

# What Is an Organization?

Chapter-4



CS449-Professional Issues in Information Technology  
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# Chapter Outcome

After studying this chapter you should know and understand:

- the different ways in which an organization can become a legal entity;
- the situations for which the different types of legal entity are appropriate;
- what a limited company is and why it is the preferred legal form for a commercial organization;
- the most important ways in which the law regulates limited companies.

# Organization

An organization is a group of people working together in a formal way. Our life in a modern society is dominated by our interactions with organizations.

- We go to school and to college; schools and colleges are organizations.
- We or our friends and relatives go to hospital; a hospital is an organization.
- We have a bank account; a bank is an organization.
- We take the examinations of the BCS; which is an organization.
- Companies or Govt. Departments are also organizations.

# Organization.....

We may even set up a business of our own and thus create an organization ourselves.

However, as we mentioned before, organizations need to have a legal existence.

Here we will describe the different ways in which an organization can acquire a legal existence, concentrating on the idea of a limited company, because this is the most important type of commercial organization.

# Organization.....

A very broad distinction can be made between commercial organizations, which are in business to make money, and public organizations or other non-profit-making bodies.

This distinction is reflected in the different procedures used to set up the organizations and the different ways in which they are governed.

# COMMERCIAL ORGANIZATIONS

The law offers several different ways of setting up and operating a commercial organization.

Depending on the circumstances, the business may be operated as:

1. a *sole trader*,
2. a *partnership*,
3. a *cooperative*,
4. or a *limited company*.

# Sole trader

A **sole trader** is an individual who runs their own business.

There are no legal formalities attached to becoming a sole trader; you become a sole trader simply by starting to run a business.

If the income of your business is large enough, you will need to register with Customs and Excise for VAT (value-added tax) purposes.

You may even need to negotiate with the Inland Revenue about your income tax status, but neither of these is necessary in order to become a sole trader.

# Sole trader.....

A sole trader is personally liable for all the debts of the business so that all the trader's assets, including the family home, are at risk if the business fails.

For this reason, anyone who is in business, other than a very small one, should not operate as a sole trader. It is usually better to form a limited company.



# Partnership

If a group of people carry on a business with a view to making profits, and the business is not a limited company, then the law will treat them as being in a *partnership*.

The legal framework governing partnerships was established in the Partnership Act 1890 and has since been changed only in minor ways.

The Act has important consequences for people going into business together.

# Partnership....

The most important consequences are that the liability of the partners is unlimited and that the partners are *jointly* responsible for the partnership's liabilities.

What does this mean in practice?

Suppose that you and a friend are working together to write software for a local company. Your friend is doing most of the work and you have agreed that he will get most of the money.

# Partnership....

Unfortunately, his software doesn't work and the company decides to claim damages for the harm it has suffered because of the defective software.

You own a house and a car and have money in the bank; your friend doesn't.

The company can sue you for the entire amount of the damages, despite the fact that it was your friend's software that didn't work.

# Partnership....

A second problem with partnerships is the difficulty of making changes in the ownership.

If one of the partners wishes to leave the partnership, perhaps to retire, how much money are they entitled to receive in return for relinquishing their share of the partnership?

And how do the remaining partners raise this money? In the extreme case if one of the partners dies, how much is his due share?

# Partnership....

Partnerships are mainly used in professions such as the law, medicine or architecture.

The bodies that govern these professions have often insisted that their members practice caution in partnerships.

The rigorous rules regarding liability are a way of discouraging recklessness and ensures that the business is done properly.

# Cooperatives

*Cooperatives* are another way in which an organization can acquire a legal existence.

They are important in fields such as agriculture and enjoy a special legal status.

They are, however, unusual in the information systems industry and we shall say no more about them.

# Limited company

By far the commonest form of commercial organization is the *limited company*.

It is also the most suitable form of organization for most businesses.

There are three principles that are fundamental to the concept of a limited liability company:

1. The company has corporate legal identity, that is, it is a legal person, completely separate from the people who work in it or the people who own it.

# limited company.....

2. The ownership of the company is divided into a (usually large) number of shares. These shares can be bought and sold individually.

The people who own these shares are known as the members of the company or shareholders.

3. In the event that the company incurs debts or other legal liabilities, the owners of the company have no obligation to pay these.

The most that shareholders stand to lose is the money they paid for their shares.



# limited company.....

The UK recognizes two main types of limited companies, the *public limited company* (**Plc**) and the *private limited company* (**Ltd**).

The essential difference is that a '*Plc*' can offer its shares for sale to the public, but a private limited company cannot.

The name of a private limited company will end with the word Limited or Ltd, e.g. Augusta Technology Ltd, while the name of a *Plc* will end with Plc, e.g. Lloyds TSB Bank Plc.

# limited company.....

Till the middle of the 19th century, the only way to create a limited company was through an Act of Parliament or the issue of a Royal Charter, they were both very slow and expensive routes.

From the middle of the 19th century it is developed through a number of Acts of the UK Parliament.

This proved as an important part in subsequent economic development, which would have been much more slower if the convenient mechanism to form a limited company had not been available.



# THE CONSTITUTION OF A LIMITED COMPANY

In order for a company to be registered, it must have a constitution. This consists of two documents:

- the *memorandum of association*
- the *articles of association*

The memorandum of association is a fairly short and straightforward document. It states:

1. The name of the company: The choice of name for a company is subject to a number of rules. The most obvious one is that the name must not already be in use by another company.

# THE CONSTITUTION OF A LIMITED COMPANY....

There are many words that cannot be used in company names without special permission.

The list includes words that might give the impression that the company has some sort of official status,

Such as '*Parliament*' or '*Pakistan*',

and words implying a representative role,

Such as '*Association*'.

2. It must include the country in which its registered office(Head office) will be located.

# THE CONSTITUTION OF A LIMITED COMPANY.....

## 3. The objects of the company:

This mentions the type of business the company will be doing.

This may also state that its object is to carry on business as a general commercial company.

## 4. A liability clause:

In the case of a company limited by shares, this clause states that the liability of the members is *limited*.

# THE CONSTITUTION OF A LIMITED COMPANY.....



5. The company's *authorized share capital* and the number and nominal value of its shares:

- The authorized share capital is the maximum amount up to which the company can issue shares.

- The company need not, and usually will not, issue all its shares.

In UK, a company must have an issued share capital (that is, the nominal value of the issued shares) of at least £50,000.

- This amount may vary from country to country.

# THE CONSTITUTION OF A LIMITED COMPANY.....

In addition, the memorandum will conclude with a *declaration of association* along the following lines:

**“We, the several persons whose names, addresses and descriptions are written below, are desirous of being formed into a company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the company set out opposite our respective names.”**

Once a company has been registered, the memorandum of agreement & the articles of association are deposited at Companies office and are available for public to view.

# DIRECTORS

In small companies, the shareholders may actually be directors or at least be in regular contact with them.

In large public companies, however, the shareholders have very little opportunity to influence the directors.

To compensate for this, the law makes directors subject to certain obligations.



# DIRECTORS.....

Directors must have regard to the interests of both the company's employees and its shareholders.

Previously directors were only required to act in the best interests of the shareholders, and theoretically at least, could have been sued if they took into account the interests of the employees to the loss of the shareholders.

Directors must exercise the skill and care in carrying out their duties that might be expected from someone of their qualifications and experience.

## DIRECTORS.....

The obligations described above can be described as domestic; that is, they are obligations owed to the company. In addition, there are certain external or legal obligations that the directors must fulfil.

First, directors are required to keep themselves aware of the company's financial position and not allow it to continue to incur debts when they know or should have known that the company will be unable to repay them.

If they fail to do this, a court can make them personally liable for the company's debts.

## DIRECTORS.....

Secondly, the directors are responsible for drawing up the company's annual report, including its accounts, and for filing this report with *Companies House* (The Head office).

In particular, they are responsible for selecting suitable accounting policies.

Thirdly, the directors are responsible for ensuring that the company complies with all relevant provisions of the law.

## DIRECTORS.....

While the company itself, having a legal existence, can be prosecuted for criminal breaches of the law, in some cases directors can be made personally responsible.

Thus the Health and Safety at Work Act 1974 provides that in appropriate circumstances a director or other senior manager can be criminally liable if a company is found to be in serious breach of the Act.

# DIRECTORS.....

Many companies have both *executive* directors and *non-executive directors*.

Executive directors are normally also employees of the company, with specific responsibility for certain areas of its activities.

Non-executive directors are directors who act in an advisory capacity only. Typically, they attend monthly board meetings to offer the benefit of their advice and are paid a fee for their services.

Legally, the duties and responsibilities of both directors are the same.

# SETTING UP A COMPANY

A **limited company** is created by a group of people each agreeing to invest to set up an organization to pursue some stated goal and to register the organization as a limited company in accordance with the law.

Mostly the process of setting up a limited company is straightforward and it can be done quite quickly and cheaply.

It is not essential to employ a lawyer or an accountant, although this may be advisable if you have no experience of dealing with formal documents.

# SETTING UP A COMPANY.....

The commonest way of setting up a company is to buy an 'off-the-shelf' company.

There are a number of company formation agents that set up companies with a standard constitution; they hold a stock of such companies, which never actually trade, and they sell them to customers wanting a company through which to run their business.

Once the customers have bought the company, they can make changes to its constitution, including its name, at their leisure.

# SETTING UP A COMPANY.....

The alternative is to create a company specifically to meet the requirements of the business.

The process of registering the business is quick and cheap; the Registrar of Companies offers a same-day service.

In practice, however, there are decisions to be made and forms to be completed, with the result that the process is likely to be slower and more expensive than buying an off-the-shelf company.



# NON-COMMERCIAL BODIES

Many familiar companies came into existence by statute, that is, by Act of Parliament.

Such organizations are often known as *statutory bodies*. Frequently the organizations themselves are created by secondary legislation.

# NON-COMMERCIAL BODIES....

Usually the government prefers to outsource delivery of state services to free-standing statutory bodies rather than having these services provided directly by government ministries.

This preference is shared by most English-speaking countries. British universities, for example, (and those in most Commonwealth countries and in the USA) are independent organizations.

They are created by Royal Charter and are free to plan their own programs.

# NON-COMMERCIAL BODIES....

Most of mainland Europe prefers a centralized system in which government ministries directly control and operate state services.

There are very many organizations whose activities are generally seen to be in the public interest and which are not intended to be profit-making.

Such organizations include professional bodies, such as the BCS or the Institute of Physics, charities such as Oxfam, Christian Aid and Salvation Army and so on.