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Not-for-Profits, ESGs, and The Economic Structure of Corporate Law

Saul Levmore
University of Chicago, dangelolawlib+saullevmore@gmail.com

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Not-for-Profits, ESGs, and *The Economic Structure of Corporate Law*

Saul Levmore

A compelling point in The Economic Structure of Corporate Law *is that the single goal of maximizing shareholder value is efficient and generally desirable because it gives the managers one aim—while leaving room for law and private contracts to impose constraints on the firm in order to control negative externalities and other social concerns. Easterbrook and Fischel say that: "A manager told to serve two masters (a little for the equity holder, a little for the community) has been freed of both and is answerable to neither." The point is an especially good one when the manager has more of an interest in one master's success than another's, and this is the point that Easterbrook-Fischel emphasize. But it is also the case that the single goal of value maximization, encapsulated in share price in an efficient market, allows investors to monitor managers, not so much to look for misbehavior and the prospect of a lawsuit, but to decide whether to invest in one enterprise or another. In this Article, I ask what this brilliant insight tells us about not-for-profit (NFP) entities which do not offer "investors" (donors) or the law a single metric in order to evaluate their performance. Should investors, and the "market," prefer an NFP with a single goal or cause, like the environment, however hard it is to measure progress towards this goal, or should we expect the market—as we might think of the competition for donor dollars—to evaluate performance through some alternative mechanism, spread perhaps across a diversified portfolio inside the "firm," including a university or foundation? Falling in between these two types of opportunities for investment are self-proclaimed ESG (Environment, Social, and Governance) sensitive corporations. These firms attract investors not only by earning profits and increasing shareholder wealth but also by adding to shareholder welfare with a promise to undertake causes, like environmental sensitivity, that appeal to shareholders who invest in these ESG-sensitive enterprises. Easterbrook-Fischel might be expected to disparage the development of ESGs, because they intentionally depart from the single-goal advantage of conventional corporations. On the other hand, if some shareholders want not only to profit but also to pursue various social goals, a corporation can appeal to these shareholders, even if their actual behavior is difficult to assess. Not-for-profits are at the other end of the spectrum. They suffer from many of the same problems. Investors have difficulty knowing whether an NFP is doing a good job. One strategy, developed in this Article, is to follow the advice of donors who have some incentive to evaluate the NFP and compare it with other organizations that would be happy to take their gifts. This explains the ability of an NFP like Harvard (the best endowed university) to receive support from private donors, foundations, and the government. It might seem like a successful NFP does not "need" the money as much as other, less well-endowed NFPs but, on the other hand, its ability to attract large gifts might inform new donors that it is a good investment, just as the share price of a conventional corporate firm, or a takeover offer from a sophisticated company, offers useful information. It also explains the tendency of NFPs to attract*

large gifts directed at specific goals. If donor Y sees that donor X gave $100 million to an NFP to investigate a particular disease, donor Y might give that NFP a gift because Y shares an interest in that cause, and now wants the recipient to do yet more. Another potential donor, with a different goal in mind, might also learn from X's gift, and reason that the favored NFP is well-managed and reliable. Just as Easterbrook-Fischel explained the advantage of a corporation's obligation to follow a single goal, an NFP can be understood as aiming to show that it follows the single goal of reliability, and especially its ability to keep a promise about a single goal as expressed by the investor, or donor. ESGs are unlikely to offer a comparable message because it will not be clear to Y, or another investor, what to learn from a large investment in an ESG corporation.

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I. INTRODUCTION

A compelling point in *The Economic Structure of Corporate Law*, by Frank Easterbrook and Dan Fischel, is that the single goal of maximizing shareholder value is efficient and generally desirable because it gives the managers a single aim—while leaving room for law and private contracts to impose constraints on firms. "[A] manager told to serve two masters (a little for the equity holder, a little for the community) has been freed of both and is answerable to neither."[1] The point is an especially good one when the manager has more of an interest in one master's success than another's, and this is the point that Easterbrook and Fischel emphasize.[2] But it is also the case that the single goal of shareholder value maximization, reflected in the share price in an efficient market, allows investors to monitor and compare managers, and then to decide whether to invest in one enterprise or another.

1 FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991).

2 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976).

In this Article, I ask what this Easterbrook-Fischel insight tells us about not-for-profit (NFP) entities, which do not offer "investors" (donors), or even the law, a single metric in order to evaluate their performance. Perhaps investors, and the "market," will prefer a not-for-profit with a single goal, like its impact on the environment, however hard even that might be to measure. After all, a concern for environment can be subdivided into many subgoals, unlike a dedication to share value in a for-profit corporation. Alternatively, we might expect the market to evaluate performance through some alternative mechanism, spread across a diversified portfolio within an NFP, whether it be a university or foundation. Falling in between these extremes are firms that attract investors not only by earning profits, but also by adding to shareholder welfare by promising some sensitivity to causes that appeal to shareholders who invest in these Environmental-Social-Corporate Governance-aware enterprises, or ESGs.[3] Easterbrook and Fischel might be expected to disparage the development of ESGs, because they intentionally depart from the single-goal advantage of conventional corporations. On the other hand, if some shareholders want a reasonably high rate of return on their investments but are willing to sacrifice a little wealth in order to pursue some social goals, a corporation can appeal to these shareholders. If ESGs are a bit to the left of conventional value-maximizing firms, then we can think of NFPs as yet further to the left, but as suffering from some of the same problems as entities to their right. In the NFP world, investors, also known as donors, and even some socially minded employees, have difficulty knowing which NFPs are doing good work at reasonable cost. Investors would like to know where to invest. They might not be able to exit in the manner of someone who sells shares of a publicly traded corporation, but they are likely to choose among NFPs when it comes to advancing what they consider to be good work. One strategy, developed in this Article, is for a donor to follow the advice of a large, earlier donor who has some incentive to evaluate an NFP and compare it to other organizations, often directed at the same goal, that would be happy to accept a large gift. This explains the ability of an NFP like Harvard (one of the largest NFPs) to continue to receive money from private donors, foundations, and the government. It might seem like a successful NFP does not need the money as much as other less well-endowed NFPs, but its ability to attract

[3] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L., FIN., & ACCT. 247, 248 (2017).

large gifts informs new donors that it is a good investment, just as movement in the share price of a conventional corporate firm offers valuable information to investors. The perspective developed here will also explain the tendency of NFPs to attract large gifts directed at particular causes, perhaps in the same way that investors in corporate stocks believe that some industries are better bets than others. If donor Y sees that donor X gave $100 million to an NFP to decode a particular disease, donor Y might give that NFP a gift aimed at that goal, or even a large gift to do something completely different, because X's confidence in the particular NFP as a steward informs Y of that NFP's perceived reliability. Just as Easterbrook-Fischel explained the value of a corporation's obligation to follow a single goal,[4] some NFPs can be understood as aiming to be the best investment when it comes to a specific social problem, while other NFPs show that they follow the single goal of reliability across multiple subjects of interest. Even these NFPs will be judged by their ability to keep a promise about a single goal as expressed by the investor, or donor. On the other hand, ESGs do not offer comparable information to investors, because it will be unclear to a potential investor what is revealed by another investor's choice of an ESG-oriented corporation.

Part II reviews, and comments on, the Easterbrook-Fischel contribution with regard to corporate profit maximization, or more accurately, the maximization of shareholder value. Part III presents the major argument here, as it considers how this insight can be applied to NFPs (not-for-profit entities). Part IV then toys with the idea that the advantage that the single-goal approach offers to investors, who wish to compare investment opportunities, can be applied to ESG-oriented (Environmental, Social, and Corporate Governance sensitive)—but for-profit—corporations. Part V concludes.

II. WHAT SHOULD FIRMS MAXIMIZE?

From Milton Friedman through Easterbrook-Fischel, most economists have been drawn to the idea that firms should maximize shareholder value.[5] The more managers of a for-profit firm aim to maximize share price, or a suitable combination of that

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4 *See* EASTERBROOK & FISCHEL, *supra* note 1, at 38–39.

5 For perhaps the most famous articulation of this idea, *see* Milton Friedman, *A Friedman Doctrine: The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://perma.cc/TU2U-FJUE.

price and distributions to shareholders, the more these managers have a single goal, and it is one that allows investors to evaluate the managers' performance. Managers can be rewarded in ways that encourage their devotion to value maximization. There are other parties, not to mention society as a whole, that care about a corporation's activities unrelated to, or even inconsistent with, maximizing shareholder value, but these interests can, at least in theory, be satisfied through other means, including contracts and legal rules that firms will take into account as they maximize shareholder value. For example, depending on the negative externalities a firm imposes, tort law or environmental regulations might cause the firm to see that maximizing profit will require it to avoid some tort judgments or regulatory fines and interventions. Value maximization thus allows many other goals to be met, but this happens because law uses the single goal that corporate law encourages of the firm to take other matters, however indirectly, into account.

The single goal idea is imperfect. One problem is that tax law affects the behavior of managers and causes shareholders to have divergent views of what exactly the firm is to maximize; every shareholder's wealth is not maximized the same way. A shareholder facing a low tax rate, or an NFP shareholder, like a university with no income tax obligation at all, might prefer high dividends, because this shareholder can face some constraints of its own, allowing it to spend "earnings" rather than increases in the value of its investments. A very different reason to prefer dividends, rather than a combination of payouts and retained earnings, is that the more a for-profit firm distributes its earnings, the more it must seek new investments, or reinvestments, for new projects, and the more the market will discipline the firm.[6] At the other extreme, there will be shareholders in high tax brackets, who prefer that the firm retain earnings even if the next best opportunities available to the firm are somewhat inferior to other investments available in the market. These shareholders benefit by deferring taxation, and they will want the firm to maximize shareholder value as understood by considering their own portfolios. Some of this diversity among shareholders can be satisfied by publicly traded firms' responding to these differences among prospective investors. A subset of firms will adopt policies that appeal to high tax bracket shareholders while other firms will not,

[6] This is another Easterbrook insight, developed in Frank H. Easterbook, *Two Agency-Cost Explanations of Dividends*, 75 AM. ECON. REV. 650, 654–55 (1984).

so that a clientele effect produces a market that can appeal to a variety of shareholders.[7] Just as multiple stores might appeal to buyers with different preferences, so too different publicly traded firms will appeal to a variety of investors. For present purposes, it is sufficient to think of all this detail as part of the claim that a corporation should maximize shareholder value—acknowledging that firms might actually be appealing to different subsets of shareholders. It is fair to say that value-maximizing firms offer investors a good means of evaluating these firms. They can look at share prices and earnings, and compare changes to those produced in the market as a whole or by other firms in the same industry—thus controlling for industry specific variation, like environmental and legal changes that might have caused firms to earn high or low returns in a given time period regardless of the management's skills. Meanwhile, investors have reason to discover not only the earnings of firms, but also their history of making distributions, as well as the riskiness of their operations, because investors would like to know the risk-adjusted returns of firms as well as particular investors' after-tax returns. *The Economic Structure of Corporate Law* was written with these things in mind.

III. WHAT DO NOT-FOR-PROFIT ENTITIES (NFPS) MAXIMIZE AND HOW ARE THEY EVALUATED?

A. The difficulty of assessing NFP performance

The fact that asking a for-profit firm's managers to focus on a single goal enables investors to evaluate that firm and its managers warns us that it is far more difficult to evaluate the performance of people and entities in other settings. Every sports fan knows that it is difficult to compare the value of players. Baseball player *A* might have a higher batting average than players *B* and *C*, but *B* and *C* may have more runs batted in—and then *B* may be on a superior team with more players on base when *B* is at bat. *A* might commit more errors, but he might be faster and get to more balls. It is no simple task to evaluate the players because of

[7] Berkshire Hathaway, for example, virtually promises not to pay dividends but to reinvest earnings. *See* Warren E. Buffett, *Annual Shareholder Letter 2012*, BERKSHIRE HATHAWAY 19–21 (Mar. 13, 2013), https://perma.cc/YH38-J9UD. Shareholders can, of course, sell shares as they like. A firm of this kind only shrinks if it redeems its own stock, and in the normal course it does not return to the market to test its ability to raise funds. On the other hand, the share price of the firm offers some indication of how the market evaluates the firm's ability to make profitable investments.

the multiple characteristics that make for value. In the case of sports, the difficulty of comparing players might add to fan interest, as they enjoy debating the quality of the players they follow. Online betting has added to this interest, though by necessity it focuses on particular characteristics of players and games, thereby avoiding the difficulty of a single, overall valuation that teams must consider when considering investments and trades. The same might be true when it comes to evaluating politicians, judges, and other players of interest to investors, voters, and employers. It is difficult to evaluate political candidates, though it is easy to bet on election results. In these examples, as in the case of corporations, it is also the case that past performance is not a perfect indicator of future value. Even if baseball player *A*'s numbers are superior, *B* may be younger, and therefore more valuable because of a longer expected career or a decreased likelihood of injury. There are few entities and individuals that can be judged with single metrics. A car salesperson might be easily compared to another salesperson in the same dealership, but politicians, friends, artists, vehicles, countries, novels, and faculty members are far more difficult to evaluate. If money is not the goal, preferences differ among those who do the hiring and consuming, and even when everyone agrees on the goal (like earnings, victories, fan appeal, and law school grades—as opposed to potential as a lawyer), the performance of a candidate in politics and in most legal professions is more like that of a baseball player than that of a corporation, which is instructed, and perhaps strongly encouraged by market pressure and structured compensation, to maximize shareholder value. Corporations are relatively unusual because the evaluators share a preference for wealth, and the firms they evaluate can be measured in terms of the value they are expected to produce.

Easterbrook-Fischel's narrow (but important) focus on corporations, and especially publicly traded corporations, is not a defect of *The Economic Structure of Corporate Law*, because the book does note the problems associated with telling a manager—rather than using environmental law or other legal mechanisms to affect the single goal of shareholder value—to care about the environment along with, rather than as part of the quest for, value.[8] At the same time, it is useful to think of the insights about value-maximizing firms as a springboard to understanding the structure of not-for-profit institutions. Consider the

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[8] EASTERBROOK & FISCHEL, *supra* note 1, at 39.

decision-making of a potential and well-meaning donor who cares about the environment, scientific research, or the difficulties facing poor people in a distant country. One very clever and well-known explanation of NFPs and the tax rules attached to them is that it is difficult for the investor to monitor far-away entities.[9] A partial solution is to give the entity special status if it qualifies as the right kind of NFP.[10] The status includes freedom from taxation on the gifts made to it and on any earnings, or "related income," it enjoys. In addition, qualified NFPs, the subset that qualify as 501(c)(3) organizations, can attract gifts because donors are entitled to (somewhat limited) deductions for contributions, which is another word for investments.[11] One of the requirements for this status is that invested and earned money cannot be distributed except in the form of reasonable salaries; there are essentially no owners of a qualifying NFP.[12] The donor knows this and might be willing to fund the NFP, even though its behavior is difficult to observe, because at least the people who run the entity are not taking profit out for themselves. The managers are employees with no claim on any residual earnings.[13]

This protection against the danger that managers will completely misuse the funds the NFP receives from trusting donors is, however, not enough for many investors. The managers of the NFP can arrange to take fairly large salaries, and they can shirk or simply be incompetent. In the case of a public foundation, and most other qualifying NFPs, these risks are in principle controlled by a board of directors that must have (the equivalent of) outside directors.[14] In addition, the state can step in if salaries are

9 Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 843–45 (1980).

10 *Id.* at 883.

11 *Id.*

12 *Id.* at 838.

13 However, as Geoffrey Manne points out in *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 228–29 (1999), the nonprofit form partially solves the contracting problem discussed by Hansmann by introducing new and sometimes significant agency problems for the NFP. In the for-profit case, agency costs are managed by largely self-enforcing mechanisms like shareholder monitoring and markets for corporate control. As Manne argues, NFPs lack both of these mechanisms because of the non-distribution constraint. *Id.* Investors can seek out poorly run for-profit organizations, attempt to take control of their management, and profit from any efficiency gains. Manne notes that this is largely impossible in the NFP context because they are functionally "unowned," and derivative lawsuits, which would ordinarily serve a similar function, are also impossible. *Id.* at 235, 243–44.

14 The specific requirements for board membership depend on state law. The IRS requires 501(c)(3) entities to file Form 990 if they receive over $200,000 in annual income or have $500,000 in assets. The form requires the NFP to answer detailed questions about the composition of the board of directors. The IRS recommends that the board be

too large, and the matter comes to its attention; it is the party best able to litigate against the NFP registered in its domain.[15] As a practical matter, what controls the behavior of NFP managers is that they are likely to have self-selected in the first place as people who are other-regarding or seek the approval of their societies, and they would like to attract more resources over time from donors who will occasionally observe their performance, as well as their compensation. Donors will be attracted to NFPs that demonstrate that they have been using contributions wisely. Still, on a larger scale, even if an NFP is run by dedicated and completely other-regarding persons, how would the average donor discern whether this NFP is better than others? Even the most honest and selfless manager might not be very good at her job, or she might choose inferior projects to accomplish the goal that motivates the investor. In the case of conventional corporations, the wealth-oriented investor can see how well this single goal is fulfilled, but where NFPs are concerned, it is very difficult to know which NFP is doing the best job or can most effectively deploy additional resources when it comes to the environment, to conducting research, and so forth.

B. Assessments through the work of large donors and through matching-gift programs

Many NFPs try to solve the assessment problem facing potential investors by disclosing information and specific plans. Some are required by law to show how much of what they take in goes to managing the entity and to raising yet more money, rather than to working on the goal that interests the donors.[16] Moreover, NFPs have every reason to advertise their accomplishments. Much like for-profit corporations, and government officials, NFPs rarely advertise their failures, even though doing so might make discerning investors more confident about the reports they receive, but that is a subject for another day. NFPs that are searching for additional investments regularly publish magazines, visit significant donors, and send e-mails to advertise their projects. In theory, while they cannot distribute dividends, they can contract

structured so it "represents a broad public interest" and to avoid "insider transactions that could result in the misuse of charitable assets." IRS, GOOD GOVERNANCE AND RELATED TOPICS – 501(C)(3) ORGANIZATIONS 3–4 (2008).

[15] Hansmann, *supra* note 9, at 853.

[16] The IRS requires a tax-exempt organization to make its recent filings available to the public. Private foundations face the additional requirement of disclosing the identities of substantial contributors. 26 CFR § 1.6033–2(a)(2)(ii)(F).

if they cannot find better "investments"; they are not in a position to repurchase stock, and they cannot pay dividends, but they can transfer funds to other tax-protected NFPs, perhaps by asking their own employees to choose other NFPs and then offering matching-gifts programs. Such voluntary contracting by NFPs is atypical, setting aside the distributions required of private foundations, which face limits on their ability to be a tax-favored holding-company that does not serve much of a public interest.[17] For most NFPs, targeted expansion is a more likely goal. They show potential donors photographs of a child or of promising students whose lives can be improved with a single gift. However, the donor does not know that this NFP will be particularly efficient in advancing the advertised cause. An NFP is likely to communicate its overall performance or its best projects, while donors should probably be interested in marginal projects—as the best evidence of what the NFP will accomplish with additional resources.

On a larger scale, some NFPs are designed to be intermediaries and to assess other hard-working NFPs on the ground. It is understandable why an organization like the Ford Foundation, which expends resources looking for the right causes to support and then funds a large number of smaller NFPs focused on particular projects, does not ask *individuals* to give it more money so that it can support yet more projects or give the selected sub-NFPs yet greater support. It would be unsurprising if the Foundation's search costs and results would attract many individual donors to it, the way a university attracts the support of individual, relatively uninformed, donors in the wake of large gifts from donors who create new institutes. The Ford Foundation does, however, encourage its own employees to take advantage of a matching gift program; employees are invited to contribute to an NFP of their own choosing, and the Ford Foundation matches these gifts on a 3:1 basis.[18] The MacArthur Foundation does the same for its employees, and it provides a list of eligible recipients.[19] A matching gift program of this kind should probably be thought of as compensation to employees rather than as an efficient way to fund good works. The foundation presumably has better information about the projects it studies than it or its

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[17] Private foundations are required to distribute a minimum of 5% of their average non-charitable use assets per year. I.R.C. § 4942(e)(1). Private foundations that do not meet this requirement are subject to an excise tax.

[18] *Matching Gift Program*, FORD FOUNDATION, https://perma.cc/QTY9-TJZP (last visited Feb. 11, 2022).

[19] *John D. and Catherine T. MacArthur Foundation Matching Gifts*, DOUBLE THE DONATION, https://perma.cc/7NTU-YRKT (last visited Feb. 22, 2022).

employees have about the NFPs that the participating employees elect to support; employees are not encouraged to name local organizations about which they might have greater knowledge. In any event, it is hard for the typical individual, who wants to contribute to the betterment of our society, to assess the work of the Ford Foundation. One can easily see how well a Vanguard account has performed in terms of maximizing wealth, even considering the fact that different Vanguard funds come with different risks; each Vanguard vehicle has a single goal and can be compared to opportunities offered by other mutual funds that also claim to help investors make (profitable) choices. In contrast, it is very difficult for an individual to compare the Ford Foundation to parallel foundations, universities, or other intermediaries.

Matching gifts are easy to understand when they are offered inside a family or within most corporations—assuming one can justify a corporation's philanthropy rather than direct profit maximization. A profit-maximizing firm might want to be appreciated rather than resented by local residents and politicians, so it has reason to contribute to local causes and to gain good publicity as a result. It will often offer its own employees the opportunity to give on their own, and often to local causes, and promise to match employee gifts up to some limit. The employees are likely to have more information about local causes, and the matching gift program also serves as a fringe benefit to other-regarding employees. Some employers restrict the program to a list of NFPs in order to avoid disputes, encourage local causes, or avoid the likelihood that some employees will simply be motivated by their private preferences (for a church, for instance) rather than the community or other causes that are likely to give the employer a good reputation, rather than provoke controversy.[20]

The fact that local employees might be well-positioned to assess the performance of particular NFPs points to the important problem of assessing the performance of larger NFPs. The Easterbrook-Fischel approach suggests that the performance of publicly traded corporations can best be evaluated by the market, and

[20] The Ford Foundation, General Electric, the Bill and Melinda Gates Foundation, Johnson and Johnson, and Apple all offer to match their employees' donations up to certain thresholds. However, none of them will match donations to religious or political organizations. Many, like Apple and GE, also require that the organization does not discriminate against protected classes in their operations. A less charitable view of matching gift programs is offered below, following some attention to the likelihood that a small donor gets valuable information from the choices made by large donors. *See Top Matching Gift Companies*, DOUBLE THE DONATION, https://perma.cc/K57S-XZ9H (last visited Feb. 22, 2022).

especially so when the corporation is encouraged to focus on the single goal of maximizing shareholder value.[21] A typical investor can be seen as benefitting from the wisdom of the crowd of investors and, no doubt, from the above-average information garnered by large investors who can be imitated or who simply have substantial impact on market prices. In the case of a sizeable NFP, however, there is no market price for prospective donors to observe, but they can still free-ride on other, better informed donors. If donor *C* sees that donor *D* gives $100 million to support research through the American Cancer Society, *C* might reason that *D* has investigated the field and decided that this is the best place to invest that considerable sum. It is rational for *C* to direct a $500 gift to that NFP rather than another, especially if *C* has already decided to support the cause of cancer research. It is noteworthy that NFPs, like the American Cancer Society, normally advertise large gifts. The conventional wisdom is that the advertisement serves to enhance the donor's social standing, but another way to look at it is that it motivates people like *C*, who have neither the time nor skill to study the various organizations devoted to the cause *C* cares about. It may be inefficient for *C* to search. If searching costs $250, *C* will be left with the ability to give a $250 gift; *C* might do more good selecting a certified NFP at random, and *C* is likely to do best by with the $500 by copying *D*, inasmuch as D is likely to have studied the field before choosing where to invest $100 million. *C* spends virtually no effort discovering that *D* has selected an NFP like the American Cancer Society, so that following *D's* lead is a very efficient way to support the cause that already appeals to *C*.

Free-riding in this way is not a perfect solution to the problem of selecting and assessing the provider of a good deed. It is possible that *D* chose the recipient in order to secure a position on its board and obtain the social approval that goes along with this position.[22] It is also possible that *D* is securing employment for several family members who want to work for the organization, though this is an expensive way to secure employment. In theory, it is also possible that *D* could have given a bit more than $100 million but studied the matter and decided that the chosen NFP would experience diminishing marginal returns as it expanded its reach. *D* may have decided that the next $500 he gives away would be better deployed elsewhere. But all these possibilities

[21] *See* EASTERBROOK & FISCHEL, *supra* note 1, 38–39.

[22] Divergent motivations increase monitoring costs, as noted by Geoffrey Manne, *supra* note 13, at 233–35.

seem rather remote. It is plausible that *C* will do well to free-ride on *D*, just as some investors free-ride on Warren Buffett's choices when it comes to investing for profit.

Rational donors must also recognize cases where larger donors are unlikely to have good information, as well as cases where there is no economy of scale on which a large donor can capitalize. At a local level, even very small donors can assess the value of modest contributions. This was part of the argument, made earlier, about employers' matching-fund programs. Small donors can also band together through their own trusted intermediaries, that often concentrate on local causes unobserved by large far-away NFPs. If someone belongs to a church and has some confidence, or faith, in how the church is run and how it helps poor people, the donor might be comfortable giving, or even tithing, to the church. A small donor who cares about feeding poor people, might volunteer or contribute to a local soup kitchen. The donor knows more about the effectiveness of this NFP than does the donor's employer, or a large far-away NFP, or the national government—however much the latter two entities care about feeding poor people. Other small donors might rely on a local church to supervise the soup kitchen and encourage contributions to it. Occasionally a church will also investigate far-away causes and encourage church members to contribute to the church which will then support some of the far-away causes. The donor trusts the church to make local and even world-wide assessments much as a purchaser of stock trusts the market or a large investor to assess the potential of a given publicly-traded corporation.

Most potential donors will have trouble deciding among NFPs. An unusually optimistic donor could overpay on her taxes and simply give more money to the government, if she thinks the government is so well-run that it can be trusted to spend on good causes, whether these aim to provide food to the hungry, repair bridges, or redistribute wealth. For a variety of reasons this is rare. A donor who gives to the United Way can be fairly confident that it is redistributing wealth, while contributions to the government might fund more national defense. Still, a preference for the United Way or even the American Cancer Society, over an individual's overpayment of taxes, demonstrates some inconsistency on the part of that person's claim that tax rates and government spending ought to be higher than at present. Individuals, especially high-income persons, who argue for higher taxes could simply give more of their own money to the government, which is itself a well-studied intermediary. At the very least they could

favor a higher marginal tax rate on high earners along with a tax credit for contributions to certified NFPs. Instead, the government's own matching program is more modest; the government matches only some gifts by offering charitable deductions to the tax-paying donors.[23] This deduction can be understood as the government's "giving" money to causes that individual citizens know more about than do far away government officials.[24] Essentially, the government offers its own matching-fund program, not to employees but to taxpayers, and it does so with significant limitations.[25]

C. Large gifts and the single-goal solution

It is useful to restate and then expand upon the connection between this argument about NFPs and Easterbrook-Fischel's insistence that corporate law is and should be directed to giving managers a single goal.[26] They argue that donors and social welfare are better off with a single-goal system—and the point here begins with the observation that the single-goal idea, or solution, is unavailable where NFPs are concerned. NFPs do not come with a sensitive market price or another measurement of effectiveness; with rare exception, it is difficult to attach a number to what they accomplish each year and to the impact that additional funds given to them are likely to make in the future. The suggestion in this Article is that there is something of a substitute in the form of information about the investments undertaken by large donors. A small investor, or donor, can free-ride on the decision-making of large donors, who create a kind of market that helps small investors choose among entities that claim, and for the most part honestly aim, to solve one or more social problems. The large donor normally has a single goal, whether it is to improve the environment or conduct cancer research. When the thoughtful large donor gives a huge sum to NFP-1, it makes sense for the more modest donor to do less searching and, instead, to follow the large donor's lead in the direction of NFP-1. In turn, NFP-1 has every reason to try to attract a large donor like *D,* because that in turn will make smaller, rational donors like *C* invest yet more in the

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23 *See* I.R.C. § 170.

24 Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 388 (1998).

25 For a discussion of present law, and how it might be improved, see Daniel Halperin, *Legislative Options for Simplifying and Restructuring the Charitable Deduction*, URBAN INST. (Dec. 2012), https://perma.cc/3RLK-DVPZ.

26 *See* EASTERBROOK & FISCHEL, *supra* note 1, 38–39.

same NFP, once the smaller donor has chosen the cause that *D* has also selected.

It is even possible that a small and socially minded donor, like *C*, is uncertain about which cause—or sub-cause in the case of a broad goal like helping poor people or improving the environment—to address, and *C* free-rides on *D*'s choice of both cause and NFP. After all, a careful *C* might try to maximize social welfare and might have compared NFP-1's work on a given social problem to other opportunities for socially-minded investments, even if these address other problems than the one addressed by NFP-1. It is more likely, however, that a rational *C* has as much information or as strong preferences about social causes than does *D* or other well-positioned, socially minded donors. In that case, *C* chooses an area of concern, and then looks to see the choices made by informed donors in that area.[27] One test is to look for NFPs that have recently attracted large donors, and this is similar not only to investing where Warren Buffett invests, but also to looking at market prices where the market is full of firms that are managed with an eye only on maximizing shareholder value. There are a number of examples of this investment pattern. For instance, the Pearson Family Foundation had no previous affiliation with the University of Chicago, but it had a longstanding interest in world peace and means of avoiding global conflict. The Foundation gave $100 million to support the family's favorite cause at the Harris School at the University, and then invited smaller donors to follow their lead.[28] The Foundation might in the future tie its contributions to those of smaller donors, and

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[27] Expanding mandated disclosures for NFPs is frequently proposed as a solution for this problem. However, it is not likely to succeed for many donors due to the costs incurred in making use of the disclosed information. As Lumen N. Mulligan notes in his discussion of proposals for a Sarbanes-Oxley equivalent for nonprofits, the average donation size is simply too small to make it cost-efficient to consider disclosures closely. *What's Good for the Goose Is Not Good for the Gander: Sarbanes-Oxley-Style Nonprofit Reforms*, 105 MICH. L. REV. 1981, 1996–99 (2007). Indeed, as proposed here, trailing large donors is a way of achieving both the disclosure and more of its benefits without legal mandates. As Mulligan notes, large donors can extract desired information about the NFP by conditioning their gift on disclosure, and the costs they incur to fruitfully consider it will be a negligible portion of the overall donation while it may eclipse the entire value of the average donation.

[28] Dawn Rhodes, *Pearson Family Members Foundation Sues University of Chicago, Aiming to Revoke $100M Gift*, CHI. TRIBUNE (Mar. 6, 2018, 6:15 AM), https://perma.cc/NV3C-Z5MS. It happens that the donors and the university then had a dispute, *id.*, but setting aside the details of the various complaints, this can be taken as a sign that the donor (which had also claimed that a prior religious organization had defaulted on promises made when acquiring a gift from the Pearson family, *id.*) was in a position to monitor the NFP.

perhaps (as in the case of National Public Radio) do so not just to encourage their contributions with a reverse matching fund program, but to get a sense of the smaller donors' enthusiasm for the NFP's work. Note that donors to Public Radio are likely to be people who listen to programs and therefore have information about the NFP's performance; the large donor might do well to copy the small donors, rather than the other way around. The more common solution to the problem of finding causes is more obvious and already mentioned; a donor who is comfortable with an intermediary's goals, like that of her church, can use the church as an intermediary and as an organization that solves the collective action problem shared by parishioners. The novel point in this Article is to see the role played by large donors.

Another way to think about this novelty, or strategy, is to ask why *C* does not look to see where *D* contributes funds in a political campaign. The answer is obvious and reveals the difference between *D* and a parishioner's church. The two investors, *C* and *D*, might not share preferences, or what we commonly call values. The smaller investor, *C*, has as much information as the larger one, *D*, about worthy goals and about *C*'s preferences about goals. *D*'s value is in ascertaining the effectiveness of particular NFPs in achieving a goal. In the realm of politics, *C* has no reason to think that *D*'s preference for a political party or even for a candidate within a party is superior to *C*'s. *C* should be more interested in *D*'s choice among cancer research institutes than in *D*'s choices when it comes to political parties or religious denominations.

The approach advanced in this Article solves, or at least helps with, a familiar puzzle, even as it expands the analogy to Easterbrook-Fischel's thinking. The puzzle is why people give money to a well-endowed institution, like Harvard. One often hears students (though not at the University of Chicago Law School, of course!) claiming they will not donate to universities in the future, because the universities with which they are familiar have so much money already and surely do not need more. But the argument here is that the more money an NFP like Harvard has, and especially the more its resources are the product of recent gifts, the more it is rational for one who cares about education, student debt, or research, to give money to Harvard (or, if I can lure the reader, to the University of Chicago) because people who had reason to study the matter chose to invest there. The new socially-minded donor will probably better advance the social interest by free-riding, after a fashion, and giving to the University than by choosing on her own to give to a cause that is almost

impossible for her to evaluate. Easterbrook-Fischel argued that corporate managers should follow a single goal to enable monitoring and avoid the problem of a manager following her own preferences.[29] A large investor will study a firm, compare it to others in the industry, and assess the value of its intellectual property and other assets that are not ordinarily visible. In the case of Harvard, or distant NFPs quite generally, it is almost impossible for most potential donors to assess the NFP's efficiency or likely contribution to society, and then compare the value of a gift to one NFP rather than another. But these investors can come close to the ideal searching and assessing of NFPs by imitating the behavior of very large and well-motivated donors.

Viewed in this manner, the assessment service provided by large donors does suggest some new puzzles even as it solves others. Consider again the popularity of employers' matching-gift programs. As suggested, the employer might encourage or use local information available to employees. The employees are better informed than the employer. At the same time, to be sure, the employer develops some good will. But the information or assessment component of this claim does not work for the Ford or MacArthur Foundations. These are NFPs that specialize in assessing individuals or smaller NFPs. It would make sense for an employee who is charitably inclined to copy an employer's judgment, when that employer is such a large foundation, rather than for the large foundation to free-ride on the assessments of its employees. Counter-intuitively, an outsider might think less of the Ford Foundation when it offers a matching-gift program because it can be taken as a signal that the Foundation and its employees think that the employees are better at choosing causes in which to invest than is their employer, which is supposed to be a specialist in assessing causes and smaller organizations that claim to be skilled at addressing social problems (identified by the larger NFP) on the ground. If an employee returned some of her salary to the Ford Foundation, that would be impressive and, indeed, some faculty members donate to their universities—and this greatly impresses less-informed donors. One possibility is that the employee finds a local cause to benefit, and this is a deserving recipient, but one that is outside the mission of the large foundation. Another optimistic thing to say is that when the money moves in the other direction, with the foundation matching the contributions of its employees, the aim is to raise employee

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[29] EASTERBROOK & FISCHEL, *supra* note 1, 38–39.

morale or to suggest a pattern of matching gifts to other employers, rather than to maximize the social value of contributions. For the most part, these explanations are insufficient because the largest foundations with matching gift programs are willing to match employee gifts to NFPs that the foundation could have supported but did not.

There is yet another puzzle with respect to a well-informed intermediary, like the Ford Foundation, offering its employees a matching-gift program. The program might be expected to increase gift-giving by an employee, because she sees her gift multiplied. We have seen the negative implication that might be drawn from the matching gift; the employee knows a good deal about the Foundation and yet, apparently, chooses to give money elsewhere. Another problem is that the program takes money away from the Foundation's chosen causes. Imagine that the employee gives $100 to a cause, and this turns into $400 because of the Foundation's 3:1 matching program. This takes $300 away from the "superior" causes chosen by the Foundation, but perhaps the rational employee and Foundation think that $400 to a slightly inferior recipient, as chosen by the employee, does more social good than $300 to the better cause selected by the Foundation. For this reason, the Foundation is eager to encourage its employees to give gifts that will be matched. But the problem with this is that the employee can give $100 to a cause, whether it is or is not one chosen by the Foundation, and not ask for the match. Again, when the employee asks for a gift to be matched, the action sends something of a negative signal about the employee's assessment of what the Foundation chooses to do—unless the employee's gift is to an entity that is outside the purview of the Foundation.

Returning to the information provided by most large donors, and setting aside the prevalence of matching gifts and intermediating foundations, the argument offered in this Article is strongest where the trailing donor shares the goal of the earlier, more significant donor. But in an important way the argument remains, and it draws yet more attention to the Easterbrook-Fischel way of thinking, where the two donors' interests are only slightly connected.[30] If *C* wants to support cancer research and is deciding among NFPs, and *C* observes that a significant donor, *E*, gives $100 million not to a university's cancer research laboratories but

[30] *Cf.* EASTERBROOK & FISCHEL, *supra* note 1, at 11 (discussing the rationality of passive investing).

rather to the cause of financial aid for its students, *C* might still reason that *E* has decided that the university is a well-run organization; when it comes to financial aid, such a well-run organization is more likely to choose the right financial-aid recipients, and administer funds quite efficiently, than would other organizations. This comes closer to mimicking Easterbrook-Fischel's argument, because the observed university is strongly encouraged to show reliability, which can be thought of as a single goal. The signaling is especially good if the significant donor did not attend the university, so that the donation is a real investment decision rather than a reaction that might derive from gratitude alone. But even gifts from donors who have some personal connection to the NFP are meaningful, inasmuch as these large-scale donors are likely to have relatively good information about the efficiency of the NFP, and they certainly have other causes, and emotional attachments, that compete for their gifts, just as publicly traded corporations and mutual funds compete with one another. In reality, of course, most large investments in a university are motivated by a combination of confidence in the university and personal connection, but they convey information to other potential investors. This last observation suggests that the argument advanced in this Article is more secure as a normative rather than descriptive matter. There are surely some cases where small donors follow the lead of large ones, who have no emotional tie to the NFPs they fund. It is easy to say that large donors use a combination of emotional ties and factfinding to choose the objects of their largesse, but the relative importance of these factors is difficult if not impossible to discern. The normative appeal of the argument advanced here also suffers from the problem of discerning whether the lead donor has assessed the quality of the NFP or is simply drawn to it for personal reasons. Still, if the small donor sees that a more significant donor chooses to give a huge gift to a university or to the American Cancer Society in 2022, when the assessment or personal obligation could have produced a sizeable gift in an earlier or later year, it is reasonable for the smaller donor to think that the larger one has confidence in the current management of the NFP or in a project it has recently undertaken.

A surprising product of this analysis is the light it casts on the usual claim of NFPs, that they prefer unrestricted gifts. On the one hand, this allows a well-informed manager, like a Dean, to use up-to-date information in order to decide where new resources are best applied. If donor *F* targets a very substantial gift

to the University of Chicago's Housing Clinic, valuable information is provided to other donors who are already interested in housing-related work. As already emphasized, *F*'s gift provides information about the University's reliability, as apparently judged by *F*, but this is not quite as valuable as what has been provided to a donor already interested in housing. And yet, if donor *G* gives a huge unrestricted gift, another donor with a preference for housing work might reason that *G* has signaled through the unrestricted gift that the Law School's Dean is especially reliable. The unrestricted gift gives direct information about reliability and good decision-making, rather than about the work of one particular clinic.

IV. ESG THINKING

While the single-goal idea is helpful when it comes to NFPs, even if slightly off the mark because NFPs are not out to maximize shareholder value, it is less helpful, or perhaps completely contrary, to the ESG (Environmental-Social-Governance) movement. That movement encourages corporations to say and to believe that they are not aimed at the single goal of maximizing shareholder value, but rather at maximizing a larger conception of shareholder *welfare*, by taking the environment and other causes into account.[31] If shareholders care about the environment, then (as the best ESG argument goes[32]), their corporation might do well by maximizing shareholder welfare, and this includes not just profits but also a concern for the environment and perhaps also the wage distribution among its workers, even when these interior concerns will reduce profit and shareholder wealth. I have argued elsewhere that the argument is difficult to sustain; it might require a belief that the corporation can do more for these causes than can another organization, likely a dedicated NFP, that a shareholder can fund on her own after receiving a larger dividend from the for-profit corporation with the single goal of maximizing shareholder value.[33]

But, returning to the single-goal idea, consider how difficult it is to compare ESG-driven corporations. First, there is currently no requirement for a corporation to reveal how much profit was sacrificed for the cause of socially beneficial projects.[34] Indeed,

[31] Hart & Zingales, *supra* note 3, at 265.

[32] *Id.* at 248.

[33] Saul Levmore, *Least-Cost Altruists and ESG*, BUS. LAW. (forthcoming 2022).

[34] *Id.*

some ESG supporters, and even some corporations and notable mutual fund managers, insist that many ESG causes increase shareholder value. This is certainly plausible but, if it is the case, an ESG orientation is consistent with maximizing shareholder value, and with Easterbrook-Fischel thinking; it is non-ESG corporations that would have explaining to do, unless the claim is that only some corporations maximize value by doing things like raising minimum wages or exceeding legal requirements with respect to the environment. Second, it will be difficult for investors to know whether a corporation is any good at fulfilling the ESG goals. An investor who wants to do more for income equality, for example, needs to know whether a corporation should sacrifice some earnings in order to raise the wages of its lowest paid employees, open factories in what it previously considered to be suboptimal locations, or lower the pay of its highest paid managers. One alternative is to do none of these things, in order to raise the value of the corporation and allow shareholders to decide how much money to give to poor people or to causes directly addressing wealth distribution matters—and then which NFPs will most likely and most efficiently accomplish these goals. The ESG idea, almost by definition, addresses multiple goals, and as we have seen, managers will not know what precisely to maximize, and investors will be unable to monitor their ESG performance.

In the case of NFP organizations, this Article has argued that, at least in theory, investors can, and perhaps should, follow the lead of large donors who have the ability and incentive to see where their contributions are best used. If investors see that a large donor gives a large sum to the American Cancer Society or to a local women's shelter, then investors of more modest means have valuable information. In support of this argument, it is interesting that unlike modest contributors, who often give relatively small contributions to tens of organizations, most donors who can afford to give millions of dollars, usually choose one or two organizations and give the bulk of their money to these NFPs, whose work they have presumably studied. If their motive is to gain recognition or to advertise their wealth, they could simply give a very large gift to an intermediary like the United Way or even the government; a gift to the latter would surely generate attention. It seems unlikely that someone who considers a $100 million gift to the American Cancer Society or to Harvard, would instead invest that sum in a single ESG-oriented corporation, or would invest $1 billion there, figuring that the corporation probably sacrifices 10% of its potential profit in order to support an

ESG cause that it had carefully considered. If a very wealthy, thoughtful, and socially minded person chooses a cause, then it is rational for a modest donor to follow this lead, or at least to minimize the second donor's search effort. This pattern is something of an alternative, or imitation, of the argument for a single goal in the case of for-profit corporations.

In sum, most investors—whether we apply the word to people seeking more wealth or to funding the work of NFPs—benefit when a single goal is attached to a conventional corporation, and they also benefit by the (nearly) single goal that takes the form of a large donor's selection of an NFP. In turn, the NFP has an incentive to attract large donors. But this logic does not seem to apply to ESGs. The growth of the ESG movement is likely to be about something else. It might be that investors are virtue signaling to themselves or to others, or it might be that there is simply disutility associated with investing in a corporation that is perceived as doing harm to others even as it profits its investors.[35] The Easterbrook-Fischel insight addressed in this Article can be applied, albeit with considerable variation, to not-for-profits, but not, or at least not easily, to ESGs.

V. CONCLUSION

Easterbrook and Fischel stress that shareholder value maximization is and ought to be a single goal for a corporation, and that this single goal is an effective way of telling managers what they ought to do.[36] The single-goal approach, along with sophisticated thinking about Coasian bargains, is shown by Easterbrook-Fischel to inform a great deal of corporate law.[37] This Article has stressed the other side of the coin. A single goal makes it much easier for investors to assess managerial behavior and performance, and to compare corporations in which they might invest. The difficulty of monitoring distant not-for-profit entities is something stressed by Henry Hansmann in developing the idea that the tax advantage of an NFP comes with the requirement that it not distribute funds or "profits" to its managers or investors.[38] But

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[35] If the disutility associated with something unpleasant does the work here, then some of the problems developed in this article disappear. Investors in ESGs may not really care about the allocation of the corporation's effort among causes, inasmuch as the investor simply wants to avoid an association with a corporation that declines to identify with the ESG movement and is therefore something to be avoided. Even if this is the case, the investor would benefit from information about how much value is lost to this cause.

[36] EASTERBROOK & FISCHEL, *supra* note 1, 38–39.

[37] *Id.*

[38] Hansmann, *supra* note 9, at 874–75.

this Article has advanced the idea that NFPs can also be seen as having something of a single-goal, and ease-of-assessment. Here, investors have even more difficulty than when they consider investments in widely traded stock, but in both cases they can follow the lead of very large investors, called donors in the world of NFPs, who might well study their options in order to decide where to invest in order to advance their goals. In turn, NFPs have reason to attract these investors, and then to gather resources from smaller investors who follow the lead of well-informed investors. On the other hand, ESG-oriented corporations, while also difficult to assess, are unlikely to offer this advantage to large and then to modest investors, precisely because their behavior cannot be evaluated with a single metric. The single-goal approach tells us something new about NFPs, and it is likely good news, but it does not inform or make one optimistic about ESGs.