SHARES ISSUANCE

MANAGERS/SHAREHOLDERS CONFLICTS

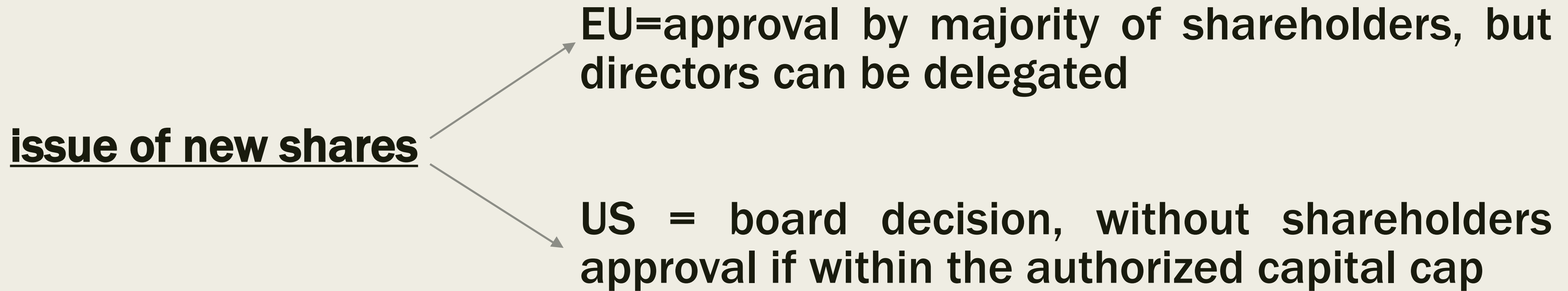
THE ISSUE: whenever material decisions can influence voting or cash flow rights of shareholders they must have direct control over such decisions

Issuing new shares is a core corporate decision because it directly affects both **cash-flow rights (economic dilution**) and **voting power (control dilution)**, making it a paradigmatic manager–shareholder agency problem.

Risks arising from the issuance or repurchase of shares:

- dilution of current levels of ownership,
- create new controlling shareholder,
- entrenchment of managers,
- permission to exit,
- reimbursement of shareholders,
- etc.

In such cases is reasonable to deploy a decision rights strategy



Underlying rationale of different models

- EU law relies on **ex ante shareholder control** to prevent dilution and opportunism.
- U.S. law grants greater discretion to directors, relying more heavily on **fiduciary duties and ex post judicial review.**
- Japan combines formal shareholder involvement with **minority-triggered protections**.

US+JAPAN distinguish authorized (approved by shareholders) and issued (approved by board) share capital BUT shareholders approval is necessary: (i) in US when the issue of the new shares can shift voting control, unless the issue takes the form of a public offering, while (ii) in Japan when the subscriber reaches the majority of shares and there an opposition to the issuance from at least 10% of minority shareholders

EU states rely on shareholders approval with no distinction between authorized and issued shares but the shareholders can delegate the power to issue new shares to the board, up to five years

Decisions about **trading of shares** (repurchase policy) and **reduction of capital** are left to shareholders in Europe and to directors in US

2. MAJORITY/MINORITY CONFLICTS

Core concern: majority shareholders may use corporate powers strategically to **extract private benefits** at the expense of minority shareholders, especially through dilution.

THE ISSUE: minority shareholders need further protection as the decision rights are only for the benefit of the majority shareholders

Pre-emptive rights: by default in EU and Brazil (but a qualified majority vote of shareholders can opt it out), not in US (relies on standard strategy - duty of loyalty) + JAPAN where pre-emptive right is an opt-in

Commonly pre-emptive rights can be waived only subject to certain requirements

Japan = decision strategy (supermajority) + standard strategy

EU = preemptive right only for cash issue!

This limitation reflects the focus on **economic dilution**, rather than purely formal dilution of voting rights.

Where pre-emptive rights are disapplied under the articles of association, applicable law, or by resolution of the shareholders, the following matters become subject to court scrutiny: (a) the substantive justification for issuing shares without pre-emptive rights; and (b) the fairness of the issue price offered to non-shareholders.

MERGERS

Mergers as fundamental changes

Mergers are often treated as fundamental corporate changes because they:

- reorganize corporate control,
- redistribute risk, and
- may reduce or eliminate shareholders’ individual exit options.

➞ Therefore, mergers typically justify enhanced procedural protections.

Key implications

- Exchange ratio risk: valuation uncertainty and potential unfairness in the share exchange ratio
- Stakeholder realignment: mergers reshape relationships among shareholders, managers, creditors, and other stakeholders
- Consolidation: assets and liabilities of two (or more) corporations are combined into a single entity

Shareholder approval: comparative perspective

i. EU, Japan, UK: approval is generally required, often by a supermajority,

ii. unless the target is immaterial (i.e., too small to materially affect the acquiring firm).

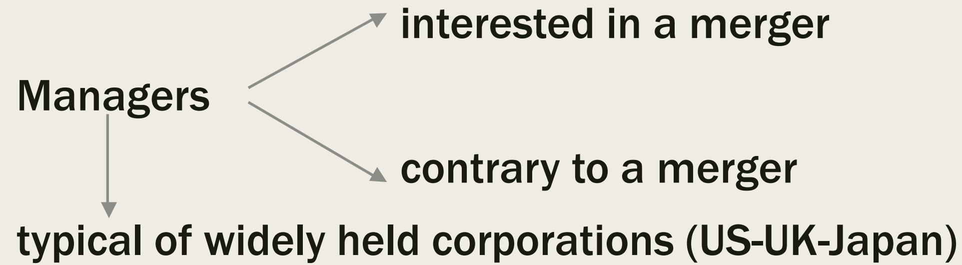
iii. U.S., Brazil: approval is typically by a simple majority of outstanding shares.

Policy justification

Shareholder approval is required when the transaction fundamentally alters:

- the firm's identity,
- its risk profile, or
- shareholders' residual claims.

1) conflict managers/shareholders



1.1. Managerial entrenchment

Definition: manager's actions and decisions are taken to increase their own private benefits rather than to maximize shareholder wealth.

This problem is particularly acute in **widely held corporations**, where shareholders face coordination problems and boards enjoy informational advantages.

How to block self interested managers ?

- trusteeship strategy (independent directors)

US - rewards strategy (high powered incentive - compensation)

- appointment right strategy (new directors)

- residually ex post judicial review (standard strategy – compliance with the duty of loyalty)

However an acquirer can shift to a "share acquisition" instead of a merger so directors cannot hamper the deal!

This limits the effectiveness of board veto powers and explains why **hostile takeovers remain feasible** in board-centered systems.

1.2. Managerial nest-feathering

Definition: when building an empire or securing their employment, managers put first their own interest when negotiating a merger

- shareholders approval can stop the merger
- gatekeepers approval (i.e. independent experts' reports prior to shareholders meeting, investment banks fairness opinion, court approval, etc.)
- exit strategy, appraisal right: of little use to shareholders in US
- right to challenge the fairness of merger prices by minority (Germany + Italy)

2) Majority - minority shareholders conflicts

When a controlling shareholder is present, mergers may involve **conflicts of interest on both sides of the transaction**, requiring stricter judicial scrutiny.

2.1. - independent assessment and exit operate also to protect minority!

- standard strategy = of use to challenge conflicted merger (when majority shareholders stand on both sides!)

2.2. Parent company has more than 90% of the target = short form merger

2.3. Parent company has less than 90% of the target: freeze-outs allowed but:

- additional minority protection
- disclosure of fairness
- entire fairness review
- appraisal right

Entire fairness review typically requires both **fair dealing (process)** and **fair price (substance)**.

2.4. Compulsory share sales

- after a public offering, if acquirer reaches → 90% - 95%

- via a public offer (95%), price to be fixed ex ante (France)

- Germany, no ex ante price fixing, minority can challenge price ex post before a court

- UK, unavailable squeeze-out techniques other than post bid, but there are other possible ways, e.g. a charter amendment requiring minority to sell, amendment subject to court review: "*good corporate reason*"

Functional equivalence principle: economically equivalent techniques may be reviewed as de facto squeeze-outs, even if they are not formally classified as such.

2.5. Other squeeze-out techniques

- reverse stock split (stock consolidation)

- sale of all assets + dissolution

- reduction of capital

- delisting

- deregistration

Such techniques are mainly addressed through standard strategies – ex post review

This confirms the central role of **standards-based enforcement** in controlling majority opportunism.

COMPARATIVE TAKEAWAY

Corporate law systems address identical agency problems by combining decision rights, standards, and exit rights in different proportions, reflecting ownership structures and enforcement capacity.