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Controlled Company in Asia**

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Family Resemblances: The Family Controlled Company in Asia

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Abstract

Perhaps the most notable characteristics of overseas Chinese business enterprises, large and small, is the use of the family controlled company. A question which has been asked, quite legitimately, is whether Asian businesses should have a new and unique form of business vehicle, better suited to family controlled companies. The conclusion of this article is that the family controlled company is the rule in most of the world. Across jurisdictions its characteristics are remarkably similar. Accordingly, legal devices prevalent in many western jurisdictions, especially those addressing dispute resolution, could be adopted to Asian uses.

Introduction¹

History has made the Asia Pacific a region of great diversity, politically, economically and legally. As has been well documented, a unifying thread in the commercial activities of the region has been the phenomenon of the overseas Chinese business empires, large and small.

The overseas Chinese business community has provided the common denominator for business structures and practices throughout the region. Although the overseas Chinese comprise only a small percentage of the population of ASEAN nations, they exercise economic influence out of all proportion to their numbers.² Notable characteristics of overseas Chinese businesses include an emphasis on informal relationships, networking along ethnic and linguistic lines, and aversion to litigation and debt.

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¹ This article is based in part on a background memorandum prepared by Stephen Wishart in the course of a review of Hong Kong companies legislation commissioned by the Hong Kong Government. The views expressed in this article, however, are those solely of the author and are not those of the Hong Kong Government. Philip Duffy and Karen Cheong, both students at the Faculty of Law, McGill University, Montréal and Stephen Du, a student at Osgoode Hall Law School in Toronto assisted in the preparation of this article. An earlier version of this article appeared in (1997) 8 Aust. J. of Corp. Law 89.

² M Chen, "Overseas Chinese Family Businesses: A Case Study" *East Asian Executive Reports* (15 November 1995) 8 at 8. [hereinafter Chen]

Perhaps the most notable characteristic is the use of the family controlled company. Many private companies are family controlled, of course. In Hong Kong, the “de facto capital of the overseas Chinese business community”,³ many public and listed companies are also family controlled. A recent study by the Hong Kong Society of Accountants lends credence to anecdotal evidence as to the extent of family control of publicly listed companies in Hong Kong. The Second Corporate Governance Study confirmed the “widespread view that the extent of control by one shareholder or one family group of shareholders in the shareholding of listed companies in Hong Kong is significant”.⁴ Almost 90% of all Hong Kong listed companies have one shareholder or one family group of shareholders owning 25% or more of their entire issued capital; 77% show one shareholder or family group owning 35% of the entire issued capital and more than half have one shareholder or family group owning 50% or more.

Many of the jurisdictions in the Asia Pacific region have inherited, or have had imposed upon them, UK-style common law legal traditions: Australia, New Zealand, Malaysia, Singapore and Hong Kong. The traditional UK-style company has encountered criticism as being particularly unresponsive to the needs of private companies, of which many are family controlled.⁵ The complaint is that traditional UK company law, especially in its earlier forms as are found in the Asia Pacific, is based on 19th century legislation designed to accommodate the joint stock company, ie a commercial vehicle with public subscribers. With its cumbersome formalities and reliance on judicial intervention,⁶ the traditional UK-style company is ill-suited to the informal ways of the family company.

The question has thus been asked, quite legitimately, whether Asian businesses require a unique form of business vehicle, better suited to their characteristics. In the course of the

³ M Enright et al, *The Hong Kong Advantage: A Study of the Competitiveness of the Hong Kong Economy*. Hong Kong: Vision 2047, 1996 at 3.

⁴ Hong Kong Society of Accountants, *Second Report of the Corporate Governance Working Group*, 19 January 1997 at 4.

⁵ A certain boot and shoe manufacturer comes to mind. “Aron Salomon...did not want to part with the business. He had a wife and a family consisting of five sons and a daughter. Four of the sons were working with their father. The eldest, who was about thirty years of age, was practically the manager. But the sons were not partners: they were only servants. Not unnaturally, perhaps, they were dissatisfied with their position. They kept pressing their father to give them a share in the concern. “They troubled me,” says Mr. Salomon, “all the while”. So at length Mr. Salomon did what hundreds of others have done under similar circumstances. He turned his business into a limited company. He wanted, he says, to extend the business and make provision for his family...The subscribers to the memorandum were Mr. Salomon, his wife and five of his children who were grown up. The subscribers met and appointed Mr. Salomon and his two elder sons directors.” *Salomon v Salomon & Co* [1897] AC 22 LJ Ch 35 (HL) per Lord MacNaghten. Several of the typical problems of the family controlled business are implicit in this famous case: an aging patriarch who does not wish to relinquish control, a family dispute over remuneration, succession problems, dispersion of control in the second generation and, true to the Chinese adage, the business did not last into the third generation.

⁶ Although his business was a “one man company” in the words of the House of Lords, poor M. Salomon (literally, a pauper by the time he reached the House of Lords) was saddled with seven shareholders and three directors.

Review of the Hong Kong Companies Ordinance,⁷ this question was posed and an answer tentatively posited.

Although the economic success of overseas Chinese family controlled companies has sparked much interest in academic and popular literature, there has been little written comparing family controlled companies across jurisdictions. Broad generalizations have been made, contrasting the Asian family controlled company to the “Western” widely held public corporation.⁸ The United States is noted for its widely held public companies, the “Fortune 500”, and deep, liquid, capital markets. In this respect, however, the United States is very much the exception. On closer examination, the supposed differences between East and West are overstated.

The family controlled company is the rule in most of the world. Statistics indicate that family controlled business accounts for 99% of Italian businesses, 70% of Portuguese, 75% of British, 80% of Spanish, 85–90% of Swiss, 90% of Swedish⁹ and 80% of Canadian.¹⁰ Even in the United States, 80–95% of businesses are family controlled.¹¹

These statistics are not surprising when the prevalence of the private company or closely held corporation, many of which are family controlled, is factored in. In Hong Kong, for example, nearly 99% of companies are private. Of particular interest though is the significant number of public companies which are family controlled.

There are relatively few truly widely held public companies, even in the United States. The population of so called “first tier” public companies¹² is quite small; it is estimated to comprise approximately 1500 to 2000 corporations in the United States.¹³ “Second tier” public corporations or “small publicly held corporations” in the United States outnumber those in the first tier three to one.¹⁴ These second tier corporations are more typically dominated by controlling shareholder groups.¹⁵ Family controlled companies even comprise one-third of the Fortune 500!¹⁶

⁷ The *Consultancy Report on the Review of the Hong Kong Companies Ordinance* (March 1997) was made public 1 May 1997 and is out for public consultation until 31 December 1997. The author of this article prepared the *Consultancy Report*.

⁸ Eg, see B Semkow, “Chinese Corporate Governance and Finance in Taiwan” (1994) *Butterworths Journal of International Banking and Financial Law* 528 [hereinafter Semkow].

⁹ “Italian Small Business: Change in the Heartland,” *The Economist* (2 April 1994) 63 [hereinafter Heartland].

¹⁰ D Berard, “Family Circus” (Jan/Feb 94) *CA Magazine* 39 at 40 [hereinafter Berard].

¹¹ T Goldwasser, *Family Pride*. New York: Dodd, Mead & Co. 1986 at 203 [hereinafter Goldwasser]; Heartland, *supra* n 9.

¹² Those with at least 2000 shareholders and \$100m in total assets.

¹³ American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*. Vol 1. St Paul: American Law Institute Publishers, 1994 at 79 [hereinafter ALI].

¹⁴ *Ibid* at 80.

¹⁵ *Ibid* at 79.

¹⁶ Heartland, *supra* n 9.

Family controlled corporations in the United States produce more than half of the country's goods and services.¹⁷ In Canada, family controlled businesses generate more than 50% of the GNP and, as in the United States, make up fully 30% of the largest Canadian companies. Family owned enterprises are responsible for more than 50% of the aggregate wages paid in Canada and provide employment for more than 60% of the Canadian labor force.¹⁸ In Europe, the economic significance of family controlled businesses is more striking yet. Family businesses may account for up to two-thirds of GDP and employment in Western Europe.¹⁹

The prevalence of family controlled companies, both private and public, is thus not unique to Asia. Across jurisdictions, these companies also share, to a greater or lesser degree, certain characteristics. Although there are cross cultural differences in terms of degree and intensity, statistical and case studies on Chinese family controlled companies tend to support the proposition that they are very similar to their Western counterparts on several levels.²⁰

In terms of size and corporate form, they tend to be small to medium sized private companies with ownership and management concentrated in the hands of a patriarch/matriarch or a small group of family members. Chinese and "Western" family controlled companies share common strengths: decision making is rapid and quick; their organizational structure is flexible and informal; they are better than public companies in undertaking long term plans and investments; employees are managed in a paternalistic, family-like way which in turn may breed strong employee loyalty and more effective clientele service; all these strengths combined make family controlled companies particularly adept at carving out market niches.

Conversely, the decision making process in Chinese family controlled companies, like their Western counterparts, has inherent weaknesses. Given that decision making and ownership is heavily centralized, senior management tends to become overburdened. Centralized decision making also leads to inefficiencies and frustration among middle management which in turn makes it difficult for family controlled companies to attract and retain competent, outside, professional managers. The lack of constructive outside advice and criticism inhibits the development of fresh business ideas. In addition, family controlled companies are particularly vulnerable to family disputes which vary from the

¹⁷ Ibid.

¹⁸ Berard, supra n 10 at 40.

¹⁹ Heartland, supra n 9.

²⁰ See generally, Chen. Supra n 2 at 21-8; S Cromie, B Stephenson & D Monteith, "The Management of Family Firms: An Empirical Investigation" (1994) 13 *International Small Business Journal* 11 [hereinafter Cromie et al]; L Kraar, "The Overseas Chinese" *Fortune* (31 October 1994) 91 [hereinafter Kraar]; G Redding, *The Spirit of Chinese Capitalism*, Berlin: Walter de Gruyter, 1990 [hereinafter Redding]; B W Semkow, "Chinese Corporate Governance and Finance in the ASEAN Countries – Some Implications for Europe and European Firms", INSEAD Euro-Asia Centre Research Series (No 34), Fontainebleau, France: INSEAD Euro-Asia Centre, 1995 [hereinafter Semkow (I)]; B W Semkow, *Taiwan's Capital Market Reform* (Oxford: Clarendon Press. 1994) [hereinafter Semkow (II)]; Semkow, supra n 8.

fair remuneration of family members, to sibling power struggles, to generational conflicts over the issue of succession.²¹

Despite these similarities to their Western counterparts, Chinese family controlled companies do have certain distinctive features which may stem in part from their historically strained relationships with state authorities. They tend to place great emphasis on the building of informal strategic alliances; their networks tend to be clannish in nature (ie their connections tend to be from the same linguistic and ethnic group); and, they are generally much less litigious as well as more averse to debt than their Western counterparts.²²

Similarities Between Chinese and Western Family Controlled Companies

In terms of corporate form, family controlled companies tend to be private companies (or closely held corporations as they are referred to in North America). These corporate entities have the following general characteristics:

The following factors generally characterize a closely-held corporation: (1) a small number of shareholders; (2) lack of a public trading market for the corporation's stock; (3) a close relation between management and at least the principal shareholders; (4) a personal relationship among all or some of the shareholders; (5) shareholder knowledge about the corporation; (6) shareholder desire to exert some control over the corporate voting process; and (7) an informality in day-to-day management of the corporation. Also, due to the informality and personal relationships often existing within the close corporation, most legal agreements between the various corporate actors will, unfortunately, be oral.²³

In terms of size, the vast majority of family controlled companies are small companies that employ less than 30 people. They have small management teams, often fewer than five shareholders and between one to three directors.²⁴

However, not all family controlled companies are small and medium sized private companies. Some family controlled companies are large public companies which make a certain percentage of their shares available to the public while maintaining a majority or minority controlling interest. For example, Cargill's, America's largest family controlled company has annual sales of over \$50b, over 73,000 employees and offices in 66 countries.²⁵ In Asia, the Charavanot family, which heads the Charoen Pokphanol (CP) group (the largest agribusiness and Chinese conglomerate in Thailand), had, as of 1994,

²¹ Ibid.

²² See generally, B Buchholz, M Crane, *Corporate Bloodlines: The Future of the Family Firm*, New York: Carol Publishing, 1989 [hereinafter Buchholz & Crane]; Chen, supra n 2; Kraar supra n 20; Redding. Supra n 20; Semkow (I), Supra n 20; Semkow (II), supra n 20, Semkow, supra n 8.

²³ J J Norton, "Adjustment and Protection of Shareholder Interests in the Closely-Held Corporation in Texas" (1985) 39 *Southwestern LJ* 781 at 785.

²⁴ Cromie et al. Supra n 20 at 29 ; Redding, supra n 20 at 146.

²⁵ "How to Feed a Growing Family", *The Economist* (9 March 1996) 71 at 71 [hereinafter Feed].

“between 50,000 to 70,000 employees, over 200 affiliated companies and sales revenue of more than \$5 billion in 1993”.²⁶

Strengths of Family Controlled Companies

Family and non-family companies tend to have different approaches to decision making. Family controlled companies tend to demonstrate a highly centralized form of decision making; decision making in non-family companies may be centralized or decentralized, depending on the complexity of the organization’s business environment.²⁷ In a first generation family controlled company, strategic decision making is typically the prerogative of the company’s founders. In subsequent generations, decision making remains centralized in the hands of a small group of family members. The centralization of decision making in family controlled companies allows them to make decisions rapidly. This in turn, allows family controlled companies to be nimble. They can react continuously to changes taking place in their business environments. This affords them a clear competitive advantage provided their business environment remains relatively simple so as to be easily understood by the company's senior management.²⁸

With both ownership and management firmly in the hands of a single family, family controlled companies tend to take a long term view with respect to planning horizons and investments. Without the pressure of pesky outside shareholders seeking more immediate gratification, family controlled companies have much greater freedom to reinvest in the future growth of the company.²⁹

Again, Cargill, America's largest and most successful family controlled company, is a good example of this phenomenon. Much of its success has been attributed to the willingness of family members to forego large short term dividends in order that profits may be reinvested in the business.³⁰ The willingness of family controlled companies to take a long term approach is likely attributable to the fact that family members are much more likely than professional managers, or anonymous shareholders, to see their company as an institution worth preserving for its own sake. Given that family name and pride are at stake, family members view their company as much more than a transient instrument of profit maximisation.³¹

Family controlled companies also tend to have a more adaptable and informal organisational structure than is the case in public companies.³² This informal organisation is reflected in the assignment of tasks, organisation of work, dissemination of information, and the process of controlling the work in family firms. The focus in family

²⁶ Semkow (I). Supra n 20 at 26.

²⁷ Cromie et al. Supra n 20 at 12 ; Redding, supra n 20 at 161-2, 174 ; Semkow (II), supra n 20 at 91.

²⁸ Cromie et al. supra n 20 at 23.

²⁹ Kraar, supra n 20 at 102; Semkow (II). supra n 18 at 92.

³⁰ Feed, supra note 25 at 71.

³¹ "In Praise of the Family Firm", The Economist (9 March 1996) 16 at 16.

³² Cromie et al. supra n 20 at 22; Semkow (II). supra n 20 at 93.

controlled companies, as is the case in most private companies, is more on getting the job done than on following proper procedures and channels.

In contrast, public companies, especially those that are unionised and bound by collective agreements, are renowned for having formal organisational structures with detailed job descriptions and titles. Professional managers in such companies are often required to justify their actions to shareholders and unions; consequently, they initiate numerous formal reporting procedures to keep a close eye on events.³³ Family controlled companies are reputed to have a more caring, paternalistic style of management. This family like management style has often been cited as a source of strength in family controlled companies, serving to promote a more positive, flexible and committed attitude among employees. Employees often attribute their greater sense of belonging and pride in their work to the family-like culture that reigns in their company.³⁴

Senior management in family controlled companies strive to create for their clients and suppliers a comfortable, familiar atmosphere in which a relationship of trust and continuity can be established. Employee loyalty to the family controlled company contributes to this goal in the form of improved clientele service and better relations with suppliers. Both customers and suppliers tend to prefer doing business with a company that has a family-like quality about it rather than dealing with faceless employees in a larger public company.³⁵

The strengths of family controlled companies (rapid decision-making, informal organisational structure, paternalistic management style, employee loyalty, improved clientele service and supplier relations) all contribute to better market positioning on the part of family controlled companies relative to their competitors. Family controlled companies carve out market niches and demonstrate a clearer sense of direction in terms of developing their clientele.³⁶

Weaknesses of family controlled companies

Despite its strengths, the centralised decision making process of the family controlled company has its weaknesses. The first weakness is simple overload. Founders of family controlled companies are usually highly independent individuals, by nature concerned about the possibility of losing control. Their businesses embody a good deal of themselves, and they are accordingly reluctant to delegate decision-making powers. Such individuals tend to become overloaded because most matters, irrespective of their importance, gravitate to their desk.³⁷ Family members in subsequent generations, having been schooled at the knee of the founder, may perpetuate this management style and suffer the same consequences as they seek to keep decision making a "family affair".

³³ Cromie et al, supra n 20 at 12.

³⁴ Goldwasser, supra n 11 at 206; Redding, supra n 20 at 156. Semkow (II), supra n 20 at 91-2.

³⁵ Goldwasser, supra n 11 at 204; Cromie et al, supra n 20 at 13.

³⁶ Cromie et al, supra n 20 at 13.

³⁷ Ibid.

This overcentralisation creates inefficiencies and results in much frustration for middle management. Many of the tasks assumed by family members could often be more efficiently performed by middle management if the tasks were properly delegated. Moreover, middle managers often become frustrated by "meddling" family members.

A centralised decision-making process in family controlled companies also makes it difficult for them to attract and retain competent professional managers. Few bright managers will choose to work for an organisation which will never give them an important role in company decision-making. Qualified professional managers often leave family controlled companies because they are shut out from decision making and blocked from obtaining higher levels of responsibility within the company. For example, the Bata group, a major Canadian shoe manufacturer, lost six out of the seven outside executives it hired in 1994 and 1995 to improve its competitiveness. Most left, reportedly, because they could not abide the incessant interference by Tom Bata, the 82 year old family patriarch.

Moreover, the centralisation of decision-making in family controlled companies inhibits the development of new business ideas. In first generation family controlled companies, respect for the founder's authority and age often rules out any constructive criticism. Rigidity and narrow mindedness frequently continue into subsequent generations as family bound attitudes and traditions prevent senior management from coming to terms with changes in their business environments.³⁸ As a result, many family controlled companies will fail to make appropriate adjustments to their product lines or services just because that's the "way the family has always done things".³⁹

Some family controlled companies have attempted to attenuate these problems by giving professional managers greater control once the company has reached a certain size and complexity.⁴⁰ Professional managers are evidently less tied to family traditions and are better able to implement strategic changes in corporate direction. Much of Cargill's success and longevity may be attributed to the willingness of the family to turn to outside professional managers when required.⁴¹ Also, in Asia, the continued success of Giordano International Ltd, a retail chain, is largely credited to the willingness of the company's founder, Jimmy Lai, to leave his company in the hands of professional managers. Since Mr Lai's departure, the company prospered, net profit growing an average 42% a year and revenues have tripled to about US\$450m.⁴²

Family Feuds

³⁸ Cromie et al, supra n 20 at 13.

³⁹ "Business in Asia", *The Economist* (9 March 1996) 3 at 23.

⁴⁰ Ibid at 17.

⁴¹ Feed, supra n 25 at 72.

⁴² P Stein, "Giordano. After Jimmy, Remains Quirky: With Flamboyant Founder Gone, A Quiet Accountant Runs Retail Chain", *The Asian Wall Street Journal* (30 August 1996) 1: see also Semkow's discussion of Indonesia's Salim group in Semkow (I), supra n 20 at 15-18.

Family disputes are a common pitfall of family controlled companies. The causes of disputes vary from the remuneration of family members, to inter-sibling power struggles, to generational conflicts over the succession process. Such disputes are common to all family controlled companies whether they be large or small, Asian or Western. Succession problems are often the ultimate cause of business failure. The life expectancy of a family business is 24 years compared with 45 years for a public company. Most family businesses do not survive the first five years and only 30% are successfully transferred to the next generation. Only one in ten makes it to the third generation.⁴³

The succession process is the most contentious issue. Who determines the control and future direction of the family controlled company? Sometimes, eager potential heirs are too self confident and will try to assume control of the company too quickly.⁴⁴ At other times, the founder refuses to let go of the company even though the next generation is ready and willing to take over.⁴⁵ Conversely, family pressures may compel heirs to carry on the family business even though they have no interest in it.⁴⁶

A lack of planning is the usual source of difficulty in the succession process. There is abundant speculation to explain this lack of planning. It has been argued that the founder may be reluctant to deal with the issue raising as it does the unwelcome spectre of his own mortality. Founders can also be simply reluctant to choose between their offspring. Procrastination results in succession matters being left unattended until too late.

In addition, the founder's children are often not keen to broach the sad scenario of replacing their parent.⁴⁷ Some authors have even suggested that because the business is such a powerful source of personal pleasure, the owner may harbour a subconscious ambivalence towards the company's prospects after his departure, or even have feelings of resentment towards his eventual successor.⁴⁸

Goldwasser's study of five successful American family controlled companies found that these companies, unlike most, had made logical, sensible, and realistic plans for succession years ahead of time. The founders of these family controlled companies had all taken steps well in advance of their departure to ensure the long-term training of their eventual heirs.⁴⁹ Equally, the founders of successful Chinese family controlled companies groom their offspring for their eventual duties through practical involvement in the company coupled with "first class" university education.⁵⁰

Some successful Western family businesses such as Mars, Ford, and Sainsbury have avoided succession problems through the gradual integration of professional managers

⁴³ Heartland, supra n 9: also see generally "Fissiparous Fortunes and Family Feuds" *The Economist* (30 November 1996) 69.

⁴⁴ Buchholz & Crane, supra n 22 at 267-80.

⁴⁵ This seemed to be Mr Salomon's problem.

⁴⁶ Goldwasser, supra n 11 at 211.

⁴⁷ Cromie et al, supra n 24 at 14.

⁴⁸ Ibid.

⁴⁹ Goldwasser, supra n 11 at 211, 215-216.

⁵⁰ Kraar, supra n 20 at 112.

into the company's senior management. In this way, these family controlled companies have ensured that outside professional managers are in place so that the commitment and competence of the next generation is less crucial for the company's future.⁵¹ An excellent example of planned succession is the Merloni family's Elettrodomestici which produces refrigerators, cookers, washing machines and dishwashers. In 1993, Mr Merloni set up a committee of experts, including Renato Rivero, a former chairman of a large Italian company, and Joseph Bower, a Harvard academic, to prepare a plan for the succession process within the company. The committee came up with two main recommendations. The first was that Mr Merloni's twin sons and two daughters should have personal tutors taken from academia and the business world. The tutors would not only teach the children but also assess their prospective business talents. The other recommendation was that the company's succession process be designed so as not to alienate its professional management.⁵² Although Mr Merloni liked his children to eventually take over the family business, he believed that they must earn top positions within the company. Following this philosophy, the children started out at the bottom of their company's corporate ladder.⁵³

In a similar vein, Quek Leng Chan, head of the Hong Leong Malaysia conglomerate, "insisted that all his five brothers learn the company business by starting with the least responsible positions".⁵⁴ Also, the Kwek family, which controls the Hong Leong group in Singapore, worked out a succession plan well before the company/group founder died: one family member started out as a clerk in the father's trading company; three family members were sent abroad for studies; other family members were strategically placed within the group to work alongside professional managers.⁵⁵

Despite these notable exceptions, satisfactory successions in family controlled companies are the exception. There are signs that some Chinese family controlled companies are moving in the right direction.⁵⁶ In Canada, the business landscape is littered with family controlled companies that have fallen prey to internal squabbling over the succession process; the Birks, the Woodwards, the Gersteins, the Steinbergs, the McCains and the list goes on. A brief survey of these families illustrates how family disputes can cripple large successful family controlled companies to the point of bankruptcy. Apart from the McCains, all these family controlled companies either went into bankruptcy or were bought out after filing for bankruptcy.

Family feuds: Canadian family controlled companies

McCains, a multinational frozen food business, was rocked by a family dispute in the early 1990s when problems arose between two brothers, Wallace and Harrison, who had

⁵¹ "The Limits of Family Values", *The Economist* (9 March 1995) 10 at 17 [hereinafter Limits].

⁵² "Face Value: The Fridge Maker as Dynast", *The Economist* (28 September 1996) 100.

⁵³ *Ibid.*

⁵⁴ Semkow (I). *supra* n 20 at 20: see also Semkow (II), *supra* n 20 at 92.

⁵⁵ Semkow (1). *supra* n 20 at 25.

⁵⁶ See J Barnathan, "The Sons are Rising in the East" *Business Week* (6 December 1993) 64.

worked successfully as business partners since 1957.⁵⁷ The succession question was at the heart of the McCains' dispute.

Prior to 1991, the issue of succession would have been decided by the two brothers as equal partners in the business. However, in 1991, the brothers appointed a committee with the power to select successors. Some time later, in what Wallace alleged was an attempt by Harrison to take over the succession process, a majority of the company's board voted to remove Wallace from his responsibilities. After first launching a legal action, Wallace decided to respect the family's tradition of keeping company affairs private and agreed to use a private arbitrator to settle the dispute.⁵⁸ The arbitrator ruled in favour of Wallace's removal but Wallace remains a one-third owner and board member.⁵⁹

For decades, Birks jewellers was a successful pan-Canadian chain. Beginning in the late 1970s the company fell victim to family ownership struggles which persisted into the 1980s. In 1976, Drummond Birks squeezed out his cousin Robert Birks, leaving Drummond with sole control of the family business. Drummond then proceeded to promote his three sons to senior positions in the company. This move, however, eventually led to another ownership struggle, this time between siblings. In 1989, Thomas Birks offered to buy out his two brothers under the conditions of a 1988 "shotgun" agreement. Counter offers followed, and ownership was eventually left with Jonathan, the eldest of the three. Jonathan tried to reposition Birks in the market in order to appeal to young, affluent customers. However, this market strategy proved ill-fated when recession struck the Canadian economy and the company was left with heavy debts and unsaleable merchandise. Birks was forced to file for bankruptcy protection and was eventually purchased by an Italian gift-ware maker. The sale marked the end of 114 years of family ownership.⁶⁰

The Gerstein family lost control of People's Jewellers Ltd, another large Canadian jewellery store, when the company fell victim to a settling of accounts between Marvin Gerstein, the son of People's founder, and his nephew Irving. In the winter of 1992, Irving succeeded in ousting his uncle from People's board. In the summer of 1993, in what appeared to be an act of vengeance, Marvin voted against a plan that would have restructured the company's CDN \$200m debt to keep the company operating. As a consequence, People's went bankrupt and was subsequently bought by a brokerage executive at a bargain price.⁶¹

In 1989, Steinberg Inc, a Québec based grocery retailer chain which had stayed within the Steinberg family for almost sixty years was bought out by a group of outside investors in an effort to save the chain from falling into bankruptcy. The company was brought to the brink of bankruptcy after squabbling started amongst Sam Steinberg's daughters, Mitzi,

⁵⁷ B Dalglish, "Family Feud" *Macleans* (6 September 1993) 32 at 32-4.

⁵⁸ *Ibid.*

⁵⁹ J McFarland, "Companies move away from courtroom battles" *Globe & Mail* (22 November 1996) B-19.

⁶⁰ "Divided Dynasties", *Macleans* (6 September 1993) 38 at 38-9.

⁶¹ *Ibid.*

Evelyn and Marilyn. Infighting amongst the sisters broke out in 1986 when Mitzi proposed to sell the company. Outraged by their sister's proposal, Evelyn and Marilyn tried to remove Mitzi from the company's board. This in turn led to a prolonged court battle between the sisters which contributed to the company's financial difficulties as stores were closed and employees were laid off. Steinberg Inc eventually did go bankrupt and its assets were liquidated to other supermarket chains.⁶²

In the early 1990s after a protracted family dispute between rival cousins, Woodward's, a century-old family owned retail chain based in Western Canada, was bought out by another large Canadian retailer, the Bay. The family dispute began in 1985 when Grant MacLaren launched a takeover bid for the company. However, he was ultimately outmanoeuvred and stymied in court by his cousin Charles. The court battle left the family divided and the chain began to lose money. Despite efforts to restructure, the family could not stave off the 1990-1991 recession and was forced to sell out.⁶³

Family feuds: Chinese family controlled companies

Like their Canadian counterparts, Chinese families have lost control of companies because succession was left unresolved or a family dispute divided family members.⁶⁴ For example, as Semkow notes:

[...] in Singapore, the Teo family in 1992 were unable to present a unified front, and lost Malayan Credit in a joint takeover bid by Cycles and Carriage and Hotel Properties. The Techapaibuls once were one of the most powerful Chinese families in Bangkok. However, disagreements between the founder's ten sons, most of whom had two or more wives, and many offspring, over the future direction of the conglomerate was very divisive, almost tearing the group apart. The family focus was diverted, and the family conglomerate was eclipsed by other faster rising Chinese-Thai conglomerates.⁶⁵

Moreover, succession problems rocked such families as the Huangs, who controlled Teco, one the world's largest manufacturers of electric motors; and the Yeos, who controlled a food and beverage empire. In 1992, the Soeryadjayas lost control of Astra, Indonesia's second biggest company, because of enormous losses at the Bank of Summa which had been poorly run by one of the family's sons. Some Chinese family controlled companies have even been subdivided because of family infighting. For example, Sir Y K Pao, a Hong Kong billionaire, subdivided his company among four of his son-in-laws in order to put an end to family squabbling.⁶⁶ Climax International, a paper products company owned by the Fung family, was the scene of a very noteworthy family coup d'état In 1993. Kenneth, a western educated son of one of the original founders, succeeded in removing his uncle and his uncle's children from the company's board with

⁶² Ibid.

⁶³ Ibid.

⁶⁴ Semkow (I), supra n 20 at I4.

⁶⁵ Ibid.

⁶⁶ Also see D Biers & J Mark, "Succession Battles Shake Asia's Family Businesses" *Asian Wall Street Journal* (1 June 1995) 1 at I; Limits. supra n 52 at 17; for more discussion of the subdivision of Chinese family controlled companies, see Semkow (II), supra n 20 at 91.

the help of non-family shareholders. Kenneth staged his coup d'état after older family members sought to isolate him within the company because they did not approve of his plans for expanding the company.⁶⁷

Legal Solutions to the Problems of Family Controlled Companies

Family controlled companies may not necessarily be more prone to disputes than other business but the nature of the disputes tends to be more predictable. The Chinese adage that "wealth does not last more than three generations" appears to be firmly rooted in experience for all family controlled companies. The succession process which determines the control and future direction of the family controlled company, appears to pose the greatest difficulties. Sibling rivalry in the second generation may give rise to "cousin" rivalry in the third.

There is greater reluctance in family controlled companies to resort to judicial intervention and a greater premium placed on privacy. If anything, the aversion to litigation and the premium placed on privacy are more acute in Chinese family controlled companies, for a variety of reasons.

The overseas Chinese are reputed to be chary of state authorities, including the judiciary. As a merchant class, they have experienced state repression both on the mainland and in their adopted countries.⁶⁸ Confucianism, with its emphasis on presenting the impression of harmony within the family unit, has been cited as another reason for the avoidance of litigation. According to Redding, "the family boardroom may be the scene of the most bitter and vituperative quarrelling but it would be unthinkable not to present a united front to the world outside".⁶⁹ Informal solutions are much preferred over formal legal action, although this reticence to have recourse to judicial solutions may be diminishing in the face of changing times as more and more Chinese return from higher education in North America.

Related to the issue of dispute resolution is the protection of minority shareholders. As a family controlled business passes from generation to generation, the family holdings may become more fragmented, producing more minority interests within the family. In publicly traded companies, the majority interest may be held by a family group, leaving the public shareholders in the minority and, in most circumstances, effectively disenfranchised.

In addition, the existence of a large family holding may result in a small publicly traded float, making the market for the shares relatively illiquid. For a minority shareholder in such a company, the option of selling into the market in the event of unhappiness with the state of the company's affairs may in fact be illusory. Here too, the Chinese family controlled company may demonstrate some differences from other family controlled companies. Confucianism, it is said, has taught the Chinese to put the good of the family

⁶⁷ N Vittachi, "Fighting Over Family Values" *South China Morning Post* (10 March 1996) 3.

⁶⁸ See generally Redding, *supra* n 20 at 45.

⁶⁹ *Ibid* at 54.

ahead of its individual members. In the context of family controlled companies, it is important that the family as a whole derive wealth from the company. If disgruntled family members benefit indirectly from this wealth, then they should have no reason to complain.

The phenomenon of "shareholder apathy" may also be more pronounced in Chinese family controlled companies that are publicly traded than in their Western counterparts. Investment decisions may be made based primarily on the identity of and the investor's personal relationship to the controlling shareholder; once the initial decision to invest is made, investors take their lumps. Unhappy minority shareholders neither make waves nor benefit from any great solicitude on the part of the majority. This state of affairs, however, is based on assumptions which are now being transformed. With greater internationalisation of capital markets and the rise of institutional investors, especially American, minority shareholders in publicly traded Chinese family controlled companies may prove to be more demanding than in the past.

So, despite some differences in degree, Chinese family controlled companies share much in common with their Western counterparts. They are similar in terms of corporate form and size, in addition to demonstrating the same strengths and weaknesses. Family is family. Although Chinese family controlled companies are particularly non-litigious, all family controlled companies have the cross-cultural trait of being prone to predictable family disputes yet having the competing desire to keep family squabbles private.

This conclusion has implications for company law regimes in Asia. There would not appear to be a necessity for creating a culturally specific form of business entity for the Chinese family controlled enterprise. There would appear to be great merit in promoting non-litigious forms of dispute resolution. And, in the interests of accommodating rapidly maturing capital markets, a range of minority shareholder protections would be welcome.

As for alternative dispute resolution, to cite another adage, an ounce of prevention is worth a pound of cure. In private family controlled companies, shareholder agreements can provide consensual mechanisms, agreed to in advance, for the resolution of possible disputes. There are any number of contractual formulations of rights of first refusal, so-called "shot gun" clauses and various other buy-out provisions which serve to resolve shareholder disputes without recourse to litigation. They are usual in partnership agreements and quite in keeping with the nature of private companies.

Arbitration and mediation would seem especially well suited to settling differences in the family controlled company. Since the business partners often go home to have dinner with each other, informal and non-adversarial dispute resolution is preferable to litigation. Privacy is a major concern. The use of arbitration and mediation keeps disputes out of the public eye; neither the proceedings nor the awards are public. Mediation, which unlike arbitration is not binding on the parties, has proved so successful in avoiding litigation that in at least one jurisdiction in Canada it is now a mandatory pre-condition to proceeding with any non-family law civil litigation.

Litigation is the least desirable means of resolving disputes in any jurisdiction. It is slow, often destructive, and in places like Hong Kong, prohibitively expensive. As well, in Asia there is the well documented cultural bias against public litigation.⁷⁰ As a practical matter, it is simply not highly effective.

Does this mean that there is little utility in providing statutory shareholders remedies? Not necessarily. Some statutory remedies in effect offer an alternative to litigation by creating, in statutory form, the dispute resolution mechanisms often found in contractual arrangements. The so-called buy-out or appraisal remedy is a good example of this. And despite a reluctance to resort to judicial intervention on the part of family shareholders, statutory remedies do play an effective deterrent role. Their importance should not be discounted. There is no silver bullet for what ails minority shareholders in family controlled companies: "... no single technique of accountability (including market and legal remedies) is likely to be optimal under all circumstances. Each has its characteristic and well known limitations, and, as a result, shareholders are best served by an overlapping system of protections".⁷¹

In Hong Kong (where there was a strong perception of minority shareholder abuse, irrespective of the reality), it was suggested that overlapping and alternative remedies were preferable to inadequate ones. A panoply of remedies was suggested; a broad unfairly prejudicial remedy (likely to be the remedy of choice), a statutory derivative action (primarily to put to rest the noisome ghost of *Foss v Harbottle*), a statutory compliance and restraining order, a fairly traditional just and equitable winding-up remedy (for cases of deadlock which does not amount to oppression), and the US-style appraisal or buy-out remedy.⁷²

The suggestion of an appraisal or buy-out remedy proved somewhat controversial in working parties involved in the Review of the Hong Kong Companies Ordinance. Neither the United Kingdom nor Australia has a similar remedy.⁷³ Given the desirability of developing self executing mechanisms to protect minority shareholders and to avoid public litigation, however, the buy-out remedy seems admirably suited to the family controlled company, both private and public. The buy-out remedy permits an unhappy shareholder to leave a company which has decided for quite legitimate commercial reasons, to embark on a fundamental change in course. There is usually support for such a decision by the great majority of shareholders. The statutory buy-out remedy gives shareholders the right to have the company buy their shares upon the occurrence of

⁷⁰ See generally P Lawton, "Corporate Governance and Informal Decision Making: the Theoretical and Practical Limits of Hong Kong's Legal Regime" (1995) 1:1 *Corporate Governance Quarterly* (1995), 1:2 *Corporate Governance Quarterly* 29.

⁷¹ ALI, *supra* n 13, The Derivative Action. Introductory Note, at 5.

⁷² see *Consultancy Report*, *supra* n 7.

⁷³ A paper by the UK Law Commission suggested a very limited variation which involved a court ordered purchase of a shareholder's interest in very small companies on the basis of exclusion from management. (Great Britain, Law Commission. *Shareholder Remedies* (Consultation Paper No 142) by the Honourable Mrs Justice Arden (Chairman) DBE, Andrew Burrows. Diana Faber, Charles Harpum. Stephen Silber. QC (London: HMSO. 1996)).

certain fundamental changes in the company, such as a decision to merge with another company or variations to share conditions.

The beauty of the remedy lies in the fine balancing of minority shareholder interests and management freedom of action (together with the non-judicial nature of its operation). The company may proceed unimpeded on its course of action provided it buys out the unhappy shareholder; there is no necessity for judicial intervention unless a dispute arises as to the valuation of the shareholder's interest.

The attractiveness of the buy-out remedy is fairly obvious in the context of private family controlled companies. There is no market for an unhappy shareholder's shares. In the absence of carefully crafted contractual provisions which would permit a shareholder to transfer its holdings or be bought out, such shareholders may have no recourse available to them. For publicly traded family controlled companies in Asia, the buy-out remedy may be of particular significance. For shareholders in widely held companies which have well developed markets for their securities, the value of the buy-out remedy is controversial. A shareholder unhappy with management's course of action can sell into the market. Where there is little liquidity in the public market, as is often the case with family controlled public companies, the market exit option may be illusory. For this reason, the Listing Division of the Stock Exchange of Hong Kong was cautiously in favour of introducing such a remedy in Hong Kong.

On the question of a market in the shares, it must be admitted that, in the case of many HK second and third-liners, the market may be lacking in true liquidity. Further, there would of course be no market in the case of suspensions.

On balance, and provided that the introduction of the remedy would not result in an alternative "market" to the Exchange, we see merit in providing an equitable exit route for dissentient shareholders, provided that the remedy did not prove irreconcilable with the Listing Rules.⁷⁴

Conclusion

Family controlled companies are in no way unique to Asia; they are an important commercial phenomenon across all economies. Equally, despite their distinctive features, Chinese family controlled companies are, for the most part, very similar to their Western counterparts in terms of corporate form and size, in addition to sharing the same strengths and weaknesses. Although Chinese family controlled companies are particularly non-litigious, all family controlled companies have the cross-cultural trait of being prone to family disputes yet having the competing desire to keep family squabbles private. Accordingly, legal devices prevalent in many Western jurisdictions, such as shareholder agreements, arbitration and mediation as well as statutory remedies, should be adaptable to Asia.⁷⁵

⁷⁴ Letter of Stock Exchange of Hong Kong (Listing Division) to the Review (2 September 1996).

⁷⁵ For analysis and discussion of these remedies see generally. Beck, "The Shareholders' Derivative Action" (1974) 52 CBR 159; B Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988) 10 *University of Pennsylvania Journal of International Business Law* 305; I G MacIntosh, "The

Oppression Remedy: Personal or Derivative?" (1991) 70 *CBR* 29; J G Macintosh, "The Shareholders' Appraisal Remedy in Canada: A Critical Reappraisal" (1988) 13 *Canada-United States LJ* 299; M A Maloney. "Whither the Statutory Derivative Action?" (1986) 64 *CBR* 309; K W Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*" [1957] *Cambridge LJ* 194, [1958] *Cambridge LJ* 93; B Welling. *Corporate Law in Canada*, 2nd ed, Toronto: Butterworths, 1991; P G Xuereb. *The Rights of Shareholders*. London: BSP Professional, 1989 at 163-76.