

Dr. MPS MEMORIAL COLLEGE OF BUSINESS STUDIES, AGRA

BBA 3rd SEMESTER

COMPANY LAW (BBA 301)

UNIT – I

SYLLABUS:- Introduction – Meaning, Definition and Characteristics of Company, Different types of Companies, Privileges and Exemptions granted to a Private Company, **Formation of Company:** Promotion, Incorporation and Commencement of Business, **Documents:** Memorandum of Association, Articles of Association, Prospectus and Statement in Lieu of Prospectus.

What is Company Meaning, Definition & Characteristics of Company?

Meaning

A company is a third legal business structure and has entirely a different organizational structure from the sole proprietorship or partnership. Its formation is due to firstly, the sole proprietorship and partnership cannot meet the increased capital demand of industry and commerce. Secondly, the company ensures the protection of limited liability to the shareholders and investors.

Definition

According to Prof. L.H. Haney, “Company is an artificial person created by law having separated entity with a perpetual succession and common seal”. According to Justice Lindley a company means association of persons who contribute in shape of money or money’s worth to a common stock and employ it for some specific purpose.

There are three main activities of a business

1. **Merchandising activities.** This involves activities deal with goods in a ready to sell condition.
2. **Manufacturing Activities.** This involves from purchase to raw material and put labor and factory overhead on the raw material and produces a product.
3. **Services Activities.** This involves banking, education, insurance and training activities.

Characteristics of a Company

The company has several distinct characteristics; the significant ones are discussed here:

Separate Legal Entity

A company is a separate legal entity from its members who constitute it. It can hold, purchase and sell properties and enter into contracts in its own name. It is an artificial legal person who can sue and be sued. Companies are owned by shareholders and they elect the Board of Directors, who runs the company. The board in turn selects the management. Thus the shareholders exercise only indirect control over the affairs of the company. The separation of ownership from the management some-times results in a conflict of interests between owners and management. The best the shareholders can do is to change some of the directors through vote in the annual general meeting subsequent to any such conflict.

Limited Liability

The liability of the shareholders of a company is limited to the nominal value of the shares held by them. In the event of liquidation the maximum loss of a shareholder is equal to the nominal value of the shares held by him. The creditors have no claim on the personal assets of the shareholders in the event of liquidation.

Transferability of Shares

The shares of a joint stock company are freely transferable. It does not require any permission from the company or consent of other shareholders. The shares of listed companies can be sold or purchased on the stock exchange and ownership transferred without any difficulty. However, in case of a private limited company, the transfer of shares is subject to the restrictions given in the company's articles.

Ability to Acquire a Broad Capital Base

Following are significant factors that enable a company to raise large amount of capital

1. The nominal value of shares is kept small, as a result of which investment of any size is possible.

2. Limited liability minimizes the risk of the investors and makes investment attractive and safer.

An Artificial Person created by Law

A company is called an artificial person because it does not take birth like a natural person but it comes into existence through the law. The company possesses only those properties which are conferred upon it by its Memorandum of Association (Charter).

Continuous Existence

The companies generally have a continuous existence irrespective of changes in ownership. In the cases of sole proprietorship and partnership, change in ownership means the dissolution of the original business and formation of a new business.

Common Seal

Being an artificial person, a company can act through natural persons only. The acts of a company are authorized by the “common seal”. The “common seal” is the official signature of the company. A document not bearing the common seal is not binding on the company.

Different Types of Companies?

Company forms of businesses have become immensely popular over the years. Their development has led to the creation of so many new types of companies. Companies are to be classified on the basis of liabilities, on the basis of members and on the basis of control.

Types of Companies

- Companies Limited by Shares
- Companies Limited by Guarantee
- Unlimited Companies
- One Person Companies (OPC)
- Private Companies

- Public Companies
- Holding and Subsidiary Companies
- Associate Companies
- Companies in terms of Access to Capital
- Government Companies
- Foreign Companies
- Charitable Companies
- Dormant Companies
- Nidhi Companies
- Public Financial Institutions

We can classify all these companies in various categories.

Classification of Different Types of Companies

Classification of Companies

Companies on the Basis of Liabilities

- Companies Limited by Shares
- Companies Limited by Guarantee
- Unlimited Companies

Companies on the Basis of Members

- One Person Companies
- Private Companies
- Public Companies

Companies on the Basis of Control

- Holding and Subsidiary Companies
- Associate Companies

Companies on the Basis of Liabilities

When we look at the liabilities of members, companies can be limited by shares, limited by guarantee or simply unlimited.

a) Companies Limited by Shares

Sometimes, shareholders of some companies might not pay the entire value of their shares in one go. In these companies, the liabilities of members is limited to the extent of the amount not paid by them on their shares.

This means that in case of winding up, members will be liable only until they pay the remaining amount of their shares.

b) Companies Limited by Guarantee

In some companies, the memorandum of association mentions amounts of money that some members guarantee to pay.

In case of winding up, they will be liable only to pay only the amount so guaranteed. The company or its creditors cannot compel them to pay any more money.

c) Unlimited Companies

Unlimited companies have no limits on their members' liabilities. Hence, the company can use all personal assets of shareholders to meet its debts while winding up. Their liabilities will extend to the company's entire debt.

Companies on the basis of members

a) One Person Companies (OPC)

These kinds of companies have only one member as their sole shareholder. They are separate from sole proprietorships because OPCs are legal entities distinct from their sole members. Unlike other companies, OPCs don't need to have any minimum share capital.

b) Private Companies

Private companies are those whose articles of association restrict free transferability of shares. In terms of members, private companies need to have a minimum of 2 and a maximum of 200. These members include present and former employees who also hold shares.

c) Public Companies

In contrast to private companies, public companies allow their members to freely transfer their shares to others. Secondly, they need to have a minimum of 7 members, but the maximum number of members they can have is unlimited.

Companies on the basis of Control or Holding

In terms of control, there are two types of companies.

a) Holding and Subsidiary Companies

In some cases, a company's shares might be held fully or partly by another company. Here, the company owning these shares becomes the holding or parent company. Likewise, the company whose shares the parent company owns becomes its subsidiary company.

Holding companies exercise control over their subsidiaries by dictating the composition of their board of directors. Furthermore, parent companies also exercise control by owning more than 50% of their subsidiary companies' shares.

b) Associate Companies

Associate companies are those in which other companies have significant influence. This “significant influence” amounts to ownership of at least 20% shares of the associate company.

The other company’s control can exist in terms of the associate company’s business decisions under an agreement. Associate companies can also exist under joint venture agreements.

Companies in terms of Access to Capital

When we consider the access a company has to capital, companies may be either listed or unlisted.

Listed companies have their securities listed on stock exchanges. This means people can freely buy their securities. Hence, only public companies can be listed and not private companies.

Unlisted companies, on the other hand, do not list their securities on stock exchanges. Both, public, as well as private companies can come under this category.

Other Types of Companies

a) Government Companies

Government companies are those in which more than 50% of share capital is held by either the central government, or by one or more state government, or jointly by the central government and one or more state government.

b) Foreign Companies

Foreign companies are incorporated outside India. They also conduct business in India using a place of business either by themselves or with some other company.

c) Charitable Companies (Section 8)

Certain companies have charitable purposes as their objectives. These companies are called Section 8 companies because they are registered under Section 8 of Companies Act, 2013.

Charitable companies have the promotion of arts, science, culture, religion, education, sports, trade, commerce, etc. as their objectives. Since they do not earn profits, they also do not pay any dividend to their members.

d) Dormant Companies

These companies are generally formed for future projects. They do not have significant accounting transactions and do not have to carry out all compliances of regular companies.

e) Nidhi Companies

A Nidhi company functions to promote the habits of thrift and saving amongst its members. It receives deposits from members and uses them for their own benefits.

f) Public Financial Institutions

Life Insurance Corporation, Unit Trust of India and other such companies are treated as public financial institutions. They are essentially government companies that conduct functions of public financing.

Privileges and Exemptions

- A private company can appoint a body corporate or a firm to an office or the place of profit under the company.
- It need not have more than two directors.
- Statutory notice will not be required to a person who stands for election as a director.

- Central government sanction is not required in the case of increasing the directors above 12 or the number which is fixed by the articles of association.
- While passing the resolution for electing the directors, a single resolution is enough to appoint all directors.
- Consent to act as a director need not be filed with the registrar.
- Central government sanction is not required in the case of modifying the provisions related to appointment of directors, whether its whole time or part time.
- There are no certain restrictions on the power of Board of directors and no prohibition against loans to directors.
- No need of government approval if any changes in the remuneration of the directors, appointment or reappointment of directors.
- A method of determining the net profits and ascertainment of depreciation do not apply.
- Provisions as to kinds of voting rights, share capital, an issue of shares with disproportionate rights, termination of disproportionate excessive rights.
- Date of birth need not mention in the register of the directors.
- Managing director need not be appointed more than 5 years.
- There is no restriction on investments or making of loans or guarantee.
- The Central government cannot exercise its powers to prevent the change in the board of directors which may affect the company prejudicially.

Formation of Company: Promotion, Incorporation & Commencement of Business

The formation of a company goes through a number of steps, starting from idea generation to commencing of the business. This whole process can be broken down into 4 major phases or steps, which we will be discussing in the lines below.

The major steps in formation of a company are as follows:

1. Promotion stage
2. Registration stage
3. Incorporation stage
4. Commencement of Business stage

Let us discuss these steps in detail.

Promotion Stage: Promotion is the first step in the formation of a company. In this phase, the idea of starting a business is converted into reality with the help of promoters of the business idea.

In this stage the ideas are executed. The promotion stage consists of the following steps:

1. Identify the business opportunity and decide on the type of business that needs to be done.
2. Perform a feasibility study and determine the economic, technical and legal aspect of executing the business.
3. Interest shown by promoters towards the business idea and supply of capital and other necessary procedures to start the business.

Registration stage: Registration stage is the second part of the formation process. In this stage, the company gets registered, which brings the company into existence.

A company is said to be in existence, if it is registered as per the Companies Act, 2013. In order to get a company registered, some documents need to be provided to the Registrar of Companies.

There are several steps involved in the registration phase, and are as follows:

1. Memorandum of Association: A memorandum of association (MoA) must be signed by the founders of the company. A minimum of 7 members are required in case of a public company and 2 in case of a private company. The MoA must be properly registered and stamped.

2. Article of Association: Article of Association (AoA) is also required to be signed and submitted. All members who previously signed MoA, should also be signing the AoA.
3. The next step is preparing a list of directors which should be filed with the Registrar of Companies.
4. Directors of the company should provide a written consent agreeing to be directors, should be filed with the Registrar of Companies (RoC).
5. The notice of address of the office needs to be filed.
6. A statutory declaration should be made by any advocate of either the High Court or Supreme Court, or a person of the capacity of Director, Secretary or Managing Director. This declaration shall be filed with the RoC.

Certificate of Incorporation: Certificate of incorporation is issued when the registrar is satisfied with the documents provided. This certificate validates the establishment of the company in the records.

Certificate of commencement of business: Certificate of commencement of business is required for a public company to start doing business, while a private company can start business once it has received the certificate of incorporation.

Public companies receiving the certificate of incorporation can issue prospectus in order to make the public subscribe to the share for raising capital. Once all the minimum number of required shares have been subscribed, a letter should be sent to the registrar along with a bank document stating the receiving of the money.

The registrar will issue a certificate upon finding the provided documents satisfactory. This certificate is known as certificate of commencement of business. The company can start business activities from the date of issue of the certificate and the business shall be done as per rules laid down in the MoA (Memorandum of Association).

Documents Issued by a Company: Memorandum, Articles and Prospectus

Some of the most important documents issued by a company are as follows: 1. Memorandum of Association 2. Articles of Association 3. Prospectus 4. Statement in Lieu of Prospectus.

1. Memorandum of Association:

The Memorandum of Association is the constitution of the company and provides the foundation on which its structure is built. It is the principal document of the company and no company can be registered without the memorandum of association. It defines the scope of the company's activities as well as its relation with the outside world.

The company law defines it as “The memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous Company Laws or of this Act.” —Section 2 (28) of the Companies Act

Purpose:

The main purpose of the memorandum is to explain the scope of activities of the company. The prospective shareholders know the areas where company will invest their money and the risk they are taking in investing the money. The outsiders will understand the limits of the working of the company and their dealings with it should remain within the prescribed scope.

Clauses of memorandum:

The memorandum of association contains the following clauses:

1. The Name Clause:

A company being a separate legal entity must have a name. A company may select any name which does not resemble the name of any other company and it should not contain the words like king, queen, emperor, government bodies and the names of world bodies like U.N.O., W.H.O., World Bank, etc.

The name should not be objectionable in the opinion of the government. The word ‘Limited’ must be used at the end of the name of a Public and ‘Private Limited’ is used by a Private Company. These words are used to ensure that all persons dealing with the company should know that the liability of its members is limited.

The name of the company must be painted outside every place, where business of the company is carried on. If the company has a name which is undesirable or resembles the name of any other existing company, this name can be changed by passing an ordinary resolution.

2. Registered Office Clause:

Every company should have a registered office, the address of which should be communicated to the Registrar of Companies. This helps the Registrar to have correspondence with the company. The place of registered office can be intimated to the Registrar within 30 days of incorporation or commencement of business, whichever is earlier.

A company can shift its registered office from one place to another in the same town with an intimation to the Registrar. But, if the company wants to shift its registered office from one town to another town in the same state, a special resolution is required to be passed. If the office is to be shifted from one state to another state it involves alteration in the memorandum.

3. Object Clause:

This is one of the important clauses of the Memorandum of Association. It determines the rights and power of the company and also defines its sphere of activities. The object clause should be decided carefully because it is difficult to alter his clause later on. No activity can be taken up by the company which is not mentioned in the object clause.

Moreover, the investors i.e., shareholders will know the sphere of activities which the company can undertake. The choice of the object clause lies with the subscribers to the memorandum. They are free to add anything to it provided it is not contrary to the provisions of the Companies Act and other laws of the land.

The object clause can be altered to enable a company to carry on its activities more economically, or by improved means to carry on some business which under existing circumstances may conveniently be combined with the object clause.

4. Liability Clause:

This clause states that the liability of the members is limited to the value of shares held by them. It means that the members will be liable to pay only the unpaid balance of their shares. The liability of the members may be limited by guarantee. It also states the amount which every member will undertake to contribute to the assets of the company in the event of its winding up.

5. Capital Clause:

This clause states the total capital of the proposed company. The division of capital into equity shares capital and preference share capital should also be mentioned. The number of shares in

each category and their value should be given. If some special rights and privileges are conferred on any type of shareholders, mention may also be made in the clause to enable the public to know the exact nature of capital structure of the company.

The capital clause can be altered by passing a special resolution and by obtaining the approval of Company Law Board.

6. Association Clause:

This clause contains the names of signatories to the memorandum of association. The memorandum must be signed by at least seven persons in the case of a public limited company and by at least two persons in case of private limited company. Each subscriber must take at least one share in the company. The subscribers declare that they agree to incorporate the company and agree to take the shares stated against their names. The signatures of subscribers are attested by at least one witness each. The full addresses and occupations of subscribers and the witnesses are also given.

2. Articles of Association:

The rules and regulations which are framed for the internal management of the company are set out in a document named Articles of Association. The articles are framed to help the company in achieving its objectives set out in memorandum of association. It is a supplementary document to the memorandum.

“Articles of association of the company as originally framed or as altered from time to time in pursuance of any previous companies law or of this act.” —Section 2(2) of the Companies Act. The private companies limited by shares, companies limited by guarantee and unlimited companies must have their articles of association. A public company limited by shares may or may not have its own Articles of Association.

◀ As per Section 26 of Companies Act, it is not obligatory on the part of a public company limited by shares to prepare and register Articles of Association along with Memorandum of Association. However, such a company may adopt all or any of the regulations contained in the model set of Articles given in Table A in Schedule I of the Act.

It means the company can partly frame its own articles and partly incorporate some of the regulations in Table A. Unless the company prepares its own articles then regulations of Table A shall be applicable in the same manner as if they were contained in its own registered articles.

The articles cannot contain anything contrary to the Companies Act and also to the memorandum of association. If the document contains anything contrary to the Companies Act or memorandum, it will be inoperative. When articles are proposed to be registered, they must be printed, divided into paragraphs and numbered consecutively. Each subscriber to the memorandum must sign the articles in the presence of at least one witness.

The nature of Articles of Association may be explained as follows:

- (i) Articles of association are subordinate to memorandum of association.
- (ii) These are controlled by memorandum.
- (iii) Articles help in achieving the objectives laid down in the memorandum.
- (iv) Articles are only internal regulations over which members exercise control.
- (v) Articles lay down the regulations for governance of the company.

Contents:

Some of the contents of articles of association are as follows:

1. The amount of share capital issued, different types of shares, calls on shares, forfeiture of shares, transfer and transmission of shares and rights and privileges of different categories of shareholders.
2. Powers to alter as well as reduce share capital.
3. The appointment of directors, powers, duties and their remuneration.
4. The appointment of manager, managing director, etc.
5. The procedure for holding and conducting of various meetings.
6. Matters relating to maintaining of accounts, declaration of dividends and keeping of reserves, etc.

7. Procedure for winding up the company.

Alteration of Articles of Association:

The articles of association can be altered by passing a special resolution. Certain restrictions are imposed on the nature and extent of the alternation that may be made.

- (a) The change should not be violating the provisions of the Companies Act.
- (b) It should not be contrary to the provisions of the memorandum of association.
- (c) The alteration must not have anything illegal.
- (d) The alteration should not adversely affect the minority shareholders.

3. Prospectus:

After getting the company incorporated, promoters will raise finances. The public is invited to purchase shares and debentures of the company through an advertisement. A document containing detailed information about the company and an invitation to the public subscribing to the share capital and debentures is issued. This document is called 'prospectus'. Private companies cannot issue a prospectus because they are strictly prohibited from inviting the public to subscribe to their shares. Only public companies can issue a prospectus.

“A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate.”
—Section 2(36) of the Companies Act

The prospectus is not an offer in the contractual sense but only an invitation to offer. A document construed to be a prospectus should be issued to the public.

A prospectus should have the following essentials:

- (i) There must be an invitation offering to the public.
- (ii) The invitation must be made on behalf of the company or intended company.
- (iii) The invitation must be to subscribe or purchase.
- (iv) The invitation must relate to shares or debentures.

A prospectus must be filed with the Registrar of companies before it is issued to the public. The issue of prospectus is essential when the company wishes the public to purchase its shares or debentures.

If the promoters are confident of obtaining the required capital through private contacts, even a public company may not issue a prospectus. The promoters prepare a draft prospectus containing required information and this document is known as a statement in lieu of 'prospectus.' A prospectus duly dated and signed by all the directors should be filed with the Registrar of Company before it is issued to the public.

A prospectus brings to the notice of the public that a new company has been formed. The company tries to convince the public that it offers best opportunity for their investment. A prospectus outlines in detail the terms and conditions on which the shares or debentures have been offered to the public. Every prospectus contains an application form on which an intending investor can apply for the purchase of shares or debentures.

A company must get minimum subscription within 120 days from the issue of prospectus. If it fails to obtain minimum subscription from the members of the public within the specified period, then the amount already received from public is returned. The company cannot get a certificate of commencement of business because the public is not interested in that company.

Contents:

The following matters are to be disclosed in a prospectus:

1. Name and full address of the company.
2. Full particulars about the signatories to the memorandum of association and the number of shares taken up by them.
3. The number and classes of shares. The interest of shareholders in the property and profits of the company.
4. Name, addresses and occupations of members of the Board of Directors or proposed Directors.
5. The minimum subscription is fixed by promoters after taking into account all financial requirements at the beginning.

6. If the company acquires any property from vendors, their full particulars are to be given.
7. The full address of underwriters, if any, and the opinion of directors that the underwriters have sufficient resources to meet their obligations.
8. The time of opening of the subscription list.
9. The nature and extent of interest of every promoter in the promotion of the company.
10. The amount payable on application, allotment and calls.
11. The particulars of preferential treatment given to any person for subscribing shares or debentures.
12. Particulars about reserves and surpluses.
13. The amount of preliminary expenses.
14. The name and address of the auditor.
15. Particulars regarding voting rights at the meetings of the company.
16. A report by the auditors regarding the profits and losses of the company.

These are some of the contents which every prospectus must include. The prospectus is an advertisement of the company therefore, the company may give any information which promotes its interest. Any information given in the prospectus must be true otherwise the subscriber can be held guilty for misrepresentation.

4. Statement in Lieu of Prospectus

The Statement in Lieu of Prospectus is a document filed with the Registrar of the Companies (ROC) when the company has not issued prospectus to the public for inviting them to subscribe for shares. The statement must contain the signatures of all the directors or their agents authorized in writing. It is similar to a prospectus but contains brief information. The Statement in Lieu of Prospectus needs to be filed with the registrar if the company does not issue prospectus or the company issued prospectus but because minimum subscription has not been received the company has not proceeded for the allotment of shares.