Book Review: The Danish Industrial Foundations, Steen Thomsen (2017)

The quest for permanence is a familiar theme in the world of closely-held and family businesses. Entrepreneur-founders often wonder how the businesses they have created can go on without them and remain in private hands. The ownership succession discussion typically is centered on the alternatives of becoming employee owned (via ESOP or a direct sale of equity to key employees) or maintaining long term ownership in the founder family. If those forms of ownership succession are not feasible, a sale to a third party is in the cards.

Outside the U.S., there is another ownership succession tool available for entrepreneur-founders—the transfer of all or part of the equity in the firm to what is called an "industrial foundation". While the details vary a bit country by country, an industrial foundation is a tax exempt or charitable foundation that "owns" all or part of a company, public or private. They are created by the irrevocable transfer by an owner, family or government of the equity ownership of the business to a qualified foundation.

This form of transfer is very prevalent in Europe, especially in the high inheritance tax Northern countries, such as Denmark, Norway and Germany. In fact, some of the best known companies in that part of the world have been owned by industrial foundations for years—such companies as Robert Bosch GMBH, The Carl Zeiss Group, ThyssenKrupp AG, Rolex, Investor AB, Novo Nordisk and IKEA. Denmark is the clear leader; it has over 1,300 industrial foundations in operation and the value of publicly listed companies controlled by foundations represents about 68% of the total market capitalization of the Copenhagen Stock Exchange.

Until now, there has not been any significant academic study of this form of corporate ownership. How does the financial performance of companies owned this way compare to their peers? What are the regulatory and tax pre-requisites for this to work? Do foundation owned companies have an unfair tax or competitive advantage? What are the most effective governance mechanisms for operating the business once the transfer is made? By whom and how should this kind of company be regulated? Is this form of long term ownership a good thing for society? What are the philanthropic benefits of this form of ownership? If this is such a good thing, why is this alternative not available in the U.S.?

The answers to all these questions and many more are the subject of Professor Steen Thomsen's fascinating new book, The Danish Industrial Foundations. Professor Thomsen is an expert in corporate governance and is the founding chairman of the Center of Corporate Governance at Copenhagen Business School. The Center has undertaken a comprehensive study of the industrial foundation form of ownership in Europe and, as a starting point, has taken an in-depth look at the Danish experience. This book contains the findings of that research.

The results are stunning. Foundation owned firms have a very credible financial performance profile. They obviously have a very long life and are a stabilizing influence on employment levels and the local economies in which they operate. They tend to be less levered and more risk averse when compared to their peers. They also play an incrementally significant role in philanthropy in

the communities in which they operate. By reason of the associated regulation, there are no claims of unfair competition or of tax abuse.

Professor Thompson has assembled impressive data on the benefits and costs of this form of ownership. Included in this is a very constructive review of the role of regulation and taxation that enables companies to function this way. He also analyzes the terms of the organic documents that establish the governance of the Danish cohort of industrial foundations. He highlights the particular approaches to governance or "best practices" that yield better long term performance among the companies studied. All in all, I found that there was nothing not to like about the Danish industrial foundation experience.

This leads to the obvious question for readers of this book in the U.S.—if the experience with foundation ownership in Denmark, Germany and other countries is so good, why is it that this form of ownership succession is not an option here? The answer is that the tax code provisions adopted for charitable foundations in the U.S in 1969 effectively prevent U.S foundations from having ownership control of business companies. At present a U.S. foundation is, with some exceptions, limited to a maximum holding of 20% of the stock of a single company. The shares of any disqualified related person are aggregated with the foundation ownership for purposes of applying the 20% test. There are substantial tax penalties for exceeding this limitation.

It was not always this way. Pre-1969, many companies in the U.S., such as Ford Motor Company and Eli Lilly, had substantial foundation ownership. Today, only the Hershey Company is controlled by the equivalent of an industrial foundation; there the Hershey charitable trust owns about 8% of the stock and controls just under 80% of the vote. The financial performance of the Hershey Company has been exceptional over the years. But for the trust ownership, the company would have been acquired by a hostile suitor years ago.

Professor Steen's main purpose for writing this book undoubtedly was to put a well-earned spotlight on this very successful form of long term corporate ownership in Denmark and the rest of Europe. He definitely succeeded. Yet, in doing so, he has also resurrected the question of "what were we thinking in the U.S. in 1969 when this form of ownership (and longevity) was prohibited"? The leading American scholar on our foundation laws, Professor Fleishman at Duke University, said it this way in 2001:

> "We arrive at what seems to be an inescapable conclusion therefore, that the U.S. excess business holding provision in its present form was, simply put, a wrong-headed idea, unevenly applied. In other words, it probably should not have been enacted at all". Fleishman, Foundations in Europe (2001) at p. 394.

One can only wonder how many family businesses might have taken advantage of long term foundation ownership as part of their succession planning had the 1969 tax prohibitions not existed. If the Danish experience is any indication there is no question that our society here would have benefited greatly. Many more entrepreneur-founders would have found their answer to their quest for permanence and we would all have been better off.

The Danish Industrial Foundations is about much more than what its modest title suggests. It is about the quantifiable benefits of long term ownership of quality companies and the many ways they give back to the societies of which they are a part. This is a must read for the legions of entrepreneur-founders and family business executives who want to learn more about running a

successful business for the long haul. Just maybe, this book will also be a catalyst for more debate about our “misguided” foundation ownership rules in the U.S.

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August 2017

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