4.1 Research objective

The degree of misalignment of ownership and control has been regarded as a good indicator of corporate governance. Thus, this research is aimed at measuring the separation of ownership and control before and after the establishment of SinoPac Holdings Corp. LTD from the ultimate owner’s perspective. The ultimate owner, for the purpose of this research, is the Hong family. Prior to the establishment of the SinoPac Holdings, the Hong family was a controlling shareholder of the National Securities.

By studying the cash flow rights and control of the Hong family, this research is intended to examine whether SinoPac Holdings leads to a better alignment between the Hong family’s ownership and control compared to the pre-SinoPac Holdings era, i.e. National Securities. If the formation of SinoPac Holdings leads to better alignment between ownership and control as far as the Hong family is concerned, then the conclusion can be drawn that FHC achieves better corporate governance in the Hong family case. On the contrary, if FHC in fact leads to greater misalignment, then FHC may well serve as a mechanism to further separate ownership and control.

4.2 Data

4.2.1 Sources

- 2002 SinoPac Holding Co., LTD. prospectus
- 2003 Business Groups in Taiwan
- 2002 Business Groups in Taiwan
- 2002 Bank SinoPac financial reports
- 2002 SinoPac Securities Corp. financial reports
- Taiwan Economics Journal database
- Market Observation Post System
- SinoPac Holdings website

4.2.2 Cross-comparison

Since some of the above data sources, such as financial reports, SinoPac Holdings’ prospectus, publications of China Credit Service, are static, they have to be used in comparison with other dynamic information sources like Market Observation Post System in order to plug the time gap.

4.3 Research methods

4.3.1 Definition of ultimate owner

For the purpose of this research, the shareholdings of the Hong family is chosen as the subject of this study. Richard M. Hong is the Chairman of SinoPac Holdings and the business leader of the Hong family. Thus, this research will treat the Hong family as the ultimate owner of SinoPac Holdings. However, there may well be another ultimate owner(s), but this research will not cover that part. Because of this,
the entire research will be based on the Hong family’s cash flow rights, control and deviations between the two.

4.3.2 Measuring ownership

In terms of cash flow rights measurement, there is a consensus on the calculation of cash flow rights.

The total cash flow rights of the ultimate owner is equal to the sum of the ultimate owner’s direct and indirect shareholdings in the company.¹

\[
\text{The ultimate owner’s cash flow rights} = \text{The ultimate owner’s total direct shareholdings of the company} + \text{The ultimate owner’s total indirect shareholdings of the company}
\]

4.3.3 Measuring control

Different methods have been introduced to calculate the control rights, among which are methods introduced by La Porta et al. and Claessens et al.

1) In accordance with La Porta et al. (1999), the ultimate owner’s control rights are equal to the ultimate owner’s direct shareholdings in the company plus the sum of the last links in the chains of voting rights.

\[
\text{The ultimate owner’s control rights} = \text{The ultimate owner’s direct shareholding in the company} + \text{the sum of the last links in the chains of voting rights}
\]

¹ See 許崇源 et al., 2003.
2) Claessens et al. (2000) define the control rights as the ultimate owner’s direct shareholdings in the company plus the sum of the weakest links in the chains of voting rights.

The ultimate owner’s control rights = The ultimate owner’s direct shareholding in the company + the sum of the weakest links in the chains of voting rights

The method introduced by La Porta et al. in calculating control rights overlooks the importance of other links down the chains of voting rights. Therefore, this model cannot really reflect the control truly exercised by the ultimate owner. For example, if the first link of the chain of voting rights is minimal, then it does not matter whether the last link is optimal given that the ultimate owner’s control is very weak as far as that specific chain of voting rights is concerned. Claessens et al. take different approach by using the weakest links in the chains of voting rights to determine the ultimate owner’s indirect control. In order to reflect the reality as much as possible, this research adopts Claessens’ method because it can better reflect the reality.

4.3.4 Control measured by board seats ratio

In response to Taiwan’s unique corporate features, Shen and Wu (2003) introduce a method which calculates control from the perspective of board member ratio. Shen and Wu cite Taiwan’s banking problems as examples, demonstrating the
important role played by board of directors. Most of problems in the banking industry occurred in the past decade were largely attributed to board members’ misconduct, such as unauthorized or unlawful loans to board members’ affiliated businesses. Due to this, Shen and Wu stress the importance of not overlooking the significant role played by board of directors when corporate governance is concerned. The greater the misalignment is between a board member’s ownership and control, the more likely moral hazard will take place. As a result, Shen and Wu devise an index to measure the misalignment between ownership and control over board seats of the controlling shareholders. This is referred to as the local Moral Hazard Index.

The ultimate owner’s board seats ratio equals the cubic root of the product of non-executive directors ratio multiplied by executive directors ratio multiplied by board members ratio.

\[
\text{The ultimate owner’s board seats ratio} = (\frac{\text{non-executive directors ratio} \times \text{executive directors ratio} \times \text{board members ratio}}{\text{}})^{\frac{1}{3}}
\]

4.3.5 **Measuring the separation of ownership and control**

1) La Porta et al. define deviation as control rights minus cash flow rights

\[
\text{Deviation} = \text{Control rights} - \text{Cash flow rights}
\]
2) Claessens et al. define ‘wedge’ as cash flow rights divided by control rights

\[
\text{Wedge} = \frac{\text{Cash flow rights}}{\text{Control Rights}}
\]

3) Moral Hazard I: measuring separation as the amount of capital controlled per unit of capital owned (Bianchi, Bianco and Enriques, 2001). As La Porta et al. state, indirect shareholding contributes to the increase in Moral Hazard I.

\[
\text{Moral Hazard I} = \frac{\text{Amount of capital controlled}}{\text{Per unit of capital owned}}
\]

4) Shen and Wu (2003) have introduced the local Moral Hazard Index model, or otherwise referred to as Moral Hazard II. This index is calculated as the ultimate owner’s board seats ratio divided by cash flow rights.

\[
\text{Moral Hazard II} = \frac{\text{Board seats ratio}}{\text{Cash flow rights}}
\]

The greater the Moral Hazard II is, the actual capital contributed by the owner is relatively small and the ultimate owner’s voting powers in the board is disproportionately greater.
Figure 4.1: SinoPac Holdings structure chart

Source: 2003 Business Groups in Taiwan
Figure 4.2: Hong family shareholding structure in SinoPac Holdings

The Hong Family

28.62%*

Hong Yu Investment Corp., LTD.

49.68%

National Holding

1.89%

100%

Sino Pac Holdings Co., LTD.

100%

10.90%**

Sino Pac Holdings Co., LTD.

100%

Bank SinoPac

SinoPac Securities Corporation

Source: 2003 Business Groups in Taiwan, China Credit Information Service, LTD.

* 洪敏超(22.1%), 黃愛惠(4%), 洪敏弘(2.5%), 黃昭文(0.02%) Total = 28.62%

** 洪敏弘(7.61%), 洪敏超(3.29%) Total = 10.90%
Table 4.1: Composition of SinoPac Holdings board of directors
(serving for a term of three years commencing on 9 May 2001)

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Director</td>
<td>洪敏弘* (National Holding Co., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>尹衍樑 (Jin An Investment Co., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>盧正昕 (Individual)</td>
</tr>
<tr>
<td>Director</td>
<td>葉天政 (Jin An Investment Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>洪裕人* (National Holding Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>許道義* (National Holding Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>黃敏助* (National Holding Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>陳開元 (東碱股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>許忠明 (華承投資股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>徐正材 (瑞孚投資股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>陳柏昌 (Individual)</td>
</tr>
</tbody>
</table>

*Directors represent companies controlled by the Hong family

Source: SinoPac Holdings Prospectus and Market Observation Post System

4.4 The Hong Family and SinoPac Holdings

4.4.1 Cash flow rights

The Hong family’s direct and indirect shareholdings in SinoPac Holdings Co., LTD. So,
its Cash flow rights = (28.62%)×(1.89%) + (28.62%)×(49.68%)×(3.79%) + (10.9%)×(3.79%) = 0.541% + 0.539% + 0.413% = 1.493%

4.4.2 Control rights

The Hong family’s direct shareholdings in the company plus the sum of the weakest links in the chains of voting rights. So, its

Control rights = 0% + \( \min \{28.62\%, 1.89\%, 49.62\%, 10.9\%, 3.79\%\} \) = 1.89%

※Note: Single chain approach is adopted in calculating control. As Hsu et al. (2003) suggest, multiple-chain approach is likely to overstate control.

4.4.3 Board seats ratio

The Hong family’s board seats ratio equals the cubic root of the product of non-executive directors ratio multiplied by executive directors ratio multiplied by board members ratio. So, its

Board seats ratio = \( \left( \frac{3}{8} \times \frac{1}{3} \times \frac{4}{11} \right)^{1/3} = (0.0455)^{1/3} = 35.7\% \)

4.4.4 Separation of ownership and control

a. La Porta’s deviation = Control rights − Cash flow rights

= (1.89%) − (1.493%) = 0.397%

b. Claessens defines ‘wedge’ = Cash flow rights divided by control rights = 1.493% ÷ 1.89% = 0.78995

c. Moral Hazard I = 1.89% ÷ 1.437% = 1.31524
d. Moral Hazard II = board seats ratio divided by cash flow rights =

\[ 35.7\% \div 1.493\% = 23.91 \]

4.5 The Hong family and Bank SinoPac

Table 4.2: Composition of Bank SinoPac board of directors

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Director</td>
<td>鯤正昕 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>尹衍樑 (SinoPac Holdings Co., LTD./ Jin An Investment Co., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>陳柏蒼 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>賈監一 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>葉天政 (SinoPac Holdings Co., LTD./ Jin An Investment Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>林英峰 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>黃崇興 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>陳開元 (SinoPac Holdings Co., LTD./ 東碱股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>許忠明 (SinoPac Holdings Co., LTD./ 華承投資股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>李成家 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>李天傑 (SinoPac Holdings Co., LTD./ Jin An Investment Co., LTD.)</td>
</tr>
</tbody>
</table>

Source: Bank SinoPac 2002 Annual Reports

※Note:
1. The above directors were elected on April 19, 2001 with a term of three years.
They were appointed by SinoPac Holdings on 9 May 2002 to resume the remaining term.

2. Since the Hong family was not a major shareholder of Bank SinoPac prior to the establishment of SinoPac Holdings, therefore, the Hong family did not have control over Bank SinoPac.

4.5.1 **Board seats ratio**

\[
= \left( \frac{0}{8} \times \frac{0}{3} \times \frac{0}{11} \right)^{1/3} = 0
\]

4.5.2 **Moral Hazard II** = board seats ratio divided by cash flow rights = 0 ÷ 1.493% = 0

4.6 **Hong family and SinoPac Securities Corp.**

**Table 4.3: Composition of SinoPac Securities Corp. board of directors appointed by SinoPac Holdings on 7 April 2003**

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Director</td>
<td>黃敏助* (SinoPac Holdings Co., LTD / Hong Yu Investment Corp., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>黃愛惠* (SinoPac Holdings Co., LTD / Hong Yu Investment Corp., LTD.)</td>
</tr>
<tr>
<td>Executive Director</td>
<td>鄭丁旺 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>Outside Director</td>
<td></td>
</tr>
<tr>
<td>Director</td>
<td>(許道義* (Sino Pac Holdings Co., LTD / 國際電化商品公司))</td>
</tr>
<tr>
<td>Director</td>
<td>涂宗典* (SinoPac Holdings Co., LTD / 國際電化商品公司)</td>
</tr>
<tr>
<td>Director</td>
<td>江瑞塘 (SinoPac Holdings Co., LTD / 瑞孚投資)</td>
</tr>
<tr>
<td>Director</td>
<td>莊坤榮* (SinoPac Holdings Co., LTD / 弘裕國際財務管理顧問公司)</td>
</tr>
<tr>
<td>Director</td>
<td>張立荃 (SinoPac Holdings Co., LTD.)</td>
</tr>
<tr>
<td>-------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td>Outside Director</td>
<td>陳世平 (SinoPac Holdings Co., LTD.)</td>
</tr>
</tbody>
</table>

* Directors served in previous board who represented companies affiliated with the Hong family

Source: SinoPac website in cross-comparison with SinoPac Securities Corp. 2002 annual financial reports

※ Note:
1. Since the shareholding structure is based on 2003 Business Groups in Taiwan published by China Credit Service, LTD. in January 2003. The information presumably is based on late 2002 data. However, the latest board of directors was appointed on 7 April 2003. Thus, there left a time gap. In order to explore whether there was any changes in the shareholdings of National Holdings Co., LTD. and Hong Yu Investment Corp., LTD. in SinoPac Holdings, steps were taken to check whether these two companies’ shareholdings changed during this period of time by using the Market Observation Post System. No significant changes in shareholdings during this period of time have been noticed.
2. The five directors identified (designated with “*”) also served as members in the previous board, representing companies affiliated with the Hong family.

4.6.1 **Board seats ratio** = \[
\frac{(3/6) \times (2/3) \times (5/9)}{1/3} = (0.185)^{1/3} = 56.98% \]

4.6.2 **Moral Hazard II** = board seats ratio divided by cash flow rights = 56.98% 
\[
\div 1.493% = 38.1648
\]
4.7 The Hong Family and National Securities

- **Figure 4.3:** Hong family shareholding structure in National Securities

![Diagram showing shareholding structure]

The Hong Family

- 28.62%*

Hong Yu Investment Corp., LTD.

- 49.68%

National Holding

- 5.08%

- 12.6%

National Securities Corp.

- 2.22%

National Affiliates Corporation

- 100%***

*洪敏超(22.1%), 黃愛惠(4%), 洪敏弘(2.5%), 黃昭文(0.02%) Total = 28.62%

**洪敏弘(7.61%), 洪敏超(3.29%) Total = 10.90%

***The Hong family is regarded as having 2.2% direct cash flow rights over National Securities

Source: 2002 & 2003 Business Groups in Taiwan

※Note:
1. 2002 Business Groups in Taiwan does not disclose the major shareholders in
both Hong Yu Investment Corp., LTD. and National Holding Co., LTD. so the information disclosed in the 2003 Business Groups in Taiwan is used to calculate the Hong family’s shareholdings in these two companies.

2. National Affiliates Corporation is not a public company so there is no way of knowing its exact shareholding structure. Thus, this study adopts the approach of Hsu et al. (2003) by according all the cash flow rights of the unlisted company to the ultimate owner. In this case, National Affiliates Corporation has direct cash flow rights of 2.22% in National Securities Corp. so all the 2.22% cash flow rights will be accorded to the Hong family.

Table 4.4: Composition of the Board of National Securities Corp. as in September 2001

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive</td>
<td></td>
</tr>
<tr>
<td>Director</td>
<td>黃敏助* (Hong Yu Investment Corp., LTD.)</td>
</tr>
<tr>
<td>Executive</td>
<td></td>
</tr>
<tr>
<td>Director</td>
<td>黃愛惠* (Hong Yu Investment Corp., LTD.)</td>
</tr>
<tr>
<td>Executive</td>
<td></td>
</tr>
<tr>
<td>Director</td>
<td>張秀政 (鴻禧酒店股份有限公司)</td>
</tr>
<tr>
<td>Director</td>
<td>黃文治* (Hong Yu Investment Corp., LTD.)</td>
</tr>
<tr>
<td>Director</td>
<td>林哲生* (National Affiliates Corporation)</td>
</tr>
<tr>
<td>Director</td>
<td>許道義* (National Affiliates Corporation)</td>
</tr>
<tr>
<td>Director</td>
<td>涂宗典* (National Affiliates Corporation)</td>
</tr>
<tr>
<td>Director</td>
<td>許正義</td>
</tr>
<tr>
<td>Director</td>
<td>江瑞璣 (瑞孚投資股份有限公司)</td>
</tr>
</tbody>
</table>

* Directors represented companies controlled by the Hong family

Source: National Securities Corp. LTD. 2001 annual financial reports
4.7.1 **Cash flow rights** = The Hong family’s direct and indirect shareholdings in National Securities Corp.

Cash flow rights = (100%) x (2.22%) + (10.90%) x (12.6%) + (28.62%) x (49.68%) x (12.6%) + (28.62%) x (5.08%) = (2.22%) + (1.3734%) + (1.7915%) + (1.4539%) = 6.8388%

4.7.2 **Control rights** = The Hong family’s direct shareholdings in the company plus the sum of the weakest links in the chains of voting rights.

Control rights = 2.22% + min { 28.62%, 49.62%, 10.9%, 12.6%, 5.08% } = 2.22% + 5.08% = 7.30%

4.7.3 **Board seats ratio** = The Hong family’s board seats ratio equals the cubic root of the product of non-executive directors ratio multiplied by executive directors ratio multiplied by board members ratio.

Board seats ratio = \( \left( \frac{4}{6} \times \frac{2}{3} \times \frac{6}{9} \right)^{1/3} \) = \( (0.296)^{1/3} \) = 66.64%

4.7.4 **Separation of ownership and control**

a. La Porta’s deviation = Control rights − Cash flow rights

= (7.30%) − (6.8388%) = 0.4612%

b. Claessens defines ‘wedge’ = Cash flow rights divided by control rights

= 6.8388% ÷ 7.30% = 0.9368

c. Moral Hazard I = 7.30% ÷ 6.8388% = 1.067
d. Moral Hazard II = board seats ratio divided by cash flow rights =

\[ \frac{66.64\%}{6.8388\%} = 9.744 \]

Table 4.5: Table of Comparison

<table>
<thead>
<tr>
<th></th>
<th>SinoPac Holdings</th>
<th>National Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow rights</td>
<td>1.493%</td>
<td>6.8388%</td>
</tr>
<tr>
<td>Control rights</td>
<td>1.89%</td>
<td>7.30%</td>
</tr>
<tr>
<td>Board seats ratio</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SinoPac Holdings</td>
<td>35.7%</td>
<td></td>
</tr>
<tr>
<td>Bank SinoPac</td>
<td>0%</td>
<td>66.64%</td>
</tr>
<tr>
<td>SinoPac Securities</td>
<td>56.98%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Misalignment of ownership and control</th>
</tr>
</thead>
<tbody>
<tr>
<td>La Porta’s deviation</td>
</tr>
<tr>
<td>Classens’ ‘wedge’</td>
</tr>
<tr>
<td>Moral Hazard I</td>
</tr>
<tr>
<td>Moral Hazard II</td>
</tr>
<tr>
<td>SinoPac Holdings</td>
</tr>
<tr>
<td>Bank SinoPac</td>
</tr>
<tr>
<td>SinoPac Securities</td>
</tr>
</tbody>
</table>