variegated portfolio of philanthropic activity.

Specific moral capital. Philanthropic activity generates positive moral capital in a community to the extent that the ethical values underlying the activity are consistent with the ethical values of the focal community. As firms identify those stakeholder groups (and their associated communities) that contribute significantly to the firm's stock of relational wealth, managers should choose philanthropic activities consistent with central and identity-rich values among these stakeholder groups and communities (Albert & Whetten, 1985; Rowley & Moldoveanu, 2003). Such central and identity-rich values are those differentiating the focal community from others in the pluralistic world and contributing to its sense of uniqueness; by definition, these values will not be among those that overlap with other communities and are not likely to be widely held or generally embraced moral values in the larger polity (Whetten & Mackey, 2002). This activity/value consistency should produce not only positive moral capital among those communities but also intense and deeply held moral capital, as the communities identify the firm with their own identifying values. Through these types of investments, managers can build *specific* positive moral capital (and its associated mens rea value) among stakeholder groups central to the protection of relational wealth.

Specific moral capital produces a strong upside of positive and intense moral capital in the focal community, but yields significant drawbacks as well. First, these types of philanthropic activities can lead to a myopic focus on certain stakeholder groups at the expense of others, which may lead to activities generating negative moral capital among other communities that may also include stakeholders or stakeholder groups. These may not be the dominant stakeholders described above, but they may, when provoked by actions antithetical to their values, become dangerous stakeholders, with power to negatively affect relational wealth and a sense of urgency leading to action (Mitchell et al., 1997). The communities that forced AT&T to reverse its Planned Parenthood support represent one such group and one such situation. Further, given that philanthropic activity is not endless (there is a constraining optimal value), nor are budgets unlimited, it seems unlikely that a firm can calibrate its philanthropic activities with enough precision to generate specific moral capital among all relevant stakeholder groups.

General moral capital. When stakeholder groups belong to varied, diverse, and perhaps divergent communities, the optimal portfolio of philanthropic activity should focus on creating *general* positive moral capital. General moral capital arises from philanthropic activities that rest on moral values generally accepted and widely held by multiple communities with different value systems. This suggests that managers also consider those broader areas of social involvement that most stakeholders would likely consider indicative of a "good mind" or those values most likely to overlap communities.

The types of social involvement and philanthropic activity advocated by business citizenship scholars represent a category of activities likely to generate imputations of a good mind among varied and diverse sets of stakeholders and communities. Involvement in activities such as clean water provision, AIDS relief, provision of basic health care services, poverty eradication through basic literacy for children and adults, contributions to microenterprise funds, and philanthropic activity that encourages the development and enforcement of basic human rights suggests a good mind, because the moral values grounding these activities (health is preferred to sickness, surplus to want, liberty to oppression) are held by many to be good moral values (Harrison, 2003).

I present Figure 2 to visually capture the core ideas presented here. In general, an optimal portfolio focuses philanthropic *activity* toward quadrants III and IV—activities supported by values consistent with specific communities and/or the larger community in general. An optimal *distribution* of moral capital would be weighted to these quadrants but would most likely include some community-specific negative moral capital (quadrant I) as a natural consequence of targeting quadrant III. Quadrant II, although a logical possibility, should be an empty quadrant, since rational managers will avoid activities supported by ethical values opposed by the majority of a larger community.

Figure 2 allows a conceptual mapping of different philanthropic portfolios. Consider the three types of companies described above: (1) a company with a key stakeholder group that corresponds to an identifiable community, (2) a company with a key stakeholder group diffused over many communities, and (3) a hybrid firm with a broad stakeholder (community) base but also pockets of stakeholders belonging to identifiable communities. The first company would concentrate philanthropic activities in quadrant III; the second would concentrate activities in quadrant IV; the third would engage in activities in both quadrants III and IV in an attempt to garner positive moral goodwill among both specific and general communities.

In terms of the distribution of moral capital, the focused company would see an optimal distribution weighted toward quadrant III, but with some negative moral capital appearing in quadrant I as a consequence of engendering opposition among other communities. The broad-based company should see its optimal distribution of moral capital heavily weighted toward quadrant IV, with some small group of ardent dissenters creating negative moral capital in quadrant I (because dissent from generally accepted norms is a local, not a general, phenomenon [Donaldson & Dunfee, 1999]). The hybrid company would see its distribution of moral capital split in some manner among quadrants III and IV, again with some negative moral capital being generated in quadrant I.

This analysis on optimal targeting helps illuminate the exodus of large corporate donors to

FIGURE 2
Toward a Portfolio of Moral Capital

	Underlying ethical value	
Type of moral capital generated	**Community specific**	**Generally accepted**
Positive	III	IV
Negative	I	II

the Boy Scouts of America (BSA) following the Supreme Court's decision *Boy Scouts of America* v. *Dale* (2000), which upheld the right of the BSA to screen scoutmasters and scouts based on sexual orientation. During an earlier period, supporting the BSA would have been viewed by the general populace of the United States as a morally good activity, because the Boy Scouts embodied and transmitted core American values. With *Boy Scouts of America* v. *Dale,* however, support of the BSA became an activity now endorsed by only specific community values, such as religious conservatism. The above analysis suggests that corporate sponsors, such as Chase Manhattan Bank, Levi Strauss, Textron, Wells Fargo, Novell, and CVS Pharmacy, ceased contributing to the BSA because such an investment would no longer produce *general* positive moral goodwill but only *specific* positive moral capital among so-called conservatives, and would surely produce *specific* negative moral capital among communities favoring the moral value of tolerance.

Optimal Organizational Contexts for Philanthropic Activity

The sufficient condition for generating moral capital through philanthropic activity highlights the issue of community perceptions about the intents, motivations, goals, and vision of the actors that are imputed into the activities and the processes generating those activities. Actors perceived as using philanthropy to ingratiate themselves with communities will receive negative evaluations, whereas actors who are perceived as genuinely manifesting their corporate visions and missions through their philanthropic portfolios will receive positive evaluations. Negative actor evaluations generate negative moral capital.

The straightforward implication of the sufficient condition is don't be ingratiating. Put in a positive formulation, managers should work to ensure that their philanthropic activities are consistent with the firm's identity—those values that are most core, enduring, and central to the firm's self-definition (Albert & Whetten, 1985). While this implication is not sufficient to guide a firm's philanthropic activities and the processes for allocating resources among options, neither is it trivial. Actions driven by core, enduring, and central organizational values will be genuine and likely to be perceived as such. Such actions are also most likely to be consistent with other policies, processes, and activities the firm engages in, ensuring consistency between a firm's philanthropic portfolio and its other activities. Finally, identity-consistent actions are efficient, since sustaining actions at variance with a firm's core identity and values requires significant additional energy, resources, and concentration over the broad range of organizational actions and over time.

Identity consistency represents a critical foundation for a firm's philanthropic activities and the organizational context and processes that allocate those resources. However, in a world of pluralistic stakeholders, some of whom may be negatively disposed toward the firm and cynical about its activities, identity consistency should be supplemented by management processes that work to "avoid the appearance of ingratiation." I note three principles that should underlie a firm's processes: transparency, stability, and responsiveness.

Transparency. The principle of transparency argues that firms should publicly disclose details of their philanthropic portfolio. Shareholders and community members should be informed of the targets of philanthropic activities, the levels of funding or other support, and the goals and rationale that underpin these decisions. The principle of transparency invites scrutiny by interested outsiders about the nature and extent of a firm's philanthropic activities. The reality of scrutiny and the attendant accountability for choices and actions provide decision makers with a strong incentive to engage in activities and to allocate resources to causes consistent with the firm's identity and corporate values. Transparency also means that the firm discloses its activities as they occur, thus allowing stakeholders to create a stock of positive moral capital before bad acts occur. Transparency facilitates moral capital formation in advance of need, for when the firm needs positive moral capital, it will be too late to build it.

Stability. A pattern of consistent philanthropic activity avoids the appearance of ingratiation, since it provides counterfactual evidence that decision makers engage in philanthropy on an opportunistic or capricious basis; it shows that the commitment by a firm to doing good continues through time. Decision makers can exhibit stability in at least three ways: (1) through stable funding levels, (2) through stability in the recipients of philanthropic activity, and/or (3) through stability in the process through which decisions regarding philanthropic activity are made. Target Stores stabilizes funding at 5 percent of profits, which provides evidence that its commitment to philanthropy is genuine and not opportunistic. Disney has a history of supporting educational institutions and causes, building a stable and enduring presence in this social sector. Process mechanisms such as corporate foundations provide executives with an opportunity to stabilize funding and to professionalize their philanthropic activities; removing decision making from business decision makers both institutionalizes and communicates a commitment to stabilize philanthropic activities and decision processes in ways that discourage opportunistic or capricious giving.

Responsiveness. Responsiveness means that decisions about philanthropic activities and allocations should change as economic or social conditions change. Philanthropic advisory boards with community and stakeholder representation, a professionalized corporate giving function, or other environmental scanning mechanisms can all work to ensure that philanthropic activities are genuinely being responsive to current social issues and pressing needs. For example, in 2003 ChevronTexaco abandoned a sixty-plus-year philanthropic commitment to the Metropolitan Opera. Such a move would exhibit responsiveness *if* ChevronTexaco reallocated those resources to causes such as AIDS awareness/prevention in Eastern Europe, drought relief in Sub-Saharan Africa, or flood relief in South Asia. Such a reallocation of corporate resources need not signal the abandonment of support for good causes but, rather, the realization that what constitutes a good cause will change as social conditions change.

This section has provided some implications for managers considering how to design and implement a firm's philanthropic strategy. As corporate executives or contributions managers consider *where* to engage in philanthropic activity and *how* to manage these processes, the necessary and sufficient conditions that link philanthropic activity to moral capital help sketch out important principles and guidelines.

CONCLUSION

I argue that strategic philanthropy does not represent an oxymoron but, rather, that this position can fruitfully meet the objections of critics at both extremes in the CSR-CFP debate. The existence of a conceptual optimal level of philanthropic activity, with the attendant implications for determining the actual level and targeting of philanthropic activity, is aimed at the strict capitalism position, which views strategic philanthropy as lacking a clear and definitive stopping rule for managerial engagement in philanthropic activity. The importance of philanthropic activities that create general positive moral capital among a broad base of stakeholders suggests that the type and scope of activities advocated by business citizenship scholars can generate shareholder wealth. Thus, while the risk management model presented here works because philanthropic activity is morally discretionary rather than morally obligatory, the model helps solidify a manager's economic *incentive* to allocate some of the firm's resources toward philanthropic activity. In sum, rational managers should engage in corporate philanthropy because such activity benefits shareholders.

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