

LESSON : 1

MEANING, CHARACTERISTICS AND TYPES OF A COMPANY

STRUCTURE

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Introduction

Meaning of Company

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OBJECTIVE

After reading this lesson, you should be able to:

- (a) Define a company and explain its features.
- (b) Make a distinction between company and partnership firm.
- (c) Explain the various types of companies.

INTRODUCTION

Industrial revolution led to the emergence of large scale business organizations. These organizations require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to

overcome the limitations of partnership business. The Multinational companies like Coca-Cola and, General Motors have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Tubro etc.

MEANING OF COMPANY

Section 3 (1) (i) of the Companies Act, 1956 defines a company as “a company formed and registered under this Act or an existing company”. Section 3(1) (ii) Of the act states that “an existing company means a company formed and registered under any of the previous companies laws”. This definition does not reveal the distinctive characteristics of a company . According to Chief Justice Marshall of USA, “A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation of its creation confers upon it either expressly or as incidental to its very existence”.

Another comprehensive and clear definition of a company is given by Lord Justice Lindley, “A company is meant an association of many persons who contribute money or money’s worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from. The common stock contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted”.

According to Haney, “Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership”.

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

CHARACTERISTICS OF A COMPANY

The main characteristics of a company are :

1. Incorporated association. A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

For forming a public company at least seven persons and for a private company at least two persons are persons are required. These persons will subscribe their names to the Memorandum of association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability [Sec 12 (1)]

2. Artificial legal person. A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. It was rightly pointed out in *Bates V Standard Land Co.* that : “The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them”.

But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and be sued in its own name.

However, it is not a citizen as it cannot enjoy the rights under the Constitution of India or Citizenship Act. In *State Trading Corporation of India v C.T.O* (1963 SCJ 705), it was held that neither the provisions of the Constitution nor the Citizenship Act apply to it. It should be noted that though a company does not possess fundamental rights, yet it is person in the eyes of law. It can enter into contracts with its Directors, its members, and outsiders.

Justice Hidayatullah once remarked that if all the members are citizens of India, the company does not become a citizen of India.

3. Separate Legal Entity : A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and nor for

the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act. Where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend of income. This proves that a company that a company and its shareholders are two separate entities.

The principal of separate of legal entity was explained and emphasized in the famous case of Salomon v Salomon & Co. Ltd.

The facts of the case are as follows :

Mr. Saloman, the owner of a very prosperous shoe business, sold his business for the sum of \$ 39,000 to Saloman and Co. Ltd. which consisted of Saloman himself, his wife, his daughter and his four sons. The purchase consideration was paid by the company by allotment of & 20,000 shares and \$ 10,000 debentures and the balance in cash to Mr. Saloman. The debentures carried a floating charge on the assets of the company. One share of \$ 1 each was subscribed by the remaining six members of his family. Saloman and his two sons became the directors of this company. Saloman was the managing Director.

After a short duration, the company went into liquidation. At that time the statement of affairs' was like this: Assets :\$ 6000, liabilities; Saloman as debenture

holder \$ 10,000 and unsecured creditors \$ 7,000. Thus its assets were running short of its liabilities b \$11,000

The unsecured creditors claimed a priority over the debenture holder on the ground that company and Saloman were one and the same person. But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the assets of the company must be utilized in payment of the debentures first in priority to unsecured creditors.

Saloman's case established beyond doubt that in law a registered company is an entity distinct from its members, even if the person hold all the shares in the company. There is no difference in principle between a company consisting of only two shareholders and a company consisting of two hundred members. In each case the company is a separate legal entity.

The principle established in Saloman's case also been applied in the following:

Lee V. Lee's Airforming Ltd. (1961) A.C. 12 Of the 3000 shares in Lee's Air Forming Ltd., Lee held 2999 shares. He voted himself the managing Director and also became Chief Pilot of the company on a salary. He died in an aircrash while working for the company. His wife was granted compensation for the husband in the course of employment. Court held that Lee was a separate person from the company he formed, and compensation was due to the widow. Thus, the rule of corporate personality enabled Lee to be the master and servant at the same time.

The principle of separate legal entity of a company has been, in fact recognized much earlier than in Saloman's case. In Re Kondoi Tea Co Ltd. (1886 ILR 13 Cal 43),

it was held by Calcutta High Court that a company was a separate person, a separate body altogether from its Shareholders. In *Re. Sheffield etc. Society* - 22 OBD 470), it has been held that a corporation is a legal person, just as much in individual but with no physical existence.

The characteristic of separate corporate personality of a company was also emphasized by Chief Justice Marshall of USA when he defined a company “as a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as accident to its very existence”. [*Trustees of Dartmouth College v Woodward* (1819) 17 US 518)

4. Perpetual Existence. A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can dissolve it. Members may come and go but the company can go on for ever. “During the war all the member of one private company, while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed it”. The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.

5. Common Seal. As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural person who are called its directors. But having a legal personality,

it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company. A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document. If the Articles are silent, the provisions of Table-A (the model set of articles appended to the Companies Act) will apply. As per regulation 84 of Table-A the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose, and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

6. Limited Liability : A company may be company limited by shares or a company limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares. For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs. 7 per share, he can be called upon to pay not more than Rs. 3 per share during the lifetime of the company. In a company limited by guarantee the liability of members is limited to such amount as the member may undertake to contribute to the assets of the company in the event of its being wound up.

7. Transferable Shares. In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision

in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition.

In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

8. Separate Property : As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

9. Delegated Management : A joint stock company is an autonomous, self-governing and self-controlling organization. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, known as directors. They look after the day-to-day working of the company. Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines. Majority decision and centralized management compulsorily bring about unity of action.

DISTINCTION BETWEEN COMPANY AND PARTNERSHIP

The difference between a company and partnership is as follows:

	Company	Partnership
1. Mode of creation	By Registration by Statute.	By Agreement
2. Legal Statute	Legal entity distinct from members, perpetual succession.	Firm and partners are not separate; no separate entity; uncertain life
3. Liability	Limited liability of members	Unlimited joint and several liability of partners
4. Authority	Divorce between ownership and management Representative Management	Right to share management, common and ownership and Management. Mutual agency - Implied authority.
5. Transfer of shares	Public Co.-freely transferable; transferee gets all the rights of the transferor	Ordinarily no right of transfer of share by a partner-limited rights of transferee

6. Number of members	Private Co-Minimum 2 and Maximum 50 public Co. Minimum 7 and Maximum unlimited.	Minimum 2 Maximum 20.
7. Resources	Large and unlimited resources	Personal resources of partners are limited.
8. General powers	Memorandum defines and confines the scope of the company. alteration difficult.	Easy to change the agreement and so also the powers of the partners.
9. Legal formalities	Statutory books, Audit, Publication Registration, filing, etc. lots of legal formalities	No legal formalities Registration not compulsory. No audit, no publication of accounts etc.
10. Dissolution	Only according to the provisions of law- usually by an order of the court. Death of a shareholder does not affect the existence of a company.	Dissolution by agreement by notice, by court. Death of a partner may mean dissolution of partnership

TYPES OF COMPANY

Joint stock company can be of various types. The following are the important types of company:

1. Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies.

A. Chartered companies. These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the chartered, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

B. Statutory Companies. These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alterations in the powers of such companies can be brought about by legislative amendments.

The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts [Sec 616 (d)]

These companies are generally formed to meet social needs and not for the purpose of earning profits.

C. Registered or incorporated companies. These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following.

i) Companies limited by Shares : These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining unpaid on the shares subscribed by him. Such a company is called company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.

ii) Companies Limited by Guarantee : These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company [Sec 13(3)] This amount promised by him is called

‘Guarantee’. The Articles of Association of the company state the number of member with which the company is to be registered [Sec 27 (2)]. Such a company is called a company limited by guarantee. Such companies depend for their existence on entrance and subscription fees. They may or may not have a share capital. The liability of the member is limited to the extent of the guarantee and the face value of the shares subscribed by them, if the company has a share capital. If it has a share capital, it may be a public company or a private company.

The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company. Non-trading or non-profit companies formed to promote culture, art, science, religion, commerce, charity, sports etc. are generally formed as companies limited by guarantee.

iii) Unlimited Companies : Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an ‘unlimited company’ [Sec 12(c)]. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered [Sec 27 (1)]

The articles of an unlimited company shall state the number of member with which the company is to be registered.

II. On the Basis of Number of Members

On the basis of number of members, a company may be :

(1) Private Company, and (2) Public Company.

A. Private Company

According to Sec. 3(1) (iii) of the Indian Companies Act, 1956, a private company is that company which by its articles of association :

- i) limits the number of its members to fifty, excluding employees who are members or ex-employees who were and continue to be members;
- ii) restricts the right of transfer of shares, if any;
- iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

Where two or more persons hold share jointly, they are treated as a single member.

According to Sec 12 of the Companies Act, the minimum number of members to form a private company is two. A private company must use the word “Pvt” after its name.

Characteristics or Features of a Private Company. The main features of a private of a private company are as follows :

- i) A private company restricts the right of transfer of its shares. The shares of a private company are not as freely transferable as those of public companies. The articles generally state that whenever a shareholder of a Private Company wants to transfer his shares, he must first offer them to the existing members of the existing members of the company. The price of the shares is determined by the directors. It is done so as to preserve the family nature of the company’s shareholders.

- ii) It limits the number of its members to fifty excluding members who are employees or ex-employees who were and continue to be the member. Where two or more persons hold share jointly they are treated as a single member. The minimum number of members to form a private company is two.
- iii) A private company cannot invite the public to subscribe for its capital or shares of debentures. It has to make its own private arrangement.

B. Public company

According to Section 3 (1) (iv) of Indian Companies Act. 1956 “A public company which is not a Private Company”,

If we explain the definition of Indian Companies Act. 1956 in regard to the public company, we note the following :

- i) The articles do not restrict the transfer of shares of the company
- ii) It imposes no restriction no restriction on the maximum number of the members on the company.
- iii) It invites the general public to purchase the shares and debentures of the companies

(Differences between a Public Company and a Private company)

1. **Minimum number** : The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.
2. **Maximum number** : There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.

3. **Number of directors.** A public company must have at least 3 directors whereas a private company must have at least 2 directors (Sec. 252)
4. **Restriction on appointment of directors.** In the case of a public company, the directors must file with the Register a consent to act as directors or sign an undertaking for their qualification shares. The directors of a private company need not do so (Sec 266)
5. **Restriction on invitation to subscribe for shares.** A public company invites the general public to subscribe for shares. A private company invites the general public to subscribe for the shares or the debentures of the company. A private company by its Articles prohibits invitation to public to subscribe for its shares.
6. **Name of the Company :** In a private company, the words “Private Limited” shall be added at the end of its name.
7. **Public subscription :** A private company cannot invite the public to purchase its shares or debentures. A public company may do so.
8. **Issue of prospectus :** Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.
9. **Transferability of Shares.** In a public company, the shares are freely transferable (Sec. 82). In a private company the right to transfer shares is restricted by Articles.
10. **Special Privileges.** A private company enjoys some special privileges. A public company enjoys no such privileges.
11. **Quorum.** If the Articles of a company do not provide for a larger quorum. 5 members personally present in the case of a public company are quorum for a meeting of the company. It is 2 in the case of a private company (Sec. 174)

12. **Managerial remuneration.** Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.
13. **Commencement of business.** A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a “Certificate of Commencement of business”.

Special privileges of a Private Company

Unlike a private a public company is subject to a number of regulations and restrictions as per the requirements of Companies Act, 1956. It is done to safeguard the interests of investors/shareholders of the public company. These privileges can be studied as follows :

- a) Special privileges of all companies. The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company :
 1. A private company may be formed with only two persons as member. [Sec.12(1)]
 2. It may commence allotment of shares even before the minimum subscription is subscribed for or paid (Sec. 69).
 3. It is not required to either issue a prospectus to the public or file statement in lieu of a prospectus. (Sec 70 (3))
 4. Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. [Sec 81 (3)]

5. Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 14)
6. It need not keep an index of members. (Sec. 115)
7. It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required. [Sec. 149 (7)]
8. It need not hold statutory meeting or file a statutory report [Sec. 165 (10)]
9. Unless the articles provide for a larger number, only two persons personally present shall form the quorum in case of a private company, while at least five member personally present form the quorum in case of a public company (Sec. 174).
10. A director is not required to file consent to act as such with the Registrar. Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private companies [Sec. 266 (5) (b)]
11. Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company on or before 1st April 1952 [Sec. 284 (1)]
12. In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two member if not more than seven member are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up (Sec. 179).

13. It need not have more than two directors, while a public company must have at least three directors (Sec. 252)
- b) Privileges available to an independent private company (i.e. one which is not a subsidiary of a public company)

An independent private company is one which is not a subsidiary of a public company. The following special privileges and exemptions are available to an independent private company.

1. It may give financial assistance for purchase of or subscription for shares in the company itself.
2. It need not, like a public company, offer rights shares to the equity shareholders of the company.
3. The provisions of Sec. 85 to 90 as to kinds of share capital, new issues of share capital, voting, issue of shares with disproportionate rights, and termination of disproportionately excessive rights, do not apply to an independent private company.
4. A transfer or transferee of shares in an independent private company has no right of appeal to the Central Government against refusal by the company to register a transfer of its shares.
5. Sections 171 to 186 relating to general meeting are not applicable to an independent private company if it makes its own provisions by the Articles. Some provisions of these Sections are, however made expressly applicable.
6. Many provisions relating to directors of a public company are not applicable to an independent private company, e.g.

- a) it need not have more than 2 directors.
- b) The provisions relating to the appointment, retirement, reappointment, etc. of directors who are to retire by rotation and the procedure relating, there to are not applicable to it.
- c) The provisions requiring the giving of 14 days' notice by new candidates seeking election as directors, as also provisions requiring the Central Government's sanction for increasing the number of directors by amending the Articles or otherwise beyond the maximum fixed in the Articles, are not applicable to it.
- d) The provisions relating to the manner of filing up casual vacancies among directors and the duration of the period of office of directors and the requirements that the appointment of directors should be voted on individually and that the consent of each candidate for directorship should be filed with the Registrar, do not apply to it.
- e) The provisions requiring the holding of a share qualification by directors and fixing the time within which such qualification is to be acquired and filing with the Registrar of a declaration of share qualification by each director are also not applicable to it.
- f) It may, by its Articles, Provide special disqualifications for appointment of directors.
- g) It may provide special grounds for vacation of office of a director.
- h) Sec. 295 prohibiting loans to directors does not apply to it.