# Discussion of theoretical-practical aspects of squeeze out

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**Abstract**

The presented article has mainly a nature of theoretical discussion on the issue of squeeze out. The squeeze out entitles a majority shareholder to exercise his rights to buy out remaining shares of an offeree company. It a specific transaction mechanism with an impact on shareholders, offeree company, procedural regulation of the transfer of ownership rights arising from shares, methodological aspects of determining a squeeze out price of shares of minority shareholders, efficiency of capital markets etc. In case of Slovakia, the squeeze out has been used for more than one decade, however the number of such kind transactions is low. The main objective of the article is to point on specifics of that transaction and methodological aspects of determination of a general value of shares as a criterion of a fair price relying on basic attributes of procedural regulation of squeeze out in Slovakia, synthesis of knowledge from empirical studies, existing legal and financial theory as well practical experience one of the authors.

**Keywords:** consideration, fair price**,** general value, share, squeeze out

## Introduction

Determining the value of a company (business valuation), parts of a company, its assets or other property is not a new instrument from the view of the Slovak (or Czechoslovak) economy. Its existence was already evident at a time when our economy had the feature of central planned economy. However since its transformation into the market economy that was related (except other) to the process of changing ownership structure of state-owned enterprises, emergence of new (private) enterprises, new legal forms of business etc., the view on a business valuation and reasons for valuating have changed. In connection with the forensic engineering, a business valuation is related to the determination of a general value that is considered objective. The essence of the process

of valuation, regardless of the subject of valuation, is to objectify a source value to a final – general value. *A general value* is an expert estimate of a most probable price of a company under assessment or its parts (on the valuation date, at given place and time) that would be accepted by the both sides of transaction, provided there is a free competition, fair trading, demand and supply side act with an appropriate awareness, caution, and assumption that the price is not affected by a disproportional motive. Concerning the purpose of business valuation, the general nature of a company´s value may be identified with different types of value e.g. with investment value, liquidation value, fair market value, inherent value and other types depending on the legal or other act that raises any need to determine the value, including squeeze out (Sedláková, 2006).

The squeeze out is a specific transaction of a forced nature. It is not a result from an arm´s-length negotiation and thereby an aspect of voluntary is questionable in the context of general value. The valuing usually falls within the remit of an independent expert (determined by the national legislation), who should determine a fair value of shares in the context of understanding the legal implications of squeeze out, but without examining compliance with procedural acts legally. Such a way determined value – redemption price should be acceptable for participants of squeeze out transactions.

## Primary attributes of squeeze out

For the purpose of the article, *"squeeze out"* is a legal mean to push out minority shareholders from an offeree company by a majority (controlling) shareholder. On the one hand, it establishes the right of a majority shareholder, who is interested in transferring the entire company to his person without economic liquidation of an offeree company, to buy, on the other it obliges a minority shareholder to sell. The legitimacy of the right is conditional – a majority shareholder must keep in hands a certain threshold of an offeree company´s shares and votes, and offer to the minority an adequate *"equivalent"* for shares. If a majority shareholder exercises the right, majority shareholder is obliged to sell.

Obviously, in case of the squeeze out, the rights and obligations of a majority and minority shareholder are affected in a specific way, which results from the very nature of a joint stock company. The share capital of a joint stock company is allocated to a certain number of shares with a given par value that are in a property of more natural persons or legal entities (the number is not legally restricted). De facto, a managing of a company may be a potential interest of all shareholders. The rights of shareholders are "materialize" into the ownership of shares, while the specificity of the rights is a matter of the legislation of individual countries. The general nature of shareholder´s rights express that all shareholders have the right to ask a company to treat all of them equally

and under the same conditions. In addition, no shareholder may exercise own right at the expense of other shareholders' rights and interests. The primary economic goal of the existence of a joint stock company is the same as in case of other legal forms of businesses – to be profitable and contribute to a market appreciation of a share capital. However, the potentially existing high fragmentation of a shareholder base may be (and in many cases, the practice has proved that is) an obstacle to effective corporate governance and lead through a complicated process of compromises in the enforcement of important decisions. The fragmentation may be a source of agency problems and costs[1], information asymmetric etc. that creates a difference in the value of the same company, provided *"unanimous decision-making"* and provided *"fragmented decision-making"*. As well, it is important to highlight the presence of business risk and different preferences related to the dividend policy. The business risk is considered higher in case of a majority shareholder than in case of a minority shareholder, in other words it is proportional to the size of their investment (Pokorná, 2003). The disproportion in the area of dividend policy includes a conflict of long-term goals and short-term goals concerning an earnings distribution.

It is obvious that the squeeze out is rather a means of protecting interests of a majority shareholder. As a mechanism for concentrating fragmented ownership structure of companies to rationalize their financial, economic and strategic governance, it firstly appeared in the 1930s in the United Kingdom. (Havel, Pihera, 2008) Hečková and Chapčáková (2009) state that the squeeze out is a legal means of "purifying" the ownership structure from minority shareholders by a "strong" majority shareholder, who is interested in developing a company´s business according to own ideas. Incentives for the squeeze out are mainly a need to increase a company's competitiveness, reducing administrative and governance costs and burdens[2], and restructuring a company by going private. (Hečková and Chapčáková, 2009; Mařík, 2008). The concentrated structure may be a positive impulse for investments, which otherwise a majority shareholder would not undertake (Uzsák, 2007), generally said a majority shareholder cannot fully exploit synergies, while not fully owning an offeree company. (Bergstorm et al., 1994; Chen et al., 2018) Damodaran (1997) emphasizes that the squeeze out is able to bring benefits not only for a company itself but also for the society. Van der Elst – Van den Steen (2006) in their comparative analysis note benefits of the squeeze out in connection with the public interest, too. Miliutis (2013) deals with it in connection with

[1] We assume agency problems and agency costs of the second type. See e.g. A. Shleifer & R. E. Vishy (1986)

[2] In the meaning of simplifying and rationalization of a company´s management system mainly due to minimization of abusing legitimate rights that belong to minority shareholders in order to protect them from the consequences of various company decisions (solving a free ride problem), information duty etc.

disparities in the legislatives governing its process. Despite the identified disparities, he states that rationales for going private are the same – avoidance of agency costs and compliance with listing-related reporting, economies of scales, constant under-pricing of listed shares, improved D/E ratio, tax mitigation etc. The squeeze out legislation emphasizes economic efficiency and benefits to the society at the expense of non-controlling shareholders. (Kainsanlahti, 2002) In connection with the legislative, there is a discussion about shareholders´ wealth, allocative efficiency, means of protection of minority shareholders, as well chosen valuation approaches (e.g. Chen et al., 2018; Enriques, 2014; Saastamoinen and Savolainen, 2019).

The squeeze out affects all rights of minority shareholders that is obvious. As regards a possibility to participate in the decision-making and management of a company, a minority shareholder is usually in such a position that he cannot enforce own managerial interests (if such an interest exists at all). The practice, therefore mainly points to a moot of property rights. By a forced sale, a minority shareholder loses forever an entitlement to dividends and potential gain in a form of an increase of the market price of shares and so allows to a majority shareholder to acquire 100% stake in an offeree company and benefit from associated effects. The protection of minority shareholders (depending on the legislation of that country) is therefore ensured by legislative quantitative and qualitative requirements that the squeeze out transaction must meet to minimize interference with minority rights, mainly property ones.

*Quantitative criteria* stipulate a minimal level of the capital carrying voting rights and voting rights of an offeree company that allows to a majority shareholder to exercise the right of squeeze out (so-called a personal condition of the existence of a majority shareholder). The threshold differs country to country. E.g., the Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bid (hereinafter *"Directive"*), general directive on take-over bids in the EU, sets a threshold at 90%. However, the Directive allows to the member states to be stricter and apply a higher threshold, but no higher than 95% (Article 15, paragraph 2 a) – b) of the Directive). As a rule, the quantitative criterion also usually includes a time criterion determining the time limit or the moment when a majority shareholder can exercise the squeeze out right. *Qualitative criteria* stipulate in which companies the squeeze out can be undertaken[3] and define a legislative process of this transaction, including the appointment of a supervisory authority. Except that, criteria include determining a value of compensation for shares of minority shareholders with a requirement to consider all

[3] Generally, the principle of squeezing can be applied in any company with a fragmented structure. From the legislative point of view, the squeeze out right is regulated and connected mainly with public joint stock companies. In some countries, the right is possible to apply also in other legal forms of business.

relevant quantitative and qualitative aspects that may determine a fair price. In most countries, the consideration paid to minority shareholders must be supported by an independent opinion. The criterion also defines the institutions of protection of minority shareholders' rights.

## Theoretical aspects of fair value determination (fair squeeze out price)

On the theoretical level, it is possible to identify several valuation approaches, whose aim is to determine a fair price. The most preferred are methods based on discounted cash flows of different nature, in general, based on the principle of present value of expected benefits generated by any asset. By deductive approach applied in the issue of business valuation, the value of a share determined for an investor´s need will be at the level of the present value of future incomes that a share is expected to generate. From the point of view of the squeeze out and consideration for the forced sale of shares, minority shareholders should be compensated such a way that the consideration takes into account all value-forming factors, which are inherent for an offeree company and which minority shareholders lose. If minority shareholders do not get an appropriate return on their shares when are being squeezing out of a company, they will never get a second chance to gain a return again. (Croci et al., 2013) Concerns associated with minority shareholders welfare in the squeeze out have frequently garnered the attention because the pricing of minority shares does not emerge from an arm´s-length negotiation and reflect a conflict inherent with disparate ownership interests. (Bates et al., 2006) A majority shareholder aims to minimize own costs in gaining full control of a company, whereas a minority shareholder seeks to maximum exit value for his stake. In connection with this Maliutis (2013) identified three basic standards of a fair price in the squeeze out – market value, going concern value, and third-party sale value. As many other authors point, each of suggested standard is case specific with own application restrictions (Dukes et al., 1996; Steinmeyer and Hägar, 2002; Herz et al., 2007; Anderson, 2009; Hamernesh and Wachter, 2009; Ventoruzzo, 2010; Saastamoinen and Savolainen, 2019 etc.). In the practice, each standard is probably applicable only in the scope of legislation governing the squeeze out and valuation process in particular countries. It is mostly applied that the squeeze out price is given by more standards of value or other quantitative criteria at the same time, as the squeeze out is a legislative forced sale and not a voluntary one. For instance, the Slovak Republic accepts previous transaction prices in a company´s stock as one but not the only legally determined criteria of an adequacy of the consideration in case of the squeeze out. The legislative accepts a going concern approach, too since an expert in charge of determining a general value of an offeree company is required to apply this approach within both required

valuation methods in the squeeze out transaction. Regarding a third-party sale value, this approach is being applied within in case of valuating securities for determining their general value[4], however the Slovak legislation its usage in case of the squeeze out does not admit.

## Formal-procedural side of squeeze out in Slovakia (legal framework)

With regard to Slovakia, the introduction of the squeeze out is a systematic step toward the harmonization of the Slovak legal system with the community law of the EU. (Hečková and Chapčáková, 2009) Previously mentioned Directive of the EU was intended to promote the integration of the European capital markets, provides for an efficient market for corporate control, and harmonize take-over regulations. (Enriques et al., 2014) Into our legal system, the squeeze out through the Directive was incorporated as *"buy-out right"* by the approval of the Act No. 644/2006 Coll. that amends and supplements the Act No. 483/2001 Coll. on banks as amended and by the Act. No 209/2007 Coll. that amends the Act No. 566/2001 Coll. on securities and investment services as amended (hereinafter *"SA"*) with effect from 1 January 2007. The legal introduction of the squeeze out has had a direct or indirect impact on other legal norms, e. g. Act No. 513/1991 Coll. on commercial code as amended, Act No. 431/2002 Coll. on Accounting as amended, Act No. 747/2004 Coll. on financial market supervision as amended, Decree of the Ministry of Justice No. 492/2004 Coll. on determination of general assets value (hereinafter *"Decree"*), and other statutory norms. With effect from 1 January 2019, the SA was amended by the Act No. 373/2018 Coll. that amends and supplements the Act No. 371/2014 Coll. on resolution in the financial market as amended, which has changed the procedural side of squeeze out in Slovakia[5].

According to the Slovak law, *squeeze out* is the right of a majority shareholder to require all minority shareholders to pass on him all remaining shares of an offeree company at a fair price (Article, 118i, paragraph 1 of the SA). *An offeree company* is a joint stock company whose shares are the subject of a take-over bid (Article 114, paragraph 2 of the SA), while shares must be admitted on a regulated market in Slovakia (Bratislava Stock Exchange) or on other regulated market in other member states of the EU (Article 114,

[4] Appendix No. 7 *"Determination of a general value of securities"* of the Decree of the Ministry of Justice No. 492/2004 Coll. on determination of general assets value.

[5] From the procedural point of view, a majority shareholder is no longer obliged to send to each shareholder a contract proposal for the purchase of shares, or proposal for exchange of shares for other securities. The transfer of ownership rights of shares does not relate any more to the consensus of minority shareholders´ will and neither it is not needed to be replaced by the court order (in case of the disagreement of minority shareholder). This was replaced by a decision of a general meeting with a requirement to register the transfer of share resolution in the Business Register and by the establishment of the institute of an authorized person.

paragraph 1 – 4 of the SA). A majority shareholder is *an offeror*, who has carried out a take-over bid (before exercising the buy-out right) and holds at least of 95% of a company´s shares and votes. *A take-over bid* is a public offer to conclude a contract under the terms of the Commercial Code (Article 114, paragraph 1 of the SA; Article 276 – 279 of the Commercial Code). Its subject is a purchase of shares of an offeree company or exchange them for other securities. A public offer, which was neither partial (it only concerns a designed part of remaining shares) nor conditional (it concerns a minimum number of shares that an offeror wants to acquire), is made on a mandatory basis (following the acquisition of control[6] of an offeree company), or voluntary basis (its objective is acquisition of control of an offeree company). The buy-out right must be exercised not later than 3 months after the validity period of a take-over bid period. The validity period is precluded. An offeror may exercises his squeeze out right only in case of the approval of the National Bank of Slovakia (hereinafter *"NBS"*), *a supervising authority* (Article 118i, paragraph 4 of the SA). The NBS is eligible to examine the application related to the exercise of the right; after that the application approves, rejects or requests an offeror to revise it. Before an offeror submits the application to the NBS, it must deposit a cash necessary to provide the full consideration to minority shareholders to the hands of *authorized person* (Article 118i, paragraph 12 the SA). An authorized person ensures a centralized payment of a consideration belonging to minority shareholders for their shares. It may be a bank, broker, central depository, or a foreign person authorized to carry out similar activities in the territory of Slovakia like previously mentioned subjects (Article 118i, paragraph 11 of the SA). If a majority shareholder meets the mentioned conditions, may ask a board of director of an offeree company to convene *a general meeting to take a decision on the transfer of all remaining shares* to a majority shareholder (Article 118i, paragraph 5 of the SA). The general meeting approves the transfer of shares only if the resolution is accepted at least by 95% of all votes of all shareholders. By expressing favourable opinion of a general meeting, a majority shareholder‘s squeeze out right is considered to be exercised (Article 118i, paragraph 6 of the SA). After 30 days since the registration of approval on the transfer resolution in the Commercial Register, shares of minority shareholders are transferred to a majority shareholder who becomes their owner (Article 118i, paragraph 6 of the SA). The *transfer of the ownership of shares*, a legal matter, is registered in the statutory register of securities (in favour of a majority shareholder´s account and debited to minority shareholders´ accounts) on the date of transfer of shares based on the order given by an offeree company. An authorized person pays the consideration to minority

[6] For the purposes of the SA, control means a share of at least 33% of the voting rights attached to shares in an offeree company (Article 114, paragraph 2 of the SA).

shareholders within 3 days of the transfer of shares. It is responsible and obliged, on behalf of an offeror, to publish in the Commercial Bulleting a notice of consideration payment for shares. The notice must inter-alia inform about the date of transferring of shares in favour of a majority shareholder, amount of the consideration per share, and due date of the consideration. The legal means of protection of minority shareholders in case of the squeeze out – the right to file a petition on the validity of decision of the general meeting on the transfer resolution and right to object that the consideration is not adequate are governed by Article 118i, paragraph 15 – 16 of the SA.[7]

## Methodological aspects of business valuation in case of legal act of determining general value of shares for purpose of determining adequacy of consideration in squeeze out

### Legal criteria of adequacy of consideration for shares of minority shareholders

Determining a fair price is a crucial element in the success of squeeze out transaction. We build on the already mentioned statement that a property fragmentation of shares and corresponding voting rights do not allow minority shareholders to participate effectively in managing in terms of promoting their own interests, so property settlement remains the priority disputed task. The property interests of a minority shareholder whose shares are subject to *"expropriation"* have been incorporated through the term of adequacy into the legislation regulating the methodology of share valuation in order to determine a fair price of the consideration. We emphasize that *a fair price* we deem as a price that a majority shareholder will pay for shares of minority shareholders and that is adequate from the legal point of view. The SA is currently set up in such a way that the rights of minority shareholders are protected by meeting the aforementioned quantitative and qualitative criteria. The guarantee of meeting conditions of adequate consideration is given by a requirement that the consideration shall be established by *an expert opinion*. Determination of an expert in the field of Economics and Business Management, the business valuation sector falls within only the competence of the NBS. The consideration under the squeeze out may be offered in cash, securities or combination (Article 118i, paragraph 9 – 10 of the SA) and must be equitable concerning the value of shares of an offeree company.

[7] The use of legal means of protection of minority shareholder is case of the squeeze out does not restrict the legal power of a majority shareholder to become an owner of a minority stake. However, in case of the first mean, his disposition rights will be restricted – given shares cannot be used as a collateral or to be transferred to other persons unless the court takes a decision. In the second case, only the question of consideration will be questionable without contesting ownership rights of a majority shareholder.

*The consideration if the squeeze out is preceded by a mandatory take-over bid* shall not be lower than the consideration in that take-over bid. It must be evidenced by an expert opinion (Article 118g, paragraph 7 of the SA). According to the Slovak legislation governing the forensic engineering, only an expert – a legal entity (specialized team of experts – natural persons), is competent to prepare an expert opinion. The price, at which an offeror or persons acting in concert with him acquire shares of remaining shareholders, shall meet all the conditions of adequacy at the same time (Article 118g, paragraph 6 of the SA):

- *is not lower than the highest price, which an offeror (or persons acting in concert) has paid for shares in the period of 12 months before a take-over bid became mandatory,*
- *is not lower than the average market price of shares quoted on the stock exchange over the period of 12 months before a take-over bid became mandatory,*
- *is not lower than a general value of share stipulated by an expert opinion that is calculated as a general value of an offeree company divided by the number of shares while taking into account their par value* (Appendix No. 16 of the Decree); an expert is obliged to identify a general value of a company for the purpose of squeeze out by applying two valuation methods – asset-based method and business method; *the adequacy of consideration determined by an expert is always in accordance with the higher general value* (Article 118g, paragraph 5 of the SA)[8],
- *is not lower than net value of a company´s assets per share, including the value of intangible assets according to the most recent financial statements audited before a take-over bid became mandatory*.

*If a voluntary take-over bid precedes the squeeze out*, an offeror may use the same price in both cases, if the price is adequate. *A legal fiction of a fair price is defined by a requirement that through a take-over bid, an offeror acquired at least 90% of capital carrying voting rights of an offeree company comprised in a voluntary bid.* If an offeror was able to acquire the necessary number of shares and voting rights, the price is considered attractive and acceptable for the rest of minority shareholders. Otherwise, an offeror is requested to determine a fair price in accordance with the procedure of a mandatory take-over bid.

[8] Note: An offeror for the purpose of the squeeze out and determination if the consideration is adequate may use an expert opinion prepared prior to the obligation to declare a mandatory take-over bid.

## Business valuation in case of legal act of determining general value of shares for purpose of determining adequacy of consideration in squeeze out

The buy-out right was incorporated in the methodology of business valuation through the Act No. 626/2007 Coll. that amends and supplements the Decree of the Ministry of Justice No. 492/2004 Coll. on determination of General Assets Value. The Decree requires an expert to comply with the substance principle – to consider all company´s specificities as an open system with all its effects on the external environment and vice versa when determining a general value of a share. From the practice point of view, the principle comprises a detailed understanding of the squeeze out as a legal action and application of a principally unified methodological approach. The Appendix No. 16 *"Determination of general value in order to find out adequate consideration for shares under Act No. 566/2001 Coll. on securities and investment services as amendment"* of the Decree rules methodology of valuation only for the purpose of squeeze out. The methodology is designed is such a way that the consideration has a nature of *"absolute"* indemnity for an investment of a minority shareholder, who loses it due to a squeeze out, while *"opens a way"* for an opposite party to get 100% ownership of an offeree company. It does not take into account only the importance of investment that a minority is losing (could be identified with a price at which a majority shareholder would receive a similar risk-oriented investment with a similar return), but also the importance of investment, which a majority shareholder is acquiring.

The Act No. 382/2004 Coll. on experts, interpreters and translators as amendment and the Decree of the Ministry of Justice of the Slovak Republic No. 228/2018 Coll. govern the structure of an expert opinion, which is the same for all legal acts of business valuation. The squeeze out is not an exception, however in an expert opinion must be included all relevant specifics of an offeree company and take-over bid that precedes the squeeze out. It must include an ex-post financial and economic analysis of an offeree company as well as a business plan submitted by a majority shareholder and verifying of its feasibility, while an expert takes full criminal responsibility for a general value quantified in an expert opinion. The determined general values of shares by the assed-based method and business method are provided at the end of an expert opinion.

## Use of asset-based method to determine general value of company and general value of shares for purpose of squeeze out

According to the Appendix No. 16 of the Decree and applying the asset-based method, a general value of an offeree company is the sum of general values of all components of company´s assets reduced by the general value of liabilities and accruals on the valuation date. It is based on the accounting of an offeree company and documents providing the existence of assets and liabilities. A general value of assets is determined

by experts in required expert fields depending on a type of assets. The general value of liabilities is determined in accordance with the Appendix No. 12 *"Determination of general value of liabilities"* of the Decree. The date on which the general value of a company is determined, is decisive and unified for all assets and liabilities.

**Use of business method to determine general value of company and general value of shares for purpose of determining an adequacy of squeeze out**

According to the Appendix No. 16 of the Decree, the business method determines a general value of an offeree company through the capitalization of drainable resources during the evaluation period. It is a 2-component value category – it is the sum of the present value of drainable resources for the evaluation period and continuing value. For the purpose of determining the general value of shares for the squeeze out (*netto value*), the general value of a company calculated in this way (*brutto value*) is adjusted by a general value of needless assets from operational point of view (*plus*) and general value of interest-bearing debts on the valuation date (*minus*). A general value of needless assets is determined by experts in required expert fields depending on a type of assets. A general value of interest-bearing debts is determined based on accounting information and other documentation in accordance with the Appendix No. 12 of the Decree. According the Appendix No. 16, an expert shall apply different approaches to the calculation of general value of drainable resources depending on a kind of an offeree company. It is needed to distinguish between a business and a financial institution.

*A drainable resource* is a monetary value of benefits generated, in particular, from a profit, revenues or cash flows that are generated from business activities of a company or its parts, or company´s assets, which depends on a company's past, market position and anticipated development (Article 2, paragraph 1 k) of the Decree). *In case of the squeeze out, an expert determines a drainable resource in accordance with the theoretical quantification of FCFF*. An expert shall take into account all benefits gained by a company´s own activity that is financed by the interest-bearing capital whether implicitly or explicitly.

*A discount rate* is the weight average cost of capital *("WACC")*. It considers the capital structure of an offeree company (equity and interest-bearing debts), cost of forms of financing and their risk that ensures that the theoretical assumption of symmetry of valuation of invested capital is met. *Cost of equity* (implicitly interest-bearing capital) is given by the average return on a risk-free investment, which is equal to an average return on a government bond with the longest maturity in the bond market in Slovakia on the date of valuation. *Cost of debt* is calculated as a ratio of interest expenses to interest-bearing debts converted on an annual basis.

*A sustainable growth rate of drainable resource*s is derived from the historical and projected returns indicated in a business plan. If the growth rate cannot be reliably identified (taking into account historical and expected development), it shall be replaced by the average growth of an industry concerned in which an offeree company belongs to, for the previous period usually of 5 years based on the findings of the Statistical Office of the Slovak Republic. The sustainable growth rate found in this way shall also be used if the growth rate derived from a business plan is higher than the applied discounted rate. If any of previous approaches cannot be used, the sustainable growth rate of drainable resources will be equal to the expected inflation rate found on the valuation date.

## Discussion

The squeeze out as a legal mean of a majority shareholder to acquire remaining shares of an offeree company has been used in Slovakia more than a decade. The right belongs to the Slovak and to a foreign majority shareholder of an offeree company, whose shares are admitted to trading on the Bratislava Stock Exchange or on other regulated market in other member states of the EU. The Slovak legislation governing the squeeze out is conditional and more pro-minority oriented since it stipulates the limit of ownership interest and corresponding voting rights enabling a majority shareholder to exercise the right clearly more strictly than the EU Directive. At the time when the squeeze out was implemented into the Slovak law, questions were been arising, whether its existence will not detract the trading on the already dysfunctional and less liquid Slovak capital market. This fact has not been confirmed since only six companies has been exercised the squeeze out right so far in Slovakia.

Tab. 1: Squeeze out transactions in Slovakia (2007 – 2018)

| Business name or name of person who has consent of NBS | Business name of offeree company | Par value / consideration per share (in EUR, for given ISIN) | Average value / highest value since listing on stock exchange (in EUR) | Date of approving by NBS | Consideration compared to par value / average value / highest value (in %) | Period for exercising right (from - to) |
|---|---|---|---|---|---|---|
| Ing. Alžbeta Janusová | MINERÁLNE VODY a.s., Prešov | **33.1934 / 78.650** | **9.582 / 9.582** | 19.12.2018 | **136.94 / 720.81 / 720.81** | 21/10/18 - 21/01/19 |
| SC FOOD, AGRO&INDUSTRIAL a.s. (Czech Republic) | Poľnonákup HONT a.s., Hontianske Nemce | **33.190 / 29.400** | **4.156 / 5.809** | 19.9.2014 | **(-)11,419 / 607.41 / 406.11** | 09/07/14 - 08/10/14 |
| COLAS SA (France) | Inžinierske stavby a.s., Košice | **33.194 / 1.500**[1] | **16.279 / 85.640** | 31.1.2012 | **(-)95.48 / (-)63.91 / (-)98.25** | 31/12/11 - 30/03/12 |
| Achmea B.V. (Netherlands) | Union poisťovňa a.s., Bratislava | **33.200 / 71.270** | **6.845 / 12.000** | 26.1.2012 | **114.67 / 941.20 / 493.92** | 03/12/11 - 03/03/12 |
| BONGRAIN EUROPE S.A.S., Viroflay (France) | Liptovská mliekareň, a.s., Liptovský Mikuláš | **33.194 / 53.020** | **5.509 / 7.867** | 25.11.2008 | **59.73 / 862.43 / 573.95** | 16/09/08 - 15/12/08 |
| Sudop Internationál B.V., Barendrecht (Netherlands) | DOPRAVOPROJEKT a.s., Bratislava | **33.194 / 286.030**[2] | **87.413 / 219.080** | 20.11.2007 | **761.69 / 227.22 / 30.56** | 27/10/07 - 26/01/08 |

[1] A bid price in a voluntary take-over was EUR 1.00.
[2] A bid price in a voluntary take-over was EUR 213.10.

Source: By authors based on statistics of trading of Bratislava Stock Exchange and NBS.

We think that this situation was mainly related to the formal-procedural side of the transfer of ownership rights and its time-consuming nature. This also was the main reason for the already mentioned amendment of the SA with effect from 1 January 2019. Its aim is to simplify and speed up the process of exercising a squeeze out right and related transfer of ownership rights of minority shareholders to a majority shareholder and therefore we assume that the number of squeeze out transactions may increase in Slovakia. Potential litigation we do not exclude, since the means of protection of minority shareholders for the purpose of squeeze out the law admits. However, despite the minimal number of squeeze out transactions, as follows from the Table 1, we can state that the consideration paid to minority shareholders in most cases exceeded not only the par value of shares, but also the average value of the market price since listing the shares on the Bratislava Stock Exchange. If we took into account just the results of this simple analysis, we state that the squeeze out price included also the premium for the gained control.

As regards the discussion about a fair price, the condition to determine a general value of shares of an offeree company by an independent expert according to the Decree is one of the legislative requirements that the consideration is adequate. *We state that the nature of squeeze out as a legal act has been clearly reflected in the methodology of an expert opinion as an expert is obliged to determine a general value of a company by using of two valuation methods simultaneously*. We consider relevant that the criterion of adequacy of consideration for shares is identified with a higher general value. The methodical procedure determining a general value of an offeree company, then a general

value of shares is relatively exact. Nevertheless, practical experience has shown disputed areas, which arises a question whether the valuation methodology for the purpose of squeeze out is really the most relevant procedure. Taking about a *business valuation method*, the legal nature of squeeze out affects the valuation methodology such a way that the legislation obliges an expert:

- *apply going concern principle that ensures an expert takes into account future returns, which minority shareholders are losing by squeezing them out,*
- *impartially assess the relevance of a business plan, make a relevant corrections if they are needed,*
- *identify and properly use all economic categories need for a general value calculation – sustainable growth rate of drainable resources, discounted rate, cost of explicitly and implicitly interest-bearing capital,*
- *relevantly determine the value of needless assets from the operational point of view; a general value is determined by experts in relevant fields of expertise and added to a general value of an offeree company; the assets and reasons why they are needless is determined by an offeror; such approach is logical, since the needless assets should not be taken into account in the prediction of company´s drainable resources,*
- *reduce a general value of an offeree company by a general value of interest-bearing debts on the date of the valuation.*

A general value of an offeree company identified in such a way is primarily depended on a submitted business plan that points to a company's revenue potential for the period of 5 years. We consider the period optimal, because it is sufficient in terms of reducing the risk of unrealistic estimation of predicted development. It is a source document for quantifying future drainable resources, as well as a sustainable growth rate. It is required a business plan shall contain relevant and true information that make it possible to investigate its feasibility in terms of its creation and amount of drainable resources in the context of past and future periods, including starting points of their creation and parameters. It shall be in coexistence with a financial health of a business. An expert is not able a business plan clearly objectify because the legislation does not precisely determine the process and methodology of a plan´s creation. Moreover, a majority shareholder submits it himself. The fact that the legislation requires a majority shareholder to provide all the requisites for an expert to review it is not a 100% guarantee of its objective content. The practical experience have shown that a quality financial analysis undertaken by an independent expert is a prerequisite of his ability to assess a business plan. The real problem is mainly that the projected revenue potential is not in coexistence with opportunities generated in the past or in current period and the set direction of an offeree company.

The general problem is that the discount rate used to calculate the present value of drainable resources, takes into account capital structure of an offeree company and cost of capital on the valuation date. It is rather ex-post discount rate however. In case of the squeeze out, an expert works with the assumption that the discount rate is constant for all projected cash flows in each period, de facto even with the assumption of fixed capital structure for forecast periods (Mařík et al., 2011), which is contrary to the reality. In accordance with the legislative methodology of quantification of the cost of equity (see in the following text), it is at least desirable the business plan to provide information that in the context of projected drainable resources will also point to the need of capital sources. In practice, this would mean that an expert would work with more discounted rates determined analytically or iteratively that could contribute to objectifying a general value of an offeree company. This problem is partly treated in case of the cost of equity because it is taken into account the government bond with the longest maturity on the bond market. Regarding the cost of debt, in the nature of the transaction as a squeeze out is, we do not consider the *"general"* way of determining it under the Decree sufficient even with regard to the specificity of an offeree company. This way should be confronted with the cost of interest-bearing debts found by analysing credit conditions under which the capital was borrowed. These are facts that can be documented, are specific to an offeree company, so the assumption of their different valuation by experts on the same date is minimized. From the methodology of the calculation of cost of equity for the purpose of squeeze out it follows that a general value of an offeree company may be seen over-valued from the perspective of minority shareholders. It is fact that the methodology does not reflect the existence of any risk premiums and so it is a fact that the methodology is lagging behind existing and commonly used financial theories[9]. In practice, this would mean that if shareholders participate in the future benefits of a company (that is the fact in the general value calculation), they should also be involved in the riskiness of those benefits. (Bartošová and Klieštik, 2018) E.g. Hečková and Chapčákova (2009) argue in their study that the method of determining the cost of equity according to the Appendix No. 16 of the Decree should be only used as a reference risk-free interest rate and not the rate of the total cost of equity. However, on the other hand of the issue is the nature of squeeze out that should not be forgotten – squeeze out is a forced sale and definitive unwanted loss of a minority shareholder´s investment. Therefore, we consider the identification of the cost of equity only with the yield of

[9] Note: E.g. CAPM, Fama French 3-factor model, arbitrage pricing model, dividend capitalization model, average profitability method, build-up models, deriving the cost of equity from the cost of debts etc. The use of chosen method shall be in correspondence in particular, with the specifics of a company in terms of availability and relevance of the data used in the context of the requirements of individual methods of quantifying of the cost of equity. (Michálková – Kramárová, 2017)

government bonds to be a clearly compensation of expropriation of minority shareholders in case of squeeze out transactions.

The Decree defines more possibilities of calculating the sustainable growth rate of drainable resources and thereby experts may gain different results in the process of valuation. The priority is given to the rate derived from historical and projected revenues; the influence of extraordinary and extreme values should be excluded. Such a way determined growth rate would be inherent for an offeree company. However, the methodology does not exactly identify what kind of revenues "is bearing" the potential of sustainable growth. Even it does not identify the length of time-series of historical and projected revenues that should be taken into account in the process of rate quantification. We reiterate that the sustainable growth rate identified in this way is highly dependent on the objectivity of a business plan and, in the long run, should not exceed the pace of economic growth in the sector concerned. We are of the opinion that the choice of this approach falls only within the competence of an expert and his theoretical and practical knowledge with regard the specifics of an offeree company to justify the relevance of the choice. However, only a more detailed specification of category of "revenues" would contribute to minimizing potential litigation, as it would eliminate the presumption that an expert acts subjective. In our opinion, a relevant category could be sales revenues for merchandise, products, and services or the category of added value, a parameter that moreover considers the cost of purchased inputs.[10] We see both indicators to be the ones of the main generators of the value of a company. The Decree also does not specify which methodological procedure to use to derive a sustainable growth rate of drainable resources. It is therefore up to an expert to decide which methodological procedure will be applied. It is clear that an expert most likely will follow the procedure of the "general" business valuation method that is set out in the Decree in the Appendix No. 1 *"Basic procedures to laid down the general value of a company and its parts"*. The other two options for determining the sustainable growth of rate of drainable resources that the Decree governs we seen as marginal, as they do not take into account the specificities of an offeree company.

In case of the asset-based valuation and in connection with the squeeze out, the valuation has a multidisciplinary feature, as it requires experts from different expert fields to cooperate closely, thereby it is extremely robust, time-consuming, and demanding in terms of finances. Whereas the accounting data is the starting point for this method, the method offers rather a static view on an offeree company however

[10] Note: The added value in the meaning of the value that is added to purchased inputs, whether from commercial or manufacturing activity.

without considering its income potential. The method requires considering technical and economic usage of all assets, and determining their real useful life with respect to their physical and moral depreciation or other usage. The practice draws attention to the weaknesses related to the valuation of assets in close relation to debts and liens, if they are related, weaknesses in valuing of intangible assets, double considering of assets in a process of acquisition, investments in progress etc. Despite this, the valuation of assets and liabilities must comply with accounting and valuation standards. In relation to the consideration to minority shareholders under the SA, particular emphasize shall be placed on attachments of an expert opinion. They are irreplaceable for an expert due to a large scope of the valuation subject and methodological procedures that are needed to apply in valuating all single parts of company´s assets and liabilities.

## Conclusion

The squeeze out is really a specific transaction mechanism that is mirrored in the existing legislative. Companies in Slovakia do not used it frequently, although the Slovak capital market still *"offers"* such kind of companies that could "reap" from it, mainly companies created thanks to the voucher privatization in the 90´s of the last century. Some of them used other *"alternative"* ways of squeezing the minority out. The legal aspect of squeeze out as a forced sale, without violating property rights in the sense of the Constitution in Slovakia, has an impact on the business valuation methodology. The business valuation for the purpose of squeeze out, unlike some other countries, is only in the competence of an independent expert appointed by the NBS. By analysing the Slovak law and valuation methodology, we state that is more strictly than e.g. the Directive of the EU especially in terms of protecting the interests of minority shareholders. In the process of valuation, an expert is obliged to apply asset-based valuation method and business method. The use of two valuation methods at the same time creates a scope for objectifying a general value of a share and adequacy of the consideration, and that reflects legal and economic specifics of the squeeze out. The use of both methods is justified because a squeeze out cannot be seen as a normal transaction driven by supply and demand side. The use of both methods is also relevant to the anticipated cycle in which an offeree company is located[11]. Existing practical experience shows that despite the fact that the Appendix No. 16 of the Decree is relatively more precisely determined than the Appendix No. 1, regarding the squeeze out, still there are "sources" that lead to disparities in a general value. It would be desirable in this context to more precisely

[11] Note: Other valuation methods of shares given in the Decree (Appendix No. 7. „Determination of general value of securities") – liquidation method, combined method, and comparative method are not allowed to use in case of the squeeze out in Slovakia.

defined at least the approach to a business plan construction including determination of relevant sources generating drainable sources, *"revenues"* that are used to derivate the sustainable growth rate of drainable sources. The way of determining other economic categories is disputable also in purely theoretical level.

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