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SELECTED PROBLEMS OF CONCENTRATION OF OWNERSHIP IN JOINT STOCK COMPANIES AND THEIR SOLUTION IMPLEMENTATION SQUEEZE OUT

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Abstract in original language
Príspevok poukazuje na problémy pri koncentrácii vlastníctva v akciových spoločnostiach, ktorých akcie sú obchodované na kapitálovom trhu vrátane problému "free-rider" a navrhuje ich riešenie uplatnením a realizáciou inštitútu squeeze out.

Key words in original language
Akciová spoločnosť; Problém "Free-Rider"; Vlastníctvo; Squeeze Out.

Abstract
The paper points to problems in concentration of ownership in public joint stock companies whose shares are traded on the capital market including the "free rider" problem and the solution implementation and execution squeeze out.

Key words
Joint-stock company; Free-Rider problem; Ownership; Squeeze Out.

1. INTRODUCTION

Economic theory (Samuelson, 1954, pp. 387-389, Musgrave, 1959, Musgrave, Musgrave, 1994, pp. 38-41, Buchanan, 1998, pp. 117-118) explains the free-rider problem as a hiding of „actual preferences“of an individual with the aim "to hamper" an achievement of generally beneficial results of group decision-making. An individual will not be willing to absorb certain costs, unless at the same time to be able to expect certain visible benefits, measured from the point of view of a contribution to his/her personal benefit. If an individual expects that other individual (or more individuals) will provide certain benefits to him/her, he/she shall not initiate an action in accordance with costs takeover. Because the individual thinks in such a manner that his/her attitude cannot influence the attitude of others, and therefore the effort to maximize the benefit does not force him/her to make anything independently or privately in respect of common interests.

2. TAKEOVER BID VERSUS FREE RIDER

Empirical studies of Grossmann, Hart (1980), Yarrow (1985), Weston, Chung, Siu (1998), Fishman (1988) and other authors in the sphere of takeover bids at joint-stock companies from the part of new shareholder are dealing with an influence of dynamic changes in proprietary structure of these companies to general system of their administration (so called corporate governance). Empirical observation of the influence of changes in proprietary structure of the joint-stock companies on internal structure of management of these companies, was determined by certain basic prerequisites, such as:

- there were joint-stock companies the stock of which is publicly marketable at capital market,
- joint-stock companies had perfectly disintegrated proprietary structure,
- rational consideration of all „concerned“ subjects were taken into account,
- the base was knowledge of value of particular joint-stock companies,
- transaction costs were taken into account.

The results of studies proved and confirmed a difference in a perception of value of joint-stock company from the point of view of current shareholders within the framework of disintegrated proprietary structure of the company and from the point of view of a new accessory shareholder. New shareholder, carrying out a takeover bid, is sure that he/she will achieve the increases of economic-efficiency and performance in target joint-stock company by appropriate management of the company, implementation by economies of scale and achieved synergic actions. Finally, the total value of this company will subsequently increase as well.

Takeover Bid Model	Before Takeover Bid		After Takeover Bid	
	Current shareholder	External Subject carrying out takeover bid	New shareholder	Former shareholder
Stock value	AS	AP (AP>AS)	AN	AB
Price quoted	M/A	AB(AP>AB >AS)	AB(income=AP-AB)	M/A

Takeover Bid Model	Before Takeover Bid	After Takeover Bid
Source: Modified after Morava (2006, pp. 16-17) AS – a value perceived by current shareholder (or price at stock exchange), AP - a value perceived by shareholder carrying out a takeover bid within management buy-outs[1] (MBO - Management-Buy-Outs) and leveraged buy-outs[2] (LBO -Leveraged-Buy-Outs), AB - a price quoted to current shareholders for their stock.		

Table 1 Model of takeover bid

The increase of performance of joint-stock company according to Damodaran (1997, p. 677) must be higher than the price quoted to current shareholder for their stock (AB) so as to achieve the mentioned synergic actions after the takeover bid has been carried out. Failing this, a loss in the amount of transaction costs connected with the takeover bid could occur, what would finally conduce to withdrawal of the takeover bid.

Similar situation occurs also on the side of current shareholder, who compares the price quoted for stock possessed by him/her (AB) to publicly marketable stock, or to the price of a share perceived by him/her (AS). If the price quoted (AB) is equal or even lower than the value perceived by current shareholder (AS), the takeover bid will not occur. It results from abovementioned that takeover bids are carried out only from certain significant boundaries of differences of the price, which is perceived by current shareholder and the price quoted by external subject (new shareholder) carrying out the takeover bid.

In the case of takeover bid (purchase of major block of shares) of joint-stock company operating in capital market from the part of external subject (new shareholder), the effort of current shareholders to maximize their income within disintegrated proprietary structure in form of price for the stock possessed by them is on the one side, and the effort of external subject to maximize the takeover effects is on the other side.

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[1] Management buyouts (MBO) are carried out (Kislingerová, 2007) if a company as a whole, or a certain part of it, is bought by management itself or with another participants (investment companies). Management buyouts are used in large companies in the case of so called spin-off, what means a separation of those parts of the companies, which are not suitable for its basic profile. The benefit of management buyouts is usually very good information about the company from the part of purchasing management. On the contrary, more extensive utilization of loan capital is the disadvantage (buying on loan).

[2] Leveraged buyout is carried out if a company is bought by a group of persons not coming from the given company (Kislingerová, 2007).

Under the given circumstances, current shareholder is adopting a decision, whether he/she will sell his/her stock for price quoted (AB) to external subject (a new shareholder) (suppose that price quoted is higher than the value of a share AB>AS perceived by him/her), or he/she will hold the stock and try to benefit from the situation after the takeover bid carried out in the form of a difference between the value perceived by new shareholder carrying out the takeover bid and the value perceived by current shareholder (AP - AS).

In the case of notice of takeover bid, the current shareholder supposes that the external subject (new shareholder) will carry out the takeover for the price quoted (AB), which is higher than the value perceived by current shareholder (AS) while there is concurrent intention to achieve a prospective of additional income in the form of a difference (AP - AB). At the same time, current shareholder need not know the value perceived by external subject (AP), which carries out the takeover bid within management or leverage buy-outs.

There is no certainty for any current shareholder that external subject (new shareholder) did not come to terms with other shareholders within disintegrated proprietary structure of the company. Considering the circumstances, any of current shareholders shall intend to trade his/her stock for the price quoted (AB). Because, he/she shall try „to ride free“ as a „free-rider“.

Thus, Free-rider Problem will become evident at takeover bid in the effort of current shareholder to maximize takeover effects, what will cause that any current shareholder will not respond even under ideal conditions of takeover bid, what means that takeover will not occur.

Free-rider problem occurs, if current shareholders within disintegrated proprietary structure are indifferent to sale of stock to external subject (new shareholder) and further persistence in the given joint stock company. The given circumstances occur when the price quoted to current shareholder for their stock (AB) equals to the value perceived by new shareholder (AP). Therefore, a motivation to takeover from the part of current shareholders occurs only if the price quoted (AB) is higher than the value (AP). However, in the given case, external subject (new shareholder) will not be interested in carrying out of takeover, because he/she could suffer a loss in the amount of a sum of transaction costs (connected with possible takeover execution) and value quantified by the difference between the price quoted (AB) and the value perceived by him/her (AP).

3. FREE-RIDER VERSUS SQUEEZE OUT

Squeeze out („right to buy out“, or „displacement of minor shareholders“) enables for major shareholder, who has achieved a certain high property limit, to displace other (minor) shareholders. Thus, the aim of squeeze out is „to clear“ property in the joint stock companies, where strong major shareholder, or more shareholders acting concordant, exist. These ones are concerned with further developing of business activity of joint stock company according their own ideas and as well as are ready to simplify and decrease the administrative burden of the company, to make more rationalized and to decrease the flexibility of its management, or to change its dividend policy through displacement of other shareholders, who, based on proprietary rights, dispose of low decision-making potential.

The effort of major shareholder to acquire 100 per cent interest in the joint stock company is, to some extent, similar to takeover bid. Every minor shareholder can sell his/her stock for the value perceived by him/her (AS), and perceived identically by major shareholder as well. In the case that major shareholder offers the price for stock of minor shareholders, which is higher than the value of the stock perceived commonly (AS), minor shareholders expect correctly that major shareholder tries to acquire 100-per cent majority. Therefore they will "wait for willingness" of major shareholder to offer even higher price for their stock, what, theoretically, can continue for ages. And finally, it may significantly raise total costs for takeover.

Efficient solution of the abovementioned problems incidental to „free riding“ can be the application of squeeze out institutes. In the situation, when every minor shareholder actually considers possible "free ride", and thereby also implementation of the effect in the amount of the difference between the value perceived by major shareholder and the price offered for their stock (AP - AB), but at the same time he/she is afraid that just at the application of squeeze out from the part of major shareholder he/she will be displaced for market price (AS) or for the price set in the expert’s statement (not taking the value perceived by major shareholder (AP) into account in full extent), he/she will finally accept the price offered in the amount of AB, despite the fact that AB is lower than the value perceived by major shareholder (AP). The price offered (AB) will be equal or higher than the value perceived by minor shareholder (AS).

4. CONCLUSION

Solving of problems connected with the concentration of property in the joint stock companies, which operate at capital markets, including the problem of free-rider, enables to apply efficiently the institutes of squeeze out (thus the right of buyout) and subsequently their implementation. The change of proprietary structure from disintegrated one with many minor shareholders to the concentrated one with 100-per cent majority of one shareholder as so called going private process carries synergic effects of rationalization and flexibility of management system of a joint stock company at concurrent economies of scale and lower administrative burden of its management.

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