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Sang Yop Kang

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“Game of Thrones”: Corporate Governance Issues of Children’s Competition in Family Corporations

Sang Yop Kang[†]

This Article delves into corporate governance issues of a “game of thrones” in a family corporation where the children of a parent-controller compete to become the successor. During the course of a game of thrones, children have an incentive to take on suboptimal projects. Although these projects are inefficient to a corporation, they can sometimes provide children with a better opportunity to ascend the throne. Particularly when a child has a small fraction of ownership in the corporation, shareholders and creditors will bear the brunt of the costs from these projects. Taking a theory-based approach, this Article examines the negative externality problems that shareholders and creditors face. This Article also explores whether shareholders have legal or non-legal recourse in relation to challenges arising from a game of thrones. In addition, this Article shows that even if a meritocratic standard is relied upon in determining an heir to a family corporation, competition among children might generate undesirable consequences.

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[†] Professor of Law, Peking University (School of Transnational Law); J.S.D. (Doctor of the Science of Law), Columbia University School of Law; Attorney at Law; CFA (Chartered Financial Analyst). I developed the core ideas and analytical frameworks of this Article while I researched in the J.S.D. program. I presented earlier drafts at the Asian Law and Economics Association Conference (Seoul National Univ. School of Law) and Comparative Corporate Governance Conference (Univ. of California, Berkeley School of Law) and in seminars at Tsinghua Univ. School of Law, Peking Univ. School of Transnational Law, and Peking Univ. PHBS Business School. I thank participants of these conferences and seminars for their questions and comments. Also, I thank Curtis Milhaupt (Stanford Law School), Jesse Fried and Mark Ramseyer (Harvard Law School), Ok-Rial Song (Seoul National Univ. School of Law), Douglas Levene, Francis Snyder, and John Aycock (Peking Univ. School of Transnational Law), Simin Gao (Tsinghua Univ. School of Law), Jaehyuk Choi and Seungjoon Oh (Peking Univ. PHBS Business School), Daeyong Lee (Iowa State Univ.), and Heungju Park (Sungkyunkwan Univ.), for their comments and discussions. In addition, I thank Tong Ling, and Shuping Shao, Zhiyou Cheng, and editors of the Berkeley Business Law Journal, for their feedback and suggestions. Last but not least, I thank my wife, parents-in-law, and brother for their endless support. Note that the titles and analytical frameworks of earlier drafts relate to “King Lear problems,” which are any corporate governance problems associated with family issues in family corporations. Among many King Lear problems, this Article extensively explores issues in a “game of thrones.”

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PART I: INTRODUCTION

Outside of the United States, a prevalent form of business associations is “family-controlled corporations” (hereafter “family corporations”).¹ In family corporations, controlling shareholders frequently engage in conflicted transactions such as “tunneling,”² i.e., wealth transfer from corporations to controlling families. In many countries, a recurring issue of corporate governance is how to effectively curb controlling families’ extraction of private benefits of control.³ Besides tunneling, however, “family matters” are critical factors as well in family corporations. For instance, as seen in Samsung Group and Formosa Plastic Group, disputes within controlling families are often fierce and sour.⁴ In family corporations, there are many types of family matters relating to marriage, divorce, and internal feuds. Although all of these issues have significant implications in family corporations, this Article explores corporate governance issues of what I refer to as a “game of thrones”: the competition among children of a parent-controller to inherit their parent’s wealth and business position.⁵ Instead of case studies, this Article examines games of thrones from a theoretical perspective, mainly in countries that lack “good” market infrastructures and legal systems.

A parent-controller gives his children a business opportunity in order to train and test them. To show the best performance, children are incentivized to take

1. See, e.g., Mike Burkart et al., *Family Firms*, 58 J. FIN. 2167, 2167 (2003) (“Most firms in the world are controlled by their founders, or by the founders’ families and heirs.”); Rafael La Porta et al., *Law and Finance After a Decade of Research*, in HANDBOOK OF THE ECONOMICS OF FINANCE 425, 441 (2013) (“[E]xtremely heavily concentrated corporate ownership and family control are common even among the largest firms outside the US.”) (citing Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999)).

2. For seminal research on tunneling, see generally Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22 (2000). For a further discussion of tunneling, see *infra* note 37.

3. A controlling shareholder can enjoy private benefits of control, which they do not share with the rest of shareholders. For a further analysis of private benefits of control, see Sang Yop Kang, “*Generous Thieves*”: *The Puzzle of Controlling Shareholder Arrangements in Bad-Law Jurisdictions*, 21 STAN. J. L. BUS. & FIN. 57 (2015) [hereinafter Kang, *Generous Thieves*]. For a further analysis of the international comparison of private benefits of control, see generally Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004). Although this Article generally does not explore issues on tunneling, this Article discusses tunneling profits in the context of risk-adjusted returns. See *infra* Part II. B. 3.

4. See Evan Ramstad, *Court Sides with Samsung Chairman in Family Feud*, WALL ST. J. (Feb. 1, 2013, 3:02 AM), available at <https://www.wsj.com/articles/SB10001424127887323701904578277002155753668> (explaining the family feud relating to Samsung Group). See also Russell Flannery, *Taiwan Billionaire Wang Left No Will: Court Filing*, FORBES (May 26, 2009, 8:50 AM), available at <https://www.forbes.com/2009/05/26/wang-taiwan-inheritance-markets-equity-billionaire.html#53d94bb26b5e> (explaining the family feud in Formosa Plastic Group).

5. Some children do not wish to succeed to their parents’ business positions as controlling shareholders, preferring to pursue their personal dreams (e.g., being an actor, singer, movie director, photographer, chef, etc.) with their parents’ financial support. However, many children are still strongly interested in succeeding to their parents’ business positions. Particularly in large family corporations, I proposed a hypothesis that children face a huge amount of “opportunity cost,” if they give up the opportunity to succeed their parents.

on highly risky projects⁶ in hopes of producing higher profits.⁷ As long as high rates of return are expected, pursuing high-risk projects can be justified, if not encouraged in some situations. However, problems arise when children intentionally undertake “inefficient projects.” In this Article, a project is considered inefficient if the *expected risk-adjusted return* is lower than that of alternative projects available.⁸ For instance, an inefficient project is associated with a higher risk than alternative projects with the same level of expected rates of return. Pursuing these inefficient projects—i.e., “inefficient risk-taking”—will, on average, lead to an adverse outcome for a corporation. Under certain circumstances, however, inefficient risk-taking is useful to the children participating in a game of thrones.

When inefficient projects succeed, they sometimes generate higher *realized rates of return* than efficient projects. The children may boast of their managerial performance based on realized rates of return, which are a more intuitive performance measurement than expected risk-adjusted returns. Once children believe that higher realized rates of return are construed as hard evidence to prove their business acumen, children are more inclined to take on risky projects even if these projects are inefficient. As long as the chance of ascending the throne is enhanced, self-interested children are willing to rely on inefficient risk-taking, to the potential detriment of a corporation and its shareholders. If inefficient projects fail, the children—who are not usually self-made businesspeople—are likely to only lose wealth that they did not accumulate on their own.

In extreme cases, the children—particularly those who lag far behind their siblings—might have an incentive to pursue “Hail Mary projects.” These projects are characterized by the very wide fluctuation of profits and losses with a significantly high chance of failure. Additionally, Hail Mary projects often generate large negative rates of return. In this respect, Hail Mary projects are the worst form of inefficient risk-taking.⁹ If the risk-taking succeeds, these successful (or simply lucky) children may believe they have a higher chance of a come-from-behind victory. However, the downsides for the children are few: even if the risk-taking fails and they ultimately do not ascend the throne, they would still have lost had they not adopted the Hail Mary strategy.

A child may rely on inefficient risk-taking more frequently when she has a small fraction of ownership (for example 0.5%) in a corporation.¹⁰ On the one

6. For an empirical study on risk-taking by children of a parent-controller, see Jongsub Lee et al., *Family Feud: Succession Tournaments and Risk-Taking in Family Firms*, 11TH ANNUAL MID-ATLANTIC RESEARCH CONFERENCE IN FINANCE (MARC) (Dec. 14, 2015), https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2703571 (showing that “[m]ore sons (less daughters) in controlling families are associated with higher income volatility and lower performance.”).

7. See *infra* Part II.

8. For further discussion of “inefficient project (risk-taking),” see *infra* Part II. B. 1.

9. For further discussion of “Hail Mary project (risk-taking),” see *infra* Part II. B. 2.

10. For a further explanation of a child’s 0.5% of ownership, see *infra* note 14 and accompanying text.

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hand, with a small ownership interest, the child's potential financial loss from business failure is relatively limited. On the other hand, the child's potential benefits from business success could be disproportionately large. These benefits include not only profits on a pro rata basis and an increase in ownership,¹¹ but also the throne and pecuniary and non-pecuniary private benefits.¹² This asymmetric payoff structure, biased in favor of a child, is facilitated in a controlling minority structure (CMS),¹³ where a controlling family runs a corporation with a fraction of ownership (e.g., 5%).¹⁴ When a child has no ownership, the asymmetric payoff structure is more favorable to her.

Although any risk-taking is akin to gambling, inefficient risk-taking is a more problematic type of gambling because of its potentially adverse effect on a corporation and its shareholders. Non-controlling shareholders do not have decision-making power in risk-taking. Nonetheless, they bear the costs of the children's gambling. In this way, inefficient risk-taking creates a negative externality against shareholders.¹⁵ In addition, where the family controls the corporation with only a fraction of ownership, children gamble mostly with the other shareholders' money.¹⁶

Depending on the nature of risk-taking, the costs of these gambles can be transferred, at least partially, to creditors. Accordingly, creditors may face a negative externality as well.¹⁷ Creditors can transfer these costs back to shareholders, for example, by imposing a higher interest rate in proportion to children's risk-taking. In this way, the negative externality against creditors can be fixed. In a game of thrones, however, the problem is that the beneficiaries of the inefficient risk-taking are not general shareholders but the children of the parent-controller. From the standpoint of shareholders who do not participate in

11. The child's ownership will be greater when she ultimately wins a game of thrones since she will inherit most of her parent's shares in a family corporation.

12. For a further explanation of (pecuniary) private benefits of control, see Luca Enriques et al., *The Case for an Unbiased Takeover Law (With an Application to the European Union)*, 4 HARV. BUS. L. REV. 85, 98 (2014) ("Pecuniary private benefits are extracted at the expense of minority shareholders Controlling shareholders may appropriate private benefits of control through the ordinary operation of the business or they may take the capitalized value of operational private benefits through a control transaction.") (citation omitted).

13. See generally Lucian A. Bebchuk et al., *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP 295 (Randall K. Morck ed., 2000), <http://www.nber.org/chapters/c9013.pdf> (discussing CMS voting leverage mechanisms such as stock pyramiding, dual-class equity structures, and cross-ownership (or circular shareholding)).

14. For instance, a parent-controller, his spouse, and three children have 3%, 0.5%, and 1.5% (0.5% per child), respectively.

15. See *infra* Part III. A. For the externality effect against other family members, see *infra* Part III. B. For the definition of an externality, see N. GREGORY MANKIW, PRINCIPLES OF MICROECONOMICS 196 (7th ed. 2015) ("An externality arises when a person engages in an activity that influences the well-being of a bystander but neither pays nor receives compensation for that effect.").

16. See *infra* Part III. A.

17. See *infra* Part III. C.

a game of thrones, creditors' response creates an undue outcome.¹⁸ In this sense, the form of an externality transforms into the one against general shareholders.

To remedy such externalities, one may consider legal recourse.¹⁹ Even in a jurisdiction with a good corporate law system (e.g., the United States), however, it is difficult for corporate law to resolve corporate governance problems arising from such games. This is because risk-taking is commonly regarded as being within the realm of "business decisions" rather than that of "conflicts of interest."²⁰ Accordingly, the business judgment rule²¹ generally applies, and corporate insiders are shielded from liability for breach of fiduciary duty.²² In many countries, due to the lack of efficient disclosure systems, capital market professionals, and sophisticated market institutions, it is also difficult to correct those externalities based on market mechanisms.²³

Given these shortcomings, one may consider monitoring systems as an alternative solution to children's inefficient risk-taking and its externality effects. Most of these systems, however, have inherent limits as well.²⁴ For instance, an independent director system does not work well in family corporations. Perhaps a parent-controller is the last resort to constrain children's (inefficient) risk-taking, particularly in relation to Hail Mary projects. However, he might not always prevent his children from engaging in undesirable business ventures. For example, if a parent-controller's control is based on a CMS, he sometimes has an incentive similar (although not same) to that of his children, to externalize the family's (including his children's) gambles to shareholders or creditors.

Regarding this Article, two additional points are worth noting. First, in terms of research methodology, this Article takes a theory-based approach, relying on a hypothetical example. As will be discussed later, this is partially because empirical studies on games of thrones are potentially subject to limitations.²⁵ Second, although this Article focuses on competition among children and their business performance, it does not suggest that parent-controllers select heirs based solely on a meritocratic system. In the real world, a parent-controller considers a variety of factors to determine the successor; these factors include

18. See *infra* Part III. C.

19. For further discussion of legal recourse, see *infra* Part IV. A.

20. More precisely, risk-taking includes both efficient and inefficient risk-taking. This Article focuses on corporate governance problems arising from inefficient risk-taking (including Hail Mary risk-taking) that children intentionally choose.

21. For a classic discussion of the business judgment rule in modern corporate law, see generally S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979).

22. Under special circumstances, however, it is theoretically possible that Hail Mary risk-taking can be associated with a conflict of interest and the business judgment rule would not apply. See *infra* Part IV. A. 3.

23. See *infra* Part IV. B.

24. For further discussion of monitoring systems and their limits, see *infra* Part IV. C.

25. For further analysis of the limitations of empirical studies on games of thrones, see *infra* Part II. B. 3.

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not only children's managerial capability but also the degree of filial piety, the extent of the parent's preference for the first child (or eldest son), and even a child's physical resemblance to the parent. Rather, what this Article examines is that *even if* a purely meritocratic standard is used in determining an heir to a family corporation, "competition" among potential successors—which is considered a desirable factor in modern corporations—might create unintended corporate governance problems.

The rest of this Article is structured as follows. Part II introduces the concept of the game of thrones and children's intentional undertaking of suboptimal projects. Part III explores externality problems that a game of thrones creates. Part IV examines whether a game-of-thrones situation has remedies in law, the market, or other institutions. Part V summarizes and concludes.

PART II: "GAME OF THRONES": CHILDREN'S INEFFICIENT RISK-TAKING

Family corporations suffer from the mean-reversion of management capacity: when corporate control passes within a family, on average, the heir of the next generation will be less capable in management than the founder.²⁶ One may argue that the competition among children can mitigate, if not eliminate, the mean-reversion problem. As discussed in Part II, however, competition among children may result in, counterintuitively, a suboptimal situation.

A. *Competition Among Children and Choice of Business Projects*

Suppose that a parent-controller, who has three children, wishes to choose his successor based on each child's business performance.²⁷ Also, suppose that each child has a small fraction of (or no) ownership. This is plausible since the parent-controller and non-controlling shareholders may hold most (or all of) shares. In order to train and test the three children, the parent-controller gives business opportunities to each child in his controlled corporation (or a corporate group). To be the next king of a family corporation, the three children need to prove their business capability to investors, employees, and—most importantly—their parent. Under a system in which the child with the best performance will succeed to the parent's throne, the payoff for a child with the second-best performance is not significantly different from that for the child with the worst performance: losers do not share the parent's legacy, i.e., control over

26. See Randall Morck & Bernard Yeung, *Agency Problems in Large Family Business Groups* 27 *ENTREPRENEURSHIP THEORY & PRAC.* 367, 375 (2003).

27. Often, children's competition ends up with the "winner-takes-the-most" situation rather than the "winner-takes-all" situation. In a corporate group with 9 affiliated companies, for instance, a parent-controller divides the corporate group for three children: the winner-child may succeed to the chairpersonship of 7 affiliated companies; the other two children may succeed to the chairpersonship of one affiliated company, respectively.

the corporation (but may gain a small portion of the parent-controller's properties).²⁸ Let me introduce a simplified hypothetical example below.²⁹

Table 1: Expected Rates of Return for Each Type of Business Projects

Projects	When Succeed		When Fail		Expected Rate of Return (%)	Standard Deviation (%)
	Profits (%)	Probability	Losses (%)	Probability		
A	12	0.5	(-) 2	0.5	(+) 5	7
B	15	0.5	(-) 9	0.5	(+) 3	12
C	18	0.5	(-) 12	0.5	(+) 3	15
D	60	0.5	(-) 60	0.5	0	60
E	200	0.1	(-) 220	0.9	(-) 178	126

As seen in Table 1, suppose that five types of business projects—A, B, C, D, and E—are available to the competing siblings. When these five types of projects succeed, they will generate profits of 12%, 15%, 18%, 60%, and 200%, respectively. When the projects fail, they will cause losses of 2%, 9%, 12%, 60%, and 220%, respectively. For Types A, B, C, and D, the chances of success and failure are evenly 50%. For Type E projects, however, the chances of success and failure are 10% and 90%, respectively. Thus, the expected rates of return for Types A, B, C, D, and E are (+) 5%, (+) 3%, (+) 3%, 0%, and (-) 178%, respectively.³⁰ The risk of each type of projects is measured by a standard deviation of expected rates of return in success and failure.

As discussed, the efficiency of a project can be evaluated by the project's expected risk-adjusted return.³¹ Among the five available types of projects, Type A provides the highest expected rate of return, 5%.³² Besides, Type A projects have the lowest level of risk. Accordingly, Type A is the most efficient (optimal) among the five types of projects.³³ By contrast, Type E is the least efficient. It

28. See *supra* note 27.

29. For simplicity, this hypothetical example does not further distinguish systematic risks and unsystematic risks of projects. In addition, I do not further discuss shareholders' capacity to diversify their portfolios.

30. For Type E Projects, for example, the expected rate of return is calculated as follows: $[0.1 \times 200\%] + [0.9 \times (-) 220\%] = (-) 178\%$.

31. See *generally supra* Part I.

32. Other things being equal, Type A also generates the highest net present value (NPV). The NPV is "[t]he difference between a project's value and its cost." RICHARD A. BREALEY ET AL., *PRINCIPLES OF CORPORATE FINANCE* 105 (11th ed. 2012).

33. For the explanation of (in)efficient projects, see *supra* Part I.

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generates the lowest expected rate of return, (-) 178%, and it is the riskiest with the greatest standard deviation of rates of return. Both Type B and Type C produce the same expected rate of return (3%). However, Type B's risk is lower than Type C's risk. In this regard, Type B projects are more efficient than Type C projects. If a corporation has limited resources, other things being equal, the corporation should prioritize projects according to their efficiency. Otherwise, shareholders will lose the opportunity to enjoy profits from better projects available.³⁴

B. "Game of Thrones": Children's Distortive Incentives

In a game of thrones, children may undertake projects less desirable to a corporation (i.e., inefficient risk-taking), if taking on such projects can provide greater *private* benefits to the children.

1. Inefficient Risk-Taking

Suppose that a child succeeds at a Type A project and makes a 12% profit. Even if the child produces a decent profit from a Type A project, the child's performance can be undervalued if another child succeeds at a Type B project that yields a 15% profit. In turn, this child's success in a Type B project can also be undercut by the other child's success in a Type C project with an 18% profit. Under these circumstances, it is probable that the three children do not seriously consider the higher risk associated with Types B and C. In a game of thrones, children generally attempt to demonstrate their business acumen to shareholders, employees, and the parent-controller. In order to win the game, therefore, some children have an incentive to choose Type C or Type B over Type A.

The difference in expected rates of return and risks between Types A and B (or even between Types A and C) is relatively small. In a capital market that is not subject to any degree of information asymmetry, market participants may see expected risk-adjusted returns of Types A, B, and C. If so, due to explicit or implicit demand from the capital market that a corporation should repeatedly attempt to raise capital in the future, children are more likely to take on Type A projects, the most efficient for the corporation and its shareholders. In reality, however, the capital markets of many jurisdictions are underdeveloped, and disclosure systems are unsophisticated. Accordingly, precise information on expected rates of return and the risks of specific projects is not available in the market.

In addition, given the relatively subtle difference between Types A and B (or even between Types A and C), it is less likely that the market institutions can

34. Besides, when costs of capital are sufficiently high, inefficient projects (including Type B or C projects which are relatively efficient) can lead to a higher chance of reducing a corporation's value.

keep children's inefficient risk-taking (i.e., taking on Type B or Type C projects) in check. Even the parent-controller might not be able to discern a subtle difference, if business units that children manage do not provide full and precise information when reporting to the parent-controller.³⁵ Basically, a business unit that a child manages—although the parent-controller is the official controller of the entire corporation—is the child's feudal domain, where corporate insiders are often more loyal to the child than to the parent-controller.³⁶

Note that this hypothetical example relates to the children's managerial agency problem rather than a direct tunneling problem.³⁷ In principle, children—if they are sincere agents who make business decisions for the benefits of shareholders—should choose a Type A project. However, if children put their own interests before those of shareholders, a Type C project can be an attractive business opportunity to satisfy their *personal* utility, since their primary goal is to ascend the throne. Without the complete information on expected (ex ante) risk-adjusted returns of available projects, market participants, and even the parent-controller, can be misled by realized (ex post) rates of return. Also, some parent-controllers are inclined to be outcome-oriented. Accordingly, unless projects are excessively risky, these parent-controllers consider realized rates of return more important than expected risk-adjusted returns. In other words, even if these parent-controllers are fully aware of risk-return characteristics of Types A, B, and C, they might prefer, for example, Type B to Type A.

If a child takes on a Type B or Type C project rather than Type A, in microeconomic terms, the child chooses a “privately optimal strategy” by sacrificing a “socially optimal strategy” (if, in this context, a corporation is treated as a society). A market failure arises in the midst of competition among controller-candidates.³⁸ During the course of the competition, this inefficient risk-taking may last for a long time until the succession issue is ultimately resolved. In a game of thrones, accordingly, the cumulative effect of inefficient

35. See *infra* Part IV. C. 2. (explaining that a parent-controller's role to constrain his children's inefficient risk-taking is also subject to limits).

36. See *infra* Part IV. C. 2. Inefficient risk-taking might also be problematic in the context of CEO candidates' competition in a widely-held corporation. It seems, however, that inefficient risk-taking by children of a parent-controller in a family corporation is more severe, since children are royal family members. Put differently, it might be more challenging for internal monitoring systems in a family corporation to regulate children's risk-taking activity.

37. For a further analysis of tunneling, see Vladimir Atanasov et al., *Unbundling and Measuring Tunneling*, 2014 ILL. L. REV. 1697, 1698 (2014) (“[I]n much of the rest of the world, the dominant concern is the risk that ‘insiders’ (managers and controlling shareholders) will extract firm value, disproportionate to their economic ownership—a practice known as ‘self-dealing’ or ‘tunneling.’”); see also Pierre-Henri Conac et al., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 ECFR 491, 496 (2007) (explaining that tunneling is referred to as “all kinds of transfers of resources out of a company to a dominant shareholder (or a coalition of shareholders jointly dominating the firm).”) (citation omitted).

38. In a game of thrones, a market failure is associated with, in particular, externalities that children generate against shareholders and creditors. For a relationship between market failure and externalities, see ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 306 (6th ed. 2005).

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risk-taking would be gigantic, although the extent of inefficiency in pursuing a single Type B or Type C project is relatively small.

2. *Hail Mary Risk-Taking*

A more severe problem—though less frequent—will arise when children undertake Type D or even Type E projects, which are excessively risky and generate the lowest expected rates of return. Regarding expected risk-adjusted returns, Type E projects in particular comprise a troubling subset of inefficient projects.³⁹ Based on the above hypothetical example of various types of projects, let me provide a theoretical analysis. Suppose that it is perceived that Children X, Y, and Z are ranked in first, second, and third place, respectively, in terms of business performance. As the time of succession approaches, Child Z—if she ranks far behind Child X—may consider that the success of a typical business project with a decent rate of return would not change the outcome of the game of the throne.

Under these circumstances, Child Z might be tempted to undertake a Hail Mary project, notably a Type E project. (1) In the case of failure, the corporation's losses are enormous due to the negative 220% rate of return in a Type E project. However, if a parent-controller and non-controlling shareholders hold most of the ownership, they bear the bulk of the losses.⁴⁰ Given the smallness of her stake in the corporation, the cost that Child Z assumes is relatively limited, although she might lose significantly in absolute terms. (2) In the case of success, on the other hand, Child Z can gain profits, in proportion to her stake, from the positive 200% rate of return in a Type E project. In addition, she may believe that the success can award her an opportunity—even if it is a long shot—for a come-from-behind victory. Since the total benefits of the success that she conceives are disproportionately huge, Child Z may sometimes engage in a gamble as long as the amount of her own cost is acceptable. If Child Z has no ownership, this tendency is reinforced since she has nothing to lose. Accordingly, she is more likely to take on a Type E project.

In many cases, the parent-controller—if he is aware of a Hail Mary project's risk-return characteristics and Child Z's reckless plan—would not recognize the success of such risk-taking as Child Z's accomplishment, but rather an outcome caused by luck or other incidental factors. In this respect, Child Z's belief that she might win the game would be illusory. However, even if her hope of ascension turns out to be misguided in the future, the problem is that Child Z might take on a Hail Mary project at present because of this hope. The parent-controller might restrict Child Z's Hail Mary risk-taking, but not always eliminate such attempts.

39. See *supra* Part I (explaining Hail Mary projects).

40. For further discussion, see *infra* Part III.

Understanding Child Z's incentive, Child Y, who is currently in second place, might have a similar incentive. Before the end of a game of thrones, indeed, it is not certain that Child X will be the winner. Put differently, Child X, who is currently in first place, might also have an incentive to undertake a Type E project. In sum, under certain circumstances, a vicious circle can be formed. Regarding the possible cascade effect which might be extended from Child Z to Child X, two additional points are worth analyzing further.

First, Child Z has more incentive to engage in the Hail Mary strategy just before the "final period" of a game of thrones. Therefore, a relevant question is how Child Z can know that the final period is imminent. Often a game of thrones officially ends when the parent-controller retires or dies. However, the *de facto* final period begins when the parent-controller becomes very old or seriously ill. Although children do not know when precisely the official final period is, they are able to notice at some point that the game of thrones is accelerating into the *de facto* final period.

Second, the possibility of the vicious circle does not mean that Hail Mary risk-taking is inevitable and at equilibrium in a game of thrones. Rather, children can seldom take on such projects if the parent-controller monitors and regulates their activity. Even in the absence of the parent-controller's restriction, Child Z would not utilize the Hail Mary strategy, if she can maintain her stake even after the game, and if the amount of her own cost in failure is beyond her tolerable level. Also, Child X may voluntarily abandon the Hail Mary strategy for the following reason, if there is a significant performance gap between Child X and the other children. With an enormous performance gap, another child's success in a Type E project *alone* would not change the outcome that Child X will be the winner. In this case, if Child X (unreasonably) selects a Type E project, her choice will merely endanger her established status as *de facto* successor, due to the Hail Mary project's substantially high chance of failure and its massive losses. In other words, the *combination* of another child's success (generating a positive 200% rate of return) *and* Child X's failure (generating a negative 220% rate of return) could alter the current performance ranking. Under these circumstances, accordingly, Child X, if she is savvy, does not have any incentive to rely on the Hail Mary strategy.

3. *Limitations of Empirical Studies on Games of Thrones*

To what extent children in a game of thrones engage in inefficient (and/or excessive) risk-taking is ultimately an empirical question. One may point out that outcomes of empirical studies are useful to analyze a game of thrones. However, these studies are subject to limitations. Regarding children's projects, outsiders (including empiricists) have incomplete information on the characteristics of risks and expected rates of return. Accordingly, they often do not have reliable

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data on expected risk-adjusted returns of the projects. To solve this problem, scholars may use realized rates of return with risks that are measured based on available data.

The practice of tunneling, however, makes data on risks and returns less meaningful. In countries without sufficient investor protection, a parent-controller often engages in wealth transfer in favor of corporations (or business units) that his children manage. Accordingly, the data on rates of return for these corporations reflect tunneling profits as well. Since the parent-controller awards tunneling profits to children as a “gift,” tunneling profits are a windfall to children. Put differently, in seeking such profits, children are not concerned about the risk of losses.⁴¹ Outsiders may know a corporation’s *total* profits, which are the sum of tunneling and non-tunneling profits. Because tunneling is a hidden activity, outsiders are unaware of the amount of tunneling profits. Based on the available data, empiricists may attempt to calculate the risk-adjusted returns of children’s projects. The problem is that the calculation tends to be distorted by the unknown size of tunneling profits that are not associated with the risk of losses in the projects.

C. One-Child Situation and Inefficient Risk-Taking

Although this Article does not extensively cover the implications for family corporations with only one eligible heiress,⁴² the one-child situation poses unique issues in the context of games of thrones. Due to the absence of competition among children, one may expect that the only child does not have a strong incentive to take on inefficient projects (including Hail Mary projects). While I partially agree with this view, I hypothesize that, at least in some cases, the only child’s inefficient risk-taking might also be serious, if she would like to prove to the market, employees of the corporation, and her parent, that she is not a “lucky child,” but a “capable successor.” Additionally, if a parent-controller, a successful and wealthy businessperson, concurrently maintains multiple domestic relationships (extra-marital affairs), an official one-child situation is less meaningful, due to the possible competition among half-siblings.⁴³

41. Of course, the parent-controller who tunnels in favor of his children is subject to legal risk. In many countries with underdeveloped law and market institutions, however, it is often challenging to detect tunneling. Even if tunneling is detected, the enforcement system is inefficient, and thus, the parent-controller is rarely punished.

42. See generally Jerry Cao et al., *One-Child Policy and Family Firms in China*, 33 J. CORP. FIN. 317 (2015) (discussing the effect of the one-child policy on family corporations).

43. Stanley Ho, Macau gambling king, provides a famous example of a businessperson’s multiple domestic relationships and a serious family feud in relation to business control and the succession. See Shai Oster & Kate O’Keefe, *Family Feud Grips Ho Casino Empire*, WALL ST. J. (Jan. 21, 2011, 12:01 AM), available at <http://www.wsj.com/articles/SB1000142405274870355804576102892126323426>.

Recently, China abandoned its one-child policy, which had been previously imposed on nearly all of its citizens.⁴⁴ I am currently conducting research on not only the one-child situation in general (not limited to China), but also this recent policy change in China and its potential effects on succession issues in the corporate governance context.

PART III: EXTERNALIZING COSTS OF INEFFICIENT RISK-TAKING

When children bet on various types of projects, other shareholders and creditors may bear a significant portion of the costs created by the children's strategies in a game of thrones. Based on the hypothetical example discussed, Part III analyzes the negative externalities arising from inefficient risk-taking. Although a Type E Hail Mary project can create a severe externality problem,⁴⁵ Hail Mary risk-taking seldom happens.⁴⁶ Instead, children's continuous betting on a series of slightly inefficient projects (such as Type B or Type C projects) could generate a more serious externality problem due to the cumulative effect.⁴⁷

A. Externalizing Costs to Shareholders

If children engaged in a game of thrones take on privately optimal projects that are inefficient to a corporation, the costs of betting on these projects can also be borne by the non-controlling shareholders, who do not play the game.

1. Controlling Family Without Voting Leverage

When a controlling family holds 50.1% of ownership in a corporation, the costs arising from a game of thrones will be borne 50.1% by the family and 49.9% by non-controlling shareholders. To exercise control, however, a controlling family does not need 50.1% of voting rights (and thus, 50.1% of ownership under the one-share-one-vote rule⁴⁸). In a public corporation, a turnout ratio in a shareholder meeting is almost always less than 100%. Even

44. See, e.g., Meera Senthilingam, *How Quickly Can China Come Back from Its One-Child Policy?*, CNN (Oct. 13, 2016, 22:31), <http://edition.cnn.com/2016/10/13/health/china-one-child-policy-population-growth/index.html>.

45. Note that Hail Mary risk-taking is the worst form of inefficient risk-taking. See *supra* Parts I and II.

46. See *supra* Part II. B. 2.

47. For an explanation of the cumulative effect of inefficient risk-taking, see *supra* Part II. B. 1.

48. For a further explanation of the one-share-one-vote rule, see generally Sanford J. Grossman & Oliver D. Hart, *One Share-One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175 (1988). For a brief explanation of dual-class equity structures, which depart from the one-share-one-vote principle, see Andrea Tan & Benjamin Robertson, *Why Investors Are Fretting over Dual-Class Shares*, BLOOMBERG (July 10, 2017, 1:00 PM), available at <https://www.bloomberg.com/news/articles/2017-07-10/why-investors-are-fretting-over-dual-class-shares-quicktake-q-a>. For a recent academic work on dual-class equity structures, see generally Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017).

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without any voting leverage device,⁴⁹ a controlling family holding only 25.1% of shares can sometimes dominate a corporation. In other words, when the quorum in a shareholder meeting requires a 50% share attendance level to make a shareholder resolution, 25.1% of shares account for a majority of those who attend the shareholder meeting.⁵⁰ In this case, a controlling family with 25.1% of shares can elect most directors, who support corporate policies. It means that the family can externalize the adverse effect arising from inefficient risk-taking to non-controlling shareholders who hold 74.9% of shares.

2. Controlling Family with Voting Leverage

Moreover, the negative externality to non-controlling shareholders can be greater when a controlling family relies on the CMS where voting leverage devices are available.⁵¹ Suppose that through dual-class equity structures, stock pyramiding, or cross-ownership (or circular shareholding), a controlling family holds 5% of ownership but exercises 50.1% of voting rights. In this case, children understand that they can externalize the costs of inefficient projects to non-controlling shareholders holding 95% of ownership. The controlling family bears only 5% of costs arising from such risk-taking. In many countries, the CMS is not uncommon.⁵² In Korea, corporate groups often use the CMS.⁵³ As I explain elsewhere, Alibaba Group and Huawei are examples of CMS corporations in China.⁵⁴ Jack Ma, the controlling shareholder of Alibaba Group, was reported to

49. Voting leverage devices include, for example, dual-equity structures, stock pyramiding, and cross-ownership. See Bebchuk et al., *supra* note 13.

50. For control with less than a majority of voting rights, see also Sang Yop Kang, *Re-envisioning the Controlling Shareholder Regime: Why Controlling Shareholders and Minority Shareholders Often Embrace*, 16 U. PA. J. BUS. L. 843, 853–54 (2014) [hereinafter Kang, *Re-envisioning the Controlling Shareholder Regime*].

51. For a further analysis of CMS, see *id.* See also Sang Yop Kang, *Transplanting a Poison Pill to Controlling Shareholder Regimes—Why It Is So Difficult*, 33 NW. J. INT’L L. & BUS. 619 (2013) (explaining the impact of a poison pill in the context of CMS); Nansulhun Choi & Sang Yop Kang, *Competition Law Meets Corporate Governance: Ownership Structure, Voting Leverage, and Investor Protection of Large Family Corporate Groups in Korea*, 2 PEKING U. TRANSNAT’L L. REV. 411 (2014) (exploring issues of competition law and corporate governance in the context of CMS).

52. CMS has also been used in some jurisdictions with sufficient investor protection such as Sweden. See, e.g., Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365, 385 (2002) (“Sweden also has the highest percentage of firms issuing dual class shares (66.07%).”).

53. See, e.g., KOREA FAIR TRADE COMM’N, STOCK OWNERSHIP OF LARGE CORPORATE GROUPS IN 2016 [공정거래위원회, 2016 대기업집단 주식소유현황 정보공개], https://www.ftc.go.kr/news/ftc/reportRelationView.jsp?report_data_no=6820 (reporting that in 2016 controlling families’ ownership in the ten largest corporate groups was around 0.9% on average).

54. See, e.g., Sang Yop Kang, *Tension Between Shareholder Primacy and (Quasi) Monopoly: A Theoretical Analysis of Controlling Shareholder Economies and China*, 11 U. PA. ASIAN L. REV. 128, 149 (2015) [hereinafter Kang, *Shareholder Primacy and (Quasi) Monopoly*] (explaining Alibaba’s CMS); see also Sang Yop Kang, *Rethinking Self-Dealing and the Fairness Test: A Law and Economics Framework for Internal Transactions in Corporate Groups*, 11 VIRGINIA L. & BUS. REV. 95, 122 (2016) [hereinafter Kang, *Self-Dealing and the Fairness Test*] (explaining Huawei’s CMS).

own less than 8% of shares.⁵⁵ Ren Zhengfei, the controlling shareholder of Huawei, was known to hold approximately 1% of the total share capital.⁵⁶

Due to the CMS's inherent power to enhance externalities, the CMS facilitates children's inclination to take risks. In general, the deeper a CMS (i.e., the larger the discrepancy between a controlling family's voting rights and ownership), the stronger the children's incentive to take on risky or even suboptimal projects.

3. *House Money Effect*

Regarding the propensity toward risk-taking, another crucial issue is a "house money effect"—namely, the effect where "a prior gain can increase subjects' willingness to accept gambles."⁵⁷ Children's ownership in a corporation, like a parent's ownership that children are expected to inherit, is often a windfall to children who won the "lottery" of having wealthy parents.⁵⁸ Under the house money effect, when children fail in risky projects and lose part of their share value in a corporation, they feel *less* agonized than in cases where they earned the property on their own. Thus, it is plausible that children who gamble with house money may take risk less seriously. If a house money effect is combined with a CMS effect, children's inclination toward risk-taking is further strengthened. Non-controlling shareholders are the primary, though not the sole, victims of the fomented risk-taking.

B. *Externalizing Costs to Other Family Members*

When children externalize costs of inefficient risk-taking to other people, the category of other people may include not only non-controlling shareholders but also other family members such as a parent-controller and siblings.

55. See, e.g., Kang, *Shareholder Primacy and (Quasi) Monopoly*, *supra* note 54, at 149 (explaining the Alibaba Partnership as a CMS leverage device).

56. See, e.g., Kang, *Self-Dealing and the Fairness Test*, *supra* note 54, at 122 (explaining Huawei's employee stock ownership plan as a CMS leverage device).

57. Richard H. Thaler & Eric J. Johnson, *Gambling with the House Money and Trying to Break Even: The Effects of Prior Outcomes on Risky Choice*, 36 MGMT. SCI. 643, 643–44 (1990).

58. In family corporations, children generally do not earn their fortunes on their own, but mostly receive them from their parent-controllers. In China, children who have wealthy parents are referred to as 富二代 (fuerdai, literally, "rich second generation"), which is an important socio-economic topic. For a further explanation of the fuerdai, see Christopher Beam, *Children of the Yuan Percent: Everyone Hates China's Rich Kids*, BLOOMBERG BUSINESSWEEK (Oct. 1, 2015, 9:00 AM), <https://www.bloomberg.com/news/features/2015-10-01/children-of-the-yuan-percent-everyone-hates-china-s-rich-kids>; see also Young, *Rich and Chinese: It's Life in the Fast Lane for the Emerging Class of Fuerdai*, SOUTH CHINA MORNING POST (Aug. 19, 2016, 6:33 AM), <http://www.scmp.com/news/china/society/article/2005658/young-rich-and-chinese-its-life-fast-lane-emerging-class-fuerdai>.

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1. *Egocentric Children: A More Serious Externality*

Different children regard their parents' wealth differently. On one end of the spectrum, some children may treat their parents' benefits and costs as *equivalent* to their own. I characterize these children as purely "family-centric." On the other end of the spectrum, some children may perceive that they are completely *separate* economic entities from a parent-controller and the other members of the controlling family. I characterize these children as purely "egocentric." Children may fall between these two extremes.

Suppose that a parent-controller has 30% of ownership in a corporation and his children have none. Under these circumstances, purely family-centric children feel that their inefficient risk-taking externalizes 70% and internalizes 30%. By contrast, purely egocentric children feel that their inefficient risk-taking externalizes 100% and internalizes 0%. Children who compete with their siblings are generally egocentric, but not always entirely (purely) so. As a game of thrones becomes bitter, however, children who participate in the game become more egocentric. In turn, more egocentric children make the game more bitter.

If there are no external restrictions, a purely egocentric child with no ownership conceives that she can gamble entirely with other people's money. If she wins a game of thrones, she will enjoy an extremely high level of benefits, including cash-flow rights,⁵⁹ tunneled benefits, and non-pecuniary benefits, in addition to taking the throne.⁶⁰ However, if the purely egocentric child loses in the game, she will not feel her family's financial loss at all, since she is apathetic to her family's interests.⁶¹ In this regard, she does not care much about risk-taking even if it could create losses to her family as well as non-controlling shareholders. In general, the more egocentric a child is, the more inclined she is to risk-taking. In other words, games that are harmful to corporations are often dominated by children who are very (or purely) egocentric.

59. In this example, it is assumed that the purely egocentric child holds no ownership in a corporation, and thus, during the course of a game of thrones, she does not have her own cash-flow rights. If she wins the game, however, she will inherit the parent-controller's ownership, which will be the basis of the child's future cash-flow rights.

60. In general, there are two forms of private benefits of control: (1) pecuniary private benefits of control; and (2) non-pecuniary private benefits of control. See Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 199 HARV. L. REV. 1641, 1663–64 (2006). In this Article, roughly speaking, tunneled benefits are equivalent to a controlling shareholder's pecuniary private benefits (of control), and cash-flow rights are equivalent to benefits that are shared among all shareholders according to their proportionate investment. For a further analysis of non-pecuniary private benefits, see Kang, *Re-envisioning the Controlling Shareholder Regime*, *supra* note 50, at 869–78 (explaining non-pecuniary private benefits in the context of corporations' empire-building).

61. Children's participation in a game of thrones resembles an option. If an option arrangement is fair, the expected value of an option when parties (i.e., an option buyer and an option seller) enter into the arrangement is zero to both. In the call option of the child in the example above, however, the expected value is positive to her.

2. *Tragedy of the Commons*

A “tragedy of the commons” refers to a situation where, in the absence of *private* ownership, people tend to overuse *public* resources.⁶² The logic of a tragedy of the commons can also apply in the context of a game of thrones. Before the question of who will become the next king of the business empire is clarified, children may conceive their parent’s economic interest in a corporation as the “commons” that all siblings can consume. In a game of thrones, children—who want to maximize their own personal benefits rather than maximize the group of siblings’ (or family’s) collective benefits—have a strong incentive to overuse the commons.⁶³ In theory, the problem of overuse can be alleviated if players agree on rules for the use of the commons or if the commons is privatized.⁶⁴ For the following reasons, however, it is difficult to resolve a tragedy of the commons in a game of thrones.

In a game of thrones, siblings compete for the purpose of gaining *more* from their parent-controller; siblings who lose in the competition gain *less* (or nothing). Thus, “competition” necessarily assumes an *unsettled* allocation of the parent-controller’s properties (including shares), i.e., commons. By contrast, “privatization” goes along with *a settled* allocation of the commons. Put differently, the two concepts, “competition” and “privatization,” are incompatible with each other. In this light, privatization is not a solution for a tragedy of the commons in a game of thrones because of the inherent competition.

Excessive risk-taking—which can contaminate an entire business association that a parent-controller directs—is “overuse” of the commons. For excessive risk-taking, however, it is difficult for children to agree on rules such as those to set the maximum level of risk. Even if children agree on rules for the use of the commons, compliance and enforcement remain at issue.⁶⁵ The risk-contamination effect damages the value of the commons, namely the business association under a parent-controller’s direction.⁶⁶

62. For an explanation of the “tragedy of the commons,” see ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 140–42 (6th ed. 2016), available at <https://scholarship.law.berkeley.edu/books/2>. The term became popular after Garrett Hardin published an article. See generally Garrett Hardin, *The Tragedy of the Commons*, 162 *SCIENCE* 1243 (1968).

63. However, if the loss a child incurs is treated as a part of her inherited properties (and thus, if the loss is deducted from the portion of properties that children would inherit), a tragedy-of-the-commons situation can be mitigated.

64. See, e.g., Margaret Banyan, *Tragedy of the Commons*, BRITANNICA, <https://www.britannica.com/science/tragedy-of-the-commons> (last visited July 11, 2017).

65. See *The Tragedy of the Commons: Property Rights May Be the Way to Preserve Forests*, *ECONOMIST* (May 7, 2007), <http://www.economist.com/node/9136122> (explaining that proper enforcement plays a significant role in resolving a tragedy of the commons).

66. In general, the risk-contamination effect takes place when children take on risky projects within the same “corporation.” The excessive risk that a child takes will spread out to the entire corporation, and the risk can affect adversely all family members including other siblings. In a “corporate group” where children manage independent affiliated companies, the risk-contamination effect is still a problem, if affiliated companies are networked (e.g., mutual guarantee among affiliated companies).

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C. Externalizing Costs to Creditors and (Again) Shareholders

When children externalize the costs associated with inefficient risk-taking, it seems that non-controlling shareholders are the most apparent victims.⁶⁷ Two points are worth noting. First, non-controlling shareholders might seek legal or non-legal solutions. Second, the costs of children's risk-taking may be transferred to creditors. I will discuss issues relating to this first point later.⁶⁸ Section C will focus on issues relating to the second point.

1. Inefficient Risk-Taking, Creditors, and Externality

Shareholders enjoy limited liability where the maximum loss they assume is the amount of their investment.⁶⁹ Thus, under certain circumstances—not necessarily in a game of thrones—costs caused by an excessive risk may be transferred to creditors. On the other hand, shareholders can enjoy the unlimited benefits that risky, but sometimes very profitable, projects bring.⁷⁰ In this sense, creditors who hold various debt instruments of a corporation can also be victims of the negative externality. This type of agency problem—“shareholders v. creditors”⁷¹—is apparent “in the vicinity of insolvency”⁷² when the equity

67. As discussed, sometimes other family members are also victims of externalities that children generate. See *supra* Part III. B.

68. See *infra* Part IV.

69. *Limited Liability*, BLACK'S LAW DICTIONARY (10th ed. 2014) (Westlaw) (explaining limited liability as “the liability of a company's owners for nothing more than the capital they have invested in the business”). Piercing the corporate veil is considered an exceptional situation under limited liability. *Piercing the Corporate Veil*, BLACK'S LAW DICTIONARY (10th ed. 2014) (Westlaw) (explaining piercing the corporate veil as “[t]he judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts”).

70. This is because shareholders are residual claimants. For an explanation of shareholders as residual claimants, see Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 6 (2007) (“As a normative matter, it is often argued that the stockholders, as the residual claimants of the corporation, are the group best able to keep management honest and focused on increasing the value of the corporation.”). However, shareholders are not the only residual claimants. See, e.g., Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L. J. 1554, 1575 (2015) (“The assumption that current and future (common) shareholders are the firm's only residual claimants is, of course, a simplification. Other stakeholders, such as creditors, preferred shareholders, and employees, may also be affected by the firm's actions.”); see also Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 30 REG. 42 (2007) (“The other mistaken idea that often influences experts is the claim that shareholders are the ‘sole residual claimants’ in corporations.”).

71. For an explanation of the conflict between shareholders and creditors as an independent agency problem, see Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1910 (2013) (“Historically and comparatively, corporate law seeks to control three sorts of agency costs: those between managers and dispersed shareholders, between controlling and noncontrolling shareholders, and between shareholders and creditors”) (citation omitted). Note, however, that this Article does not emphasize merely the conflict between shareholders and creditors. Rather, it emphasizes the more complicated, combined conflict among a child, non-controlling shareholders, creditors, and even within a controlling family. See *supra* Part III. B. 1-2 (explaining the conflict within a controlling family); see *infra* Part III. C. 2-4 (analyzing the conflict among a child, non-controlling shareholders, and creditors).

72. Delaware courts have discussed a board's fiduciary duty “in the vicinity of insolvency” (or “in the zone of insolvency”). See *Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm'ns Corp.*, Civ. A. No.

cushion of a corporation is insufficient to protect creditors from potential financial distress.

However, what I emphasize more in this Article is that even when the chance of bankruptcy is remote (and thus, the situation is far from being “in the vicinity of insolvency”), creditors may bear the costs of children’s (rather than shareholders’) risk-taking. Against this backdrop, the rest of Section C focuses on the framework of “children v. creditors” and its related issues.

2. *Information Asymmetry and Externality*

Children’s risk-taking lowers the value of debt instruments that creditors own even when a corporation is firmly solvent. Creditors may attempt to resolve the problem. For instance, by charging a higher interest rate in advance on a family corporation, creditors can shield themselves from the extra costs arising from a game of thrones.⁷³ Such response generates an outcome equivalent to transferring the costs of children’s risk-taking, at least to some extent, back to the shareholders. This is because the corporation should pay more interest, resulting in less net income available to residual claimants, i.e., shareholders.⁷⁴ However, if there is information asymmetry between a corporation and creditors, an accurate reflection of the risks in interest rates is not possible. In this case, the premium in interest rates will have either an under-coverage or over-coverage problem.

First, when the premium in interest rates is insufficiently high (i.e., under-coverage), creditors (and shareholders) will still assume some amount of costs generated by children’s risk-taking. Second, when the premium is too high (i.e., over-coverage), creditors take the net economic value from shareholders. In either situation, although the gamblers are children, shareholders and creditors—who do not play the game—also pay the price for the gamble. An externality

12150, 1991 WL 277613, at *34 (Del. Ch. 1991); *see also* North American Catholic Educational Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (“When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.”).

73. *See, e.g.*, Marcel Kahan, *Rethinking Corporate Bonds: The Trade-off Between Individual and Collective Rights*, 77 N.Y.U. L. REV. 1040, 1067 (2002) (explaining that companies with a bad reputation may be subject to a higher interest rate when they return to the capital market). In addition, creditors may be able to protect themselves by various means. *See, e.g.*, Production Resources Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 787 (Del. Ch. 2004) (“It is presumed that creditors are capable of protecting themselves through the contractual agreements that govern their relationships with firms.”).

74. *See, e.g.*, STEPHEN A. ROSS ET AL., CORPORATE FINANCE 534 (10th ed. 2012) (“Bondholders protect themselves accordingly by raising the interest rate that they require on the bonds. Because the stockholders must pay these high rates, they ultimately bear the costs of selfish strategies.”). In this sense, in the conflict between shareholders and creditors, the costs of risk-taking can be internalized to shareholders who take risks. Note, however, that children’s game of thrones is different from the situation of the conflict between shareholders and creditors. When creditors are damaged in a game of thrones, it is children rather than shareholders who initially externalize the costs of risk-taking.

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problem remains because individuals and entities other than the players unduly bear the gambling costs.

3. *Sufficient Amount of Information and Externality*

Suppose that creditors have a sufficient amount of information on the children's risk-taking patterns. In this situation, creditors may impose on a corporation the interest rate that precisely reflects the expected riskiness of the children's projects. It initially seems that there is no under-coverage or over-coverage problem, and the negative externality generated against creditors can be resolved. Even in this seemingly perfect situation, however, at least two important potential issues may arise. First, given an ex ante adjusted interest rate, children, ex post, may be able to behave opportunistically by taking on a riskier project than what the adjusted interest rate justifies.⁷⁵ Second, aside from children's ex post opportunism, an externality problem remains unsolved in a different version.⁷⁶ Let me further explain the second issue.

In a game of thrones, the beneficiaries of risk-taking are not general shareholders but children. In this respect, a higher interest rate, which the entire shareholder group primarily bears, is an undue cost to non-controlling shareholders. Note that the analysis in Section C intrinsically relates to the framework of "children v. creditors" rather than that of "shareholders v. creditors."⁷⁷ When the high interest rate precisely reflects children's risk-taking, the externality faced by creditors is resolved. Nonetheless, the price of gambling is not fully internalized to children, the players in the gamble. Rather, it is still externalized to the non-controlling shareholders who do not benefit from the gamble. A market failure remains.⁷⁸

75. For instance, anticipating the riskiness of projects that children take, creditors set an interest rate at 15%. This interest rate is proportionately adjusted in accordance with the expectation and information that are available at the time when the interest rate is set. After the interest rate is set at the 15% level, however, children may choose riskier projects for which a 20% interest rate is justified. This is children's opportunistic risk-taking. In advance, creditors may know the possibility of the children's opportunism and may have an incentive beforehand to charge a higher interest rate, for example, a 20% interest rate. In this case, children may have an incentive to take on projects that are compatible with at least a 20% interest rate.

76. Note that for the simplicity, it is assumed that there is no children's ex post opportunism in the discussion of the second issue below.

77. See *supra* Part III. C. 1.

78. Note that one of the reasons for market failures is an externality where the price internalization does not work. See, e.g., Thomas Helbling, *Externalities: Prices Do Not Capture All Costs*, IMF (July 29, 2017), <http://www.imf.org/external/pubs/ft/fandd/basics/external.htm>. See also *supra* note 38.

4. *Limits of Agreements Restricting Children's Inefficient Risk-Taking*

If creditors and a corporation enter into agreements that restrict a child's risk-taking,⁷⁹ these restrictions are effective in preventing a child from, for example, taking on Type E projects. If the scope of restrictions is expanded in a more sophisticated manner, such agreements can also regulate Type D projects.

Based on agreements, however, it would be difficult for creditors to restrain Type B or Type C projects. Type A projects are the most efficient. However, there is only a subtle discrepancy in terms of expected rates of return and riskiness between Types B and C on the one side and Type A on the other.⁸⁰ Creditors may be unaware of this subtlety, particularly in developing countries where creditors are not well equipped with finance techniques. If a child constantly relies on a series of Type B and Type C projects, this subtle discrepancy will ultimately become significant, given the cumulative effect.

PART IV: DO SHAREHOLDERS HAVE REMEDIES IN CORPORATE LAW, MARKET MECHANISMS, OR MONITORING SYSTEMS?

Parts II and III explained children's inclination to inefficient risk-taking and externality problems in a game of thrones. In regard to these issues, Part IV will analyze whether shareholders can rely on legal recourse or utilize market mechanisms and monitoring systems.

A. *Potential Legal Recourse in a Game of Thrones*

Regarding a game of thrones, the legal recourse available to investors (i.e., non-controlling shareholders) is to bring a suit based on the claim of a breach of fiduciary duty.⁸¹ A jurisdiction that has inefficient corporate law with insufficient investor protection generally has a more lenient approach to corporate insiders. Therefore, children's inefficient risk-taking is likely to go unpunished. In order to apply more stringent rules to a game of thrones, the jurisdiction may consider transplanting corporate law from the United States, where investors are far more protected. As will be discussed below, however, it

79. See, e.g., *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 790 (2004) ("Creditors are often protected by strong covenants, liens on assets, and other negotiated contractual protections.").

80. Expected rates of return of Types A, B, and C projects are 5%, 3%, and 3%, respectively. In terms of riskiness, among these three types, Type A has the smallest standard deviation while Type C has the largest standard deviation. See *supra* Table 1.

81. Section A starts with the assumption that shareholders will bring suits in breach of fiduciary duty cases. Note, however, that Section A will later show the limits (and the absence) of shareholder derivative suits in certain jurisdictions. See *infra* Part IV. A. 5. For the further explanation of the limits of shareholder litigation in Asia, see Sang Yop Kang, *Taking Voting Leverage and Anti-Director Rights More Seriously: A Critical Analysis of the Law and Finance Theory*, 28 COLUM. J. ASIAN L. 1, 51-55 (2015) [hereinafter Kang, *Voting Leverage and Anti-Director Rights*].

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is still difficult to hold children and their directors (and managers) liable for their inefficient risk-taking.

1. *The Business Judgment Rule in a Game of Thrones*

According to corporate law in the United States, unless a transaction relates to tunneling, a court will usually rely on the business judgment rule⁸² to decide a case involving a business decision.⁸³ The business judgment rule states that courts should not second-guess business decisions that experts make.⁸⁴ In this regard, “[the business judgment] rule shields directors and officers from liability for unprofitable or harmful corporate transactions if the transactions were made in good faith, with due care, and within the directors’ or officers’ authority.”⁸⁵

In the United States, the business judgment rule is generally defined as “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”⁸⁶ When children take on projects as the de facto decision makers, their risk-taking is a business decision, which is in principle subject to the business judgment rule. The next issue is whether the inefficient risk-taking—which is less desirable to shareholders than normal risk-taking—is legally permissible in the context of an “honest belief that the action taken was in the best interests of the company.” For the following reasons, children’s inefficient risk-taking will be shielded from liability in most cases.

First, the expression “honest belief” can substantially limit the expression “in the best interests of the company.” Even in a case where the outcome of the project is disappointing, a child and her directors (and managers) may claim that, ex ante, they “honestly believed” that the project could provide a sound investment opportunity for a corporation. Second, practically (or cynically) speaking, what the fiduciary duty requires of corporate insiders is that they should be *in pursuit of* the “best interests of the corporation.” In other words, “attempting to generate a positive outcome”—rather than “generating a positive

82. In the United States, the business judgment rule is an established case law doctrine. See, e.g., Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 83–84 n.1–2 (2004) (introducing numerous cases on the business judgment rule). For a further explanation of the modern business judgment rule in the United States, see generally Arsh, *supra* note 21.

83. In modern economies, in the absence of conflicts of interest, it is not easy for courts or regulatory agencies—even if their corporate law systems do not officially recognize or adopt the business judgment rule—to impose corporate-law penalties on corporate insiders for corporate strategies or decisions that corporate insiders make. In this respect, at least in some jurisdictions, the business judgment rule (or a similar, de facto rule) functionally exists, irrespective of the name or formality, although the extent to the rule’s protection of corporate insiders varies.

84. For the business judgment rule in a context of a merger, see, for example, *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304, 306 (Del. 2015) (“For sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder is in their best interests.”).

85. *Business Judgment Rule*, BLACK’S LAW DICTIONARY (10th ed. 2014) (Westlaw)

86. *Aronson v. Lewis* 473 A.2d 805, 812 (Del. 1984).

outcome”—is a criterion when determining corporate insiders’ liability.⁸⁷ Third, unless it is apparent that the business decision of taking on a project involves a conflict of interest, the plaintiff-shareholders should generally provide a specific allegation. Even in a jurisdiction where investors are relatively well protected, it is usually challenging—if not impossible—for shareholders to gather a sufficient amount of relevant facts to support their claims.

Even for a Type D project,⁸⁸ the business judgment rule can shield a child from potential liability. Particularly when a “long-term” corporate interest is considered, corporate insiders have wide discretion as to the interpretation of the “best interests of the corporation.” Even if a Type D project is less desirable than, for example, a Type A project, a child and her directors (and managers) may argue that they “honestly believe” the Type D project is beneficial to shareholders “in the long run.” Also, they may claim that a Type D project acts as an indispensable foundation for a series of future projects with a highly positive expected rate of return. Of course, sometimes their claims are true.

2. *The Business Judgment Rule’s Broad Range of Protection for Children*

A Type E project provides the worst expected rate of return (i.e., negative 178%) with a substantially low chance of success (i.e., 10%).⁸⁹ In this kind of Hail Mary risk-taking, the presumption that children are in pursuit of the best interests of a corporation can be weakened. Nonetheless, it does not necessarily mean that children and their directors (and managers) will be liable for such Hail Mary risk-taking.

The business judgment rule is designed to protect corporate insiders’ *normal* risk-taking, as long as the risk-taking is not inherently detrimental to shareholders. The idea is that corporate insiders’ risk-taking is, on average, beneficial to shareholders, who hold diversified portfolios of invested corporations that can mitigate the adverse effect from the failure of a particular project. In Hail Mary risk-taking, however, a child in a game of thrones intentionally acts to create benefits for herself and, generally, to the detriment of shareholders. In these instances, in principle, the business judgment rule should not justify Hail Mary risk-taking.

Nonetheless, when applying the business judgment rule to an actual case, the final result is likely that even Hail Mary risk-taking—which a child chooses on purpose, expecting a substantial loss to the corporation—will be protected from liability. This phenomenon can be explained mainly by the following two points. First, a plaintiff-shareholder needs to demonstrate particular facts, which create

87. By the nature of the business world, the success of a business decision is not (and should not be) guaranteed.

88. *See supra* Table 1.

89. *See supra* Table 1.

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a reasonable doubt that the inefficient risk-taking is intended to favor a specific child to the detriment of a corporation. This is often a challenging task. Second, without apparent facts, courts are usually reluctant to second-guess business decisions, as they lack sufficient expertise.⁹⁰ For either point, if children's destructive gambling is consequentially shielded, it is not because Hail Mary risk-taking is the sort of risk-taking the business judgment rule is intended to foment and protect. In sum, unless a business decision directly relates to tunneling, it is still unlikely that a court will rule against a child's risk-taking.⁹¹

The above analysis is based on the situation where a child takes on a single Hail Mary project. By contrast, if the child *constantly* takes on a series of Hail Mary projects, a court may doubt the child's honest belief (or good faith) of her business decisions in the best interests of a corporation. Another issue is irrationality, "[which] is the outer limit of the business judgment rule."⁹² If a court determines that there is no legitimate business basis for taking on Type E projects in a repeated manner, the court is likely to consider the child's act irrational. Accordingly, the business judgment rule would not protect the child or her directors and managers.⁹³ In this case, the court may also think that the child's gamble amounts to "rare cases [where] a transaction may be so egregious on its face that the board approval cannot meet the test of business judgment."⁹⁴

3. *Conflict-of-Interest Argument*

In general, corporate insiders' risk-taking in a normal business situation is not associated with conflicts of interest. When a transaction is contaminated by a conflict of interest for some reason, however, the business judgment rule is not able to justify the transaction.⁹⁵ Sub-section 3 explains whether and under what circumstances courts may characterize children's Hail Mary risk-taking as a conflict of interest.

In a corporation, a conflict of interest usually arises when a controlling shareholder makes a business decision that is designed to benefit her at the sacrifice of non-controlling shareholders. In the context of a game of thrones, however, a conflict-of-interest case does not require that a child be an *official* controller. Rather, it is sufficient as long as the child is a *de facto* controller, who can exercise decision-making power in projects, even if she has no ownership and voting rights in a corporation.

90. *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 260 (Del. 2000).

91. *Id.*

92. *Id.* at 264.

93. *See id.* ("Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.")

94. *Id.*

95. *See, e.g.*, Shlensky v. Wrigley 237 N.E.2d 776, 780 (Ill. App. Ct. 1968).

In addition, taking on *one* Hail Mary project is generally not enough to be a conflict-of-interest case. In the case where a child undertakes only one Hail Mary project, non-controlling shareholders, *ex ante*, can possibly expect to gain benefits from the project, when the Type E project succeeds (which happens at a 10% chance with a 200% profits).⁹⁶ By contrast, if a child takes on, for example, two Hail Mary projects in a row, the chance of succeeding two Type E projects is only 1%,⁹⁷ and the chance where non-controlling shareholders lose is 99%.⁹⁸

One may point out that the chance where the child financially loses—if she has an economic stake in a corporation—is also 99%. It is noteworthy, however, that in the case where a child takes on two Hail Mary projects in a row, the child believes that she might gain additional benefits (i.e., the opportunity to ascend a throne and its accompanying pecuniary and non-pecuniary private benefits), which non-controlling shareholders cannot share with the child. Accordingly, if a child undertakes a series of Hail Mary projects, while the expected value of “continuous gambling” could be positive to her, non-controlling shareholders will “almost always” lose their financial value. In sum, if a child pursues *multiple* Hail Mary projects, it is possible that her Hail Mary risk-taking can be construed as a conflict of interest.

If the child has a tiny fraction of ownership in a corporation, relatively speaking, she does not feel overly concerned with the potentially destructive effect that failed Hail Mary projects bring. In this situation, even if the amount of the financial loss in absolute terms could be massive, the child—compared to the situation where she has a significant portion of ownership—is likely to have a greater incentive to abuse Hail Mary risk-taking to win the game of thrones. Moreover, if the child has no ownership, she has nothing to lose in continuous gambling. In these instances, due to the conflict-of-interest feature, the judicial suspicion against the business judgment rule will be strengthened.

Another issue is that taking on Hail Mary projects does not amount to self-dealing. This is because, in Hail Mary risk-taking, a controlling shareholder is not on both sides of a transaction as a buyer and a seller simultaneously.⁹⁹ Self-dealing is, however, a special form (and a subset) of conflicts of interest. Thus, although taking on Hail Mary projects is not self-dealing, it may present a conflict of interest. As long as corporate insiders’ acts are characterized as

96. *See supra* Table 1.

97. Since the chance of succeeding a Type E project is 10%, the chance of succeeding the two Type E projects in a row is 1% (i.e., $10\% \times 10\% = 1\%$).

98. The 99% cases include not only cases where two projects fail, but also the cases where one project succeeds and the other fails. In the latter cases, other things being equal, non-controlling shareholders ultimately lose since a successful Type E project generates 200% profits and a failed Type E project generates 220% losses. *See supra* Table 1.

99. For the further discussion of self-dealing, see generally *Sinclair v. Levien*, 280 A.2d 717 (Del. 1971). For a further discussion of the three conditions, see Kang, *Self-Dealing and the Fairness Test*, *supra* note 54, at 112–15 (explaining *Sinclair*’s three conditions of self-dealing).

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conflicts of interest (even if such acts do not amount to self-dealing), in theory, a stricter rule—rather than the deferential business judgment rule—can apply.

4. *Insightful, Adventurous Entrepreneurship*

Adventurous entrepreneurship is another issue. At the end of the 1960s, for instance, Joo-Young Chung, founder of Hyundai Group, decided to enter the shipbuilding business.¹⁰⁰ In the late 1970s, Byung-Cheol Lee, the founder of Samsung Group, entered the semiconductor business. At the time, these founders' ambition and boldness were considered “silly,” “fanatical,” or “irrational” to most in business and policy-making circles in Korea and the larger global community.¹⁰¹ In the 1960s, Korea (the base of both corporate groups) was one of the poorest countries in the world.¹⁰² Even in the 1970s, Korea was still a “developing” country far behind technologically advanced countries.

These projects were characterized by a low chance of success (perhaps lower than a 1% probability based on the global market's perception) and gigantic negative expected rates of return. In short, these ventures might be far riskier than a Type E project. If they failed, they could have ruined the two groups' entire business portfolios, even damaging the domestic economy on a large scale as well. After Samsung Group and Hyundai Group succeeded in their wildly risky ventures, however, the two founders' attempts were praised as examples of “insightful, adventurous entrepreneurship.”

In this respect, it is understandable, at least to some extent, to defend children's taking on, for example, two Type E projects in a row (the chance of succeeding at two Type E projects is 1%). If so, it would be difficult to treat repetitive Hail Mary risk-taking as a conflict of interest per se.¹⁰³ To be sure, one problem in relation to children's competition is that outsiders—such as non-controlling shareholders, regulatory agencies, institutional investors, and courts—do not know whether a child's choice of Type E projects is the outcome of her honest boldness as an adventurous entrepreneur or her greedy, selfish gambling with other people's money.

100. For Joo-Young Chung's entrepreneurship, see 이샘물, 정주영 회장, 500 원 지폐 '거북선' 보여주며 차관 유치, 동아일보 (Sept. 7, 2015, 03:06), available at http://news.donga.com/List/Series_70010000000852/3/70010000000852/20150906/73467597/1 (explaining that Chung thought about shipbuilding business in the late 1960s). According to a report, Chung completed a shipbuilding business plan and started the business in the early 1970s. *Id.* See also 김이석, 정주영 회장의 “이파, 해봤어”에 담긴 기업가 정신, 자유경제원 (Mar. 11, 2015), available at http://cfe.org/20150311_137076; Richard M. Steers, *The Last Confucian Autocrat*, WALL ST. J. (Mar. 26, 2001, 12:01 AM), available at <https://www.wsj.com/articles/SB985559177178312867>.

101. See, e.g., 김이석, *supra* note 100.

102. See, e.g., *South Korea's Economy: What Do You Do When You Reach the Top?*, ECONOMIST (Nov. 12, 2011) (“In 1960, in the aftermath of a devastating war, the exhausted south was one of the poorest countries in the world, with an income per head on a par with the poorest parts of Africa.”).

103. Cf. *supra* Part IV. A. 3 (explaining the conflict-of-interest argument).

Another possibility is that in terms of the chance of success and an expected rate of return, a child may honestly believe in a Type E project. This honest belief might be an outcome of merely the child's "overconfidence."¹⁰⁴ Alternatively, there could be information asymmetry between the market and outsiders on the one hand and the child's side on the other hand.¹⁰⁵ In other words, due to the lack of information, it is possible that the market and outsiders mistakenly underestimate the project that the child takes on.

5. *Absence of a Well-Functioning Derivative Suit System*

In countries with insufficient protection for investors, it is generally difficult for non-controlling shareholders to use shareholder litigation (e.g., derivative suits). The United States appears to be an exception in that derivative suits are available to public investors.¹⁰⁶ In many other countries, derivative suit systems exist in name only.¹⁰⁷ Without a workable derivative suit system, there is little litigation. If shareholders do not bring cases, courts do not have to consider whether they will apply the business judgment rule or any other rules to litigation. Therefore, the lack of a well-functioning derivative suit system makes the discussion in Section A about the corporate law's recourse less meaningful.

B. *Inefficient Risk-Taking and Market Mechanisms*

If legal systems do not protect investors in a game of thrones, market mechanisms might work as a solution to inefficient risk-taking. The basic idea is that a corporation is not able to attract investors if the quality of corporate governance is low; then, the corporation will not survive in the capital market.

104. For a brief explanation of "overconfidence," see *Behavioral Finance: Overconfidence*, FIDELITY (Dec. 2014), <http://www.fidelity.com.au/insights-centre/education/behavioural-finance-overconfidence> ("[O]verconfidence is perhaps the most damaging because our faith in our judgements usually exceeds their accuracy."). For another explanation of "overconfidence" in a different context, see, for example, Eugene F. Fama, *Market Efficiency, Long-Term Returns, and Behavioral Finance*, 49 J. FIN. ECON. 283, 289 (1998) (introducing an explanation of overconfidence in the context of informed investors).

105. For a seminal paper of the information asymmetry, see George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970). For a brief explanation of the information asymmetry, see *What Is Information Asymmetry?: How Greater Transparency Makes Markets Work Better*, ECONOMIST (Sept. 5, 2016), <https://www.economist.com/blogs/economist-explains/2016/09/economist-explains-economics-1>. For a further explanation of the information asymmetry in the context of issuing securities in a capital market, see Merritt B. Fox, *Regulating Public Offerings of Truly New Securities: First Principles*, 66 DUKE L. J. 673, 680–86 (2016).

106. It does not mean, however, that the derivative suit system is perfect in the United States. For instance, some scholars explain that in the United States shareholders' strike suits are problematic. See, e.g., Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 861 (2016) (indicating that "the pervasive problem in [mergers and acquisition-related litigation] is not breaches of duty by directors and officers but rather strike suits filed by the plaintiffs' bar.").

107. Even if a derivative suit system works to some extent, it is often challenging for shareholders to rely on the system. See, e.g., Kang, *Voting Leverage and Anti-Director Rights*, *supra* note 81, at 51–55 (explaining difficulties that shareholders in Korea and China face when they consider bringing derivative suits).

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In other words, market mechanisms can punish corporations that are fraught with inefficient risk-taking.

As discussed, however, many countries do not have high-quality disclosure systems, and investors suffer from the lack of information on corporations that are in the potential pool of investment. Accordingly, investors are unable to discern the extent of children's inefficient risk-taking across various family corporations. The dearth of pertinent information in the capital market would lead to an outcome where "good" family corporations (assessed in terms of children's risk-taking) are eventually treated similarly to "bad" family corporations.¹⁰⁸ In these instances, share pricing would be distortive and less relevant to the quality of corporate governance. In sum, bad family corporations are not specifically punished by market mechanisms.

Based on "raw information," institutional investors produce meaningful investment-related information and attempt to figure out the precise share pricing of a specific corporation. In many developing countries, the information asymmetry problem between a family corporation and investors initially arises from the lack of raw information. Even if raw information is available in these countries, the problem would remain unresolved, since there are few institutional investors who are sophisticated enough to scrutinize raw information. In some countries, although a significant number of institutional investors officially exist, they do not yet act as dominant market players in trading, compared to a country with the developed capital market.¹⁰⁹

In theory, investors can purchase shares of a family corporation at an accurately measured discount on a stock price in accordance with the risk that children take. Given the lack of information that investors and capital market professionals can utilize, however, children's risk-taking is imprecisely reflected in discounting the stock prices. Under certain circumstances, it is possible that, in the short run, some non-controlling shareholders can gain windfall profits, on an ad hoc basis, from an imprecise discount of a stock price.¹¹⁰ Nonetheless, due

108. This phenomenon relates to the lemon market problem, the adverse selection, and information asymmetry. For a further discussion of the lemon market problem, see generally Akerlof, *supra* note 105; see also Simin Gao, *Battling with "Lemon Problem": Investors Protection in Chinese ABS Market*, 7 *TSINGHUA CHINA L. REV.* 249 (2015) (explaining the lemon market problem in the Chinese ABS market). For a brief explanation of the adverse selection, see Carmen M. Alston, *Adverse Selection*, *BRITANNICA*, <https://www.britannica.com/topic/adverse-selection> (last visited July 23, 2017); see also Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 *YALE L. J.* 1223, 1223 (2004) ("The phrase 'adverse selection' was originally coined by insurers to describe the process by which insureds utilize private knowledge of their own riskiness when deciding to buy or forgo insurance.").

109. For example, I elsewhere explain that in China the trading volume that institutional investors engage in accounts for merely around 15%. See, e.g., Sang Yop Kang, *The Independent Director System in China: Weaknesses, Dilemmas, and Potential Silver Linings*, *TSINGHUA CHINA L. REV.* 151, 179–80 (citation omitted) [hereinafter Kang, *Independent Director System in China*].

110. For instance, when investors purchase shares of a family corporation with children's inefficient risk-taking, it is possible that the stock price traded at the time of purchase is discounted more than it should be. Accordingly, investors purchase shares at a lower price, compared to the extent of children's inefficient risk-taking. Other things being equal, investors (who become non-controlling shareholders)

to the distorted share pricing, a market failure remains unsolved. In turn, the market failure will impede the further development of a capital market and general investors' systematic, long-term benefits that go along with an advanced, efficient capital market.

C. *Monitoring by Boards, Gatekeeping Systems, and Parent-Controllers*

Concerning children's inefficient risk-taking, Sections A and B have discussed the limits of legal recourse and market mechanisms. Section C covers internal and external monitoring systems that can regulate children's activity.

1. *Limits of Boards and Gatekeeping Systems*

In a game of thrones, in theory, a board of directors acts to keep children's inefficient risk-taking in check. The effectiveness of a board system hinges on directors' independence from the controlling family and directors' capability to understand whether a specific project is efficient or not. Regarding the effectiveness of a board's checks-and-balances task, at least three potential issues may arise.

First, directors might not be independent, even if some are titled "independent directors."¹¹¹ The independence of directors is weakened particularly in a family corporation where a controlling family can elect (and replace) directors.¹¹² Second, directors—particularly independent directors who work for a corporation on a part-time basis (e.g., 10 days of work per year)¹¹³—might not fully understand the risk-return characteristics of specific projects.¹¹⁴ Independent directors might know the inferiority of Hail Mary projects such as Type E. They might be unaware, however, of the relatively subtle difference

would gain profits later if the discount rate for the risk-taking is going to decrease at the time when they sell the shares. A further explanation requires additional, separate analyses, and they are beyond the scope of this Article. I am currently conducting independent research on the interaction among information asymmetry, discounting share prices, investors' payoff and its effect under portfolio diversification, and long-term effects on a capital market.

111. For a further analysis of the independence of independent directors, particularly in China, see Sibao Shen & Jing Jia, *Will the Independent Director Institution Work in China?*, 27 *LOY. L.A. INT'L & COMP. L. REV.* 223, 226 (2005); Ling Zhou, *The Independent Director System and Its Legal Transplant into China*, 6 *J. COMP. L.* 262 (2011); Kang, *Independent Director System in China*, *supra* note 109.

112. See, e.g., Kang, *Independent Director System in China*, *supra* note 109.

113. Even in the United States where the quality of corporate governance is relatively high, independent directors work for a very short time for corporations. See, e.g., *How Independent Directors Bridge the Information Gap*, WHARTON UNIV. PENN. (June 16, 2015), <http://knowledge.wharton.upenn.edu/article/how-independent-directors-bridge-the-information-gap> ("[Independent directors] are busy individuals with typically high-profile jobs. They're only spending four or five or six days a year involved with the company.").

114. Even worse, it is possible that corporate insiders may exclude independent directors from information flow within a corporation. For limits of an independent director system in emerging countries, see Kang, *Independent Director System in China*, *supra* note 109 (explaining the difficulties in implementing a workable independent director system in China).

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between Type A and Type B (or between Type A and Type C).¹¹⁵ Third, in a corporate group setting, if each child is in charge of managing an affiliate, the affiliate where directors work is actually each child's feudal territory. Directors of affiliated companies may feel that they are in the same boat with their feudal rulers, the children. For example, as a child's chance of winning in a game of thrones diminishes, directors might even instigate the child's inefficient risk-taking rather than advise her to refrain from it.

If a board does not work for checks and balances in a game of thrones, another potential solution can be sought from the presence of effective gatekeepers,¹¹⁶ such as auditors, lawyers, securities analysts, and credit rating agencies. Regarding gatekeepers, however, many countries are subject to severe limits. Often, there are few gatekeepers in these countries. Even if they exist, they tend to be unsophisticated. Besides, due to information asymmetry, a gatekeeper's opinion concerning children's inefficient risk-taking might be offered based on a dearth of information or incorrect information.

2. Limits of Parent-Controller's Monitoring

A controlling family is a repeat player in a product market and a capital market, and thus, a parent-controller has reason to care about the controlling family's reputation.¹¹⁷ Accordingly, many parent-controllers may work as the last resort to suppress children's indulgence in suboptimal business decisions. As discussed below, however, some parent-controllers do not (or cannot) suppress their children's indulgence.

First, a parent-controller can notice a significant discrepancy between Type A and Type E (and thus, may prevent his children from taking on Type E projects). It is often possible, however, that he is unable to notice the relatively subtle discrepancy between Type A and Type B (or even between Type A and Type C). A parent-controller may have a basic understanding of individual projects and yet lack precise information on their risk-return characteristics, particularly when children effectively run his corporate group's affiliate companies as their own feudal domains. In such affiliates, directors and managers, who are directly under the children's actual control, are often more loyal to their boss than to their boss' parent. When these directors and managers do not fully report the risk-return characteristics of various types of projects to

115. While Type A projects are the most optimal for shareholders, Type B or C projects are less optimal. *See supra* Table 1.

116. For a brief explanation of gatekeepers, see Merritt B. Fox, *Gatekeeper Failures: Why Important, What to Do* (reviewing JOHN C. COFFEE JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* (2006)).

117. For a controlling family's characteristics of a repeat player, see Ronald Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 *STAN. L. REV.* 633 (2007); *see also* Kang, *Generous Thieves*, *supra* note 3.

the parent-controller, he is subject to information asymmetry vis-à-vis his children, though it might be less serious than the information asymmetry faced by outsiders. Accordingly, the parent-controller is unable to closely monitor and regulate his children's inefficient risk-taking in Type B or Type C projects.

Second, a parent-controller, notably a founder, is usually a risk-taker. As discussed, the founder of Hyundai Group's embarking on a shipbuilding business and the founder of Samsung Group's entrance of the semiconductor business received sour responses from business circles and public sectors.¹¹⁸ Within one or two decades, however, the two groups became leading business entities, and the two founders showed that the "objectively pessimistic" views were wrong.¹¹⁹ In this respect, a parent-controller may at times, at least passively, "understand" (though not actively "encourage") his children's risk-taking of Type D (or even Type E) projects.

Third, nonetheless, a parent-controller who is cautious about his children's business acumen often regulates his children's decisions to engage in Type E projects. It is possible that children might sometimes reap enormous profits from such projects. A parent-controller, however, would not think highly of his children's successes in Type E projects, since they might be mere luck.¹²⁰ Regarding Type B or Type C projects, by contrast, a parent-controller may be more lenient, even if he is fully aware that these projects are not optimal. In this regard, compared to undertaking a single Type E project, a more realistic problem might be the *cumulative* effect of children taking on a series of Type B or Type C projects, which are also inefficient but more often acceptable.

Fourth, if a parent-controller is a CMS controller, he is also associated with the problems in a similar way as his children are.¹²¹ Put differently, a parent-controller may have an incentive to engage in inefficient risk-taking, a similar incentive that his children have (though for different purposes).¹²² Under certain circumstances, a parent-controller may allow (or even encourage) his children's inefficient risk-taking (more frequently for Type B or Type C projects), when he expects that his children will transfer most costs of the risk-taking to other people (e.g., non-controlling shareholders or creditors).

118. See *supra* Part IV. A. 4.

119. Theoretically, however, another possibility is that the two founders were simply lucky (or, their corporate groups were substantially subsidized by the government).

120. The problem is, however, that some children, perhaps mistakenly, believe that parent-controllers will consider the success of such risk-taking as proof of the children's business capability.

121. For the discussion of children's externality problems in relation to the CMS, see *supra* Part III. A. 2.

122. Note, however, that there is a critical difference between children and a parent-controller. A main purpose of gambling, from the standpoint of children, is to win a game of thrones, which is not the goal of the parent-controller.

Game of Thrones

PART V: CONCLUSION

In a game of thrones, children may take on inefficient projects, generating negative externalities to non-controlling shareholders and creditors. When the ownership structure of a family corporation is CMS, the extent of negative externalities will be amplified. The house money effect, egocentricity, and the tragedy of the commons may reinforce children's inclination toward inefficient (or Hail Mary) risk-taking. In order to resolve problems in a game of thrones, two sets of potential solutions might be proposed: (1) potential solutions from legal reform including transplant of a more developed jurisdiction's (e.g., the United States) corporate law; (2) potential solutions based on market mechanisms and monitoring systems. As discussed, however, these two sets of potential solutions are subject to many limits.

For legal recourse in relation to (1), it is challenging to rectify problems occurring in a game of thrones. This is because taking on projects is an outcome of children's business decisions, which are mostly protected by the business judgment rule (or similar rules in countries outside the United States). Under certain (perhaps rare) circumstances, this Article explains that courts (or regulatory agencies) may consider a series of Hail Mary ventures as a conflict of interest.¹²³ For the solutions in relation to (2), many countries are subject to a severe information asymmetry problem, which distorts share pricing. Also, they lack market infrastructures and professionals such as institutional investors, securities analysts, and credit rating agencies.

These countries need fundamental measures to correct children's suboptimal risk-related activities. A sophisticated disclosure system is valuable to investors and gatekeepers in the capital market.¹²⁴ For instance, with a sufficient amount of information on the children's projects, market participants may better understand which project is undesirable to a corporation and beneficial only to a child. A system with genuinely independent directors is useful to rein in children's inclination toward inefficient (or Hail Mary) risk-taking. In addition, if a regulatory regime can lower the extent (or depth) of CMS in a jurisdiction, the adverse effect on non-controlling shareholders and creditors can be alleviated, if not eliminated.¹²⁵ It should be noted, however, that cultivating these institutions and market infrastructures takes significant time.

123. Nonetheless, this conflict-of-interest argument is also subject to limits, since truly insightful, adventurous entrepreneurship can also be unduly discouraged by the argument. For the discussion of insightful, adventurous entrepreneurship, see *supra* Part IV. A. 4.

124. For an extensive discussion of the social value of disclosure, see Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 252–69 (2009).

125. For instance, regulating voting leverage devices (such as stock pyramiding, dual-class equity structures, and circular shareholding) can lower the extent of CMS and reduce negative externalities in games of thrones. However, a drastic change of ownership structure of corporate groups or ultimately dismantling large corporate groups is not necessarily desirable. A further analysis of this issue is beyond the scope of this Article. I am currently conducting independent research on this issue.

One of the recent contributions in corporate governance scholarship on family corporations is the notion that controlling families are repeat players.¹²⁶ While I agree with this concept in general, I would add that controlling families' characteristics of repeat players can be weakened during the course of children's competition.¹²⁷ When children lose a game of thrones, they may feel that they are entering the end game. Accordingly, repeated interactions between a controlling family and investors can be interrupted. In such instances, another problem is that controlling families—who repeatedly tunnel generously in order to maximize the cumulative private benefits of control in the long run—may become less generous.¹²⁸ This is because the children who lose in the competition and have no promising future with the company may attempt large, one-time tunneling in the final stage of the game. In this respect, a game of thrones, which generates managerial agency problems of children's inefficient risk-taking, can lead to another key corporate governance issue—tunneling. In a follow-up research project, I plan to propose an analytical framework to comprehensively explore the combined effects of tunneling and managerial problems in family corporations.

126. See generally Gilson, *supra* note 117; Kang, *Generous Thieves*, *supra* note 3.

127. See Kang, *Generous Thieves*, *supra* note 3, at 63 (“[S]ibling rivalry and succession problems . . . in a family business can adversely affect the existing continuous relationship between a controlling family shareholder and minority shareholders.”).

128. In other words, if a controlling family shareholder is not a repeat player, he is—in terms of the level of tunneling—likely to be a “roving controller” (who is *harsh* to non-controlling shareholders) rather than a “stationary controller” (who is *generous* to non-controlling shareholders). See *id.* at 68–85 (discussing roving and stationary controlling shareholders).