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## **Family-based Corporate Governance Disaster<sup>1</sup>**



# “ The Principles of Corporate Governance



The Organization for Economic Co-operation and Development (OECD) published its principles of corporate governance on July 7<sup>th</sup>, 1999 as part of a global effort to promote economic efficiency, sustainable growth, and financial stability. Adherence to these principles gives companies easier access to capital for long-term investment and helps ensure the fair treatment of shareholders and stakeholders.

These OECD principles call for corporate governance frameworks that ensure shareholders' basic rights and access

to decision-making; ensure equity for all domestic and overseas shareholders; actively work with stakeholders to make decisions, build wealth, and improve the working environment; disclose correct information and promote transparency; and supervise the effectiveness of board of directors.

<sup>1</sup> 民國 88 年 1 月 19 日，臺北地檢署 87 年度偵字第 24674 號等案件，以業務侵占、證券交易法等罪名起訴被告張朝翔等 6 人。被告張朝翔、張朝曉兄弟為禾豐集團負責人，為個人及家族公司資金需求，挪用國產汽車新臺幣 252 億 7534 萬元 (8 億 4251 萬美元)，且為維持國產汽車公司股價，利用人頭戶為沖洗買賣。起訴後經臺北地方法院以 88 年度訴字第 203 號案件判處被告張朝曉 10 年有期徒刑，被告張朝翔 7 年有期徒刑。本案偵查檢察官為曾部倫。

## The OECD updated and revised their principles of corporate governance in 2004.

01

These now included the promotion of transparent and efficient markets, consistency with the rule of law, and clear articulation of the division of responsibilities among different supervisory, regulatory and enforcement authorities;

02

protection and promotion of the exercise of shareholders' rights;

03

ensuring the equitable treatment of all shareholders, including minority and foreign shareholders, and that all shareholders have the opportunity to obtain effective redress for violations of their rights;

04

recognition of the rights of stakeholders established by law or through mutual agreements and the encouragement of active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises;

05

ensuring that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company;

06

and ensuring the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

## The OECD further updated its principles in 2015 to read:

01

The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement;

02

The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights;

03

The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance;

04

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises;

05

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company;

06

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

In short, corporate governance principles convey an essential message to the directors and board of directors of the company that companies must work for the interest of shareholders and stakeholders, and not the interest of directors.





**Mr. Zhang Chao-Xiang**

Photo from March 21, 1999 National Central Library

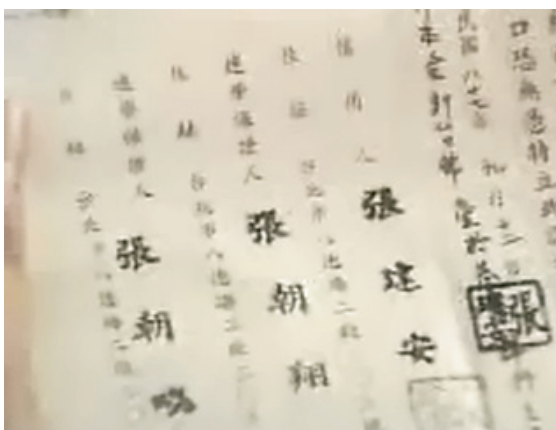
## “ The Panma Conglomerate ( 禾豐集團 )

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**Z**hang Chao-Xiang ( 張朝翔 ) came from a family in Daya Township in Taichung County that had earned its fortune as a major rice exporter and that owned a fleet of ships and significant amounts of land in Taiwan. After 1946, Chao-Xiang' s father Zhang Jian-An ( 張建安 ) and uncle Zhang Tian-Gen ( 張添根 ) founded Yongtai Enterprise ( 永太行 ) to import bicycles and export agricultural products.

Good business relations with the Hitachi Company ( 日立公司 ) in Japan led to the

Jian-An and Tian-Gen' s introduction to other Japanese companies, including Idemitsu Kosan ( 出光興業株式會社 ) and Nissan Motor ( 日產汽車株式會社 ). The former, Japan' s second largest oil company, granted Yongtai franchise rights to sell its engine oil in Taiwan. In 1958, Jian-An signed a deal with Nissan that established a technology sharing partnership with Yueloong (later Yulon) Motor ( 裕隆汽車製造股份有限公司 ). Chinese Automobile Co., Ltd. ( CAC, 國產汽車股份有限公司 ) was then founded to sell Yueloong Motor cars



**The court judgment**

Photo from March 21, 1999 National Central Library

domestically. As the exclusive sales organization for both Nissan and Yueloong in Taiwan, CAC had set itself up for 3 decades of prosperity.

In 1988, CAC and Yueloong ended their partnership, and second-generation owners Chao-Xiang and Yan Kai-Tai (嚴凱泰) took charge of the business. Zhang's family management team separated as well about the same time, with Chao-Xiang taking control of the Panma Conglomerate (禾豐集團), Tian-Gen and his

son Zhang Xiu-Zheng (張秀政), taking control of the Hongxi Conglomerate (鴻禧集團), and Xiu-Zheng's brother-in-law Xu Yun-Xia (許雲霞) taking over Yungtay Engineering Co. Ltd. (永大機電公司).

## Sindian Taipei Mansion

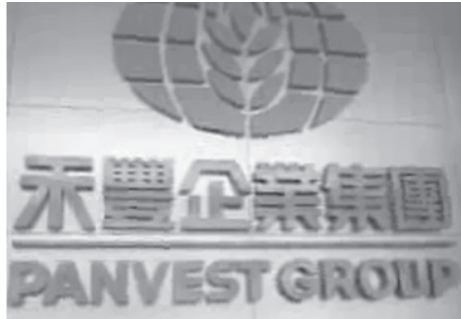


Photo from April 12, 2014 Apple Daily

Chao-Xiang, eager to expand his family's business, signed a franchise agreement with the U.S. General Motors Company (通用汽車公司) and a technology sharing contract with France's Citroen Motors (雪鐵龍汽車公司). Moreover, he used investments in Japan's Sumitomo Corporation (住友商事株式會社) and Taiwan's Sanxin Business Corporation (三信商事股份有限公司) to found the domestic Daihatsu Motor Co. Ltd. (大發汽車股份有限公司); cooperated with Family Mart of Japan to set up Family Mart convenience stores (全家便利商店) in Taiwan; founded C.F.C. International Co., Ltd. (中法國際乳品股份有限公司) and made his third sister Zhang Zheng-Fen (張正芬) president;

founded Changlay Electronic Company (昌磊電子工業股份有限公司) and made his eldest sister Zhang Xin-Zhen (張信貞) president; and appointed his youngest brother, Zhang Chao-Liang (張朝曉), in charge of stock trading management and business development at Sindian Taipei Mansion (新店大台北華城). Within a decade, the Zhang's family had invested in companies spanning construction, communications technology, and channel management / logistics. The Panma Conglomerate was now valued at around NT\$ 200 billion (US\$6.7 billion).

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**Panma Conglomerate**

Photo from March 21, 1999 National Central Library



Problems with

## **CORPORATE GOVERNANCE**

in Family-owned Enterprises

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Panma Conglomerate was practically a Zhang family-owned and controlled business group. The family treated its employees well and was known as almost never laying off an employee - a practice that would become an increasingly heavy burden as the group began facing financial troubles. In addition, both Jian-An and Tian-Gen had encouraged employees to loan funds to the group, for which they paid interest at a generous rate of 18%. This employee-funded bankroll fueled the Zhang family's aggressive investments in the stock market and continued business expansion. However, the group was not licensed to operate a banking business. Their private borrowing and lending

practices would soon become a troublesome black hole.

In addition, the management's good treatment and protection of its employees ultimately worked against the best interest of group shareholders. Corporate governance would become the Achilles heel of this family-based company.





## “ The Domestic Financial Crisis

The Asia Financial Crisis of 1997 overwhelmed Asia's securities markets. While Taiwan weathered the crisis relatively unscathed, the domestic economy was sideswiped by a domestic financial crisis that sent financial markets and the general economy into the doldrums from 1998 through 2007. This latter crisis sunk over ten large domestic conglomerates and cost taxpayers trillions of NT dollars in emergency rescue funds and compensation schemes. These conglomerates included Tong Lung Metal Industry Co., Ltd. (東隆五金), New Magnitude Group (新巨群集團), Kuoyang Construction Group (國揚建設集團), Chinese Automobile Co., Ltd. (國產汽車公司), Tuntex Department Store (東帝士百貨), Typhone Conglomerate (台鳳集團), Zhongxing Commercial Bank (中興銀行), Anfon Conglomerate (安鋒集團), Kuangsan Conglomerate (廣三集團), Changyi Conglomerate (長億集團), Hualon

Conglomerate (華隆集團), Hongxi Conglomerate (鴻禧集團), and Rebar Conglomerate (力霸集團).

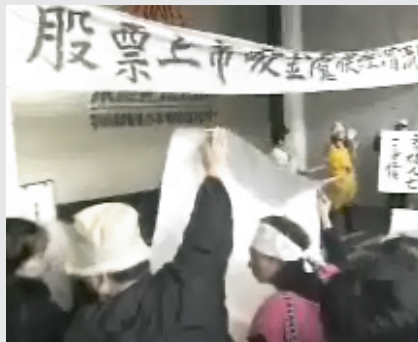
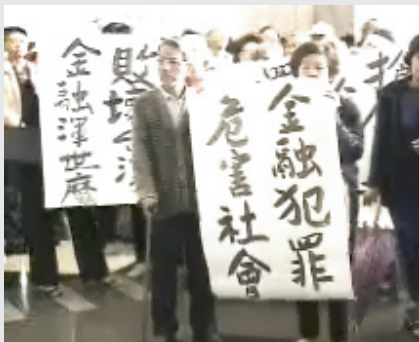
The domestic financial crisis set prices on the Taiwan Stock Exchange into a tailspin in 1998, with the TAIEX index falling from 9000 points to 6000 points. Falling stock values hit the value of many large companies and conglomerates the worst, leading to fiscal insolvency for those that had made plans based on highly optimistic stock-price predictions when their checks started to bounce. Highly leveraged finances and rapid business expansion further aggravated the financial crisis. In the end, most of Taiwan's conglomerates crashed and their representatives were held criminally liable for embezzlement, fraud, and other similar charges. Many executives fled the country to avoid imprisonment.



Mr. Zhang Chao-Xiang



Mr. Zhang Chao-Liang



**Photo from**

National Central Library

## “ The Investigation

The double whammy in 1998 of a big slump in domestic automobile sales and the stock market crash sent the Panma Conglomerate into a financial cul-de-sac. However, Chao-Xiang already had several new IPOs in the pipeline, ready to go. In order to launch these IPOs successfully, Chao-Xiang needed to re-inflate CAC's sagging stock price. Thus, Chao-Liang and Chao-Xiang used other Panma Conglomerate members and nominal accounts to take out loans from CAC that, all told, came to NT\$3.446 billion (US\$114.86 million). They further mortgaged CAC stocks with banks as well as with illicit, unregistered private financiers. By the end of 1998, the value of CAC's mortgaged funds topped NT\$18 billion (US\$600 million).

To prop up CAC's stock price, these two arranged for conglomerate companies and their nominal accounts to do a wash sale, which, by the end of 1998, led to NT\$24.553 billion (US\$818.41 million US) in failed deliveries.

Upon investigation, although Chao-Liang, Chao-Xiang, and other conglomerate accomplices admitted to their wrongdoings, they argued that they had done so only for the altruistic purpose of maintaining CAC's stock price.





**Taipei District Prosecutors Office**  
Sand draw from Penghu Prison

## “ THE INDICTMENT

Prosecutor Zen Bu-Lun ( 曾 部 倫 ) indicted 6 defendants, including Zhang Chao-Liang and Zhang Chao-Xiang, for embezzlement under the Criminal Law and for manipulating stock prices, holding illegal wash sales, and failing to deliver in violation of the Security Law.

## “ The TRIAL

During the trial, Chao-Liang and Chao-Xiang argued that they used the “borrowed funds” mainly to maintain CAC’s stock price in order to stabilize its financial situation. However, after reviewing evidence, the tribunal found that the only beneficiary of the higher CAC stock price was the Zhang family and sentenced Chao-Liang to 10 years’ incarceration and a fine of NT\$500 million and Chao-Xiang to 7 years’ incarceration and the same fine. Other accomplices were sentenced to between 18 months and 3 years’ incarceration.

Although the High Court rejected a request to hear the defendant’s appeal, the Supreme Court overruled the judg-

ment and ordered the High Court to take the appeal. In 2003, the High Court revised the sentence of Chao-Liang to 6 years’ incarceration and a NT\$300 million fine and of Chao-Xiang to 5 years’ incarceration and a NT\$300 million fine.

The case was finalized in 2006. Chao-Liang finished his full sentence on September 8<sup>th</sup>, 2012 and Chao-Xiang completed his on November 5<sup>th</sup>, 2011. Ironically, these two were the only of Taiwan’s numerous conglomerate tycoons wrapped up in the late-1990s ~ early 2000s domestic financial crisis to actually spend time in prison for their crimes. All of the others fled overseas.

## “ The **CONSEQUENCES**

The Zhang family empire broke under the weight of the domestic financial crisis and were left with NT\$ 120 billion (US\$4 billion) in unpaid debts. The NT\$200 billion empire vanished, with outstanding debts of NT\$40 billion (NT\$1.3 billion), unpaid employee salaries of NT\$30 billion (US\$1 billion), and private bank debts of NT\$70 billion (US\$2.3 billion). The court declared CAC bankrupt in 2006.

Further compounding the social troubles caused by Panma's collapse, the Zhang family had NT\$30 billion (NT\$1 billion) in outstanding private loans taken from Panma Conglomerate employees. Thus, after the bankruptcy, not only were former employees out of a job and pension, but many were mired in debt.

The Zhang family did what it could to compensate by liquidating much of their personal and company properties. However, the black hole of debt was too deep to fill.

Five luxury homes in Sindian Taipei Mansion (新店大台北華城), the pride of the Zhang family, and hundreds of other properties were put up for auction by creditor banks. The printout of the auction list came in at an incredible 3 meters in length.

The Zhangs never recovered from this devastating setback. Conglomerate subsidiaries C.F.C. International Co., Ltd. (中法國際乳品股份有限公司) and Changlay Electronic Company (昌磊電子工業股份有限公司) ceased operations in 2005 and 2016,



**Bidding room  
of Taipei District Court**  
Photo from editors

respectively. C.F.C. International Co., Ltd. (中法國際乳品股份有限公司) was dissolved on October 29<sup>th</sup>, 2007. Chao-Liang and Chao-Xiang were unemployed after their release from prison. They reportedly operated a street-snack stand for a short period of time.

Corporate governance principles are at risk when family-dominated companies treat operations as their own property and either devalue or overlook the inter-

ests of shareholders and stakeholders in the decision-making process. Tragedy follows where board directors give priority to their personal interests.

This NT\$120 billion debacle offers a valuable lesson on the importance of true corporate governance.









A.D. 1969 The Presidential Hall  
Photo from Academia Historica