

DISADVANTAGES OF MINORITY SHAREHOLDERS IN THE CASE OF AN INCREASE IN SHARE CAPITAL

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***Abstract:** Over time, in the activity of any company there is a time when we will find ourselves in a situation where we want to increase the share capital for various reasons: we want to bring a new partner into the company, to receive an investment by incorporating the issue bonuses, ask our trading partners to have a higher share capital for liability, we want to become a corporate tax payer on demand; we have financial difficulties, the extension of the object of activity: the territorial expansion of the company; purchase of installations, machinery, technologies; merger and division of the company. The increase in the share capital may also be imposed by legal regulations if, by decision of the government, the minimum ceiling of the share capital is changed (Article 10 of Law No 31/1990). .*

The paper asks to identify some aspects of the advantages that shareholders may encounter when an increase in share capital occurs.

***Keywords:** share capital, issue premiums, capital increase, shares, nominal value*

1. INTRODUCTION

Any economic entity in order to be established must constitute its share capital. Capital is an economic category in the form of cash, cash equivalents or goods intended for economic activity from which other goods and services are obtained, to be redeemed for profit.

Detailed accounting of the share capital shall be kept on each shareholder and shall show the number of shares, the nominal value of the shares subscribed and paid out and the total amount of the capital paid by the shareholder.

The nominal value of a share (V_{na}) is thus determined:

$$V_{na} = \frac{\text{Capital}_{social}}{\text{Nr.actiuni}}$$

The share capital shall be valued and recorded in the accounts at **the nominal value (VN)** indicated per share. In addition to this value, it is also operated with other categories of values, including:

1. **the accounting mathematical value (VMC)**, determined as the ratio between equity and the number of shares;
2. **the issue price is the price** at which the new shares are issued and must be placed between the nominal value and the mathematical value of the shares.
3. **Issue premiums** = the value added at the nominal value of the shares thus obtaining the emission price or the sales value.

2. INCREASE IN SHARE CAPITAL BY ATTRACTING NEW CASH CONTRIBUTIONS.

The purpose of this increase may be to strengthen the financial situation or to attract new resources to finance the investments needed to continue working in the context of increasing competition in all areas. This operation can be done according to 3 methods: increasing the nominal value of existing shares, issuing new shares and incorporating reserves and income from previous years.

2.1 Increase of the share capital by increasing the nominal value of existing shares.

Avoid an increase in the number of existing shares and thus does not change the balance between shareholders. This process can only be applied with the agreement of all shareholders and is not approved in practice where the number of shareholders is high. For companies with a small number of shareholders this method can be achieved.

TRAVEL SRL has a share capital of 40,000 lei, divided into 1,000 shares. Following the general assembly of shareholders meeting, the decision was taken to increase the share capital, the method chosen unanimously being to increase the nominal value of the shares by 30%. Thus, each shareholder comes and brings a certain amount of capital depending on the percentage held.

$$VN_{\text{inițială}} = \frac{\text{Share capital}}{\text{No of shares}} = \frac{40.000}{1.000} = 40 \text{ lei/share}$$

The table below shows the shareholder structure with the percentage held before the increase and after the 30% increase in capital.

| | | No. | Percent % | Value | 30% increase | Percentage held |
|----|---------------|-------------|------------|--------------|--------------|-----------------|
| 1. | Shareholder A | 400 | 40 | 1600 | 480 | 40 |
| 2. | Shareholder B | 300 | 30 | 1200 | 360 | 30 |
| 3. | Shareholder C | 150 | 15 | 600 | 180 | 15 |
| 4. | Shareholder D | 100 | 10 | 400 | 120 | 10 |
| 5. | Shareholder E | 50 | 5 | 200 | 60 | 5 |
| | TOTAL | 1000 | 100 | 40000 | 12000 | 100 |

Following the decision approved by the general assembly of shareholders, the nominal value of the shares after the increase will be 52 lei. (i.e. 40,000 + 12,000 =

52,000 / 1000 = 52 lei/share). Thus, the share capital will be increased by the amount of 12,000 lei. Each shareholder according to the percentage held will deposit the appropriate capital. As a result of this increase operation shareholders do not change their shareholding and in conclusion they are not disadvantaged. The nominal value of the shares will increase to 52 lei compared to 40 lei before the increase.

2.2 Increase of share capital by issuing new shares.

For new capital contributions, the recipient company shall issue new shares to the persons who bring capital. Once the proportion between the value of the contribution and the nominal value of the securities awarded is established, the issue of new shares may be:

- a) **without capital premium** – issue price = face value
- b) **with capital premiums** – issue price > face value

Issue price = the value at which a share will be sold.

- 1. **No capital premium** – when the issue price = the nominal value

In this case the issue price = with the nominal value of the shares appear several peculiarities related to the protection of old shareholders. There is a situation where some of the old shareholders do not have the capital to participate in the increase. Thus there are 2 possibilities:

- 1. securities to be offered for subscription only to **old shareholders**.
- 2. equity securities are subscribed **by any shareholder (may also be a new shareholder)** and the financial protection of old shareholders is ensured by the use of preferential subscription rights (DS).

Subscription right (DS) = a negotiable security which is established as the difference between the mathematical value – the accounting value of the old shares and the mathematical value – the accounting value of the new shares. So, the theoretical value of a DS is due to the loss of value of the share as a result of the increase in capital. The old action loses its value because new shares are issued at a value less than the mathematical – accounting value of the old shares. Totunci "old" shareholders who do not participate in the subscription of new shares register a loss and will therefore have to be protected by the distribution of subscription rights (DS).

$$DS = VMC \text{ old} - VMC \text{ new}$$

For example, we use the accounting data of **Travel SRL** dated 31.12.2020 with the following elements:

Balance sheet at 31.12.2020

| Active | | Pasiv | |
|-----------------------|---------------|----------------------------------|---------------|
| Name | sum | Name | sum |
| A1. Buildings | 20.000 | P1. Share capital (1,000 shares) | 40.000 |
| A2. Claims | 30.000 | P2. Reserves | 8.000 |
| A3. Accounts at banks | 20.000 | P3. Reported result | 12.000 |
| A4. Goods | 15000 | P4. Suppliers | 25.000 |
| TOTAL ACTIVE | 85.000 | TOTAL PASIVe | 85.000 |

Where the company decides to issue **500 new shares** at face value, **40 lei/share**, the situation shall be as follows:

1. **Vn = 40 lei/action and**
2. **VMC old = 60 lei/action**

$$VN = \frac{\text{Share capital}}{\text{No of shares}} = \frac{40000}{1000} = 40 \text{ lei/share}$$

$$VMC_{old} = \frac{\text{Share capital}}{\text{No of shares}} = \frac{40000 + 8000 + 12000}{1000} = 60 \text{ lei/share}$$

Following the new VMC capital increase is:

1. Initial capital = 40,000 lei
2. Capital increase 500×40 lei = 20,000 lei
3. **Total capital = 60,000 lei**
4. Reserves = 8,000 lei
5. Deferred result = 12,000 lei
6. *Equity = 80,000 lei*
7. *No. of shares (1000+500) = 1500 lei,*
8. **New VMC = 53,3 lei/action**
9. **1 DS = 60-53.3 = 6.7 lei**

$$VMC_{new} = \frac{\text{Share capital}}{\text{No of shares}} = \frac{60000 + 8000 + 12000}{1500} = 53,3 \text{ lei/share}$$

After the increase there is a decrease in VMC from 60 lei/share to 53.3 lei/share equivalent to the dS value. So, **1 DS = 6.7 lei** which is granted to the old shareholders who do not wish to participate in the increase of the share capital.

The parity of the issue is: at 1000 old shares / 500 new shares or 2 old shares / 1 new shares.

If a shareholder owned 10 old shares at 60 lei (value 600 lei) now he still owns 10 shares at 53.3 lei (value 533 lei) the value difference of $600 - 533 = 67$ lei represents 10 DS ($67 \text{ lei} / 6.7 \text{ lei}$). This allows him to buy 5 new shares at the price of 40 lei/share. On a new share bought at 40 lei must have 2 DS i.e. $40 + 13.3 = 53.3 \text{ lei/share}$. DS can be purchased from the shareholder who does not wish to participate with capital in the increase.

Table 1 below shows the initial structure of the shareholder with the number of shares and the amount of capital held by each (column 2 and column 4). After the issuance of 500 new shares (column 5) the value of the capital will be increased by the amounts due (column 6) to each shareholder and will amount to capital increased by 20,000 lei (column 9). In this case the percentages held by the old shareholders do not change because the new shares due to each shareholder are bought in full by them.

Table no.1 Shareholding structure after increase without external capital contributions.

| | | No. of shares | Percent % | Capital value 40 lei/share | No of new shares | Value of capital increase | No of share after capital increase | Owned % | Value after capital increase | Owned percentage after capital increase | Value DS |
|---|---------------|---------------|-----------|----------------------------|------------------|---------------------------|------------------------------------|---------|------------------------------|---|-------------|
| 0 | 1 | 2 | 3 | 4 | 5 | 6 = 5 x 40 lei | 7=2+5 | 8 | 9=4+6 | 10 | 11 |
| 1 | Shareholder A | 400 | 40% | 16000 | 200 | 8000 | 600 | 40% | 24000 | 40% | 2667 |
| 2 | Shareholder B | 300 | 30% | 12000 | 150 | 6000 | 450 | 30% | 18000 | 30% | 2000 |
| 3 | Shareholder C | 150 | 15% | 6000 | 75 | 3000 | 225 | 15% | 9000 | 15% | 1000 |
| 4 | Shareholder D | 100 | 10% | 4000 | 50 | 2000 | 150 | 10% | 6000 | 10% | 667 |
| 5 | Shareholder E | 50 | 5% | 2000 | 25 | 1000 | 75 | 5% | 3000 | 5% | 333 |
| | TOTAL | 1000 | | 40000 | 500 | 20000 | 1500 | | 60000 | | 6667 |

Table2 Shareholder structure in case the new shares are bought by the old shareholders without external capital contributions.

| | | No. of shares | Percent % | Capital value 40 lei/share | No. of new shares | No of new shares | Value of newly bought shares | Value DS | No of new shares | Percent | Value of new capital |
|---|---------------|---------------|-----------|----------------------------|-------------------|------------------|------------------------------|-------------|------------------|-------------|----------------------|
| 0 | 1 | 2 | 3 | 4 | 5 | 12 | 13 | 11 | | | |
| 1 | Shareholder A | 400 | 40% | 16000 | 200 | 0 | 0 | 2667 | 400 | 27% | 16000 |
| 2 | Shareholder B | 300 | 30% | 12000 | 150 | 150 | 6000 | 2000 | 450 | 30% | 18000 |
| 3 | Shareholder C | 150 | 15% | 6000 | 75 | 75 | 3000 | 1000 | 225 | 15% | 9000 |
| 4 | Shareholder D | 100 | 10% | 4000 | 50 | 50 | 2000 | 667 | 150 | 10% | 6000 |
| 5 | Shareholder E | 50 | 5% | 2000 | 25 | 225 | 9000 | 333 | 275 | 18% | 11000 |
| | TOTAL | 1000 | | 40000 | 500 | 500 | 20000 | 6667 | 1500 | 100% | 60000 |

In Table 2 we present the situation where Associate A does not wish to participate in the increase and does not buy new shares. In this case it has 400 DS related to the 400 old shares it holds worth 2667 lei (400 x 6.667 lei). The parity of old shares / new shares = 2/1 so you must have 2old shares to buy 1 new share or you can buy 2DS so you can buy 1 new share. In this case the percentage held by the old Shareholder decreases from 40% to 27% due to the capital increase.

2. With capital premiums – when issue price > face value

If the company wishes to increase its share capital by issuing new shares at a certain issue price given by the market value, then it must be between 40 lei and 60 lei per share.

Example:

The general assembly of shareholders has decided to increase the share capital through new cash contributions for which 500 shares will be issued at the issueprice of 50 lei/share the issue premium being 10 lei (50-40=10) worth 5,000 lei

Before the increase of the share capital, the situation of TRAVEL SRL is presented as follows:

Balane sheet at 31.12.2020

Activ

Pasiv

| Denumire | Suma | Denumire | Suma |
|-----------------------|---------------|----------------------------------|---------------|
| A1. Buildings | 20.000 | P1. Share capital (1,000 shares) | 40.000 |
| A2. Claims | 30.000 | P2. Reserves | 8.000 |
| A3. Accounts at banks | 20.000 | P3. Reported result | 12.000 |
| A4. Goods | 15.000 | P4. Suppliers | 25.000 |
| TOTAL ACTIV | 85.000 | TOTAL PASIV | 85.000 |

1. *The relationship between old and new actions*

$$\frac{\text{Acțiuni vechi}}{\text{Acțiuni noi}} = \frac{1000}{500} = \frac{2}{1}$$

$$VN = \frac{\text{Capital social}}{\text{Numar de actiuni}} = \frac{40000}{1000} = 40\text{lei/actiune}$$

$$VMC_{veche} = \frac{\text{Capitaluri proprii}}{\text{Numar de actiuni}} = \frac{40000 + 8000 + 12000}{1000} = 60\text{lei/actiune}$$

Following the issuance of 500 shares, the share capital will increase by 20.000lei(500 shares x 40 lei) and issue premiums will be recorded for the difference between the issue price of the shares and their nominal value. Thus, the premiums will be at the level of 5.000 lei (500 shares x 10 RON).

The final situation shall be as follows:

Balance sheet after increase

| Activ | | Pasiv | |
|--|----------------|--|----------------|
| Denumire | Suma | Denumire | Suma |
| A1. Buildings | 20.000 | P1.Capital social (1.500 actiuni) +20.000 | 60.000 |
| A2. Claims | 30.000 | P2. Reserves | 8.000 |
| A3. Accounts at banks (+30.000) | 45.000 | P3. Reported result | 12.000 |
| A4.Goods | 15.000 | P4. Suppliers | 25.000 |
| | | P5 Issue premiums | 5.000 |
| TOTAL ACTIV | 110.000 | TOTAL PASIV | 110.000 |

| | | |
|---|----------------------------------|-------------------|
| * | Capital social (40.000 + 20.000) | 60.000 lei |
| + | Reserves | 8.000 lei |
| + | Deferred result | 12.000 lei |
| + | Issue premiums | 5.000 lei |
| = | Equity | 85.000 lei |

$$VMC_{noua} = \frac{Capitaluri\ proprii}{Numar\ de\ actiuni} = \frac{85000}{1500} = 56,7\ lei/actiune$$

In this case, the VMC decreases as a result of the increase from 60 lei/share to 56.7 lei/share i.e. with a value of 3.3 lei = 1DS.

$$DS = VMC_{veche} - VMC_{noua} = 60 - 56,7 = 3,3lei$$

From a theoretical point of view, for each share held, the old shareholder will receive 3.3 lei/share, which will make him regardless of the change in the mathematical book value (VMC) of the shares from 60 RON to 56.7 RON. Thus the value of a share held after the increase will reach RON 43.3.

Shareholder F is the new member of the company and as a result of the shares purchased will hold 13% of the share capital. He paid for the 200 new shares the value of 10,000 lei (200 shares x 50 lei = 10000 lei). Out of 10,000 lei 8667 represents capital and 1333 represents the right of subscription that Shareholder A gives.

As a result of the increase Shareholder A holds 27% and loses 13% that we find at Shareholder F.

Tabelul nr.3 Shareholder structure after increase **with non-eurocapital contributions.**

| | | No of shares | Percent % | Value 40 lei/acț | No of new shares | Value DS | Newly bought shares | Value of newly bought shares | Value DA | Value capital new | Percent % | Total number of shares | Percentt % |
|---|---------------|--------------|-------------|------------------|------------------|---------------|---------------------|------------------------------|----------|-------------------|-------------|------------------------|-------------|
| 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| 1 | Shareholder A | 400 | 40% | 16000 | 200 | 1333 | 0 | | 1333 | 17333 | 27% | 400 | 27% |
| 2 | Shareholder B | 300 | 30% | 12000 | 150 | 1000 | 150 | 7500 | | 19500 | 30% | 450 | 30% |
| 3 | Shareholder C | 150 | 15% | 6000 | 75 | 500 | 75 | 3750 | | 9750 | 15% | 225 | 15% |
| 4 | Shareholder D | 100 | 10% | 4000 | 50 | 333 | 50 | 2500 | | 6500 | 10% | 150 | 10% |
| 5 | Shareholder E | 50 | 5% | 2000 | 25 | 167 | 25 | 1250 | | 3250 | 5% | 75 | 5% |
| 6 | Shareholder F | | | | | 0 | 200 | 10000 | -1333 | 8667 | 13% | 200 | 13% |
| | TOTAL | 1000 | 100% | 40000 | 500 | 3333,4 | 500 | 25000 | | 65000 | 100% | 1500 | 100% |

2.3 Increase of share capital by incorporating reserves and income from previous years.

This method of increase involves the incorporation of reserves, profits or capital premiums. This operation involves the issuance of new shares or the nominal increase of existing ones corresponding to the value of the profit. So instead of dividends, shareholders will receive new shares issued by the company. New shares issued are distributed free of charge to old shareholders. In this case, the dl-like attribution rights (DAs) are determined, i.e. as the difference between the old VMC and the new VMC of the shares.

Example:

| Activ | | Pasiv | |
|-----------------------|---------------|----------------------------------|---------------|
| Denumire | Suma | Denumire | Suma |
| A1. Buildings | 20.000 | P1. Share capital (1,000 shares) | 40.000 |
| A2. Claims | 30.000 | P2. Reserves | 8.000 |
| A3. Accounts at banks | 20.000 | P3. Reported result | 12.000 |
| A4. Goods | 15.000 | P4. Suppliers | 25.000 |
| TOTAL ACTIV | 85.000 | TOTAL PASIV | 85.000 |

There are two possibilities:

1. Increase in Nominal Value without the issuance of new shares. In this case the situation will be:
 - Initial capital = 40,000 lei
 - Reserves = 8,000 lei
 - Deferred result = 12,000 lei
 - Increased capital = 60,000 lei

$$VN_{inițial} = \frac{\text{Capital inițial}}{\text{Numar de actiuni}} = \frac{40000}{1000} = 40 \text{ lei/actiune}$$

$$VN_{majorat} = \frac{\text{Capital majorat}}{\text{Numar de actiuni}} = \frac{60000}{1000} = 60 \text{ lei/actiune}$$

$$VMC_{veche} = \frac{\text{Capitaluri proprii}}{\text{Numar de actiuni}} = \frac{60000}{1000} = 60 \text{ lei/actiune}$$

$$VMC_{noua} = \frac{Capitaluri\ proprii}{Numar\ de\ actiuni} = \frac{60000}{1000} = 60\ lei/actiune$$

As a result of this operation and increase the nominal value increases from 40 to 60 lei without the shareholders bringing capital from home. The percentages held do not change. In conclusion the best option.

1. Increase the nominal value by issuing new shares.

The decision was taken to increase the share capital by incorporating the result in the amount of 12.000 RON, for which 250 shares awarded free of charge will be issued.

The ratio between old and new actions 1000 / 250 is 4 to 1.

Initial capital = 40,000 lei

Deferred result = 12,000 lei

Increased capital = 42,000 lei

$$VMC_{veche} = \frac{Capitaluri\ proprii}{Numar\ de\ actiuni} = \frac{60000}{1000} = 60\ lei/actiune$$

$$VMC_{noua} = \frac{Capitaluri\ proprii}{Numar\ de\ actiuni} = \frac{60000}{1250} = 48\ lei/actiune$$

$$DA = VMC_{veche} - VMC_{noua} = 60 - 48 = 12\ lei$$

In conclusion an old shareholder should hold 4 DA to receive a new share. As the parity of 4 old shares shows, you get 1 new action.

3. CONCLUSIONS

Regardless of the reasons for the capital increase, we must know that this will affect the ownership structure and benefit the majority Shareholder over the minority shareholder. I have tried in this paper to present by clear examples what are the disadvantages of Minority Shareholderui when the capital increase takes place.

One of the major disadvantages is when the minority Shareholder has no capital with which to participate in the capital increase and is forced to cede part of his rights to another shareholder. This diminishes the percentage it holds in the share capital.

Another disadvantage is the diminution of power in terms of the decisions that will be taken in the General Meeting of Shareholders. Decrease in future dividends received from realized profit.

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