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**Research Report**

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## The Sale of Treasury Stocks and Protection of Management Rights

**Sung Ick Cho**, Fellow at KDI

**“Treasury stocks play a vital role in retaining, protecting and transferring management rights in large enterprises. However, the sale of treasury stocks is essentially identical to the issuance of new shares in economic nature. Therefore, using treasury stocks to protect management rights could obscure the equal treatment of shareholders. Even if such practices are permitted for policy purposes, the government needs to put other measures into place to protect general and minority shareholders from the damages that may arise.”**

### I. Introduction

Treasury stocks have garnered mounting attention in the wake of the Cheil Industries Inc. (formerly Samsung Everland) and Samsung C&T merger in 2015 and Samsung Electronics' recent review of a split-off. At the same time, however, the myriad of highly technical and complicated contents in relation to legal and accounting matters have created more confusion than understanding.

In order to shed light on the issue of treasury stocks, take the merger between Cheil

\* Based on Cho, Sung Ick and Yong Hyeon Yang, *A New Discipline for the Inter-Corporate Shareholding*, Research Monograph, 2016-05, Korea Development Institute, 2016 (in Korean).

The sale of treasury stocks and the issuance of new shares are the same in economic nature since both increase stock trade volume and seek outside funding.

Industries Inc. and Samsung C&T as an example. When Elliott Management opposed its takeover of Cheil Industries Inc., Samsung C&T sold its entire treasury holdings to KCC Corporation to win the vote at the shareholders' meeting. This was possible because, under the current law, treasury stocks can be disposed of via a board of directors' resolution, unlike new stock issuances. And yet, economically, selling treasury stocks and issuing new stocks are essentially the same in nature in that both increase stock trade volume and secure outside funding. Indeed, if the same law for new stock issuance was applied to the sale of treasury stocks, the third-party allotment seen above would not have been feasible. Moreover, what this reveals is that a discrepancy exists in Korea between the economic nature and legal understanding of treasury stocks, and that this provides a line of defense for management who seek to exploit this loophole. Accordingly, clarifications are needed with regards to the ongoing discussions on the matter.

Another important issue is the allotment of new shares during a split-off. A number of recently attempted demergers, including that of Hyundai Heavy Industries, were thrust into the media spotlight for allegedly being a ploy by owner families to maintain, or rather, transfer management rights.<sup>1)</sup> The main point of contention here is whether it is justifiable to allot new shares to treasury stocks as they are deemed worthless. In this study, the focus has been primarily placed on the sale of treasury stocks for the protection of management rights, however, this also presents implications for the allotment of new shares to treasury shares.

Song (2014) believes that the current laws and systems in place are founded on a misunderstanding of the real situation in terms of the economic nature of treasury stocks. Although it is not always true that all systems should be designed to fit economic nature, as long as their policy goals are reasonable, Korea's treasury stock management system, at least tacitly, appears to be based on the premise that treasury stocks can be used to protect the management rights of large companies.

Even at a glance, it is obvious that allowing controlling shareholders to dispose of treasury stocks at their discretion would create damages to general and minority shareholders. Accordingly, this study undertakes the additional task of considering the premise that the collaboration or division of labor with a new share buyer would significantly improve management efficiency. In this case, the value of the company will increase and the general and minority shareholders will benefit. However, if the controlling shareholders decide to protect their management rights regardless of the loss to the company, the ensuing sale of treasury stocks would deal a blow to general and minority shareholders.

Therefore, in working to overhaul the market for management rights, the government

1) In the case of a demerger, a company is split into a holding company and a newly established operating company (by transferring the operating business of the existing company to the new company). In this process, the shares of the newly established company are allotted to the holding company in proportion to their holding stake of treasury shares. In doing so, the owner family can maintain the holding stake required to maintain their management control even after selling out some shares of the newly established operating company to pay an inheritance tax.

needs to develop policy measures that allow the use of treasury stocks only as a means of financial management in the mid- to long-run—in line with the underlying economic nature of treasury stocks—while prohibiting the excessive use of the stocks to protect management rights in the short-run, which could have a crippling effect on the value of the company.

## II . Sale of Treasury Stocks: Economic Nature and Current System

This section closely examines the economic nature of the sale of treasury stocks and the relevant laws and systems. To better understand treasury stocks, the following reviews how shares become economically valuable. A stock is a certificate issued by a company that certifies ownership, and it also includes the right to claim dividends from company assets. In this sense, as long as the shares are distributed outside of the company, they can be of economic value. However, once they are bought back, they no longer have such value; because the company cannot lay claim to its own assets.

If treasury stocks are sold and traded within the markets, economic value is again created. This process is identical to the issuance of new stocks. Take for example, a company that has issued ten shares and bought back two. The company is valued at 8 billion won and assuming that this is accurate, the company's stock prices will be set at 1 billion won apiece.<sup>2)</sup> Then, if the company disposes of the two treasury stocks it previously bought back at market price, it will receive 2 billion won, which would bring the total value of the company to 10 billion won with all ten shares being traded in the market. Meanwhile, if the company chooses to retire the two treasury stocks and issue new shares, the company is again valued at 10 billion won as the company will acquire 2 billion won from the new shares. So, in financial terms, the sale of treasury stocks and the issuance of new shares are, in fact, identical.

However, according to Korea's Commercial Act, the two are very different.<sup>3)</sup> In relation to the sale of treasury stocks, Article 342 of the Act acknowledges a company's right to

Within the legal system, the difference between the sale of treasury stocks and issuance of new shares seems to have been created intentionally during the legislative process. As a result, controlling shareholders are able to use treasury stocks to defend their management rights.

2) A company's value is not fully known in reality, and it is often the case that share prices do not reflect the value of the company accurately. Take a company whose value is at 10 billion won but market value is at 8 billion won. Its executives may choose to purchase shares, which is indicative of the fact that the shares are undervalued. This is referred to as 'information signalling hypothesis' in preceeding literatures regarding the motive of share purchases. Refer to Chapter 6 in Cho and Yang (2016) for other hypotheses on leverage, dividend, free cash flow, takeover deterrence, etc.

3) Although the author explains that the selling of treasury shares is identical to issuing new shares in terms of economic nature, this is not the case according to Korea's current laws and systems. The purchase creates no change in the share capital on the balance sheet, and thus, it is different from retiring treasury shares which is intended to reduce the share capital on the balance sheet. Also, the purchase creates no changes in the holding stakes of shareholders' treasury stocks, unless they are retired. In this context, the current laws regard the transaction of treasury stocks as a profit and loss transaction which does not change the amount of capital. True, the balance sheet shows no change in the share capital, but in reality, some of the share capital was used to purchase shares. Not only that, the actual voting rights of shareholders change since treasury shares have no voting rights. In this context, it is logical to regard the transaction of treasury shares as a capital transaction. What determines a treasury stock transaction as a profit and loss transaction or a capital transaction is whether the treasury shares are economically valuable. Refer to Lee (2006), An (2011) and Song (2014) for more legal concepts and discussions.

&lt;Table 1&gt; Sale of Treasury Stocks vs. Issuance of New Stocks

		Sale of treasury stocks	Retirement of treasury stocks and issuance of new shares	Issuance of new shares
Economic nature	Number of traded shares	<b>Increase</b>	<b>Increase</b>	Increase
	Outside funding	<b>Inflow</b>	<b>Inflow</b>	Inflow
Balance sheet	Capital/asset	<b>Increase</b>	<b>Increase</b>	Increase
	Capital on the balance sheet <sup>5)</sup>	No change	No change	Increase
Voting rights	Existing shareholders' holding stake on balance sheet	<b>No Change</b>	<b>Increase</b>	Increase
	Real voting rights of existing shareholders	<b>Decrease</b>	<b>No Change</b>	No Change
Legislative intent, law/system	Decision-making body	<b>Board of Directors</b>	<b>General Shareholders' Meeting</b>	General Shareholders' meeting
	Protection measures for management rights	<b>Yes</b>	<b>No</b>	No

decide on how and to whom it will sell its stocks based on a board of directors' resolution. As for the issuance of new shares, Article 418 of the same Act recognizes the entitlement of existing shareholders to the allotment of new shares.<sup>4)</sup> Indeed, from the controlling shareholders' perspective, this legal differentiation creates an economic disparity between selling treasury shares and issuing new ones. That is, in the event new shares are issued, there will be no change in the real voting rights of existing shareholders. However, if treasury stocks are sold, the controlling shareholders can then sell their treasury stocks to friendly groups. In this case, the company will acquire the same amount of funds that it would have received if it issued new shares, but the proportion of shares the controlling shareholders can use at will increases by the proportion of sold shares; these shares can be put to good use when management rights are threatened.

Unlike other countries where treasury stocks are used mainly for financial management, Korea's Article 342 seemingly allows the use of treasury stocks as a means to protect management rights. In fact, looking back at the enactment and implementation of the Act, it is possible that the law was legislated in consideration of such a purpose. The amendment pre-announced by the Ministry of Justice in 2006 inserted Provision 2 to

4) Issuing new shares for the purposes of allotting to a third party to protect management rights was rejected by the Supreme Court (Supreme Court, 2008Da50776, Decision Date: Jan. 30, 2009).

5) Take a company which issued 8 shares at 5,000 won per share. The company holds 4 shares while party A holds 3 shares and party B holds 1 share. In this case, the company has the share capital of 40,000 won on its balance sheet, and the holding stake expressed on the balance sheet is 37.5% for party A and 12.5% for party B. However, given that treasury shares have no voting rights, the actual holding stake of party A is 75% and that of party B is 25%. Now, in the case that 4 treasury shares are retired and 4 new shares are issued, party A will be given 3 shares and party B will be given 1 share in proportion to the stake they held. The company's share capital on the balance sheet stays the same, at 40,000 won, and the actual voting rights do not change, either. However, party A's holding stake on the balance sheet will rise from 37.5% to 75% while party B's holding stake on the balance sheet will rise from 12.5% to 25%. Or, in the case that the company sells 4 treasury shares to party C, the company's share capital on the balance sheet stays the same, 40,000 won, and the holding stakes of parties A and B stay at 37.5% and 12.5%, respectively. Or, in the case that the company issues an extra 4 new shares and there is no unclaimed share, party A will be given 3 shares totalling 6 shares while party B will be given 1 share totalling 2 shares. There are no changes to the voting rights. However, the company's share capital will rise to 60,000 won, and the holding stakes of parties A and B on the balance sheet will be 50% and 16.7%, respectively. After the increase in share capital, the company's treasury stock ratio will drop to 33% from 50%.

Article 342, stating that the process of selling treasury stocks shall be applied *mutatis mutandis* to the regulation on new share issuances (Chung, 2015, p.16). This provision, however, was later deleted in the 2011 amendment which wholly permitted the acquisition and holding of treasury shares. What was stated instead was that a company is free to sell treasury shares via a board resolution. This revision supports the claim that the current law intentionally distinguishes between the sale of treasury stocks and issuance of new shares.

Such legislative intent is evident in the court's ruling regarding Elliott's request for an injunction to block the merger between Samsung C&T and Cheil Industries. Inc. A Seoul high court rejected the request, citing that Article 342 imposes no restrictions on how treasury stocks are sold and that such practices do not create any changes in the capital and official holding stakes of existing shareholders. In the end, it was deemed that Samsung C&T violated no laws in selling its treasury stocks to KCC. The court added that consideration must also be given to the reasons why there have been no amendments to the Commercial Act despite the ongoing discussions on the sale of treasury stocks.<sup>6)</sup>

Thus, although the economic natures are the same, if the policy goals are clear, the legal discrepancy can be rationalized. Accordingly, the following section will examine whether these rationalizations are possible and analyze the economic impact of protecting management rights through the sale of treasury stocks on the respective interested parties.

Although identical economic natures do not necessitate identical regulations, policy considerations can be rationalized if the positive economic impact from the protection of management rights, through the sale of treasury stocks, is significant.

### III. Protecting Management Rights via the Sale of Treasury Stocks: Gain and Loss of Interested Parties

This section theoretically examines the economic impact of the sale of treasury stocks. Share repurchasing is commonly found in preceding literatures and is highly significant, unlike the sale of treasury stocks.<sup>7)</sup> This is probably because the sale of treasury stocks to protect management rights is unique to Korea.

Take, for example, a controlling shareholder/managing executive who is considering selling the treasury stocks to a specific affiliated company. Given that affiliates tend to side with controlling shareholders in a vote, such a sale could be beneficial in protecting management rights. To clarify the situation, the example is further examined. There are two companies, companies A and B, and both are managed by a single controlling shareholder. In fact, there are often cases wherein it is economically more efficient to

It is often the case that having a single managing executive to control two companies is more economically efficient, in terms of business synergy and reduced transaction costs.

6) Seoul High Court, 2015Ra20485, Decision Date: Jul. 16, 2015.

7) In foreign countries, treasury shares are in most cases retired or used as a financial management tool, and the research on the sale of treasury stocks is of little significance. Most preceding domestic literatures also deal with purchasing. Refer to Chapter 6. in Cho and Yang (2016) for further theoretical details.

**Affiliated companies that are mobilized to help the controlling shareholder protect his/her management rights could suffer from a loss in efficiency, for instance lost opportunities for better investments.**

have one executive manage two companies simultaneously. That is, if companies A and B are engaged in similar or related business activities, it is be more economical to have one decision-maker. Also, if companies A and B operate as a single company, the transaction costs between the two could be reduced significantly.

Now, let us consider that there is a third-party who has the potential to become a managing executive, and is seeking to obtain the management rights of company B. In such a case, the existing executive, i.e. the controlling shareholder, has one of two options: the first is protecting his/her management rights in company B by purchasing the treasury stocks with company A's funds; and the other is relinquishing his/her management rights in company B. The former is an investment that can be made anytime. Hence, it is safe to assume that for company A, there may be equal or better investment opportunities than acquiring company B's treasury stocks. That is, company A could face a loss in opportunity cost if it acquires company B's treasury stocks.

In this case, from the perspective of company A's general and minority shareholders, there will still be gains if the losses from the synergy created through integrated management and reduced transaction costs outweigh the loss in economic efficiency incurred by company A's purchase, even if the controlling shareholder uses the company's treasury stocks to protect his/her management rights. However, the opposite holds true if the loss in company A's economic efficiency is larger under the same circumstances.

**Unlike general and minority shareholders, because controlling shareholders take into account the control premium when deciding on the sale of treasury stocks, the gains are highly likely to be focused on them, creating losses for the others.**

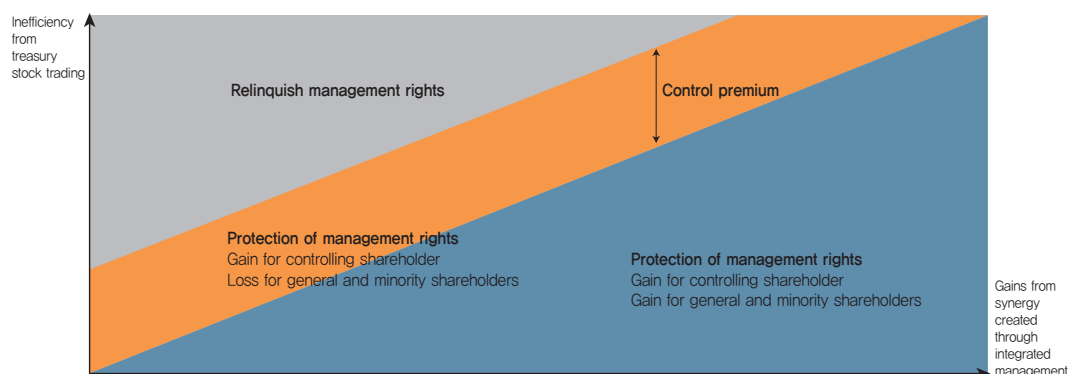
The controlling shareholder's decision, however, may be very different. If the controlling shareholder has a certain level of 'control premium,'<sup>8)</sup> he/she will consider the protection of management rights by comparing the loss in company A's efficiency with the gains obtained from the synergy created through integrated management plus the premium. Ultimately, the considerations of the controlling shareholder may lead the losses of the general and minority shareholders.

In the meantime, the general and minority shareholders of company B could also suffer losses from company A's acquisition. This is because if company B rushes to sell its treasury stocks, the sale does not consider the evaluations for long-term investment decisions. Nevertheless, for the controlling shareholder, gaining the control premium of company B is of great importance; and this inevitably generates losses to company B's general and minority shareholders.

In sum, general and minority shareholders can only benefit from controlling shareholders' protection of their management rights if the gains from the synergy created through integrated management is large enough to make up for the loss in efficiency in company A or B. Indeed, if such a possibility can be reflected, the use of treasury stocks to protect management rights can be considered for policy.

8) Here, the control premium refers to all tangible and intangible benefits gained from obtaining management rights, including decision-making authority, executive privileges, legal and illegal tunneling schemes, etc.

[Figure 1] Sale of Treasury Stocks to Protect Management Rights and Gain and Loss for Shareholders



On the other hand, if the gains added to the control premium is larger than the loss in efficiency in companies A or B and despite the fact the gains from the synergy created through integrated management are not large enough, the controlling shareholder may still choose to use treasury stocks to protect his/her management rights, notwithstanding the loss to general and minority shareholders. This implies that countermeasures are needed to regulate the practice of using treasury stocks to protect management rights in order to prevent the damages inflicted on the company's value and general and minority shareholders.

#### IV . Cases for the Sale of Treasury Stocks and Interests of General Shareholders

The following section presents two cases of treasury stock sales and looks into the impact on general and minority shareholders. Treasury stocks are sold typically to either white knights or affiliates or those with special ties.

##### 1. Sale to White Knights

There are two cases in Korea in which treasury stocks were sold to white knights; KCC played the white knight in both. In August 2003, foreign investors started to aggressively buy up Hyundai Elevator (HE) shares and in order to protect its management rights, HE sold its treasury holdings totaling 430,000 shares (7.67%) to six companies, including KCC, that were owned by the families of Hyundai Group's founder, Chung Ju-yung.

If this case is applied to the aforementioned scenario, the six companies, including KCC, would become company A while HE would become company B. And since the six buyers are not Hyundai Group affiliates, any business synergy between the two parties is hard to expect from the transaction of treasury stocks.

The controlling shareholders' decision to sell treasury shares to white knights could generate losses for general and minority shareholders since it is a 'rushed sale,' while the controlling shareholders reap the benefits of maintaining the control premium.



So, under the circumstances, how much inefficiency did the transaction induce? With regards to the white knight companies, there was probably no consideration given to the control premium for HE and therefore, if there was a better investment opportunity, the acquisition would have not been made. As a result, any loss to the general and minority shareholders of the white knight companies would have been unlikely.<sup>9)</sup> On the other hand, HE's general and minority shareholders might have experienced some loss. Although HE acquired cash from the sale, because the sale was rushed (to protect management rights), it is hard to expect that the acquired cash was spent to make a timely investment at an optimum opportunity under a long-term plan. Instead, HE might have either explicitly or tacitly provided the white knight companies with extra compensation,<sup>10)</sup> in the form of further price cuts or other benefits, resulting in certain losses for itself and its shareholders. Moreover, the fact that the controlling shareholder acquired an additional 7.67% in voting rights means that the voting rights of general shareholders were curtailed, implying that there was an infringement of their proportional rights.

HE is not only a large business, it also has a critical part in the management rights of Hyundai Group, along with Hyundai Merchant Marine (HMM). Thus, HE is a vital asset to the owner family of Hyundai Group, since having the control premium of HE means having control over the entire Hyundai Group. Ultimately, HE's decision to sell its treasury stocks was most likely swayed by the significance of the control premium, which probably bought about damages to the general and minority shareholders as a result.

## 2. Sale to Affiliated Company

Selling treasury shares to affiliated companies is mostly aimed at strengthening management control by increasing the holding stake and restructuring the entire group.

The sale of treasury stocks to affiliates is not uncommon, unlike the sale to white knights. And the main aim is to strengthen management rights by increasing friendly shares and to readjust the share structure of the entire group. For instance, Samsung Fire & Marine Insurance (SFMI) sold its treasury holdings of 4% to Samsung Life Insurance (SLI) and in return, acquired SLI's 4.79% share in Samsung C&T and 41.7 billion won in cash. This transaction is assumed to have been a part of SLI's ownership restructuring process in which SLI disposed of its shares in non-financial affiliates and strengthened its ownership of financial affiliates.

Both SLI and SFMI are engaged in the insurance business, and thus, the synergy created from integrated management was probably huge. From SLI's perspective, the sale of Samsung C&T was to acquire SFMI's shares, and hence, was not an inefficient exchange.

9) However, it is still possible that the buyers might have decided to acquire HE's treasury shares for some interest other than the company's, and in this case, certain losses would have been inflicted on the general and minority shareholders. There were press releases regarding the family meeting of Hyundai Group and discussions about joint defense strategy (Hankook Economic Newspaper, Aug. 14, 2003).

10) HE's treasury stocks were sold at 25,000 won per share. Upon the completion of the sale, foreigners sold HE shares at 27,000-31,000 won (Kyunghyang Biz, Aug. 28, 2003), indicating that HE, the seller, may have charged a cheaper price.

On the other hand, SFMI exchanged its treasury shares with Samsung C&T's shares, whose business was unlikely to create meaningful synergy for SFMI, meaning that the exchange may not have been the optimal investment decision for SFMI. However, given that Samsung C&T is of great importance to Samsung Group's ownership structure, the control premium would have been a critical element in the controlling shareholders' decision about the exchange.

Another prime example is Hyundai Motor Company (HMC)'s sale of its treasury shares to Incheon Steel in 2001, which was deemed to be a part of Hyundai Motor Group (HMG)'s ownership restructuring. In exchange for its 4.87% treasury stock holdings and 109.1 billion won in cash, HMC received Incheon Steel's 9.74% share in Kia Motors.

This exchange may not have been a bad choice given the synergy created through integrated management. However, HMC's purchase of Kia Motors shares was probably for the purposes of holding stock, and thus, it is expected that there was little profit other than the share dividends. In light of this, the exchange may not have been a good investment. Meanwhile, Incheon Steel acquired a large amount of cash and HMC's shares. And if the exchange was, in fact, conducted at a fair price, there was probably no particular disadvantages or damages.

The synergy created through integrated management was actively taken into consideration in this exchange, and hence, any instant losses for general and minority shareholders is unlikely. But, as the exchange was made during the transition of HMG's ownership structure to a circular investment structure, a considerable number of fictitious voting rights was created. As a result, the proportional rights of general and minority shareholders would have been significantly damaged.

Controlling shareholders can also use treasury stocks to acquire the management rights of a specific company by exploiting affiliated companies' funds. In 2008, HMG acquired Shinheung Securities to launch HMC Investment Securities. HMG's holding stake in HMC investment securities was 29.76% at the time of acquisition, and this needed to be increased. So, HMC Investment Securities sold its treasury stocks to HMC, Kia Motors, Hyundai Mobis, Hyundai Steel and Hyundai AMCO, and pulled up HMG's holding stake to 38.41%. Given that these buyers have little business synergy to gain from investing in a securities firm, the purchase was probably unwelcomed by the buyers, including their general and minority shareholders. On the contrary, the controlling shareholders would have embraced the purchase as they were able to strengthen their management rights of the newly acquired company by using affiliate funds.

There are also cases in which controlling shareholders use affiliate funds to buy treasury shares in order to retain management rights. Before Cheil Industries (formerly Cheil Synthetic Fiber) merged with Samsung SDI in 2014, Samsung Electronics acquired the treasury shares of Samsung SDI (for 344.2 billion won) and Cheil Industries (for 143.0 billion won). Thus, Samsung Electronics was able to maintain a 19.6% holding stake in

If it is difficult to expect certain business synergies, the sale will not be welcomed by the purchasing company's general and minority shareholders.

Samsung SDI after the merger, which would have otherwise been 13.5%, down from 20.4%.

The synergy would have been quite large since Samsung Electronics was able to secure a stable supply of electronic materials from Samsung SDI. However, it should be noted that the holding stake acquired to maintain management rights lost considerable liquidity, meaning that there was limited efficiency in terms of investment. To put it another way, Samsung Electronic's decision, worth approximately 500 billion won, would not have been beneficial to the company itself or to its general and minority shareholders.

## V. Conclusion and Policy Suggestions

Under the current laws and systems in Korea, treasury stocks are regarded as economically valuable goods. As such, their transaction is considered a typical transaction of assets and based on such an understanding, the sale of treasury stocks by a resolution from the board of directors is rationalized. However, given the economic nature of treasury stocks, this rationalization is far from appropriate. And, in the mid- to long-run, this must be amended via a revision of the current laws and systems.<sup>11)</sup> Nevertheless, as aforementioned, laws and systems do not always have to reflect the economic nature as long as the policy goal is sufficiently clear. Moreover, the current laws and system in place, seem to have been based, at least tacitly, on the premise that due to the current disorganization of Korea's market for management rights, treasury stocks can be used to protect management rights. So, efforts to overhaul the systems regarding the sale of treasury stock should be made in tandem with measures to reform the market for management rights.<sup>12)</sup>

In addition, improvements to the current laws and systems must be made before implementing large-scale reforms to reflect the economic nature of treasury stocks. In other words, even if the use of treasury stocks to protect management rights is permitted, it is still necessary to regulate the cases in which such practices are beneficial only to the controlling shareholder and are harmful to general and minority shareholders; the examples of which are presented above.

11) Introduction presents a case in which treasury stocks are used as a means to transfer management rights in the process of allotting new shares to treasury shares. This is possible only from an accounting perspective of the profit and loss transaction in which treasury stocks are recognized to be economically valuable. If the transaction of treasury stocks is regarded as a capital transaction, and hence no economic value is recognized, the allotment of new shares to treasury shares should not be allowed in terms of logic and consistency.

12) Cho and Yang (2016) states that Korea's market for management rights is not functioning properly and the principle on which the reform should be based is "to let a competent person have the management rights." To ensure the proper function of the market, it is necessary to first create an environment allowing for the actual transaction of management rights. The new system should discourage short-term attacks by speculative funds, while regulating any overprotection of existing controlling shareholders. These efforts however do not mean an instant prohibition of the sale of treasury stocks to protect management rights, even if the market performs poorly due to the overprotection of controlling shareholders and the source of such overprotection is treasury stocks being used to protect management rights. Still, a thorough consideration is necessary to find the appropriate level of and means for management rights protection.

In the mid- to long-run, the current laws and systems need to be revised so that the transaction of treasury stocks fits the economic nature.

Even if the current laws and systems are maintained, regulations that could generate losses for general and minority shareholders need to be overhauled as soon as possible.

One possible solution is for the supervisory authority to adopt a screening procedure that could review the sale of treasury stocks. By examining diverse data on company operating margins, PER, sale prices and purposes, it may be possible to conduct ex-post and ex-ante evaluations on the gains and losses of general and minority shareholders. The Financial Supervisory Service previously conducted such evaluations for bonds of warrants (BW) issued for specific targets,<sup>13)</sup> which can serve as a precedent for ex-post and ex-ante supervision of corporate investment. During this process, a cautious approach should be taken so that ex-ante screening cannot be used as an excuse to push ahead a sale or so that ex-post evaluations do not entail additional uncertainties for the company involved.

However, nothing is as important as voluntary regulation via the market, although public supervision by the government is meaningful as it is. To that end, all relevant means and systems need to be revised to ensure that outside directors have an independent role, that opinions presented by institutional investors, including pension funds and/or the “Wall Street Rule,”<sup>14)</sup> are adequately reflected and that claims for damages by general and minority shareholders are rationally and fairly dealt with.

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13) The issuance of BW was prohibited in 2013. It was later approved in 2015, but not the issuance for specific targets.

14) If the company's performance is unsatisfactory or decisions are unfavorable to the investors, the investors choose to sell their shares and walk away to express objection.