LINKING CHARITABLE DONATIONS TO COMMERCIAL SALES: Evidence that firms can boost their profits

Firms can earn significantly higher profits when they tie sales of their products with a donation of 5% of their gross revenues to charity. That is the central finding of experimental research by Adriaan Soetevent, Te Bao and Anouk Schippers, to be presented at the annual congress of the European Economic Association in Geneva in August 2016.

Their study investigates whether there is a profit motive (alongside possible altruistic or reputational concerns) for why commercial firms offer charity-linked bundles. After all, such offers can be profitable if consumers’ willingness to pay for the product increases by more than the actual amount that is transferred to the charity.

The authors find that a donation of 5% of the sales price is the best of both worlds because it significantly increases a firm's profits and total donations to charity. A donation of an absolute amount (equivalent to 5%) has similar effects on sellers’ profits, but reduces consumers’ private donations by almost exactly the amount they donated by purchasing the product. A donation of 2% neither benefits the firm nor the charity.

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Existing studies find that consumer’s willingness to pay for a product increases if it is linked to charity, but the increment does not exceed the actual donation amount. For example, Elfenbein and McManus (2010) find that consumers pay 6% more if 100% of the price is donated to charity, and in Frackenpohl and Pönitzsch (2013), consumers pay €0.72 more for a mug if €2 is donated. This new study investigates if and under what conditions charity-linked bundling is able to increase profits net of the donation.

In the lab experiment (102 participants, 59% female, average age 22.35 years), subjects were paired and assigned the role of seller or buyer. In each of the 15 rounds, sellers decided at which price to offer the product.

To ensure competitive markets, sellers competed with a computer-seller selling the product at production cost. Buyers received an endowment in each period, and then decided from which seller to buy and whether to make a private donation to charity. A seller’s profits are the price received minus all costs, and zero if no product is sold. A buyer’s payoff is the endowment minus the price paid and private donations.

In the four treatments, only the donation part differed: 0 in ‘Control’, 2% of the product price in ‘2-Percent’, 5% in ‘5-Percent’, and an absolute amount (equivalent to 5%) in ‘Absolute’. The computer-seller never donates to charity. To avoid reputational effects, the donation to charity (except in Control) is imposed on the subject-seller.

The authors find that consumers are willing to pay an average price that is higher than total costs (production plus possible donation) in all four treatments. In Control, this is evidence of altruism: consumers prefer to buy from another participant rather than from a computer.

Charity-linked bundling increases net profits significantly if sellers donate 5% of the price (129% higher profits) or an equivalent absolute amount (148% higher profits). A
donation of 2% does not affect profits; the donation is possibly too small to benefit from profitably.

The charity also significantly benefits from linking the product to a 5% donation. Total donations (product donations plus private donations) are 117% higher and product donations do not crowd out private donations. Almost full crowding-out occurs in 2-Percent and Absolute: consumers reduce their private donations by almost exactly the amount of the product donation.

Conversely, some consumers, especially in Absolute, donate the exact product donation themselves if they buy from the computer-seller. This suggests that the product donation acts as a social norm to which consumers wish to adhere in their private donations.

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‘A Commercial Gift for Charity’
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References
