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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 economic interests 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 and creditors may 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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PART I: INTRODUCTION

Outside of the United States, a prevalent form of business associations is “family-controlled corporations” (“family corporations”).¹ In family corporations, controlling shareholders, particularly in developing countries, 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 which take investors’ wealth and depress firm value.

Rather than focusing on tunneling,⁴ however, this Article explores corporate governance issues of what I refer to as a “game of thrones”: the competition among a parent-controller’s children to inherit his business position.⁵ 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 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, serious problems arise when children intentionally take on “inefficient projects.”

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).

4. 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.

5. Some children would not like to succeed to their parents’ business positions as controlling shareholders, since these children want to pursue their personal dream (e.g., being an actor, singer, movie director, photographer, chef, etc.) based on 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 to their parents’ business positions.

6. For an empirical study on risk-taking of a parent-controller’s children, 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.

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 higher realized rates of return are construed as hard evidence to prove children’s business capacity, children are more inclined to take 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—would likely only lose wealth that they did not accumulate on their own.

In extreme cases, the children—particularly those who fall behind in the competition—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. In addition, 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 lucky) children may believe that they will have a greater chance to win a come-from-behind victory in the game of thrones. Even if the risk-taking fails and these children ultimately do not ascend the throne, they still would have lost had they not adopted the Hail Mary strategy.

A child may rely on inefficient risk-taking more frequently when she has only a small fraction of ownership (for example 0.5%) in a corporation.¹⁰ With a small ownership interest, the child’s potential financial loss from business failure is limited (for example, up to 0.5% of economic interests of a corporation). On the other hand, the potential benefits to the child could be disproportionately large, since these benefits include not only the child’s economic interests,¹¹ but also the throne and pecuniary and non-pecuniary

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% economic interests, see *infra* note 14 and accompanying text.

11. The child’s economic interests will be greater when she ultimately wins a game of thrones, since she will inherit most of a parent-controller’s properties including shares of a family corporation.

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private benefits.¹² This asymmetric payoff structure, biased in favor of the children, is facilitated in a controlling minority structure (CMS),¹³ where a controlling family runs a corporation with a less than a majority, for example, 5%, of economic interests.¹⁴

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 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

Based on limited liability and the nature of risk-taking, shareholders in turn can transfer, at least partially, the costs of these gambles 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 reduced or eliminated. In a game of thrones, however, the problem is that the beneficiaries of the inefficient risk-taking are not shareholders, but the children of the parent-controller. From the standpoint of general shareholders who do not participate in a game of thrones, creditors' response creates an undue outcome.¹⁸ Market failure is still unresolved even after creditors' "corrective actions," unless children, gamblers, properly compensate the other shareholders.

To remedy such negative 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

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 (who are also shareholders), see *infra* Part III. B.

16. See *infra* Part III.

17. See *infra* Part III. C.

18. See *infra* Part III. C.

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

problems arising from such games. This is because risk-taking is commonly associated with the matter 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 a country that has insufficient investor protection, due to the lack of sophisticated market infrastructures (e.g., the deficiency of efficient disclosure system), a capital market is not able to provide solutions to the negative externalities.²³

Given these shortcomings, one may also consider systems of checks and balances 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. He is likely to effectively regulate children’s opportunistic behavior, particularly in relation to Hail Mary projects. However, the parent-controller might not always prevent his children from engaging in undesirable business ventures. For instance, if a parent-controller’s control is based on a CMS, he 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. Accordingly, the parent-controller may acquiesce to—or even tolerate—his children’s undesirable risk-taking, if not outright encourage it.

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 solely on a meritocratic system. In the real world, a parent-controller considers a variety of factors to determine the successor; these factors include not only children’s managerial capability, but also filial piety, the extent of the parent’s preference for the first child (or son), and even a child’s resemblance to the parent. Rather, what this Article examines is that *even if* a purely meritocratic standard

20. Note, however, that in general, risk-taking includes both efficient risk-taking 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 checks-and-balances mechanisms 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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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. The one-child situation, a special case of a game of thrones, is also discussed. Part III explores externality problems that a game of thrones creates. Part IV examines whether a game-of-throne 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 in 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.

Competition Among Children and Choice of Business Projects

Let us start with a hypothetical example of a game of thrones.²⁷ Suppose that a parent-controller, who has three children, will choose his successor based on each child’s business performance. In order to train and test the three children, the parent-controller gives business opportunities to the children 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 the corporation (but may gain a small portion of the parent-controller’s properties).²⁸ Let me introduce a simplified hypothetical example below.²⁹

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.

28. See *supra* note 27 and accompanying text.

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 (and thus eliminate unsystematic risks).

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 is measured by the project's expected risk-adjusted return.³¹ Among the available five types of projects, Type A provides the highest expected rate of return, 5%.³² In addition, Type A projects have the lowest level of risk. Accordingly, Type A is the most efficient (optimal) among five types of projects.³³ By contrast, Type E is the least efficient. It generates the lowest 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 respect, Type B projects are more efficient than Type C projects. If a corporation has limited resources, other things being equal, the corporation

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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should prioritize projects according to their efficiency. Otherwise, shareholders will lose the opportunity to enjoy profits from better projects available.³⁴

“Game of Thrones”: Children’s Distortive Incentives

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

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 18% profits. Under these circumstances, it is probable that the three children do not consider seriously the higher risk associated with Types B and C. In a game of thrones, children generally attempt to demonstrate their business capability to shareholders, employees, and a 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, participants in the capital market may be able to see expected risk-adjusted returns of Types A, B, and C. If so, due to express or implicit demand from the capital market that a corporation should go repeatedly to raise capital in the future, children are more likely to take Type A projects, the most efficient ones 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 differences between Types A and B (or even between Types A and C), it is less likely that the market institutions can keep children’s inefficient risk-taking (i.e., Taking Type B or C projects) in check.³⁵ Even the parent-controller might not be able to discern these subtle differences, if business units that children manage do not provide full and precise information when reporting to the parent-controller. Basically, a corporation that

34. In addition, 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.

35. Although a parent-controller, to some extent, can constrain his children’s inefficient risk-taking, the parent-controllers’ role is also subject to limits. *See infra* Part IV. C. 2.

a child manages—although the parent-controller is the official controller of the 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 interests before the interests 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. In addition, 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 actually takes Type B or Type C 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). In essence, a “market failure” arises in the midst of competition among controller-candidates.³⁸ During the course of competition, this inefficient risk-taking will be ongoing perhaps for a long time until the succession issue is ultimately resolved. In a game of thrones, accordingly, the cumulative effect of inefficient risk-taking would be gigantic, although the extent of inefficiency in pursuing a single Type B or Type C project is relatively small.

Hail Mary Risk-Taking

A more serious problem—though less frequent—will arise when children undertake Type D or even Type E projects, which are excessively risky and generate the worst expected rates of return. In terms of expected risk-adjusted returns, Type D and Type E projects comprise a particularly troubling subset of

36. See *infra* Part IV. C. 2.

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. For a further discussion of market failure, see *Market Failure*, BRITANNICA, <https://www.britannica.com/topic/market-failure> (last visited July 24, 2017).

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inefficient projects.³⁹ Based on the above hypothetical example of various types of projects, let me provide a theoretical analysis. Suppose 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 rationally considers that the success of a normal 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 with an extremely volatile return and a substantially high chance of failure. (1) In the case of failure, even if the corporation's losses are huge (e.g., the negative 220% rate of return in a Type E project), this might not concern Child Z. She will lose the opportunity to take the throne regardless. Additionally, if non-controlling shareholders and a parent-controller hold most of the economic interests, they bear the bulk of the losses; Child Z would not lose very much financially.⁴⁰ (2) Should the project succeed, on the other hand, Child Z may believe that the high profits (i.e., the positive 200% rate of return in a Type E project) can award her an opportunity—even if it is a long shot—to win a come-from-behind victory in the game of thrones.

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 (at Time 2), the problem is that Child Z might take a Hail Mary project (at Time 1) because of this hope. The parent-controller might restrict Child Z's Hail Mary risk-taking, but not always eliminate such attempts.

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. In other words, Child X, who is currently in first place, might also have an incentive to undertake a Type D or E project, which could be very harmful to shareholders. 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 quite old or seriously

39. See *supra* Part I.

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

sick. 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. Even if the parent-controller does not restrict children's Hail Mary risk-taking, Child X would not engage in the vicious circle if there is a significant performance gap between Child X and the other children. Put differently, in this situation, Child X does not have an incentive to rely on the Hail Mary strategy. If Child X (unreasonably) selects the Hail Mary strategy, Child X's 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 extremely large losses.

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 do not have reliable data on *expected* (*ex ante*) risk-adjusted returns of the projects. To solve this problem, scholars may use data on *realized* (*ex post*) rates of return with observable cash flow fluctuation.

The practice of tunneling, however, makes data on (*ex post*) 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 *realized* 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. In other words, from the standpoint of children, the *business* risk that is required to gain such profits is close to zero.⁴¹ Outsiders may know a corporation's *total* profits (from the data on *realized* rates of return), which are the sum of tunneling and non-tunneling profits. By definition, tunneling is a hidden activity, and thus, outsiders do not know the amount of these illicit profits. When empiricists rely on the available data (e.g., data on the *total* profits), their calculated risk-adjusted returns are biased due to the unknown size of tunneling profits that require almost zero business risk.

41. Of course, the parent-controller who tunnels in favor of his children is subject to legal risk. In bad-law jurisdictions, however, it is difficult to detect tunneling. In addition, even if tunneling is detected, the enforcement system is inefficient, and thus, the parent-controller will be rarely punished.

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One-Child Situation and 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 special 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 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 be also 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." In addition, if a parent-controller, a successful and wealthy businessperson, concurrently maintains multiple domestic relationships (i.e., extra-marital affairs), an official one-child situation is less meaningful, due to the possible competition among half-siblings.⁴³

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 GAMBLING COSTS

In order to win a game of thrones, children bet on various types of risky projects. However, non-controlling shareholders and creditors bear a significant portion of the costs created by gambling. 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 serious externality problem,⁴⁵ Hail Mary risk-taking seldom happens.⁴⁶ Rather, 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

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, the gambling king in Macau, 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'keeffe, *Family Feud Grips Ho Casino Empire*, WALL STREET J. (Jan. 21, 2011, 12:01 AM), available at <http://www.wsj.com/articles/SB10001424052748703555804576102892126323426>.

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.

Externalizing Gambling Costs to Shareholders

If children engaged in a game of thrones take privately optimal projects that are inefficient to a corporation, the costs of betting on inefficient projects will be borne by the corporation, and especially by the shareholders.

Controlling Family Without Voting Leverage

When a controlling family holds 50.1% of economic interests 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 necessarily need 50.1% of voting rights (and thus, 50.1% economic interests 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 without any voting leverage device,⁴⁹ a controlling family holding only 25% of shares could 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% of shares account for a majority of those who attend the shareholder meeting.⁵⁰ In this case, a controlling family with 25% of shares can elect most directors, who support corporate policies. Then, the family can externalize the negative effect arising from inefficient risk-taking to non-controlling shareholders who hold 75% of shares.

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

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).

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*

pyramiding, or cross-ownership (or circular shareholding), a controlling family holds 5% of economic interests 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 economic interests. The controlling family bears only 5% of costs arising from such risk-taking. In many countries, the CMS is not uncommon.⁵² In Korea, many corporate groups 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 the Alibaba Group, owns less than 8% of shares.⁵⁵ Ren Zhengfei, the controlling shareholder of Huawei, owns approximately 1% of shares.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 economic interests), the stronger the children's incentive to take on risky, even suboptimal projects.

House Money Effect

Regarding the propensity of risk-taking, another important issue is a “house money effect”—namely, the effect where “a prior gain can increase subjects' willingness to accept gambles.”⁵⁷ Children's economic interests, or a parent's economic interests which are expected for children to inherit, are often a windfall to children who won the “lottery” of having wealthy parents.⁵⁸ Under the house

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 been also 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 [□□□□□□□□, 2016 □□□□□□ □□□□□□ □□□□□□], 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).

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 employment 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*

money effect, when children fail in risky projects and lose part of their economic interests 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 the risks less seriously. If a house money effect is combined with a CMS effect, children's inclination toward risk-taking is further strengthened.

Externalizing Gambling 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.

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 "family-centric." On the other end of the spectrum, some children may perceive that they are completely *separate* economic persons from a parent-controller and the other members of the controlling family. I characterize these children as "egocentric."

Suppose that a parent-controller has 30% of economic interests in a corporation and his children have no economic interest. 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%. In most cases, children fall between these two extremes.

If there are no outside restrictions, in a game of thrones an egocentric child can gamble entirely with other people's money. If the egocentric child wins a game of thrones, she will enjoy an extremely high level of benefits, including cash flow rights,⁵⁹ tunneled private benefits, and non-pecuniary benefits, as well as taking the throne.⁶⁰ However, if the egocentric child loses in the game of

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 Fuedai*, 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-fuedai>.

59. In this example, it is assumed that the egocentric child holds zero economic interest, 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 economic interests, 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 private benefits are equivalent to a controlling

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thrones, she will not feel the financial loss at all, since she is completely apathetic to her family's payoff. In the parlance of option theory, an egocentric child with no economic interest faces a call option, for which she does not pay a premium (i.e., zero premium). Put differently, the child does not lose anything, when she purchases (plays) options (gambles).⁶¹ The egocentric child, who holds zero economic interest, is *entirely* insured. Consequently, egocentric children—compared to family-centric children—are more inclined to take excessively risky projects, even if these projects are undesirable to a corporation.

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 interests 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 A tragedy of the commons can be extremely serious if children compete fiercely without considering future consequences. 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,

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. If an option arrangement is fair, the expected value of an option when parties (an option buyer and an option seller) enter into the option is zero to both. In the call option of children in the aforementioned case, however, the expected value is positive to children.

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 that 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> (“[regarding a tragedy of the commons], scholars have identified and structured a number of tentative solutions, such as enclosing the commons by establishing property rights, regulating through government intervention, or developing strategies to trigger collective behaviour.”) (last visited July 11, 2017).

“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 game’s 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

Externalizing Gambling Costs to Creditors and (Again) Shareholders

When children externalize the costs associated with their gambling, non-controlling shareholders are the most apparent victims. The non-controlling shareholders are directly subject to the outcome of children’s inefficient risk-taking.⁶⁷ Two points are worth noting. First, non-controlling shareholders might discount the stock price of a corporation when they purchase shares, and thus the effect of the externality can be mitigated. Second, costs of children’s gambling 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.

Gambling Costs to Creditors

Shareholders enjoy limited liability where the maximum loss they assume is the amount of their investment.⁶⁹ Thus, under certain circumstances—not

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 risky projects within the same “corporation.” 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, risk-contamination effect is still a problem, if affiliated companies are networked (e.g., mutual guarantee among affiliated companies).

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. B.

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 to be an exception of limited liability. *Piercing*

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limited to a game of thrones—shareholders may transfer costs caused by an excessive risk 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 are also victims of the negative externality that competing children may generate. This type of agency problem—“shareholders v. creditors”⁷¹—is apparent “in the vicinity of insolvency”⁷² when the equity cushion of a corporation is insufficient to protect creditors from potential financial distress.

What I emphasize more 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 costs of gambling in which the children (rather than shareholders) engage. All else equal, the enhanced risks lower the value of debt instruments that creditors own even in a situation where a corporation is firmly solvent.

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 Commc’ns Corp.*, Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 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.”).

Information Asymmetry, Creditors' Response, and Suboptimal Outcomes

In the case of children's risk-taking, rational creditors attempt to defend the value of their debt instruments. 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 This response generates an outcome equivalent to transferring children's gambling costs, 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, the precise 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.

On one hand, when the premium in interest rates is insufficiently high (i.e., under-coverage), creditors will still assume some amount of costs generated by children's gambles. On the other hand, when the premium is too high (i.e., over-coverage), creditors take the net economic value from the shareholders. In either situation, although the gamblers are children, those who pay the price for the gambling are not the children but "other people"—i.e., the shareholders or creditors—who are not playing in a game of thrones. An externality problem still remains because "other people" unduly bear the gambling costs.

Opportunistic Risk-Taking, Creditors' Response, and Suboptimal Outcomes

Suppose that creditors have a sufficient amount of information on the children's risk-taking patterns. In this situation, creditors may ascertain the interest rate that properly 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,

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 (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 gambling can be internalized to stockholders who gamble. Note, however, that children's game of thrones is different from the situation of a conflict of interest between shareholders and creditors. When creditors are damaged in a game of thrones, it is children rather than shareholders who initially externalize gambling costs. See *infra* Part III. C. 3. (explaining that in the case where creditors charge properly higher interest rates on a family corporation, the costs of gambling will not be internalized to children who gamble, unless shareholders properly impose such costs on the child).

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ex post, may be able to behave opportunistically by taking a riskier project than what the adjusted interest rate justifies.⁷⁵ Second, aside from children's ex post opportunism, an externality problem still remains unsolved in a different version.⁷⁶ Let me further explain the second issue.

By charging a high interest rate precisely in accordance with risk, creditors may be able to resolve the externality. In a game of thrones, however, the beneficiaries of risk-taking are not the shareholders but the children. In this respect, a higher interest rate, which the entire shareholder group primarily bears, is an undue cost to non-controlling shareholders and other family members holding shares. Note that the situation in Section C intrinsically relates to the framework of "children v. creditors" rather than that of "shareholders v. creditors."⁷⁷ In sum, the market for control contests fails, since this market is still subject to another externality where the price of gambling is not internalized to children, the players in the gamble.⁷⁸

Limits of Agreements Restricting Children's Risk-Taking

If creditors and a corporation enter into agreements that restrict a child's risk-taking,⁷⁹ these restrictions would be effective to prevent a child from, for example, taking 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 and 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 Type B and C projects on the one side and Type A projects on the

75. For instance, expecting the riskiness of projects that children take, creditors set an interest rate at 15%. This adjusted interest rate is proportionately set 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. Creditors may know this situation in advance and may have an incentive beforehand to charge a higher interest rate, for example, a 20% interest rate. This is not the end of the story. Under the 20% interest rate, two more issues arise. First, if children ultimately choose projects that are compatible with a 15% interest rate—note that these projects are the projects that creditors originally expect—creditors gain an unfairly large amount of benefits. In sum, it turns out that creditors overcharge. Second, on the other hand, even a 20% interest rate might not be sufficient compensation for creditors, if children take by far riskier projects that are suitable to, for example, a 30% interest rate. In sum, creditors undercharge.

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. Of course, frameworks of "children v. shareholders" and "shareholders v. creditors" are also partially related.

78. Note that one of reasons for market failure is 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>.

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.").

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 C projects, this subtle discrepancy will ultimately become significant, given the cumulative effect.

PART IV: DO SHAREHOLDERS HAVE RECOURSES IN CORPORATE LAW OR MARKET INSTITUTIONS?

Parts II and III explained children's inclination to gambling and externality problems in a game of thrones. Part IV will analyze potential responses and recourses to children's risk-taking.

Legal Recourse to Children's Gambling

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 U.S. corporate law, which is far more protective of investors. As will be discussed below, however, even if the jurisdiction transplants stricter U.S. corporate law, it is still difficult to hold children and their managers/directors liable for their inefficient risk-taking.

The Business Judgment Rule in a Game of Thrones

According to U.S. corporate law, 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

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 bring law 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*].

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 Arsht, *supra* note 21.

83. In modern economies, in the absence of conflict of interest, it is difficult 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

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second-guess business decisions that business experts make.⁸⁴ In this respect, “[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 projects as the de facto decision makers, their risk-taking is the 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 “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 interest of the corporation.” In other words, “attempting to generate a positive outcome”—rather than “generating a positive outcome”—is a criterion when determining corporate insiders’ liability.⁸⁷ Third, unless the business decision of taking a certain project *appears* to engage in conflicts of interest (even if the business decision *actually* engages in conflicts of interest), the plaintiff-shareholders should provide a specific allegation. Even a jurisdiction where investors are relatively well protected, it is usually impractical—if not impossible—for shareholders to gather relevant facts and evidence 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 what the “best interest of the corporation” implies. Even if a Type D project is less desirable than, for

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) (emphasis added).

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.

example, a Type A project, a child and her directors may argue that they “honestly believe” the Type D project is beneficial to shareholders “in the long run.” For instance, a child and her directors 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.

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 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 a diversified portfolio of invested corporations that can mitigate the negative 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, on average, to the detriment of shareholders. Therefore, the business judgment rule does not (and should not) justify Hail Mary risk-taking.

Nonetheless, when applying the business judgment rule in an actual case, the final outcome is likely that even Hail Mary risk-taking—which a child chooses on purpose, expecting a large 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 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 difficult task. Second, without apparent facts, courts are reluctant to second-guess business decisions, in which the courts do not have 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 which the business judgment rule is intended to foment and protect. In sum, unless a business decision directly relates to tunneling, it is still uneasy for a court to make a decision against a child’s risk-taking.⁹¹

The above analysis is based on the assumption that a child takes a single Hail Mary project. By contrast, if the child *constantly* takes a series of Hail Mary

89. See *supra* Table 1.

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

91. *Id.*

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projects, a court may doubt the child's honest belief (or good faith) of her business decisions in the best interests of a corporation. In addition, "[i]rrationality is the outer limit of the business judgment rule."⁹² If a court determines that there is no legitimate business basis of taking Hail Mary (e.g., Type E) projects, particularly in a repeated manner, the court is likely to consider the child's act as irrational. Accordingly, the business judgment rule would not protect the child as well as her managers and directors.⁹³ In this case, the court may also think that the child's gambling 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

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 zero economic interest and voting rights in a corporation.

In addition, taking *one* Hail Mary project is generally not enough to be a conflict-of-interest case. In the case where a child takes 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, 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

92. *Id.* at 264.

93. Regarding irrationality and the waste test, 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).

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% x 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.

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

If the child has small economic interests in a corporation, she does not have to feel overly concerned with the potentially destructive effect that failed Hail Mary projects bring. In this situation, the child is likely to have a stronger incentive to abuse Hail Mary risk-taking to win a game of thrones. 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 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.

Inightful, 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

99. For the further discussion of self-dealing, see generally Sinclair v. Levien, 280 A.2d 717 (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).

100. For Joo-Young Chung’s entrepreneurship, see http://news.donga.com/List/Series_70010000000852/3/70010000000852/20150906/73467597/1 (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 1968). Chung completed a shipbuilding business plan in 1971 and started the business in 1972. *Id.* See also 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>.

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, damaging even the domestic economy on a large scale as well. After Samsung Group and Hyundai Group succeeded in the semiconductor and shipbuilding businesses, 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, for example, two Type E projects in a row (the chance of succeeding 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 taking 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.

Another possibility is that in terms of the chance of success and an expected rate of return, a child honestly believes, for example, a Type E project in a more positive manner. This honest belief might be an outcome of merely the child’s “overconfidence.”¹⁰⁴ Alternatively, there could be the 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

101. See, e.g., □ □ □, *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).

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).

the market and outsiders mistakenly underestimate the project that the child takes on.

The 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 actually 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 rule 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.

Market Responses to Children's Inclination to Gambling

In a game of thrones, if legal systems do not protect investors from children's attempt to take inefficient projects (or Hail Mary projects), non-controlling shareholders would seek recourse in a market. For instance, if non-controlling shareholders know the extent of excessive risk-taking by a parent-controller's children, in theory, non-controlling shareholders will discount the stock price of a family corporation appropriately.¹⁰⁸ As discussed, however, many countries do not have high-quality disclosure and enforcement systems or market infrastructure (e.g., the presence of sophisticated institutional investors). Given this situation, it is difficult to expect that the sufficient amount of information on a family corporation's game of thrones would be conveyed to participants in a capital market. Accordingly, investors in the capital market would be subject to serious information asymmetry, and thus would not be able to properly discount the stock price in a game of thrones. Based on this background, I analyze further the following two additional points, at a *macro* and *micro* level.

106. It does not mean, however, that the U.S. derivative suit system is perfect. 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).

108. According to the efficient market hypothesis, "market prices fully reflect all available information." Andrew W. Lo, *Efficient Market Hypothesis*, THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS (2d ed. 2007). If the information disclosure system is efficient and enforceable, the information on the extent of risk-taking in a game of thrones will be available to the public. Subsequently, such information will be fully reflected as a discount factor in the share price of a family corporation.

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First, consider, at a *macro* level, the impact of asymmetric information on a *capital market in general*. Under the information asymmetry of a game of thrones in a certain family corporation, the best strategy available to investors is to speculate, on average, risk-taking of all children in all family corporations, and thus to discount every stock price based on the estimation. In this case, a certain jurisdiction's capital market faces a "country discount" applying to *all* family corporations in the jurisdiction. Accordingly, even a family corporation where children do not take gambles with other people's money will be punished by investors' *on-average* discount rate.¹⁰⁹ If so, it is possible that even children who *initially* have no intent to take riskier, less efficient projects may *later* justify their adventure and attempt to take riskier, less efficient projects.

Second, consider, at a *micro* level, the impact of asymmetric information on *one specific family corporation*. Given the lack of information, non-controlling shareholders of a family corporation over-react (over-discount the stock price) or under-react (under-discount the stock price) in response to children's risk-taking. If non-controlling shareholders initially over-react at the time of purchasing shares and such an over-reaction later subsides, other things being equal, non-controlling shareholders will gain windfall profits. On the other hand, if non-controlling shareholders initially under-react and then such an under-reaction is corrected, non-controlling shareholders will lose financially.

If non-controlling shareholders diversify their investment portfolios across a large number of family corporations, profits and losses caused by inaccurate discounting (i.e., over- and under-reaction) of family corporations' stock prices may be canceled out. However, if non-controlling shareholders of a family corporation do not diversify their investment portfolios, the effect from inaccurate discounting may persist. In this respect, the presence of sophisticated institutional investors is important, since institutional investors can help investors diversify their investment. In a jurisdiction where a capital market is not well developed, unfortunately, institutional investors are less available to individual investors.¹¹⁰

109. This phenomenon relates to the lemon market (the information asymmetry) problem and the adverse selection. For a further discussion of the information asymmetry, 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.").

110. 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*].

Checks and Balances That Regulate Children's Gambling

Sections A and B have discussed potential legal recourse and market responses to children's risk-taking. Section C covers systems of checks and balances in family corporations that can restrict children's gambling.

Limits of Boards and Gatekeeping Systems

When children engage in inefficient risk-taking, in theory, a board of directors acts to keep children's gambling 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 be able to fully understand the return-risk 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 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 certain child's chance of

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 110.

112. *See, e.g.*, Kang, *Independent Director System in China*, *supra* note 110.

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 110 (explaining the difficulties in implementing a workable independent director system in China).

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

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winning in a game of thrones diminishes, directors might even instigate children's risk-taking rather than advise children 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. In many countries, however, such gatekeepers—even if they exist—tend to be unsophisticated. Given this situation, market gatekeepers are not easily able to regulate children's risk-taking behavior.

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 children's indulgence.

First, it is true that a parent-controller may screen out children's Hail Mary projects (e.g., Type E) since they are the most dangerous to a corporation. However, he is likely to tolerate or overlook projects that are slightly inefficient projects (e.g., Type B or Type C), even if he recognizes the inherent inefficiency in these projects. Second, regarding risk-return characteristics of projects, a parent-controller can notice a large discrepancy between Type A and Type E (and thus, may prevent his children from taking Type E). It is often possible, however, that he does not notice the relatively subtle discrepancy between Type A and Type B (or even between Type A and C). A parent-controller's lack of detailed, precise information on the characteristics of individual projects—although he knows roughly—may arise, particularly when children effectively run a corporate group's affiliate companies as their own feudal domains. In these affiliates, managers and directors, who are directly under the control of the children, are often more loyal to their boss than to their boss' parent. In essence, a parent-controller is still subject to information asymmetry vis-à-vis his children, though it might be less serious than information asymmetry that outsiders face.

Third, a parent-controller, particularly a founder, is often a risk-taker. As discussed, the founder of Hyundai Group's embarking on a shipbuilding business and the founder of Samsung Group's entrance into a semiconductor business

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.

received a sour response 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).

Fourth, parent-controllers would often regulate children’s business decisions to engage in Type D or Type E. In addition, parent-controllers would not think highly of large profits from the success of Type D or Type E projects, if they believe that children’s success might be mere luck.¹²⁰ With respect to Type B or Type C projects, however, parent-controllers are more likely to be lenient, even if children repeatedly take these inefficient projects. In this respect, compared to taking Type E projects, a more realistic problem that may often emerge is the *cumulative* effect of taking Type B or Type C projects.

Fifth, if a parent-controller is a CMS controller, basically the parent-controller 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 risk-taking (more frequently for Type B or Type C projects), when he expects that his children will transfer most costs of inefficient risk-taking to other people (e.g., non-controlling shareholders or creditors).

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 based on market institutions, infrastructure, and participants (such as a variety of

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 the evidence 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.

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gatekeepers, institutional investors, and a board); and (2) potential solutions from legal reform including transplant of a more developed jurisdiction's (e.g., the United States) corporate law. However, these two sets of potential solutions are subject to many limits.

Regarding (1), countries with insufficient investor protection (which usually have less-developed capital markets) need fundamental measures to correct children's suboptimal risk-related activities. A better disclosure system can help investors and gatekeepers in the market, such as securities analysts and institutional investors, to understand children's inefficient risk-taking behavior.¹²³ For instance, with a sufficient amount of information on the expected rates of return and risks of children's projects, market participants may identify which project is undesirable to a corporation and beneficial only to a child. A system with *independent* 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 negative effect on non-controlling shareholders and creditors can be alleviated, if not eliminated.¹²⁴ It should be noted, however, that cultivating these institutions and market infrastructures takes significant time.

For legal recourse in relation to (2), it is also difficult to rectify children's gambling with other people's money. This is because taking projects is an outcome of children's business decisions, which are mostly protected by the business judgment rule (or a similar rule 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.¹²⁵

One of the recent contributions in corporate governance scholarship on family corporations is the notion that controlling families are repeat players.¹²⁶ Agreeing with this concept in general, I add the last point 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

123. 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).

124. In addition, for instance, preventing families from using voting leverage devices (such as stock pyramiding, dual-class equity structures, and circular shareholding) can lower the extent of CMS and provide a positive effect to reduce negative externalities. However, a drastic change of ownership structure of corporate groups or ultimately dismantling large corporate groups is not always desirable. A further analysis of this issue is beyond the scope of this Article. I am currently conducting independent research on this issue.

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

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.”).

that they face a final stage. Accordingly, repeated interactions between a controlling family and investors can be interrupted. If so, another problem is that controlling families—who repeatedly tunnel generously in order to maximize the sum of cumulative private benefits of control in the long run—may become less generous.¹²⁸ This is because the loser-children, who do not have a promising future with the company, may attempt large-sized, one-time tunneling. 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.

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).