Optimized Theft: Why Some Controlling Shareholders “Generously” Expropriate from Minority Shareholders

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OPTIMIZED THEFT: WHY SOME CONTROLLING SHAREHOLDERS
“GENTEROUSLY” EXPROPRIATE FROM MINORITY SHAREHOLDERS

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I thank my mentors—Professors Jesse Fried at Harvard University, Merritt Fox, Jeffrey Gordon, Curtis Milhaupt, and Katharina Pistor at Columbia University—for their invaluable advice and insightful comments for this article. I also thank Professors Todd Henderson at University of Chicago, Milton Regan at Georgetown University, Ehud Kamar at University of Southern California, Rüdiger Veil at Bucerius Law School, Tomotaka Fujita at University of Tokyo, Li Guo at Peking University, Ching-Ping Shao at National University of Taiwan, Kon Sik Kim, Joon Park, and Ok-Rial Song at Seoul National University, Francis Snyder, Douglas Levene, Mark Feldman, and Jin Zining, at Peking University (School of Transnational Law), Diane Desierto at University of Hawaii, Young Joon Park and Daeyong Lee at Peking University (HSBC Business School), and Jaymin Lee and Kun-Young Yun at Yonsei University for their comments and discussions. This article is based on an unpublished J.S.D. dissertation chapter. I benefitted from a presentation at Columbia University, an international conference (Recent Issues on Corporate Law) held at Seoul National University, a workshop at Peking University School of Transnational Law, and a seminar at Shin & Kim. Last but not least, I thank my father, mother, brother, and my wife for their endless support, trust, and sacrifice for me.

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ABSTRACT

Although controlling shareholder agency problems have been well studied so far, many questions still remain unanswered. In particular, an important puzzle in a bad-law jurisdiction is: why some controlling shareholders (“roving controllers”) loot the entire corporate assets at once, and why others (“stationary controllers”) siphon a part of corporate assets on a continuous basis. To solve this conundrum, this Article provides analytical frameworks exploring the behaviors and motivations of controlling shareholders. To begin with, I reinterpret Olson’s political theory of “banditry” in the context of corporate governance in developing countries. Based on a new taxonomy of controlling shareholders (“roving controllers” and “stationary controllers”), I examine under what circumstances a controlling shareholder chooses to be roving or stationary, and why economically rational controlling shareholders with a long time horizon voluntarily abstain from looting minority shareholders. In addition, agreeing with weaknesses of family corporations, I explain that controlling “family” shareholders tend to be more stationary, and thus improve the quality of corporate governance. Moreover, I explain that a controlling shareholder’s non-pecuniary benefits (i.e., psychic value of corporate insiders when running business) can potentially lower the level of expropriation from public shareholders.
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I. INTRODUCTION

Dispersed shareholder ownership, 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.\(^1\) Nonetheless, the dispersed shareholder ownership of the Berle and Means model\(^2\) is an uncommon phenomenon observed only in the United States and the United Kingdom.\(^3\) In the rest of the world, a corporation controlled by a dominant shareholder is the standard form of business organization.\(^4\) A traditional view portrays the controlling shareholder system—in particular in developing countries—as having many innate problems in terms of investor protection.\(^5\) Unfair self-dealing and expropriation of minority shareholders by a controlling shareholder\(^6\) are common business practices in many controlling shareholder countries.\(^7\) In this sense, these countries are labeled as “bad-law” jurisdictions.\(^8\)

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 the corporate assets for their benefit even if the inefficient legal system does not regulate controlling shareholders’ expropriation? And (2) if controlling shareholders in such jurisdictions are ruthless corporate pirates, why do

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\(^4\) In most countries outside the United States and the United Kingdom, large firms are typically controlled by either controlling families or governments. See Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership around the World*, 54 J. Fin. 471, 496 (1999) [hereinafter La Porta et al., *Corporate Ownership*].

\(^5\) See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113, 1148, 1152 (1998) [hereinafter La Porta et al., *Law and Finance*]. These four distinguished economists have pioneered a new research area of “law and finance” in an international context.


\(^7\) See, e.g., La Porta et al., *Law and Finance*, supra note 5, at 1113 (finding that negative correlation between ownership concentration and investor protections).

minority shareholders have (relatively) *constructive* relationships with some controlling family shareholders over the long term?

To solve these conundrums, this Article reinterprets Mancur Olson’s theory of banditry—a political economics analytical framework—in the context of comparative corporate governance. According to Olson, a “roving bandit” is one who will not come to expropriate victims again. Thus, he rationally takes every property possible from victims. The dominance of roving bandits in a community creates chaos and anarchy. In contrast, a “stationary bandit” is one who settles down and rules his subjects in a certain domain as a king. 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.

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. First, some controlling shareholders siphon *all* (or *substantially all*) corporate assets through an abrupt one-shot deal. 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%.” This Article refers to them as “roving controllers.” Second, other controlling shareholders are prone to extracting *part* of a corporation’s assets through ongoing transactions. Controlling shareholders of large corporate groups in Korea generally fall in this group. This Article refers to this second type of controlling shareholders as “stationary controllers.” Recently, the Chinese economy developed rapidly. While a large fraction of the Chinese economy is comprised of state-owned enterprises (SOEs), some controlling shareholders have emerged

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10 Id. at 568.
11 Id.
12 Id. at 571.
13 Id. at 568.
15 This Article uses “controlling shareholders” and “controllers” interchangeably.
16 For a further discussion of controlling shareholders and corporate groups in Korea, see infra Part III.B.3.
as important market players. This Article shows that China is an interesting jurisdiction since roving controllers and stationary controllers are commingled. The new typology of controlling shareholders—“roving” versus “stationary”—can enable policy-makers, jurists, and corporate governance scholars to further understand the diverse features of Chinese controlling shareholders.

Another contribution of this Article is to examine the expropriation of a controlling shareholder in a bad-law country through the analytical framework of “taxation.” The illicit transfer of corporate wealth by a controlling shareholder is akin to an unavoidable tax to public investors in a country with insufficient investor protection: this business practice is not kept in check by law enforcement due to deeply-rooted “bad-law” features. Just as a rational king imposes generous taxes on his subjects in order to maximize the accumulated tax revenue in the long run, a far-sighted stationary controller (i.e., “generous thief”) voluntarily abstain from looting a corporation to the fullest extent. However, the leniency of a stationary controller has nothing to do with his innate generosity. Rather, it is because a benevolent expropriation policy is often economically optimal for him in the long run due to the accumulated effect of periodic expropriations. As such, even without efficient enforcement and good-law infrastructure, minority shareholders inadvertently end up being more protected than their counterparts under a roving controller’s reign. In turn, this creates the incentive for minorities to participate in transactions with stationary controllers in the capital market.

These capital market transactions form a long-term relationship between a stationary controller and minority shareholders, 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. Corporate autocracy is established when a dominant corporate insider is featured as stationary

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20 Discussion with Curtis J. Milhaupt at the Columbia University School of Law.
21 See infra Part II.B.
22 See infra Part II.B.
23 Many corporate governance scholars and policy-makers have evaluated the quality of corporate governance in Korea as low. La Porta et al., Law and Finance, supra note 5, at 1130-31. In particular, the anti-director score of Korea was 2 (out of 6), where the average score for common law jurisdictions was 4. Id. Although a controlling family shareholder of a typical Korean corporate group holds a very small fraction of economic interest, he can exercise a majority of voting power
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, stable autocracy is certainly a superior system to anarchy, in which roving controllers’ vandalism and disorder crowd out any possibility of prosperity and development. If the nature of bad-law is too systemic in a certain economy, having stationary controllers is desirable to investors as the second-best scenario.

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 this question. In this simplified model, a controlling shareholder has two options—being stationary or roving. When he considers being stationary, he expects two sources of periodic “pecuniary benefits;” one from pro-rata economic interest based on his cash flow rights; and the other from the extraction of minority shareholders’ assets. In addition to these pecuniary benefits, psychological utility (“non-pecuniary benefits”) such as fame, reputation, and social influence arising from running corporations adds value for him. By contrast, when he considers becoming 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 will not exist after his looting. Considering 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 (including psychological value).

In addition, 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 via voting leverage devices (such as cross-shareholding). See Stijn Claessens, Simon Djankov & Larry H.P. Lang, The Separation of Ownership and Control in East Asian Corporations, 58 J. FIN. ECON. 81, 82 (2000). This large discrepancy between cash flow rights and voting rights of the controlling shareholder is generally considered undesirable. Nonetheless, Korea has long been considered a model for economic growth in developing countries.

24 See infra Part III.C.2.
25 Compare with a roving controlling shareholder who relies on one-time large pecuniary benefits.
26 See infra Part III.C.2.
27 Gilson, supra note 8, at 1663-64 (explaining non-pecuniary benefits). 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 psychological benefits add to a controlling shareholder’s utility, and he takes into account non-pecuniary benefits in his utility function.
28 Thus, the total benefits that a stationary controller is able to enjoy are the sum of the present value of the pecuniary and non-pecuniary benefits. See infra Part IV.B.
29 See infra Part IV.B.1 (explaining “two-factor analysis”).
(and thus more generous). Through inheritance within a family, the 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 his 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 proverbial “golden goose,” producing non-pecuniary as well as pecuniary benefits forever. Concomitantly, minority shareholders are better off in stable family corporations.

However, this does not mean that all controlling family shareholders are stationary. Often, carpe diem holds. In addition, it is possible that at some later point stationary family controllers can transform into roving controllers. A second generation’s poor management skill, sibling rivalry and a succession crisis problem, unfavorable macro-economic environments, and structural changes in a family business can adversely affect the existing continuous relationship between a controlling family shareholder and minority shareholders.

Against this backdrop, 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

30 See infra Part IV.
31 See Ronald J. Gilson, Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange, 60 Stan. L. Rev. 633, 643 (2007) (explaining a controlling family shareholder’s infinite time horizon through inheritance).
32 Gilson attempts to answer a conundrum of why some controlling shareholders in bad-law countries imposes “a ceiling on private benefit extraction” (i.e., less-radical expropriation) from minority shareholders. Id. at 648. Gilson explains, “[s]uppose that the treatment of minority shareholders is visible to a company’s potential trading partners at a low cost … Fair treatment of minority shareholders then serves as evidence of the corporation’s integrity, including its commitment to performing its contractual obligations . . . .” Id. Accordingly, “minority shareholders play the role of reputational canaries, whose value is that they help credibly convey to potential traders that the corporation is an honest trading partner.” Id. In sum, “[m]ore speculatively, the role of reputation in the product market may help explain why we observe publicly held minority shares in the capital market even though poor shareholder protection does not impose a formal limit on the amount of private benefits that a controlling shareholder can extract.” Id. at 636. In this respect, Gilson explains the conundrum “from a product market perspective rather than a capital market perspective.” Id. at 648.

Contrary to Gilson’s product market-based account (PMBA), the Author proposes an answer for the same conundrum by analyzing the nature of a stationary controller. A stationary controller would voluntarily impose “a ceiling on private benefit extraction” (in Gilson’s vocabulary) since a series of a low rate of extraction for a long time would generate a larger total amount of extraction (and non-pecuniary benefits). See infra Part III.C and Part IV. In this view, fair treatment of minority shareholders is not merely a signal to trading partners in the product market, but in itself an important source of economic and psychological benefits for the stationary controller. For a further critical review of Gilson’s PMBA, see generally Sang Yop Kang, Re-envisioning the Controlling Shareholder Regime: Why Controlling Shareholders and Minority Shareholders Often Embrace, 16 U. Pa. J. Bus. L. (2014).

33 There are two types of roving controllers: (1) those who are determined to be roving controllers in the first place (they initially plan to defraud public investors and they loot soon); and (2) those who play as stationary controllers, but become roving under new circumstances.

34 Currently, the Author conducts further research to answer these issues.
puts forward a theory determining the circumstances under which a controlling shareholder would choose to be stationary. Part IV explores why a controlling family shareholder is more likely to be stationary (and thus generous). 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 are 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 in relation to family corporations. To be sure, the grade for family corporations in developing countries is not an A+. It is not a C either if they are stationary, however, and perhaps the corporate governance of stationary family corporations is better than we may have thought.

II. ANALYSIS OF BANDITRY

Politics and corporate economics share a lot in common. 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. This Part starts with a seeming digression—although it is ultimately pertinent to the topic of this Article—to Mancur Olson’s political economics theory on the evolution of governmental systems in history.


36See generally Olson, supra note 9.
A. Roving Bandits and Stationary Bandits

In anarchies and autocracies, powerful political groups are analogous to “bandits,” since these groups exploit laypeople by means of violence.\(^{37}\) 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.\(^{38}\)

In short, bandits are classified into at least two groups: less generous “roving bandits” and more generous “stationary bandits.”\(^{39}\) As the vocabulary explains, roving bandits are bandits who are ready to depart from the pillaged place soon after total plundering.\(^{40}\) In anarchy where no single entity dominates the entire domain, powerful groups loot a limited number of victims. Facing uncoordinated competitive theft with other groups, it is in their best interest to take all property possible from their victims.\(^{41}\) This problem arises since bandits overuse “common properties”—i.e., the properties of victims—without a control tower so that common properties are depleted quickly. In other words, roving bandits face the “tragedy of the commons”\(^{42}\)—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

\(^{37}\)Mancur Olson, Power and Prosperity: Outgrowing Communist and Capitalist Dictatorship 6-7 (2000).
\(^{38}\)Olson, supra note 9, at 568.
\(^{39}\)See generally Olson, supra note 9.
\(^{40}\)Id. at 568.
\(^{41}\)Id.
\(^{42}\)See generally Garrett Hardin, The Tragedy of the Commons, 162 SCI. 1243 (1968).
nothing. Only “today” is meaningful in the minds of roving bandits. In a similar way, Somalian pirates are roving bandits; they are ruthless because they do not expect to see the same victims on the sea in the future.

After fierce competition among many roving bandits, a more powerful bandit emerges as a sole ruler in a certain domain. In the absence of competing bandits with whom he must share trophies in a regime with roving bandits, he resides with his subjects, and monopolizes theft from them. In this respect, he is referred to as a stationary bandit. Anarchy turns into stable autocracy. As a king, rather than one of many bandits, a stationary bandit finds it optimal to thieve in the form of regular taxation with a long-term perspective rather than occasional and brutal plundering.

Since the dismal inter-temporal problem existing under the threat of roving banditry is solved, a stationary bandit considers “tomorrow” as well. In the vocabulary of game theory, a stationary bandit enters into a repeated game with his subjects.

B. Bandits’ Tax Policies and Impacts

This Section 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 and a tax rate is 20%, tax revenue is $20 million. 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. Initially, when the tax rate increases, tax revenue increases as well since the

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43In this Article, “today” is used to explain a controlling shareholder’s short-termism. In a similar way, “tomorrow” is used to explain a controller’s far-sightedness.


45Ölson, supra note 9, at 568.

46Id.

47See WALTER NICHOLSON & CHRISTOPHER SNYDER, THEORY AND APPLICATION OF INTERMEDIATE MICROECONOMICS 195-200 (Thomson South-Western 10th ed. 2007) (Int’l ed.).


49Id. at 1-2. As Laffer himself admits, however, this concept should be credited to Ibn Khaldun and John Meynard Keynes. Id. at 2-3. See also Olson, supra note 9, at 569.
positive effect of the increased tax rate is stronger than the negative effect of the decreased tax base.\textsuperscript{50} After the tax rate reaches the revenue-maximizing point, however, tax revenue goes down as the tax rate continues to rise (due to the distortion of taxpayers’ incentive to earn income).\textsuperscript{51} Put differently, the positive effect of the increased tax rate is overwhelmed by the negative effect of the decreased tax base. Thus, if the government is economically rational to maximize tax revenue, it imposes the “optimal tax rate”\textsuperscript{52} (a lower tax rate), rather than levy a harsh tax rate that destroys the taxpayers’ willingness to work.

\textit{Figure 1}

\begin{center}
\includegraphics[width=0.5\textwidth]{optimal_tax_rate.png}
\end{center}

- X axis: tax rate ("0" equals 0\% and "1" equals 100\%)
- Y axis: tax revenue

In Olson’s world, an (extreme) roving bandit’s tax rate is 100\%. This total plundering may work in the first stage. However, since victims soon recognize that endurance of a painful “today” will not generate any fruit “tomorrow,” they will end up producing nothing from the next stage on.\textsuperscript{54} Accordingly, the tax base will shrink to

\begin{itemize}
\item \textsuperscript{50}Laffer, \textit{supra} note 48, at 2-3.
\item \textsuperscript{51}\textit{Id}.
\item \textsuperscript{52}\textit{Id}. In this Article, the “optimal tax rate” is referred to as the tax rate that maximizes tax revenue for a bandit.
\item \textsuperscript{53}This is a simplified graph for the revenue-maximizing tax rate. The graph is not necessarily symmetric.
\item \textsuperscript{54}Olson, \textit{supra} note 9, at 568.(“In a world of roving banditry there is little or no incentive for anyone to produce or accumulate anything that may be stolen, and, thus, little for bandits to steal.”).
\end{itemize}
zero, and the tax revenue accruing to a roving bandit will also approach zero. Consequently, the welfare of the entire society—both bandits and victims—will deteriorate as this vicious cycle is formed.

In contrast, when a bandit becomes stationary, a self-interested bandit chooses a revenue-maximizing optimal tax rate, which is far less than a roving bandit’s ruthless tax rate. The sum of accumulated tax revenue over a long time will generally exceed the one-shot tax collection of a comparable roving bandit. Since only a part of their income is taken by a stationary bandit periodically, his subjects have an economic incentive to produce, save, and invest. Accordingly, a larger tax base will be created. 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. Democracy with political legitimacy might be the best situation for the general population. Given the condition that democracy is a remote possibility for the current generation, however, coexistence with stationary bandits rather than with roving bandits would be much more desirable to victims.

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

In Part II, concepts of bandits in a political-economy theory and bandits’ tax policies have been introduced and reviewed. In Part III, 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 observed only in the United States and United

55 See Laffer, supra note 48, at 2; see also Olson, supra note 9, at 568.
56 Olson, supra note 9, at 569.
57 Id. at 568.
58 Id. at 567.
59 Id. at 571.
60 BERLE & MEANS, supra note 2, at 47-48.
61 For a further explanation of dispersed shareholder ownership, see generally John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of the Law and the State in the Separation of Ownership and Control, 111 YALE L.J. 1 (2001).
62 See Hofstetter, supra note 1, at 600-01.
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. China is a good example for both types of controlling shareholders: in China, the importance of family corporations has grown rapidly; nonetheless, the Chinese economy is still dominated by state-owned corporations (SOE). Economies such as Korea, Indonesia, and Thailand are under the significant influence of 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 relating to a controlling shareholder’s interested transactions, provides a useful definition of self-dealing: “[s]elf-dealing occurs when [a controlling shareholder], by virtue of its 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

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64 See generally Coffee, supra note 3, at 642.
65 La Porta et al., *Corporate Ownership*, supra note 4, at 496.
67 See generally La Porta et al., *Law and Finance*, supra note 5 (conducting a comparative governance study). See Gilson, supra note 8, at 1644 (“In this [Law and Finance] account, controlling shareholder regimes exist in jurisdictions whose legal systems do not protect minority shareholders from dominant shareholders’ diversion of private benefits of control.”). But see id. at 1643 (“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.”).
68 Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22, 22 (2000) (“[W]e 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.”).
69 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, 100 (1998). On the other hand, the dispersed shareholder system is subject to managerial agency problems. 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, 679 (2007).
70 *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971).
minority stockholders of [the corporation].”

Sinclair also clarifies issues related to standards of review. For instance, proportional payment of dividends to shareholders is protected under the business judgment rule. When a business transaction at issue is a controlling shareholder’s interested transaction, however, the business judgment rule is not applied. Rather, the fairness standard—a less favorable standard of review from the standpoint of a controlling shareholder—will be used. In addition, criminal sanctions may be imposed in severely tainted conflict-of-interest cases as well in some jurisdictions.

A simple form of tunneling is outright theft of corporate value by a controlling shareholder. 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% ownership) and Company B (by 10% 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% of economic interest. Another complicated form of tunneling can take place by manipulating the price of corporate securities.

One may be curious how the controlling shareholder can dominate Company B with only 10% 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 rights through stock pyramiding, dual-class equity

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71 Id. at 720.
72 Id. at 719-20.
73 Sinclair, 280 A.2d 720 (Del. 1971). See also Mary Siegel, The Erosion of the Law of Controlling Shareholders, 24 Del. J. Corp. L. 27, 27-8 (1999) (“Because the fairness standard requires defendants to prove innumerable considerations that are both subjective and amorphous, defendants view the entire fairness standard as highly problematic.”).
76 Johnson et al., supra note 68, at 22-23.
77 Id. at 22-23.
78 For a further explanation of self-dealing, see generally Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, The Law and Economics of Self-Dealing, 88 J. Fin. Econ. 430 (2008).
80 There are two types of controlling shareholder regimes—(1) the controlled structure (CS) and (2) the controlling minority structure (CMS). See Lucian Arye Bebchuk, Reinier Kraakman & George G. Triantis, Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights, CONCENTRATED CORPORATE OWNERSHIP 295 (Randall K. Morck ed., 2000). In the CS, a controlling shareholder has power
structure,\textsuperscript{82} and various types of cross-shareholding.\textsuperscript{83} Suppose that a controlling shareholder has 50.1% ownership of a holding company, which owns a 50.1% stake in Company X. Subsequently, Company X owns a 50.1% stake in Company Y.\textsuperscript{84} The controller’s economic interest in a grandchild legal entity (Company Y) is only 12.6%. Nonetheless, he effectively exercises control over it through the pyramiding chain from the holding company.\textsuperscript{85} As of 2011, Kun-Hee Lee, the controlling shareholder of Samsung Group, controlled 78 affiliated firms (including Apple’s archrival, Samsung Electronics).\textsuperscript{86} Interestingly, his personal economic interest in Samsung Group was only 0.69%.\textsuperscript{87} The magical scheme on which he relies was complicated circular-shareholding. A more adroit person who uses voting leverage is Tae-Won Choi, the dominant shareholder of SK Group, another large business group in Korea.\textsuperscript{88} Astonishingly, he held only 0.04% ownership of SK Group.\textsuperscript{89} Although the effectiveness of voting leverage mechanisms varies over a great range, stock pyramiding, dual class equity structure, and cross-shareholding are widely used in the world. Morck took examples such as Hees-Edper Group in Canada, Anglo-American Group in South Africa, and Agnelli Group in Italy.\textsuperscript{90}

Use of a to control a corporation by owning a majority of shares. \textit{Id.} In the CMS, a controlling shareholder controls a corporation through his inflated voting rights even though he does not own a majority of shares. \textit{Id.} Ownership based on the CMS provides a controlling shareholder with various types of benefits. For example, a CMS controlling shareholder has advantages in a hostile takeover war. \textit{See generally} Sang Yop Kang, \textit{Transplanting a Poison Pill to Controlling Shareholder Regimes—Why It Is So Difficult}, 33 NW. J. INT’L L. & BUS. 619 (2013).

\textsuperscript{81}Bebchuk et al., \textit{supra} note 80 at 298.

\textsuperscript{82}See Bebchuk et al., \textit{supra} note 80, at 297 (explaining that a company can issue two or more classes of stock with differential voting rights). For a further explanation of the dual class share structure, see generally Ronald J. Gilson, \textit{Evaluating Dual Class Common Stock: The Relevance of Substitutes}, 73 VA. L. REV. 807 (1987); Jeffrey N. Gordon, \textit{Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice}, 76 CALIF. L. REV. 1 (1988).


\textsuperscript{85}50.1% x 50.1% x 50.1% = 12.6%.


\textsuperscript{87}Jong-Sung Yun, Kun-Hee Lee and Tae-Won Choi Control Their Business Groups with 0.69% and 0.04% Ownership Respectively, \textit{E-DAILY} (May 30, 2013), http://www.edaily.co.kr/news/NewsRead.edy?SCD=JA11&newsid=01974566602814168&DSCD=A00101&OutLknChk=Y.

\textsuperscript{88}See Yun, \textit{supra} note 87.

\textsuperscript{89}Id.

\textsuperscript{90}Morck, \textit{supra} note 84, at 137-38.
pyramiding scheme is prevalent among Chinese companies as well.\textsuperscript{91} Developed industrial countries with good-law are not exceptions. In the United States, dual-class structures have been permitted,\textsuperscript{92} although they are rarely used among public corporations.\textsuperscript{93} In many public corporations in Switzerland, Italy, and Sweden, dual-class stock systems are used as well.\textsuperscript{94}

B. Roving Controllers and Stationary Controllers

In the context of corporate governance, whoever takes corporate assets to the detriment of investors can be named a corporate bandit.\textsuperscript{95} When corporate law is not protective in a jurisdiction and looting is inevitable, one significant issue for victims—usually minority shareholders—is a corporate bandit’s degree of looting of a corporation. Put differently, whether the corporate bandit is roving or stationary is a focal point.

1. A New Typology of Controlling Shareholders

It is true that even good-law countries are not able to perfectly prevent transactions with conflicts of interest. However, minority shareholders in such jurisdictions are generally insulated from a large scale of expropriation by corporate insiders.\textsuperscript{96} In the United States, as Merritt Fox explains, doctrines and the jurisprudence of corporate law have been developed in order to solve problems imposed by corporate buccaneers.\textsuperscript{97} As a result, U.S. statutes and common law effectively protect public investors, especially from unfair transactions arising from conflict of


\textsuperscript{92}ALLEN ET AL., \textit{supra} note 74, at 202 (“American corporate law does not require all shares to have voting rights, nor does it require all voting shares to have equal voting rights. Thus, most U.S. jurisdictions permit super-voting stock.”).

\textsuperscript{93}Id. “For many years, the New York Stock Exchange (NYSE) would not list common stock that did not possess equal rights. Since access to the NYSE was essential for public companies, firms simply did not adopt dual-class structures.” \textit{Id.} (citation omitted).

\textsuperscript{94}For example, 66.1\%, 51.2\%, 41.4\%, 17.6\% of listed companies have dual class stock in Sweden, Switzerland, Italy, and Germany respectively. \textit{See} Gilson, \textit{supra} note 8, at 1647 tbl. 2 (citing Mara Faccio & Larry H.P Lang, \textit{The Ultimate Ownership of Western European Corporations}, 65 J. FIN. ECON. 365, 385-86 (2002)).


\textsuperscript{96}It is noteworthy, however, that good-law countries can be subject to huge managerial agency problems, which “corporate law does not even try directly control.” \textit{See} Mark J. Roe, \textit{Corporate Law’s Limits}, 31 J. LEGAL STUD. 233, 234 (2002).

\textsuperscript{97}Discussion with Merritt B. Fox at Columbia University School of Law.

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interest. In addition to *Sinclair*, 98 *Weinberger v. UOP, Inc.* proposed the analysis based on fair price and fair dealing when evaluating whether a conflicted transaction should be permitted. 99 In Sweden, although a limited number of wealthy families dominate the entire economy, it is known that they do not siphon public corporations’ wealth. 100 In these law-abiding economies, when a corporate bandit is recognized, enforcement agencies or courts will generally intervene and punish him.

Notable U.S. examples include legal enforcement against Bernie Madoff’s Ponzi scheme and the accounting manipulation of Enron’s top management (e.g., the former CEO, Skilling). 101 For these corporate scandals, masterminds of large-scale frauds face harsh criminal punishment: Madoff was sentenced to 150 years and Skilling was sentenced to 24 years. 102 In addition, new enactments and corporate governance reforms such as the Sarbanes-Oxley Act have been passed. 103 It is true that these examples of corporate governance fiascos reveal a weakness of the U.S. corporate governance. On the other hand, 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) lack well-performing legal infrastructures that are designed to effectively protect investors in the capital markets. 104 The piracy of controlling shareholders is, in practice, a default rule in many bad-law countries. In other words, expropriation of minority shareholders is understood as an “unavoidable tax” imposed by a corporate bandit. In this sense, the analysis of taxation aforementioned in Part

98*Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).*

99*Weinberger v. UOP, Inc. 457 A.2d 701, 711 (Del. 1983).*

100See, e.g., Gilson, *supra* note 8, at 1660 (“[T]he United States and Sweden no longer fall on opposite sides of a widely held/controlling shareholder dichotomy, but represent points on a single functionally good law continuum . . . .”).


103Nonetheless, there are arguments that Sarbanes-Oxley Act is counter-productive to the U.S. economy due to the additional burdens and regulations that U.S. corporations should bear. See William Baldwin, *These Stocks Sidestep Sarbanes-Oxley Idiocies*, FORBES (Jan. 2, 2013), http://www.forbes.com/sites/baldwin/2013/01/02/these-stocks-sidestep-sarbanes-oxley-idiocies.

104See, e.g., Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 739 (1997) (“[C]orporate 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.”).
II.B can be used to explain the context of corporate governance in a bad-law jurisdiction. 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.

Similar to Olson’s political bandits,105 in bad-law jurisdictions there are two basic types of controlling shareholders. Ruthless controlling shareholders with myopia—“roving controllers”—may take almost all of the corporate value through a one-shot transaction. They are the ones who siphon all assets from corporations at the expense of minority shareholders. Put differently, a roving controller imposes excessively harsh “taxation” on corporate constituencies (mainly minority shareholders). As a result, it is so severely detrimental to minority shareholders 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.106 As such, roving controlling shareholders do not use the long-term “optimal tax rate”107 strategy. Rather, they are subject to short-termism.108 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 rationally 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.109 In order to maximize the amount of pecuniary private benefits110—which are “tax revenues”—a stationary controller

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105 See supra Part II.A.
106 See Laffer, supra note 48, at 2.
107 See supra note 52 (explaining the “optimal tax rate”).
108 Short-termism is not a problem for only a roving controlling shareholder. See, e.g., Martin Lipton & William Savitt, The Many Myths of Lucian Bebchuk, 93 VA. L. REV. 733, 745-47 (2007) (explaining short-termism of institutional investors such as hedge funds and arbitrageurs).
109 If a king relies on total plundering all at once, he is not able to stay with his subjects
110 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. See generally Lucian Arye Bebchuk, Efficient and Inefficient Sales of Corporate Control, 109 Q.J. ECON. 957 (1994) (explaining pecuniary private benefits); Alexander Dyck & Luigi Zingales, Private Benefits of Control: An International Comparison, 59 J. FIN. 537 (2004) (discussing cross-country differences in private benefits).
chooses the “optimal extraction rate”\textsuperscript{111} that is far less than a roving controller’s prohibitively high expropriation rate. This is similar to a rational stationary bandit’s strategy of imposing tax on his subjects.\textsuperscript{112}

Indeed, the presence of a stationary controller provides many corporate governance implications. Most of all, 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. In other words, a stationary controlling shareholder is a “generous thief.” He also realizes that patience is gold. Nonetheless, his self-control is not the result of his sincere generosity or business ethics, but of his carefully calculated rationality. In addition, 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, extra-legal factors such as the self-interest of controlling shareholders can partially substitute for an efficient and protective legal infrastructure for public investors. Without strong intervention by the government and judiciary, the market with bad-law may perform self-regulation, which is similar to Adam Smith’s explanation of the invisible hand.\textsuperscript{113} In short, a stationary controlling shareholder system is a win-win game for a controller and for minority shareholders.

2. Examples of Roving Controllers

Since China’s economic reforms in the 1980s, the country’s economic development has been remarkable. However, the quality of corporate governance among its corporations is still poor.\textsuperscript{114} For example, the largest shareholder in Meierya siphoned $44.6 million in 2001—the amount of embezzlement was 41% of the company’s equity capital.\textsuperscript{115} In 2001, the largest shareholder in Sanjiu Parma expropriated $301.9 million, 96% of the

\textsuperscript{111}Similar to the “optimal tax rate,” the “optimal extraction rate” is defined as the extraction rate which maximizes a controlling shareholder’s pecuniary private benefits.

\textsuperscript{112}See Olson, supra note 9, at 568; Laffer, supra note 48, at 1-2.

\textsuperscript{113}See Olson, supra note 9, at 568 (“[T]he rational, self-interested leader of a band of roving bandits is led, as though by an invisible hand, to settle down, wear a crown, and replace anarchy with government.”).


\textsuperscript{115}Id. at 2.
company’s equity capital, from the company. These examples show sudden and total (or substantial) plundering of corporate value, which is the very feature of roving controllers’ extraction.

It was a serious social problem in China that foreign business people took substantially all corporate assets and left China overnight without any legal notice to other investors, trading partners, and employees. Such “moonlight flitting” cases often happened with respect to bankruptcy and liquidation. In this respect, these cases are different from embezzlement by active roving controllers. Nonetheless, basically moonlight flitting is 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, the new Russia adopted market-oriented economic policies characterized in particular by 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 “ultimately 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.” Relying on outright theft and self-dealing, oligarchs transferred massive corporate value to the detriment of other corporate constituencies as well as minority shareholders. When oligarchs were involved, judges were often bribed, so that oligarchs had no fear when they stole property from corporations.

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116 Id.
120 Id. at 218.
123 Id. at 1754.
124 See, e.g., Black & Tarassova, supra note 119, at 218; Black et al., supra note 122, at 1736-37.
The case of Mikhail Khodorkovsky, previously so-called “the richest man in Russia,” is a good example of roving banditry during the massive privatization in Russia.\(^\text{126}\) He “made his fortune—estimated at more than $15bn (£9.72bn) according to Forbes magazine—from the controversial post-Soviet privatisation of state assets.”\(^\text{127}\) Using his control of Bank Menatep, Khodorkovsky acquired Yukos, a major oil holding company in Russia in 1995.\(^\text{128}\) Allegedly, he then personally took over 30% of Yukos’ revenues in 1996,\(^\text{129}\) effectively expropriating the wealth of minority shareholders.\(^\text{130}\) After substantial stealing between 1996 and 2000, the board of Yukos interestingly pledged compliance with international principles of good corporate governance.\(^\text{131}\) As it is widely known, Khodorkovsky had political ambition as well, and was considered a political rival of Vladimir Putin.\(^\text{132}\) In this respect, it is rumored that the real intention of Khodorkovsky in following the global standard of corporate governance was to fend off any future political attacks by seeking alliances with foreign investors.\(^\text{133}\)

Due to the Russian financial crisis in 1998, Bank Menatep suffered huge losses on ruble-denominated Russian government bonds.\(^\text{134}\) Although Khodorkovsky could have saved the bank through his offshore wealth, he chose to let the bank collapse.\(^\text{135}\) Subsequently, he transferred its good assets to a new bank, Menatep-St. Petersburg, leaving depositors and creditors empty handed.\(^\text{136}\) Furthermore, he stripped virtually all of the assets of Yukos and its subsidiaries by transferring these assets to offshore companies.\(^\text{137}\) Minority shareholders faced


\(^{127}\)Id.

\(^{128}\)Black et al., supra note 122, at 1736; see also BBC NEWS EUR. supra note 126 (“In 1995, Khodorkovsky acquired Yukos at a state auction at the knockdown price of $350m.”).

\(^{129}\)Black et al., supra note 122, at 1736-37.

\(^{130}\)MILHAUPT & PISTOR, supra note 121, at 154-55.

\(^{131}\)Id. at 155.

\(^{132}\)Cf. id. at 156 (“Although several observers speculated that Putin attacked [Khodorkovsky] because he announced that he might run for president in 2008, Putin did not really have to fear a rival who was loathed by the public at large.”).

\(^{133}\)Id. at 155.

\(^{134}\)Black et al., supra note 122, at 1770.

\(^{135}\)Id.

\(^{136}\)Id. at 1754.

\(^{137}\)See, e.g., Black & Tarassova, supra note 119 at 241-42 (explaining transfer pricing); see also Black et al., supra note 122, at 1769-72.
substantial losses and opposed such proposals, but their opposition was easily suppressed by Khodorkovsky in a bold way.\textsuperscript{138}

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, Khodorkovsky then transferred Yukos’ remaining shares in two of the three oil-producing subsidiaries to still other offshore companies.\textsuperscript{139}

Finally, Khodorkovsky was arrested for his tax evasion, fraud, and embezzlement.\textsuperscript{140} He was in jail for more than a decade (Khodorkovsky was pardoned in December 2013).\textsuperscript{141} It is alleged that his personal misfortune is not entirely due to his misconduct and violation of law in relation to his business: Putin’s animosity towards him was reflected in legal enforcement as well.\textsuperscript{142}

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 common business practice in Chinese companies was that controlling shareholders extract corporate profits by means of corporate loans.\textsuperscript{143} Nonetheless, most Chinese companies are going-concern

\textsuperscript{138}Black et al., \textit{supra} note 122, at 1770-71.
\textsuperscript{139}\textit{Id.} at 1771.
\textsuperscript{140}BBC NEWS EUR., \textit{supra} note 126.
\textsuperscript{142}See BBC NEWS EUR., \textit{supra} note 126 (“However [Khodorkovsky] had made no secret of his support for the liberal opposition to Mr Putin.”); Charles Clover, \textit{Khodorkovsky to Be Freed Early in 2014}, FIN. TIMES (Dec. 20, 2012), http://www.ft.com/intl/cms/s/0/060cb53c-4aaf-11e2-9650-00144feab49a.html#axzz2fop9rwu7 (“Mr Putin . . . has in the past publicly labelled Mr Khodorkovsky a ‘thief’ who ‘must sit in prison.’” (quoting Vladimir Putin)).
\textsuperscript{143}See generally Guohua Jiang, Charles M.C. Lee & Heng Yue, \textit{Tunneling in China: The Surprisingly Pervasive Use
entities. This means that controlling shareholders are generally stationary and do not loot all (or substantially all) of the corporate assets at the expense of minorities.

Another example of stationary banditry can be found in Korea. During the period from the 1960s to the late 1980s, military dictatorship had ruled Korea. A stroke of good luck in the midst of the 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 firmly established chaebols — powerful business groups in Korea — and become controlling family shareholders. In general, chaebols were considered to be an engine for Korean economic growth. For instance, Samsung, LG, and Hyundai Motors successfully compete in the global market.

On the other hand, chaebols 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, “[i]n 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 corporate bandits. Due to a series of corporate governance reforms in the 2000s, however, the quality of corporate governance has been remarkably improved. As for tunneling, government agencies, politicians, prosecutors and judges—who used to be generous to chaebol controllers—do not blindly condone substantial controlling shareholder agency problems any more.

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145 See id. at 245.
146 Id. at 245-46.
147 See Song, supra note 83, at 190-91 (2002) (explaining how the economic system based on chaebols has been established in Korea); see also Bernard Black, Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness, 26 J. Corp. L. 537, 540 (2001) (explaining the chaebol system in Korea); James Jinho Chang & Hyun-Han Shin, Family Ownership and Performances in Korean Conglomerates, 15 PACIFIC-BASIN FIN. J. 329, 329 (2007) (explaining controlling shareholders’ concentration of economic power in Korea).
148 See Gilson & Milhaupt, supra note 144, at 245-47 (explaining the implicit alliance between the Korean government and business elites).
149 Id.
151 Id. at 23.
A recent court decision on Samsung Group, the largest chaebol in Korea, deserves attention. The succession plan in Samsung Group from the current controlling shareholder Kun-Hee Lee to his children started in the 1990s. When a part of his control ownership was passed to his children, Lee allegedly misappropriated minority shareholders’ corporate wealth in a very sophisticated and complicated scheme. In particular, the allegation is that Everland—a theme park, but, interestingly, the de facto holding company of the Samsung Group with almost 80 affiliated companies—issued convertible bonds to the Lee family at an unfairly low price. In relation to this transaction, Lee was charged with breach of trust in 2008. Eventually, he was found not guilty by the Supreme Court in 2009, a result that is still controversial. Nonetheless, in a subsequent civil suit, a lower court ruled in favor of minority shareholders of an affiliated firm. The controlling shareholder of Hyundai Motors Group (the second largest chaebol), Mong-Koo Chung was also involved in unjust support for his son’s benefit. For this case, he was ordered to pay roughly $73 million in 2011. In 2013, Tae-Won Choi, the dominant shareholder of SK Group (the third largest chaebol) was sentenced to four years of imprisonment for his embezzlement. Choi’s case is very special, since it is extremely rare that a chaebol controller really sits in prison for tunneling although his controlled corporate group is not in trouble.

Indeed, the above examples show that until recently tunneling is still the main corporate governance problem among Korean chaebols. On the other hand, these examples ironically explain that corporate governance environment in Korea has been significantly improved—de facto impunity for chaebols’ tunneling is over. More

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155 Chen, supra note 154.
159 Id.
important, it is noteworthy that chaebol controllers’ misconduct differs sharply from the one-time, sudden, and total plundering in roving banditry. In other words, they do not fatally damage minority shareholders by “killing” their controlled corporations. The tendency is clear when aforementioned examples of roving banditry—Sanjiu Parma in China (embezzlement of 96% of equity capital) and Khodorkovsky in Russia (abandoning corporations for the controlling shareholder’s benefits)—are compared.\textsuperscript{161} Although the amount of extraction by a chaebol controller is large in terms of absolute value, it is relatively small, compared to the corporations’ asset size and market capitalization. In fact, “generous” tunneling has been a long tradition in a chaebol even in the past when a typical controlling shareholder was more insulated from the enforcement system than now.

C. When Does a Controlling Shareholder Rationally Choose to Be Stationary

It is puzzling that some controlling shareholders in bad-law countries “generously” expropriate from minority shareholders. It is possible that some controlling shareholders are moralistic by nature. Or, a partial expropriation would be the only viable option to some controlling shareholders, when they believe that large-scale business scandals are not condoned by the government and the judicial system. Although these possibilities are not entirely ruled out, this Article pays attention to economic/psychological rationalities that affect a controlling shareholder’s decision on the method of stealing.

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

Perhaps, a “semi-stationary” controller may exist and the question of “roving” versus “stationary” is too simple. Nonetheless, developing a new theory based on a simplified analytical framework of two extremes might be a good start. In a simplified model, I hypothesize an extreme roving controller who takes all corporate assets suddenly through a one-shot transaction (note that in reality it is possible that roving controllers take a substantial amount of corporate assets through a series of transactions in a short time period).

A numerical example can explain a controlling shareholder’s choice in a more concrete way. Suppose that minority shareholders invest $100 million in a corporation that one dominant shareholder exercises control over.

\textsuperscript{161} See supra Part III.B.2.
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. This sort of misconduct by corporate insiders was prevalent during Russian privatization.\footnote{162} 

Alternatively, the controlling shareholder may think that maintaining a corporation as a 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 the controlling shareholder illicitly transfers a cash flow of $5 million from the same minority shareholders each year continuously.\footnote{163} If this amount of exploitation is sustainable and acceptable to minority shareholders, they are willing to keep investing their money in that corporation.\footnote{164} For the sake of simplicity, the discount rate is assumed to be zero here. If the controlling shareholder is patient enough to maintain a long time horizon, in 20 years he will be better off because the total pecuniary benefit that he can gain as a stationary controller is more than $100 million, which is the amount of a one-shot extraction as a roving controller. Conversely, if the controlling shareholder is short-sighted for some reason—for example, he intends to stay in the corporation 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’ conduct, the valuation model based on discounted cash flow (DCF) can be used.\footnote{165} 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.\footnote{166} Since the life of common stocks is assumed to be infinite, except in the case of bankruptcy or acquisition,\footnote{167} the price of common stocks is assumed to be infinite, except in the case of bankruptcy or acquisition,\footnote{167} the price of common

\footnote{162}See, e.g., Black et al., supra note 122, at 1738.

\footnote{163}In this simple numerical example, the controlling shareholder’s legitimate cash flows (e.g., cash dividends) generated from his invested capital are not considered. Accordingly, only the amount of total plundering and the amount of partial extractions are compared.

\footnote{164}When public shareholders decide whether or not to remain in a controlled corporation, they will take into account “tax” (expropriation) by controlling shareholders. If the “after-tax” (after-expropriation) return is satisfactory to public shareholders, they keep their investment in that corporation.

\footnote{165}See Richard A. Brealey, Stewart C. Myers & Franklin Allen, Principles of Corporate Finance 61-63 (8th ed. 2006) (explaining valuation of common stocks based on the DCF model).

\footnote{166}Id. at 63-64. The DCF model has been acknowledged in Delaware for the purpose of valuation. See, e.g., Weinberger v. UOP, Inc. 457 A.2d 701, 712-13 (Del. 1983).

\footnote{167}See Brealey et al., supra note 165, at 64.
stocks of a firm \((P_0)\) is 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 \((CF_1)\) by the difference between the discount rate \((r)\) and the growth rate \((g)\), as is suggested by the constant growth model in Table 1.

Table 1: The Present Value of Common Stock

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

- \(P_0\): 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

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, a stationary controlling shareholder receives two types of cash flows from a corporation. First, he is paid \textit{pro-rata} “normal cash flows” on a continuous basis. Such cash flows are \textit{normal} because they are legitimate pecuniary benefits. 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” with relevant discount rates is defined as the “present value of normal cash flows” \((ND_0\)). Second, the stationary controlling shareholder is paid “special cash flows” on a continuous basis. Such cash flows are \textit{special} because they are illicit pecuniary benefits from the corporation. Generally, these cash flows are exclusively for the stationary controlling shareholder in the form of pecuniary private benefits of control through self-dealing or

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\(^{168}\) Id.

\(^{169}\) Id. at 65.

\(^{170}\) The formula in Table 1 is called constant growth model. \textit{See generally} Myron J. Gordon & Eli Shapiro, \textit{Capital Equipment Analysis: The Required Rate of Profit}, 3 MGMT. SCI. 102 (1956).

\(^{171}\) In this model, a corporation is assumed to be a perpetual entity. \textit{See BREALEY ET AL., supra} note 165, at 64-65.
tunneling.\textsuperscript{172} The total sum of all “special cash flows” with relevant discount rates is defined as the “present value of special cash flows” ($SD_0$). Then, the DCF model can calculate $ND_0$ and $SD_0$.

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\textsuperscript{173}—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,\textsuperscript{174} this assumption is maintained temporarily. Then, $SD_0$ can be reduced to a formula similarly found in valuing common stock without maturity:\textsuperscript{175} $SD_0 = Ext_t / (r – g)$.

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, $ND_0 = Div_1 / (r – g)$. Consequently, the “present value of total pecuniary benefits” ($V_0$) for a stationary controlling shareholder is the sum of $ND_0$ and $SD_0$. Thus, $V_0 = ND_0 + SD_0 = [Div_1 / (r – g)] + [Ext_t / (r – g)] = [Div_1 + Ext_t] / (r – g)$.

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

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<td>$ND_0 = \frac{Div_1}{r – g}$</td>
<td>$SD_0 = \frac{Ext_t}{r – g}$</td>
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<tr>
<td>$V_0 = ND_0 + SD_0 = \frac{Div_1}{r – g} + \frac{Ext_t}{r – g}$</td>
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- $Div_1$: the amount of pro-rata cash flow that a controller is paid at the end of year 1

\textsuperscript{172}“Special cash flows,” “pecuniary private benefits,” “tunneling” and “tax (revenue)” are used interchangeably in this Article. Generally in this Article, while “pecuniary private benefits” 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.

\textsuperscript{173}Note that the original DCF model designed to value a common stock uses infinite $N$ as well. See BREALEY ET AL., supra note 165, at 64; see supra Table 1.

\textsuperscript{174}See infra Part IV.A (discussing the concept of a controlling family shareholder with an infinite time horizon through family inheritance).

\textsuperscript{175}See supra Table 1.
- Ext$_1$: the amount of extraction that a controller siphons at the end of year 1
- $r$: the discount rate
- $g$: the growth rate
- $ND_0$: the present value of normal cash flows
- $SD_0$: the present value of special cash flows
- $V_0$: the present value of the total pecuniary benefits = $ND_0 + SD_0$

Alternatively, a controlling shareholder may choose to be roving if he wishes. In that case, he—an extreme roving controller—takes all corporate wealth, $ROV_0$, including his own invested capital as well as that of the minorities’ at time 0.\textsuperscript{176} 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)\textsuperscript{177}, 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.\textsuperscript{178}

$ROV_0$ and $V_0$ represent the liquidation and going-concern values of private benefits of control respectively. Just as the going-concern value is generally larger than the liquidation 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 mentioned previously in the numerical example,\textsuperscript{179} 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 bandit settles down and rules over his subjects exclusively in a certain domain, it is in his best interest to maximize the total value of theft in the long run.\textsuperscript{180}

\textsuperscript{176}In other words, a roving controller does not think of future cash flows at time 1, 2, 3, . . . , n, since he is not a repeat player. He takes into account only the one-shot cash flow at “time 0.” Nonetheless, it does not mean that the roving controller looks simultaneously when public investors invest in the corporation. For instance, it is possible that “time 0” can be one year after public shareholders invest in the corporation. Usually, a roving controller first attracts minority shareholders and waits for a while. Then, he ultimately pillages the corporation at “time 0.”

\textsuperscript{177}See infra Part IV.B.

\textsuperscript{178}Cf. infra Part IV.B (describing a two-factor analysis).

\textsuperscript{179}See supra Part III.C.1.

\textsuperscript{180}Olson, supra note 9, at 569.
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 of a controlling shareholder. As seen in the formula of Table 2, i.e., \( V_0 = \frac{D_1 + E_1}{r - g} \), 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 \( D_1 \), an extraction at a sustainable level in year 1 \( E_1 \), the growth rate \( g \), and the discount rate \( r \). Given a \( D_1 \) and \( E_1 \), \( V_0 \) 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 stationary. 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.

3. Why Don’t Investors Invest Abroad to Avoid Controlling Shareholders’ Exploitation?\(^{181}\)

So far, I have developed a theory of controlling shareholders based on an implicit assumption that investors in developing countries invest only in the domestic capital markets. One may argue that public investors in a bad-law country can invest abroad if they do not like bandits in their jurisdiction. In general, however, this has been impractical, if not impossible. Most of all, many developing countries have implicit or explicit capital regulations\(^{182}\) preventing public investors from investing abroad. Even without such regulations, public investors in bad-law jurisdictions have difficulties investing abroad.\(^{183}\) For example, financial intermediaries, who pool funds and invest abroad on behalf of small investors, have not been well-developed until recently in bad-law countries.\(^{184}\) In addition, “[people] feel comfortable investing their money in a business that is visible to them.”\(^{185}\) Such 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.\(^{186}\) Moreover, most public investors, especially in developing

\(^{181}\) As for the explanation in this Sub-Section, see generally Kang, supra note 32.


\(^{184}\) For a brief explanation of additional reasons that impede international investment, see Gur Huberman, Familiarity Breeds Investment, 14 REV. FIN. STUD. 659, 659 (2001) (quoting ECONOMIST).

\(^{185}\) Id.

\(^{186}\) For a further discussion of home bias, see Fox, supra note 183, at 2512-15; see also Huberman, supra note 184, at
countries, are relatively unsophisticated and poor. Thus, they might have fewer hedging tools and less capacity for the additional risk of international diversification.

IV. FAMILY CORPORATIONS AND STATIONARY CONTROLLERS

Based on the analytical framework 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{187} in this Article a “family” corporation refers to a corporation where family control is expected to continue through the next generation via inheritance.\textsuperscript{188}

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 plundering.\textsuperscript{189} This is why the king’s subjects have reason to be sincere when they say, “Long live the king.”\textsuperscript{190} “If the king anticipates and values dynastic succession, that further lengthens the planning horizon and is good for his subjects.”\textsuperscript{191} With an infinite tenure through inheritance, the king is more likely to act as a stationary bandit. As a repeat player, the king cares much about his reputation as an absolute but generous monarch.

The same logic applies to the context of corporate governance in developing countries. In a bad-law jurisdiction, like in 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

\textsuperscript{188}Id.
\textsuperscript{189}See supra Part II.A.
\textsuperscript{190}Olson, \textit{supra} note 9, at 571.
\textsuperscript{191}Id.
shareholder’s tenure is, the more likely he is to be stationary, all other things being equal. Since a stationary controlling shareholder and minority shareholders share encompassing interests, minority shareholders wish to have a controlling shareholder with a more extended time horizon.

In this respect, the notion of a “family” corporation is significant in the economic analysis of stationary banditry. In Part III, I propose a model for calculating the present value of total pecuniary benefits to a stationary controlling shareholder.\(^\text{192}\) The model is based on the assumption that a controlling shareholder’s tenure is infinite.\(^\text{193}\) Unlike a corporation that is an eternal entity, the life of a controlling shareholder is limited—therefore, in principle, the model based on perpetuity is not practical. Through intra-family inheritance, however, a controlling “family” shareholder—rather than merely a controlling shareholder—can achieve immortality as long as he treats his descendants as his alter ego.\(^\text{194}\) Accordingly, the assumption can be justified.\(^\text{195}\) 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”\(^\text{196}\) feature, he is expected to keep a golden goose for the future rather than to kill it and take more eggs for today.

Like the tyrant in the above example, a controlling shareholder with absolute power—if his tenure is limited—is likely to change his status from a stationary controller to a roving controller, as his final period of reign in a corporation comes closer. In other words, to the controlling shareholder, transactions with minority shareholders are not repeated any more so that he is less likely to care about the future payoffs of the transactions. However, family succession can reduce the likelihood of the final-period problem since the tenure is effectively extended to infinity via inheritance.\(^\text{197}\) A controlling family shareholder shares more encompassing interests with minority shareholders, and a family corporation is more likely to be prosperous and productive under the repeated

\(^{192}\) See supra Table 2.

\(^{193}\) The DCF valuation model is based on the assumption that a corporation receives cash flows for an infinite time horizon. BREALEY ET AL., supra note 165, at 64.

\(^{194}\) See Gilson, supra note 31, at 643 (“[F]amily ownership solves the intergenerational transfer process rather elegantly. Because of intrainfamily inheritance and family ties, the current generation of decision makers . . . treats the next generation’s utility as the equivalent of their own, so there is not temporal distortion of incentives to invest in reputation.”). But, compare with infra note 212 and accompanying text.

\(^{195}\) See supra notes 173-175 and accompanying text.

\(^{196}\) I borrow the terminology of the “selfish gene” from RICHARD DAWKINS, THE SELFISH GENE (1976).

\(^{197}\) See supra note 194.
transactions between an immortal controlling shareholder and public shareholders. This analysis explains at least partially why controlling family shareholders in large business groups in Korea were (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 the minority shareholders’ fate to stay in a bad-law jurisdiction without the opportunity for international investment, having a controlling “family” system is more favorable to minority shareholders than having a corporate dictator—whether a controlling shareholder or a professional manager—with limited tenure.

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

In extant literature, it is predominantly 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 (social prestige, reputation, and social influence) is an important factor as well. Thus, a controlling shareholder considers non-pecuniary benefits to be another form of compensation. Running sports teams is a good example of gaining non-pecuniary benefits: the Steinbrenner family, even if they 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). Simply put, money is not everything, even to business people. The goal of a

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198 As for repeated transactions, the following explanation is also 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.” (citation omitted). JOEL WATSON, STRATEGY: AN INTRODUCTION TO GAME THEORY 266 (2d ed. 2008).

199 See supra Part III.C.3.

200 Gilson, supra note 8, at 1664.


202 Id. at 1667.

203 Id. at 1667.


205 Economics is not merely a study of money. Instead, it is a study of various topics including non-financial incentive mechanisms and the happiness of human beings. Thus, psychological satisfaction should be included as an important factor in an economics model.
controlling shareholder is not only to maximize his wealth, but to maximize his utility from attaining a combination\textsuperscript{205} of pecuniary and non-pecuniary benefits.\textsuperscript{206}

Indeed, every human being wants to show that he has achieved more than other people have.\textsuperscript{207} To business people, for example, building their own business empire is a special achievement that other people may not have. Putting names of founding partners in law firms is often explained in a similar way. By bequeathing his throne to his children, the founder of a family corporation may feel that he can continue to impact the world even after his death—his (selfish) gene\textsuperscript{208} is still alive in future generations. Keeping the family legacy in his empire—which in itself does not generate money—is therefore significantly valuable to a controlling family.

In Politics, the Kim dynasty in North Korea provides an interesting example of the family legacy. Khrushchev heavily criticized Stalin after Stalin passed away. Observing this, Kim Il-Sung—the founding father of the dynasty—might be concerned about the possibility of a similar denouncement after his death. In addition to protective instinct of his family, arguably he appointed his son, Kim Jung-II as his successor in order to reduce such a risk. Ultimately, Kim Jung-II’s son (and Kim Il-Sung’s grandson), Kim Jung-Un did succeed his father’s position after his father died.\textsuperscript{209}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{205}Pecuniary benefits and non-pecuniary benefits can be considered to be two different “goods” to a controlling shareholder. For a possible microeconomics analysis, see infra note 211.
\item \textsuperscript{206}Measuring wealth is \textit{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 (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. Accordingly, it is impractical to add up the utility of non-pecuniary and pecuniary benefits that lack a common and justified unit. Probably these are reasons why extant literature has not paid close attention to non-pecuniary benefits. Nonetheless, at least a theoretical corporate governance model of a controller’s utility function should take into consideration the presence of non-pecuniary benefits. Otherwise, we would not precisely understand what determines a controlling shareholder’s strategic and operational decisions. In addition, non-pecuniary benefits can alter the looting policy of a controlling shareholder. See \textit{infra} Part IV.B.2.
\item \textsuperscript{207}Self-esteem or pride is another form of psychological satisfaction or non-pecuniary benefits. See, \textit{e.g.}, Gilson, \textit{supra} note 8, at 1663-64. Gilson is one of the first few scholars who take into account the presence and value of non-pecuniary private benefits of control.
\item \textsuperscript{208}See generally DAWKINS, \textit{supra} note 196.
\end{itemize}
\end{footnotesize}
1. One-Factor Analysis v. Two-Factor Analysis

According to the “one-factor analysis” introduced earlier:210 (1) when $ROV_0$ (i.e., the value that a roving controller loots at time0) is greater than $V_0$ (i.e., the present value of the total pecuniary benefits to a stationary controller), he chooses to be roving; (2) when $V_0$ is greater than $ROV_0$, he chooses to be stationary. In this analysis, only pecuniary benefits are considered. However, the presence of non-pecuniary benefits—which increase a controller’s utility—should be recognized as well. In this respect, the more realistic “two-factor analysis”—taking into account both the pecuniary and non-pecuniary benefits—is required to analyze a controlling shareholder’s decision to be stationary or roving.

Note the present value of non-pecuniary benefits of control, including a controlling shareholder’s descendants’, as Alpha. Then, a controlling shareholder compares $ROV_0$ and the sum of two factors, $V_0$ and Alpha: (i) when $ROV_0$ is greater than the sum of $V_0$ and Alpha, he chooses to be roving; (ii) when the case is the reverse, he chooses to be stationary. Since Alpha reflects psychological value that a controller enjoys as a dictator of a corporate empire, an extreme roving controller who takes every corporate assets (thus, a corporate empire is dismantled) is not able to benefit from it. Table 3 summarizes.

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

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<th>One-Factor Analysis</th>
<th>Two-Factor Analysis</th>
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<td></td>
<td>(i) $ROV_0 &gt; V_0$: a controlling shareholder chooses to be roving</td>
<td>(i) $ROV_0 &gt; V_0 + Alpha$: a controlling shareholder chooses to be roving</td>
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<tr>
<td></td>
<td>(ii) $ROV_0 &lt; V_0$: a controlling shareholder chooses to be stationary</td>
<td>(ii) $ROV_0 &lt; V_0 + Alpha$: a controlling shareholder chooses to be stationary</td>
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The two-factor analysis provides important corporate governance implications. For example, when $ROV_0$ is $100 million and $V_0$ is only $70 million, according to the one-factor analysis, a controlling shareholder chooses to

210See supra Part III.C.2.
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, it is a controlling shareholder’s rational choice to be stationary with a $V_0$ of $70$ million. Accordingly, there is more likelihood that a controlling shareholder will be found to be stationary when the value of $Alpha$ is large. The more a controlling family shareholder values fame, social prestige and family influence in the society, the more beneficial it is to minority shareholders, since the controller is more likely to be stationary and is willing to extract private pecuniary benefits to a lesser degree. In other words, the controlling family shareholder can give up some pecuniary benefits when he is able to attain non-pecuniary benefits.\footnote{In this sense, the pecuniary benefits and non-pecuniary benefits can be analyzed through a consumer’s optimization theory. 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” some amount of the pecuniary benefits for additional non-pecuniary benefits. This tendency can be measured theoretically by the marginal rate of substitution (MRS) of two goods that a controlling shareholder consumes. See ROBERT S. Pindyck & DANIEL L Rubinfeld, MICROECONOMICS 71-72 (6th ed. 2005) (explaining the MRS).}

Since $Alpha$ is the non-pecuniary private benefits to all family members, a part of $Alpha$’s value 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 this is more beneficial to minority shareholders for the same 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.\footnote{Cf. Gilson, supra note 31, at 643 (explaining that a controlling shareholder would think of his children’s utility as equivalent to his own).} 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

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.”\footnote{This phrase was written by a Chinese philosopher, Xun Zi (荀子) in his book AI GONG (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.} Harsh taxation and looting by an absolute monarch has led to his subjects’ discontent, resistance, and ultimately to a revolution resulting in the dynasty’s demise, exemplified by events such as the Boston Tea Party. This lesson is applicable to family shareholders managing large
corporations as well, because they 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: (1) a controlling shareholder usually has a majority of votes; and (2) 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 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.

It is noteworthy that a displeased minorities’ exodus from a business empire threatens only a stationary controller: minorities’ exit is not a punishment at all to a roving controller. All the roving controller is concerned about is how to efficiently extract corporate assets at the time when he loots. After looting, he does not care whether minority shareholders leave the 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.

Generating 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 debt he can borrow. As a result, he controls more assets, which means he can 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.

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214 ALLEN ET AL., supra note 74, at 367 (“Where all investors hold small stakes in the enterprise, no single investor has a strong incentive to invest time and money in monitoring management.”); see also Bebchuk, supra note 69, at 689 (discussing a free-rider problem); Bernard S. Black, Agents Watching Agents: The Promise of Institutional Voice, 39 UCLA L. REV. 811, 813 (1991) (discussing the collective action problem).

215 See, e.g., Robert C. Pozen, Institutional Perspective on Shareholder Nominations of Corporate Directors, 59 BUS. LAW. 95, 96 (2003) (discussing the Wall Street Rule, the tendency of shareholders to sell stocks when they are disappointed by those stocks).

216 Originally, “votes with feet” was coined to explain people’s migration to another community which provides the optimal level of tax and public goods. See generally Charles Tiebout, A Pure Theory of Local Expenditures, 64 J. POL. ECON. 416 (1956).

217 See generally Kang, supra note 32.
Accordingly, 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 “generous thief.” This 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 by lenient policies. In this sense, non-pecuniary benefits and the tax rate are negatively correlated (the more generous a controller is, the larger a corporate empire is). 219

“Tax-cut” is of significance with respect to its impacts on pecuniary and non-pecuniary benefits for a controlling shareholder. First, suppose that the current “tax rate” (i.e., extraction rate) is above the “optimal tax rate” maximizing revenue. Then, a reduction in the tax rate can affect both pecuniary and non-pecuniary benefits positively; 220 (1-i) tax rate reduction increases “tax revenue” (i.e., pecuniary private benefits); (1-ii) in addition, the 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 the corporation will be larger. Second, suppose that the current “tax rate” is below the “optimal tax rate.” A reduction in the “tax rate” has conflicting effects on pecuniary and non-pecuniary benefits of a controller; 221 (2-i) “tax revenue” will decrease; (2-ii) by contrast, non-pecuniary benefits will increase since more minority shareholders—attracted by a more lenient policy—come to “reside” in his empire and the controlling shareholder can control a larger corporation. Therefore, the net effect of tax reduction depends on the relative sizes of decreased “tax revenue” and increased non-pecuniary benefits.

3. Implications of Non-Pecuniary Benefits for Corporate Governance

In this respect, a stationary controller may be able to enhance his utility by reducing his “tax rate” twice. First, by reducing his tax rate from a roving controller’s “prohibitively high tax rate” (e.g., 100%) to the “optimal tax rate” that maximizes pecuniary private benefits, a stationary controller can increase “tax revenue.” Second, by

218 See, e.g., Gilson, supra note 8, at 1673.
219 See infra Figure 2.
220 See infra Figure 2.
221 See infra Figure 2.
reducing the tax rate further from the “optimal tax rate” to the “adjusted optimal tax rate” that maximizes the sum of pecuniary private benefits and non-pecuniary benefits, the stationary controller can attain sufficient non-pecuniary benefits by expanding the business empire. The stationary controller can improve his total utility from pecuniary and non-pecuniary benefits, although reducing the “tax rate” from the optimal point results in lowered pecuniary benefits. Figure 2 explains that the “adjusted optimal tax rate” (Max 3) is lower than the “(original) optimal tax rate” (Max 1). Thus, from the stationary controller’s perspective, being generous to (i.e., extracting less from) minority shareholders by imposing a low tax rate is in fact protecting and improving his own interests.

Likewise, minority shareholders find that having a stationary controller is more beneficial to them than having a roving controller in two ways: (1) through the stationary controller’s reduction of the “tax rate” from a roving controller’s prohibitive point to the “optimal tax rate”; and (2) through the stationary controller’s additional reduction of the “tax rate” from the “optimal tax rate” to the “adjusted optimal tax rate.” Minority shareholders are better off under the “adjusted optimal tax rate” (Max 3) than under the “(original) optimal tax rate” (Max 1) since Max 3 represents a lower expropriation rate than Max 1.

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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222 See infra Figure 2.
223 See infra Figure 2.
224 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. If “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. A stationary controller can be praised as a “benevolent king” (or cynically, a “generous thief”) by minority shareholders, and the ship can stably float on the peaceful water. This analysis explains (at least partially) why some bad-law controlling shareholders—if they evaluate non-pecuniary benefits highly—voluntarily extract a small amount of tunneling from minority shareholders.\textsuperscript{225} Again, it cannot be emphasized enough that controlling shareholders’ generosity is a simple reflection of their calculated self-interest to maximize the sum of utility from their pecuniary and non-pecuniary utility. Nonetheless, it is noteworthy that minority shareholders can be protected not only by good corporate law, but also by a stationary controlling shareholder’s own self-interest.

\textsuperscript{225}Thus, Gilson’s question—why some controlling shareholders in bad-law jurisdictions voluntarily set the limit of extracting private benefits from minority shareholders—can be solved. \textit{See supra} note 32 (comparing the Author’s approach with Gilson’s approach to a controlling shareholder’s lenient expropriation).
C. Reputation for Being (Benevolent) Stationary Controlling Shareholders

Being a stationary controlling shareholder is more advantageous to a controlling family shareholder. Thus, a rational controlling shareholder would choose to be stationary, as long as he is patient. However, a problem is that he is not able to become stationary by his unilateral acts. A meeting of two minds—a controlling shareholder’s mind as well as minority shareholders’ collective mind—is required.

1. Distrust Among Potential Minority Shareholders

A significant problem is that minority shareholders are not able to know for sure whether the controlling shareholder they deal with is stationary or roving. This information asymmetry—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. Given the fear that a controlling shareholder they will potentially deal with is a roving controller, prospective investors are reluctant to invest their money in any corporation. When they decide to participate in capital market transactions, they require a high discount rate for all controlling shareholders irrespective of controllers’ nature (“roving” or “stationary”).

The high discount rate arising from uniform distrust among prospective investors is, from a perspective of a controlling shareholder who initially wishes to be stationary, unfair. With this discount rate, he would end up with a low value of pecuniary benefits of \( ND_0 \) and \( SD_0 \). Thus, the expected value of \( V_0 \) shrinks \( (V_0 = ND_0 + SD_0) \). In addition, due to the reluctance of prospective investors’ participation in the capital market, the size of

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228 For a similar analysis of this Section, see generally Kang, *supra* note 32.

229 See *supra* Table 2 (explaining the inverse relation between a discount rate \( r \) and \( ND_0 + SD_0 \)).
equity capital (thus, finally the size of assets) shrinks. Accordingly, \textit{Alpha}—the value of non-pecuniary benefits which are dependent on the size of assets—becomes low.

As a result, a stationary controller’s value in two-factor analysis—the sum of \textit{Alpha} and \textit{V}_0—is going to contract.\footnote{See supra Table 3.} If so, being roving would be better to a controlling shareholder, even if he initially wishes to be stationary.\footnote{See supra Table 3.} Indeed, under the asymmetry of information, it is not primarily important whether a controlling shareholder \textit{is} a stationary controller. Instead, whether the market \textit{deems} a controlling shareholder to be a stationary controller is more determinative. Under these market-failure conditions and adverse selection, ultimately only roving controllers remain in the market.

2. Reputational Advantages of Family Corporations

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. In this regard, the philanthropy of corporate tycoons 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 this disguise of altruism for image-making purposes.\footnote{See, e.g., Nancy J. Knauer, \textit{The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and The Social Construction of Charity}, 44 DePaul L. Rev. 1, 94 (1994) (“Associating the corporate name with a charity or charitable cause is good for the corporate image and at some point what is good for the corporate image is good for the corporate bottom line.” (citation omitted)).} Such “advertisements,” which are costly, can portray the corporate tycoons as truly honest and principled people who do not cheat investors and consumers.

In this sense, a controlling “family” shareholder has a comparative advantage in building a reputation and convincing prospective investors of his integrity.\footnote{Cf. Gilson, supra note 31, at 648 (explaining that building reputation in the \textit{product} market is a primary issue to a controlling “family” shareholder).} To understand a family corporation’s advantage, consider first public investors’ investment opportunity in a non-family corporation (\textit{e.g.}, a widely held company). Virtually, prospective investors do not know whether, in a top corporate insider’s own mind, he is roving or stationary. This is a main reason that business people need to take costly measures to show that they are trustworthy people or at least that they are stationary controllers. In contrast, prospective investors are able to
recognize more easily that a certain corporation is a "family" corporation because they can simply review the corporation’s governance structure (e.g., whether a large number of shares are spread among family members, or whether children of a founder are executives or members of a board of directors, etc.). Clearly, it is more convenient 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 sending off credible signals, which are costly.235

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.236 Then, potential minority shareholders are convinced that if a controlling family shareholder makes repeated transactions with them in the capital market for a long time, it will be in the controlling family shareholder’s best interest to be stationary as well.237

V. CONCLUDING REMARKS

Controlling shareholder regimes in developing countries generate many corporate governance problems. Nonetheless, it would be an oversimplification to treat all of controlling shareholders 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


235 Cf. Gilson, supra note 31, at 641-45 (explaining the importance of family from the product market-based perspective).

236 As for an infinite time horizon of a controlling family shareholder, see id at 643.

237 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 a reasonable stationary controller will not suddenly become roving unless there are revolutionary or catastrophic changes in the business environment surrounding him.
proposes that controlling shareholders in bad-law jurisdictions can be classified into at least two sub-categories: stationary controllers and roving controllers.\textsuperscript{238}

When a controlling shareholder is a family shareholder, he is more likely to be stationary and establishes his own dynasty.\textsuperscript{239} With a long-term interest in his controlled corporation, it is in the controlling family shareholder’s best interest to \textit{voluntarily} reduce the degree of expropriation against minority shareholders.\textsuperscript{240} 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 stationary family controller and public shareholders make up partially for the deficiency in good corporate law.

Controlling family shareholders, however, are not necessarily stationary even in the first place. It is also possible that at some point stationary family controllers would transform into roving controllers due to major factors in family businesses (e.g., a second generation’s poor management and sibling rivalry) and significant external variables. 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, more globalization in the future will foment international investment by non-controlling shareholders in bad-law countries,\textsuperscript{241} and it may fundamentally change the corporate governance system based on local banditry.

\textsuperscript{238}See \textit{supra} Part III.B.
\textsuperscript{239}See \textit{supra} Part IV.
\textsuperscript{240}See \textit{supra} Part III.C.1-2.
\textsuperscript{241}Cf. \textit{supra} Part III.C.3.