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A study of governance practices in corporate foundations

Sérgio Ephim Mindlin

RESUMO

Estudo das práticas de governança em fundações empresariais

É crescente a realização de investimentos sociais por meio de fundações empresariais e, portanto, é importante que se aprofunde o estudo da sua governança. Governança é conceituada como conjunto de mecanismos de incentivo e controle para superar os chamados conflitos de agência, originários da separação entre propriedade e gestão das empresas, conceito também aplicado a organizações sem fins lucrativos. Argumenta-se que as fundações empresariais apresentam características tanto das empresas quanto das organizações da sociedade civil, o que as distingue das organizações desses dois setores. Neste trabalho, analisa-se estudo em que um conjunto de mecanismos de governança, adaptados a partir daqueles identificados na literatura de governança de empresas e organizações sem fins lucrativos, foi selecionado para pesquisa. É um estudo de casos, descritivo e exploratório, em que se colheram e se analisaram dados sobre oito organizações por meio de publicações e entrevistas com seus principais executivos. A análise dos dados indica ser adequado distinguir entre os tipos organizacionais e aplicar a teoria de agência. Os resultados da pesquisa indicam que os mecanismos de governança são passíveis de adaptação e aplicação nas fundações empresariais. Entretanto, na realidade analisada são aplicados apenas parcialmente, o que sugere a necessidade de ampliar os estudos que possam consolidar essas práticas nessas organizações.

Palavras-chave: fundações empresariais, governança, teoria de agência.

1. INTRODUCTION

Two relatively recent phenomena in the Brazilian corporate context have been attracting the attention of managers and researchers and their interrelation

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is worthy of studies, for one to understand them better: the increase in private social investment by businesses and the rising demand for transparent and effective governance mechanisms, not only in businesses but in not-for-profit organizations as well.

The first phenomenon has been evolving since the late 1980s, together with the end of the military dictatorship and Brazil's re-democratization, topped with the "Citizen's Constitution" in 1988. In parallel to the stronger political participation of organized civil society, businessmen began to promote, support or implement social projects, dedicating private resources to public ends, either directly through their companies or through institutes or foundations specifically created for that purpose. Examples of this involvement include organizations that brought together these initiatives, such as the Abrinq Foundation for Children's Rights, instituted by toy manufacturers in 1990, the Ethos Institute – Business and Social Responsibility, created by business leaders in 1998, and *Grupo de Institutos, Fundações e Empresas* (GIFE – Group of Institutes, Foundations and Enterprises), created in 1995 to congregate business organizations that promote social investment. GIFE tripled its number of member organizations in ten years, adding community, family and independent foundations as well, besides corporate ones.

Concomitantly, in 1995, a group of entrepreneurs, executives and academics founded the Brazilian Institute of Corporate Directors (*Instituto Brasileiro de Conselheiros Administrativos* – IBCA), with the objective of strengthening the performance of this supervisory and control business organ. This initiative derived from the Corporations Law (*Lei das Sociedades Anônimas*) of 1976, which made corporate boards mandatory in publicly-listed companies, besides other mechanisms, with the objective of improving investors' security. In 1999, IBCA changed its name to Brazilian Institute of Corporate Governance (*Instituto Brasileiro de Governança Corporativa* – IBGC), a sign of the strengthening of the requirement that more effective and transparent business management practices be adopted in the economic universe of the Brazilian market.

These two changing vectors met in their evolution as private resources – financial, human, technological – from companies and businessmen flowed toward social actions. It became common to hear that nonprofits should be **managed as businesses**, and a natural demand was created for this private social investment to be the object of governance practices, if not identical, at least similar to those adopted by corporate governance.

Although demand was configured, the efforts to materialize this tendency are recent and rare, be it as legal codes, be it in the form of normative propositions and technical or academic studies. This paper, whose analyses are based on an exploratory study carried out with a sample of corporate foundations dedicated to private social investment, aims at taking one more step toward understanding the potentialities and limitations of the application of governance practices to the management of the so-called Third Sector organizations.

2. THE INVESTIGATION PROBLEM

Corporate foundations, in recent years, have acquired a significant role in the context of organizations whose efforts aim at reducing Brazilian social-economic problems and at giving the population ample access to cultural products. It is therefore important to clarify what is meant by Private Social Investment (PSI), the context in which it occurs, and the importance of the governance theme for these organizations.

In general, PSI designates the financing and implementing of voluntary social, cultural and environmental actions by companies, families and individuals for the benefit of society as a whole or of specific segments, in general less favored. This phenomenon showed significant growth in Brazil from the 1990s onward.

Different companies adopted one of two organizational models to promote this form of contribution to society: creating areas responsible for this activity within their own businesses or instituting dedicated PSI foundations or institutes. From the business strategy viewpoint, both models are practically equivalent. From the administrative viewpoint, however, each presents different issues in terms of management models, assignment of responsibilities, decision-making structures and performance verification, among others factors.

The first model creates within the companies themselves an area specialized in social, cultural and environmental actions that is part of the organizational structure, just like other departments commonly found in businesses, such as the finance, marketing and other functional areas. The difference among them is that the prime objective of the latter is to contribute to the results of the company itself, whereas the former aims primarily at contributing to society, using corporate resources. It is a difference of objectives, not of managing processes.

Nevertheless, the second model creates within the business administration sphere an organization characterized by its lack of profit objectives, exactly the opposite of the most emphasized business objective, profit. This fundamental difference between corporate foundations and their founding companies leads to questions about the possibility of extending to the former the management practices generally adopted by the latter. If the organization's main objective is not the generation of profit, the most widely adopted business success indicator, how should foundations' results be evaluated? What orientation and objectives should be established for their management? What should be the management **best practices** for these organizations?

3. PRIVATE SOCIAL INVESTMENT

PSI is understood as social, cultural and environmental actions of public interest, voluntarily promoted or financed by companies or by the foundations and institutes created by them. These actions are characterized by being structured and long term. Investors are concerned with results and, therefore, in-

stead of being called social, cultural or environmental expenses, they are called private social **investments**, as are productive investments of businesses.

Companies' willingness to promote them derives from the perception that development, growth and sustainability of healthy businesses are irreconcilable with a society that has large social-economic situation differences among its segments. It derives, as well, from a business vision that companies, besides supplying their products and services, providing employment, paying taxes and having financial resources, have significant intangible resources, such as technical knowledge, management experience, planning and organization procedures and means of communication that can contribute to society's development, complementing the efforts of the State, which is responsible for essential rights, such as safety, justice, basic health and education, and social assistance (FISCHER, 2002).

There is, however, a discussion as to whether it is suitable for companies to take on responsibility for social actions in their communities, based on two theoretical management concepts: the **stockholders** and the **stakeholders** theories. The former argues that the basic business function, to be primarily pursued by management, is to maximize profit, in order to optimize shareholders' return on their investment (FRIEDMAN, 1970; SILVEIRA, 2006). The latter considers that the interests of the different parties (people and organizations) with which the company maintains relations are often conflicting among themselves and should be taken into account in business decisions, so that profit maximization should not be an absolute target (FREEMAN, 1994; MACHADO FILHO, 2006).

The growing number of companies practicing PSI, either directly or through their foundations, is an indication that they operate by the **stakeholders** theory, as they dedicate part of their human, financial and technical resources to fulfilling the needs of stakeholders, beyond their shareholders. GIFE, a Brazilian association whose members include the largest private social investors in the country, was created in 1995, with 25 members; by 2000, there were 48; and by 2011, its membership listing comprised 130 companies, foundations and institutes (GIFE, 2011).

The growth in the number of organizations promoting PSI resulted in a significant increase of the financial resources dedicated to social action and of the people who benefited from them. In 2006, 91 GIFE members invested about R\$1 billion in PSI, vs. R\$480 million by 63 members in 2001 (GIFE, 2006, p.21). The number of beneficiaries evolved from almost two million to five million, between 2003 and 2005 (GIFE, 2006, p.15). In 2007, 80 members invested about R\$1.15 billion and, in 2010, 110 members invest some R\$1.9 billion (GIFE, 2011).

Social action carried out by businesses in Brazil goes well beyond PSI promoted by GIFE's members, but there are no data on this investment. Taking into account all kinds of social actions driven by businesses, including the sporadic, occasional and purely philanthropic ones, except those legally required,

IPEA⁽¹⁾ estimated that most Brazilian companies promote social action (IPEA, 2005), according to the Business Social Action investigation conducted in 2003 in the Northeast and Southeast regions of the country, which concentrate about 70% of all companies, 70% of *Gross National Product* (GNP) and 78% of the Brazilian population.

4. ARE CORPORATE FOUNDATIONS PART OF THE THIRD OR OF THE "TWO AND A HALF" SECTOR?

Corporate foundations, as private-sector agents with public objectives, could be considered as part of the third sector organizations category (FERNANDES, 1994). An important set of attributes to characterize organizations of this sector was proposed by Salamon and Anheier (1992) and complemented by Salomon (1999). According to these authors, to be part of the third sector (nonprofit sector in their terminology), organizations should be:

- formal – institutionalized, legally or otherwise, with rules and procedures to assure their permanency;
- private-sector – without institutional ties to the State, even if receiving State resources;
- non distributive of profits – although they may generate financial surpluses, these should not be their objective; this **non-distribution constraint** is particularly relevant;
- voluntary – employing a significant volume of voluntary effort "and created voluntarily, not by legal or contractual imposition" (added by the author);
- with public objectives – aiming at an external public as beneficiary, beyond the organization's membership;
- autonomous – not controlled by external agents, with their own governance structure, being usually governed by a board.

Corporate foundations do not necessarily fulfill this last attribute because, in many cases, they are dependent of the founding company for their management and financial support. One can therefore argue that although they have all the other characteristics of third sector organizations, they should not be considered as part of this sector, an argument with which Falconer (1999, p.33-34) agrees.

While third sector organizations are characterized by having no owners, these foundations, although legally without shareholders, **belong** in general to the companies that instituted them. The majority of third sector organizations provide the financial resources they need through donations from a pulverized set of individuals and legal entities that may or may not be associated with the organization. Corporate foundations, on the other hand, usually have their instituting company as the main source of funding. This resource dependency confers upon the companies a position analogous to that of shareholders, a condition often reinforced by corporate dispositions that confer upon the instituting company the power or the responsibility of naming the foundation's main executives. Thus, although

from a legal standpoint the strategic direction and resource allocation definitions should be made by the most senior management body of these foundations (a governing board, a members meeting), the instituting company has a strong power to influence these decisions.

These distinctive characteristics of corporate foundations in relation to other nonprofit organizations as a whole are relevant and, therefore, it is important to take them into account when studying corporate foundations governance. Thus, it is convenient to consider them as belonging to an intermediate sector between the second sector (that of businesses) and the third sector (that of nonprofit organizations). In this interface area, they appropriate specific attributes of each of those two sectors and begin to form what one might call the **two and a half** sector.

5. AGENCY CONFLICT AND GOVERNANCE

Governance is a term employed in many contexts, always related to the act of governing, or to the structures required to do so. Houaiss and Villar (2001, p.1470) defines it as “the act of governing; government, governing”. Usually with the “corporate” qualification, the term is largely used in the second sector, typical of for-profit business organizations, especially the publicly listed ones.

Brazilian Institute of Corporate Governance (IBGC), an entity that promotes in Brazil a wider and more consistent study and use of the governance concept, defines it as a system whereby companies are directed and monitored, involving relationships among the shareholders, board of directors, executive board, independent auditing and fiscal committee, with the objective of increasing the organization’s value, facilitating its access to capital and contributing to its perpetuity (IBGC, 2006).

IBGC itself explains the function of corporate governance based on business economics concepts:

“In traditional economic theory, corporate governance arises to try to overcome the so called ‘agency conflict’ present because the phenomenon of separation between business ownership and management occurs. The ‘principal’ property owner delegates to the ‘agent’ the decision-making power over this property. From this, the so-called agency conflicts emerge, as the interests of the party managing the property are not always aligned with those of its owner. From the agency theory perspective, the major concern is to create efficient mechanisms (monitoring and incentive systems) to guarantee that the interests of management are aligned with those of the shareholders” (IBGC, 2006).

Silveira (2006, p.45) also relates corporate governance to the issue of how to deal with the problems derived from agency conflicts, pointing out that:

“The discussion of the need to improve corporate governance in businesses emerged as an answer to several records of shareholders wealth expropriation by managers in companies with pulverized property structure and of minority shareholders by controlling shareholders in companies with concentrated property structure. These records elapse from the agency problem of managers, which occur when managers make decisions with the intent of maximizing their personal utility and not the wealth of all shareholders, the reason they were hired for”.

Agency conflicts originate in agency relations, defined by Jensen and Meckling (1976) in their work about the theory of the firm as

“[...] a contract whereby one or more persons (the principal or principals) hire another person (the agent) to execute a service on his [their] behalf, which involves delegating some decision power to the agent” (JENSEN and MECKLING, 1976, p.308).

As the two parties search to maximize their personal returns, there is good reason to suppose that the agent will not always act in the best interests of the principal, thereby creating agency conflicts. To minimize the gap in relation to his interests, the principal may create suitable incentives for the agent or may monitor the latter’s actions. In some cases, as necessary, the agent may offer guarantees that he will not act against the principal’s interests. These incentives, as well as the monitoring and the possible guarantees have costs for both parties. It is practically impossible to ensure that, at zero cost, the agent will always make decisions that optimize the owners’ interests.

Machado Filho (2006, p.82) proposes that these cost are composed by the sum of

1. The residual losses characterized by shareholders wealth decrease as a result of decisions made by the managers (agents).
2. The cost of monitoring the managers’ actions (reports, balance sheets, managerial information systems, disclosure).
3. The cost of promoting transparency and accountability of managers’ accounts.
4. The expense of preparing contracts between the managers and the shareholders”.

Given the governance concept based on the need to minimize or overcome agency conflicts, basically originated from the separation between property and management in business organizations, it is important, in order to study governance in nonprofits, to consider whether in these organizations agency conflicts also occur, in the absence of shareholders or owners.

Jensen and Meckling (1976) comment that agency costs occur in any situation that involves cooperative efforts, even if a clear principal-agent relationship does not exist. The authors indicate that the agency problem is general and occurs in any for-profit or nonprofit organization.

Machado Filho (2006, p.76), based on the agency conflicts concept, to which he refers as conflicts of interests, expands the governance concepts to other situations beyond the separation between property and management in organizations:

“In any situation in which decision-making power is transferred or shared, informational asymmetry occurs, to a greater or lesser extent. In a private-sector company, club, association, cooperative or university there always will be conflicts of interest, derived from the delegation of some of the power. In other words, ‘someone’ governs in name of ‘someone else,’ who delegated rights for the exercise of power. In its essence, governance deals with minimizing asymmetries and conflicts of interest inherent to power delegation” [Emphasis in the original].

Zylbersztajn (2005) considers that the agency conflict problem also occurs in nonprofit organizations, although there is no holder of property rights over the organization. According to this author, governance deals with the exercise of two property rights: the right to make decisions and the right to the flow of resources. In for-profit businesses, the possibility of conflicts occurring over the access to the flow of resources is clear, since the maximization of agents’ gains in the short term may lead to the reduction in principals’ gains in the long term. The agents have more access to information about the company’s business, a phenomenon known as **informational asymmetry**, and are therefore able to make decisions that favor themselves to the detriment of the principals.

In nonprofit organizations, the conflict over access to the flow of resources does not exist, since the nonprofit condition, the non-distribution constraint, excludes this component. However, conflicts of a different nature may occur between founders or maintainers, on one hand, and managers, on the other. According to Zylbersztajn (2005), in organizations whose subsistence depends on obtaining funding voluntarily provided to them in order for them to attain their aims, the principal is represented by a resources donor that wants to be sure that these resources will be used in actions and with objectives aligned with the entities’ mission. Agency conflicts may then arise from divergence about strategic decisions and resource allocation, even if one disregards the possibility of fraudulent deviation of funds.

Fama and Jensen (1983) have also advocated the applicability of agency theory to nonprofit organizations. They argue that there are no residual rights in such organizations, which avoids agency problems between donors and residual rights

owners, but does not eliminate the possible occurrence of agency problems between donors and decision-making agents who, lacking the burden of a major share of the effects of their decisions on assets, may appropriate themselves of the donations. The authors’ hypothesis is that

“as in other organizations characterized by separation between decision-making management and the responsibility for residual risk, nonprofit organizations have decision-making systems that separate management (proposition and implementation) from control (ratification and monitoring) of decisions. These decision-making systems survive in nonprofit organizations because they ensure that donations will be used effectively and not easily expropriated” (FAMA and JENSEN, 1983, p.319).

Thus, instead of considering the separation between property and management, in nonprofit entities it is more appropriate to deal with the separation between control and management. This conceptual specificity, however, does not eliminate, but to the contrary, reinforces, the need for these organizations to implement governance practices that avoid the arising of conflicts of agency and/or interests and that assure the transparency of management actions and decisions.

6. GOVERNANCE OF CORPORATE FOUNDATIONS

Corporate foundations, as seen above, are a particular type of nonprofit organization, in that they are generally not autonomous, depending on their founding companies for their maintenance and receiving from the latter their strategic directives. In addition, they play an interconnection role between the companies, the third sector organizations and the public beneficiaries of PSI.

These foundations differ from other nonprofit concerns by maintaining ties, of variable degrees, with their founding company. They frequently continue to be a part of the corporate group that gave rise to them. Their directors’ ties with the organization are also, in general, different from those of the directors of other nonprofit concerns. While some of these directors are resource donors that sit on the board of the nonprofit organization to guarantee the proper use of their donations, the directors on the boards of corporate foundations are often executives of the founding company, that sit on the board to guarantee that the foundation’s strategy is aligned with that of the founding company.

Different ties also characterize the permanent relationship between the companies and the foundations, so that the latter may have a larger or smaller degree of autonomy in relation to the former. This autonomy may vary from total dependency, whether in terms of resources or of strategy and programs definition, to the opposite extreme of full detachment, in which

case the foundation has enough resources to fulfill its mission and autonomy to determine its strategy and action plans.

These relationships occur in a context in which there are no residual rights – taken as rights over financial results – to be appropriated by the management of the company or by the management of the foundations. However, the very mission of corporate foundations aimed at promoting private social investment creates a potential for agency conflicts to arise between them and their parent companies. Foundations' actions are targeted at a cause (poverty reduction, defending the rights of a specific population segment, environmental protection, cultural enhancement) whereas companies' actions target the market for their products and services.

In attempting to fulfill their mission, foundations carry out activities that target their audience and try to communicate the conceptual nature of their programs and actions. Their main objective is to contribute to their cause and to benefit their target audience. Companies, on the other hand, have the permanent need to increase their competitiveness in the market in which they operate: besides determining their products, services, price, quality and other attributes of their business, their reputation is a significant element for winning over and maintaining their customers. To upgrade this, the foundation contribution can be very relevant to the company's institutional positioning concerning their customers and the public in general (WESTHUES and EINWILLER, 2006).

One may consider, therefore, that corporate foundations have a dual mission: a social (or environmental or cultural) one, related to the cause and the target audience, and an institutional one, related to the strategic positioning and the reputational capital of the company. The latter's contribution may be seen as the return on investment expected by the founding company, akin to shareholder expectations in relation to companies. One mission does not necessarily conflict with the other, but this duality can give rise to a large portion of the agency conflicts between the company and the foundation. These conflicts have a different nature from those between directors and managers, since they involve the predominant mission definition, and not the definition and ratification of decisions to fulfill the mission.

If the first mission, the social one, is fulfilled and properly communicated, so that the company's public becomes aware of it, it will be contributing to the second one, of institutional character. On the other hand, if the first one does not contribute to the second or if the company stresses the institutional mission only, at the expense of the social mission, this can then become one source, among others, of conflicts.

Resource allocation, whether in terms of amounts or how these amounts are employed, may be the object of divergence between companies and their foundations. The foundation's mission and the determination of its purpose, as mentioned by Miller-Millesen (2003), are a key issue in this relationship. The establishment of policies, financial controls, human resources management and directives as to where and how to allocate the

foundation's resources are among the important instruments that can be used to minimize agency conflicts in foundation management.

These distinguishing features of corporate foundations relative to other nonprofit organizations allow one to assume that the governance mechanisms proposed for nonprofits, themselves derived from those applied to business, may operate differently for the corporate organizations. The study that originated this article (MINDLIN, 2009) tried to establish whether the corporate governance mechanisms of for-profit organizations would be applicable to the management of foundations and institutes founded by companies to promote their private social investment. Based on the analysis of governance mechanisms applied to nonprofits, as discussed by Mendonça and Machado Filho (2004) and further detailed by Machado Filho (2006), the following governance mechanisms were considered:

- Board of directors (board);
- Management compensation;
- Legal and regulatory system;
- Resources source – budgeting system.

To provide guidance for empirical data collection and analysis, the research investigation problem was broken down into the following guiding questions:

- Are the selected mechanisms applied in the organizations studied?
- Are they effective, i.e., do they yield the expected effects, or do they exist only formally, but do not operate?
- Are they compatible with those employed by the founding company?
- Are there other mechanisms applied to the corporate foundations?
- Do these mechanisms yield a suitable degree of separation between control and management of the studied organizations?

7. METHODOLOGY – THE EXPLORATORY STUDY

Mindlin (2009) conducted an exploratory descriptive investigation, through case studies that combined secondary and primary qualitative data, which made it possible to characterize the management of the foundations studied, with emphasis on the governance mechanisms used.

The nature of the problem studied, in addition to the fact that there was little knowledge about it at the time, suggested that a qualitative approach was better suited to lead to an understanding of governance processes. Reinforcing this methodological choice, Mindlin (2009) opted to analyze data in the form of case studies, which constitute

“[...] a method of organizing social data that preserves the unitary character of the social object un-

der study [...] an approach that considers any social unit as a whole [...] [and] includes the development of such a unit, which may be an individual, a family or another social group, **a set of relationships or processes** [...] or even a culture [...]" (GOODE and HART, 1968, p.422, *apud* GODOY, 2006, p.118-119) [Author emphasis].

Besides providing a possibility of understanding a scarcely studied phenomenon, case studies, according to Godoy (2006, p.127)

"[...] perform an important role by allowing explanatory hypotheses generation and theory elaboration, as Eisnehardt (1989) advocates".

As for the empirical investigation, secondary data were obtained through annual reports published by the founding companies and the studied foundations, from information posted by those organizations on their internet sites, and from the analysis of the studied organizations' bylaws, obtained in their sites or through the organizations themselves.

To validate and complement the information collected, and to identify managers' perceptions and opinions, primary data were collected through semi-structured interviews with the foundations' main executives. The choice of personal interviews, instead of questionnaires that could have been sent by mail or email, was made based on the possibility of obtaining information not necessarily included in the interview script.

Consequently, the number of organizations included in the investigation was reduced, given the time required to obtain their agreement to take part in the research, the scheduling of the interviews and the interviewing itself.

7.1. Sample

The study covered eight organizations select among GIFE's members headquartered in São Paulo or in nearby cities. Therefore, this was not a random sample, statistically representative of the universe of corporate foundations and its small size and intentional selection do not permit generalized analyses, inferences and conclusions.

This procedure was adopted due to the difficulty of gathering information about the Brazilian institutes and foundations group that would have enabled selecting a random sample. No reference source that might be considered as a data bank of organizations from this universe was found.

Brazilian foundations are required to register with the Foundations Curatorship, an organ of the Public Attorney's Office. This registry, however, is decentralized by district, does not differentiate corporate foundations from the other types (public, independent or family ones) and lacks a structured data search system. Additionally, institutes, which take the legal form of

associations, are not supervised by the Foundations Curatorship and are only required to register with the Documents Registry Office of their respective city, thus making their detection impossible for research purposes.

Given these difficulties, the GIFE membership listing was used as the source for selecting the sample. The GIFE members are institutes, foundations and companies that make private social investment. As of June, 2008, when the participating organizations were selected for the study, the association had 114 members, 86 of which were corporate foundations or institutes. The remainder consisted either of companies or of family and independent foundations.

Of these 86, 40 were headquartered in São Paulo, from which a list of 21 was drawn. These were invited to participate in the study. This selection tried to include both organizations that qualified as *Organização da Sociedade Civil de Interesse Público* (OSCIPs)⁽²⁾ and those that did not, as well those that were recognized as social assistance benefiting organizations (whether or not they had obtained the respective certificate, *Certificação de Entidade Beneficente de Assistência Social* – CEBAS⁽³⁾) and those that were not. It also tried to include organizations whose founding companies were listed with United States stock exchanges, which would make them subject to the Sarbanes-Oxley⁽⁴⁾ act, as well as others that were not. For reasons of ease of access, preference was given to those based in the São Paulo metropolitan area or Campinas.

Of the 21 organizations invited to participate by an invitation letter signed by the researcher, nine replied, eight affirmatively. The latter became the intentional sample of cases in this study.

8. THE MECHANISMS OF GOVERNANCE AND THE EMPIRICAL INVESTIGATION RESULTS

8.1. Board (of directors)

In corporate foundations, the board is a very relevant governance mechanism, considering its formal role of being the most senior body in charge of approving action plans and budgets and of electing the organization's executive management. In many cases, founding companies reserve the right to elect and destitute the directors; when they do not do this directly, they determine the mechanisms whereby directors are elected and dismissed. Company executives often sit on these boards, leading one to suppose that board members will be more interested in the foundation's success and proper management than the board members of other nonprofit concerns, since directly or indirectly this influences the company's image and even its results. Furthermore, because these directors are company executives, they are paid by it. Even if they are not compensated by the foundation, their performance tends to be more professional and less voluntary than that of the non-paid directors of nonprofits. The two factors – professional respon-

sibility in the company and in the foundation, and remunerated activity – should contribute to the board members' interest in the foundation's management, in their active participation and in greater effectiveness.

However, the boards are not necessarily comprised only of company representatives. In principle, the situation of members from outside the company is similar to that of the directors of other nonprofit concerns, with voluntary participation and little representation of stakeholders.

The composition of the board of nonprofit concerns has been a frequently studied theme (STONE and OSTROWER, 2007), but not that of corporate foundations and institutes specifically. Thus, identifying these board composition criteria, the proportion of company employees that sit on the foundation's board, the origin and the ties of external members, and the role that they play might contribute to understanding how governance mechanisms, when adapted to the foundational model, operate and might be improved.

Besides the existence of the board of governors, the IBGC Corporate Governance Best Practices Code (IBGC, 2004) recommends the existence of a consulting board, a fiscal committee and the hiring, by the board of directors, of independent auditing. These recommendations are also part of the Best Practices Guide for the Governance of Corporate Foundations and Institutions (IBGC, 2009). IBGC recommends further that the board chairman should not be the organization's Chief Executive Officer (CEO), that the board should organize committees to do deal with specific matters and to prepare recommendations for the board, especially an audit committee, and that every organization should have a code of conduct binding managers and employees, covering matters pertaining to conflict of interests and procedures to be adopted should such conflicts arise.

These questions were addressed in the field research. The Table below summarizes the characteristics of the boards of the eight foundations in the study that gave rise to this paper.

One can see that five of the studied organizations had a formal and specific board, but that one of them did not. Most of these boards was not really active and did not fulfill the functions set in the bylaws. In two cases, the board coincided with the founding company's board; in others, its duties were taken up by the board or some other body of the parent company. In only one case (F6) did the board have its own identity and proceedings.

Just two of these foundations had external members on their boards. These, however, had a consulting character in one of them and were dedicated to only one specific project in the other. In the remaining five organizations headed by a board, these were comprised solely of company representatives. In only one foundation was the existence of a consulting board observed, although it was not statutory. Another two also had non-statutory management bodies. Although almost all had fiscal committees, these were not active. Auditing procedures were not applied to the foundations independently from their founding companies.

The foundations studied operated, in general, as a functional area of their founding companies, monitored not by their boards, but by a company executive. These cases evidence a relative degree of autonomy regarding the institutions' room for action, though more concentrated in their technical and conceptual aspects, and less in the decision-making area. Several managers manifested, however, that it was desirable for their organizations to operate in a more integrated fashion with their companies, even to the detriment of autonomy, if their area of technical and conceptual competence was preserved. They expressed that what differentiates managing a corporate foundation from managing a nonprofit independent organization is the need to integrate it with the company, to migrate to strategic social investment,

Characteristics of the Boards of the Foundations Studied

Boards \ Foundations	F1	F2	F3	F4	F5	F6	F7	F8	Frequency
Structured	X	*	X	X	X	X		X	6X
Active	*		*	*	*	X		*	1X / 5*
Specific	X			X	X	X		X	5X
Coincide with Company		X	X						2X
Company Members		X	X		X	X		X	5X
External Members	X			X					2X
Foundation Decisions						X			1X
Company Decisions	X	X		X	X		X		5X
Both Decisions			X					X	2X
Non Statutory Organs			X	X			X		3X
Fiscal Board	X	X	X	X	X		X	X	7X

Note: X means characteristic observed; * means partially observed.

which creates value both for society and the business, correlating further the business and the social strategies.

This tends to confirm the earlier suggestion of situating corporate foundations in the **two and a half** sector, and may represent the core of the potential agency conflicts between the maintaining company's management and the foundation's technical and executive bodies.

The study observed that board members usually lacked solid knowledge about the organizations' specific field of action and that boards had no room for stakeholder representation. Therefore, the boards did not operate as proper monitoring and incentive mechanisms and although they had the outward appearance of governance structures, they did not actually play this role.

8.2. Managers compensation

For corporate foundations, unlike other nonprofit organizations, there is the possibility of variable compensation instruments related to the financial results of the company being used to manage the foundation's staff. However, it is not obvious how a variable compensation policy can be used to align a foundation's activities with shareholder interests, as the influence of the foundation's managers actions over the company's financial results may be very small and difficult to determine. The more the company attributes to the foundation part of the responsibility for the company's overall success, related to its positioning and to the company's institutional image and its reputation, the more these variable compensation policies may operate as governance instruments.

Five of the studied foundations adopted variable compensation practices. Of these, only one did not relate the goals to the organization's own actions. All of them reported that variable compensation amounts were influenced by the company's financial results, as the company was the non-profit institution's resource provider. Still, it is interesting to note that the foundations' budgets were small in relation to the companies' income and financial results. Therefore, the potential impact if the foundations' management over the financial corporate results could only be very modest. Consequently, tying the variable compensation of the foundation managers to the company's financial performance goals should have no impact as an incentive mechanism.

It thus makes sense that the amount of incentives be unrelated with the company's results, being tied, instead, to the foundations' performance goals.

8.3. Legal and regulatory system

Brazilian corporate foundations may qualify as OSCIPs, provided that they comply with the provisions of Law 9790/99, requiring them to create a fiscal committee, to be subject to external and independent auditing, to adopt administrative practices that comply with the principles of legality, imper-

sonality, morality, publicity, cost effectiveness and efficiency, and to publish their financial statements and activity reports. Thus, this law's regulatory guide can function as a governance mechanism, even if it is just a first step. Empirically, the question to be considered is whether the structures required by these legal norms are in effect created in the foundations qualified as OSCIP and how they operate in practice.

Another law that may affect the administrative practices and governance mechanisms of Brazilian corporate foundations is the United States Sarbanes-Oxley act. Although it is an American law, foreign companies whose stock is traded on US stock exchanges or that are subsidiaries of companies whose stock is traded in the USA are required to comply with it, applying it to all companies under their control, including their foundations. The requirements include transparency, accountability and preventing conflicts of interest in order to protect the interests of society and minority shareholders.

Among the foundations studied, although four of them qualified as OSCIPs and their bylaws incorporated all formal OSCIP requirements, compliance with these requirements tended to be a formality rather than a driver of actual actions: foundation managers were compensated by the company (the law allows compensation by the foundations without loss of tax rebates), fiscal committees were not active and the disclosure of the foundations' activities was conducted by the company, through its annual reports. Even so, as these organizations were the youngest in the sample, this might indicate that qualifying as an OSCIP may be an emerging trend.

Four of the founding companies in the sample were subject to the Sarbanes-Oxley law. Nevertheless, no influence of this was observed in their foundations' governance. On the contrary, even in these four organizations, interviewed managers were unaware of this law and of its possible effects over corporate foundations' governance practices.

8.4. Budgeting system

The budgeting system was considered an external governance mechanism of corporate foundations, akin to what the stock markets represents for companies. Three of the organizations studied had a pre-established rule for budgeting: endowment income, percent of company sales and multi-annual plan. The other five had budgets determined on a yearly basis. The former case, contrary to expectations, did not confer upon foundations more autonomy from their companies, but rather denoted stronger commitment of these companies to their foundations' actions. In the latter case, it was neither possible to observe whether the budget bore any relation with the attainment of targets nor whether the budget worked as an incentive mechanism for the foundations' managers. None of the eight foundations made any use of their companies' tax rebates, though some supported selecting projects in which their companies had invested ECA⁽⁵⁾ and Rouanet Law⁽⁶⁾ benefits.

9. CONCLUSION

A number of recommendations can be extracted from this study: first, the cases studied suggest that it makes sense to distinguish corporate foundations as a particular type of nonprofit organization and to categorize them as part of a specific sector of organizational typology, the proposed naming of which is the **two and a half sector**. This denomination aims to make it explicit that these organizations have characteristics derived in part from the business sector, the second sector, and in part from the so-called civil society organizations, the third sector. This theoretical distinction was mainly based on the lack of autonomy of corporate foundations in relation to their founding companies. The case studies evidenced that the observed organizations had limited autonomy and, to a large extent, despite being separate legal entities, maintained a strong operational and managerial dependency on their founders.

Second, the boards, considered in the literature as the main governance mechanism of both for-profit and nonprofit organizations, have, in general, relations with the foundations and performance levels below the importance of their role. In most cases, the governing boards were comprised of company representatives, who lacked in-depth knowledge of the foundations' field of action and neither represented nor were aware of the needs of the different stakeholders. It was found that some board members were not qualified to support and provide guidance for the foundations' executives in the conduction their work. It is likely that the debates to outline strategic directives might be more productive for the foundation's mission (institutional as well as social) if the boards were comprised of people with more varied competences, embracing management and social investment themes.

The recommendation extracted from the analyses is that corporate foundations' boards will become more effective and will in effect help these organizations to fulfill their dual missions if they are comprised of people with more varied competences (representing the different stakeholders; having knowledge about social and business needs; being active and meeting regularly; and making use of information plus monitoring and encouraging the foundations' action instruments).

This does not mean that the foundations in this study were ineffective, but rather that they could perform their work better.

This recommendation may be an orientating hypothesis for future investigations, with studies that examine not only governance mechanisms and governing boards in particular, but address, specifically, the evaluation of results and the fulfillment of foundations' missions. Several research possibilities and needs derive from this proposition: studying, in practice, the very existence of the dual nature of the mission and its consequences; researching how best to evaluate foundations' performance, with which indicators and how; and conducting longitudinal studies that make it possible to investigate cause and effect relationships.

Another governance mechanism to be studied further is the legal regulatory system. Additional studies about its influence on corporate foundation management are necessary, as well as analyses of the nonprofit organizations regulatory code and, in particular, of the aspects that concern corporate foundations. Almost all cases studied indicate little adherence, in practice, to legal requirements, although they were formally fulfilled. The diversity of certifications creates breaches enabling a lack of effective oversight and of management guidance, as the internal governance efficacy depends on the strength of legal institutional guidelines.

Finally, despite the difficulties for instituting variable compensation for the foundations' managers and staff, an important step toward making this governance mechanism effective would be to improve the human resources management of these organizations with policies and procedures adapted to their specificity. The practice observed was that the human resources systems of founding companies are in general adopted for the foundations. This does not seem to consider the specific needs of this **two and a half sector**.

There is still a long way to go in the corporate foundations and institutions governance study and research field. The study that gave rise to this paper is one of the few conducted in Brazil on this subject. It is hoped that the observations and analyses presented here will stimulate the expansion of this research line, benefiting theoretical development as well as the management of these organizations, and helping them to fulfill their public mission more effectively. ♦

NOTES

- (1) IPEA (*Instituto de Pesquisa Econômica Aplicada*): Applied Economics Research Institute, a federal public foundation of the Bureau of Strategic Issues of the Presidency.
- (2) OSCIP (*Organização da Sociedade Civil de Interesse Público*): Public Interest Civil Society Organization. Legal qualification of nonprofit organizations instituted by law 9790/99. It created transparency requirements and management qualifications and

contributed to the professionalization of these organizations by allowing their executive management to be paid.

- (3) CEBAS (*Certificação de Entidade Beneficente de Assistência Social*): Social Assistance Beneficent Entity Certificate. Legal qualification of nonprofit organizations that perform direct social assistance. It also exempts them from paying the employers social benefits contribution.

NOTES

- (4) The Sarbanes-Oxley Act was passed in the United States in 2002, after accounting frauds such as those of Enron and Worldcom were revealed in 2001. It created a number of requirements regarding transparency, accountability and mechanisms to protect minority shareholder rights.
- (5) ECA (*Estatuto da Criança e do Adolescente*): Child and Adolescent Statute (Law number 8069/90). Its provisions include the possibility of companies

deducting up to 1% of their income tax due, if they make donations to the Children and Adolescents Funds that exist in every municipality and state, and at the federal level as well.

- (6) The Rouanet Law (Law number 8313/91) instituted fiscal incentives for the promotion of culture and allows companies to deduct up to 4% of their income tax due if the funds are invested in projects approved by the Ministry of Culture.

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ABSTRACT

A study of governance practices in corporate foundations

Implementation of social investments through corporate foundations is growing and, therefore, it is important to study their governance aspects better. Governance is conceptualized as a set of control and incentive mechanisms to overcome the so-called agency conflicts, which originate from the separation of property and management in for-profit organizations, a concept also applied to nonprofit institutions. It is argued that corporate foundations have the characteristics both of companies and of civil society organizations, which distinguishes them from both types of organizations. This paper analyses a study in which a set of governance mechanisms, adapted from those identified by a literature review of corporate and nonprofit governance, was selected for study. It is an exploratory descriptive case study, which analyzed data about eight organizations collected through publications and interviews with their CEOs. The data analysis indicates that it is appropriate to distinguish the different organization types and to apply the agency theory. Research results indicate that the selected governance mechanisms may be adapted and used in corporate foundations. However, they are only partially applied in the observed cases, which suggests the need for further studies that might consolidate these practices in such organizations.

Keywords: corporate foundations, governance, agency theory.

RESUMEN

Estudio de las prácticas de gobierno en fundaciones empresariales

Es creciente la realización de inversiones sociales por medio de fundaciones empresariales y, por lo tanto, es importante que se profundice el estudio de su gobierno. Gobierno se conceptualiza como un conjunto de mecanismos de incentivo y control para superar los llamados conflictos de agencia, que tienen origen en la separación entre propiedad y gestión de las empresas, concepto también aplicable a organizaciones sin ánimo de lucro. Se argumenta que las fundaciones empresariales presentan características tanto de empresas como de organizaciones de la sociedad civil, por lo cual se distinguen de las organizaciones de esos dos sectores. En este trabajo se analiza un estudio en el cual un conjunto de mecanismos de gobierno, basado en los mecanismos que aparecen en la literatura de gobierno de empresas y de organizaciones sin ánimo de lucro, fue seleccionado para estudio. Es un estudio de casos, descriptivo y exploratorio, en el que se recolectaron y analizaron datos sobre ocho organizaciones por medio de publicaciones y de entrevistas a sus principales ejecutivos. El análisis de los datos indica que es adecuado distinguir entre los tipos organizacionales y también aplicar la teoría de agencia. Los resultados indican que los mecanismos de gobierno seleccionados pueden ser adaptados y aplicados a las fundaciones empresariales. Sin embargo, en la realidad estudiada, son aplicados sólo parcialmente, lo que sugiere la necesidad de ampliar los estudios que puedan consolidar esas prácticas en dichas organizaciones.

Palabras clave: fundaciones empresariales, gobierno, teoría de agencia.