

PROCESS OF CHANGING THE LEGAL FORM OF COMPANIES

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Abstract: In recent years, many businesses have increasingly found themselves in a situation of dangerous threat. Their competitiveness and the use of advantageous opportunities decreased. The concept of change management has thus gained in importance and corporate change has become an important tool for achieving success. Every company manager must be able to respond flexibly to changing environmental conditions and recognize the opportunity for change or improvement, which can be realized by transforming the legal form of the company. After a major recodification of commercial law in 2014, the individual legal forms of business were also modified. Major changes have also affected limited liability companies and joint-stock companies. These legislative changes have led to further transformations in various forms, most often mergers and changes in legal form. Transformations of companies shall be carried out in accordance with the written draft terms of conversion. The aim of the article is to evaluate the process of changing the legal form from a limited liability company to a joint-stock company in the Czech Republic. The data were obtained using a questionnaire survey and a structured interview with shareholders and board members of joint-stock companies. The results point to the fact that most transformations take place in the form of mergers by merger and change of legal form. Most transformations take place with the consent of all shareholders and the primary reason for the change in legal form is the need to obtain new resources for business. The registered capital and issued shares of the examined companies were further processed using selected statistical methods.

Keywords: change, limited liability company, joint-stock company, transformation process, management

JEL Classification: M10, L20, K20

INTRODUCTION

There are many possible alternatives how to do business in Czech Republic. At the beginning of every business there is an important choice – do business as a natural or legal person – while one of the key decisions is considered the choice of the legal form of business itself. Based on data from 2021, it is clear that the business of individuals is 4x more widespread. 2,015,292 natural persons and 531,481 legal persons were registered in 2021. The most widespread legal form is limited liability company, of which there were registered 495,911 (Český statistický úřad, 2021). During the life of every company, there are situations when it is necessary to adopt drastic changes in order to maintain its market position. One of these changes may be the transformation of company. These transformations may be carried out by several options – as mergers, divisions, changes in legal form or transfer of assets to a shareholder. Last, but not least, the trend of cross-border transformations has become increasingly important in the last few years (Josková, 2018).

Like every change, the transformation of business company is based primarily on quality preparation. The transformation project is a basic document by which the whole process can be managed. It is important to note that this project is also a legal act that is – depending on the number of participants – unilateral or multilateral. It contains in detail all the information, points and terms that relate to the transformation. In fact, it is a document very similar in its characteristics to the plan (Skálová, 2019).

As any change in the company, the transformation also has an impact on the company, whether from an economic, organizational or accounting point of view. It is worth to note that the position of individual partners does not remain the same (Šafránek, 2019). Skálová (2019) adds the basic legal information

regarding the transformation. It is noted that the possible implementation of the process is decided by the General Meeting, when at least three-quarters of the votes of the shareholders presented are required for implementation. The transformation project is linked to the financial statements, which are drawn up on the same date as the project. In the situation this article evaluates - i. e. the change of legal form to a capital trading company – the law mandates the valuation of the company's assets.

1. CHANGE MANAGEMENT IN COMPANIES

Nowadays, instability and change are the most common characteristics of the environment that determine changes in companies (González González & Lázaro Torres, 2013). Change is extremely difficult because any change in one detail of everyday life of the company causes problems or misunderstanding. (Leichenko et al., 2010). It is not easy to manage the change, but it does not mean, it is impossible; different strategies can increase success (Self & Schraeder, 2009). It is important to realize that change is necessary because it is important to use new opportunities that our environment constantly offers (Thompson & Martin, 2011).

Changes in companies are taking different dimensions. Many companies still face the challenge how to ensure market relevance, which translates into success overall (Van den Ven, 2005). Thus, the main aim for management is to combine the best skills that are important for managing the change. They create an environment where is possible to implement changes (Kemp & Low, 2008). Effective acceptance and implementation of change depends on human resources. Right people have a huge influence on successful implementation of change (Collins, 2001). It is obvious that change requires a phase of transition (Hulme, 2009).

Successful change requires more than what is defined as change management, i. e. right strategy, competencies (employees with skills to adopt to change) and structure including organizational tools (Carter, 2008). Manager has key role in process of change, especially after he is convinced about the need of change (Kolektiv, 2012). Leadership increase effectiveness of change process (Higgs & Rowland, 2005). It is essential to believe in change for everyone (Vithessonti & Thoumrungraje, 2011). Change management requires different skills, ranging from effective communication, honesty, perseverance and determination (Ajayi, 2002).

Change management is process of constantly renewing and organization's direction, structure and capabilities to serve the ever-changing needs of external and internal customers (Moran & Brightman, 2001). Change management contains many aspects such as analyzing and organization's effectiveness and finding the required changes for achieving better performance and determining steps to follow for managers to successfully implement change (Hayes, 2007).

Change management processes cover many aspects that ensure a smooth transition and decrease the amount of resistance to change (Park & Pena-Mora, 2003). The discipline focuses on issues such as: organization development and change (Pless & Maak 2004), changing organizational processes (Chesbrough 2010). There is a wide range of techniques available for managing organizational change (Smith, 2011, Pillay et al., 2012). Kotter's (1996) eight-step model of creating a huge change is one of the most popular models for transforming the organization (Mento et al., 2002). It has been described as the most convincing model for successful managing of changes (Phelan, 2005). As both an academic research topic and a practical discipline, organizational change management focuses on managing and understanding the ways in which organizations adapt and change (Pollack, 2015).

2. AIMS AND METHODOLOGY

The main aim of this article is to find out how the process of changing the legal form in Czech Republic takes place. The partial aim is to provide insight into the change of legal form from limited liability company to a joint-stock company, not only from a legal point of view. This type of change is further viewed from a managerial, economic and statistical point of view. For systematic evaluation of the aims set there have been identified several research questions:

1. Is the primary reason for the transformation the need of new resources to expand the business?
2. Did the transformation take place without major problems and with the consent of the majority of the shareholders?
3. Does the established joint-stock company prefer the dualistic system of internal arrangement to a monistic system?
4. Have certificated shares been issued?
5. Has any type of shares other than ordinary been issued?
6. Is the most common used valuation method some of the income methods?
7. In the opinion of involved persons in transformation, is the legislation optimal and sufficient?

The basic starting point for data collections was study of the relevant legislation. These are the following three standards: Act no. 125/2008 Coll., on Transformations of Commercial Companies and Cooperatives; Act no. 89/2012 Coll., the Civil Code and Act no. 90/2012 Coll., on Commercial Companies and Cooperatives (Business Corporations Act). A questionnaire survey was used to obtain primary data. Its respondents were shareholders and members of Board of Directors (or other statutory body) of joint-stock companies. This form was used because of its low cost. The questionnaire was divided into two parts. The first part was consisted of identification questions that serve as an adequate filter. Second part contained only questions related to the issue. At all, respondents answered 15 questions, both open and closed.

The structured interview was the second method of data collection used. Interview was realized with member of Board of Directors and with the majority shareholder of randomly chosen joint-stock company. In order to make a comprehensive conclusion on the research questions mentioned above, this interview was necessary. It took about 60 minutes and very original and valuable answers were collected. The questions were mainly focused on the benefits of transformation, its main cause and opinion about forms of shares/today's situation on the stock exchange.

Moreover, there has been done a statistical evaluation of data obtained. First, basic descriptive statistics (average, median, standard deviation and variance) were calculated for values of registered capitals of the companies being acquired as well as for the nominal values of the shares of new companies. The calculated medians were tested by relevant statistical method. The last part of statistical analysis is a calculation of correlation coefficient. This coefficient should prove/refute whether the nominal values of shares in the new company are affected by the values of the registered capital of the company being acquired. This analysis was done in several software, i. e. statistical software R studio, programme Microsoft Excel and for the calculation of basic descriptive characteristics were used the relevant formulas as offered by Mrkvička (2006).

3. RESULTS AND DISCUSSION

In 2014, the major change of commercial law took place in Czech Republic. The Commercial Code was repealed and the Business Corporation Act was introduced with many novelties. These new options are not, for now, widely used. A practical example is fact, that monistic structure of internal arrangement is still not used much compared with classic dualistic arrangement. A certain reaction on this fact is a new change in the law when the position of statutory director was abolished.

The Act on Transformation of Commercial Companies and Cooperatives is positively received by business community. During the transformation of company from the category of SME certificated shares are still increasingly preferred, especially for their easier transferability, over book-entry shares. Still the question remains, how outlined a structured interview, whether transferability of book-entry shares is still more complicated. Companies prefer to issue ordinary shares during the transformation. They proceed to the issuance of other types of shares after the transformation is complete.

3.1 Evaluation of research questions from a perspective of a questionnaire

The questionnaire consisted of 15 questions and 35 answers were obtained. The return of the questionnaire was almost 10 %. At the beginning, respondents answered identification/filter questions providing wide spectrum of the sample. These questions were followed by questions about the researched area. Most of the closed questions had an extra open question where respondent had the opportunity to comment the issue by his own. A comment on issues related to shares and registered capital was mandatory.

Research question 1 - Is the primary reason for the transformation the need of new resources to expand the business?

Of the sample examined, only 20 % of companies did transformation because of this need. After the deeper analysis it was found out that all these companies (which did transformation because of need of new resources) used the form of change a legal form. On the basis of this observed fact, it can be inferred that the majority of companies undergo the change of legal form to attract more affluent portfolio of investors. However, this research question cannot be confirmed.

Research question 2 - Did the transformation take place without major problems and with the consent of the majority of the shareholders?

Almost all respondents, exactly 91.4%, answered that all partners were in favor of transformation, or this decision was taken after some dialogues. After more detail analysis of minority part of the sample it was observed that the dissenting partners had a different attitude to the future economic direction of the company. Only in one case was found that shareholder did not accept the transformation because of personal disputes. This question can be confirmed.

Research question 3 - Does the established joint-stock company prefer the dualistic system of internal arrangement to a monistic system?

As same as above, 91.4 % of respondents agreed on same answer. The Czech market is still dominated by dualistic arrangement including the General Meeting, the Board of Directors and the Supervisory Board. From this point of view, it can be said, that it is a rigid market. Especially if since 2014 exist an alternative version – monistic arrangement. However, it is used significantly less, representation in examined sample is only 8.6 %. This system is preferred by small and micro companies because they require great flexibility in management and decision-making. According to the respondents, dualistic system has a historical tradition and therefore is preferred. At the same time, it is also necessary to note that some companies are controlled by larger companies, which requires to work with dualistic system. This question is confirmed.

Research question 4 - Have certificated shares been issued?

83 % of companies from examined sample issued certificated shares. Remaining part issued book-entry shares or did not issue new shares at all (there was no need to increase registered capital). According to the structure of the sample, when major part of the companies is from category SME, is not surprising to find that certificated shares were preferred. These companies do not have ambitions to be traded on stock exchange market or other relevant markets, so this classic form of shares, which is easily transferable, is sufficient for them. This research question is confirmed.

Research question 5 - Has any type of shares other than ordinary been issued?

Ordinary shares were issued in 100 % of cases. During the transformation there was no need to issue any other form of shares, but a number of respondents answered, that after the transformation was done other forms of shares were issued. During the transformation itself only ordinary shares were clearly preferred. Thus this question cannot be confirmed.

Research question 6 - Is the most common used valuation method some of the income methods?

About 60 % of companies in the sample reported that some of the income methods were used for valuation of their assets. This fact can be linked to the fact that these methods are very popular with mergers and changes in legal form, which were the mostly found forms of transformation in examined sample. On the contrary, the least represented methods are market methods (of which only 11.4 % of cases were used). The question can be confirmed.

Research question 7 - In the opinion of involved persons in transformation, is the legislation optimal and sufficient?

In the sample, only 8 % of respondents expressed a strongly negative attitude towards the legislation. 60 % of respondents say that legal issues are treated to a sufficient extent, the rest of the participants expressed a negative opinion. In fact, most of the respondents rather did not know what exactly reproach about the standards. This may be due to the fact, that during the transformation itself, they used assistance of lawyers or other persons. However, it cannot be said that the success of the transformation depends only on the wording of individual paragraphs. There is no doubt that there are a number of other elements influencing the whole process. This question is confirmed.

3.2 Evaluation of research questions from a perspective of a structured interview

Research question 1 - Is the primary reason for the transformation the need of new resources to expand the business? – rejected

Research question 2 - Did the transformation take place without major problems and with the consent of the majority of the shareholders? - confirmed

Research question 3 - Does the established joint-stock company prefer the dualistic system of internal arrangement to a monistic system? - confirmed

Research question 4 - Have certificated shares been issued? - confirmed

Research question 5 - Has any type of shares other than ordinary been issued? – rejected

Research question 6 - Is the most common used valuation method some of the income methods? - confirmed

Research question 7 - In the opinion of involved persons in transformation, is the legislation optimal and sufficient? - confirmed

It can be noted that the overall evaluation of questions turned out the same as their evaluation from a perspective of questionnaire. Data obtained from a structured interview confirmed the answers obtained earlier and there was no change in evaluating the research questions. Two questions were rejected or not confirmed. It is not confirmed that the main reason for the transformation is the need of new resources to expand the business and at the same time the claim that non-ordinary shares are issued is also rejected. The generally preferred income valuation methods have become the answer to question 6.

3.3 Statistical analysis

There can be found two datasets in this section. The first dataset contains the values of the registered capitals of the companies being acquired, the second dataset contains the values of newly issued shares in the new companies. The data were obtained as an additional part of a questionnaire survey. The basic descriptive characteristics were calculated for both datasets (Table 1) and then the validity of calculated numbers were verified by statistical test and correlation analysis is offered in conclusion.

Table 1: Descriptive characteristics

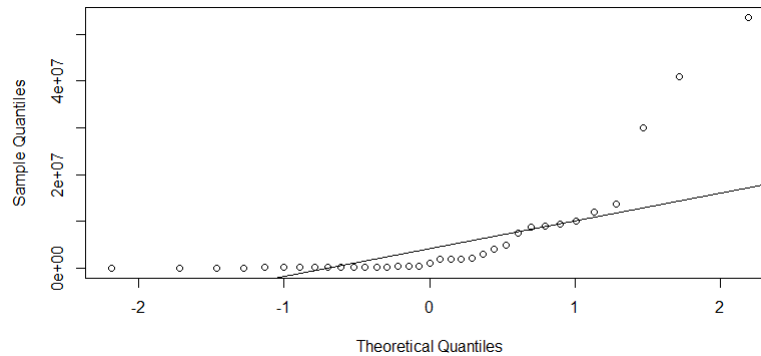
Dataset	Characteristics	Average	Median	Standard deviation
Registered capital		6 291 403 CZK	1 099 000 CZK	11 962 725
Issued shares		252 731 CZK/share	30 000 CZK/share	570 509

Source: authors based on questionnaire survey

The standard deviation value in both datasets is unusually high. Taking into account the fact that there are extreme values in both sets, the obtained values no longer appear so extraordinary. Especially in first set – the values of registered capital – there are values ranging from 100 000 CZK to 53 million CZK. The

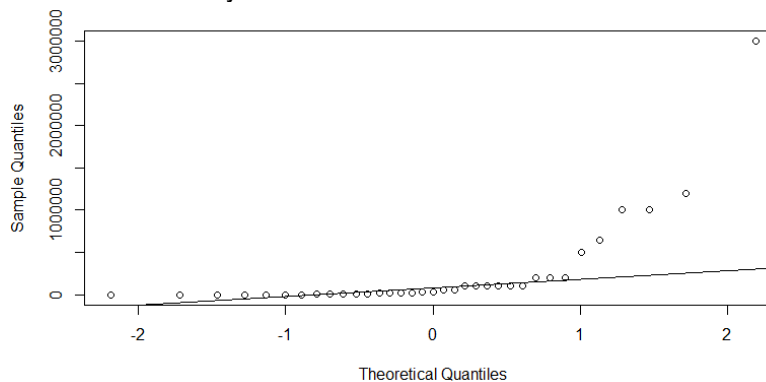
values of variances take on ever more extreme values, since it is square of the standard deviation. In order to select right statistical test that would confirm or refute the calculated value of the median, it was necessary to verify normality of data obtained. For this verification the Shapiro-Wilk normality test was chosen. This test rejected normality of data. For a clearer idea of the examined data, QQ graphs are offered for both datasets. Graphs were processed in software R.

Figure 1: QQ graph of values of registered capital



Source: authors

Figure 2: QQ graph of values of newly issued shares



Source: authors

Figures 1 and 2 clearly show significant extreme values in both sets. These values are the cause the data cannot be marked as normal. If the data showed normality, it would be possible to proceed in the standard way using the standard One-sided t-test. The non-parametric test had to be chosen. Testing was carried out using the Sign test. The first monitored dataset, consisting of values of registered capital, was tested to determine whether the median is actually equal to 1 million CZK. Two hypothesis were established, namely H_0 and H_A , where H_0 claims equality with the calculated value. Same procedure was used in the case of verifying the median values of newly issued shares. Again two hypothesis were established, H_0 and H_A , where H_0 claims equality to 25 000 CZK. In neither case was the hypothesis H_0 rejected. It is based on calculated p-value. There is no statistical evidence that the median of the observed samples is different from standard calculated values.

The last part of the statistical analysis is correlation analysis of both datasets. A positive correlation was observed, with the correlation coefficient taking value of 0.45489. On this statistical basis, it is claimed that there is a dependence between the value of newly issued shares in the new company and the value of registered capital in the company being acquired.

CONCLUSION

Nowadays, the surrounding environment of companies can be described as very turbulent. Managers of companies have to constantly adapt to the new changes that can be found on the markets. These changes

do not necessarily come from the external environment, many of them come from the internal environment. The need of quality change management is significantly increasing and is becoming one of the great competitive advantages. A flexible and quick reaction to changes becomes a matter of survival of the company, maintaining its market share, employees, and profitability. For effective change management is an appropriate strategy required.

One of the possible changes that companies undergo is the transformation. There are 4 main forms of transformation. The most common used forms are mergers or changes in legal form. In the case of mergers, the most common form in the Czech Republic is merger by acquisition. The opposite of merger is division, which is a less used form of transformation. There is also a form of transfer of assets to a shareholder, but this method is sporadically being practice, especially in large companies. The most common valuation methods are income methods.

The transformation process is not carried out for the purpose of the need of new resources for expansion of the business. This reason can be applied only to 20 % of companies in examined sample. However, when acquiring new resources, the most common used form is a change in legal form. Furthermore, the value of newly issued shares is influenced by the value of registered capital of the company being acquired, as demonstrated the correlation analysis. According to the results, respondents perceive the Transformation Act as very good and do not find any fundamental problems.

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