International Journal of Innovative Research in Engineering and Management (IJIREM)
ISSN: 2350-0557, Volume-9, Special Issue-9, September-2022
Innovative Projects 2022
Organized by Presidency University, Bangalore, India

Analysis of Redeemable Shares: Features, and Implications

Razina Ahmed
Assistant Professor, Department of Law, Presidency University, Bangalore, India,
Email Id-razina.ahmed@presidencyuniversity.in

ABSTRACT

A kind of share capital known as redeemable shares gives the issuer the opportunity to buy back or redeem shares from shareholders at a certain price or on particular dates. The notion of redeemable shares is explored in this abstract, with an emphasis on its characteristics, benefits, legal consequences, and ramifications for shareholders and businesses. It looks at the crucial elements to take into consideration while analysing redeemable shares, including the conditions of redemption, shareholder rights, accounting treatment, and legal requirements. The conclusion emphasises the significance of adequate structure, transparency, and compliance in redeemable share transactions after discussing the keywords related to redeemable shares in the abstract.

KEYWORDS

Accounting, Capital, Repurchase, Redemption, Regulatory, Shareholders.

I. INTRODUCTION

Shares may be issued as redeemable at the choice of the firm, the shareholder, or on a certain date depending on the jurisdiction and the company. When shares are redeemed, the corporation pays the subscribed capital back to the shareholder in exchange for the cancellation of the shares. This is one way to lower the companys capital requirements. In venture capital, redeemable shares might be beneficial. The parties to a venture capital deal are aware that the venture capital company would want to depart the target after, say, five years. Redeemable shares may be used by a venture capital company to reduce risk. When the target is not yet ready for an IPO but has distributable assets, for instance, redeemable shares might make it simpler for the venture capital company to cash out [1]–[3].

Avoiding receiving equal treatment. Other business legal justifications for using redeemable shares are possible. While the use of redeemable shares can offer an alternative method of leaving the company without violating the principle of equal treatment of all holders of shares who are in the same position, share buy-backs are typically restricted by this rule because holders of redeemable shares and holders of other shares are not in the same position. Depending on the country, using redeemable shares may result in tax advantages. Returning money to shareholders is often not seen as the distribution of profits, although the distribution of earnings typically has tax ramifications.

Core Provisions

The fundamental guidelines for redeemable shares for public limited liability organizations are outlined in the Second Company Law Directive: Member States may issue redeemable shares, but they are not required to do so if they do, the requirements outlined in Article 39 of the Second Company Law Directive must be met. In particular, before redeemable shares are subscribed for, redemption must be permitted by the companys bylaws or instrument of formation. The shares need to be paid in full. The companys laws or instrument of formation must specify the conditions and the process for redemption.

Only funds available for distribution to shareholders or the proceeds of a fresh issue issued specifically with the intention of achieving such a redemption may be used to accomplish redemption. A reserve that cannot be transferred to shareholders must include an amount equal to the nominal worth of all redeemed shares, or, in the absence of that, the attributable par. It may only be used to capitalizing reserves in order to raise the subscribed capital. This restriction wont applies, however, if a fresh issue is made specifically to accomplish the redemption and the redemption is carried out using the proceeds of the new issue. Additionally, money might be given to shareholders in the case that the subscribed capital declines.

Withdrawal of Shares Otherwise

Withdrawing shares would be legally more challenging unless done after a share buy-back or using redeemable shares. The Second Company Law Directive serves as the foundation for the most significant legislative restrictions on public limited liability companies: Member States may, although they are not required to, approve the forced withdrawal of shares in order to reduce the subscribed capital. If so, they must adhere to the requirements outlined in Article 36 of the First Company Law Directive.

1. Prior to the subscription of the shares that are to be withdrawn, compulsory withdrawal must always be provided for or approved by the articles of association.
2. Unless it has been unanimously authorized by the shareholders in question, the general meeting must make the decision in cases where the forced withdrawal is simply permitted under the articles of organization. Under Community law, there are no particular quorum or majority requirements.
3. In cases where the articles of organization require a mandatory withdrawal, the requirements of local company law govern how authority is distributed internally. If the conditions and modalities of the withdrawal have not previously been established by the articles of association, they will be defined by the business body making the decision on the mandatory withdrawal.
4. The Second Directives creditor protection measures will typically be in effect.

Third Party as a Source of Remuneration

By selling shares to a third party, a shareholder may free money that has been invested in the business. Shares may be sold by a shareholder for money. The alternative is for the third party to propose to issue its own shares to the shareholder as payment for the shares. The sale may take place off-exchange or at a stock exchange, and it may be a private sale or a public offering. Getting a clean exit on advantageous terms is a must-have for many investors, including private equity sponsors. It’s not always voluntary or free to sell shares for cash. On how shares may be purchased or sold, the shareholders may have reached an agreement. This is crucial in family-owned businesses and businesses with a small number of shareholders.

II. DISCUSSION

Initial Public Offering

An alternative to a private sale is an IPO. The utilization of an IPO relies on market investors choices. There are several methods to organize an IPO. A significant shareholder offers to sell all of his shares for cash in a clean departure. The shareholder would choose to maintain a portion of his ownership in order to indicate the quality of the shares the perceived risk for prospective purchasers might be decreased if they felt that the seller’s objectives were adequately aligned with their own. The company may issue new shares and make them available to the public at the same time as a shareholder makes their current shares available to the public, partially for the same reason and partially to raise fresh capital. Because the company will need funding in the future and a decline in share value after the IPO would harm the companys reputation, raise perceived risk, and make it more expensive for the firm to raise equity funding in the future, potential investors may believe that their interests have been partially aligned with those of the company itself.

The shareholder may also choose to retain a sizeable portion of his shares. By floating some of the shares on a regulated market, the controlling shareholder, for instance, may transform the nature of his ownership from illiquid to more liquid and earn a market value for the shares. Sometimes, controlling shareholders may have the option of selling the companys assets or going public with the company. For instance, a private equity company may realize the value of its goodwill via an IPO otherwise, the group would not be able to do so by simply selling its portfolio businesses [1]–[3]. The sellers public offering. A significant shareholder may offer shares for sale to the general public in cases where the shares have already been allowed to trade on a regulated exchange. public offer to purchase. Instead of a shareholder considering selling his shares, the buyer may make the public offer. The

Takeover Bids Directive is applicable to takeover offers made for a firm whose securities are allowed to trade on a regulated market in full or part of a Member State.

Auctions

Auction techniques are used in stock market trading. Both private transactions and public offers may be conducted via auctions. Private equity sponsors and trade sellers are increasingly choosing auctions over an IPO. On the other side, the pricing strategy may still employ an auction procedure even if the seller decides on an IPO. A dual-track method, which combines an IPO and an auction, is also an option. Economics auction types. According to economic theory, an auction is a game in which i buyers submit bids for the item, ii the product is then allotted to at most one of the purchasers, and iii buyers pay the seller which might theoretically be in the negative. When there is a monopoly on one side of the market and the auction organiser has the opportunity to commit himself in advance to a set of policies, auctions are employed. This pledge may persuade bidders to make advantageous offers. According to auction theory, a monopolist decides to sell through auction because he is unaware of the buyers estimates of value.

The second-price sealed-bid auction is often referred to as the William Vickrey auction after Vickrey, who won the 1996 Nobel Prize in Economics. The top bidder in the Vickrey auction pays the second-highest bid rather than their own, even if they were the highest bidder. It is simpler for the seller to learn what the top bidder is prepared to pay thanks to the Vickrey auction. Its interesting to note that Johann Wolfgang von Goethe used a comparable auction system as early as 1797. one of the most well-known uses of the Vickrey auction is Ebay. The auctioneer starts off with a high asking price at a Dutch auction. The asking price is decreased until a bidder agrees to pay the auctioneers price or until the minimum price is achieved. The prize winner will pay the most recent amount stated. A call auction to start trading and a continuous auction to run the whole trading day are two separate trading procedures. Orders build up in a call auction, and the expert decides on a single market-clearing price at which all completed orders trade. In a continuous auction, the expert quotes the ask and bid prices, and exchanges take place one at a time.

The MiFID serves as the foundation for the regulation of trading methods in the EU. The regulated markets and multilateral trading facilities MTF activities are covered by the MiFID, among other things. Both combine, or assist in the combination of many third parties purchasing and selling interests in financial instruments, so as to produce a contract. The MiFID establishes broad criteria for pre-trade transparency. Investment companies and market operators running an MTF or a regulated market are required to continuously disclose, on fair commercial conditions, the depth of trading interests at the current bid and offer prices. Depending on the kind of system, each includes a summary of information that will be made public. There are four different kinds of trading systems: the quote-driven trading system, the periodic auction trading system, the continuous auction order book trading system, and additional trading systems.

A private auction may be set up in a variety of ways. Potential bidders will often get a process letter outlining the procedures details. The interested parties who have agreed to confidentiality requirements will get an information memo. The possible liability that might result from the dissemination of the information memorandum is often limited by the seller and its advisors. The information memorandums contents may be verified at least in part by interested parties by doing so in a data room [4]–[6]. Prospective bidders will normally get a draught contract in addition to the information note. Bids from interested parties will be submitted together with any comments on the draught contract. In a closed auction, there are often many rounds and maybe concurrent talks with multiple bidders. Typically, the parties draught sale agreement will include the same provisions as a privately written agreement between two parties.

IPO/trade sale procedure with two tracks. An auction procedure and an IPO process are sometimes combined by trade sellers and private equity sponsors. In a dual track IPO/trade sale procedure, the seller first seeks a trade sale via an auction with trade or finance purchasers before switching to the IPO track, where price is set by institutions on a book building basis. There are various advantages to using a dual track IPO/trade sale procedure. Generally speaking, the dual track approach might raise the likelihood that the departure will occur. Prospective bidders also have an incentive to provide an IPO option in addition to competing to make the highest offer. Therefore, prospective bidders have an incentive to conclude their offers on clean departure terms and in accordance with the IPO timeline.

However, there are some disadvantages. The expenses of running two simultaneous processes are greater for the vendor. If the vendor cannot guarantee the secrecy of the information given during the selling process .The completion period may be prolonged by the IPO track. After the seller has changed from the trade track to the IPO track, it might be challenging to put an offer from a trade or finance bidder on hold. After following the IPO track, it might be tough to go back to the trade sale exit option. Investment banks who counsel the vendor are also biased in favor of the IPO. A share exchange offer may cause concerns inside the target firm about the application of takeover defenses as well as concerns about whether the offeror can do due diligence on the target company. In addition, the targets articles of association include takeover protections that may be activated by surpassing a particular level. The ability of other shareholders to sell their shares or the acquirers obligation to make an offer for the remaining shares may be outlined in the articles of association [7]–[9].

Share exchange legal elements of securities markets. Parties to the share exchange must abide by the rules of EU securities markets legislation if one of the participating firms is one whose shares have been allowed to trade on a regulated market. When the offerors shares have been admitted to trading on a regulated market or when the offeror plans to apply for their admission to trading, there may be a duty to prepare and publish a prospectus under the Prospectus Directive or an offer document under the Takeover Bids Directive when the targets shares have been admitted to trading on a regulated market. The Board of the Offeree Company is required under the Takeover Bids Directive to create and publish a document outlining its position, and there are limitations on the use of takeover defenses that might thwart the bid. Squeeze-out rights, sell-out rights, and a duty to make a forced offer for the remaining shares may all be triggered by a successful share exchange if the target companys shares have been admitted to trade on a regulated market. It may also result in the shares of the target being delisted.

Termination of a Joint-Venture

To produce a result that is advantageous to all parties, a commercial joint-venture often entails the coordinated utilization of strategic assets from two or more parties. Commercial joint ventures include more than just money. The company endeavor typically has worth even when its proprietors are not present. The company enterprise does not always have to conclude with the departure of one owner. These commercial endeavors vary from unincorporated joint ventures to limited liability corporations with corporate status. Regardless of the joint-ventures structure, the parties have traditionally governed their interactions with one another through a joint-venture agreement. Plan your exit. The goals of the joint venture determine the partner's departure strategies. A joint venture for the development of a products market may come to an end through a joint sale of the joint venture or an initial public offering IPO, and a joint venture for the fusion of complementary goods or services may result in a merger, for instance. As a result, the joint venture may either survive the termination or it may be incorporated into one of the parties.

A party in a two-party joint venture might, in theory, assume control of the joint venture or sell its stake in it in order to achieve the full value of the business. Shares may be purchased, sold, or compelled to be purchased or sold by a party. In theory, a party was free to sell its interests to either the opposing party or a third party. An obligation to present ones interests to the other party may have been established by agreement. This party may act alone or in concert with the other party to sell its interests to a third party. As a result, a party may purchase, sell, or be compelled to acquire or sell the shares. All long-term contracts have certain circumstances that might result in termination. The offended party may be entitled to cancel the contract if the other party defaults. In the case that the other partys control changes, one party may be able to end the agreement. A materially negative change might be mentioned.

In addition to a general termination event and a general major adverse change provision, clauses on the joint ventures inability to fulfil its objectives or its deteriorating financial position may be included. In joint enterprises, specific termination provisions are also used. The possibility of impasse must be discussed, and the parties must set rules for circumstances when one party wishes to leave the joint venture before the contracts predetermined duration has run its course. There are specific means to agree on issues of departure and removal in this context since a business joint-venture is not only a financial investment. Departure terms are essential provisions of the joint-venture agreement. In a joint venture owned by two parties, three unique circumstances may occur: the departure of both parties, the departure of one party, and the removal of the other party.

The contributions of both sides are necessary for two-party commercial collaborations to succeed, yet one party may want a departure while the other may not. Normally, the parties will agree on this issue beforehand. There can be a termination provision in the joint venture agreement. The parties must also determine what will happen in the event of termination. The company enterprise has two options: it may either be liquidated or kept continuing. Whether or whether the parties have ongoing duties that continue after the contract expires is up for debate. A party may have a sell-out right, which gives them the ability to sell their interests to the opposing party or to a third party. The opposite party will often want to be shielded by a lengthy notice period. The duration and expiration of the joint venture agreement must be separated from the presence and termination of the joint venture as a distinct legal entity. Usually, the corporation must decide internally whether to liquidate itself. If a company is founded on a contract between its shareholders, the termination of that contract may nevertheless result in the companys dissolution. For instance, the contract creating a GmbH under German law may provide that a shareholder may end the agreement with notice and order the liquidation of the Gmb. In certain corporate partnerships, one side wishes to get rid of the other, maintain the complete company partnership, and alter the nature of its investment. Due to the fact that neither party wishes to be removed, the contractual rule of the other partys removal is difficult to enforce legally.

III. CONCLUSION

Redeemable shares provide businesses flexibility in how they manage their capital while giving shareholders access to cash. The conditions of redemption, shareholder rights, accounting treatment, and legal obligations must all be carefully taken into account while analysing redeemable shares. Companies may use redeemable shares as a tool for capital management while preserving shareholder interests, ensuring transparency, and abiding by relevant rules and regulations by appropriately structuring, reporting, and doing so. For instance, if the joint venture has been formed as a limited liability company, the termination of the shareholder’s joint venture agreement does not result in the businesss dissolution.

REFERENCES

[1] J. L. Proclanoy en P. C. D. Motta, Inovação tecnológica: a privatização após o uso das moedas podres, Rev. Adm. Empres., 1992, doi: 10.1590/s0034-75901992000500006.

[2] D. French, 10. Distributions and maintenance of capital, in Mayson, French & Ryan on Company Law, 2019. doi: 10.1093/he/9780198841517.003.0010.

[3] D. J. Brophy en L. C. Gupta, Preference Shares and Company Finance., J. Finance, 1976, doi: 10.2307/2326705.

[4] K. Mikami, Raising capital by issuing transferable membership in a worker cooperative, Ann. Public Coop. Econ., 2013, doi: 10.1111/apce.12013.

[5] M. Lyne en R. Collins, South Africas new cooperatives act: A missed opportunity for small farmers and land reform beneficiaries, Agrekon, 2008, doi: 10.1080/03031853.2008.9523796.

[6] I. Moore, 9. Share Capital, in Concentrate Questions and Answers Company Law, 2020. doi: 10.1093/he/9780198856726.003.0009.

[7] G. López-Espinosa, J. Maddocks, en F. Polo-Garrido, Equity-liabilities distinction: The case for Co-operatives, J. Int. Financ. Manag. Account., 2009, doi: 10.1111/j.1467-646X.2009.01033.x.

[8] L. Tiehen en E. Frazao, Where do WIC participants redeem their food benefits? An analysis of WIC food dollar redemption patterns by store type., Econ. Inf. Bull. - USDA Econ. Res. Serv., 2016.

[9] M. A. Gumport, Accounting for Equity Transactions - Marking Equity to Market: 400 Years Overdue? Or, GAAPs Gap: Pacioli After the Dutch East India Company, SSRN Electron. J., 2011, doi: 10.2139/ssrn.1062201.