

Management Profiles of Capital Increases with a Premium. Evidence from Italy

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Abstract: *The present contribution investigates the issue of shares with a premium, especially concerning those factors that influence the pricing of securities. In particular, the analysis was carried out by examining a sample of small businesses listed on the Italian Stock Exchange and showed that the phenomenon of the share premium represents a situation of considerable importance. Furthermore, the study aims to demonstrate how the share premium can perform both a compensatory or equalizing function between old and new shareholders, and an eminently financial function in favor of the company. In the case of the compensatory function, typical of older companies, the determination of the share premium measure is mainly due to the amount of the accumulated net equity, since the subscription of the new shares gives the right to participate in its benefits. In the case of the financial function, more typical of younger companies, the main purpose of the share premium is to provide the company with adequate financial resources to support its future growth.*

Keywords - Net Equity, Self-financing, Share Capital Increases, Share Premium

I. Introduction and Research Objectives

Share capital increases represent - in business economics, as well as in legal interpretations - management interventions that are alternatively susceptible to a) a distorted use, especially aimed at the recalculation of the ownership structure in favor of some shareholders, generally of majority shareholders; b) a physiological acquisition of financial resources, supported by business, non-private, reasons [1].

In the two functions mentioned above, increases in capital with a share premium represent a special case, in which the issue price of the shares, as determined by the shareholders' meeting, is higher than their nominal value.

The present paper aims to demonstrate that the share premium is not only related to the size of the issuer's net equity but depends on a variety of factors and, above all, may exist even in the absence of accumulated reserves.

Given the negative view of some doctrine and jurisprudence towards premiums, the present discussion, while attempting to overcome any a priori negative preconceptions, intends to reconstruct the main theories of the share premium and their foundation, also in light of some empirical evidence.

II. Research Methods and Study Limitations

The research method combines the use of the inductive-deductive approach with statistical analysis, based on the use of financial statement data.

In relation to the first profile, the study makes use of the analysis of national and international literature on the topic, both legal [2] and economic [3], and aims to contribute to the study of the financing processes of companies implemented through share capital increases, as an alternative to debt.

With regard to the statistical method, the research considers the sector of small and medium-sized innovative companies listed on the Italian Stock Exchange and data from financial statements for the financial year 2017.

The statistical study aims, above all, to detect the empirical dimension of the phenomenon by analyzing the financial statement area that refers to net equity.

In particular, we propose an index for this purpose, constructed as a percentage ratio between the value of the share premium reserve and the total value of the net equity (SPR/NE), in order to determine the average weight of the share premium in the company financing.

The first limitation of the present study concerns the size of the sample which, while being inclusive of the entire sector of innovative SMEs listed, is limited to one year only.

Hence, while the analysis is able to provide an updated measure of the magnitude of the premium phenomenon, it does not allow the estimation of the trend over time, for example, in order to identify whether there are any particular phases of company life in which the use of the premium increases or decreases.

Secondly, the statistical analysis, while elucidating whether the premium is quantitatively significant or marginal, does not allow us to identify the circumstances that led to apply it, and, in particular, to distinguish between opportunistic premiums and legitimate premiums.

III. The Causes of Premiums

The identification of the causes of premiums necessitates, first of all, a distinction to be drawn between the different attitudes that the doctrine assumes concerning the problem.

In this regard, there are at least three representations of the premium which, although not antithetical, take on a different interpretive perspective: a) on the one hand there are the formal or strictly accounting perspectives, which define the premium as the excess of the subscription price of the shares, compared to their nominal value; b) on the other hand, there are the more concrete conceptions [4] which tend to focus on the causes - economic, instrumental or legal - of the share issues with a premium; c) finally there are the adjustment theories that take on an intermediate position between a) and b) [5].

The interpretative limits of the concepts of the first type concern, above all, two profiles.

Firstly, they offer a superficial view of the phenomenon, according to which the premium is attributable to the higher value of the company assets, compared to that of the share capital. The same concepts, however, take account of the existence of a surplus of value, but fail to investigate the causes, thus excluding, in this way, the possibility of exploring in greater depth, among other things, the veracity of the premium decided by the shareholders' meeting, the determinant factors of the revaluation of the company value and, consequently, the nature - be it durable, ephemeral or inconsistent - of the factors themselves.

Secondly, the interpretations in question, which stop at the ascertainment of the existence of an increase in the value of capital, require some clarifications, not only terminologically, because of the technical inaccuracies to which an external vision of the phenomenon can lead.

It is therefore necessary to understand the exact notion of "company capital" [6] to be compared with the amount of the share capital: this company capital does not obviously coincide with the assets, given that the same assets must be reduced by liabilities, so that the relevant notion is that of *net equity*.

As is widely accepted, net equity can be expressed in accounting values, or at current values [7]: in the first case, the surplus value of net equity, compared to the share capital, corresponds to the value of reserves, whether of profits or of capital. Where, to simplify the matter, capital reserves and generally those deriving from any extraordinary transactions were excluded, the premium would correspond to the accumulated profits realized by the company and not distributed. It follows, according to this first approach, that the premium would correspond to the increase in value that the net equity obtained as a result of management and, therefore, would represent the measure, albeit in purely accounting and conventional terms, of the wealth generated by the company and retained in the form of self-financing.

In the case of expression at current values, the meaning of net equity changes in part: it is a measure not only of the wealth historically produced by the company, but also of the *presumed wealth*, determined by bringing out the latent unrealized surpluses, estimated in the *an* and in the *quantum*.

However, in both hypotheses, it is necessary, above all, to ask *if the premium is really always an expression of the increased value of net equity* [8], because, if this were the case, in the absence of increases in net equity, there could not be a premium.

Consideration of this issue leads us to address the conceptions under b), which, instead of moving on from the assumption that there has been an increase in net equity, strengthen the reasons for the issuing of shares with premiums [9].

In this regard, Italian economic and legal doctrines [10] - seen through dominant classical frameworks - address two main themes: 1) the determinants of the measure of the premium; 2) the qualification of the economic nature of the premium.

In relation to the first aspect, the aforementioned doctrines *tend to exclude the idea that the measure of the premium is necessarily related to the amount of reserves accumulated by the company up to the date of issue with premium* [11].

In this sense, there may be cases where the reserves are not abundant, but the premium is still applied, as well as situations in which the reserves are abundant, but the premium is not equally large.

Assuming otherwise would mean excluding - contrary to what happens in reality - the possibility that there might be a premium in the issuance of shares set up by new or newly established companies in which the amount of net equity is generally not significant.

On the contrary, the determination of the premium is affected by multiple factors [12], some related to economic, business and general issues, such as, for example, the existence of favorable business prospects, or

the good performance of shares, or even the expansive phase of financial markets; others, which may also exist alongside the previous ones, driven by reasons attributable to the will of the majority to obtain new capital, without, however, changing the existing ownership structures.

The combination of these factors implies that, in the conditions concerning the issuance of the shares, not only are there the presumed or realized increases in company net equity, but also a number of contributing factors, varying from company to company and changing over time, among which *the economic and financial situation of the company which increases the share capital and the conditions of the financial and monetary markets*.

In relation to the profile under 2), that is, the qualification of the economic nature of the premium, the doctrine has widely discussed, especially in the last century, after the mobile wealth tax came into force, if the premium has the nature of income, and therefore should be subjected to taxation, or that of capital, in as much as it is representative of additional contributions, permanently subservient to the company.

The proponents of the first hypothesis assume that, ultimately, the application of the premium is nothing more than *the result of the sale of the company's goodwill*, accumulated over time, or the result of an increase in capital caused by production of income. *However, it is essential to underline the need not to confuse capital with income, given that capital growth, even if produced by income, remains capital, while income is the product derived from capital and its growth.*

Furthermore, it is worth highlighting that we cannot rightly talk about the sale of goodwill, given that the increase in share capital with a share premium does not in any way imply a reduction in the value of the company's goodwill, as it would do if it were sold. Similarly, in this case, it is necessary not to confuse the price-setting basis with the price itself: it may well be that the goodwill of the company is involved in determining the premium, but this is only a parameter used to calculate the premium and not the premium itself.

In this sense, the share premiums always have the nature of capital as they are part of the overall contributions of the shareholders and increase the capital injected, without increasing the size of the share capital.

With regard to the theories of the adjustment under c), they capture a very important aspect of the problem, namely the need to find a solution to *the contrast of interests between new and old shareholders*, considering that the former, thanks to the subscription of newly issued shares, will share with the latter the fruits and risks of the company and, above all, they will be able to benefit from the distributions of the reserves previously accumulated, even if they have not contributed, with their capital, to the production of the profits that can be assigned to them.

In this sense, the premium represents the remuneration that the new members pay to obtain equalization with the old ones for the right to the profits generated by the entire share capital, and, in particular, by the increase it enjoyed before their entry.

Therefore, we conclude that the application of the premium, aside from opportunistic behavior, must find its cause and measure in the favorable economic conditions of the company, both already present at the time of the issue of new shares or yet to be consolidated, but predictable: in the first case, the prosperity of the company is demonstrated by the equity measure, i.e. by the increase that the share capital has achieved as a result of management; in the second case, typical of the youngest companies, even if the growth of capital has yet to occur, there are already sufficient growth prospects to justify the request for a premium from the underwriters of the shares, also with the aim of providing the company with capital that is consistent with the financial needs posed by the planned expansion.

IV. The Empirical Investigation

In order to quantify the magnitude of the phenomenon and to investigate its characteristics, we considered the sector of small-medium innovative companies, listed on the Italian Stock Exchange, on the basis of data from the financial year 2017.

The sample, corresponding to the entire population, is made up of 28 joint-stock companies.

In particular, the following variables were considered:

- a) the date of establishment (D);
- b) the amount of share premium reserves (SPR);
- c) the amount of the share capital (SC);
- d) the amount of net equity (NE);
- e) the amount of other reserves (OR).

On the basis of the aforementioned variables, the percentage index SPR/NE was calculated, corresponding to the ratio between the value of the share premium reserve and the value of the net equity.

The consideration of the year of establishment was useful mainly in order to demonstrate how the presence of the premium can be justified not only in terms of previous company growth, but also in terms of future expansion, which is especially important in recently established companies.

Furthermore, considering the size of the various components of net equity allows both the appreciation of the quantitative importance of the share premiums in the analyzed sector, and the concrete verification of whether its size has been determined on the basis of existing reserves, as claimed by part of the doctrine.

Sample data are shown in Table 1.

Table 1: Small and medium-sized innovative companies listed on the Italian Stock Exchange. Year 2017.
Values in thousands of Euros.

COMPANY	DATE OF ESTABLISHMENT	SHARE PREMIUM RESERVES	SHARE CAPITAL	TOTAL NET EQUITY	OTHER RESERVES INCOME AND LOSSES
CLABO SOCIETA' PER AZIONI	18/03/2014	6.921	8.194	17.474	2.359
GIGLIO GROUP S.P.A.	10/02/2003	11.455	3.208	11.711	-2.952
FOPE S.P.A.	12/01/1972	1.810	4.748	11.769	5.211
HEALTH ITALIA S.P.A.	07/11/2013	3.378	14.308	20.866	3.180
WIIT S.P.A.	19/06/2007	19.249	2.566	23.626	1.811
GEL S.P.A.	04/12/1984	5.481	719	7.632	1.432
EXPERT SYSTEM S.P.A.	05/11/1999	35.980	357	37.187	850
DIGITOUCH S.P.A.	12/03/2007	8.790	695	14.083	4.598
NOTORIOUS PICTURES SOCIETA' PER AZIONI	04/07/2012	6.886	562	9.978	2.530
ESAUTOMOTION S.P.A.	22/11/2011	0	10	4.351	4.341
MAILUP S.P.A.	23/09/2002	11.041	354	13.244	1.849
BIO-ON S.P.A.	27/03/2007	41.419	188	48.178	6.571
ALFIO BARDOLLA TRAINING GROUP S.P.A.	30/10/2012	2.347	5.094	7.796	355
SCIUKER FRAMES S.P.A.	29/04/1999	0	702	3.182	2.480
TECHNICAL PUBLICATIONS SERVICE S.P.A. O T.P.S. S.P.A.	01/01/1964	2.426	949	4.939	1.564
KOLINPHARMA S.P.A.	18/07/2013	0	1.000	1.246	246
ABITARE IN S.P.A.	19/11/2015	9.651	82	10.168	435
BLUE FINANCIAL COMMUNICATION S.P.A.	22/12/1995	1.409	150	1.787	228
ELETTRA INVESTIMENTI - S.P.A.	11/05/2005	4.572	3.837	10.274	1.865
RENERGETICA S.P.A.	08/07/2008	148	93	1.137	896
DIGITAL360 S.P.A.	17/12/2012	5.852	1.537	7.013	-376
CIRCLE S.P.A.	28/05/2012	329	121	1.608	1.158
WM CAPITAL S.P.A.	13/03/2000	1.025	142	1.082	-85
ENERGICA MOTOR COMPANY S.P.A.	26/08/2014	10.392	140	5.142	-5.390
MYBEST GROUP	27/01/2004	10.161	2.463	12.173	-451

S.P.A.					
DOMINION HOSTING HOLDING S.P.A. O DHH S.P.A.	09/07/2015	6.709	142	6.861	10
CASTA DIVA GROUP S.P.A.	09/03/2000	4.184	6.056	10.529	289
SOSTRAVEL.COM S.P.A.	27/11/2017	n.a.	n.a.	n.a.	n.a.

Source of data: Aida

The data relating to the ratio between the share premium reserve and net equity are shown in Table 2.

Table 2: SPR/NE Index

COMPANY	SPR/NE (%)
CLABO SOCIETA' PER AZIONI	40
GIGLIO GROUP S.P.A.	98
FOPE S.P.A.	15
HEALTH ITALIA S.P.A.	16
WIIT S.P.A.	81
GEL S.P.A.	72
EXPERT SYSTEM S.P.A.	97
DIGITOUCH S.P.A.	62
NOTORIOUS PICTURES SOCIETA' PER AZIONI	69
ESAUTOMOTION S.P.A.	0
MAILUP S.P.A.	83
BIO-ON S.P.A.	86
ALFIO BARDOLLA TRAINING GROUP S.P.A.	30
SCIUKER FRAMES S.P.A.	0
TECHNICAL PUBLICATIONS SERVICE S.P.A. O T.P.S. S.P.A.	49
KOLINPHARMA S.P.A.	0
ABITARE IN S.P.A.	95
BLUE FINANCIAL COMMUNICATION S.P.A.	79
ELETTRA INVESTIMENTI - S.P.A.	45
RENERGETICA S.P.A.	13
DIGITAL360 S.P.A.	83
CIRCLE S.P.A.	20
WM CAPITAL S.P.A.	95
ENERGICA MOTOR COMPANY S.P.A.	202 ^(*)
MYBEST GROUP S.P.A.	83
DOMINION HOSTING HOLDING S.P.A. O DHH S.P.A.	98
CASTA DIVA GROUP S.P.A.	40
SOSTRAVEL.COM S.P.A.	n.a.

(*) The value is greater than 100% due to the presence of negative items in net equity. We have considered it equal to 100%.

As can be seen, the premium represents an extremely significant component of total net equity. In particular, if we consider the impact of the share premium reserve on the total net equity not exceeding 20% to be marginal, the following significant intervals can be constructed (Table 3).

Table 3: Intervals of the SPR/NE index

SPR/NE (%)	Number of companies	Percentage of companies
SPR/NE < 20%	7	25%
20% < SPR/NE ≤ 50%	5	18%
50% < SPR/NE ≤ 100%	15	54%

Not available	1	3%
TOTAL	28	100%

We can see that 54% of the companies considered have an index value of over 50%; therefore, it can be concluded that, in most of the companies that make up the small and medium-sized innovative companies listed on the Italian Stock Exchange, own funds are made up of more than 50% by share premium reserves.

Furthermore, as regards the correlation between the impact of the share premium reserve and the date the company was established, it is noted that almost all the companies in the sample were no more than 18 years old, so the sample can be considered relatively young.

Only six companies established in the last century are exceptions, in which, however, the index does not show a univocal tendency, but instead can be placed in all three intervals considered in Table 3.

With regard to the assumption that the most recently established companies are also those with lower accumulated reserves (other than that for premiums), it is noted that, in the sample, the condition is actually verified, given that the majority of the companies considered hold other reserves (net of losses and including retained earnings) that are significantly lower than the premium.

Therefore, this observation seems to confirm that the determination of the share premium is in practice decoupled from the size of the net equity existing at the date of the increase of the share capital and, additionally, from the age of the company, since, as shown above, the assumption that younger companies have relatively smaller net equity than the older businesses is proven. Despite this, even in the younger companies the premium can be high.

V. The Distorted Use of the Share Premium

Finally, a further profile remains to be considered, connected to the possibility that the premium is bent in the name of a distorted use [13], one that does not correspond to the social objectives of adequate capitalization, but rather to the personal interests of the shareholders who, in contrast to the company's aims, establish an intentional fraudulent activity through which the rights of minority shareholders are infringed [14]. For example, this may happen in cases where the magnitude of the premium does not adequately reflect the good economic prospects of the companies and their satisfactory goodwill, and is instead determined, in whole or in part, by a behavior contrary to good faith, aimed at obtaining net equity without attributing to the subscribers participatory rights in line with the investment, as long as, in the absence of a premium, the same contribution would correspond to the ownership of a greater number of shares [15].

In this regard, it should also be remembered that setting particularly high premiums, in the absence of adequate economic justifications related to the current or prospective goodwill of the company, could be aimed at making the subscription impracticable to the shareholder in situations of financial difficulty, in such a way to reduce its chances of exercising the option, and therefore its participation and its weight in the shareholders' meeting decisions, with a strengthening of the existing majority.

VI. Conclusions

The premium represents a complex case in which economic-business problems take on considerable importance.

In this regard, evaluations aimed at identifying the intrinsic value of the company, or its internal goodwill, are especially relevant, given that, from a substantial point of view, the premium must be justified by the increase in company value - already occurred or foreseeable - in which the old and new shareholders can participate.

In this sense, the functions of the premium can be summarized in two main groups:

- a) a compensatory function;
- b) a financial function.

The compensatory function emerges above all in relation to the companies which are already well-established, in which the growth of company value has already been consolidated, so that the request to shareholders for additional payments with respect to the nominal value of the shares is justified by the right of the underwriters of the new shares to participate in profits made in an earlier period.

The financial function, on the other hand, emerges mainly in the operations of share capital increase posed by new or newly established companies, in which the capital strengthening has not yet had the space and time to happen.

Although in this case the premium might be understood as the price paid to benefit from the capital increases envisaged for the future, it should, however, be considered that its main function is to be attributed to the need to provide the company with adequate capital, capable of supporting the growth processes that have yet to take place.

In this sense, the premium is the sacrifice that is required of the shareholders so that the company can benefit from the financial resources whose needs are particularly relevant in the start-up phases: on the one hand, the company must equip itself with all the necessary production conditions to carry out its activity; on the other hand, it has not yet begun to produce income, and therefore its self-financing function has not yet been activated.

Finally, the sample analyzed confirmed that the premium represents an extremely significant part of the equity of the companies observed, in most of them abundantly outperforming both the share capital and the other reserves.

The limits of the discussion are due, above all, to the fact that the empirical investigation does not allow the establishment of on what basis the premiums have actually been determined, and therefore if, and to what extent, they have reflected the economic prospects of the companies, rather than the amount of net equity already consolidated, or the compensatory function between old and new shareholders.

The present study therefore intends contribute to the literature on the subject, also in consideration of the empirical relevance that the phenomenon currently assumes in the Italian context, offering food for thought for both legal and economic exploration of the case.

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