CHAPTER 10

LIMITED LIABILITY COMPANIES, ADVANTAGES, DISADVANTAGES AND WINDING-UP

Objectives

At the end of this chapter, students should be able to state the differences between limited liability company with private companies, their advantages and disadvantages. They should also be able to state the requirements and duties of the statutory officers of limited liability companies,

Finally, they should be able to discuss the nature, types and conditions of winding-up.

10.1 Advantages of Public Companies

The following are some of the advantages of public companies:

(i) **Large Capital Resources:** Under this point, the following should be noted;

(a) There is no limit to membership, hence, substantial funds can be brought together from large membership.

(b) The shares of public companies are quoted and marketable on the stock exchange. The fact that their shares commend value at any given time, renders the shares very attractive to many potential investors who buy readily and are able to turn their shares into cash at will.

(c) In addition to capital from shares, public companies have other capital resources like loans from the commercial banks and development banks, e.g. the Nigerian Bank for Commerce and Industries (NDCI) and the Nigeria Industrial Development Bank (NIDB).

(ii) **Ample Investment Opportunities:** Public companies provide ample investment opportunities for those who have the capital, but do not possess business ability or are not prepared to undertake business risks on their own.

(iii) **Continuity and Growth:** They have perpetual existence. Unlike the sole trader or partnership, they do not cease to exist or die because some of their members or officers die, resign, or sell their shares. public companies are therefore capable of growth.

(iv) **Limited Liability:** Unlike in the private company or ordinary partnership, the liability of members for the companyâ€™s debts is limited to the value of their shares. This characteristic encourages large membership.

(v) **Separate Legal Entity:** Since the personality of members is separate from the legal status of the company, which is a legal entity on its own, large membership is not only facilitated but undertaking of risks in the interest of expansion is stimulated.

(vi) **Large Manpower Resources**: Large membership does not only bring funds for capital, it also ushers in pools of talents with fresh ideas and various experiences.The management of the public companies is richer for such large manpower resources.

(vii) **Possibilities of Large Scale Operation:** Most public companies are large scale organizations, for instance, the United African Company (UAC), United Trading Company (UTC), etc., such organizations can afford to employ expert knowledge, undertake researches, and thereby develop new products or new uses for old products. They can produce at economic costs and sell at economic prices because of their large scale operations. They are full of employment opportunities. The combined effects of growth and continuity, limited liability, separate legal entity, large capital and human resources make large scale operations possible for public companies.

10.2 Disadvantages of Public Companies

(i) **Cumbersome Formation Procedures:** The formalities in forming a public company are too complex for the comprehension and undertaking of an ordinary man. It cannot be compared with the ease with which a one man business or an ordinary partnership is formed. The documents that have to be provided in case of public companies can only be available through an expert consultancy.

(ii) **Prohibitive Incorporation Cost:** If the incorporation procedures are cumbersome, the cost is prohibitive. Providing the required documents and raising of capital are very expensive.

(iii) **Loss of Control:** Making of broad policy matters is left with the elected directors, while the day-to-day administration is left with paid executives (like the general manager) and their other paid assistants who may not necessary be shareholders. Ownership is, therefore, divorced from management of the companies.

(iv) **Shareholdersâ€™ interest in profit rather than in business:** As long as shareholders receive their interests, they are not bothered about the business itself. It would require some crises of great proportion to stimulate shareholdersâ€™ interest in the affairs of the company. Unlike in the Co-operative societies, shareholders of public companies show little or no interest in the organization. A lot of investors in the Nigeria Tobacco Company are non-smokers, while some of the shareholders in the International Standard Breweries (Nig.) Ltd., abstain from alcohol. Such investors are mainly interested in their share of profits.

(v) **Emphasis on Shares rather than Person:** Voting is on the basis of share-ownership, whereas in Co-operative societies, voting is based on individual membership.

(vi) **Bureaucratic Organizations:** The problems inherent in this type are as follows:

(1) Decisions are long to take, even when urgent action is necessary.
(2) Adjustment to rapid changes is very difficult.
(3) Direct links of personal touch and contact between senior management staff and the junior staff is blurred.

(vii) **Scarcity of the Right Managerial Calibre:** The right calibre of professionals to manage big establishments are often unavailable. The high calibre professional managers are in short supply.

(viii) **Over-growths and Diseconomies of Scale:** Beyond certain growth limits, diseconomies of scale creep in and cost of operation becomes proportionally higher.

10.3 Advantages of Private Limited Liability Company

A private limited company enjoys the following advantages:

(i) A private company is generally designed as a small family business; while it can tap more capital, it can at the same time retain control through restriction on shares transfer.
(ii) Only two members are necessary for the company to go into business.

(iii) It does not file statutory report.

(iv) It may commence business as soon as it is incorporated.

(v) It will be able to raise more fund than the sole proprietor or partnership.

(vi) Its members enjoy the protection of limited liability.

(vii) It is relatively easier to control the affairs of a private limited company than those of the public limited company.

(viii) It has a legal personality different from its owners.

(ix) Control by founders by holding majority of the shares.

(x) Its operations are kept private at it is not required to publish a balance sheet.

10.4 Disadvantages of Private Limited Liability Company

A private limited company has the following disadvantages:

(i) Its membership is restricted to 50 persons or shareholders.

(ii) Membersâ€™ right to transfer share is restricted.

(iii) It may find it difficult to raise more capital as its shares cannot be offered to the public.

(iv) Its shares cannot be quoted on the stock market.

10.5 The Balance Sheet

The balance sheet is a document which shows the state of affairs of an organization or company as at a particular date, e.g. as at 31st December 2003. There are three ways in which a balance sheet can be laid out. The British method is to put liabilities on the left and assets on the right. The American system is to present the assets on the left and liabilities on the right. The two forms described above are referred to as the traditional method. Some companies nowadays prefer to lay out their balance sheets in a vertical form that is, the liabilities can be put on top and assets put below or vice versa. This is called the modern method.

Mayo and Pembis Puplishing co. ltd.
Balance Sheet as at 31st December 2003

Liabilities	₦	₦	Assets	₦	₦
Capital			**Fixed Assets**		
1,500 Ord. shares			Land	300,000	
₦1 per share	1,500.00		Plant & Mech.	300,000	
Retained Profit	640.00		Less Accumu-		
			lated Depreciation	300,000	
			Land	300,000	
					270,000
Total		₦2,140,000	Total		570,000
Long- term Liabilities			**Current Assets**		
10% Debentures	180,500	180,500	Cash	800,000	
			Account		
Current Libilities			Receivable	300,000	
			Stock	600,000	
Account payable	150,000		Work-in progress	70,000	
Creditors	75,000		Prepaid Insurance	50,000	
Dividends payable	80,000		Office supplies	44,500	
Taxes payable	9,000				
			Sub Total	2,064,500	
Sub Total		314,000			
Total Liability		₦2,634,500	Total Assets	₦2,634,500	

Note: You can see from the above that the liabilities side of the a balance sheet (left) is equal to the assets side of the balance sheet (right). In other words the liabilities represent the funds that have come into the company while the assets represent the items on which the funds have been spent. For a healthy company the two sides must be equal.

10.6 Statutory Officers of a Company

The following officers are provided for in law, in an incorporated company:

(i) **The Directors:** These are the trustees of the companyâ€™s property and money. They take decisions on major policy matters, run and control the affairs of the company. The shareholders, as owners of the company, are too many to run the company and, therefore, elect the directors to represent them in the business of running the company. A public company for example must have at least two directors.

The first and the most important person among all the directors is the managing director. He is fully charged with the day-to-day affairs of the company. Consequent upon their reponsibilities, directors must possess a high degree of integrity and must fulfill the following conditions:

(a) They must have agreed in writing to be directors.

(b) They are expected to have paid for their qualifying share within two months of their appointment.

(c) They must not be bankrupt.

(d) They must not be over seventy years of age.

(e) They must not have been found guilty of any offence connected with the promotion, formation or management of a company (unless they are already pardoned by the court).

(f) They cannot take any loan from the company except for their official work.

(g) They must not make secret profits; they must disclose all interests in contracts and other financial matters. Their stewardship must be a honest one.

(h) A register of directorsâ€™ financial interest in the company must be made open for the inspection of members of the company.

(ii) **The Secretary:** Every company is expected to have a secretary. The sole director of a company can at the same time act as the secretary to the company; therefore, a secretary is appointed by the directors on such terms and conditions as they deem fit, (he can similarly be dismissed by them).

He has no implied power to make commercial decisions on behalf of the company, therefore, he has no implied powers to borrow in the companyâ€™s name. However, he can negotiate on his companyâ€™s behalf only those contracts that will enable him to carry on with the administration of the company, such as the purchase of office equipment or the hiring of transport. The secretary, like the director, is liable in law, for crimes arising out of fraud and falsification of documents and returns.

(iii) **The Auditor:** The appointment of an auditor is required by law for every public company. The auditor must be a professional qualified accountant. The statement of accounts for the public company, which must be furnished annually, and one must be appointed before the first annual general meeting or during that meeting. Where in an annual general meeting, no auditor is appointed or reappointed, the company must inform the ministry of trade within one week, and the ministry may appoint a person to fill the vacancy.

The Remuneration of an auditor: This must be determined in the general meeting. The determination of same might be delegated to the directors. Any money paid to auditors in form of expenses must be included in the remuneration. The remuneration must be shown as a separate heading in the profit and loss account.

The Duties and Rights of the auditor: He must submit an audited report on:

(a) the profit and loss account.
(b) the balance sheets.

In performing his duties, he has the right to call on any documents (books and vouchers) of the company and to attend any general meeting of the company. The auditorâ€™s duty is to the company and its members. He has no duty to a third person in respect of the accounts. His main duty is not the efficient running of the company, but ascertaining the true financial position of the company. Consequently, he does not need to value shares and be familiar with the company constitution, he only needs to retake stocks of the companyâ€™s goods and accept in good faith, whatever he is presented by the servants and officers of the company.

Liabilities: Unless they have acted honestly and reasonably, the auditors are not exempted from liability for default, negligence or breach of duty ethics.

10.7 Statutory Books

The Company must keep the following books in law:

(i) A register of Shareholders (as members).

(ii) A register of Directors and Secretaries.

(iii) A register of Directorsâ€™ interest in companyâ€™s shares or debentures.

(iv) A register of members controlling 10% or more of the voting share capital.

(v) A register of charges, i.e., the companyâ€™s property use as securities for loans.

(vi) Minute books of General Meetings.

(vii) Minute books of meetings of Directors and Managers.

(viii) Books of Accounts - showing sales/purchases; receipts/payments; assets/liabilities.

Location or Records: All the records must be kept at the registered office of the company, except the last two, which can be kept where they are being used e.g., where the external auditors take them away for the purpose of statutory auditing.

Also, all the records except the last two may be inspected by members free of charge. The register of charges may be inspected free of charge by the creditors. Item (i) - (v) above can be inspected by members of the public on payment of 10 kobo.

10.8 Statutory Meetings

(i) **The Statutory Meetings:** This is a meeting of the shareholders of the (new) company, which is required by law. Until this meeting is called and its duties carried out, the incorporation of the company would not be legally completed. The main purpose of the first statutory meeting is to keep shareholders informed of the initial financial position of the company. The meeting must accomplish the following objectives:

(a) It must be able to hold within three months of receipt of certificate of trading.

(b) It must present a statutory report that gives particulars of income and expenditure, receipts and payments, and balance of cash in hand.

(c) The statutory report must be sent to the shareholders, at least 14 days of the statutory meeting.

(ii) **The Annual General Meeting:** This is held once in a calendar year and it must be called, at the latest within the last fifteen months of the last one. A minimum of twenty-daysâ€™ notice must be given. Since it is a meeting where the directorsâ€™ report and audited accounts are examined, the annual general meeting is compulsory. If the company fails to call a general meeting, the register of companies may call it by himself.

(iii) **Extra-ordinary General Meeting:** This can be likened to an emergency meeting. It is called by the directorsâ€™, but it can also be called by one-tenth of the shareholders, who must show cause for calling it. A fourteen day written notice to members is required. It can also be summoned by the court; in this case, the required quorum in a public company is three, while in a private company it is two.

Resolutions

Resolutions are decisions taken in the meetings. They are in categories.

(i) *An Ordinary Resolution:* This requires a simple majority vote (e.g. 51%).

(ii) *A Special Resolution:* This requires three quarters majority votes of those present and qualified to vote.

(iii) *An Extraordinary Resolution:* both statutory and annual general meetings require twenty-one days notice. The majority needed to pass extraordinary resolutions is three-quarters, e.g. for a premium payable on redemption of shares or debentures.

(iv) *Special Notice Resolution:* When certain matters are considered by a member to require special notice resolutions, his intention must be passed to the company with twenty-eight daysâ€™ notice, and by the company to the members with twenty-one days notice. An example is the removal of any officer of the company.

N.B. In companies, votes are reckoned with on the basis of the proportion of shares held. This is in deep contrast to the co-operative societies where votes are on the basis of individual membership.

A Proxy: This is the person sent to a meeting to represent a shareholder. A proxy may vote in a meeting, if it is allowed in the articles.

10.9 Merger of Companies

Growth is evidence of successful business operation or undertaking. It can be internal when a company expands its operations, acquires new assets and finances them with internally generated resources such as sold assets and retained or plough-back profit or with externally borrowed funds.

Growth, can also be external. This happens when a company joins with another company. This type of growth is referred to as statutory merger whereby the joined companies lose their identities or corporate existence and become one new company. The essence of merger is to generate growth through efficiency.

Reasons For Merging

Companies can merg for the following reasons:

(i) **To Achieve Operation Economies:** By merging, companies can reduce their cost of operation through consolidating certain operations which would have needed separate facilities and thus achieve lower operating cost.

(ii) **To Finance Growth:** Arapidly growing company may face difficulty in financing its growth. In order not to curtail its expansion plan, it may seek to merge with a company that has the needed fund for the financing of the envisaged growth.

(iii) **To Have a Pool of Funds:** Companies may merge in order to pool their funds together to enable them to acquire some important patent, bigger equipment or have more efficient management staff. In other words, companies merge in order to pool together expert personnel and other production resources.

(iv) **To Prevent Failure or Collapse of Business:** A further reason for merging is the desire to protect themselves from failure arising from stiff competition. This can lead to horizontal merger whereby the companies cease to compete with each other.

(vi) **To Integrate Production:** Companies may merge in order to integrate their production. This can lead to vertical merger or integration whereby the product of one company becomes the raw material of the other.

10.10 Winding-up Or Liquidation

To wind-up a company is to terminate the life of the company, i.e., to stop the operation of the company. There are four methods of doing this, and there are different circumstances under which the life of a company may be terminated.

Methods and Circumstances of a Wind-up

Winding-up could be (i) voluntary, (ii) compulsory by courtâ€™s order, (iii) under the supervision of the court, and (iv) a creditor voluntary winding-up.

(i) *Membersâ€™ voluntary winding-up:* This is when the decision to cease business operation is taken voluntarily by the members. The circumstances under which this may happen are:

  (a) When the period, if any, that is fixed for the life of the business by the articles of association expires.

  (b) If a special resolution to wind-up has been passed either for purposes of reconstruction or amalgamation.

  (c) When an extraordinary resolution has been passed saying that the company can no longer pay its debts.

(ii) *Compulsory Winding-up by Courtâ€™s Order:* Under section 208 of the Company Acts of 1968, the court that has the power to wind-up a company is the court in whose area of jurisdiction the registered office of the company is situated. However, with the Federal Revenue Courts Acts of 1973, this power has passed to the Federal Revenue Court.

The following are the circumstances under which a court can order the winding-up of a company:

(a) If the company resolves so, through a special resolution.

(b) If the company does not commence business within a year of the issue of the incorporation certificate, or if it suspends business for a year.

(c) If the number of its members falls below the statutory minimum, i.e., below two for a private company and seven for a public company.

(d) If it fails to file the statutory report.

(e) If it fails to hold the statutory meeting.

(f) If it is unable to pay its debts.

(g) When the court thinks it just and equitable to wind it up, e.g. when directors are at such logger-heads that the company cannot possibly carry out its objectives.

(iii) *Winding-up Under a Courtâ€™s Supervision:* This is a wind-up resulting from a petition for winding-up made to the Chief Justice of Nigeria. Such a petition is heard in the Federal Revenue Court as well. This grounds of the petition must be stated and supported with an affidavit within 4 days, and served at the registered office of the company. It is not usually common, since it has no advantage over winding-up by the court.

(iv) *Creditorsâ€™ Voluntary Winding-up:* This is when the winding-up is prompted by the creditors. In this case, the creditors elect the liquidator and appoint a committee of inspectors to safeguard their interest.

The circumstances under which this can happen are:

(a) If the company shows that it can no longer meet its financial obligations.

(b) If the company does not give an honest account of its stewardship.

(c) If there are grounds to believe that the directors are not giving honest and selfless services.

Dissolution

This is when a company is declared non-existent. It ceases to function as a company. A company may be dissolved under the following circumstances:

(i) When its registration is cancelled.

(ii) If it has ceased to be operational, i.e., it is â€˜defunctâ€™.

(iii) If a court orders its dissolution.

(iv) By winding-up.

However, a dissolved company is not necessarily a liquidated company for the following reasons:

(i) A court may, within twenty years, order the restoration of the company.

(ii) The liability of its members and officers remains as if the company is still operational.

(iii) The court can still come round to wind-up a dissolved company.

Summary

Advantages of Public Companies

(i) Capital Resources - unlimited membership provides large capital - stock exchange quotation of shares provides confidence in share - holding and investment opportunities; access to bank loans and loans from Development Banks (NCBI & NIDB)

(ii) Continuity of Growth.

(iii) Separate Legal Entity.

(iv) Large Manpower Resources and Scale of Operations.

Officers of a company:-

The Directors	- must consent in writing as one. - pay up for their own qualifying shares. - should not be a bankrupt. - should not take loan for private use and make no secret profit.
The Secretary	- is appointed by the directors and acts as custodian to company records. - has no implied power to borrow on behalf of his company; and like the director takes liability for the fraud, or crimes committed in his company.
The Auditor	- as a qualified professional accountant, he certifies the books of accounts of the company.
Statutory Meetings	- are the first compulsory ones; the annual general meeting and an extra-ordinary meeting.
Resolutions	- can be ordinary, special, extra-ordinary and special with varying degrees of requirements.
Wind-ups (or Liquidation) can be by:	- membersâ€™voluntary decision. - courtâ€™s compulsory order or under a courtâ€™s supervision; and - creditorsâ€™ voluntary winding-up.
Dissolution	- means a company is no longer in existence.

Revision Questions

A. ***Essay Questions***

1. State five advantages of a private company.

2. (a) Mention 3 Statutory Officers of a limited liability company.

   (b) Write short notes on the duties of a Secretary.

3. (a) What is meant by merger of companies?

(b) Why do companies merge?

4. Explain the differences between the following:-
   * Membersâ€™voluntary winding-up.
   * Compulsory winding-up by courtâ€™s order.
   * Winding-up under a courtâ€™s supervision.
   * Creditorsâ€™voluntary winding-up.

5. (a) Show the difference between liquidation and dissolution of companies.

   (b) When is a company dissolved.

B. Objective Questions

1. Which one of these can in law transfer its shares freely?
   A. Sole proprietorship
   B. Partnership
   C. Private limited liability companies
   D. Public limited liability companies

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2. The business organization that is limited in its liability is:-
   A. Private company
   B. Sole trader
   C. Partnership
   D. Public limited liability company

WASSCE 2000

3. A shareholder is limited in his liability to the company once he pays
   A. full value of alotted shares
   B. full value of minimum capital
   C. full value of his share of business
   D. full value of companyâ€™s nominal share

4. Foundersâ€™ shares are otherwise known as:-
   A. Cumulative preference
   B. Deferred shares
   C. Participating preference shares
   D. Preference shares

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5. One of these may not seem an advantage of public limited liability companies
   A. available large capital resources
   B. separate legal entity
   C. large manpower resources base

D. compulsory annual returns to Corporate Affairs Commission (CAC)

6. All except one are advantages of a private company.
   A. two members are enough to form a company.
   B. There is no need for annual statutory report to (CAC).
   C. can commence work as soon as incorporated.
   D. membership is strictly restricted to 50 shareholders.

7. One of these is not necessarily a statutory officer of a limited liability company.
   A. The directors
   B. The public relations officer
   C. The auditor
   D. The secretary

8. The public company may have these books except
   A. register of directors and shareholders
   B. register of changes
   C. register of attendance of shareholders and directors at annual general meeting
   D. books of accounts

9. One of these is NOT a statutory winding-up method in law.
   A. voluntary winding-up
   B. compulsory winding-up by courtâ€™s order
   C. debtorsâ€™ compulsory winding-up
   D. creditorsâ€™ winding-up

10. A person sent to represent a shareholder in a meeting
    A. Annual general meeting
    B. A proxy
    C. An extra-ordinary meeting
    D. An ordinary resolution
    E. Statutory meeting

Project

1. Give a list of companies that you are aware of which have gone into liquidation in any part of the country. (Ask some members of your family to assist you with this question).

2. Make 5 cuttings from the old newspapers of the published final statements of accounts of five public limited liability companies.