

News Flash

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Start-ups and memorandum of association in Slovakia: What to pay attention to?

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We introduced you in the previous [article](#) the individual legal forms of business. Since we recommended a limited liability company as the most advantageous solution, we will use it as a model. This time, we will focus on a memorandum of association which is one of the basic documents of a company.

What shall memorandum of association contain?

The memorandum of association contains basic information about company, such as its name, seat, subject of business, amount of registered capital and deposits, information about partners and first directors, and other basic information defined by Commercial Code.

In terms of participating in the life of the company, it is significant for the partners to determine in particular:

- **the amount of business share,**
- **voting rights and**
- **profit share and liquidation balance.**

Is deposit and business share the same?

It is a simple answer, but slightly complicated explanation. The terms deposit and business share are not the same. **The deposit** represents specific values which the partner puts into the company and shares the company's business result. These values may be in monetary or non-monetary character and together they create the registered capital of the company. In general, we could say that it is **an initial investment of the founder** (partner) **in the business.**

On the other hand, the **business share** represents a participation rate of the partner in the company, i.e. the extent of the property and non-property rights and obligations of the partner. Therefore, we could say that the business share is **a share in the managing, decision-making and control of the company's activities.** Each partner may only have one business share - in the case of a new deposit in the registered capital, the partner doesn't acquire another business share, but the existing one increases.

The basic rule according to which **the amount of the business share** in the company is determined is **the ratio of the deposit amount to the amount of the registered capital of the company** – e.g. in the case of a deposit of EUR 2,500 and registered capital of EUR 5,000, the partner has a business share of 50%. However, in this case, it is a dispositive provision of a law which means that **the partners may agree on the amount of the business shares regardless of the ratio of their deposits to the registered capital.** It is important that in the end, they represent a total of 100%.

In a company, it may therefore look like the company has two partners whose deposits to the registered capital are the same (each contributed EUR 2,500), but their business shares are different (for example, the partner 1 has a

business share of 70%, the partner 2 has a business share of 30%). Therefore, the amount of the business share can be set voluntarily according to the will of the partners.

The reason for this kind of agreements is usually a fact that one of the partners is the “brain” of the company and brings a significant know-how, while the another has better management skills and can ensure the company’s management, represents the company in business negotiations with investors and so on (he therefore also holds the position of an executive manager in most of the cases) – however, his business share is lower because without the first partner, the company would not be able to function for the purpose for which it was established.

Determining the amount of the business share is also substantial for a reason because it has a significant influence on the amount of the profit share, voting rights and liquidation balance. However, these can be agreed differently, as well.

The general meeting of the company is the highest body of the company and is entitled to decide on its internal affairs, but for example, it can decide on the election and dismissal of statutory bodies. For this reason, we shouldn’t omit the **distribution of the voting rights in the company and the setting of a quorum**, i.e. the required number of votes for a decision on a matter. It is therefore up to the partners if they agree that the decisions will be adopted by over a half of the majority of votes (so-called simple majority), 2/3 majority of votes (so-called qualified majority) or the decision will require the consent of all of them (so-called absolute majority).

Last but not least, **the profit-sharing and the liquidation balance agreement** must be kept in mind. Unless the partners don’t agree separately, their profit shares and the liquidation balance are governed by the amount of their shares, which means that if one partner has 70% share and the another has 30%, they will share in such a ratio the profit or the liquidation balance in the case of company’s dissolution.

What is the tag-along and drag-along right?

When it comes to business shares in the company, you may encounter the requirement to agree on the right tag-along and drag-along in the case of negotiations with the investor. These two rights represent obligations for you in the event of a transfer of business shares in the company, so you need to know exactly what they stand for.

The **tag-along** right represents a situation when you as a partner secure the right to add to the transfer of a business share of another partner. In practice, if any partner decides to sell his business share or its part, the other partners have the right to sell their business share or its part to the same buyer under the same conditions as agreed by the first partner.

On the other hand, the **drag-along** right means the right of the partner to require from other partners to sell their business shares to the buyer, which was chosen by himself, with whom he agreed on the conditions of the transfer of his share, if this buyer showed an interest in gaining the shares of other partners.

These conditions are typically the subject of an individual agreement between the partners.

However, it is not excluded that they are included directly in the memorandum of association.

What to beware of?

The above-mentioned **shares** in the company **usually change with the arrival of a new partner** or discharge of the existing one. Therefore, when you change the ownership structure in the company, it is crucial to think of their correct setup.

We may assume, that the investors will require a lower business share, but higher share on the voting rights and profit, alternatively, they might be interested in being a dominant shareholder in all company's business areas. If you want to keep the control over the company and to avoid the risk that the new majority partner would dismiss you from your function in the future, or force you to transfer your business share, pay attention to the correct distribution of the voting rights in the company, as well as correct setup of the conditions of the tag-along and drag-along rights, or insist on a setup when any decision has to be approved by an absolute majority votes of the partners.

With regard to the transfer of the business shares, the basic principle we recommend to

agree on in the memorandum of association, **is to require the consent of the general meeting with the transfer**. Otherwise, any partner would be able to transfer its business share to another partner or a third party freely.

Another principle we recommend to define in this regard is the **pre-emptive right**, which will secure that in a case when a partner decides to transfer his business share in the company, he will be obliged to offer it to you first. This will prevent third parties who are unknown to you to enter the company.

At the end, it must not be forgotten that if the partners don't exclude the **succession** of a business share in the memorandum of association, it passes to his legal successors in the event of the death of the partner.

The correct setting of the mutual rights and obligations of the partners in the memorandum of association, or in the special partnership agreement – is a basic assumption of the proper functioning of the company. Thanks to this, you can avoid unexpected and unpleasant situations at a time when the originally good relationships between the partners would break down and reaching any consensus between them becomes unreachable.

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