UNIT-5

Forms of Ownership

- Sole Proprietorship
- Partnership
- Company

Sole Proprietorship

Sole proprietorship refers to a form of business organization which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks.

Features of Sole Proprietorship

- Formation and closure
- Unlimited Liability
- Sole risk bearer and profit recipient
- Control
- No separate entity
- Lack of business continuity

Merits

- Quick decision making
- Confidentiality of information
- Direct incentive
- Sense of accomplishment
- Ease of formation and closure

Limitations

- Limited resources
- Limited life of a business concern
- Unlimited liability
- Limited managerial ability

PARTNERSHIP

The Indian Partnership Act, 1932 defines partnership as “the relation between persons who have agreed to share the profit of the business carried on by all or any one of them acting for all.”

Features of Partnership

- Formation
- Unlimited Liability
- Risk bearing
- Decision making and control
- Continuity
- Number of Partners (Min-2 & Max-50)
- Mutual agency

Merits

- Ease of formation and closure
- Balanced decision making
- More funds
- Sharing of risks
- Secrecy

Limitations

- Unlimited liability
- Limited resources
- Possibility of conflicts
- Lack of continuity
- Lack of public confidence

Types of Partners

- Active partner
- Sleeping or dormant partner
- Secret partner
- Nominal partner
- Partner by estoppel
- Partner by holding out

Types of Partnerships

Classification on the basis of duration

Partnership at will

Particular partnership

Classification on the basis of liability

General Partnership

Limited Partnership

Partnership Deed

The partnership deed generally includes the following aspects:

- Name of firm
- Nature of business and location of business
- Duration of business
- Investment made by each partner
- Distribution of profits and losses
- Duties and obligations of the partners
- Salaries and withdrawals of the partners
- Terms governing admission, retirement and expulsion of a partner
- Interest on capital and interest on drawings
- Procedure for dissolution of the firm
- Preparation of accounts and their auditing
- Method of solving disputes

Registration

The procedure for getting a firm registered is as follows:

1. Submission of application in the prescribed form to the Registrar of firms. The application should contain the following particulars:

- Name of the firm
- Location of the firm
- Names of other places where the firm carries on business
- The date when each partner joined the firm
- Names and addresses of the partners
- Duration of partnership This application should be signed by all the partners.

2. Deposit of required fees with the Registrar of Firms.
3. The Registrar after approval will make an entry in the register of firms and will subsequently issue a certificate of registration.

JOINT STOCK COMPANY

A company is an association of persons formed for carrying out business activities and has a legal status independent of its members. A company can be described as an artificial person having a separate legal entity, perpetual succession and a common seal.

The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders. Usually, the owners exercise an indirect control over the business. The capital of the company is divided into smaller parts called 'shares' which can be transferred freely from one shareholder to another person (except in a private company).

Features

- Artificial person
- Separate legal entity
- Formation
- Perpetual succession
- Control
- Liability
- Common seal
- Risk bearing

Merits

- Limited liability
- Transfer of interest
- Perpetual existence
- Scope for expansion
- Professional management

Limitations

- Complexity in formation
- Lack of secrecy
- Impersonal work environment
- Numerous regulations
- Delay in decision making
- Oligarchic management
- Conflict in interests

Difference between Public and Private Company

Types of Companies

- Private Company
- Public Company

CHOICE OF FORM OF BUSINESS ORGANISATION

- Cost and ease in setting up the organisation
- Liability
- Continuity
- Management ability
- Capital considerations
- Degree of control
- Nature of business

Stages in the formation of a company

Following stages are there:

1. Promotion: This step deals with idea generation and implementing it as a company.
2. Incorporation: This stage consists of applying for the certificate of incorporation and obtaining the same, after the certificate is received a company becomes a valid entity in the books of law.
3. Issuing of shares and debentures: This stage involves raising capital in the form of issuing stocks and debentures to the public.
4. Business commencement: In this stage the formalities are completed and company commences business.

Documents required for the incorporation of a company

Following documents are required to be submitted:

1. MoA or Memorandum of Association
2. AoA or Article of Association
3. Director's approval confirming that they will be functioning as director and buy qualification shares.
4. An agreement, with the managing director or someone who is going to be given the post of director.
5. A letter from registrar containing approving the name of the company.
6. A statutory declaration stating that all legal registration requirements have been complied
7. A notice stating the exact address of office (it can also be submitted within 30 days of being incorporated)
8. Payment evidence of registration fees in the form of a document.

Promotion of a Company

The process of conceiving or developing an idea of business and taking the initial step towards converting it into a company so that the idea can be converted into a business project is called as promotion and the people who take those initial steps are known as promoters of the company.

A promoter, apart from developing the business idea also needs to analyze the prospects in future and take necessary steps to fulfill the purpose. The promoter needs to arrange labor, machinery and capital. So here are some of the legal liabilities that a promoter has towards the company:

1. A promoter is neither an agent nor a trustee of the company as prior to getting incorporated a company does not exist as a legal entity.
2. Promoters cannot make secret profits by making deals acting on behalf of the organization or company.
3. The promoters can be held legally liable for any untrue statement that will be filed in the company prospectus.
4. Expenses incurred by promoters during the promotion of the company cannot be claimed.
5. The promoters are not may or may not be considered for payments before a company gets incorporated. Based on company's discretion they may be allotted shares to compensate for their exemplary services.

Steps taken by promoters in the promotion of a company

A promoter is that person who takes up the initiative of forming a company based on the business idea and takes the necessary steps to ensure the purpose is met. A promoter has the do the following things for promoting the company:

1. Identifying the business opportunity: The first step for a promoter is to identify a business opportunity and then analysing whether it is worth investing in.
2. Checking the feasibility of the idea: The idea that came to mind might not be feasible enough so that it can be translated into a business. For this some detailed study should be done and for this following types of checks should be done:

i. Technical feasibility: In some ideas the technical feasibility may be less, the reason for such can be the technology or the kind of raw material required for executing the project is not easily available. So this part needs to be taken care of.

ii. Financial Feasibility: All the business require initial capital to get started and sustain in the market. Also the promoters need to determine the cost that need to be beared for implementing the idea. Therefore, if there is fund crunch and the project cost is humongous. Plan needs to be changed.

iii. Economic feasibility: In some case the probability of success can be very low in spite of all other factors working in favour, that part also needs to be considered.

3. Choosing company name: As soon as a decision to establish a company is taken, the promoters select a name for it. For getting the approval of the proposed name, application needs to be submitted to registrar of companies of the state. The application should contain three names in order of preference as the possibility of similar name may exist.
4. Choosing members to sign MoA: A promoter needs to choose members who will sign the Memorandum of Association (MoA) and will become the directors of company.
5. Selecting professionals: The promoters should hire professionals who will be preparing the necessary documents for the company, these professionals can be bankers, solicitors, brokers and underwriters.
6. Getting documents ready: After all professionals are appointed, the promoter submits all the prepared documents to the registrar of companies.

Memorandum of Association

One of the most essential document in the formation of a company is Memorandum of Association or MoA. It shows the main objectives of the company and its goals in the long term.

The MoA regulates the incorporated company activities such that it can undertake activities that are mentioned in MoA. The number of persons signing the form varies as per the type of company (seven in case of public company while two members for private). The main clauses of MoA can be as follows

1. Name: It should include the name of the company that has been approved by registrar of companies.
2. Registered Office: The clause mentions address and name of company in which it is situated. Name giving is not mandatory, but it is essential to submit company name within 30 days of its incorporation.
3. Objects clause: Most important clause while filling MoA is it defines the objectives for which a company is raised. Any activity cannot be undertaken that are not stated in objects clause. There are two types of object clause namely, main objects and other objects.
4. Liability clause: This clause is all about liability of each shareholder as per amount invested by them or the shares they own.
5. Capital Clause: It refers to the clause of raising authorised capital by issuing of shares
6. Association clause: It contains the statement by those who sign the MoA and who accept MoA and also the consent of buying qualification shares.

Article of Association

Articles of Association is an important document of a Joint Stock Company. It contains the rules and regulations or bye-laws of the company. They are related to the internal working or management of the company. It plays a very important role in the affairs of a company. It deals with the rights of the members of the company between themselves.

Contents of Articles of Association

The articles generally deal with the following

1. Classes of shares, their values and the rights attached to each of them.
2. Calls on shares, transfer of shares, forfeiture, conversion of shares and alteration of capital.
3. Directors, their appointment, powers, duties etc.
4. Meetings and minutes, notices etc.
5. Accounts and Audit
6. Appointment of and remuneration to Auditors.

Contents of Articles of Association

7. Voting, poll, proxy etc.
8. Dividends and Reserves
9. Procedure for winding up.
10. Borrowing powers of Board of Directors and managers etc.
11. Minimum subscription.
12. Rules regarding use and custody of common seal.
13. Rules and regulations regarding conversion of fully paid shares into stock.
14. Lien on shares.

Alteration of Articles of Association

The alteration of the Articles should not sanction anything illegal. They should be for the benefit of the company. They should not lead to breach of contract with the third parties. The following are the regulations regarding alteration of articles:

A company may alter its Articles with a special resolution. Due importance and care should be given to ensure that the alteration of AoA does not conflict with the provisions of the Memorandum of Association or the Companies Act. A copy of every special resolution altering the Articles must be filed with the Registrar within 30 days of its passing.

1. The proposed alteration should not contravene the provisions of the Companies Act.
2. The proposed alteration should not contravene the provisions of the Memorandum of Association.
3. The alteration should not propose anything that is illegal.
4. The alteration should be bonafide for the benefit of the company.
5. The proposed alteration should in no way increase the liability of existing members.
6. Alteration can be made only by a special resolution.
7. Alteration can be done with retrospective effect.
8. The Court does not have any power to order alteration of the Articles of Association.

Prospectus

A prospectus is an invitation from a company to the general public informing about availability to purchase or subscribe shares and debentures issued by the company. IPO also known as Initial Public Offering and is a source of raising of funds from the public. But, in case of a private company, there is no need to file a prospectus as private companies are restricted from issuing IPO. A prospectus can be required if the aim is to generate funds from public. Private companies are not required to file a prospectus.

Types of Prospectus

- **Deemed Prospectus** - As per Section 25(1) of the Companies Act, 2013, a document will be deemed to be a prospectus if the company agrees to allot or offer securities to the public.
- **Abridged Prospectus** - It is defined as the brief summary of the prospectus, which includes all useful and materialistic information filed before the registrar. As per Section 33(1) of the Companies Act, 2013, an abridged prospectus must be included with the documents for the purchase of securities issued by a company.
- **Red Herring Prospectus** - It is the prospectus that is required to be filed before the registrar prior to the offer. The prospectus generally lacks information such as the particular price or quantum of securities being offered.
- **Shelf Prospectus** - It is defined as the prospectus issued by a company, bank or financial institution for more than one class of securities.

Contents of Prospectus

The prospectus must touch over the following content points:

- Details of the company, such as name, registered office address, and objects
- Details of signatories to the Memorandum and their shareholding particulars
- Details of the directors
- Details of shares offered and the class of the issue as well as voting rights
- Minimum subscription amount
- The amount payable on application, on allotment, and on further calls
- Underwriters of the issue
- Auditors of the company
- Audited reports regarded profit and losses of the company

Promoters of a Company

The idea of carrying on a business which can be profitably undertaken is conceived either by a person or by a group of persons who are called promoters. After the idea is conceived, the promoters make detailed investigations to find out the weaknesses and strong points of the idea, to determine the amount of capital required and to estimate the operating expenses and probable income.

Functions of a Promoter

The Promoter Performs the following main functions:

1. To conceive an idea of forming a company and explore its possibilities.
2. To conduct the necessary negotiation for the purchase of business in case it is intended to purchase as existing business. In this context, the help of experts may be taken, if considered necessary.
3. To collect the requisite number of persons (i.e. seven in case of a public company and two in case of a private company) who can sign the ‘Memorandum of Association’ and ‘Articles of Association’ of the company and also agree to act as the first directors of the company.

4. To decide about the following:

(i) The name of the Company,

(ii) The location of its registered office,

(iii) The amount and form of its share capital,

(iv) The brokers or underwriters for capital issue, if necessary,

(v) The bankers,

(vi) The auditors,

(vii) The legal advisers.

5. To get the Memorandum of Association (M/A) and Articles of Association (A/A) drafted and printed.
6. To make preliminary contracts with vendors, underwriters, etc.
7. To make arrangement for the preparation of prospectus, its filing, advertisement and issue of capital.
8. To arrange for the registration of company and obtain the certificate of incorporation.
9. To defray preliminary expenses.
10. To arrange the minimum subscription.

Types of promoters of a company

The promoter of a company in India includes the following type:

- **Professional promoters:** They play a significant role to establish the company, and once all the procedures are complete, they hand over the company to the shareholders. Although there are not a lot of professional promoters of a company in India, it is quite common in countries like the UK, Germany, etc.
- **Occasional promoters:** They do not stay or work in the company regularly. They dodge between companies and take the promotion work on a floating basis. Examples of such promoters in company law include engineer, architect, lawyers, etc.
- **Financial promoters:** Some financial companies may take up the work of financial promotion of a company depending on the situation of the market.

Liabilities of a Promoter

- The liabilities of a promoter of a company in India include:
- The rules do not allow them to make secret profits in any form. Out of company deals, or profits for personal promotion.
- The deposition of all the amounts received on behalf of the company has to be done in the company account.
- The promoter needs to take proper care while performing their tasks.
- In the case of any contracts signed or pending, the promoters are solely responsible till their approval.
- For any investments, the promoter has to make the compensation in case of any issues or untrue statements.

Rights of Promoters

- Being a part of the company and its incorporation, the rights of promoters include the following:
- **Right of indemnity:** In the case of partnership or involvement of over one promoter in a company, one promoter can deem the other for any untrue statements or secret profits.
- **Right of preliminary expenses:** The promoter has the right to receive the legitimate expenses for being a part of the company. Although it is not mandatory among the rights of promoters. It depends on the individual or the group to claim it.

Rights of Promoters

- **Right of remuneration:** Additionally, the promoters usually receive their remuneration depending on the services or as per the will of the director. However, the promoter cannot sue the company until they have a legal contract for the same. They provide the remuneration in several ways, including:
  - Commission
  - Grant amount
  - Shares
  - Subscription of shares
  - Buying a part of the company’s property

Shares

A share is referred to as a unit of ownership which represents an equal proportion of a company's capital. A share entitles the shareholders to an equal claim on profit and losses of the company. There are majorly two kinds of shares i.e. equity shares and preference shares.

Different types of shares

As per section 43 of the Companies Act 2013, the share capital of the company is of two types:

Preference Share Capital

Preferential shares are preferential in nature. During the liquidation of the company, the shareholders holding preferential shares are paid out first after settling the debts of the creditors of the company. Also, preferential shareholders do not have any voting rights. Various types of preferential shares are seen based on structure, maturity terms, nature of dividend payment, etc. below are some common types:

- Cumulative Preference Shares:
  - Arrear will be received in subsequent years
  - At the time of inadequate profit, you will not lose anything.
  - The fixed rate of dividend is guaranteed.
- Non-cumulative Preference Shares:
  - At the time of inadequate profit, they will not get anything.
  - Fixed rate of dividend is guaranteed.

- Participating Preference Shares
  - Entitled to share the surplus profit
  - Fixed rate of dividend is guaranteed
- Non-participating Preference Shares:
  - Does not share the surplus profit.
  - Fixed rate of dividend is guaranteed.
- Convertible Preference Shares
  - It can be converted into Equity shares within a certain period.
- Non-convertible Preference Shares:
  - It cannot be converted into Equity shares.

- Redeemable Preference Shares:
  - Shares which a company may repay after a fixed period of time or earlier.
- Irredeemable Preference Shares:
  - Shares are repayable only at winding up.
  - It does not carry the arrangement for redemption. .

Equity Share Capital:

Equity Shares are also known as ordinary shares. Equity shares are one of the most common types of share. These are equal in value and also impart various rights like voting rights, dividends, etc. to the shareholders. These shares are traded in stock exchange and are issued at a face value.

Directors of a Company

The directors are the persons elected by the shareholders to direct, conduct, manage or supervise the affairs of the company.

The Companies Act does not precisely define the term ‘director’.

According to Sec. 2 (13) of the Companies Act., “Director includes any person occupying the position of director by whatever name called.”

Number of Directors

Every public company by virtue of Sec. 43 A, shall have at least three directors, private company shall have at least two directors. [Sec. 252]

Subject to this minimum number of directors, the articles may fix the minimum and maximum number of directors for its board of directors.

The company in the general meeting may by ordinary resolution, increase or reduce the number of its directors within the limit fixed in that behalf by the articles. [Sec.258]

Powers of Director

(a) The power of employing the funds of the company;
(b) The power to declare dividend in the general meeting;
(c) The power to make call;
(d) The power of forfeiting shares;
(e) The power of receiving payment of call in advance;
(f) The power of approving the transfer of shares;
(g) The power of accepting the surrender of shares;
(h) The power of issuing the unissued shares of the company and making allotments thereof.

Types of Directors in a Company

Residential Director

As per the law, every company needs to appoint a director who has been in India and stayed for not less than 182 days in a previous calendar year.

Independent Director

Independent directors are non-executive directors of a company and help the company to improve corporate credibility and enhance the governance standards. In other words, an independent director is a non-executive director without a relationship with a company which might influence the independence of his judgment.

The tenure of the Independent directors the hall up to 5 consecutive years; however, they shall be entitled to reappointment by passing a special resolution with the disclosure in the Board's report. Following companies need to appoint at the least two independent directors:

1. Public Companies with Paid-up Capital of INR 10 Crores or more,
2. Public Companies with Turnover of INR 100 Crores or more,
3. Public Companies with total outstanding loans, deposits, and debenture of INR 50 Crores or more.

- **Small Shareholders Directors**
- A listed company, could upon the notice of minimum 1000 small shareholders or 10% of the total number of the small shareholder, whichever is lower, shall have a director which would be elected by small shareholders.
- **Women Director**
- A company, whether be it a private company or a public company, would be required to appoint minimum one woman director in case it satisfies any of the following criteria:

1. The company is a listed company and its securities are listed on the stock exchange.
2. The paid-up capital of such company is INR 100 crore or more with a turnover of INR 300 crores or more.

- **Additional Director**

  A person could be appointed as an additional director and can occupy his post until next Annual General Meeting. In absence of the AGM, such term would conclude on the date on which such AGM should have been held.
- **Alternate Director**

  Alternate director refers to a personnel appointed by the Board, to fill in for a director who might be absent from the country, for more than 3 months.
- **Nominee Directors**

  Nominee directors could be appointed by a specific class of shareholders, banks or lending financial institutions, third parties through contracts, or by Union Government in case of oppression or mismanagement.

Qualifications of Directors

The Act does not lay down any academic or shareholding qualification for a director. There is a widespread misconception that a director must necessarily be a shareholder of the company. But if it is not so, unless the articles of the company provide otherwise, a director need not be a shareholder of the company. But usually the articles provide for certain qualification shares for the directors.

1. Qualification Shares:

If the articles of the company so provide then as per Sec. 270, the directors must obtain their qualification shares as follows:

(i) The directors must obtain qualification shares within two months after their appointment unless they already hold shares.

(ii) If any provision in the articles requiring a person to hold the qualification shares before his appointment as a director or to obtain them within a period shorter than two months shall be void.

(iii) The nominal value of one qualification share must not exceed Rs. 5,000.

(iv) Bearer share warrants will not be counted for the purposes of qualification shares.

(v) If a director does not obtain qualification shares within two months of his appointment or thereafter does not possess such shares at any time, he ceases to be a director automatically.

(vi) The director should not obtain shares by way of gift from a promoter. He should make the payment for his qualification shares.

(vii) A director is required to hold qualification shares in his own right. It is also sufficient if he holds them as a trustee provided it does not appear on the register of members that he is a trustee.

(viii) Unless the articles provide otherwise, a joint holding will be sufficient for share qualification.

(ix) A person who acts as a director of a company without holding qualification shares even after the expiry of the period of two months from the date of his appointment shall have to vacate his office as a director and be punishable with a fine extending to Rs. 50 for every day from the date of expiry of the period of two months till the date he continues to act as a director. [Sec. 272]

(x) The above provisions as to qualification shares do not apply to a non- subsidiary private company, [Sec. 273]

2. Written Consent:

Every person proposed as a candidate for the office of a director has to sign and file with the company his consent to act as a director, if appointed (Sec. 264).