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Family-based Corporate Governance Disaster



“ The Principles of Corporate Governance



OCED , photo from April 08, 2014 Nick-D , Wiki

The Organization for Economic Co-operation and Development (hereinafter , OECD) published the principles of corporate governance on July 7, 1999. It is a means to support economic efficiency, sustainable growth and financial stability. It facilitates companies’ access to capital for long-term investment and helps ensure that shareholders and stakeholders who contribute to the success of the corporation are treated fairly.

In 1999, the OECD proposed 5 principles as follows:

1. The corporate governance framework shall en-

sure shareholders’ basic rights and access to decision-making;

2. The corporate governance framework shall ensure equity for all shareholders, domestic and overseas;

3. The corporate governance framework shall actively work with stakeholders to make decisions, to create fortune, and to better working environment;

4. The corporate governance framework shall disclose correct information and endeavor to transparency;

5. The corporate governance framework shall supervise the effectiveness of board of directors.

民國 88 年 1 月 19 日，台北地檢署 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，挪用國產汽車新台幣 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。

In 2004, the OECD further proposed 6 principles as follows:

01

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities;

02

The corporate governance framework should protect and facilitate the exercise of shareholders' rights;

03

The corporate governance framework should 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;

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 shall 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.

The OECD again renewed the 6 principles in 2015 as follows:

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, being that the company must sustain the interest of shareholders and stakeholders, and not the interest of directors.



Mr. Zhang Chao-Xiang

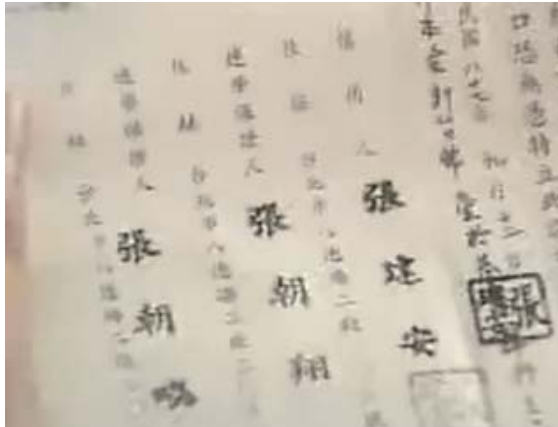
Photo from March 21, 1999 National Central Library

“ The Panma Conglomerate (禾豐集團)

Mr. Zhang Chao-Xiang (張朝翔) came from a rich family in Daya township of Taichung County (which later became Daya District of Taichung City in 2010). His ancestor was the biggest exporter of rice who owned a fleet of ships and vast land in Taiwan. After 1946, Mr. Zhang Jian-An (張建安) and Mr. Zhang Tian-Gen (張添根), father and uncle of Mr. Zhang Chao-Xiang, founded Yongtai enterprise (永太行) to import bicycles and export agricultural products.

By doing business with Hitachi Company (日立公司) in Japan, Mr. Zhang Jian-An and Mr. Zhang Tian-Gen cemented a good relationship with Hitachi. Intro-

duced by Hitachi, they connected with Idemitsu Kosan Co., Ltd. (出光興產株式會社) and Nissan Motor Co., Ltd. (日產汽車株式會社). Idemitsu Kosan Company was the second largest petroleum company in Japan. Yongtai Enterprise therefore attained franchise of engine oil from Idemitsu Kosan Company. Later in 1958, Mr. Zhang Jian-An convinced Nissan Motor in Japan to cooperate with Yueloong Motor Co., Ltd. (裕隆汽車製造股份有限公司, renamed as Yulon in 1992) in Taiwan for techniques franchise. Chinese Automobile Co., Ltd. (國產汽車股份有限公司) was then founded to car sales of Yueloong Motor Company. By monopoliz-



The court judgment

Photo from March 21, 1999 National Central Library

ing the Nissan-Yueloong car sale market, Chinese Automobile thereafter enjoyed prosperity for 30 years.

In 1988, Chinese Automobile and Yue-loong Motor terminated their cooperation and Mr. Zhang Chao-Xiang and Mr. Yan Kai-Tai (嚴凱泰), the second generation of the two families, respectively took charge. About the same time, Zhang's family management team was separated as well; Mr. Zhang Chao-Xiang took the Panma Conglomerate, Mr. Zhang Tian-Gen and his son, Mr. Zhang Xiu-Zheng (張秀政), took the Hongxi Conglomerate (鴻禧集團), and Mr. Xu Yun-Xia (許雲霞),

brother-in-law of Mr. Zhang Xiu-Zheng (張秀政), took Yungtay Engineering Co. Ltd. (永大機電公司).

Sindian Taipei Mansion

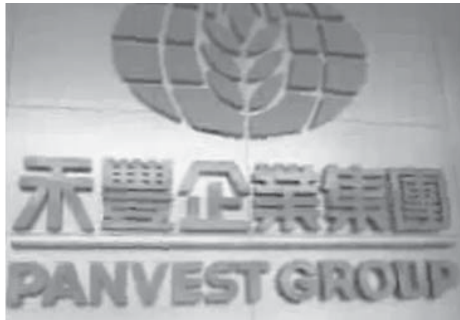


Photo from April 12, 2014 Apple Daily

Mr. Zhang Chao-Xiang (張朝翔), shouldering family business, was eager to expand. He obtained franchise from General Motors Company (通用汽車公司) of the United States and acquired technique cooperation contract from Citroen Motors (雪鐵龍汽車公司) of France. He invested with Sumitomo Corporation (住友商事株式會社) of Japan and Sanxin Business Corporation (三信商事股份有限公司) of Taiwan to establish Daihatsu Motor Co. Ltd.(大發汽車股份有限公司) in Taiwan. He cooperated with Family Mart of Japan to set up Family Mart convenience stores (全家便利商店) in Taiwan. He founded C.F.C. International Co., Ltd. (中法國際乳品股份有限公司) and his third sister Ms. Zhang Zheng-Fen (張正芬) was the president. He founded Changlay Electronic

Company (昌磊電子工業股份有限公司) and his eldest sister Ms. Zhang Xin-Zhen (張信貞) was the president. His youngest brother, Mr. Zhang Chao-Liang (張朝曉), was responsible for stock trading management and the development of Sindian Taipei Mansion (新店大台北華城).

Within 10 years, Zhang's family had invested in companies spanning from construction, communication technology, to circulation business. The Panma Conglomerate (禾豐集團) was a business group with value estimated up to 200 billion NT dollars (i.e. 6.7 billion US dollars).



Panma Conglomerate

Photo from March 21, 1999 National Central Library

“ Family-based

CORPORATE GOVERNANCE

As stated above, the Panma Conglomerate was directed by Zhang's family. It was practically a family-owned business group. Zhang's family highly valued their employees and considered them as corporate family members. Following this rationale, they never laid off any employee, which later became a burden of the Conglomerate. In addition, starting from Mr. Zhang Jian-An (張建安) and Mr. Zhang Tian-Gen (張添根), they convinced employees to give loans to the group and rewarded them with 18% high interest. With this fund, Zhang's family invested in the stock market and continued its business expansion. However, Zhang's family was not approved to run banking business and yet they had accepted fund from the public. This

unregulated fund later proved to be a troublesome black hole.

In addition, while management level valued too much of the employees, they obviously wasn't able to uphold the best interest of shareholders principle. Corporate governance became a dire challenge to this family-based company.



“ Domestic Financial Crisis

In 1997, the Asia Financial Crisis overwhelmed main markets in Asia. Taiwan was one of the few survived the Crisis. Nevertheless, starting 1998, domestic financial crisis swept through until 2007 bringing down over 10 business conglomerates in Taiwan; including 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), Tun-tex 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

cost taxpayers several millions of billions NT dollars to survive.

The domestic financial crisis started from plummeted stock market in 1998. The TAIEX drastically fell from over 9000 points to 6000 points. Many of the abovementioned conglomerates faced problems of stock prices dropped, of companies' value shrunk, and of checks bounced. High leverage finance management and fast expansion also aggravated the financial crisis. At the end, most of the conglomerates crashed and their representatives were criminally liable for either embezzlement or fraud. Many of them fled to avoid imprisonment.



Mr. Zhang Chao-Xiang



Mr. Zhang Chao-Liang



Photo from

National Central Library

“ Investigation

In 1998, the profit of motor business slid and the stock market plummeted made the Panma Conglomerate have urgent difficulty to balance out fund need within the group. At the same time, Mr. Zhang Chao-Xiang (張朝翔) had planned to IPO several companies in the Conglomerate. In order to realize the IPO plan, Mr. Zhang Chao-Xiang had to lift stock price of Chinese Automobile Co., Ltd. (國產汽車公司). Mr. Zhang Chao-Liang (張朝曉) and Mr. Zhang Chao-Xiang therefore utilized related companies in the Conglomerate and nominal accounts to take out loan from Chinese Automobile Co., Ltd. The total loan was up to 3.4 billion and 46 million NT dollars (i.e. 114.86 million US dollars).

Moreover, they used Chinese Automobile Company's stocks to mortgage from banks and illegal private banking sectors. By the end of 1998, the mortgaged fund was up to 18 bil-

lion and 24 million NT dollars (i.e. 600.8 million US dollars).

In order to maintain the stock market price of Chinese Automobile Co., Ltd., they further used related companies in the Conglomerate and nominal accounts to wash sell stocks. At the end of 1998, the failed delivery had accumulated to 24.5 billion and 52.56 million NT dollars (i.e. 818.41 million US dollars).

Upon investigation, Mr. Zhang Chao-Liang, Mr. Zhang Chao-Xiang and other accomplices from the Conglomerate confessed all wrongdoings but argued they only conducted for the purpose of maintaining company stock price.



Taipei District Prosecutors Office
Sand draw from Penghu Prison

“ INDICTMENT

Prosecutor Zen Bu-Lun (曾部倫) indicted 6 defendants including Mr. Zhang Chao-Liang (張朝亮) and Mr. Zhang Chao-Xiang (張朝翔) for embezzlement of the Criminal Law, and manipulating stock prices, wash sale, and failed delivery in violation of the Securities and Exchange Act.

“ TRIAL

During trial, Mr. Zhang Chao-Liang and Mr. Zhang Chao-Xiang argued that they used “borrowed funds” mainly to maintain company’s stock price thus to stabilize financial order. However, after looking into evidences, the tribunal found that the only beneficial owner of company’s stock price was Zhang’s family. The tribunal therefore ruled Mr. Zhang Chao-Liang to 10 years’ incarceration plus 500 million NT dollars fine, Mr. Zhang Chao-Xiang to 7 years’ incarceration plus 500 million NT dollars fine. Other accomplices were sentenced to 18 months incarceration to 3 years’ incarceration.

After appealing to Taiwan High Court, Taiwan High Court overruled the appeal. Defendants further appealed to the Supreme Court, the Supreme Court overruled Taiwan High Court’s judg-

ment and sent the case back to the High Court. Taiwan High Court ruled in 2003 and sentenced Mr. Zhang Chao-Liang to 6 years’ incarceration plus 300 million NT dollars fine, Mr. Zhang Chao-Xiang to 5 years’ incarceration plus 300 million NT dollars fine.

The case was finalized in 2006. Mr. Zhang Chao-Liang therefore served his time in jail from November 6, 2006 to September 8, 2012. Mr. Zhang Chao-Xiang served his time in jail from November 6, 2006 to November 5, 2011. Ironically, they were the only conglomerate tycoons involved in the domestic financial crisis who actually served in prison. Other conglomerate tycoons either fled and stayed overseas, or died in foreign land.

“ CONSEQUENCES

Falling with the domestic financial crisis, Zhang’ s family ended up in debt for up to 120 billion NT dollars (i.e. 4 billion US dollars). The once 200-billion-dollar empire was demolished. The Panma Conglomerate (禾豐集團) owed banks for debt of 40 billion NT dollars (i.e. 1.3 billion US dollars), owed employees salary adding up to 30 billion NT dollars (i.e. 1 billion US dollars), and owed private banking sectors debts adding up to 70 billion NT dollars (i.e. 2.3 billion US dollars). Chinese Automobile Co., Ltd. (國產汽車公司) was thus announced by court to be bankrupt in 2006.

Even worse, the Zhang’ s family took loans from employees of over 30 billion NT dollars (i.e. 1 billion US dollars). Many employees were also the nominal account holders used by the Zhang’ s family and were in huge amount of debt for failed delivery. After the company went bankrupt, they not only lost their jobs and pensions, but were also in deep

debt troubles.

Since the Zhang’ s family was willing to compensate, they exhausted family’ s and company’ s properties and tried to pay back debts. However, the debt black hole was too deep to fill.

Five exquisite and luxury mansions in Sindian Taipei Mansion (新店大台北華城), the icon fortress of the Zhang’ s family, were put up for auction. Hundreds of real estates belonged to the Zhang’ s family were put up for auction by creditor banks. The auction list was of exceptional length at 3 meters.



The Zhang's family was never able to recover after the setback. 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), companies within the Panma Conglomerate (禾豐集團), respectively ceased operating in 2005 and 2016. C.F.C. International Co., Ltd. (中法國際乳品股份有限公司) later dissolved on October 29, 2007. Mr. Zhang Chao-Liang (張朝曉) and Mr. Zhang Chao-Xiang (張朝翔) had no job for quite a long time. Some ever spotted them selling crepe on the street for a short period of time.

A typical family-based corporate governance case demonstrated itself to us when directors of the company considered the company as their belonging or family property, it would be difficult for directors to value shareholders and stakeholders equally in the decision-making process. Tragedies always happen when directors of board of directors served only for their own interest.

This 120 billion NT dollar lesson was right up to teach us about the importance of true corporate governance.





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