Controlling Shareholders: Benevolent “King” or Ruthless “Pirate”

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CONTROLLING SHAREHOLDERS:
BENEVOLENT “KING” OR RUTHLESS “PIRATE”

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Unfair self-dealing and expropriation of minority shareholders by a controlling shareholder are common business practices in developing countries (“bad-law countries”). Although controlling shareholder agency problems have been well studied so far, there are many questions unanswered in relation to behaviors and motivations of controlling shareholders. For example, a puzzle is that some controlling shareholders in bad-law countries voluntarily extract minority shareholders less than other controlling shareholders. Applying Mancur Olson’s framework of political theory of “banditry” to the context of corporate governance, this Article proposes that there are at least two categories of controlling shareholders. “Roving controllers” are dominant shareholders with a short-term view who take substantially all corporate assets at once to the fatal detriment of minority shareholders. On the other hand, “stationary controllers” are far-sighted dominant shareholders who take a part of corporate assets periodically at the modest rate. Based on this new taxonomy of controlling shareholders, this Article uses many new analytical frameworks to solve the puzzle. Most of all, through a discounted cash flow model, this Article explains under what circumstances a controlling shareholder chooses to be “roving” or “stationary.” If a controlling shareholder is able to have a large base of minority shareholders, it would be in his best interest to be stationary (thus generous), since the sum of partial but periodical expropriations would be larger than one-time total plundering. Thus, even without good-law, a stationary controller voluntarily abstains from looting a corporation to the full extent. This Article puts forward new theories of controlling “family” shareholders as well. In the game theoretic context, a controlling family shareholder plays with minority shareholders in a repeated game, so that he is more likely to be stationary and generous to minority shareholders when expropriating. In addition, under the serious information asymmetry problem, controlling family shareholders can send a more credible signal that they are stationary to minority shareholders. As a result, minority shareholders and controlling family shareholders have (relatively) constructive relationship over the long-term basis. This Article also shows that when a controlling shareholder’s psychic value to run a business is evaluated highly, a controlling shareholder is likely to extract minority shareholders less.
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I. INTRODUCTION

“Dispersed shareholder ownership,”¹ in which stocks of a corporation are widely held by atomized and numerous non-controlling shareholders, has traditionally been a dominant theme in corporate governance scholarship.² Nonetheless, the dispersed shareholder ownership based on Berle and Means’ model³ is a localized phenomenon observed only in the United States and United Kingdom.⁴ In the rest of the world, a corporation controlled by a dominant shareholder is the standard form of business organization.⁵ A traditional view portrays the controlling shareholder system – in particular in developing countries – as having a lot of innate problems in terms of investor protection.⁶ Unfair self-dealing⁷ and expropriation of minority shareholders⁸ by a controlling shareholder are common business practices in many controlling shareholder countries. In this sense, these countries are labeled as “bad-law” jurisdictions.⁹

¹ “Dispersed shareholder ownership (system)” is often deemed to be a synonym of “widely-held ownership (system),” in which shares are held by a great number of shareholders without a dominant or a controlling shareholder. U.S. corporations are typically characterized as widely-held corporations where managers and directors make important corporate decisions on behalf of dispersed shareholders with small economic stakes. See e.g., Stephen J. Choi & Eric L. Talley, Playing Favorites with Shareholders, 75 S. CAL. L. REV. 271 (2001-2002).
⁵ In most countries outside the United States and the United Kingdom, large firms are typically controlled by controlling entities – either controlling families or governments. See generally Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, Corporate Ownership around the World, 54 J. FIN. 471 (1999).
⁶ See generally Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, Law and Finance, 106 J. POL. ECO. 1113 (1998). These four distinguished economists – hereinafter, “LLSV” – pioneer a new research area of “law and finance.” In their project, LLSV evaluate corporate governance in 49 countries by means of the investor protection index. LLSV find that minority shareholders are less protected in economies dominated by controlling shareholders.
⁸ Controlling shareholders can expropriate minority shareholders through various ways such as self-dealing, control sales, and freeze-out. See generally Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. PA. L. REV. 785 (2003).
⁹ For a general explanation of bad-law jurisdictions, see Ronald J. Gilson, Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy, 119 HARV. L. REV. (2006).
Although bad-law countries account for the super-majority of the world economy, the behaviors and motivations of controlling shareholders in such jurisdictions are still in a black box with many questions unanswered. For example, (1) why don’t some controlling shareholders in bad-law countries siphon all of corporate assets for their benefits even if the inefficient legal system does not regulate controlling shareholders’ expropriation? (2) If controlling shareholders in such jurisdictions are ruthless corporate pirates as the conventional corporate scholarship describes, why do minority shareholders have (relatively) constructive relationships with some controlling family shareholders over the long-term basis?

To solve these conundrums, this Article interprets Professor Mancur Olson’s political economics framework of banditry\textsuperscript{10} in the context of comparative corporate governance. According to Olson, a “roving bandit” is one who will not come to expropriate victims again.\textsuperscript{11} Thus, he rationally takes every property possible from victims.\textsuperscript{12} The dominance of roving bandits in a community creates chaos and results in anarchy. In contrast, a “stationary bandit” is one who rationally settles down and rules his subjects in a certain domain as a king.\textsuperscript{13} Using the monopolistic power to steal without interference from other bandits, a stationary bandit executes theft in the form of regular taxation rather than total looting, since he has an encompassing interest in his subjects.\textsuperscript{14}

Based on this foundation, this Article posits that controlling shareholders in bad-law jurisdictions expropriate minority shareholders in a manner similar to Olson’s bandits. In the comparative corporate governance scholarship, it is construed that a typical controlling shareholder in a developing country can siphon all assets from a corporation to his own pocket at any time he wishes. For example, in the 1990s “A 51% shareholding interest in a Russian company conveys to the owner a license to steal from the remaining 49% [i.e., all corporate assets].”\textsuperscript{15} More precisely, however, there are at least two types of

\textsuperscript{10}Mancur Olson, \textit{Dictatorship, Democracy, and Development}, 87 AM. POL. SCI. REV. 567 (1993).

\textsuperscript{11}Id.

\textsuperscript{12}Id.

\textsuperscript{13}Id.

\textsuperscript{14}Id.

controlling shareholders. (1) Some controlling shareholders siphon all corporate assets through an abrupt one-shot deal. The above example during Russian privatization shows this type of controlling shareholders vividly. This Article refers to them as “roving controller.” (2) Others are prone to extract a part of a corporation’s assets through ongoing transactions although they can siphon all. Controlling shareholders of large corporate groups in Korea fall in this group. Although they siphon corporate assets on a continuous basis, they do not use total plundering. This Article refers to the second type of controlling shareholders as “stationary controllers.”16 Recently, Chinese economy has developed rapidly. While a large fraction of Chinese economy is composed of state-owned enterprises (SOEs), some controlling shareholders have emerged as important market players. This Article shows China is an interesting jurisdiction since roving controllers and stationary controllers are commingled.17 The new typology of controlling shareholders – “roving” v. “stationary” – can enable policy-makers, jurists, and corporate governance scholars to understand diverse features of Chinese controlling shareholders more.

Another contribution of this Article is to analyze the expropriation of a controlling shareholder in a bad-law country through the analytical framework of “taxation.” From the standpoint of public investors, the illicit transfer of corporate wealth by a controlling shareholder is akin to an unavoidable tax.18 As a rational king imposes generous taxes on his subjects in order to maximize the accumulated tax revenue in the long run, I argue that a far-sighted controlling shareholder has an incentive to be stationary and voluntarily abstains from looting a corporation to the full extent. Interestingly, the reason for the leniency of a stationary controller has nothing to do with his innate generosity. Rather, it is because

(quotin E. Michael Hunter, president of Dart Management).

16 This Article uses “controlling shareholders” and “controllers” interchangeably.

17 Depending on which type of controlling shareholders dominate the domestic economy, developing countries with bad-law can be classified as either roving controller countries or stationary controller countries. See the original version of this Article, Sang Yop Kang, Controlling Shareholders – “Roving” v. “Stationary” (an unpublished chapter of J.S.D. dissertation submitted to Columbia University School of Law). It is also plausible for roving and stationary controlling shareholders to be commingled in one jurisdiction. In that sense, a third group of countries – commingled controlling shareholder countries is possible as well. Professor Curtis J. Milhaupt at Columbia University School of Law suggested this possibility in our discussion.

18 Indeed, in most developing countries, controlling shareholders’ expropriation is not kept in check by the law enforcement due to deeply-rooted “bad-law” features.
benevolent expropriation policy is often economically optimal to him in the long run due to the accumulated effect of periodic expropriations. As such, even without enforcement by good-law, minority shareholders inadvertently end up being more protected than their counterparts under a roving controller’s reign. In turn, this creates the minorities’ incentive to participate in transactions with stationary controllers in the capital market.

In the parlance of game theory, these transactions based on “cooperation” between controlling shareholders and minorities form “repeated games,” resulting in enhanced mutual benefits. Consequently, stationary controller economies will be more prosperous than roving controller economies and sometimes even good-law economies. Perhaps this is a reason why some Asian countries with weak corporate governance are exemplary in terms of economic development.\(^\text{19}\) Corporate autocracy is established when a dominant business entity is featured as stationary and becomes a “king” in his business “empire.” It is true that autocracy is less optimal than democracy – it is best for minority shareholders not to be exploited by controlling shareholders at all. Nonetheless, autocracy is certainly a superior system to anarchy, in which roving controllers’ vandalism and disorder crowd out any possibility of prosperity and development to the full potential. If the nature of bad-law is too systemic and established in a certain economy to be defeated, having stationary controllers is even desirable to investors as the second-best possibility.

Then, under what circumstances does a controlling shareholder choose to become roving or stationary? Another contribution of this Article is to build a generalized model answering these questions. In the model, a controlling shareholder has two options – being stationary or roving. (1) When he considers being stationary, he expects two sources of periodical “pecuniary benefits;”\(^\text{20}\) one is from pro-rata economic interest; and the other is from the extraction of minority shareholders’ assets.\(^\text{21}\) In addition,

\(^{19}\) For example, although the quality of corporate governance in Korea is low according to law and finance theorists, Korea has long been considered a model for economic growth in developing countries. As for the quality of corporate governance measured by “anti-director scores,” see La Porta et al., supra note 6.

\(^{20}\) Compare with a roving controlling shareholder who relies on one-time large pecuniary benefits.

\(^{21}\) See infra Part III C-2.
psychic utility (“non-pecuniary benefits”) such as fame, reputation, and social influence arising from running corporations adds value for him. By contrast, when he considers being roving, he expects to loot (substantially) all of the corporate assets at once. However, non-pecuniary benefits would not belong to him since the corporation does not exist any longer after his entire looting. Considering both options, he can compare the total benefits of acting as a stationary controller and as a roving controller – ultimately he chooses the position where he can receive more benefits.

In addition, based on a game-theoretic approach, this Article sheds light on the roles of large family corporations in developing countries by showing that they often – but not always – function as a catalyst to make controlling shareholders more stationary. Through inheritance within a family, the length of tenure of a family controlling shareholder can be extended to infinity. Then, to stay as a controlling shareholder for a (potentially) eternal time horizon, a family shareholder has to use less radical exploitation in its relationship with minority shareholders. In fact, imposing lenient “taxation” is aligned with a controlling family shareholder’s best interest in the long run. Accordingly, a family corporate dynasty – descendants as well as a founding father – will be able to maintain a “golden goose” producing non-pecuniary as well as pecuniary benefits forever. Concomitantly, minority shareholders are better off in stable family corporations. In this sense, from the corporate governance point of view, a system based on controlling family shareholders might be better than our common sense has suggested.

However, it does not mean that all controlling family shareholders are stationary. In addition, it is possible that stationary family controllers can transform into roving. Second generation’s poor

22 Non-pecuniary benefits are psychic benefits that corporate insiders can enjoy. When a controlling shareholder manages a corporation, he is happy because for example employees follow his orders and he feels that he becomes the most powerful person in the corporation. Such psychic benefits add a controlling shareholder’s utility, and he takes into account non-pecuniary benefits in his utility function. For the explanation of non-pecuniary benefits, see generally Ronald J. Gilson, Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange, 60 STAN. L. REV. 633 (2007).

23 Thus, the total benefits that a controlling shareholder is able to enjoy are the sum of the present value of the pecuniary and non-pecuniary benefits. See infra Part IV.

24 For more explanation, see the “two-factor analysis” infra Part IV.

25 For more explanation of a controlling family shareholder’s infinity time horizon, see generally Gilson, supra note 22.
management skills and structural changes can adversely affect the existing continuous relationship between a controlling family shareholder and minority shareholders. Then the market may perceive a final period, which would destroy the concept of the controlling family shareholder with infinite tenure. In addition, although the expected value accruing to a stationary controller is larger than a roving controller’s payoff, a controlling shareholder could choose being roving. It is because a risk-averse person would like to receive certain amount of economic benefits right now — Carpe Diem may hold.

Against these backdrops, this Article proceeds as follows. Part II sketches the analytical framework of Olson’s banditry. Part III delves into the controlling shareholder regimes with bad-law. Subsequently, this Part puts forward a theory determining under what circumstances a controlling shareholder would choose to be stationary. Part IV explores why a controlling family shareholder is more likely to be stationary. Finally, Part V summarizes and concludes.

This Article highlights the bright side of the controlling family shareholder system through a theoretical prism. Nonetheless, it does not claim family corporations as perfectly optimized business entities. In fact, dark aspects of family corporations have been extensively studied so far. Instead of repeating established common sense, this Article aims to explore uncharted and misunderstood corporate governance dimensions of family corporations. To be sure, the grade for family corporations — if they are stationary — is not “A+.” It is not “C” either, however, and perhaps the corporate governance of stationary family corporations is better than we may have thought.

II. ANALYSIS OF BANDITRY

26 According to the principle of “mean-reverting,” the second generation of management in a family corporation tends to be less capable than the founding father.
27 A final period problem can generate non-cooperation among players in the game even in the first place. See generally MYERSON, infra note 46.
Politics and corporate economics share a lot in common. In fact, corporate governance is the field that examines the political power-plays and relationships of corporate constituencies such as directors, managers, and controlling and minority shareholders.\textsuperscript{29} In this Part, I start with a seeming digression – although it is ultimately pertinent – to Mancur Olson’s political economics theory on the evolution of governmental systems in history.\textsuperscript{30}

A. Roving Bandits and Stationary Bandits

In anarchies and autocracies, powerful political groups are analogous to “bandits” from the perspective of the laypeople, since these groups exploit them by means of violence.\textsuperscript{31} These bandits are diverse in terms of their generosity to the general population, as shown in modern Chinese history.

In the 1920s, China was in large part under the control of various warlords [who ruled in certain domains, independent of the central authority]. They were men who led some armed band with which they conquered some territory and who then appointed themselves lords of that territory. They taxed the population heavily and pocketed much of the proceeds. The warlord Feng Yu-hsiang was noted for the exceptional extent to which he used his army for suppressing bandits and for his defeat of the relatively substantial army of the roving bandit, White Wolf. Apparently most people in Feng’s domain found him much preferable to the roving bandits.\textsuperscript{32}

In short, bandits are classified into at least two groups: less generous “roving bandits” and more generous “stationary bandits.”\textsuperscript{33} As the vocabulary itself explains, roving bandits are bandits who are ready to depart from the pillaged place soon after total plundering.\textsuperscript{34} In anarchy where no single entity dominates the entire domain, powerful groups loot a limited number of victims. Facing uncoordinated

\textsuperscript{29} Discussion with Professor Curtis J. Milhaupt. Agency problems that have been a main topic of corporate governance scholarship can be analyzed in terms of “corporate politics.” As to agency problems in general, see Michael C. Jensen & William H. Meckling, \textit{Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure}, 3 J. FIN. ECON. 395 (1976). For a general explanation of agency problems of a controlling shareholder, see Gilson & Gordon, \textit{supra} note 8.

\textsuperscript{30}\textit{Mancur Olson, Power and Prosperity: Outgrowing Communist and Capitalist Dictatorship} (Basic Book 2000).

\textsuperscript{31} \textit{Id.}

\textsuperscript{32} Mancur Olson, \textit{Dictatorship, Democracy, and Development}, 87 AM. POL. SCI. REV. 567, 568 (1993).

\textsuperscript{33} \textit{Id.}

\textsuperscript{34} \textit{Id.}
competitive theft with other groups, it is in their best interest to take every property possible from victims.\textsuperscript{35} This problem arises since bandits overuse “common properties” – i.e., the properties of victims – without a control tower, so that common properties will be depleted soon.\textsuperscript{36} In other words, roving bandits face the “tragedy of the commons”\textsuperscript{37} – if they do not loot victims’ total wealth, but leave some of it, competing bandits will take the remainder. As a result, roving bandits do not set a long-term goal of theft because they will not come back again to expropriate victims who have nothing. Only “today” is meaningful in the minds of roving bandits.\textsuperscript{38} In a similar way, Somalia pirates are roving bandits. They are ruthless because since they do not expect to see the same victims on the sea in the future.

Facing and expecting cruel and short-term oriented vandalism, victims rationally realize that endurance of a painful “today” will not generate any fruit “tomorrow,” but that total plundering will occur anyway. As a result, victims have little incentive to produce or accumulate anything,\textsuperscript{39} and they make every attempt to leave the place in order to avoid the ruthlessness of roving bandits. As roving banditry becomes more established, it becomes more difficult for roving bandits to find victims that they can loot. Consequently, the welfare of the entire society – both bandits and victims – will deteriorate as this vicious cycle is formed.

A more socially desirable story may occur when a bandit rationally settles down and becomes a stationary bandit who resides with his subjects (who used to be victims under roving bandits’ reign).\textsuperscript{40} In this case, a bandit is established as a dictator – or a king – and monopolizes theft from a certain domain.\textsuperscript{41} Thus, it can be said that anarchy turns into autocracy under a stationary bandit’s regime.\textsuperscript{42} In the absence

\begin{itemize}
  \item \textsuperscript{35} \textit{Id.}
  \item \textsuperscript{36} As for the tragedy of the commons, see generally Garret Hardin, \textit{The Tragedy of the Commons}, \textit{ECONOMICS FOUNDATIONS OF PROPERTY LAW} 2 (Bruce A. Ackermann ed., 1975).
  \item \textsuperscript{37} \textit{Id.}
  \item \textsuperscript{38} In other words, roving bandits are short-sighted. \textit{See Olson, supra} note 32. Pirates can be defined as “roving” bandits in a similar way.
  \item \textsuperscript{39} Olson, \textit{Id.} at 568.
  \item \textsuperscript{40} \textit{See Olson, supra} note 32.
  \item \textsuperscript{41} \textit{Id.}
  \item \textsuperscript{42} \textit{Id.} at 567-568.
\end{itemize}
of competing bandits with whom he must share trophies as in a roving bandits’ regime,\textsuperscript{43} a stationary bandit finds it optimal to thieve in the form of regular taxation with a long-term perspective rather than occasional and brutal plunder.\textsuperscript{44} The reason is that when only a part of their income is taken by a stationary bandit \textit{periodically}, his subjects have an economic incentive to produce, save, and invest.\textsuperscript{45} In contrast to a roving bandit, a stationary bandit pursues long-term interest, and “tomorrow” as well as “today” is significant to him. Under a stationary bandit’s regime, victims are also far-sighted and take into account “tomorrow” as well as “today.” In the vocabulary of game theory, a stationary bandit enters into a “repeated game”\textsuperscript{46} with his subjects.

In this respect, the dismal inter-temporal problem existing under the threat of a roving banditry can be solved by the advent of a stationary bandit. In addition, through rationalizing the theft to a moderate extent and through a positive process of feedback, stationary banditry is mutually beneficial to both the bandit and the victims who are sailing on the same ship.\textsuperscript{47} The welfare of two players – a stationary bandit and his subjects – would be improved in a repeated game, when both players cooperate.\textsuperscript{48} In this way, stationary banditry functioning as an autocracy can generate much better economic performance than roving banditry functioning as anarchy. Democracy with political legitimacy might be the best situation for the general population in terms of political freedom and economic development.\textsuperscript{49} However, given the condition that democracy is remote for the current generation,

\textsuperscript{43} Without competing bandits, the problem of the tragedy of commons could be solved since a stationary bandit does not have an incentive to extract resources excessively.

\textsuperscript{44} Olson, \textit{supra} note 32 at 568. “[a rational stationary bandit] will be able to exact a larger total amount of income from his subjects if he leaves them with an incentive to generate income that he can tax.” \textit{Id.}

\textsuperscript{45} “… the victims of the theft can expect to retain whatever capital they accumulate out of after-tax income and therefore also have an incentive to save and to invest, thereby increasing future income …,” \textit{Id.} at 568.

\textsuperscript{46} For a general explanation of a repeated game, see ROGER B. MYERSON, GAME THEORY: ANALYSIS OF CONFLICT (Harvard University Press 2004).

\textsuperscript{47} In other words, the interests of both parties are generally aligned, so that they have a common incentive to cooperate.

\textsuperscript{48} \textit{See generally} MYERSON, \textit{supra} note 46.

\textsuperscript{49} There is debate as to whether a democracy is always better than a dictatorship for enhancing economic development. Some commentators argue that in certain cases, dictatorship achieves more economic prosperity than democracy. \textit{See e.g.}, Ronald J. Gilson & Curtis J. Milhaupt, \textit{Economically Benevolent Dictators: Lessons for Developing Democracies}, 59 AM. J. COMP. L. 227 (2011).
coexistence with stationary bandits rather than with roving bandits would be much more desirable to victims.50

B. Bandits’ Tax Policies and Impacts

This Subpart discusses bandits’ various exploitation methods and victims’ responses through the analytical framework of taxation. Tax revenue is equal to the product of a tax rate and taxable income (i.e., the tax base). For example, when taxable income is 100 million dollars and a tax rate is 20 percent, tax revenue is 20 million dollars. Since taxpayers’ incentive to earn income is more discouraged by a higher tax rate, the trade-off relationship between tax rate and tax base is apparent.51 As the tax rate increases, the size of tax revenue is dependent on the relative strengths of two competing factors.52 Initially, when the tax rate increases, tax revenue increases as well since the positive effect of the increased tax rate is stronger than the negative effect of the decreased tax base.53 However, when the tax rate reaches the revenue-maximizing point, tax revenue goes down as the tax rate continues to rise.54 This is because this burdensome range of tax rate adversely distorts taxpayers’ incentive to earn (taxable) income55 – the positive effect of the increased tax rate is overwhelmed by the negative effect of the

50 Another example of stationary banditry can be found in organized crimes. Once a criminal organization establishes monopolistic dominance in a certain area, members of the organization will soon understand that it is rational to protect their victims’ property rights to some degree. Under a moderate level of exploitation of victims, the criminal organization is able to extract more wealth from victims in the long run since victims have an incentive to produce continuously.

51 The trade-off relationship between tax rates and tax revenues is named the Laffer Curve. As Laffer himself admits, however, this concept should be credited to Ibn Khaldun, a 14th century Muslim philosopher, and more recently, John Meynard Keynes. Arthur B. Laffer, The Laffer Curve: Past, Present, and Future, Heritage Foundation (2004) (available at http://www.gates-home.com/files/Laffer%20Curve%20Past%20Presnt%20and%20Future.pdf.). Professor Olson stated, “As Joseph Schumpeter (1991) lucidly pointed out, and Ibn Kalduhn (1967) sensed much earlier, tax receipts will (if we start with low taxation) increase as tax rates increase, but after the revenue-maximizing rate is reached, higher tax rates distort incentives and reduce income so much that tax collections fall.” Olson, supra note 10 at 569.

52 See Laffer, supra note 51.

53 Id.

54 Id.

55 Olson, supra note 10; Laffer, supra note 51.
decreased tax base. Thus, if the government is economically rational to maximize tax revenue, it should impose the optimal tax rate\(^56\) rather than levy a harsh tax rate that destroys tax payers’ willingness to work.

**Figure 1: Optimal Tax Rate\(^57\)**

![Graph of Optimal Tax Rate]

\(X\) axis: tax rate (“0” stands for 0% tax rate and “1” stands for 100% tax rate)

\(Y\) axis: tax revenue

In Olson’s world, the method and degree of “taxation” (i.e., theft by bandits) is an important feature in distinguishing roving from stationary bandits. An (extreme) roving bandit’s tax rate is virtually 100 percent. This total plundering may work in the first stage. However, since victims soon recognize that they have no benefits, they will end up producing nothing from the next stage on. Accordingly, the tax base will shrink to zero, and the tax revenue accruing to a roving bandit will approach zero.\(^58\) In contrast, when a bandit becomes stationary and has a long-term time horizon, a self-interested bandit chooses a revenue-maximizing optimal tax rate which is far less than a roving bandit’s ruthless tax rate.\(^59\) A more generous tax policy will foment a bandit’s subjects’ incentive to produce, which will create a

\(^{56}\) In this Article, the “optimal tax rate” is referred to as the tax rate which maximizes tax revenue for a bandit.

\(^{57}\) This is a simplified graph for the revenue-maximizing tax rate. The graph is not necessarily symmetric.

\(^{58}\) Tax revenue is equal to the product of a tax rate and a tax base. When a tax base is zero, tax revenue is zero as well.

\(^{59}\) Olson, *supra* note 10.
larger tax base. The sum of tax revenue in the long run will generally exceed the one-shot tax collection of a comparable roving bandit.

III. CONTROLLING SHAREHOLDERS – “ROVING” V. “STATIONARY”

So far, concepts of bandits in a political economy theory and bandits’ tax policies are introduced and reviewed. In this Part, this political economy theory is reinterpreted in the context of corporate governance.

A. Agency Problems in the Controlling Shareholder Systems with Bad-Law

Since Berle and Means’ declaration on the separation of ownership and management in U.S. corporations, the “dispersed shareholder system” has been established as the norm and standard in corporate governance academia. However, the dispersed shareholder system is a localized phenomenon that can be observed only in the United States and United Kingdom. Rather, the alternative ownership, i.e., the “controlling shareholder system,” prevails across Europe and Asia. Broadly, there are two types of controlling shareholders – one is the government and the other is a controlling family shareholder. For example, in China many corporations are controlled by the Chinese government, although there are

60 Berle & Means, supra note 3.
62 Hofstetter, supra note 2.
63 John C. Coffee Jr., supra note 4 at 642. Professors La Porta, Lopez-de-Silanes & Shleifer find that “the Berle and Means corporation is far from universal, and is quite rare for some definitions of control.” La Porta et al., supra note 5. In addition, Professors Bebchuk and Roe explain that at present, publicly traded companies in the United States and the United Kingdom commonly have dispersed ownership, whereas publicly traded companies in other economies generally have controlling ownership. Lucian A. Bebchuk & Mark Roe, A Theory of Path Dependence in Corporate Ownership & Governance, 52 Stan. L. Rev. 127 (1999).
64 See generally Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, Corporate Ownership Around the World, 54 J. Fin. 471 (1999).
65 Coffee, supra note 4 at 643.
a great number of family corporations. Economies such as Korea, India, and Brazil are dominated by family shareholders’ corporate groups.

Comparative corporate governance scholarship based mainly on law and finance theory has explained that the controlling shareholder system is systematically worse in protecting outside investors than the dispersed shareholder system. In particular, unfair self-dealing (or “tunneling”) - a practice where a controlling shareholder illicitly transfers corporate wealth at the sacrifice of minority shareholders – is at the center of agency problems. Sinclair Oil Corp. v. Levien – a leading U.S. case in relation to a controlling shareholder’s interested transactions – provides a useful explanation of definition of self-dealing: “Self-dealing occurs when a [controlling shareholder], by virtue of domination of [his controlled corporation], causes [the corporation] to act in such a way that [the controlling shareholder] receives something from the corporation to the exclusion of, and detriment to, the minority shareholders.”

67 See e.g., La Porta et al., supra note 6.

68 LLSV made a great contribution to the comparative corporate governance scholarship. Often their research has been interpreted to mean that the controlling shareholder regime is inferior to the dispersed shareholder regime. This view has been widely accepted in the corporate governance scholarship. For example, Professor Gilson explains, “In this [LLSV’s] account, controlling shareholder regimes exist in jurisdictions whose legal systems do not protect minority shareholders from dominant shareholders’ diversion of private benefits of control.” Gilson, supra note 22. However, Gilson adds. “The simple dichotomy between controlling shareholder systems and widely held shareholder systems that has largely dominated academic debate thus far seems to me much too coarse to allow a deeper understanding of the diversity of ownership structures in different national capital markets and of the policy implications of those structures.” Gilson, supra note 9. Then, he argues that the controlling shareholder system with good-law is functionally equivalent to the dispersed shareholder system in terms of investor protection. Gilson, supra note 9. But, note that Gilson’s analysis of the controlling shareholder system centers on developed countries with good-law. In contrast, this Article emphasizes controlling shareholders in developing countries with bad-law.

69 “Tunneling” is meant to be expropriation of minority shareholders by a controlling shareholder. “… we use the term ‘tunneling,’ coined originally to characterize the expropriation of minority shareholders in the Czech Republic (as in removing assets through an underground tunnel), to describe the transfer of assets and profits out of firms for the benefit of those who control them.” Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Tunneling, 90 AM. ECON. REV. 22, 22 (2000).

70 Agency problems of controlling shareholders, such as tunneling, are referred to as “controlling shareholder agency problems.” See e.g., Zohar Goshen, Controlling Corporate Agency Costs: A United States-Israeli Comparative View, 6 CARDozo J. INT’L & COMP. L. 99 (1998). On the other hand, the dispersed shareholder system is subject to “managerial agency problems” as well. In the dispersed shareholder system, the combination of shareholders who are atomized and executives with powerful discretion in corporate operations inevitably creates opportunities for corporate managers who are principals of corporations to take advantage of shareholders. For more explanation of managerial agency problems, see generally Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. FIN. ECON. 395 (1976). Academics and practitioners have recognized and observed managerial problems in the contexts of executive compensation, M&A defense, and empire building. See Lucian A. Bebchuk, The Myth of Shareholder Franchise, 93 VA. L. REV. 675 (2007).

71 280 A.2d 717 (Del. 1971).
stockholders of [the corporation].”

Sinclair also clarifies issues related to standards of review. When a business transaction at issue is a controlling shareholder’s interested transaction, business judgment rule is not applied. Rather, entire fairness – a less favorable standard of review from the standpoint of a controlling shareholder – will be used. In addition, criminal sanctions may be imposed as well in some jurisdictions.

A simple form of tunneling is outright theft of corporate value by a controlling shareholder. A famous example is that a controlling shareholder in Czech Republic steals corporate assets through an underground tunnel. In an alternate scenario, a controlling shareholder can use a more sophisticated form of tunneling by altering terms and conditions of internal transactions. For instance, when he exercises control over both Company A (by 51 percent ownership) and Company B (by 10 percent ownership), he can transfer corporate value of Company B to Company A by manipulating transfer pricing more favorable for Company A. Victims are non-controlling shareholders of Company B who hold the remaining 90 percent of economic interest. Indeed, it is widely known that harmful effect of self-dealing or tunneling is more serious when a dominant shareholder has a low level of ownership in his controlled-corporation.

One may be curious how the controlling shareholder can dominate Company B with only 10 percent ownership. Although a shareholder holds a small fraction of the economic stake in a corporation, he can exercise controlling power if he is able to maintain a majority of voting power through stock

72 Id. at 720.
74 See Johnson et al., supra note 69 at 22.
75 Id. at 22-23.
76 For example, see Stijn Claessens, Simeon Djankov, Joseph Fan, and Larry Lang, Disentangling the Incentive and Entrenchment Effects of Large Shareholders, 57 J. Fin. 2741 (2002).
77 There are two types of controlling shareholder regimes – (1) the controlled structure (CS) and (2) the controlling minority structure (CMS). In the CS, a controlling shareholder has power to control a corporation by owning a majority of shares. In the CMS, a controlling shareholder controls a corporation through his inflated voting rights even though he does not own a majority of shares. See Lucian Bebchuk, Reinier Kraakman, & George Triantis, Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights, CONCENTRATED CORPORATE OWNERSHIP (Randall K. Morck ed., 2000).
pyramiding, dual class equity structure, and intra-shareholding. For example, an individual can inflate his voting power by means of stock pyramiding. Suppose that he has 50.1 percent ownership of a holding company, which owns 50.1 percent stake in Company X. Subsequently, Company X owns 50.1 percent stake in Company Y. He effectively exercises control over a grandson legal entity, Company Y through the pyramiding chain from the holding company. Thus, he is the controlling shareholder of three corporations even if his economic interest in Company Y is only around 12.5 percent.

Mr. Kun-Hee Lee, the controlling shareholder of Samsung Group, controls more than 70 subsidiaries (including Apple’s archrival, Samsung Electronic). Interestingly, his personal economic interest in Samsung Group is only 0.69 percent. The magical voting leverage scheme he relies on is complicated intra-shareholding (rather than a simple pyramiding). A more adroit person who uses such intra-shareholding is Mr. Tae-Won Choi, the dominant shareholder of SK Group, another large business group in Korea. Astonishingly, he holds only 0.04 percent ownership of SK Group. In fact, voting leverage mechanisms – stock pyramiding, dual class equity structure, and intra-shareholding – are widely used in the world. Examples include Hees-Edper Group in Canada, Anglo-American Group in South

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78 For a general explanation of stock pyramiding, see Bebchuk et al., supra note 77.
79 In the dual class share structure, a company can issue two or more classes of stock with differential voting rights (e.g., Class A stock for 10 votes and Class B stock for 1 vote). See Bebchuk et al., supra note 77. When the dual class share structure is adopted after a company has already become a publicly traded company, it is more problematic in terms of protection of public shareholders. For more explanation of this problem see Jeffrey N. Gordon, Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 CAL. L. REV. 1 (1988); Ronald J. Gilson, Evaluating Dual Class Common Stock: The Relevance of Substitutes, 73 VA. L. REV. 807 (1987).
81 See Randall Morck, How to Eliminate Pyramidal Business Groups: The Double Taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy (http://www.nber.org/chapters/c0167) at 137
82 50.1% x 50.1% x 50.1% = 12.5%.
83 Jong-Sung Yun, Kun-Hee Lee and Tae-Won Choi Control Their Business Groups with 0.69% and 0.04% Ownership Respectively, E-Daily (May 30, 2013), http://www.edaily.co.kr/news/NewsRead.edv?SCD=IA11&newsid=01974566602814168&DCD=A00101&OutLnkChk=Y. Including his children’s cash flow rights, Mr. Lee holds 1.27% of economic interest in Samsung Group.
84 Id.
Africa, and Agnelli Group in Italy.\textsuperscript{85} Using pyramiding scheme is prevalent among Chinese listed companies as well.\textsuperscript{86} For example, “Kelon Electronics, the listed company, is majority-owned by Kelon (Yongsheng) Holding Company, and this holding company in turn is 100% owned by the town municipal government.”\textsuperscript{87}

\section*{B. Roving Controllers and Stationary Controllers}

In the context of corporate governance, whoever takes corporate assets to the detriment of investors can be named as a corporate bandit.\textsuperscript{88} When the corporate law is not protective in a jurisdiction and looting is inevitable, one significant issue to victims is a corporate bandit’s degree of looting a corporation. Accordingly, whether he is roving or stationary is a focal point from the standpoint of victims.

\subsection*{1. A New Typology of Controlling Shareholders}

Although even good-law countries are not able to perfectly prevent transactions with conflicts of interest,\textsuperscript{89} minority shareholders in such jurisdictions are by and large insulated from a large scale of expropriation by corporate insiders (professional managers or controlling shareholders). In the United States, statutes and common law effectively protect public investors, especially from unfair transactions arising from a conflict of interests. As Professor Merritt Fox explains, the U.S. doctrines and jurisprudence of corporate law have been developed in order to solve problems imposed by corporate “buccaneers.”\textsuperscript{90} For example, entire fairness standard developed in \textit{Sinclair}\textsuperscript{91} and \textit{Weinberger v. UOP},

\begin{thebibliography}{99}
\bibitem{Morck} See Morck, supra note 81 at 137-38.
\bibitem{Roe} In this sense, corporate bandits are similar to “robber barons.”
\bibitem{Roe2} In addition, good-law countries can be subject to huge managerial agency problems. See generally Mark J. Roe, \textit{Corporate Law’s Limit}, 31 J. LEGAL STUD. 233 (2002).
\bibitem{Fox} Discussion with Professor Merritt B. Fox at Columbia Law Scho.
\end{thebibliography}
Inc. protect minority shareholders. In Sweden, although a limited number of wealthy families dominate the entire economy, it is known that they do not siphon public corporations’ wealth. In these law-abiding economies, when a corporate bandit is recognized, enforcement agencies or courts will intervene and punish him.

Notable U.S. examples include legal enforcement against Madoff’s Ponzi scheme and accounting manipulation of Enron’s top management. Although these examples reveal a weakness of the U.S. corporate governance to some extent, they also show that the U.S. legal system is resilient and has the sufficient capability to rectify problems when they appear. By contrast, most developing countries (and even some developed countries such as Italy) lack well-performing legal infrastructures that are designed to effectively protect investors in the capital markets. The piracy of controlling shareholders is in practice a default rule in bad-law countries. In other words, expropriation of minority shareholders is understood as an unavoidable tax imposed by a corporate bandit. Even after large-scale corporate scandals, legal systems in such jurisdictions are not able to learn lessons quickly to prevent similar problems in the future.

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91 Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971).
92 For example, in the United States, case laws have been developed to protect public investors from a dominant shareholder. Weinberger v. UOP, Inc. 457 A.2d 701 (Del. 1983).
93 In this sense, institutions around corporations in Sweden are functionally equivalent to those of the United States, even though the two countries differ in terms of dispersed and controlling shareholder systems. Gilson, supra note 9.
95 Interestingly, Italy – even if it is one of G-7 member countries – has been considered to be a bad-law country in corporate governance scholarship. See Gilson supra note 9. For example, Professors Shleifer and Vishny state, “In many countries today, the law protects investors better than it does in Russia, Korea, or Italy.” Andrei Shleifer & Robert W. Vishny, A Survey of Corporate Governance, 52 J. FIN. 737, 742 (1997). Another comment of Professors Shleifer and Vishny is noteworthy as well. “In contrast, corporate governance systems in most other countries, ranging from poor developing countries, to transition economies, to some rich European countries such as Italy, lack some essential elements of a good system,” id. at 739.
96 Of course, it does not mean that this default rule is desirable. What is explained here is the reality in bad-law countries. As to comparative corporate governance, see e.g., La Porta et al., supra note 6.
97 In this sense, the analysis of taxation aforementioned in Part II B can be used in the context of corporate governance in a bad-law jurisdiction.
Similarly to Olson’s “political bandits,” in bad-law jurisdictions there are two basic types of controlling shareholders. (1) Ruthless controlling shareholders with myopia – “roving controllers” – may take almost all corporate value through a one-shot transaction. They are those who siphon all assets from corporations at the sacrifice of minority shareholders. Put differently, a roving controller’s “taxation” is excessively harsh. As a result, it is severely detrimental to minority shareholders so that they lose incentive to invest their money in that corporation. Then corporate value, which is analogous to tax base, will drastically decrease in the subsequent period and a roving controlling shareholder may not have another opportunity to accumulate his pecuniary interest in the future. As such, roving controlling shareholders do not use the long-term “optimal tax rate” strategy. Since roving controlling shareholders have full discretion on the extent of expropriation, there is an urgent call to protect minority shareholders from corporate pirates’ tyranny.

However, the presence of another type of controlling shareholder – “stationary controllers” – can relieve this concern at least to some degree. A controlling shareholder with sufficient strength in the economy may rationally settle down in the domestic capital market. Now, the controlling shareholder understands that he is not a mere roving “pirate” but a stationary “king” in his empire, i.e., his controlled corporation. Then, it is in his best interest to impose partial and periodic taxes on minority shareholders. In order to maximize the amount of pecuniary private benefits – which are tax

98 As for Olson’s political bandits, see Part II A.
99 See supra note 15 and its accompanying text.
100 Tax revenue is the product of a tax rate and a tax base. When a tax base – corporate value – shrinks, ultimately tax revenue – a roving controlling shareholder’s pecuniary interest – will shrink as well.
101 As explained, the “optimal tax rate” is meant to be the “tax rate” (i.e., the extent of minority expropriation) which generates maximization of the long-term “tax revenue” (i.e., the amount of pecuniary benefits of control) to a controlling shareholder.
102 In other words, a roving controlling shareholder is subject to short-termism, or myopia problem. For more explanation of short-termism in the other contexts of corporate governance, see e.g., Bernard S. Black, Agents Watching Agents – The Promise of Institutional Voice, 39 UCLA L. REV. 811 (1991-1992); Martin Lipton and William Savitt, The Many Myths of Lucian Bebchuk, 93 VA. L. REV. 733 (2007).
103 In other words, a stationary king is not able to stay with his subjects if he relies on total plundering all at once.
104 In general, (pecuniary) private benefits of control are meant to be a controlling shareholder’s illicit benefits extracted from his controlled corporation, which result in minority shareholders’ financial damage. As to the explanation on the (pecuniary) private benefits, see e.g., Lucian Arye Bebchuk, Efficient and Inefficient Sales of
revenues – a stationary controller chooses the “optimal extraction rate”\textsuperscript{105} that is far less than a roving controller’s prohibitively high tax rate.

Indeed, this is a very important phenomenon with many corporate governance implications. First, for the sake of long-term prosperity, a stationary controlling shareholder does not abuse his power to loot to the full extent even if he can, because limiting theft in each period generates enhanced total theft in the long run. Second, a stationary controlling shareholder’s self-control is not the result of his generosity or business ethics, but of his carefully-calculated rationality. Third, irrespective of a controlling shareholder’s genuine or disguised motive, minority shareholders end up being inadvertently protected at least to some degree. In this sense, forth, extra-legal factors such as the self-interest of controlling shareholders can substitute for an efficient and protective legal infrastructure for public investors. Without strong intervention by the government and judiciary, the market with bad-law can perform self-regulation, which is similar to Adam Smith’s explanation of the “invisible hand.”\textsuperscript{106}

2. Examples of Roving Controllers

Since its economic reforms in the 1980s, Chinese economic development has been remarkable. However, the quality of corporate governance among corporations is still poor. For example, the largest shareholder in Meierya siphoned 44.6 million dollars in 2001 – the amount of embezzlement is 41 percent of the company’s equity capital.\textsuperscript{107} In 2001, the largest shareholder in Sanjiu Parma expropriated 301.9 million dollars, 96 percent of the company’s equity capital, from the company.\textsuperscript{108} These examples show


\textsuperscript{105} Similarly to the “optimal tax rate,” in this Article the “optimal extraction rate” is defined to be the extraction rate imposed by a controlling shareholder which maximizes his pecuniary private benefits.

\textsuperscript{106} See Adam Smith, \textit{THE WEALTH OF NATIONS} (1776). In fact, Olson himself explains that there is an “invisible hand” behind stationary banditry. Olson, \textit{supra} note 10.


\textsuperscript{108} \textit{Id.}
sudden and total (or substantial) plundering of corporate value, which is the very feature of roving controllers’ extraction.

Foreign investors doing business in China are sometimes characterized as roving as well. It was a serious social problem in China that some foreign business people took substantially all corporate assets and left China overnight without any legal notice to other investors, trading partners, and employees. For example, 206 cases of improper business withdrawal by Korean-owned companies were reported in Qingdao from 2000 to 2007. Most of such “moonlight flitting” cases happened with respect to bankruptcy, so that these cases are different from more active embezzlement by controlling shareholders. Nonetheless, these cases are in nature roving since other constituencies are seriously damaged for dominant business people’s benefits.

In addition, Russia in the 1990s provides vivid examples of roving banditry. After the Soviet Union collapsed in the early 1990s, new Russia adopted market-oriented economic policies characterized by in particular drastic and massive privatization. A large fraction of Russia’s enterprise was placed under control of a handful of politically well-connected “oligarchs,” the most powerful businessmen who emerged and secured control over banks, media, and natural resources during the early years of transition. Oligarchs purchased major companies at deeply discounted prices from the government, and realized that “they could plunder their firms with negligible risk of prosecution” –


111 Market-oriented economic policies adopted in Russia during the 1990s are described as a “shock therapy.” See e.g., Peter Murrell, What is Shock Therapy? What Did it Do in Poland and Russia?, 9 POST-SOVET AFF. 111 (1993).


113 Id.


116 Id. at 1754.
most of Oligarchs relied on outright theft and self-dealing, so that they transferred massive corporate value to the detriment of other corporate constituencies as well as minority shareholders. As for cases where Oligarchs were involved, judges were often bribed, so that there was no fear from Oligarchs’ side when they stole properties from corporations.

The case of Mikhail Khodorkovsky, — “(once) the richest man in Russia” — is exemplary to explain roving banditry in Russia during the massive privatization. By using his controlled Bank Menatep, Khodorkovsky acquired Yukos, a major oil holding company in Russia in 1995. Then, in 1996, he took over 30 percents of Yukos’ revenues personally, effectively expropriating the wealth of minority shareholders. After substantial stealing during the short time, interestingly the board of Yukos had pledged compliance with international principles of good corporate governance. As widely known, Khodorkovsky had political ambition as well, and was considered a political rival of Mr. Putin. Therefore, allegedly, the real intention of Khodorkovsky to follow the global standard of corporate governance was to fend off any future political attacks by seeking allies with foreign investors.

Due to Russian financial crisis in 1998, Bank Menatep suffered huge losses on Russian government bonds denominated with rubble. Although he could have saved the bank through his offshore wealth, he chose to let the bank collapse. Subsequently, he transferred its good assets to a new bank, Menatep-St. Petersburg, with depositor and creditors empty hands. Furthermore, he stripped virtually all assets of subsidiaries of Yukos (as well as Yukos itself) by transferring assets to offshore

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117 See e.g., Black & Tarassova, supra note 112; Black, Kraakman & Tarassova, supra note 115.
118 Lee S. Wolosky, Putin’s Plutocrat Problem, FOREIGN AFF. (2000).
119 Black, Kraakman & Tarassova, supra note 115 at 1736-1737.
119 Id. at 1736-1737.
119 Id. at 1736-1737.
120 Id. at 1736-1737.
121 MILHAUPT & PISTOR, supra note 114.
122 Id. at 155.
123 Id.
124 Black, Kraakman & Tarassova, supra note 115 at 1770.
125 Id. 1770.
126 Id. at 1754.
Minority shareholders faced substantial losses and opposed to such proposals – but their opposition was easily suppressed by Khodorkovsky in a bold way.

The day before the subsidiaries’ shareholder meetings, Yukos arranged for a compliant judge to declare that the minority shareholders were acting in concert, in violation of the Antimonopoly Law. The judge disqualified everyone but Yukos and its affiliated shareholders from voting. When minority shareholders arrived at the meetings, they were greeted by armed guards; most were barred from voting or attending on the basis of this court order. Yukos’ shares were voted and were counted as noninterested; the proposals all passed. Having used Yukos’ voting power to ram through these proposals, Khodorkovski then transferred Yukos’ remaining shares in two of the three oil-producing subsidiaries to still other offshore companies.

Finally, Khodorkovsky was arrested for his wrongdoing when he fled Russia. He is still in a jail. Interestingly, it is alleged that his personal misfortune is not entirely because his misconduct and violation of law in relation to his business – Putin’s animosity towards him was reflected in legal enforcement as well.

3. Examples of Stationary Controllers

Although some roving bandit cases are seen in China, many corporations in China are not involved in total plundering. A pervasive phenomenon in Chinese listed companies is that controlling shareholders extract corporate profits by means of corporate loans. This type of tunneling is found more detrimental to minority shareholders when a controlling shareholder’s voting power is larger than his economic interest in a corporation. Nonetheless, it is noteworthy that most of Chinese companies are going-concern entities. As long as controlling shareholders do not loot entire (or substantially all) corporate assets at the sacrifice of minorities, they are stationary.

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127 Black & Tarassova, supra note 112 at 2137. For more explanation, see Black, Kraakman & Tarassova, supra note 115.
128 Black, Kraakman & Tarassova, supra note 115 at 1771.
129 Id.
131 See id.
Another example of stationary banditry can be found in Korea. During the period from the 1960s to the early 1990s, military dictatorship had ruled Korea. General Jung-Hee Park led a military coup and took power until 1979 when he was assassinated by his chief officer of intelligent agency. Subsequently, General Doo-Hwan Chun mounted another successful coup and ruled Korea in the 1980s. A stroke of good luck in the midst of political misfortunes in Korea was that the military regime was committed to economic development. To that end, a handful of elite businesspeople were selected and subsidized by the government. Then, these business elites could firmly establish chaebols – powerful business groups in Korea – and became controlling family shareholders. Chaebols were developed as quasi-monopolists in each industry.

In general, chaebols were considered to be an engine for economic growth. In particular, Samsung, LG, and Hyundai successfully compete in the global market. Nonetheless, they had (and still have to some extent) serious problems with respect to protection of minority shareholders particularly before the Asian financial crisis of 1997. As some commentators explain, “In addition to the consumption of perks, the chaebols’ ‘owners’ commonly used ‘tunneling’ and ‘asset-grabbing’ schemes to transfer corporate value from their minority shareholders.” In this respect, controlling shareholders of chaebols were (and perhaps still “are”) corporate bandits.

The dominant shareholder of Samsung Group (the largest chaebol in Korea), Mr. Kun-Hee Lee expropriated minority shareholders’ corporate wealth in a very sophisticated and complicated scheme.

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132 Then, Tae-Woo Rho – who actively participated in Chun’s coup – stayed in power by 1993. Although Mr. Rho is also a former military man, he was an elected president by popular vote. In this sense, his era was in transition period between the military regime and the democratic regime in Korea.


134 Id.

135 As for chaebols and corporate governance in Korea, see e.g., Ok-Rial Song, The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol, 34 LAW & POL’Y INT’L BUS. 183 (2002); Bernard S. Black, Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness, 26 J. CORP. L. 537 (2001); James Jinho Chang & Hyun-Han Shin, Family Ownership and Performances in Korean Conglomerates, 15 PACIFIC-BASIN FIN. J. 329 (2007).

when he tried to pass a part of his control ownership to his only son. For such wrongdoing, he stood criminal trial but finally he was found not guilty,\textsuperscript{137} which is still controversial. Nonetheless, he was found liable in a following civil suit for the same conduct.\textsuperscript{138} The controlling shareholder of Hyundai Motors, Mr. Mong-Koo Chung was similarly involved in misappropriation of corporate opportunity for his son’s benefits.\textsuperscript{139} Mr. Tae-Won Choi, the dominant shareholder of SK Group is currently under the court’s custody and stands criminal trial for his alleged embezzlement from his controlled corporation.\textsuperscript{140}

Indeed, above examples show a serious problem of tunneling among Korean chaebols. Nonetheless, these controlling shareholders’ misconduct sharply differs from one-time, sudden, and total plundering in roving banditry. In other words, controlling shareholders of chaebols do not fatally damage minority shareholders by “killing” their controlled corporations. It is clear when aforementioned examples of roving banditry – Sanjii Parma in China (embezzlement of 96% of equity capital) and Khodorkovsky in Russia (abandoning controlled corporations for the controlling shareholder’s benefits) – are compared. Although the amount of extraction is large in terms of absolute value, it is not large enough in terms of relative value, compared to corporations’ asset size and market capitalization.

C. When a Controlling Shareholder Rationally Chooses to Be “Stationary”

So far, this Article reviews examples of roving controllers and stationary controllers in the real world. From now on, this Subpart uses a more theoretical approach again. It is possible that some controlling shareholders in bad-law countries may be moralistic and ethical because of their personality, and thus they voluntarily do not loot minority shareholders to the full extent. Although this humane


\textsuperscript{138} Id.


\textsuperscript{140} For more explanation of the criminal case of Choi and his brother, see generally Hyun-A Kim, President Tae-Won Choi Case: Unsolved Four Puzzles, E-Daily (Jun. 25, 2013), http://www.edaily.co.kr/news/NewsRead.edy?SCD=JC41&newsid=0283926602845328&DCD=A00304&OutLnk Chk=Y
possibility is not entirely ruled out, the aim of this Article is to figure out hidden socio-political economic rationalities that affect a controlling shareholder’s decision on the method of stealing. The question is: under what circumstances does a controlling shareholder choose to be roving or stationary? There might be more than two types of controlling shareholders. For example, a semi-stationary controller may exist and the question of “roving” v. “stationary” is too simple. Nonetheless, developing a new theory based on a simplified analytical framework of two extremes might be a good start.

1. When Does a Controlling Shareholder Become Stationary (or Roving)? – A Numerical Example

Under an inefficient legal system and ineffective enforcement, an extreme roving controller extracts corporate value from public shareholders (or other corporate constituencies) in the form of a one-shot deal. A numerical example can explain a controlling shareholder’s choice in a more concrete way. Suppose that minority shareholders invest 100 million dollars in a corporation that one dominant shareholder exercises control over. Suddenly, the controlling shareholder extracts the entire capital from the corporation at once, and it is left as a shell that does not have any meaningful assets – in fact, this sort of misconducts by corporate insiders (either managers or controlling shareholders) was prevalent during the Russian privatization.

Alternatively, a controlling shareholder may think that maintaining a corporation as a proverbial “golden goose” is more attractive to him (and his children), if he extracts a part of the corporate value for a long time. Suppose that a controlling shareholder illicitly transfers a cash flow of 5 million dollars each year continuously. If this amount of exploitation is sustainable and acceptable to minority shareholders,

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141 Of course, it does not mean that all roving controlling shareholders take the entirety of corporate assets suddenly through a one-shot transaction. Instead, it is possible that roving controlling shareholders take substantial corporate assets through a series of transactions in a short time period. The author takes an extreme type of a roving controlling shareholder – who takes all corporate assets suddenly through a one-shot transaction – in order to build a simplified model.

142 See generally Bernard Black, Reinier Kraakman, & Anna Tarassova, supra note 115.
they are willing to keep investing their money in that corporation. For simplicity, the discount rate is assumed to be zero here. If the controlling shareholder is patient enough to maintain a long horizon of time, in 20 years he will be better off – the total pecuniary benefit that he can gain as a stationary controller is more than 100 million dollars, which is the amount of a one-shot extraction as a roving controller. Conversely, if a controlling shareholder is short-sighted for some reasons – for example, he would stay for less than 20 years – he is likely to choose to be roving.

2. When Does a Controlling Shareholder Become Stationary (or Roving)? – A Generalized Model

To build a more generalized model to analyze controlling shareholders’ conducts, the valuation model based on discounted cash flow (DCF) can be used. According to the DCF formula, the present value of an asset is equal to the sum of the present values of expected cash flows with relevant discount rates. Since the life of common stocks is assumed to be infinite except in the case of bankruptcy or acquisition, the price of common stocks of a firm \( P_0 \) can be expressed as the present value of a perpetual stream of cash dividends \( CF_t \). In particular, when a company’s dividends are expected to grow at the constant rate \( g \), the stock price \( P_0 \) is calculated by dividing the dividend of the first year by the difference between the discount rate and the growth rate.

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143 When public shareholders decide whether or not to remain in a controlled corporation, they will take into account “tax” by controlling shareholders, which is a controlling shareholder’s exploitation of public shareholders. If the “after tax” return is satisfactory to public shareholders, they keep their investment in that corporation.

144 In other words, the strategy of a modest annual and periodic stealing (i.e., “taxation”) for a long time is better for him than that of a drastic looting of the entirety of corporate assets all at once.

145 This might be at least “a” reason – although not “the” reason – why many corporate insiders are roving in Russia during the Russian privatization. The Author is working another project on problems and lessons of the Russian privatization.

146 For the more information about the valuation of shares, see generally RICHARD A. BREALEY, STEWART C MEYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE (McGraw-Hill Irwin 8th ed. 2006).

147 Id. In fact, the DCF model has been used in Delaware for the purpose of valuation. See e.g., Weinberger v. UOP, Inc. 457 A.2d 701 (Del. 1983).

148 See BREALEY ET AL., supra note 146.

149 Id.
(\(CF_i\)) by the difference between the discount rate (\(r\)) and the growth rate (\(g\)),\(^{150}\) as is suggested by the constant growth model in Table 1.\(^{151}\)

**Table 1: The Present Value of a Common Stock**\(^{152}\)

\[
P_0 = \sum_{t=1}^{\infty} \frac{CF_t}{(1 + r)^t} = \frac{CF_1}{r - g}
\]

- \(P_0\): the price of common stocks of a firm
- \(CF_t\): cash dividends that shareholders are paid at the end of year \(t\)
- \(r\): the discount rate
- \(g\): the growth rate

Then, consider how this DCF valuation model can be used to explain a controlling shareholder’s choice to be stationary. In a developing country with bad-law, it can be said that a stationary controlling shareholder receives two types of cash flows from a corporation, as shown in the numerical example above. (1) He is paid *pro-rata* “normal” cash flows on a continuous basis. Such cash flows are “normal” because they are *legitimate* pecuniary benefits from a corporation. Generally, these cash flows are available to *all* public shareholders according to each shareholder’s economic interest. The total sum of all “normal” cash flows is defined as the “present value of normal cash flows” (\(ND_0\)). (2) In addition, he is paid “special” cash flows on a continuous basis. Such cash flows are “special” because they are *illicit* pecuniary benefits from a corporation. Generally, these cash flows are *exclusively* for himself in the form of pecuniary private benefits of control through self-dealing or tunneling.\(^{153}\) The total sum of all “special” cash flows is defined as the “present value of special cash flows” (\(SD_0\)). Then, the DCF model can calculate \(ND_0\) and \(SD_0\).

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\(^{150}\) *Id.*

\(^{151}\) The formula in Table 1 is called Gordon’s constant growth model. For more explanation, see generally Myron J. Gordon, *Dividends, Earnings and Stock Prices*, 41 REV. ECON. & STAT. 99 (1959).

\(^{152}\) In this model, a corporation is assumed to be a perpetual entity. See BREALEY ET AL., *supra* note 146.

\(^{153}\) “Special cash flows,” “pecuniary private benefits,” “tunneling” and “tax (revenue)” are interchangeably used in this Article. As for “tunneling” see Johnson et al., *supra* note 69. In addition, in this Article, while “pecuniary private benefits of control” refers to pecuniary benefits that *exclusively* (and *illegally*) belong to controlling shareholders, “pecuniary benefits” are defined more broadly to include any justified monetary benefits for controlling shareholders, like pro-rata dividends, as well.
Consider \( SD_0 \) first. The special cash flow at the end of year \( t \) is notated as \( Ext_t \). Then, the final period and discount rate are notated as \( N \) and \( r \) respectively. Suppose that special cash flows grow at the constant rate of \( g \), as the corporation grows. \( N \) is infinite in the model—this means that a controlling shareholder’s tenure is infinite, which is unrealistic since no human being is immortal. Since I will come back to resolve this issue soon, this assumption is maintained for a while. Then, \( SD_0 \) can be reduced to a formula similarly found in valuing common stock without maturity:

\[
SD_0 = \frac{Ext_1}{r - g}.
\]

Second, \( ND_0 \) can be calculated in the same way. Therefore, \( ND_0 \) is expressed as a pro-rata cash flow in the year 1 (\( Div_1 \)) over the difference between the discount rate (\( r \)) and the growth rate (\( g \)). Algebraically, \( ND_0 = \frac{Div_1}{r - g} \). Put together, the “present value of total pecuniary benefits” (\( V_0 \)) for a stationary controlling shareholder is the sum of \( ND_0 \) and \( SD_0 \). Thus,

\[
V_0 = ND_0 + SD_0 = \left[ \frac{Div_1}{r - g} \right] + \left[ \frac{Ext_1}{r - g} \right] = \frac{Div_1 + Ext_1}{r - g},
\]

as explained in Table 2.

**Table 2: The Present Value of Total Pecuniary Benefits to a Stationary Controlling Shareholder**

<table>
<thead>
<tr>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>( ND_0 )</td>
<td>( \frac{Div_1}{r - g} )</td>
</tr>
<tr>
<td>( SD_0 )</td>
<td>( \frac{Ext_1}{r - g} )</td>
</tr>
<tr>
<td>( V_0 = ND_0 + SD_0 )</td>
<td>( \frac{Div_1 + Ext_1}{r - g} )</td>
</tr>
<tr>
<td>( Div_1 ): pro-rata cash flow</td>
<td></td>
</tr>
<tr>
<td>( Ext_1 ): extraction</td>
<td></td>
</tr>
<tr>
<td>( r ): discount rate</td>
<td></td>
</tr>
<tr>
<td>( g ): growth rate</td>
<td></td>
</tr>
<tr>
<td>( ND_0 ): present value of normal cash flows</td>
<td></td>
</tr>
<tr>
<td>( SD_0 ): present value of special cash flows</td>
<td></td>
</tr>
<tr>
<td>( V_0 ): present value of total pecuniary benefits</td>
<td>( ND_0 + SD_0 )</td>
</tr>
</tbody>
</table>

On the other hand, a controlling shareholder may choose to be roving if he wishes. In that case, he takes *all* corporate wealth, \( ROV_0 \), including his own paid-in capital as well as the minorities’ at time 0.

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154 Note that the DCF model to value a common stock uses infinite \( N \) as well. See BREALEY ET AL., supra note 146; Table 1.

155 See the concept of a controlling family shareholder with an infinite time horizon *infra* Part IV (through family inheritance, a controlling family shareholder can extend a time horizon of his family infinitely).

156 This result is derived from the application of the DCF model in the context of a controlling shareholder’s exploitation. As to the original DCF model, see BREALEY ET AL., supra note 146; Table 1.
So far, since a controlling shareholder is assumed to be rational only in terms of “wealth” (I will loosen this assumption later in order to take into account non-pecuniary private benefits as well)\(^{157}\), he compares \(ROV_0\) (the roving controller’s value) and \(V_0\) (the stationary controller’s value). If \(ROV_0\) is larger than \(V_0\), it is in his best interest to be roving. In contrast, if \(V_0\) is larger than \(ROV_0\), a rational controlling shareholder will choose to be stationary. I call it “one-factor analysis” since the level of pecuniary benefits is assumed to be the only factor that a controlling shareholder is interested in.\(^{158}\)

\(ROV_0\) and \(V_0\) represent the liquidating and going concern values of private benefits of control respectively. In general, since the going concern value is larger than the liquidating value, it is likely that \(V_0\) is larger than \(ROV_0\) as long as a controlling shareholder is patient and a corporation can be maintained for a long time. As aforementioned in the numerical example\(^{159}\) – if a controlling shareholder can wait for 20 years, being a stationary controlling shareholder is the better choice for him than being a roving controlling shareholder. In Olson’s world of political banditry, this common sense is explained in the same way – when a roving bandit settles down and rules over his subjects exclusively in a certain domain as a stationary bandit, it is in his best interest to maximize the total value of theft in the long run.\(^{160}\)

However, it is an oversimplification to state that all controlling shareholders will choose to be stationary. There are several factors that affect the ultimate decision by a controlling shareholder. As seen in the formula of Table 2, i.e., \(V0 = \frac{[Div_1 + Ext_1]}{(r - g)}\), the present value of the total pecuniary benefits to a stationary controller \(V_0\) is the function of a pro-rata cash flow in year 1 \((Div_1)\), an extraction at a sustainable level in year 1 \((Ext_1)\), the growth rate \((g)\), and the discount rate \((r)\). Given a \(Div_1\) and \(Ext_1\), \(V_0\) becomes larger: when \(g\) is larger and \(r\) is smaller. Consequently, with the combination of a larger growth rate and a smaller discount rate, a controlling shareholder is more likely to be a stationary controlling shareholder. The reverse is true as well – with the combination of a smaller growth rate and a larger discount rate, there is more likelihood that a controlling shareholder will be roving.

\(^{157}\) See infra Part IV Section B.
\(^{158}\) Compare with two-factor analysis, infra Part IV Section B.
\(^{159}\) See Part III C-1.
\(^{160}\) Olson, supra note 10.
3. Why Don’t Investors Invest Abroad to Avoid Controlling Shareholders’ Exploitation?  

So far, I have developed a theory of controlling shareholders based on an implicit assumption that investors in a developing country invest only in the domestic capital market. One may argue that public investors in a bad-law country can invest abroad, if they do not like bandits in their domestic market. In general, however, it has been impractical, if not impossible. Most of all, many developing countries have implicit or explicit capital regulations preventing public investors from investing abroad. Even without such regulations, public investors in bad-law jurisdictions have difficulties investing abroad. For example, financial intermediaries, who pool funds and invest abroad on behalf of small investors, have not been developed well until recently in bad-law countries. In addition, public investors are subject to “familiarity bias,” which leads them to invest a significant part of their capital in domestic markets. Moreover, most public investors – who are minority shareholders in corporations – in developing countries are relatively poor. Thus, they might have fewer hedging tools and less capability for the additional risk of international diversification.

IV. FAMILY CORPORATIONS AND STATIONARY CONTROLERS

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161 The explanation in this Sub-Section is based on the Author’s article, Sang Yop Kang, Re-envisioning the Controlling Shareholder Regime: Why Controlling Shareholders and Minority Shareholders Embrace Each Other, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1857131

162 For the explanation on international diversification, see generally Haim Levy & Marshall Sarnat, International Diversification, 60 AM. ECON. REV. 668 (1970).


164 As to “familiarity bias” Professor Huberman’s explanation is worth noting. “[P]eople simply prefer to invest in the familiar. People root for the home team, and feel comfortable investing their money in a business that is visible to them. Paucity of international diversification is only one of the implications of this tendency to invest in the familiar.” Gur Huberman, Familiarity Breeds Investment, 14 REV. FIN. STUD. 659 (2001).

165 “Familiarity bias” takes concrete shape in the form of “home bias” where investors are reluctant to invest in foreign assets that they are not familiar with. For more explanation of home bias, see Merritt B. Fox, Securities Disclosure in a Globalizing Market: Who Should Regulate Whom, 95 MICHL. L. REV. 2498 (1996).
Based on analytical frameworks for stationary controllers, this Part adds the concept of a “family” corporation and makes the generalized model in Table 2 more realistic. Although the concept of a “family” corporation is very difficult to define,\textsuperscript{166} in this Article a “family” corporation refers to a corporation where family control is expected to continue to the next generation through inheritance.\textsuperscript{167}

A. Length of Tenure and Controlling “Family” Shareholders

Suppose that for some reason, an absolute tyrant in a country stays on the throne for a short period. Accordingly, he does not have a long-term plan to pursue – as the final period approaches, it is in his best interest to take as much as possible from his subjects. In this case, unfortunately, his subjects are under a roving bandit and face a high risk of total plunder.\textsuperscript{168} As Professor Olson wisely explains, this is why the king’s subjects have reason to be sincere when they say “long live the king.”\textsuperscript{169} “If the king anticipates and values dynastic succession, that further lengthens the planning horizon and is good for his subjects.”\textsuperscript{170} With an infinite tenure through inheritance, the king is more likely to act as a stationary bandit who benevolently exploits people in his kingdom. In the vocabulary of the game theory, as a repeat player, the king cares much about his reputation for absolute but generous monarch.\textsuperscript{171}

The same logic applies to the context of corporate governance in developing countries. In a bad-law jurisdiction, like a despotic kingdom, a controlling shareholder of a corporation has enormous power to extract corporate wealth at the expense of minority shareholders. Under these circumstances, the longer a controlling shareholder’s tenure is, the more likely he is to be stationary, all other things being

\textsuperscript{166} For more explanation of family corporations, see Randall Morck & Bernard Yeung, Special Issues Relating to Corporate Governance and Family Control (available at http://www.gcgl.org/ifext/cgf.nsf/AttachmentsByTitle/DP_1_Family_Control_Morck/SAFE/DP_1_CG_Family_Control_Morck_2003.pdf).

\textsuperscript{167} See id.

\textsuperscript{168} As for a short-sighted roving bandit’s total plundering, see Olson, supra note 10. Also, see Part II A.

\textsuperscript{169} Olson, supra note 10 at 571.

\textsuperscript{170} Id.

\textsuperscript{171} In a repeated game – either an infinitely repeated game or a repeated game in which players do not know the ending point – players are more likely to cooperate. For a general explanation of a repeated game, see Joel Watson, Strategy: An Introduction to Game Theory, (Norton 2\textsuperscript{nd} ed. 2008). In a repeated game, reputation works as a self-enforcing mechanism for cooperation between players. Id.
equal. Since a stationary controlling shareholder and minority shareholders share encompassing interests, minority shareholders wish to have a controlling shareholder with a more extended horizon.

Here, the notion of a “family” corporation comes into the economic analysis of stationary banditry. In the previous Part, I propose a model for calculating the present value of total pecuniary benefits to a stationary controlling shareholder, which is based on the assumption that a controlling shareholder’s tenure is infinite. Unlike a corporation that is an eternal entity, the life of a controlling shareholder is limited – therefore, the model based on perpetuity is not practical. Through intra-family inheritance, however, a controlling “family” shareholder can achieve immortality as long as he treats his descendants as his alter ego. Accordingly, the assumption can be justified. One explanation of a controlling family shareholder’s altruism towards his children is that his genes will survive in his descendants. With this “selfish gene” feature, he is expected to keep a golden goose for the future rather than to kill it and take more eggs for today.

As seen in the above example of a tyrant, the final period problem may occur if the tenure of a corporate decision-maker is limited. Accordingly, a controlling shareholder with absolute power is more likely to change his status from a stationary controller to a roving controller, as his final period of “reign” in a corporation becomes closer. However, family succession can reduce the likelihood of the final period problem since the tenure is effectively extended to infinity via inheritance. A controlling family shareholder shares more encompassing interests with minority shareholders, and a family

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172 See Table 2. Note that formulas in Table 2 are derived from the DCF valuation model. See BREALEY ET AL., supra note 146.
173 DCF valuation model is based on the assumption that a corporation receives cash flows for an infinite time horizon. See BREALEY ET AL., supra note 146.
174 Gilson, supra note 22 at 644.
175 The terminology of the “selfish gene” is borrowed from RICHARD DAWKINS, THE SELFISH GENE (Scientific American 2004).
176 When the final period problem takes place, a game is not repeated. Then, cooperation among players would not be maintained. See WATSON supra note 171.
177 In other words, to the controlling shareholder, the game is not a repeated game anymore so that he is less likely to care about the future payoffs of the game. See WATSON, supra note 171; AVINASH K. DIXIT & BARRY J. NALEBUFF, THINKING STRATEGICALLY: THE COMPETITIVE EDGE IN BUSINESS, POLITICS, AND EVERYDAY LIFE (Norton 1991).
178 See generally, Gilson, supra note 68.
corporation is more likely to be prosperous and productive\textsuperscript{179} under the cooperative and repeated game between an immortal controlling shareholder and public shareholders.\textsuperscript{180} This analysis explains at least partially why controlling family shareholders in large business groups in Korea are stationary.

It would be in the best interests of minority shareholders to have good legal infrastructures and systems that protect their interests in corporations and the capital market. Nonetheless, if it is minority shareholders’ fate to stay in a bad-law jurisdiction and invest there without the opportunity for international investment,\textsuperscript{181} having a controlling “family” system is more favorable to minority shareholders than having a corporate dictator – either a controlling shareholder or a professional manager – with limited tenure.\textsuperscript{182}

B. Non-Pecuniary Private Benefits of Control and Stationary Controllers

Extant literature predominantly emphasizes a controlling shareholder’s desire for pecuniary benefits – it is assumed that an economically rational controlling shareholder is only concerned about maximizing the level of wealth he can acquire. In reality, however, the psychological satisfaction arising from managing a corporation – for example, social prestige, reputation, and social influence\textsuperscript{183} – is an important factor as well; a controlling shareholder considers it to be another form of compensation. Put

\begin{footnotesize}
\textsuperscript{179} Professor Olson said, “Given autocracy, then, dynamic succession can be socially desirable, both because it may reduce the likelihood of succession crises and because it may give monarchs more concern for the long run and the productivity of their societies.” Olson, supra note 10 at 572. This explanation can be applied to family controlling ownerships in many developing countries as well.

\textsuperscript{180} In addition, the following explanation in game theory is worth noting. “The infinitely repeated game demonstrates that patience – valuing the future – is essential to an effective reputation. When contemplating whether to defect in one period, the players consider the future loss that would result from tarnishing their reputations. Patient players – those with high discount factors – care a lot about payoffs in future periods and therefore they do not want to ruin their reputations for some short-term gain…” Watson, supra note 171 at 266.

\textsuperscript{181} As to the limits of international investment opportunities for potential minority shareholders in a bad-law country, see Part III C-3.

\textsuperscript{182} For more explanation of a game-theoretical framework on the reputational mechanism and a repeated game, see generally Watson supra note 171.

\textsuperscript{183} See e.g., Gilson, supra note 9. Running sports teams is another example of gaining non-pecuniary benefits. Id. at 1667. For example, the Steinbrenner family, even if they have spent a lot of money to run the New York Yankees, is compensated – at least partially – when the New York Yankees win the World Series championship (perhaps, the Steinbrenner family may expect some financial benefits as well).
\end{footnotesize}
simply, “money is not everything” even to business people.\textsuperscript{184} Thus, the utility function of a controlling shareholder should take into consideration not only pecuniary benefits but also non-pecuniary benefits.\textsuperscript{185} The goal of a controlling shareholder is not to maximize his wealth, but to maximize his utility from attaining a combination\textsuperscript{186} of pecuniary and non-pecuniary benefits.\textsuperscript{187}

Indeed, every human being wants to show that he has achieved more than other people have done.\textsuperscript{188} To business people, for example, building their own business empire is a special achievement that other people may not be able to do. Putting names of founding partners in law firms can be explained in a similar way. By bequeathing his throne to his children, the founder of a family corporation feel that he can continue to impact the world even after his death – his (selfish) gene\textsuperscript{189} is still alive in the next generations. Keeping the family name in their empire – which in itself does not generate money – is therefore significantly valuable to a controlling family.\textsuperscript{190}

\begin{flushleft}
\textsuperscript{184} Economics is not merely a study of “money.” Instead, it is a study of incentive, utility, and the happiness of human beings. Thus, psychological satisfaction should be included as an important factor in an economics model. \\
\textsuperscript{185} Professor Gilson is one of the first few scholars who take into account the presence and value of non-pecuniary private benefits of control. See generally Gilson, supra note 22. \\
\textsuperscript{186} A controlling shareholder’s pecuniary benefits and non-pecuniary benefits can be labeled as “Good X” and “Good Y” respectively. Then, a microeconomics theory of a consumer’s optimization can be used to explore the relationship between pecuniary and non-pecuniary benefits. For more explanation, see infra note 191. \\
\textsuperscript{187} Measuring wealth is relatively easy – in fact, it is difficult as well – because at least a dollar amount is measurable. On the other hand, measuring psychological utility is almost impossible: psychological utility is a subjective system by its nature; thus, there is no objective “market price” for it; in addition, there is not even a definition of “one unit” of non-pecuniary benefits that can be converted into some amount of dollars. Probably, these are reasons why extant literature has not paid close attention to non-pecuniary benefits since it is impossible to add up the utility of non-pecuniary and pecuniary benefits that lack a common and justified unit. Despite these problems, however, at least a theoretical corporate governance model on the utility function of a controlling shareholder should take into consideration the presence of non-pecuniary benefits. Without non-pecuniary benefits of control, we may not precisely understand what determines a controlling shareholder’s strategic and operational decisions. In particular, non-pecuniary benefits can alter the looting policy of a controlling shareholder – whether he would be a roving or stationary controlling shareholder. \\
\textsuperscript{188} “Self-esteem” or “pride” is another form of psychic satisfaction or non-pecuniary benefits. As to non-pecuniary benefits, see Gilson, supra note 22. \\
\textsuperscript{189} See DAWKINS, supra note 175. \\
\textsuperscript{190} Having observed that Khrushchyon denounced Stalin in the Soviet Union, Kim Il-Sung in North Korea was probably concerned about a possible denouncement after his death. In order to reduce this risk, it would be the best strategy for Kim Il-Sung to appoint his son, Kim Jung-II as his successor. Ultimately, Kim Jung-II’s son, Kim Jung-Un succeeded his father’s position after his father died. This example can show how human beings care about their name, reputation and family legacy – which are non-pecuniary benefits – even after their death.
\end{flushleft}
1. One-Factor Analysis v. Two-Factor Analysis

According to the “one-factor analysis” introduced earlier: (1) when ROV\textsubscript{0} (i.e., the value that a roving controller can loot from a corporation through a one-shot transaction at time 0) is greater than V\textsubscript{0} (i.e., the present value of the total pecuniary benefits to a stationary controller), he chooses to be roving; (2) on the other hand, when V\textsubscript{0} is greater than ROV\textsubscript{0}, he chooses to be stationary. In this analysis, only pecuniary benefits are considered. However, the presence of non-pecuniary benefits should be recognized as well when determining to be roving or stationary since non-pecuniary benefits increase a controlling shareholder’s utility. In this respect, “two-factor analysis” – taking into account both the pecuniary and non-pecuniary benefits, which better reflects reality – is required to analyze a controlling shareholder’s decision to be stationary or roving. Let us note the present value of non-pecuniary benefits of control, including a controlling shareholder’s descendants’, as Alpha. Then, a controlling shareholder compares ROV\textsubscript{0} and the sum of two factors, V\textsubscript{0} and Alpha: (i) when ROV\textsubscript{0} is greater than the sum of V\textsubscript{0} and Alpha, he chooses to be roving; (ii) when the case is the reverse, he chooses to be stationary. Table 3 summarizes.

**Table 3: One-Factor Analysis v. Two-Factor Analysis**

<table>
<thead>
<tr>
<th></th>
<th>One-Factor Analysis</th>
<th>Two-Factor Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) ( ROV_0 &gt; V_0 )</td>
<td>a controlling shareholder chooses to be roving</td>
<td>a controlling shareholder chooses to be roving</td>
</tr>
<tr>
<td>(ii) ( ROV_0 &lt; V_0 )</td>
<td>a controlling shareholder chooses to be stationary</td>
<td>a controlling shareholder chooses to be stationary</td>
</tr>
</tbody>
</table>

The two-factor analysis creates important corporate governance implications. For example, when \( ROV_0 \) is 100 million dollars and \( V_0 \) is only 70 million dollars, according to the one-factor analysis, a controlling shareholder definitely chooses to be roving. However, under the two-factor analysis, he
chooses to be stationary even if $ROV_0$ is greater than $V_0$, as long as $Alpha$ compensates for the difference between the two numbers $(ROV_0 - V_0)$. In this example, if $Alpha$ is larger than 30 million dollars, it is a controlling shareholder’s rational choice to be stationary with only $V_0$ of 70 million dollars. Accordingly, there is more likelihood that a controlling shareholder will be found to be stationary when the value of $Alpha$ is large. The more highly a controlling family shareholder values reputation, social prestige and family influence, the more beneficial to minority shareholders since the controlling shareholder is more likely to be stationary and will extract private pecuniary benefits to a more lenient degree. In other words, the controlling family shareholder can give up some pecuniary benefits when he is able to attain non-pecuniary benefits.\footnote{Since $Alpha$ is the non-pecuniary private benefits to all family members, a part of the value of $Alpha$ may be reserved for a controlling shareholder’s future descendants. When an incumbent controlling shareholder is more altruistic to his future descendants, his discount for his descendants’ non-pecuniary benefits is low. As a result, the value of $Alpha$ is larger. Thus, he is more likely to be stationary and more beneficial to minority shareholders for the similar reason explained above. Conversely, when he does not put a high value on his descendants’ happiness, it means his discount for his descendants’ non-pecuniary benefits is high. As a result, the value of $Alpha$ will be deeply discounted – thus, he is less likely to be stationary.}

Since $Alpha$ is the non-pecuniary private benefits to all family members, a part of the value of $Alpha$ may be reserved for a controlling shareholder’s future descendants. When an incumbent controlling shareholder is more altruistic to his future descendants, his discount for his descendants’ non-pecuniary benefits is low. As a result, the value of $Alpha$ is larger.\footnote{Thus, he is more likely to be stationary and more beneficial to minority shareholders for the similar reason explained above. Conversely, when he does not put a high value on his descendants’ happiness, it means his discount for his descendants’ non-pecuniary benefits is high. As a result, the value of $Alpha$ will be deeply discounted – thus, he is less likely to be stationary.}

2. Interplay between Pecuniary and Non-pecuniary Benefits in Family Corporations

\footnote{In this sense, the pecuniary benefits and non-pecuniary benefits can be analyzed through the consumer theory in microeconomics. They are “X” and “Y” goods, and a controlling shareholder can choose the optimal combination of consuming both goods. Between two goods, there might be substitutability – the ratio of exchange of two goods. Thus, a controlling shareholder can “exchange” (i.e., give up) some amount of the pecuniary benefits for additional non-pecuniary benefits. This tendency can be measured theoretically by the marginal rate of substitutability (MRS) of two goods that a controlling shareholder consumes. For more explanation of pure microeconomic theory of a consumer’s choice, see ROBERT S. PINDYCK & DANIEL L RUBINFELD, MICROECONOMICS (Pearson Prentice Hall 6th ed. 2005).}

\footnote{$Alpha$ consists of non-pecuniary benefits for his descendants as well as for the founding father of a corporation. The more altruistic a founding father is for his descendants, the lower his discount rate for non-pecuniary benefits for his descendants. As a result, the value of $Alpha$ is larger.}

\footnote{Compare Gilson, supra note 22. Professor Gilson stated that a controlling shareholder would think of his children’s utility as equivalent to his own.}
There is a proverb in China: “The King is a ship and his subjects are water. A ship floats on the water, but the same water can overturn the ship.” In the history of the East and the West, we know that harsh taxation and looting by an absolute monarch has lead to his subjects’ discontent, resistance, and ultimately to a revolution resulting in ending the dynasty – the Boston Tea Party is an American example. This lesson is applicable to family shareholders managing large corporations as well, because family controlling shareholders are despotic kings in their corporate empires. In fact, it is almost impossible for minority shareholders to overthrow a particular controlling shareholder in active ways even if they are deeply discontented with corporate performance and governance; first, a controlling shareholder usually has a majority of votes; and second, minority shareholders face a huge collective action problem hindering a successful insurgency. Nonetheless, when an unjustified expropriation by a controlling shareholder is harsh enough, minority shareholders punish a tyrannical controlling shareholder by adopting a passive method of resistance – they will exit a corporation by selling shares (i.e., the “Wall Street Rule”) or move to another corporation in the domestic market (“voting with their feet.”), devastating the tyrannical corporate dynasty.

194 This phrase was written by a famous Chinese philosopher, Xun Zi (荀子) in his book Aigong (哀公). In the original Chinese, this phrase is 君者舟也。庶人者水也。水则载舟,水则覆舟.

195 “Empire-building” by an entrenched management or a controlling shareholder can be explained in this way – i.e., a CEO or a controlling shareholder is a king who would like to enlarge his “empire” (a corporation). Mostly, empire-building has a negative connotation since corporate governance scholars believe that expanding the size of a corporation takes place without careful evaluation of efficiency. See generally Shleifer & Vishny, supra note 95. For example, corporate insiders overpay for size-maximization (not profit maximization), which is empire-building. See e.g., CHARLES R.T. O’KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS (Aspen Publishers 5th ed. 2006) at 758-759.

196 See Bebchuk et al., supra note 77..

197 “Where all investors hold small stakes in the enterprise, no single investor has a strong incentive to invest time and money in monitoring management.” WILLIAM ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ASSOCIATION (Wolters Kluwer 3rd ed. 2009) at 367. For more explanation of the collective action problem, see Bebchuck, supra note 70; Black, supra note 102.

198 “Wall Street Rule” is the tendency of shareholders to sell their stocks when they are disappointed by those stocks. See e.g., Robert C. Pozen, Institutional Perspective on Shareholder Nominations of Corporate Directors, 59 BUS. LAW. 95 (2003-2004).

199 Originally, “votes with feet” was coined to explain people’s migration to another community which provides the optimal level of tax and public goods. Charles Tiebout, A Pure Theory of Local Expenditures, Journal of Political Economy 64(5), 416-24 (1956).
It is noteworthy that a displeased minorities’ exit after cruel theft might not be a punishment at all to a roving controlling shareholder. All he is concerned about is how to efficiently extract money from minority shareholders at the time when he loots, i.e., today. After looting, he does not care whether minorities leave a corporation, which is left as a shell and which he does not have any incentive to maintain. Since tomorrow is not existent in a roving controller’s mind, losing his empire by the minorities’ exit is an absent concern. As such, minority shareholders’ collective decision to enact an exodus from a business empire threatens only a stationary controlling shareholder.

Having more minority shareholders by issuing new shares to the public gives huge advantages to a stationary controller because it is the essence of non-pecuniary private benefits; the more minority shareholders a controlling family shareholder has, the more equity he holds in a corporation and the more debts he can borrow. As a result, he is able to control more assets, which means he is able to build a larger empire. Conversely, when a controlling family shareholder has a small base of minority shareholders, he will end up having a small empire, which reduces his (and his descendants’) non-pecuniary private benefits significantly. Consequently, minorities’ collective exit from a controller’s corporate empire works as a prime punishment to a controller.

In that sense, if non-pecuniary benefits – especially benefits arising from maintaining the control of large corporations – are highly valued in a particular culture, a controlling shareholder with a long-term plan has an incentive to be recognized as a benevolent bandit. It is because by imposing low “taxation” on minority shareholders, a controller is able to manage a larger corporation and enjoy higher non-pecuniary benefits as a result. In other words, if a king wishes to rule over a larger empire in a stable way, ultimately he should “buy” more subjects’ support (or public opinion) by lenient policies.

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200 Kang, supra note 161.

201 In fact, minority shareholders do not know exactly how much a controlling shareholder extracts as pecuniary private benefits. However, in the capital market, they are able to know the “after-tax” (after-extraction) return, i.e., the return that they receive after a controlling shareholder extracts pecuniary benefits as “tax.” Then, it can be said that what minority shareholders care about is not how much a controlling shareholder extracts, but how much they ultimately receive after a controlling shareholder’s extraction. Public shareholders will eventually migrate to a corporation where they can receive a higher “after-tax” return. Under these circumstances, a controlling shareholder faces two scenarios; one is to increase the firm’s value more than other controlling shareholders and extract a large
“Tax-cut” is of significant with respect to its impacts on pecuniary and non-pecuniary benefits for a controlling shareholder. (1) Suppose that the current tax rate is above the optimal level maximizing revenue. Then, a reduction in the tax rate (i.e., extraction rate) can affect both pecuniary and non-pecuniary benefits positively; (1-i) tax rate reduction can increase tax revenue (i.e., pecuniary private benefits); (1-ii) in addition, a controlling shareholder’s non-pecuniary benefits (i.e., expansion of his empire) will increase by lowering the tax rate since he attracts more minority shareholders and his corporation will be larger.\footnote{Put differently, non-pecuniary benefits and the tax rate are negatively correlated. See Figure 2, Curve 2.}

(2) What if the current “tax rate is below the optimal level? Then a reduction in the tax rate has conflicting effects on pecuniary and non-pecuniary benefits of a controller; (2-i) tax revenue (i.e., pecuniary private benefits) will decrease; (2-ii) by contrast, non-pecuniary benefits will increase since more minority shareholders come to “reside” in his empire. Thus, as long as any additional non-pecuniary benefits are larger than foregone pecuniary benefits, even choosing a lower “tax rate” than the optimal point will lead to a higher utility for a controller. Again, it cannot be overemphasized that the aim of a controlling shareholder is not to maximize his tax revenue, but to maximize the sum of the pecuniary and non-pecuniary benefits from running his business empire.

3. Summary of Non-Pecuniary Benefits

Since a roving controller takes everything from minority shareholders, his tax rate is extremely high. In contrast, by choosing an optimal tax rate which is much lower, a stationary controller may maximize tax revenue. In this respect, to a stationary controller, protecting (i.e., extracting less) minority shareholders by reducing the tax rate from a roving controller’s rate to an optimal rate is in fact protecting and improving his interests. This explains why some Asian controlling shareholders with a long-term amount from the corporation; the other is not to extract very much from the corporation if he does not enhance the firm value more than other controlling shareholders. Therefore, a more efficient and competent controlling shareholder can extract more from the corporation without losing minority shareholders. However, if the efficiency of controlling shareholders is similar, most controlling shareholders would choose to extract comparably with other controlling shareholders in order not to lose minority shareholders.
view are generous to their minority shareholders in terms of expropriation. Minority shareholders can be protected not only by good corporate law, but also by a stationary controlling shareholder’s own self-interest.

The presence of non-pecuniary benefits can reduce a stationary controller’s tax rate further. Tax revenue accounts for a large part of the pecuniary benefits for a stationary controller. However, a stationary controller is willing to give up some pecuniary benefits as long as the utility achieved from additional non-pecuniary benefits is larger than the utility foregone from lost pecuniary benefits. If sufficient utility from non-pecuniary benefits is attained from expanding the business empire, it is possible that a stationary controller is more benefited by reducing the tax rate from the optimal point, resulting in lowering tax revenue and pecuniary benefits. When this is the case, minority shareholders find that having a stationary controller is more beneficial to them than having a roving controller in two ways: (1) through a stationary controller’s reduction of the tax rate from 100 percent to the optimal tax rate; and (ii) through a stationary controller’s additional reduction of the tax rate from the optimal tax rate to the tax rate that can maximize the sum of pecuniary private benefits and non-pecuniary benefits for a controller. Figure 2 explains that the “adjusted optimal tax rate” (max 3), where the sum of pecuniary private benefits and non-pecuniary benefits of control are maximized, is lower than the “original optimal tax rate” (max 1), where pecuniary private benefits of control are maximized. Obviously, minority shareholders are better off under the “adjusted optimal tax rate” (max 3) than under the “original optimal tax rate.”

Figure 2: Adjusted Optimal Tax Rate – the presence of non-pecuniary benefits of control can reduce the optimal tax rate further

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203 A more precise graph takes into account a controlling shareholder’s “normal cash flows” (i.e., pro-rata cash flows) as well as his tax revenue (“special cash flows” or pecuniary private benefits) and non-pecuniary benefits. Since “normal cash flows” are determined independently, it is sufficient to take into account only “special cash flows” (pecuniary private benefits) and non-pecuniary benefits in this graph.
In sum, both a controller and minority shareholders are likely to be more satisfied under a stationary controller’s reign than under a roving controller’s reign – Pareto improvement takes place in the economy of stationary controllers. A stationary controller can be praised as a “benevolent” king by minority shareholders who are pleased with the low “tax rate.” As a result, the ship can stably float on the peaceful water. This analysis shows the possibility that controlling shareholders – if they culturally evaluate non-pecuniary benefits highly like East Asian stationary controllers – voluntarily extract a small amount of tunneling from minority shareholders. Again, it cannot be emphasized enough that controlling shareholders’ “generosity” towards minority shareholders is not their sincere personality, but simple reflection of their calculated self-interest to maximize their both pecuniary and non-pecuniary “utility.”

C. Reputation\textsuperscript{204} for Being (Benevolent) Stationary Controlling Shareholders

\textsuperscript{204} “Reputation building is a very common explanation for why people deliver on their agreements even if they cannot be forced to.” Shleifer & Vishny, supra note 95 at 749. “[S]everal recent articles have presented reputation-building models of private financing. Diamond (1989, 1991) shows how firms establish reputations as good
As explained, the going concern value of a controlling shareholder’s pecuniary benefits ($V_0$) is generally larger than the liquidating value of his looting ($ROV_0$). Then, there is a fairly high possibility that the sum of non-pecuniary benefits ($\text{Alpha}$) and the going concern value of pecuniary benefits ($V_0$) is larger than the liquidating value of looting ($ROV_0$). Thus, given the assumption that a controlling family shareholder is patient and holds a long-term horizon, being a stationary controlling shareholder is more advantageous to a controlling shareholder. In this case, a rational controlling shareholder would choose to be stationary. However, an important issue is that he is not able to become stationary by his unilateral acts. In order to be stationary, a controlling shareholder needs minority shareholders who are willing to reside with him for a long time. A “meeting of two minds” – a controlling shareholder’s mind as well as minority shareholders’ collective mind – is required for a controlling shareholder to be stationary. In relation to this issue, this Subpart explains further the important role of a controlling shareholder’s reputation in attracting public investors to a corporation.

1. Distrust among Potential Minority Shareholders

Suppose that a bad-law country’s domestic economy consists of stationary controlling shareholders and roving controlling shareholders. When prospective investors know with perfect certainty that a controlling shareholder that they deal with is stationary, rational investors participate in capital market transactions as minority shareholders of the stationary controller’s corporation. By doing so, they are benefited as well. A major problem in reality is that minority shareholders are not able to know for sure that the controlling shareholder they deal with is stationary or roving. This information borrowers by repaying their short term loans, and Gomes (1996) shows how dividend payments create reputations that enable firms to raise equity.” *Id.*

205 See Part III C. Likewise, the going concern value of a corporation is generally larger than the liquidating value of a corporation in corporate finance. See BREALEY ET AL., supra note 146.

206 In other words, if $V_0$ is larger than $ROV_0$, it is obvious that $V_0 + \text{Alpha}$ is larger than $ROV_0$ since $\text{Alpha}$ is a positive number. See Table 3.

207 Often, while corporate insiders know important information, investors do not know that information. See Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment decisions When Firms Have Information that Investors Do Not Have*, 13 J. FIN. ECON. 187 (1984) (authors proposed the “pecking order theory” in corporate finance – when a corporation needs external financing, it relies on debts first and then equities under the condition of
asymmetric information\textsuperscript{208} – which impedes transactions between the two parties in the capital market – is of particular significance in bad-law countries due to the deficient disclosure system and ineffective legal mechanisms.\textsuperscript{209} By the continuous process of “lemon market,”\textsuperscript{210} prospective investors may think that a controlling shareholder they will potentially deal with is a roving controlling shareholder. Thus, without specific information about a particular controlling shareholder’s nature, prospective investors are reluctant to invest their money in any corporation for the fear of total plundering by a roving controlling shareholder.

Facing the possibility of uniform distrust among prospective investors, controlling shareholders who initially wish to be stationary are likely to end up with a low value of $V_0$ ($V_0$ is the present value of the total pecuniary benefits $= ND_0 + SD_0$).\textsuperscript{211} The reason is, without a large number of minority shareholders investing their capital in his corporation, a controlling shareholder finds it difficult to collect legitimate pro-rata cash flows (“normal” cash flows, $ND_0$) as well as illicit expropriations (“special” cash flows, $SD_0$) from the corporation on a continuous basis. When there are not many minority shareholders in a corporation, the size of equity capital (thus, finally the size of assets) shrinks. Accordingly, the value of Alpha – the value of non-pecuniary benefits – becomes low during this process. As a result, under the two-factor analysis, there is substantial likelihood that the sum of Alpha and $V_0$ is smaller than $ROV_0$.\textsuperscript{212}


\textsuperscript{210} Id.

\textsuperscript{211} See Table 2.

\textsuperscript{212} See Table 3.
If so, a controlling shareholder will choose to be roving even if he initially wishes to be stationary\textsuperscript{213} – in this case, now it is his optimal strategy to take everything at once from a corporation, which is detrimental to the existing minorities.

Indeed, under the serious asymmetric information, it is not primarily important whether a controlling shareholder is a stationary controller. Instead, whether the market deems a controlling shareholder to be a stationary controller is more determinative. When prospective investors are not able to distinguish a good controller (a stationary controller) and a bad controller (a roving controller), a controlling shareholder loses his incentive to be stationary. Under these market failure conditions and adverse selection, ultimately only roving controllers remain in the market. There would be no more repeat games between a controlling shareholder and minority shareholders, so that they do not cooperate. Then, the prisoners’ dilemma arises and the end result is that each player chooses to “defect.”\textsuperscript{214} Accordingly, the market development would not be expected.

2. Reputational Advantages of Family Corporations

Indeed, a controlling shareholder finds it difficult to send a credible signal to the capital market that he is a benevolent (stationary) controller. With the capital market’s asymmetric information, a controlling shareholder encounters a greater challenge when attempting to convince minorities that he is different from roving bandits who perhaps are prevalent in the market place.\textsuperscript{215} In this regard, corporate tycoons’ philanthropy is worth mentioning. For example, many of them build non-profit foundations and donate scholarships for poor but capable students. It is possible that some of them use a disguise of altruism for image-making purposes.\textsuperscript{216} Such “advertisements” – which are costly – can portray the corporate tycoons as truly honest and principled people who do not cheat investors and consumers.

\textsuperscript{213} When the sum of $V_0$ and $\text{Alpha}$ is small, a controlling shareholder is more likely to be roving according to two-factor analysis. See Table 3.

\textsuperscript{214} For a general game-theoretic explanation, see Watson, supra note 171; Dixit & Nalebuff, supra note 177.

\textsuperscript{215} See Akerlof, supra note 208.

\textsuperscript{216} Discussion with Professor Merritt B. Fox.
In this sense, a controlling “family” shareholder has a comparative advantage in building a reputation and convincing prospective investors of his integrity. To understand a family corporation’s advantage, consider a non-family corporation first. When prospective investors think of investment in a non-family corporation such as a widely-held company, it is almost impossible for investors to know whether, in a top corporate insider’s own mind, he is roving or stationary. In fact, this is a main reason that business people need to take costly measures to show that they are trustworthy people or at least stationary controllers. In contrast, prospective investors are able to recognize more easily that a certain corporation is a “family” corporation. It is because they can simply review the corporate governance structure of a family corporation (e.g., how shares are spread among family members, whether children of a founder are managers or directors of a corporation, etc.). Clearly, it is more convenient for prospective investors to observe the appearance of a corporation than to scan the mentality of a controlling shareholder. In the parlance of law and economics, the “transaction costs” for investors to understand and trust a controlling family shareholder’s intent are low. In addition, a controlling “family” shareholder’s transaction costs to convince investors are low as well since he does not have to spend his time and resources to send off credible signals, which are costly. Put differently, a controlling family shareholder does not desperately have to donate in order to show that he is a good man, although such donations (in fact, “advertisements”) might be useful.

When a sufficient number of prospective investors share the common opinion that a particular corporation is a family corporation, the market will presume that the tenure of a controlling shareholder is perpetual via inheritance. Then, potential minority shareholders are convinced that if a controlling shareholder makes repeated transactions with them in the capital market for a long time, it will be in a controlling family shareholder’s best interest to be stationary as well.\textsuperscript{218} Based on this belief, market

\textsuperscript{217} For the textbook explanation of transaction costs, see generally ROBERT COOTER AND THOMAS ULEN, LAW AND ECONOMICS (Pearson Addison Wesley 4th ed. 2003). The Coase theorem is a good example of how transaction costs play in the area of law and economics. The theorem is discussed in Ronald H. Coase, The Problem of Social Cost, 3. J. LAW AND ECON. 1 (1960).

\textsuperscript{218} Of course, the decision of whether or not to continue to act as a stationary controller is totally dependent on the controlling shareholder’s discretion or whim. However, investors expect that if the controlling shareholder is
participants implicitly anticipate that the final period of transactions will not occur within the reasonably foreseeable future. As such, no backward induction will take place in these transactions, and coordination between minority shareholders and a controlling shareholder is expected to continue, which results in enhanced benefits for both parties.

V. CONCLUDING REMARKS

Controlling shareholder regimes in developing countries generate many corporate governance problems. Nonetheless, it would be oversimplification to treat all of them as simply “bad guys” without analyzing various personal incentives and idiosyncratic socio-economic conditions. Based on the notion that businesspeople are self-interested and may abuse inefficiencies in their countries’ legal systems, this Article proposes that controlling shareholders in bad-law jurisdictions can be classified into at least two sub-categories: (1) “stationary controllers,” and (2) “roving controllers.”

When a controlling shareholder is a “family” shareholder, he is more likely to be stationary because he can establish his own dynasty. With a long-term interest in his controlled corporation, it is in the controlling family shareholder’s best interest to voluntarily reduce the degree of expropriation against minority shareholders. Given the condition that the corporate law in a developing country is inefficient in protecting investors, having a stationary family controller might be the most optimal choice available to public investors. The relatively aligned interests of a controlling family shareholder and public reasonable, he will not suddenly become a roving bandit unless there are revolutionary or catastrophic changes in the business environment surrounding him.

219 Therefore, game players are still repeat players and can rely on the self-enforcing mechanisms such as reputation. See generally WATSON, supra note 171.

220 The textbook explanation on backward induction is “This is the process of analyzing a game from back to front (from information sets at the end of the tree to information sets at the beginning). At each information set, one strikes from consideration actions that are dominated, given the terminal nodes that can be reached.” WATSON, supra note 171.

221 Prospective investors are generally confined to a domestic capital market, since international diversification has been difficult for them. See Part III C-3.
shareholders under the stationary controlling system make up partially for the deficiency in good corporate law.

It is noteworthy that controlling family shareholders are not always (and not necessarily) stationary. It is even possible that stationary family controllers would transform into roving at some point. Second generation’s poor management skill, succession crisis problem (when a founding father has more than one child), and unfavorable macro-economic environments can prevent controlling family shareholders from maintaining their stationary status. My next project will analyze these complicated issues more in-detail. In this respect, the argument in this Article is properly construed that despite many weaknesses, family-controlled corporations might be “better” than we have thought. Last but not least, it is worth mentioning the impact of globalization on the contour of local corporate governance. The more globalization will foment international investment by non-controlling shareholders in bad-law countries, and it may fundamentally change the corporate governance system based on local banditry.