

Foundation Control and Investment Performance: Do Intrinsic Aspects Of Ownership and Control Matter?

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This paper investigates the relevance of intrinsic motives in the value-enhancing monitoring role of large shareholders. A standard view in the corporate governance literature is that the large shareholder monitors management precisely because of personal financial interests. This paper argues that the exclusive focus on extrinsic considerations sidesteps the intrinsic motives of the large shareholder to minimize managerial opportunism and inefficiency. The paper sheds light on the importance of the intrinsic aspects of firm ownership and control by examining the relative investment performance of foundation controlled firms listed on the Stockholm Stock Exchange during 1999-2005. Foundations are not-for-profit organizations with no residual claimants and thus largely lack the personal financial motives to monitor management. The empirical analysis is carried out in the framework of the marginal q methodology. The results suggest that whereas the typical firm in the sample overinvests, the extent of overinvestment is significantly lower in firms with at least one large shareholder. More importantly, the results suggest that even though foundations largely lack the residual claimants and, hence, the personal financial interest, they are as efficient as other large shareholders in curbing managerial opportunism. This finding is consistent with the view that large shareholders are not only actuated by extrinsic motives to minimize managerial opportunism and inefficiency. Intrinsic motives matter.

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1. Introduction

How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of other, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.
Adam Smith (1853, p.3)

A fact is never exclusively or purely economic; other – and often more important – aspects always exist.
Schumpeter (1934, p. 3)

The corporate governance literature suggests that the monitoring role of the large shareholder is important in curbing potential managerial opportunism and inefficiency. The mainstream agency theory implies that large shareholders monitor management because of their personal financial interest in the firm (Burkart, Groom & Panunzi 1997; Shleifer & Vishny 1986). However, this standard focus solely on the *extrinsic* motives of large shareholders sidesteps non-financial or *intrinsic* aspects of firm ownership and control and how intrinsic considerations could motivate large

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shareholders to monitor management. This paper is focused on the intrinsic motives of large shareholders to improve the firm's investment performance.

Whereas a textbook treatment of economic behaviour barely acknowledges the role of intrinsic considerations, the opening quotations above illustrate that intrinsic motives are not alien to economists. Indeed, economists such as Akerlof and Kranton (2005), Basu (2011), Becker (1991 & 1992), McCloskey (2010) and Sen (1977 & 1985) discuss at length the importance of intrinsic motives in economic behaviour. The subject is also examined extensively in the family business and the management literature (Davis, Schoorman & Donaldson 1997; Le Breton-Miller & Miller 2009; Sharma & Irving 2005). One of the main insights from these studies is that socially embedded managers are intrinsically motivated to eschew opportunistic behaviour.

This paper examines the relevance of intrinsic motives in the value-enhancing monitoring role of large shareholders. The focus is on a special type of large shareholder – *foundations*. A foundation is a *self-owning* and *not-for-profit* organization whose aim is to serve some broadly defined social purpose such as the provision of education, health, research, disaster relief and other charitable services. Foundations are governed by non-distributive constraints (Hansmann 1980 & 1987; Steinberg & Powell 2006). These constraints largely separate the personal financial interests of the founding family from the financial affairs of the foundation. As a result, foundations lack residual claimants and are therefore unlikely to be driven principally by personal financial interests to monitor management (Thomsen 1999).

The lack of residual claimants suggests that if personal financial interests of the residual claimants are the sole motive of the large shareholder to monitor management, the presence of a foundation as the largest shareholder could not rein in managerial opportunism. *Foundation-controlled* firms will be subject to a similar degree of managerial opportunism and inefficiency as is prevalent in *dispersedly-owned* firms. As a result, the investment performance of foundation-controlled firms will be statistically similar to those of dispersedly-owned firms. However, if non-financial aspects of ownership and control do drive large shareholders to monitor management, we should observe a superior performance of foundation-controlled firms relative to dispersedly-owned firms. The empirical strategy, therefore, is to investigate the relative investment performance of firms in which the largest shareholder is a foundation.

This paper contributes to the discourse on what drives a large shareholder to minimize managerial opportunism and inefficiency. The standard agency based view as reflected in the works of Cronqvist & Fahlenbrach (2009), and Shleifer & Vishny (1986), is that the large shareholder is extrinsically actuated by personal financial interests. This study extends on this view by demonstrating that intrinsic considerations are also at play. The second contribution of this paper is that it adds to the virtually non-existence empirical studies into the effect of foundation control on the performance of listed firms. Thomsen & Rose (2004)² appear to be the only other study that examines the financial performance of foundation-controlled listed firms. They find that among the firms listed on the Copenhagen Stock Exchange during 1996-1999, foundation-controlled firms "... are at least as efficient as the other listed companies..." (p.343). This paper extends on the pioneering work of Thomsen & Rose (2004). It is noted that non-foundation-controlled firms (i.e., "other listed companies") is a mixed bag of dispersedly-owned firms and firms with at least one

large shareholder. Accordingly, the current study decomposed the sample into foundation-, family-, institution-, and dispersedly-owned firms.

The third feature of this paper is that it departs from the traditional average measures of investment performance like the Tobin's q . In a standard neoclassical model with convex installation costs, optimality requires that the firm invests up to the point where marginal q equals one. Most of the existing empirical studies utilize the Tobin's q as a proxy for the marginal q (Thomsen & Rose 2004; Villalonga & Amit 2006). However Hayashi (1982) shows that the Tobin's q is an appropriate proxy for the marginal q only when the firm's technology exhibits constant returns to scale in both production and installation. Following Bjuggren & Palmberg (2010) and Gugler, Muller & Yurtoglu (2008), among others, this paper adopts Mueller and Reardon's (1993) marginal q methodology which does not require these restrictive assumptions.

The marginal q estimates underscore the value enhancing effect of the large shareholder. The empirical results show that the representative firm in the sample overinvests. However, the extent of overinvestment is significantly less pronounced in firms with at least one large shareholder. Despite the fact that foundations lack residual claimants and, hence, the personal financial interests, the estimates suggest they are as efficient monitors as block-holding families and institutions. Specifically, the results show that foundation-controlled firms outperform dispersedly-owned firms significantly. Moreover, the performance of foundation-controlled firms is marginally above institution-controlled firms and slightly below family-controlled firms.

The rest of the paper is organized as follows. The next section reviews the theoretical underpinnings of the role of the large shareholder in the performance of the firm. It starts with a discussion of the standard agency based view. This is followed by a discussion of the importance of intrinsic considerations in the context of social embeddedness. The third section is devoted to methodological issues. The empirical results are presented in section four. The fifth section discusses the results in relation to intrinsic incentives and potential alternative corporate governance mechanisms. The final section gives the concluding remarks.

2. Theoretical Framework

An essential element of the view that the firm is a nexus of contracts is that these contracts are inherently incomplete. This stems from the fact that not all future outcomes could be foreseen and described in a manner that spells out the rights and obligations in all states of the world (Martimort, Poudou & Sand-Zantman 2010). The incomplete nature of contracts leaves the question of how to assign discretionary rights open. Easterbrook & Fischel (1983, p.403) argue that "[a]s the residual claimants, the shareholders are the group with the appropriate incentives ...to make discretionary decisions". However, having the right to make discretionary decisions is only one side of the equation. Equally important is the need to make informed and value enhancing decisions. Moreover, collective choice problems can be overwhelming. Consequently, shareholders often delegate many discretionary decisions to management.

2.1 The Role of Personal Financial Incentive – The Standard Agency View

Delegation however entails conflicts of interests. The premise is "... because people pursue their own best interests, conflicts of interests inevitably arise over at least

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some issues when they engage in cooperative endeavors” (Jensen 1994, p.41). For instance, the object of shareholders is to maximize net worth of the firm (Shleifer & Vishny 1997). Nevertheless, studies show that net worth maximization is hardly the prime object of corporate managers (Burrough & Helyar 1990; Grabowski & Mueller 1972). There are thus good reasons to suggest that corporate managers will not always invest optimally.

In principle, shareholders could monitor management to ensure that mainly value enhancing investment projects are undertaken. However, monitoring is costly. Focusing on personal financial gains for a moment, an individual shareholder’s utility from monitoring $U(m)$ can be represented as the personal financial gains attributable to monitoring $\alpha V(m)$ less the cost of monitoring $c(m)$:

$$U(m) = \alpha V(m) - c(m) \quad c(0) = 0 \quad 0 < \alpha < 1 \quad (1)$$

where α is the fraction of outstanding shares owned by the individual shareholder, m denotes her monitoring effort and V represents firm value. For ease of exposition, we assume an all equity firm with one-share-one-vote. Furthermore, we assume that $V(m)$ increases at a decreasing rate with monitoring effort, whereas $c(m)$ increases at

an increasing rate such that:
$$\lim_{m \rightarrow \infty} \left\{ \frac{\partial u}{\partial m} \right\} < 0 \quad (2)$$

Equation (2) is a regularity condition to ensure that the “optimal” monitoring effort is finite. In addition, equation (2) captures the idea that monitoring and the associated reduction in managerial discretion is not “purely beneficial” (Burkart, Gromb & Panunzi 1997, p.693) and cannot therefore be infinite. In this setup, the individual utility maximizing shareholder weighs the personal financial gains from monitoring management against the associated cost. For each individual shareholder, who cares exclusively about personal financial gains, monitoring is worthwhile if:

$$\alpha \frac{\partial V}{\partial m} \geq \frac{\partial c}{\partial m} \quad (3)$$

This implies that for sufficiently low values of α , the individual shareholder may not find it worthwhile to absorb the associated costs of monitoring. In addition, there is a potential collective action problem among dispersed shareholders. This occurs because when $m_i = 0$, $c(m_i = 0) = 0$ correspondingly, but so as long as $m_{j \neq i} > 0$, $\alpha V(0) > 0$. This is an indication that a small shareholder i may opt to free ride on the monitoring effort of other shareholders. However if it is in the interest of an individual small financial stakeholder to free ride, rationality suggests that the other dispersed shareholders will act in the same manner. Thus, sufficiently low values of α can create perverse incentive problems on the part of shareholders to monitor management. Along these premises, Shleifer & Vishny (1986) argue that the presence of a large shareholder resolves the incentive problems that hinder effective monitoring of management. The sizeable personal financial stake, it is argued, makes it worthwhile for the large shareholder to bear the monitoring costs. Moreover, the large shareholder has the control (sufficient votes) to discipline ineffective managers (Tirole 2006). One implication of the discussion so far is that once we abstract from the personal financial gains of the large shareholder, it is not worth her while to monitor management.

2.2 Role of Intrinsic Motives

The claim of this paper is that it is unlikely that the large shareholder is motivated solely by the increased personal financial gains (αV) to monitor management. Take the case of foundations, which control non-trivial fractions of firms listed across Northern European stock exchanges (Thomsen & Rose 2004). These foundations are *self-owning* and *not-for-profit* organizations. In the parlance of corporate governance, foundations do not have shareholders and thus lack residual claimants (Thomsen 1999). They are barred from distributing net-earnings, if any, to individuals who exercise control over the affairs of the foundation (Hansmann, 1980&1987; Steinberg & Powell 2006). In Sweden, for example, foundations are required to distribute no less than 80 percent of their net earnings over five years to charity and/or research (Wijkström & Einarsson 2004). These non-distributive constraints largely separate the personal financial interest of the founding family from the financial outlook of the foundation. Therefore, if the individuals who control the affairs of the foundation are actuated exclusively by personal financial gains, foundation-controlled firms will be under-monitored. As a result, the investment performance of foundation-controlled firms will be significantly worse relative to firms with, say, family block-holders.

However, reasons of purely personal financial gains can hardly explain why a capitalist of Warren Buffett's stature and industrialists of the Wallenbergs' standing pledge their corporate financial wealth to charity or a foundation³. It is quite doubtful that the founder of a foundation or his family derives no intrinsic utility from the social goods to which the net earnings of the foundation are put. The very existence of foundations and other avenues of charity should alert us that beyond extrinsic considerations, human behaviour is driven by "... a much richer set of values and preferences" (Becker 1992, p. 1). Their existence and operations also signal that the textbook treatment of economic behaviour as *self-centred welfare* maximizing, *self-welfare goal* seeking and *self-goal choice* making (see Sen 1985 on the three types of "privateness") is inherently incomplete. As the opening quotations from Adam Smith (1853, p.3) and Schumpeter (1934, p. 3) demonstrate, intrinsic motives are integral aspect of economic behaviour.

Arkerlof & Kranton (2005), Basu (2011), Becker (1991), McCloskey (2010), and Sen (1977), among others, elucidate similar insights. Outside economics, the role of intrinsic considerations is examined extensively in the management literature (Davis, Schoorman & Donaldson 1997), family business studies (Le Breton-Miller & Miller 2009; Sharma & Irving 2005), and the social embeddedness literature (Granovetter 2005). For instance, Becker (1991) discusses the role of *familial altruism* extensively. Sen (1977) casts intrinsic considerations in terms of *sympathetic* and *commitment* concerns. Sympathetic concerns for others, a course, a mission, or the firm directly affects one's own utility such as feeling depressed, angered, dismayed or helpless at the sight of misery, the news of natural disaster in a distant land or managerial opportunism. Sen's conception of commitment⁴ on the other hand "involves choosing an action that yields a lower expected welfare than an alternative available action" (1977, p.328). Unlike sympathetic concern, where one's utility depends psychologically on the wellbeing of others, commitment depends on emotional attachment and/or identity with the mission, values and the legacies of, say, the foundation and/or the firm.

Arkerlof & Kranton (2005, p. 10) posit that identity – a person’s self-image as an individual and as a part of a group – is “a missing motivation in economists’ current depiction of organizations”. Arkerlof & Kranton (2005) incorporate identity into the standard principal-agency relationship. They demonstrate that the extent to which the agent and the principal identify with the organization, its missions, tradition and values have an impact on the agency relationship and the costs thereof. Arkerlof & Kranton’s (2005) approach is related to attempts in the family business literature to reconcile⁵the agency and the stewardship theories (Davis, Schoorman, & Donaldson 1997; Miller & Le Breton-Miller 2006; Vallejo 2009).

The foregoing suggests that considerations beyond personal financial gains are potential elements of the large shareholder’s incentive to monitor management. On the back of this, equation (1) above is augmented to accommodate intrinsic considerations $s(V)$ of the shareholder. We assume that intrinsic considerations increase with firm value attributable to monitoring such that:

$$U(m) = \alpha V(m) + \beta s(V) - c(m) \quad c(0) = 0 \quad 0 < \alpha < 1 \quad \frac{\beta \partial s}{\partial V} \frac{\partial V}{\partial m} \geq 0 \quad (4)$$

where β measures the weight of intrinsic considerations in the shareholder’s net utility from monitoring. Equation (4) suggests that even if personal financial gains from monitoring approaches zero, monitoring may still occur so long as $\frac{\beta \partial s}{\partial V} \frac{\partial V}{\partial m} \geq \frac{\partial c}{\partial m}$. The next subsection discusses how β varies across shareholders.

2.3 Intrinsic Motives in the Context of Social Embeddedness

A way to think about how intrinsic considerations vary across different categories of shareholders is the concept of social embeddedness (Granovetter 2005). It links intrinsic considerations to the “internalized set of behavioural expectations associated with [the monitoring] role” (Shepherd & Haynie 2009, p.1246) and the social rewards/punishments it entails (Granovetter 2005). It suggests that the shareholder’s intrinsic motive to monitor management increases with her social embeddedness.

The family as a large shareholder provides a benchmark case where β is sufficiently large. Unlike an anonymous shareholder – say, a small shareholder or a mutual fund – the controlling family is active and visible (Brundin, Florin-Samuelsson & Melin 2008) in society. Certainly, the family cares about its personal financial stake in the firm. In addition, the family is also interested in the internalized set of behavioural expectations of the “monitoring role” and the social rewards/punishments associated with it. To the family, the firm is not merely a vehicle to rake in personal financial gains. The firm is also the legacy of the family; a platform upon which the family projects itself to the larger society; and a window through which society sees the family and its contribution to the society. Consequently, the reputation and emotional welfare of the family are tied to societal perceptions engendered by the firm’s behaviour and success (Zellweger & Astrachan 2008). Hence, besides extrinsic motives, the family as a large shareholder is intrinsically motivated to monitor the management and use its control to discipline inefficient management.

In connection with the foundation, it is worth noting that even though the foundation is a self-owning organization *de jure*, society identifies it mostly with the founder and

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her family. The reputation and the legacy of the founding family are tied to the foundation and the corporation(s) it controls. For instance, the typical foundation bears either the name of the founder or the mission of the foundation. Furthermore, the internal agents of the foundation are often the founder, members of her family and/or people who are visible in society and are perceived as dedicated to the mission of the foundation (Wijkström & Einarsson 2004).

Within the social context, the foundation and the firm(s) it control are social ventures for which the founder and her family are the sole “social residual” claimants. When the foundation fails to preserve the firm and generate the necessary funding for its social programs, the ramifications extend beyond the firm and the foundation. Hence, despite the non-distributive constraint which largely removes the extrinsic (personal financial) motives, the internal agents of the foundation, the founder and her family are driven by the social dimensions of their role to care about the performance of the firm. These suggest β is sufficiently large concerning the intrinsic incentives of foundations to monitor management.

In contrast, the typical pensioner and those who control the affairs of the pension fund are generally anonymous in their “role” as the largest shareholder of the firm. The pensioner and his agents (managers of the pension fund) hardly identify themselves with the firm. In addition, society does not identify them with the firm either. They are thus not socially embedded in the societal expectations of their role as a large shareholder and the social rewards/punishments associated with it. Relative to the family and the foundation, their primary concern is the personal financial returns to the residual claimant. The success or failure of the firm entails close to no further implications for the institution (and its internal agents) beyond the financial stake in the firm. In these respects, the role of the large shareholder as discussed by Shleifer & Vishny (1986) is more or less representative of a large institutional shareholder such as the pension fund. In other words, β is sufficiently close to zero with respect to institutional owners.

Figure 1 summarizes the implications of the discussion thus far. It is drawn under the assumption that β is binary. The figure shows that the presence of a large shareholder induces improved investment performance along two-dimensions. Improvements attributable to extrinsic (personal financial) considerations are represented on the vertical axis under the caption “Extrinsic Motives”. Under this caption, family- and institution-controlled firms are placed within the *High* performance quadrants whereas foundation-controlled and dispersedly-owned firms are positioned in the *Low* performance quadrants. The placement of firms along the vertical axis is consistent with the standard agency based view of the role of the large shareholder as discussed in Shleifer & Vishny (1986) and the large number of empirical studies which employ the agency view to examine the role of the large shareholder. It reflects the fact that the foundation lacks residual claimants and, hence, the personal financial interest to monitor management. It also suggests that if incentives to personal financial gains are the sole consideration of the large shareholder, performance of foundation-controlled firms will be statistically indistinguishable from those of dispersedly-owned firms – both will be subject to severe managerial opportunism.

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		Intrinsic Motives	
		<i>Low</i>	<i>High</i>
Extrinsic Motives	<i>High</i>	Institution- Controlled Firms	Family- Controlled Firms
	<i>Low</i>	Dispersedly- Owned Firms	Foundation- Controlled Firms

Figure 1: Extrinsic and Intrinsic Motives of the Large Shareholder

Improvements in firm performance that could be credited to intrinsic considerations are measured on the horizontal axis under the heading “Intrinsic Motives”. Along this axis, institution-controlled and dispersedly-owned firms are within the *Low* performance quadrants. Their placement mirrors the lack of intrinsic motives to monitor management. Family- and foundation-controlled firms are placed in the *High* performance quadrants. This reflects the intrinsic incentive of the founder, the family and those who run the foundation to nudge management towards improved investment performance. Based on the framework outlined above, the following hypotheses are tested below.

Hypothesis 1: *Foundation-controlled firms exhibit superior investment performance relative to dispersedly-owned firms.*

Hypothesis2: *Foundation-controlled firms exhibit par investment performance relative to institutional-controlled firms.*

Hypothesis 3: *Foundation-controlled firms exhibit under par investment performance relative to family-controlled firms.*

3. Data and Method

3.1 The Sample

These hypotheses are tested on a sample of firms listed on the Stockholm Stock Exchange during 1999-2005. The sample comprises an unbalanced panel of 182 firms. Firms in the financial sector are excluded because they exhibit different capital and investment structure (Gugler, Mueller & Yurtoglu 2004). Firms with less than three consecutive years of observations are also excluded for computational reasons. Further one year per firm is lost due to the computation of the change in market value – the dependent variable. This leaves us with a final sample of 1026 firm-year observations.

The financial data were obtained from the Standard & Poors’ Compustat Global. The ownership data were collected from the Owners and Power in Sweden’s Listed Companies database, which covers all firms listed on the Stockholm Stock Exchange. This database provides comprehensive data on the ownership and voting rights of closely connected owners like members of a family, foundations and institutions such as pension funds. A useful feature of this database is that it traces the ownership and voting rights to the ultimate shareholder.

3.2 Definition of Ownership Categories

The extant research has no universal definition of the categories of firms in the sample. The family business literature suggests that the definition of a *family firm* is coined around ownership rights, voting rights, employment, owner-management, generational transfer (actual or intended), and multiple criteria (inclusive and exclusive) (Miller & Le Breton-Miller 2006). With almost no exception, the various definitions seem to gauge the degree of influence the controlling owner has on the firm. Accordingly, this paper considers a firm as a *family-controlled*, *foundation-controlled*, *institution-controlled* or *dispersedly-owned* (managerial-controlled) if the firm is *significantly influenced* by a family, a foundation, an institution or management, respectively. La Porta, Lopez-de-Silanes & Shleifer (1999) argue that the family could exert significant influence over the firm with thresholds of 10 or 20 percent of the voting rights. Following the previous studies on Swedish listed firms (e.g., Bjuggren, Eklund & Wiberg 2007; Bjuggren & Palmberg 2010), this paper adopts the 20 percent threshold. Thus, in the empirical analysis, a firm is classified as a family-, foundation- or institution-controlled firm if the said entity is the largest controlling owner with at least 20 percent of the voting rights. Firms with no block holder are classified as dispersedly-owned firms.

3.3 The Marginal q

This subsection describes the method employed to estimate the relative investment performance of the various categories of firms. In standard neoclassical models, optimality requires that the firm invests up to a point where the ratio of the market value of *marginal* investment to its replacement cost equals one. More intuitively, the stream of returns to the latest investment must at least equal the relevant cost. Most of the existing empirical studies utilize average measures of firm performance such as the Tobin's q , Return on Assets (ROA) and Returns on Equity (ROE) (Cronqvist & Fahlenbrach 2009; Thomsen & Rose 2004; Villalonga & Amit 2006). As long as average returns do not deviate systematically from marginal returns, these proxies can be good measures of investment performance. However, Hayashi (1982) shows that average returns approximate marginal returns to investment only in very restrictive settings. For instance, it requires the firm to have no market power and to exhibit constant returns to scale in both production and installation. These conditions are hardly met in the corporate world. In general, average measures of investment performance tend to confound the returns to total assets and the returns to the marginal investment (Gugler et al. 2004). In such cases, managerial opportunism of the empire building character (Grabowski & Mueller 1972; Jensen & Meckling 1976) could escape scrutiny.

In this paper, we are interested in how the presence of a large shareholder could minimize these forms of managerial opportunism. It is, therefore, imperative that we employ a measure of investment performance that does not confound marginal returns with returns to the accumulated assets of the firm. The marginal q methodology a la Mueller & Reardon (1993) is attractive in this regard. An added advantage of the marginal q methodology is that it obviates the usual problem of endogeneity emanating from omitted variable bias and/or reverse causality (Gugler et al. 2004; Gugler & Yurtoglu 2003). These features make the marginal q the preferred measure of investment performance in a number recent studies (e.g., Bjuggren & Palmberg 2010; Bjuggren & Wiberg 2008; Gugler et al. 2008, 2007).

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The main thrust of the marginal q , is the usual notion that a profitable investment opportunity should generate a stream of returns that at least equals the cost of investment. A convenient way to derive the marginal q whilst keeping down on the algebra is to cast it in terms of the Tobin's q . This approach also helps to hint the relationship between the Tobin's q and the marginal q methodology.

The Tobin's q is defined as:
$$\text{Tobin's } q = \frac{M_t}{K_t} \quad (5)$$

where M_t is the firm's market value at time t and K_t denotes the replacement cost of capital at time t . The first derivative of equation (1) with respect to time yields the marginal q , q_m :
$$q_m : q_m = \frac{d(\text{Tobin's } q)}{dt} = \frac{d(M_t)}{d(K_t)} \quad (6)$$

which, in discrete time, measures how the market value changes, ΔM_t in response to adjustment to the capital stock ΔK_t :

$$q_m = \frac{\Delta M_t}{\Delta K_t} = \frac{M_t - M_{t-1} - \delta_t M_{t-1} - \varepsilon_t M_{t-1}}{I_t} \quad (7)$$

where δ captures the rate of systematic changes in market value (e.g. depreciation rate) which is not associated with investment, and ε_t denotes how the market in time t updates expectations. In accordance with standard neoclassical models of investment efficiency, the optimal value of q_m is one (Hayashi, 1982). A marginal q less than one is a sign of overinvestment (Gugler et al. 2004; Gugler & Yurtoglu 2003; Mueller & Reardon 1993).

3.4 Empirical Specification and the Variables

To estimate the investment performance of the typical firm in the sample, equation (7) is re-arranged so that market value growth of firm i between time t and $t-1$, is expressed in terms of investment:
$$\frac{M_{it} - M_{it-1}}{M_{it-1}} = \bar{\delta} + q_m \frac{I_{it}}{M_{it-1}} + u_{it} \quad (8)$$

where $\bar{\delta}$ is the common intercept, and u_{it} is decomposable into time, firm/industry fixed/random effects and the stochastic disturbance term with the usual characteristics.

Equation (8) is the benchmark specification where $(M_{it} - M_{it-1}/M_{it-1})$ is the dependent variable and (I_{it}/M_{it-1}) is the main covariate. When the typical firm invests efficiently, the estimated q_m should not be less than one; otherwise, the firm is overinvesting (Bjuggren & Palmberg 2010; Gugler et al. 2008). Estimated marginal q within the zero and one range indicates that the corresponding investment increases market value yet it is not efficient. It is indicative of the kind of overinvestment which characterizes corporate empire builders (Grabowski & Mueller 1972).

To examine how the presence of a large shareholder ameliorates these kinds of overinvestment, we augment equation (8) with interaction terms between (I_{it}/M_{it-1}) and an indicator variable each for the relevant categories of large shareholders. The extensive specification is (see Table 3):

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$$\frac{M_{it} - M_{it-1}}{M_{it-1}} = \bar{\delta} + \beta_1 \frac{I_{it}}{M_{it-1}} + \beta_2 \frac{I_{it}}{M_{it-1}} * Foundation + \beta_3 \frac{I_{it}}{M_{it-1}} * Family + \beta_4 \frac{I_{it}}{M_{it-1}} * Institution + X_{it}'\beta_5 + \varepsilon_{it} \quad (9)$$

where *Foundation* is a dummy variable which takes a value of one when the firm is foundation-controlled and zero otherwise; *Family* is an indicator variable representing family-controlled firms; and *Institution* pertains to institution-controlled firms; and X_{it} is a vector of control variables such as firm *Size*, *Age* and *Excess Vote*. Table 1 describes the variables used in the regression analysis.

Table 1: Description of Variables

Variables	Description
(Mt-Mt-1)/ Mt-1	Growth in Market value.
It/Mt-1	Investment as a share of the preceding period's market value.
(It/Mt-1)*Large	An interaction term between It/Mt-1 and an indicator variable which equal one if a large shareholder is present and zero otherwise.
(It/Mt-1)*Foundation	An interaction term between It/Mt-1 and an indicator variable which equal one if the large shareholder is a foundation and zero otherwise.
(It/Mt-1)*Family	An interaction term between It/Mt-1 and an indicator variable which equal one if the large shareholder is a family and zero otherwise.
(It/Mt-1)*Institution	An interaction term between It/Mt-1 and an indicator variable which equal one if the large shareholder is an institution and zero otherwise.
Excess Vote	The percentage of voting rights over and above the capital stake.
Size	The log of firm's sales at the end of initial period (1999).
Age	The number of years the firm has been listed on the Stockholm Stock Exchange.
<i>where:</i>	
M_t	The total value of the outstanding shares plus total debt at time t.
M_{t-1}	The total value of the outstanding shares plus total debt at time t-1.
I_t	The sum of after tax profit, depreciation, R&D, advertisement expenditure, change in total debt, and change in equity less the total value of dividends paid to shareholders.

In this set up, β_1 represents the marginal q of dispersedly-owned firms; $\beta_1 + \beta_2$ is the marginal q for firms whose largest shareholder is a foundation; $\beta_1 + \beta_3$ denotes the investment performance of family-controlled firms; and $\beta_1 + \beta_4$ for the institution-controlled firms. In accordance with the hypothesis 1, we expect $\beta_2 > 0$. Hypothesis 2 implies $\beta_2 = \beta_4$, and $\beta_2 < \beta_3$ is consistent with hypothesis 3.

The operationalization of the dependent variable and relevant explanatory variables is similar to the previous studies that adopt the marginal q methodology (Bjuggren & Palmberg 2010). The dependent variable is market value growth $(M_{it} - M_{it-1}/M_{it-1})$ of

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firm i at time t . It measures the stock market valuation of the firm. The primary explanatory variable in the marginal q analysis is *investment intensity* (I_{it}/M_{it-1}). Investment is defined to encompass both tangible and intangible investment. It also takes into consideration investment outlays funded by both return earnings as well as new equity and new debt. Following previous studies (e.g., Gugler et al. 2008), investment of firm i at time t is defined as:

$$I_{it} = \text{after tax profit} + \text{Depreciation} - \text{Dividends} + \text{change in Equity} + \text{change in Debt} + \text{Advertisement expenditure} + \text{R \& D expenditure}$$

4. Empirical Results

4.1 Descriptive Statistics

The ownership characteristics of the firms in the sample are reported in *Panel A* of Table 2 below. The categorization of the firms into family-, foundation-, institutional-controlled and dispersedly-owned firms follows the definitions detailed above.

Table 2: Ownership and Financial Statistics

Variables	Statistics	All Firms	Family-controlled	Foundation-controlled	Institution-controlled	Dispersedly-controlled
Panel A: Ownership Structure						
Cash Flow Right	<i>Mean</i>	22.84	30.28	23.99	29.11	10.80
	<i>Median</i>	18.70	28.30	23.60	28.70	10.65
	<i>Std. Dev</i>	14.74	15.15	12.75	34.14	4.18
Voting Right	<i>Mean</i>	32.13	43.72	44.24	34.14	12.11
	<i>Median</i>	28.15	39.90	40.20	31.50	11.95
	<i>Std. Dev</i>	20.43	17.83	17.72	12.17	4.92
Excess Vote	<i>Mean</i>	16.58	18.87	22.81	13.07	4.18
	<i>Median</i>	15.7	20.1	23.2	15	3.2
	<i>Std. Dev</i>	12.51	11.26	11.79	13.49	6.36
Dual Class Shares	<i>Mean</i>	0.57	0.71	0.89	0.39	0.31
	<i>Median</i>	1	1	1	0	0
	<i>Std. Dev</i>	0.50	0.45	0.32	0.49	0.46
Panel B: Financial Statistics						
$(M_{it} - M_{it-1})/M_{it-1}$	<i>Mean</i>	0.25	0.23	0.26	0.27	0.25
	<i>Median</i>	0.12	0.09	0.14	0.09	0.10
	<i>Std. Dev</i>	0.77	0.70	0.72	0.90	0.81
(I_{it}/M_{it-1})	<i>Mean</i>	0.33	0.42	0.31	0.37	0.29
	<i>Median</i>	0.23	0.34	0.19	0.30	0.19
	<i>Std. Dev</i>	0.48	0.44	0.47	0.45	0.52

Table 2 reports that about 13 percent of the sample could be classified as foundations firm-years and about one-third of the observations represent dispersedly-

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owned firms. Family-controlled firms, with about 43 percent of the firm-years, constitute the largest category of the sample. The smallest group of firms in the sample is the institution-controlled firms with a little over 11 percent of the firm-years. These figures underscore the prevalence of concentrated ownership in Sweden. Specifically, we could infer that in 67 percent of the sample, the largest owner controls no less than 20 percent of the voting rights. The mean (median) vote controlled by the largest owner is 32 percent (28 percent).

Previous studies of ownership structure in Sweden suggest that a significant proportion of the voting rights are attributed to control enhancing mechanisms such as dual class shares (Bjuggren & Palmberg 2010; Cronqvist & Nilson 2003). Table 2 concurs with these studies. It shows that about 57 percent of the firms in the sample issue dual classes of share with average excess vote of 17 percent. Table 2 also shows that whereas vote differentiation is pervasive across all firm categories, the degree of excess voting right is more pronounced in foundation-controlled and family-controlled firms. A number of studies show that vote differentiation has an adverse impact on the investment performance of firms listed on the Stockholm Stock Exchange (Bjuggren, Eklund & Wiberg 2007; Cronqvist & Nilson 2003). Hence, in the regression analysis we control for excess votes in all the specifications.

Panel B of Table 2 presents the summary statistics on change in market valuation and investment as a share of market value. It could be seen from Table 2 that the typical firm invests about one-third of its market value. The associated increase in market value is one-fourth. A priori, we would expect that when a firm undertakes a value maximizing investment the impact will be reflected positively on the firm's market value. The data do not seem to be consistent with this expectation with respect to the various ownership categories and their respective returns to investment. For example, foundation-controlled firms invest over 40 percent of the previous market value. The associated increase in market value is only 23 percent. Meanwhile, the 37 percent investment intensity of institution-controlled firms is associated with just under one-third increase in market value.

What is evident from the descriptive statistics is that none of the firm categories record improvements in market valuation that mirrors their respective investment expenditure. The typical firm in the sample invests one-third of the market value. However, the associated increase in market value is only one-fourth. A preliminary interpretation of this disparity is that the market expects, on the average, the undertaken investment to yield streams of returns that falls short of the costs of the said investment. As pointed out in Bjuggren & Wiberg (2008), changes in market valuation cannot be explained solely by fundamentals such as investment intensity. They find that in addition to the fundamentals and the economy-wide effects, industry specific effects explain significant changes in market value.

4.2 Regression Results

The regression analyses control for both industry⁶ and time specific effects in all the specification. We also control for such fundamentals as excess voting rights (*Excess Vote*), the log of firm's sales at the end of 1999 (*Size*) and the number of years the firm listed on the stock exchange (*Age*). The results are summarized in Table 3. We begin by estimating a benchmark specification. The idea is to obtain the marginal investment efficiency of the average firm listed on the Stockholm Stock Exchange during the study period. The results of the base-line specification are reported in

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Column I of Table 3. In Column II, an interaction term between the large shareholder and investment is introduced. Columns III and IV report the estimates involving foundation control firms.

Table 3: Large Shareholding and Firm Performance

	<i>Dependent Variable: (Mt-Mt-1)/Mt-1</i>			
	I	II	III	IV
<i>(It/Mt-1)</i>	0.743*** (15.890)	0.508*** (7.286)	0.725*** (14.728)	0.509*** (6.929)
<i>(It/Mt-1)*Large</i>		0.360*** (4.501)		
<i>(It/Mt-1)*Foundation</i>			0.131 (1.191)	0.340*** (4.749)
<i>(It/Mt-1)*Family</i>				0.387*** (3.439)
<i>(It/Mt-1)*Institution</i>				0.322*** (3.197)
<i>Excess Vote</i>	-0.001 (-0.786)	-0.003 (-1.629)	-0.002 (-1.034)	-0.003* (-1.718)
<i>Size</i>	-0.053*** (-4.556)	-0.062*** (-5.232)	-0.055*** (-4.644)	-0.062*** (-5.283)
<i>Age</i>	0.005 (0.129)	0.003 (0.084)	0.000 (0.008)	0.000 (0.009)
<i>Constant</i>	0.322** (1.996)	0.405** (2.521)	0.360** (2.190)	0.426*** (2.615)
Industry & Time Effects	Yes	Yes	Yes	Yes
No. of Obs.	1 026	1 026	1 026	1 026
Adj. R-Square	0.3232	0.3369	0.3234	0.3397
F-Value	11.845	12.255	11.623	11.927

note: *** p<0.01. ** p<0.05. * p<0.1

The empirical results show that the presence of a foundation as the largest shareholder improves investment performance significantly relative to dispersedly-owned firms. However, the investment performance of foundation-controlled firms is statistically indistinguishable from those of institution-controlled and family-controlled firms. The empirical findings are consistent with the claim of this paper that large shareholders are actuated by extrinsic as well as intrinsic consideration to monitor management productively. The results reported in Table 3 underscore the value enhancing effects of the presence of the large shareholder. It indicates that whereas the typical firm in the sample over-invests, the level of over-investment is significantly lower in firms with at least one large shareholder. In line with hypothesis 1, foundation-controlled firms outperform dispersedly-owned firms both in statistical and financial senses. The estimates also indicate that foundation-controlled firms are slightly more efficient than institutional-controlled firm. However, the difference in the investment performance between foundation- and institutional-controlled firms is statistically insignificant, as stipulated by hypothesis 2. In accordance with hypothesis 3, the investment performance of family-controlled firms is marginally above foundation-controlled firms, though the difference is statistically insignificant.

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The estimates of the base-line model in Column I indicate that the representative firm in the sample is characterized by overinvestment. More specifically, the estimates imply that when the representative firm expends 100 thousand dollars on a typical investment project, the market expects the stream of returns associated with the investment to amount to 74 thousand dollars. Bjuggren & Palmberg (2010) and Bjuggren, Eklund & Wiberg (2007) document similar levels of overinvestment among the firms listed on the Stockholm Stock Exchange.

Model II extends the base-line specification to include the presence of a large shareholder in order to ascertain the monitoring role of the large shareholder. The results are presented in Column II of Table 3. The estimates show that the presence of a large shareholder is associated with significant improvement in the investment performance of the representative firm. Recent empirical studies on the monitoring role of the large shareholder document comparable findings. For example, Becker, Cronqvist & Fahlenbrach (2010) find that the presence of a large shareholder induces investment and financial performance of publicly traded firms across the United States. The analysis of Kaplan & Minton (2010) suggests that underperforming managers are more likely to be fired in corporations with a large shareholder. In a similar vein, Donker, Santen & Zahir (2009) provide empirical evidence which suggests that the presence of a large shareholder significantly reduces the probability of financial distress among a sample of Dutch corporations.

The results involving foundation-controlled firms are reported in Columns III and IV of Table 3. The estimates in Column III resonate the findings of Thomsen and Rose (2004) who examined the performance of foundation-controlled firms relative to other listed firms (both with and without a large shareholder). By hypotheses 1, 2 and 3, we are interested in how foundation-controlled firms perform relative to dispersedly-owned firms, family- and institutional-controlled firms. Hence, Column IV extends the analysis by dividing the sample into foundation-, family-, institution-, and dispersedly-owned (managerial-controlled) firms. The empirical evidence is in accord with hypothesis 1. The results show that the presence of a foundation as the largest shareholder improves investment performance significantly relative to dispersedly-owned firms both in statistics and financial terms. According to the estimates, the marginal q for foundation-controlled firms is 0.85 ($=0.509+0.340$) whereas the estimated marginal q for dispersedly-owned firms is 0.51. The difference is statistically different from zero with a t -statistics of 4.75. In financial terms, it suggests that return on a typical investment by the representative foundation-controlled firm is 66 percent higher than what obtains in the typical dispersedly-owned firm.

The estimates lend support to hypothesis 2. The marginal q for institutional controlled firms is 0.83, which is slightly lower than the performance of foundation-controlled firms. However, the difference of 2.41 is statistically insignificant. This suggests that the performances of foundation- and institutional-controlled firms are quite similar. The marginal q for family-controlled firms is 0.90 ($=0.509+0.387$) which places the performance of family-controlled firms ahead of all other firms in the sample. However, the estimate is not statistically different from the performance of foundation-controlled firms. Hence, we do not find statistical support for hypothesis 3. The estimates are qualitatively the same whether we include ownership categories per se in addition to their interaction with investment⁷.

5. Discussion, Limitations and Areas of Further Research

The empirical results indicate that over-investment is prevalent among the firms listed on the Stockholm Stock Exchange during 1999-2005 with estimated marginal q significantly less than the optimal value of one. The estimates show that the presence of a large shareholder such as a foundation reduces the extent of the over-investment significantly. A standard agency-based explanation of the observed superior performance of firms with at least one large shareholder relates to the personal financial interests of the large shareholder to monitor management productively (Burkart, Groom & Panunzi 1997; Cronqvist & Fahlenbrach 2009; Donker, Santen & Zahir 2009). In general, the standard agency-based explanation is framed as though intrinsic aspects of firm ownership and control are irrelevant.

In the theoretical framework, this paper argues that intrinsic considerations are relevant to the extent that even if we devise means to take the residual claimant's right and, hence, the personal financial interests away from the large shareholder, she may still find it worthwhile to monitor management productively. This argument relates to previous studies that examine the significance of intrinsic motives in economic behaviour. Among other things, studies show that managers (see Miller & Le Breton-Miller 2006) and employees (Vallejo 2009) who are emotionally and socially attached to the firm do not only act upon extrinsic motives but also upon intrinsic motives. This paper contributes to the literature by focusing on the intrinsic motives of large shareholders with a particular reference to corporate owning foundations.

These corporate owning foundations are a special type of large shareholder in the sense that, unlike other large shareholders, they do not have residual claimants. The non-distributive constraints, which govern foundations largely separate the financial affairs of the foundation from those of the internal agents of the foundation. As a result, the personal financial incentives to monitor management are largely absent. This implies that if personal financial interests are the sole consideration of large shareholders, the management of foundation-controlled firms will be inadequately monitored as though there are no large shareholders. As a result, the investment performance of foundation-controlled firms should be similar to firms without a large shareholder.

The empirical result shows that in spite of the apparent lack of personal financial stake, the relative investment performance of foundation-controlled firms is significantly more efficient than those of dispersedly-owned firms. This result is consistent with the claim of this paper that intrinsic motives are essential elements of the large shareholders incentive to monitor management. The remainder of this section discusses some of the potential alternative explanations of the relative investment performance of foundation-controlled firms.

A possible competing explanation relates to alternative mechanisms that constrain managerial discretion. For example, Fama (1980) posits that pressure from the managerial labour market disciplines management to act in the interest of residual claimants. He argues that managers will undertake efficient investment to enhance their chances of promotion in the firm and/or improve their chances of more attractive offers from other firms. However, Mueller (2009) argues that the discipline of a competitive market for managers is unlikely to resolve the potential agency problems with respect to top managers of large firms. In any case, if the market for managerial

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labour mechanism is significant, why is it that firms with at least one large shareholder systematically outperform dispersedly-owned firms? It appears even if the market for managerial labour mechanism is at play, it does not eliminate the agency problem and the productive supervisory role of the large shareholder.

A related alternative mechanism is the market for corporate control. This view postulates that the threat of takeovers by outsiders and the subsequent loss of job is a potent curb on the agency problem. This view suggests that managers are more reluctant to engage in self-serving actions that reduce firm value and thereby increase the probability of takeovers (Manne 1965; Scharfstein 1988). A related view is that of Grossman & Hart (1980). They observe that the threat of takeover is virtually absent in dispersedly-owned firms because of free-rider problems. One may, therefore, claim that it is the absence of takeover threats (rather than the monitoring role of the large shareholder) in dispersedly-owned firms that explain their relative under-performance. There might be some truth in this view particularly with regards to large institutional shareholders. However, anecdotal evidence suggests that the threat of takeovers is virtually absent in respect of foundation-controlled firms. Not only do these foundations tend to have long-term views, they also effectively preclude takeovers. Take the case of the Trelleborg AB. In keeping with the will of the founders, Henry and Gerda Dunker, the foundations control no less than 55 percent of the voting rights⁸. Thomsen (1996, p. 212) sites the case of the Carlsberg foundation which “must continue to own more than 51 percent” right in Carlsberg. Clearly, without the foundation replacing the incumbent management, it is difficult to see how the threat of a hostile takeover will discipline the management of foundation-controlled firms.

A potential source of bias in our empirical findings relates to (external) financial constraints. The marginal q methodology shares the standard assumption that the representative firm invests in *all* profitable projects (Hayashi 1982). Assuming the charters governing some of the foundations to control no less than a certain percentage of the shares/votes restrict the firm’s ability to raise additional external funds, the foundation-controlled firm could be forced to limit their investment outlays to those with the very best prospects. This possibility could give an erroneous impression that foundation-controlled firms outperform dispersedly-owned firms. However, several studies show that financially constrained firms tend to accumulate more cash (see Denis & Sibilkov 2010 for a review). It appears therefore that even though internal and external capital are not perfect substitutes, foundation-controlled firms are not less able to exploit investment opportunities than widely held firms are. Hence, financial constraint is unlikely to bias results substantially.

One limitation of this paper is that it focuses exclusively on the non-personal wealth incentives of those who run the affairs of the foundation to monitor. Implicitly, it assumes that the management of foundation-controlled firms shares similar characteristic with all other management teams. In relation to family-controlled firms, Miller and Le Breton-Miller (2006, p. 74) argue that managers who are emotionally linked to the firm, often “... feel motivated to do their best for the owning family and the organization”. An important area for further research therefore is to examine the relative disposition of the management of foundation-controlled firms to act in the interest of the firm.

6. Conclusions

This paper is grounded in the view that agency relations are laden with conflicts of interest and that corporate managers will not always act in the best interest of shareholders. It ascribes the monitoring role to the large shareholder to curb managerial opportunism and inefficiency. The main question explored in this paper is whether besides personal financial returns, the large shareholder is actuated by intrinsic considerations to diligently monitor management.

A conceptual contribution of the paper is that it demonstrates that intrinsic aspects of firm ownership and control are essential elements of the large shareholder's incentive to minimize managerial opportunism and inefficiency. Furthermore, the analysis shows that the prevalence of intrinsic incentives of the large shareholder is predicated on the large shareholder's social embeddedness. The conceptual analysis is backed by empirical examination of the investment performance of a sample of 182 publicly traded firms on the Stockholm Stock Exchange from 1999 to 2005. The empirical results indicate that the presence of a foundation as the largest shareholder improves investment performance significantly relative to dispersedly-owned firms. The results also indicate that the performance of foundation-controlled firms is marginally above institution-controlled firms but below family-controlled firms.

The empirical finding that foundation control firms outperform dispersedly owned firms is consistent with the conceptual claim that personal financial stakes are an inadequate representation of the large shareholder's incentive to monitor management. These findings provide both theoretical and empirical insights to enrich the on-going discussion in Europe with regards to foundation ownership and control of firms listed on the continental European Stock Exchanges.

Endnotes

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²Herrman & Franke (2002) and Thomsen (1996) are the other studies on foundations. They both relied on accounting based measures of performance which are "...subject to various measurement problems including manipulation by managers and boards that are obviously not un-biased in the view of the corporation which they want to present to the outside world" (Thomsen & Rose, 2004, p.344).

³Incidentally, corporate owning foundations are relatively common in historically high tax countries like Denmark, Germany, the Netherlands, Norway and Sweden (Thomsen 1999). It could therefore be argued that the transfer of shares to the foundation is simply a mean to avoid the high tax since foundations are tax-exempt. However, the non-distributive constraints make such a strategy inefficient, if not an inappropriate tool for wealth maximization motives of the founder and his family. For an overview of the institutional context of foundations, see Thomsen and Rose (2004).

⁴ See Sharma & Irving (2005) on the multidimensionality of commitment. They identify affective, normative, calculative and imperative commitments. The first two dimensions reflect non-economic motives and the last two are driven by personal economic gains.

⁵ Because of the stark differences in the behavioral assumptions of the agency theory and the stewardship theory, previous studies tend to see them as competing theories. Donalson & Davis (1991) is a classic example.

⁶Estimates using firm specific effects are not qualitatively different.

⁷The results are available upon request.

⁸Trelleborg Home Page, Excerpts from the Trelleborg Anniversary book.

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