What Do We Know (and Not Know) about Industrial Foundations?[1][2][3]

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Abstract

Industrial Foundations are foundations which own business companies. They are quite common in Northern Europe, but also occasionally found in other parts of the world. Several well-known companies like the Tata Group, Robert Bosch, Hershey, the Guardian, Aldi or Maersk are owned in this way. Because of their combination of non-profit and for-profit characteristics foundation-owned companies pose interesting questions to current theories of the firm. Can non-profit ownership be economically efficient? Can they derive competitive advantages from their ownership structure? How are foundation-owned companies governed? Such questions are interesting given the economic importance in Northern Europe, but they may also carry more general lessons for corporate governance. This paper surveys the sparse literature and poses questions for future research.

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Introduction

Industrial foundations are foundations which own companies. They are called Unternenmensträgerstiftungen (German) or erhvervsdrivende fonde (Danish). Most people will not be familiar with them, and we should perhaps motivate the subject by way of introduction.

In a global context, industrial foundations are a rarity since most companies are ultimately owned by private individuals either directly as in personal or family ownership or indirectly through intermediaries such as investment companies, pension funds or even government ownership. But a non-trivial number of business firms in Northern Europe and some very large global companies are owned in this way, and this alone makes foundation ownership a worthwhile object of study. There has been little research on these entities, and we need to know more.

Secondly, industrial foundations are important precisely because they are special. The combination of non-profit foundations and for profit firms creates interesting paradoxes which can inform and challenge theories of the firm. For example it may be that the profit motive is less necessary for efficient business enterprise than is commonly assumed, and this may have implications for other ownership structures as well. Foundation-owned companies may also teach us a great deal about what governance mechanisms work when profit incentives are absent or dampened

Third, in the international discussion of corporate social responsibility, industrial foundations appear to present a way to make business more socially responsible at their core. Nobody is arguing a full scale conversion of all business activity to foundation ownership. This is indeed a straw man (and a bad idea as we will argue in the following). But it may well be that more business companies around the world can benefit from foundation ownership.

Throughout the paper I have tried to abstract from any specific national and legal context preferring instead to identify and discuss more general issues pertinent to our understanding of these entities. The objective is mainly discuss and identify our ignorance on the subject which given the limited extant research is much larger than our current knowledge. Hopefully, the paper can thereby contribute to future research and help remedy the situation.

What are industrial foundations?

We define an industrial foundation as a foundation which has commercial activity or owns one or more business companies. In legal terms (Kronke, 1988) they are characterized by:

- creation by donation (“Endgültige Trennung von ausgesetzten Gütern”)
- Independence (and separate legal personality)

- An altruistic purpose ("Stiftungszweck").
- A foundation endowment (“Stiftungsvermögen”)
- a foundation organization and charter ("Stiftungsorganisation und Stiftungsverfassung“)
- Ownership of a majority of the shares/votes in a business company.

Creation by donation. An industrial foundation is created when somebody (the founder) entrusts the foundation with an endowment consisting of ownership rights to a business company. The existence of foundations therefore presupposes a gift, a renunciation on part of the donor/founder. This transaction is irreversible. Once given the founder cannot take back the gift. Irreversibility separates industrial foundations from US style family trusts. By a foundation we mean an independent self-owned legal entity. Thus most family trusts would not be foundations in the sense, we are interested in here because they can be dissolved and ownership can revert back to the beneficial ownership. However, we consider irrevocable trusts similar to foundations. Note also that the donation is typically a single event while US non-profits often dependent on a continuous supply of donations. Trusts and foundations share many characteristics and the differences between them may in many cases be a matter of degree. However, for research purposes it seems prudent to maintain a rather strict definition of industrial foundations to preserve the identity of the phenomenon.

Independence. The foundation is a private (non-government) institution. It has no owners and no members. Industrial foundations are therefore sometimes referred to as "self-owning institutions". The irreversibility of the decision to found a foundation is underlined by its legal personality. The decisive factor is a clear separation between the personal economic affairs of the founder and those of the foundation. The separation transforms the foundation into a non-profit entity, which as emphasized by Hansmann (1980, 1987) may earn profits but cannot redistribute them except for charity.

Independence here also means independence of the founder and the founding family. In many cases (in Denmark we estimate around half of the largest industrial foundations), the founder and founding family are no longer active, so industrial foundations are not a subset of family business. Moreover, even if the founding family is still active, it does not exercises unfettered control. Foundation law may proscribe, for example, that one or more or even the majority of the foundation board members are independent of the founder.

Independence also entails **independent governance**, for example a board of directors or trustees, which are to some extent at least independent of the founder and other external parties.

A charitable purpose. Running a business for the good of society is considered to be an acceptable charitable aim. The foundation may or may not have other philanthropic goals, but most industrial foundations typically support other worthy causes. The foundation cannot (or only to a limited extent) redistribute income to the founder or his descendants.

Endowment. Independence presupposes a certain initial wealth, an endowment or at least privileged access to a source of future income (such as the right to future profits from a company owned by the foundation). Once created, however, foundations are in principle self-perpetuating bodies provided that they are financially viable. In principle they will continue to carry out the will of the founder in all eternity.

Governance by Charter. Like other foundations the industrial foundation is formally governed by a charter, which defines its purpose and organization. The foundation is obliged to own and manage the company according to the charter, which represents the will of the founder (although behavioral rules are often informal rather than formal). For example, the charter may proscribe that certain worthy causes (like research, art or charity) should be supported by revenues beyond what is considered necessary to reinvest in the business. The foundation charter may also specify that the foundation should act for the benefit the company, the employees or the national interest. Moreover, the charter may oblige the foundation to maintain majority ownership of the company. The charter may furthermore include specific rules on the composition of the foundation board, e.g. whether it is self-elective or whether the founder's descendants are entitled to a seat. Under the constraints set by the charter (which are subject to government approval and supervision) the board acts at its own discretion.

Government supervision. European industrial foundations are supervised by one or more government offices, which monitor whether they are run lawfully and in accordance with their charter (Kronke, 1983). Foundations must submit audited annual reports subject to the same rules as for joint stock companies. The foundation office will intervene and in extreme cases replace the board in case of neglect or abuse, for example if the board decides to grossly overpay its own members. However, the foundation supervision office will almost never be able to challenge bad business decisions.

Business activities. This paper defines industrial foundations by majority ownership of a business company. If the foundation is the sole owner (no minority shareholders) the company and foundation board members may be identical and even (in a few cases) use the foundation structure to conduct business without incorporating a separate company. If a minority of the company's shares are held by other shareholders - e.g. if they are listed on the stock exchange - the company will in principle act as any other joint stock company. The company is legally responsible to (all of) its shareholders and at an annual general meeting they will elect a board to represent their interests. However, as a majority owner, the foundation possesses a controlling influence, which it may (or may not) choose to exercise. Often European industrial foundations retain a voting majority by having the company issue shares with limited voting rights (B shares) to the general public while the foundation maintains shares with full voting rights (A shares).

Business activity separates industrial from purely charitable foundations. By business activity we mean that the foundation owns the majority of a business company which sells goods and services to the public on a commercial basis. (i..e possesses all or the majority of voting rights of the company). There must surely be some trifle limit to commercial activity so that leaflets sold by a Red Cross bookstore does not make the Red

Cross a business organization. But we will not be concerned with the exact delimitation of commercial versus charitable activity except to say that the commercial activity must be in some sense significant (for example in terms of magnitude).

Many industrial foundations have both commercial and charitable activity, e.g. they own businesses and use the dividend income for charity. There may of course be many kinds of charity. A particularly troublesome kind from a definitional viewpoint is if the foundation supports the commercial activity of the company by donations or cheap loans which is tantamount to a subsidy and blurs the distinction between commerce and charity, As far as we know this is rarely the case in normal times, but many industrial foundations come to the assistance of their companies in cases of financial distress (as would many other owners).

In some cases, it is clear that the activity of the business contains charitable or at least non-profit elements. This would be the case in newspapers which are sold with the noble aim of informing the general public or ensuring that the views of a particular political party are voiced. As one newspaper man put it: "we make money to sell newspapers not the other way round".

Typologies

Among industrial foundations it is useful to distinguish between charitable and business foundations.

Charitable industrial foundations – such as perhaps the Tata foundations – have a charitable goal, but just happen to also own a controlling interest in one or more business companies. Not all jurisdictions accept that running a business is a legitimate goal for a foundation so to make use of the foundation structure for business ownership it may be necessary to register as a charitable foundation and to fulfill the sometimes restrictive condition which the authorities put on such entities with regard distribution of all or most income as donations within a specified time period (e.g. one year) and associated limitations on capital accumulation in the foundation. These problems may however be mitigated by holding companies as intermediaries between the foundation and the operating businesses. Reserves can be accumulated in the holding companies and dividend payments can be adjusted to suit business conditions as well as charitable goals.

Business foundations are created with the explicit goal of running a business, i.e. business activity is the goal in and of itself. Such entities, which are allowed in Denmark for example, face no obligation to distribute dividends for charity, but can accumulate or invest funds to suit the needs of their businesses. The risk, of course, is that this goal loses its meaning if it is translated as doing whatever the company is doing at any particular point in time. However, additional limitations may be placed on the foundation by its charter, for example, so that it needs to continue a company with a certain name, in a certain industry, to be headquartered in the country of origin etc.

Combinations of charitable and business goals appear to be norm, but in many cases the business goals are regarded as primary while the charitable goals are regarded as secondary. From a charity viewpoint it may not make much sense for a foundation to allocate all or a large percentage of its portfolio to a single business company given the idiosyncratic risks, which such companies run. A safe investment in government bonds or a diversified portfolio may be preferable since it reduces idiosyncratic risks and leads to more predictable revenue streams which can be an advantage for allocating charitable donations to the maximum effect. Thus a certain tension and tradeoff are present between charitable and business goals.

Family foundations are foundations created to secure and promote the wealth of descendants and other family members of the founder(s). Family foundations may or may not own business companies, but here we are interested in those which do. Depending on inheritance and tax law, this may allow the founders to reduce succession taxes. However, donations paid out to family members will then typically be income taxed, so that tax benefits are neutralized since tax authorities around the world resent the creation of tax loopholes. It may be, therefore, that family foundations are attributable to other motives, for example efficient administration of an ownership stake on behalf of many family members – and prevention of strife between descendants by a fixed set of rules. Altogether, family foundations appear to a kind of organized family business, which resemble family trusts (some even expire, and the means are distributed among the beneficiaries after a fixed period of time) and is therefore only tangential to our topic in this paper.

However, combinations are not unusual so that a foundation charter may oblige it to run a business, support members of the founding family if in need, and to distribute excess funds for charity. If support of descendant of the founder is a secondary or tertiary goal for the foundation, they may still be regarded as proper industrial foundations in the sense of this paper. It may be for example that donations are limited by charter to a fixed small amount or to emergency situations. We know relatively little about the contents of foundation charters and to what extent they actually influence foundation and company practices.

Another interesting distinction concerns the identity of the founder. **Owner-created industrial foundations** are created by entrepreneurs, which have started a business and decide to donate it to a foundation rather than letting their descendants inherit it. The entities presuppose a personal renunciation on part of the founder.

Manager-created industrial foundations. In contrast, some foundations are formed by managers rather than owners, for example when financial mutuals, savings and loans association or other financial institutions wish to convert to a corporate form, for example to list their shares or when merging with another entity. In this case, the equity of the association may be donated to a foundation which then holds a proportionate amount of stock in the new listed or merged entity. This maneuver, typical for financial institutions, does not presuppose a personal renunciation on part of the founder, but rather a gift by the incumbent management on behalf of the members of the association.

Although these two entities may be formally similar, they differ with regard to the level of managerial capture involved, and this seems likely to influence the governance and efficiency of the created entities.

Theories

The donor agency problem as a rationale for foundations. Fama and Jensen (1983) argue that on-profits such as foundations can be explained by donor agency problems. Donors which do not manage their own donations need to be assured that their gifts are not redistributed as profits or income to external parties (Thomsen 1996). For example, donor-agency problems arise if an entrepreneur wishes bequeath his shares in a company to the company in order to secure it future survival. What then is to prevent minority shareholders, managers or other stakeholders from expropriating this gift for themselves? Moreover, donor-agency problems arise if charitable foundations are considered to be recipients of donations (dividends) from the companies they own and distribute this revenue to charitable causes. Again, this gift might also be expropriated. Since foundations have no owners, they cannot redistribute profits, and the non-redistribution is one way to prevent donations from being reallocated to third parties.

The non-redistribution constraint also makes sense if founder-entrepreneurs have preferences regarding the future development of their company (e.g. a preference for its survival). For this reason, they may want to donate most of their wealth to assure the company´s survival. In principle, they might do so by burning their stock certificates, in effect giving up their rights as residual claimants. However, given the existence of other (minority) stockholders and other stakeholders, this gift would simply be redistributed as profits and control rights to the other stockholders or stakeholder income (for example higher pay to managers or employees). To get around this problem, the donor-entrepreneur donates her property rights to a special institution, a foundation, whose charter specifies the principles by which it should exercise those rights.

This means agency problems provide the rationale for both industrial foundations no less than for listed business companies. In publicly listed business companies the absentee principals (shareholders) are awarded voting rights, shareholder elected boards and safeguard to insure that their investment is protected against expropriation by agents (such as managers or other shareholders). If they do not get this assurance, they will not invest. It therefor pay for issuers of stock to provide it.

In comparison, industrial foundations also protect bequest of the absentee principals (the founders) against expropriation by agents like minority shareholders, managers and other stakeholders. The foundation charter is the direct expression of founder’s will, and the duty of the board to act in accordance with it, the foundation’s economic and organizational independence as well as the mild supervision of the government all provide assurance to the founders. If they did not get this assurance, they would establish foundations.

Business efficiency. Although foundations are an efficient way to organize charity, doubts have been raised concerning their efficiency as owners of business companies. At first glance there is not much scope for industrial foundations in agency theory, which emphasizes the role of incentives and profit maximization for economic efficiency. Thus they should have limited are at best an aberration with limited survival power in the absence of tax incentives (Fama and Jensen, 1983).

However, the empirical evidence is sufficiently inconsistent with this conjecture to generate a search for theoretical alternatives. Using an old metaphor, physicists have apparently calculated that the honey bee cannot fly: its wings are too small. But the observation that honey bees do in fact fly, indicates that theory development is called for. Apparently, it turns out that honey bees can in fact fly even theoretically, if second order effects are taken into account. Using this metaphor, we should challenge economic theory to develop theoretical alternatives, which take second order effects of dampened incentives into account.

Based on Malani, Philipson and David (2003) and the family business literature we identify 4 main theoretical approaches to the study of industrial foundations:

1) the altruism model
2) the worker cooperative model
3) the non-contractible quality model
4) the family governance model

The altruism model (Newhouse, 1970) assumes that non-profits differ from for-profits by having preferences with regard to the quantity and quality of output (e.g. running a hospital is a goal in itself). It seems straightforward to generalize this logic to concerns for product quality, sustainability, employment security, labor standards, use of child labor among suppliers etc. Thus, for example many Scandinavian (and US) newspapers are owned by foundations. These concerns may be motivated by pure altruism or by professional norms shaped by “elite workers” (e.g doctors). Altruism – or a desire to advertise a family name and make it famous into posterity (Glaeser, 2002) - appears to be a likely motive for establishing an industrial foundation by a large donation. Casual inspection of foundation charters indicates that they often make special provisions about high ethical standards in the conduct of business, concern for employees and their families or for product quality. For example Carlsberg is in this way committed to brewing beer of the highest quality. So a preference for high product quality could be a prediction of the altruism model (Malani, Philipson and David, 2003).

Worker cooperatives. An alternative is to model non-profits as worker cooperatives (Pauly and Redisch, 1973). Glaeser (2002) models US non-profits as employee cooperatives that are captured by elite employees (doctors, university professors or priests). While there are few hospitals, universities or churches among business companies, foundation ownership among consulting engineers or architects is a case in point. Alternatively, industrial foundations probably could be said to be captured by top managers in the companies that they own. At face value, the worker cooperative model would seem to imply high salaries per work worker and lower levels of employment relative to output. However, if the capturing agents are top managers rather than elite employees, the model seems consistent with a size preference. Glaeser (2002) describes how there can be conflicts of interests between donors and professional managers in US non-profits, and how over time the professional managers tend to become more powerful as organizations grow, gain control of their own resources and so become less dependent on the donors. Similar trends and conflicts – mission drift - can be observed in industrial foundations between founding families and professional managers.

With regard to performance the worker cooperative model appears to be most consistent with constrained managerialism, i.e. the interests managers of key employee are maximized subject capital or product market constraints. This is very similar to the managerialism which agency theory predicts for companies with atomistic ownership, i.e. weak owners and strong managers (Roe, 1994).

Non-contractible quality. The third body of theory is based on quality uncertainty (Hansmann, 1980, Glaeser and Shleifer, 2001). Hansmann (1980) explains the survival of non-profit institutions by a contract-failure argument: when the buyer is uncertain about the quality of a service provided to him, a market failure occurs since the producer has the capacity to reduce quality of the good in ways that cannot be detected by the buyer. To facilitate contracting under these circumstances the supplier may organize as a non-profit enterprise, which is free of any profit-incentive to cheat on customers. Non-profit enterprise can therefore be seen as a binding commitment not to maximize profits opportunistically at the expense of buyers, and in principle the argument can be generalized to include safeguarding all economic relationships in which a company has decisive information advantages. It seems possible to generalize the argument to other economic relationships characterized by high asset specificity and/or hold up risks, e.g. relations with suppliers, bank relationships, interfirm alliances, employee relations etc. All else equal a non-profit firm could be less likely to renege on implicit contracts with employees, banks or other firms because they value the extra profits less.

However appealing, the non-contractible quality model seems to be at odds with certain empirical regularities in the distribution of foundation-owned companies. While the country effects (presumably created by national laws and regulation) are strong, the industry effects are much less pronounced. We would imagine the non-contractibility to be industry specific and observed by Hansmann (1996) on US non-profits which tend to cluster in industries like hospitals and universities. It is possible, however, that certain firm-specific strategies may contain non-contractible elements and that the model therefore holds on the firm rather than the industry level. Nevertheless, until such firm specificities can be demonstrated empirically, the model has limited predictive power.

Family governance. A fourth approach is to regard foundation ownership as an extension of family ownership Foundation-owned companies are often managed by the founding families, who continue to take a strong personal interest in the firm. But even if they are not the foundations may be enacting the role of founder as intended by the charter. Several studies (e.g. Anderson and Reeb, 2003, Amit and Villalonga, 2004) have emphasized the relatively strong performance of family-owned firms and it is possible that foundation-owned firms can benefit from this type of long-term commitment. It seems likely that foundation-owned companies retain more of the company's administrative heritage, since this is the explicit formal goal of the foundation structure.

Economic Performance.

There are a couple of good reasons to expect foundation-owned companies to have lower profit rates than investor-owned firms. Basic agency theory predicts that foundation-owned firms should be inefficient because of muted incentives. According to the charity model they may not even aim for profit maximization. Because of the absence of the market for corporate control, agency problems might be likely to flourish in these entities. However, there are also some arguments. According to the family model, families may continue to monitor efficiently even in the foundation structure, and the non-contractibility model could under certain circumstance provide a rational for superior efficiency. Financing constraints have ambiguous implications. Because of the ownership constraint foundation-owned may find it difficult to attract outside capital and so have higher costs of capital. This should reduce total economic profits, but might increase realized rates of return on capital (which should be equal to the marginal costs of capital for maximizing firms). For an overview of these arguments and more see Hansmann and Thomsen (2011)

Empirically, Thomsen (1996, 1999), Thomsen and Rose (2004) and Hansmann and Thomsen (2011c) in Denmark, Herman and Franke (2003) in Germany or Dzanzig (2011) in Sweden examine how foundation-owned companies perform relative to other ownership forms. They all find that they perform well, i.e. comparable to or slightly better than other companies. However, none of these studies have been done on matched samples, and the issue of causality remains unresolved. It seems highly likely that foundation-owned firms are selected to be good performers. After all, who could donate a badly performing company to a foundation? It also seems likely that highly profitable companies which can finance their own growth are more likely to remain foundation-owned than those which need external finance. Therefore, although the evidence so far indicates that foundation-owned firms do not underperform as predicted by agency theory, more research on performance is needed.

That said, Thomsen (1999) goes some way to clear some of the more obvious alternative explanations in the case of Danish industrial foundations. For example, Danish foundation-owned companies appear to be taxed similarly to other companies. Any tax advantages would be conferred mainly at the ownership level, i.e. though the avoidance of inheritance taxation, but would not effect profitability at the company level. Moreover, to the extent that donations are paid to descendants in accordance with the foundation charter, they would be income taxed. It is unlikely, therefore, that foundation-owned companies can be said to receive tax subsidies. However, a comprehensive clarification of the tax issues does seem in order as we argue below in the discussion of pertinent research questions.

An alternative hypothesis would be that the company received an implicit subsidy in the form of patient equity and lower costs of capital. However, this is inconsistent with the performance studies which find relatively high returns on equity. Finally, being highly international it is not likely that their good performance is attributable to monopolistic advantages on the Danish home market. On the contrary, it seems quite likely as argued by Glaeser (2003) that international competition helps keep foundation-owned companies efficient.

Governance and distance

In the absence of external ownership pressure, there is an obvious risk that any potential advantages to the foundation structure will be dissipated if trusts and companies are captured by entrenched managers. Hansmann and Thomsen (2010) therefore propose that some level of "managerial distance" between foundations and companies is conducive for good performance of foundation-owned companies. For example if there is complete overlap between foundation and company boards, efficient monitoring is unlikely, since board members cannot easily monitor themselves. Hansmann and Thomsen consider various distance measures and find that foundation-owned companies do significantly better if:

1. There is some, but limited overlap between the foundation and company boards
2. The foundation-owned companies are publicly listed
3. The foundations have a general charitable aim (beyond running a company)
4. The foundations own a majority of more than one company
5. Foundations and the companies are physically separate (have different addresses).

A subsequent case study of the Indian Tata Group by Thomsen (2011a) finds that the Group is in fact characterized by a high level of managerial distance.

Alternative governance mechanisms

One way to think about the surprisingly good performance of foundation-owned companies is to examine the impact of alternative non-ownership governance mechanisms.

Thomsen (1999) examines and rejects some of these. It is apparently not the case, for example, that creditor control substitutes for investor control. As already mentioned foundation-owned companies are conservatively financed and therefore relatively independent of their creditors. Moreover, foundation boards and foundation managers tend to be conservatively paid by limited flat rate fees rather than pay for performance. It is probably not the case therefore, that profit seeking is smuggled into the foundation through the back door.

It is possible, however (although perhaps not highly probable) that the mild supervision exercised by government authorities to some extent substitutes for shareholder control. For example, Demsetz and Lehn (1985) argued that government supervision of financial firms was a substitute for shareholder control. Very little is known about the activity and efficiency of these government regulators, and this is another subject worthy of further research.

Another possibility is that informal governance mechanisms in the sense of Thomsen and Conyon (2012) address some of the governance issues in foundation-owned firms. This could be internationalization of social norms in a relatively small community. It is perhaps not unimportant that foundation-ownership appears to be relatively successful in the smaller Danish or Swedish business communities, but would perhaps be less successful in Italy. Reputation effects may be stronger in such small worlds which could then facilitate the viability of foundation-ownership. Thomsen (2005) finds that the reputation of foundation-owned firms is more sensitive to bad performance then reputations of firms with other ownership structures.

Research Questions

In this section we try to summarize our ignorance as research questions for further research.

Frequency and economic significance. We have little precise knowledge of the frequency and economic significance of industrial foundations. Casual observations indicates that they are active in parts of Northern and Central Europe, particularly Denmark, Germany, Austria, Switzerland, Sweden or the Netherlands. Nowhere, however, do appear to be as important as in Denmark, where they account for roughly 1/5 of total urban, private sector employment (including however, their sizeable foreign employment).

Casual observation also indicates that there are almost no industrial foundations in US with Hershey as the most notable, but rare exception. The same appears to be true in the

UK with the Welcome Trust is the rare exception to the rule before the merger with Glaxo. Fleischman (2001) related how industrial foundations were earlier common in the US, but declined in importance after a law adopted in 1969.

Obviously, anecdotal evidence is not satisfactory. We need much better information on their numbers, size distribution and economic activity, if we are to form a coherent picture of their importance and economic effects. This endeavor can therefore be identified as central task for future research.

Historical origins. Historically, foundations (or at least non-profit entities) are far older than corporations. In medieval times religious institutions like monasteries in many cases extended their research to activities which are nowadays often carried out by business companies or government organizations. These include healthcare (hospitals), social services (homes for the poor or the elderly) and universities. In a way the Catholic Church was what we would today call the public sector or the welfare state, and this “welfare state” was organized a large set of non-profit entities. Many of these institutions survived to the present day – for example the University of Oxford (organized as a set of colleges) is said to be more than 900 years old.

Timur Kuran (2010) describes how social services in Middle Eastern society were provided by foundations (waqfs), which were set up as perpetuities under Islamic law and supervised by religious officials (similar to present day trust commissioners). The supply of water, orphanages, schools and colleges was organized in this way. Since the goals were charitable the waqfs did not (and were not allowed to) maximize profits, and Kuran regards them as an impediment to the growth of corporations and thereby as a barrier to Islamic economic development.

However, what we think of today as industrial foundations apparently emerged along with companies in the second half of the 19th century (after 1850). We have case studies of some of these entities like the Carlsberg or Tata foundations which were established by inspired high-minded entrepreneurs, but we lack a systematic account of how so many companies can to be owned by foundation. We suspect that not all owners were motivated by lofty philanthropic goals and that at least some of them saw the foundation structure as a convenient way to escape wealth and succession taxes, while at the same time keeping the family in control.

Legal origins. The strong country differences in the frequency of industrial foundations suggests that they are attributable to differences in law. For example, Kronke (1988) relates how certain countries (e.g. France) prohibit foundations from commercial activities (with the Pasteur institute as an interesting borderline example).

Taxation. Fleischman (2001) suggests that differences in tax law can explain why industrial foundations are common in Germany, but virtually absent in the US. Industrial foundations were not uncommon in the US up to the 1969 laws, which effectively prevent US foundations from owning more than 20% of business companies (Fleishman, 2001, Thomsen 2006). Moreover, since a significant fraction of the largest US foundations were actually established by donations of shares, the 1969 laws appear to have impeded the creation of larger, charitable foundations.

We know that foundation laws have also changed over time in other countries so that for example in the case of Denmark industrial foundations are now taxed as corporations which was not the case prior to the 1987 tax laws (Lov, 2007). Thus it may over time have become less attractive for families to establish industrial foundations to minimize taxes. We definitely need systematic comparative legal studies as one possible explanation of the frequency, behavior and performance of industrial foundations.

To what extent, for example, can the frequency of industrial foundations be attributed to tax loopholes which allow business owners to transfer ownership to their offspring while avoiding succession duties, capital gains taxes, wealth and death taxes etc.? While such loopholes may have been closed in some countries (like Denmark), they may still be open in others. Moreover, to what extent can the good financial performance of foundation-owned companies be attributed to possible tax subsidies? From the viewpoint of economic efficiency the standard assumption would be to aim for tax neutrality of alternative ownership forms.

A related discussion concerns double taxation. As a general rule, foundations and their companies are taxed as consolidated entities. Double taxation both at the company and foundation level would make it attractive to do business directly through the foundation, but there may be social as well as private gains of allowing the formation of subsidiaries (for example to float their stock). The question is however, whether this entails an implicit tax subsidy since other owners – e.g. private stockholders - are taxed also at the ownership level. Note however, that tax neutrality would need to take into consideration tax subsidies awarded to other ownership forms, including for example tax subsidies awarded to collective pension schemes. An alternative view is that taxes must ultimately be levied on personal consumption, while foundations are self-owning entities.

Regulation. The implementation of law in terms of regulation is another issue worthy of study. Common law countries generally regulate foundations through the courts, while other countries such as Denmark have government regulatory bodies, which exercise supervision. We know too little about what countries use what systems and what consequences the choice of regulatory form has for the efficiency and behavior of industrial foundations.

Corporate Governance. Hansmann and Thomsen (2010) show that the foundation board's independence of the company has a positive effect on company performance. More independent foundation boards are in a better position to exercise active ownership, and this shows up in higher labor productivity (less excess labor) and faster dismissal of company managers following bad performance. Beyond this, we still know little about the governance of and by industrial foundations. More research on this issue is particularly interesting because the lack of pressure by outside owners means that foundation boards carry a greater responsibility for the success or failure of the foundation and its subsidiaries.

One critical issue is the age and tenure of board members. Since it may be difficult or even impossible to replace board members, one hypothesis is that replacement rates are too low, and there is not enough renewal of company boards. However, cultivating longtermism might call for long service periods. The obvious empirical research strategy is to check for empirical effects of board member age and tenure on company performance.

Another critical issue is the role of the founding family which should be important according to the family governance approach to industrial foundations. Hansmann and Thomsen (2010) find that founding family is only present in half of their population of 121 foundation-owned companies. Moreover, they find that founding family presence has no significant impact on company performance. However, the level of family involvement may vary a great deal, and more research is need as to whether family dominance can in some cases be a barrier to good performance.

Capital Structure. Theoretically, foundation ownership would be expected to influence the capital structure of companies towards lover leverage: more equity and less debt. This is because foundations do not have diversified portfolios and because the survival and welfare of the company are often explicitly or implicitly written into the foundation charter. They would therefore tend retain earnings and build reserves as. Moreover, limitations on their ability to tap stock and debts markets could higher option value of equity reserves. In contrast institutional investors hold stock in many companies and value the performance of their portfolio rather than the survival of individual firms. Thomsen (1996) finds that foundation-owned companies do in fact differ significantly from other firms by higher equity-to-assets ratios whereas they differ little from investor-owned companies with regard to other accounting ratios.

A theoretical explanation for these finding can be found in the work of Roy Radner, who explores the distinction between profit-maximizing and survival-maximizing firms, which is important since survival-maximization appears not to be a bad first-cut approximation of the goals of foundation-owned enterprises (Radner 1998). One important result of this research (Dutta and Radner 1999) is that if there are both survival maximizing and profit maximizing firms in a population of firms the proportion of profit maximizers will quickly dwindle into insignificance. Ceteris paribus profit-maximizing companies should be more profitable, build up smaller economic reserves (equity) and fail more often (Rose and Thomsen, 2004). Thus in an economy characterized by tax neutrality and equal efficiency of foundation-owned and non-foundation-owned companies, we would expect to see higher solvency rates and fewer failures (or takeovers) of foundation-owned companies. In consequence, their share of the total population of firms would be likely to increase over time, if entry rates were similar.

Foundation charters. Industrial foundations appear to a large extent to be governed by their charters. Since the charters are often publicly available, this implies a unique opportunity for research. For example, foundation charters may specific whether the company or charity is the main goal, whether or not it is permissible to sell the company, what kinds of charitable activity the foundation should engage in, who should sit on the board and so on. Since the majority of the charters were written decades ago, they are not likely to have been influenced by current conditions, and it is interesting to examine how they influence the behavior and performance of the foundations and the companies that they own.

Provisional studies by Thomsen (2011a, in Danish) indicate that charter provisions in 119 Danish industrial foundations are systematically related to company performance. However, additional work is needed to sort out the mechanisms involved. One complication is that charter changes are more common than one would assume, and we have little systematic information about the nature of the changes. They are mostly innocuous, we assume, but we also know that in some cases they are more meaningful than that. For example, the Carlsberg foundation apparently got permission by the regulator to lower its percentage ownership of Carlsberg as long as it maintains voting control. The general logic in these cases appears to have been that the foundation charters should not stand in the way of the company interest as advocated by the foundation board and/or company managers. This raises the possibility that charter changes are not exogenous to company behavior and performance. On the other hand, more fundamental charter provisions appear to be difficult to change.

Philanthropy. There is a large literature on foundations and philanthropy, but very little has so far been written on the philanthropy of industrial foundations. However, there is reason to believe that industrial foundations influence both the volume and the nature of private philanthropy.

There are indications, for example, that the combination of business and charitable goals is appealing to the entrepreneurs who typically create foundations. Following the 1969 tax reform, which separated the two goals for US foundations, the formation of new foundations therefore declined. All else equal we would therefore expect industrial foundations to have a positive effect on the volume of private philanthropy.

It is conceivable that industrial foundation will do their philanthropy different and that they will be more effective at it. Porter and Kramer (2002) argue that corporate philanthropy can benefit from focusing on areas where the company is in a unique position to identify and fill social needs. In other words, corporate philanthropy should be strategic. Porter and Kramer (2011) go on to suggest “shared value” as a socially responsible and privately profitable way of doing business, in which companies benefit by incorporate societal concerns into their strategy.

However, the combination of business and philanthropy also raises tensions. It may be, for example that the two activities require different skill sets (an argument discussed by Fleischman, 2001). There is also a risk that charitable goals are swamped by business interests. For example, company managers might prefer to retain earnings over and above what is needed to sustain and develop the business. This would then lead to lower dividends and donations than in a normal non-industrial foundation. It is even possible that charity can be manipulated to maximize business needs for marketing, public relations or employee benefits[5]. Many industrial foundations therefore insist on separating business and charity by Chinese walls.

These questions call for a research strategy which examines the volume and nature of philanthropy by foundations as a function of business ownership. At the micro level this means comparing charitable activity of foundations with and without business ownership. At the macro or country level comparative studies can examine whether private charity is reduced or enhanced by the presence of industrial foundations. Provisional studies by Rao (2012, in Danish) indicate that industrial foundations contribute greatly to private philanthropy in Denmark, and that their donations are focused on research. This seems to be consistent with the idea of industrial foundations using their business expertise to selectively invest in an area which is mutually beneficial to companies and society.

Discussion

Industrial foundations are fascinating research topic, not only because they are very important to some national economies and some very large companies, but also because the study of them can help increase our knowledge of a range of other topics such as

- The role of profit maximization, profit seeking and profit motives in modern corporations. Foundation-ownership is an interesting case of ownership by ownership without a personal profit motive. A key question is whether and when a dampened profit motive is good over bad for company performance over a broad range of private and social performance measures.
- Long vs short term ownership. Industrial foundations are by design long term owners interested in the welfare and survival of their companies. This contrasts with the shorttermism of many current stockholders who roll over their stock in weeks or even days. Foundation ownership also contrasts with profit seeking funds like hedge funds or private equity funds which have a somewhat longer, but still much shorter time horizon than foundations.
- Business and philanthropy. Corporate responsibility is built into the structure of many industrial foundations. How does this affect the behavior of the foundations and the companies that they own? It is possible that they do not differ much from other companies, but it seems equally possible that they do their business differently. If even companies which are pledged to be responsible by their charters or trust deeds turn out to behave pretty much as other companies, there is little hope for fundamental effects of paying more superficial lip service to corporate social responsibility.

At the risk of sounding overly grandiose, industrial foundations represent a different kind of capitalism than the one being modeled by current economic theories of the firm which assume profit or shareholder value maximization. In these theories the company is nothing but a money-making machine for shareholders and all its decisions and activities

[5] The tax-deductibility of foundation donations might be seen as a clever way to reduces taxes, but this is less of than issue than appears at first glance since companies could anyway deduct these investments from their taxable income.

are assumed to have only the lofty goal of enriching the shareholders, which exhibit no loyalty or preferences except to greed. Foundation-owned companies, in contrast, are governed by charters, which often obligate them to see running the business in a socially responsible way as a goal in itself rather than a means to an end.

At a lower level of abstraction, there are all the questions of how to make this alternative structure work in practice.

How, for example, and how much should it be regulated? Excessive regulation could effectively turn industrial foundations into a part of the public sector. However, foundation boards unchecked by any kind of regulation may conceivably end up indulging in self-serving behavior. A balance has to be struck.

How should industrial foundations be governed? What are the respective roles of foundation and company boards? Should the foundation board be represented in the company board and if so how? Through board overlap? Or through a foundation CEO? What are the uses and abuses of holding companies? Should foundations concentrated on a single company or extend their ownership? Can public listing of subsidiary companies help foundations govern them more effectively? These and many more questions need to be addressed in practice and would benefit from systematic research.

The behavioral rules for foundation-owned companies are also likely to differ from those of textbook finance or management. What should for example be the dividend policy of a foundation-owned company? How, exactly, should the two goals of the business and charity be reconciled. Company managers will generally prefer to reinvest their earnings, so when should the foundation ask for dividends? Industrial foundations grappling with these problems are likely to come up with heuristics that can be examined and perhaps validated by academic research.

In the same way, manager of foundation-owned company must grapple with reconciling charitable and business goals. For example, can they effectively translate corporate responsibility into life time employment? Should they avoid doing business in emerging economies because this raises difficult ethical issues? Should a foundation-owned company necessarily seek to minimize taxes? These and many other related questions are calling for answers.

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