

## Equity Financing and Emission of Shares

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### Abstract

Commercial companies and corporations are created to achieve a common economic objective, which is the maximization of profit. Nevertheless, the existence of the initial capital in itself might be insufficient for achievement of maximization of profit. Therefore, during its activity, the company might encounter the need for increase in the capital. Equity financing is financing conducted through the acquisition of equity, which is the part of capital that is not debt materialized in shares owned by the company. Newly emitted and existing shares are traded in regulated markets such as the stock market. It must be stressed that this method of investment has certain risks to it, because if the company is liquidated or goes bankrupt, than the shareholders owning normal shares are the last in the order of preference to take the share that they have invested in the company, after the creditors and preferential shareholders.

**Keywords:** Commercial companies, corporations, initial capital, equity financing, shareholder, creditor, law, EU Directive 2017/1132.

### 1. The Creation of Commercial Companies and Corporations

Commercial companies and corporations are created to achieve a common economic objective, which is the maximization of profit. In order to achieve the purpose for which they are created, it is necessary that corporations have an initial capital, which serves to the principal economic objective of the company. This capital should be present from the very first moment of the creation of the company and is deposited according to the specifications in the statute of the company.<sup>1</sup>

Nevertheless, the existence of the initial capital in itself might be insufficient for achievement of maximization of profit. Therefore, during its activity, the company might encounter the need for increase in the capital. In the moment that the company finds itself before the need to increase its capital, it should select the most efficient method of financing available, with the aim of accumulating the required capital in due time at the lowest cost possible. Before the company takes a decision regarding its financing, it should have full knowledge on its internal sources of financing,<sup>2</sup> so that it is able to exclude certain methods of financing. In case that the company possesses no internal sources of financing it should resort to external ones, which are categorized into equity financing and debt financing.<sup>3</sup> They may be short-<sup>4</sup> medium-<sup>5</sup> or long-term.<sup>6</sup> For the purpose of this essay, I shall focus only on equity financing as it is one of the most efficient financing methods of joint-stock companies (hereinafter, referred to as "JSC") and since it is still quite novel in the Albanian reality.

### 2. Equity Financing

Equity financing is financing conducted through the acquisition of equity, which is the part of capital that is not debt

<sup>1</sup> Article 3 of the law Nr. 9901, dated 14.04.2008 "On entrepreneurs and commercial companies".

<sup>2</sup> I.e. all assets, savings or undistributed profit of the company.

<sup>3</sup> Watson, Deniz; Head, Antony, *Corporate Finance Principles and Practice*, Prentice Hall Financial Times, 2007, 5<sup>th</sup> Ed., p. 31

<sup>4</sup> Financing realized via short-term debt titles with a maturity term of less than one year.

<sup>5</sup> Financing realized via loans or debt titles with a maturity term of up to five years.

<sup>6</sup> Financing realized via long-term loans and long-term title emission with a maturity term longer than five years.

materialized in shares owned by the company.<sup>7</sup> The capital of JSCs is composed of actions which have two attributes: they represent the capital of the company, and they constitute financial instruments that can be traded in the market. Therefore, if the company is in the right conditions to emit shares, it can use these titles to accumulate capital from outside the company. The company only has the opportunity to choose the type of shares it wants to emit. It can also choose the source from which the capital will be generated: from inside shareholders or from outer investors.

### 3. Emission of Redeemable Shares

Another alternative of this type of financing is emission of redeemable shares.<sup>8</sup> These shares offer guarantees to the investors, because they can be re-bought from the company itself if it has enough capital. They are particularly preferred from those investors who do not wish to remain attached to their investment and who want their shares to have liquidity at any moment. This method may change the structure of the ownership over the company's shares and subsequently amend the political and financial rights of the shareholders. In order for the shareholder to keep their initial property relations intact, they benefit from the right of pre-emption, if the statute envisions it.<sup>9</sup>

Newly emitted and existing shares are traded in regulated markets such as the stock market. It must be stressed that this method of investment has certain risks to it, because if the company is liquidated or goes bankrupt, than the shareholders owning normal shares are the last in the order of preference to take the share that they have invested in the company, after the creditors and preferential shareholders. Being that normal shares bear more risks compared to other methods of investment, shareholders investing in these shares should expect a higher turnout of their investment. Consequently, they should expect their share of profit to be higher than that of preferential shareholders.<sup>10</sup>

From the creditors' perspective, the generated capital is a fund owned by the company, which cannot be allocated to the shareholders or other creditors, unless it protects the interests of the creditors of the company. The capital represented by the shares represents:

- An instrument allowing its owners to collect profit in the form of dividend, which is distributed discretionarily by a decision of the general assembly of the company or according to its statute;
- Financing for the needs of the company for capital;
- Assets owned by the company which can be allocated to investors only after the interests of other interest groups are ensured;
- A certain category of assets reflected in the company's balance sheet.<sup>11</sup>

Unlike before the entrance into force of law "On Titles" nr. 9879, dated 21.02.2008 when shares were materialized in the share certificate,<sup>12</sup> with the changes that the new law introduced, shares are dematerialized and registered electronically in a share account in the computer system of the registrar,<sup>13</sup> via which the issuer undertakes to fulfill the obligations contained in the titles to towards the rights' holder. Shares may be emitted only through a public offer.<sup>14</sup> The transfer of dematerialized shares is conducted by their owner through an authorized intermediary company. The title certificate only serves *ad probationem*, as the law requires the owner of the share to be registered at the pertaining register of the company for the exercise of rights deriving from the ownership of shares.

Emission of such shares offer guarantees to shareholders, as they may leave the company at any moment, by requesting the company to buy its own shares. Nevertheless, investors are put back from the risk of remaining in that company, because existing shareholders may not be interested in buying their shares or because they may not possess liquidity.<sup>15</sup> The acquisition of shares from the company itself is allowed only in limited cases<sup>16</sup> with the condition that these

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<sup>7</sup> Agarwal, O. P., *Corporate Financial Policy*, Himalaya Publishing House, 2009, 1<sup>st</sup> Ed., P. 11.

<sup>8</sup> Shares which the company can later re-purchase.

<sup>9</sup> I.e. shares which are recently emitted must first be offered to the existing shareholders for purchase.

<sup>10</sup> Watson, Denzil; Head, Antony, *Corporate Finance Principles and Practice*, Fourth Edition, Prentice Hall Financial Times, 2007, p. 98

<sup>11</sup> Mantysaari, Petri, *The Law of Corporate Finance: General Principles and EU Law*, Springer 2010, p. 132.

<sup>12</sup> The repealed law "On Securities (in Albanian: *Per letrat me vlerë*)", Nr. 8080, dated 01.03.1996, did not envision dematerialized titles on any of its provisions.

<sup>13</sup> The Registrar is a joint stock company created with the purpose of keeping records of titles and all the steps undertaken for their transfer.

<sup>14</sup> Article 117 of law "On titles", Nr. 9879, dated 21.02.2008.

<sup>15</sup> Ferran, Eilis, *Principles of Corporate Finance Law*, Oxford University Press, 2008, p. 203.

shares are re-sold or annulled within one year from the day that they are bought.<sup>17</sup>

The annulment of these shares is allowed only if it is allowed by the statute or a decision amending the statute, taken before the assigning the shares which shall be annulled, and if the owners of these shares consent to the annulment. If the shareholders consent, it is not necessary for the statute to allow their annulment.<sup>18</sup> Nonetheless, in order for more guarantees to be offered to the company's shareholders, the law envisions that share annulment should be subjected to the conditions for ordinary reduction of capital and that this decision should be taken by the administrators of the company. Additionally, according to article 181 of the law "On Entrepreneurs and Commercial Companies", shareholders whose rights will be affected by the annulment should consent and the obligation in regards of minimum registered capital should be respected.<sup>19</sup>

Furthermore, the company should also take into consideration the rights of its creditors. Creditors who raise related claims after the date of publication of the decision on reduction of capital have the right to take sufficient guarantees by the company in relation to the credits which were not yet demandable before the publication of the decision. This right can be exercised only if the creditors request the guarantee within ninety days from the date of publication.<sup>20</sup>

#### 4. EU Directive 2017/1132 Regulation

If we analyze EU Directive 2017/1132 codifying certain aspects of company law, we reach the conclusion that the Directive makes a more detailed regulation of this situation.<sup>21</sup> More specifically, article 60 of the Directive envisions that the acquisition of shares from the company itself shall be bound by the following conditions:

- The general assembly should issue an authorization, specifying terms and conditions of the acquisition, as well as maximum purchasable number of shares, their minimum and maximum price and the term of validity of the authorization, which in any case shall not surpass five years;
- Nominal value of purchasable shares, including shares acquired earlier owned by the company and shares bought by a person acting on his own accord, but on behalf of the company, should not surpass 10% of the registered capital;
- Acquisition of shares from the company itself should not result in decrease of assets below the registered capital, or in non-distributable stocks;
- Only fully liquidated shares can be part of this transaction.

The directive has made a comprehensive regulation of the process, whereas our law contains only one provision which is incomplete. Firstly, our law does not specify the authorizing organ and the conditions of authorization. It also does not envision the relevant procedure for the acquisition of shares. Secondly, the law does not set any standard in regards of retention of registered capital.

The directive is more detailed when it provides that authorization of the assembly should specify the duration and purchase value of shares, by setting limits to the possibilities of administrators during the acquisition of shares. Additionally, the directive envisions a very important condition regarding annulment or self-acquisition of shares; that they should have been previously fully liquidated.

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<sup>16</sup> Articles 223 (1), 227 (2) and 229 (5) of law "On Entrepreneurs and Commercial Companies" entail that shares may be acquired by company itself when:

- a) A minority shareholder requests the acquisition of his shares according to article 139 (2) of law "On Entrepreneurs and Commercial Companies";
- b) Owners of the remaining shares have the right to request from the company to reacquire these shares in market values, within 6 months from their request, when the mother company owns 90% or more of the shares of the subjugated company;
- c) Shareholders who object to the procedure of merger, alteration or division of the company have the right to request from the company created due to the procedure of merger, alteration or division, the acquisition of their shares in market value.

<sup>17</sup> Article 133 (4) of law "On Entrepreneurs and Commercial Companies".

<sup>18</sup> Article 186 (2) of law "On Entrepreneurs and Commercial Companies".

<sup>19</sup> Article 181 (2) of law "On Entrepreneurs and Commercial Companies".

<sup>20</sup> Article 181 (2) of law "On Entrepreneurs and Commercial Companies".

<sup>21</sup> Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification)

## 5. Conclusions

To conclude, based on this comparative analysis, we are of the opinion that our law should envision the possibility of emission of shares with the possibility of re-acquisition from the company itself, but on the other hand, it should detail the conditions regarding the realization of this process, such as appointing an administrator for this purpose, simultaneously defining the conditions in which he may acquire shares and the obligation of the company to retain the registered capital in the required amount, by keeping the non-distributable legal and statutory stocks intact.

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