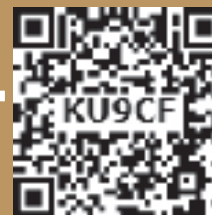


UNIT II FORMS OF BUSINESS ORGANISATION

CHAPTER

6

JOINT STOCK COMPANY



Learning Objectives

To enable the students to understand

- i. the meaning of Joint Stock Company
- ii. the characteristics, advantages, disadvantages
- iii. the types of companies
- iv. the Memorandum of Association and its contents
- v. the Articles of Association and its contents
- vi. the Prospectus and its contents

6.01 Meaning and Definition of a Company

A joint stock company is a distinct type of business organisation evolved to overcome the limitations of sole trader and partnership concerns. The advancement in science and technology and the impact of industrial revolution have all necessitated a large amount of capital investment and highly sophisticated managerial skill for running a large-scale industry. Partnership with limitations of its capital and managerial ability and with the added risk of unlimited liability has been found unsuitable for running a large-scale industry in modern

times. Therefore joint stock company form of organisation came into existence.

The joint stock companies in India are governed by The Companies Act 2013 (earlier one was, The Companies Act 1956). The new Act has been divided into 29 chapters with 470 sections.

The Act came into force on 12 September 2013 with few changes like earlier private companies maximum number of members was 50 and now it will be 200. A new class of company is of “One Person Company” is included in this Act that will be a private limited company.

Definition

“A company is 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.”

- Lord Lindley

“A company is an artificial person created by law having a separate entity with a perpetual succession and a common seal”.

- Sec 2 of Companies Act 2013

Characteristics

A company as an entity has many distinct features which together make it a unique organization. The essential characteristics of a company are as follows:

i. Separate Legal Entity

Under Incorporation a company becomes a separate legal entity as compared to its members. The company is distinct and different from its members. It has its own seal and its own name, its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, and borrowing money, employing people, having a bank account, entering into contracts and suing and being sued separately. In short, it is considered as an artificial person created by law.

ii. Limited Liability

The liability of the members of the company is limited to contribution to the assets of the company upto the face value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him. If the assets of the company are not sufficient to pay liabilities, the personal properties of the shareholders are not held responsible.

iii. Perpetual Succession

A company does not cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time but that does not affect life of the company. A company is created by law and it can be windup only through legal process.



Formation of a Company



Highlights of Companies Act, 2013

- The Act, of 2013 has 470 sections as against 658 Sections in the Companies Act, 1956
- The entire Act has been divided into 29 chapters.
- Many new chapters have been introduced such as Registered Valuers (ch.17); Government companies (ch. 23); Companies to furnish information or statistics (ch. 25); Nidhis (ch. 26); National Company Law Tribunal & Appellate Tribunal (ch. 27); Special Courts (ch. 28).
- The Act is forward looking in its approach which empowers the Central Government to make rules, etc. through delegated legislation (section 469 and others).
- The Companies Act, 2013 is the result of detailed consultative process adopted by the Government

iv Separate Property

A company is a distinct legal entity. A member cannot claim to be owner of the company's property during the existence of the company.

v. Transferability of Shares

Shares in a company are freely transferable. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares. There are restrictions in the transferability of shares in case of private companies.

vi. Common Seal



A company is an artificial person and does not have a physical presence. Thus, it acts through its Board of Directors for carrying out its activities and entering into various agreements. Such contracts must be under the seal of the company. The common seal is the official signature of the company. The name of the company must be engraved on the common seal. Any document not bearing the seal of the company may not be accepted as

authentic and may not have any legal force.

vii. Capacity to Sue and being sued

A company can sue or be sued in its own name as distinct from its members.

viii. Separate Management

A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not necessarily be the managers of the company.

ix. One Share-One Vote

The principle of voting in a company is one share-one vote i.e. if a person has 10 shares, he has 10 votes in the company. This is in direct distinction to the voting principle of a co-operative society where the "One Member - One Vote" principle applies i.e. irrespective of the number of shares held, one member has only one vote.

Advantages

A joint stock company has many advantages. These are given below:

i. Large Capital

A company can secure large capital compared to a sole trader or partnership. Large amount of capital is necessary for conducting business on a large scale. For e.g. Reliance has invested more than ₹25,000 crore in its telecom venture. Raising such huge amount of funds would be utter impossible in a sole-tradership or partnership.

ii. Limited Liability

The liability of a shareholder is limited. In the case of a company limited by guarantee, his liability is restricted to the amount that he has guaranteed to contribute in the event of winding up of the company.

iii. Transferability of Shares

Transaction of Shares between two individuals is easy. So there is liquidity of investment. Any shareholder can easily convert his shares into money by selling his shares.

iv. Perpetual Succession

A company has perpetual or continuous existence. Members may go or new members may come in, but the company continues to exist. This ensures continuity in operations and the company can undertake long term investments.

v. Promotion of Saving and Investment Habit

Joint stock company system encourages people to save. Even small amount can be used for the purchase of shares. A person can buy even one share of a company.

vi. Risk Bearing Capacity

The loss of the company is distributed over a large number of shareholders. So each shareholder bears a very little amount of loss. Hence the company form of organization has risk bearing capacity.

vii. Economies of Large-scale Operation

A joint stock company can undertake business on large scale. As a result it can derive all the advantages of large scale production. For e.g. Hero Moto Corp Ltd. 2015, the world's largest seller of

Example of Limited liability

Shyam is a share holder in a company holding 500 shares of ₹10 each, on which he has already paid ₹7 per share. In the event of losses or company's failure to pay debts, Shyam is liable to pay only ₹1,500. (i.e., the unpaid amount of ₹3 on 500 shares)

two-wheelers, manufactures motorbikes on a large scale and is able to enjoy cost efficiency.

viii. Economic Development

Joint stock company system has been responsible for the rapid growth of industries and trade in many countries. Since Joint Stock Companies have large financial resources, they are able to undertake large scale production, satisfy the needs of more number of consumers, create large scale employment opportunities, promote balanced regional development and contribute substantially to the government by way of taxes.

Disadvantages

The following are the disadvantages of company form of organization

i. Costly and difficult to form

Number of legal formalities must be observed in the formation of the company. To observe these legal formalities, promoters have to spend much time and money.

ii. Scope for dishonest and unscrupulous management

The directors manage the company with the help of paid officers. If the

directors are dishonest, they may make personal gain at the expense of the company. They may misuse their power and position.

iii. Management oligarchy

A few rich persons may secure control over the affairs of the company. Thus, the management of a joint stock company might become oligarchic in character. (Oligarchy means a small group of people having control)

iv. Speculation

A few individuals may corner the shares to gain control over the company.

v. Lack of interest

The officers of the company do not have incentive to work hard. They are not usually inclined to take risks. They lack initiative.

vi. Lack of good labour relations

In sole trading business personal supervision is possible. But in company

form of organization there is lack of personal contact between owners and workers. As a result, there is scope for more industrial disputes in a company form of organization.

vii. High taxation

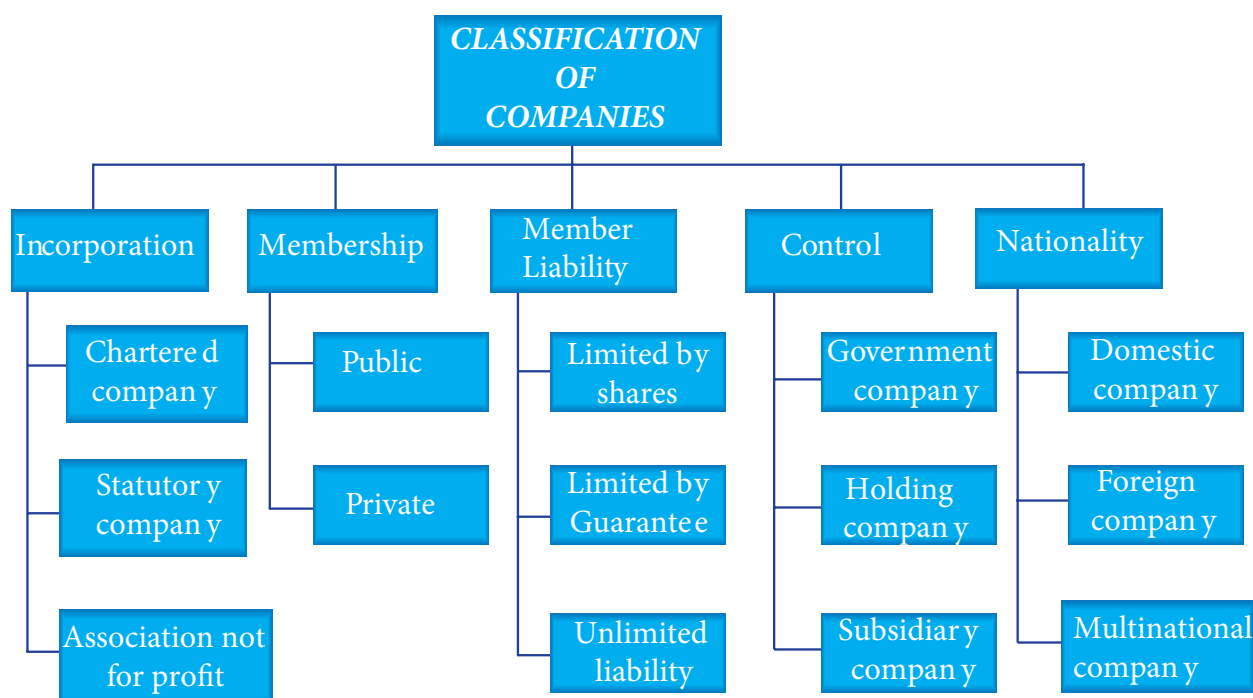
Joint stock companies have to pay tax at higher rates compared to other forms of organizations.

6.02 Types of Companies

1. Classification of Companies on the Basis of Incorporation

a. Chartered Companies

Chartered companies are established by the King or Queen of a country. Powers and privileges of chartered company are specified in the charter. Power to cancel the charter is vested with King/Queen. Examples: East Indian Company, Bank of England, Hudson's Bay Company. The Companies Act does not apply to them. Such companies cannot be started in India.





b. Statutory Companies

Companies are established by a Special Act made in Parliament/State Assembly. Constitution of company is specified in the Memorandum of Association (MOA). Rules relating to day-to-day management of statutory companies are specified in the Articles of Association (AOA). Audit of statutory company is conducted by Comptroller and Auditor General of India (CAGI). The report of CAGI is placed in Parliament/State Assemblies concerned. Examples: Food Corporation of India, LIC, GIC, RBI, SBI, IDBI. Statutory companies enjoy autonomous status. It need not use the word 'Limited' next to its name.

c. Association Not for Profit

According to Section 8 of the Companies Act (2013), the Central Government may, by license, grant that an association may be registered as a company with limited liability, without using the words 'limited' or 'private limited' as part of its name. The license will be granted only in the case of 'association not for profit'. In other words, the Central Government will grant the license only if it is satisfied that:

- (i) The association about to be formed as a limited company aims at the promotion of Sports, Commerce, Art, Science, Religion, Charity or any other useful object.
- (ii) It intends to apply its profits, if any, for promoting its objects.
- (iii) It prohibits the payment of dividend to its members.

Such companies may be public or private companies and may or may not have share capital.

2. Classification of Companies on the basis of Membership

a. Private Company

Private limited company is a type of company which is formed with minimum two shareholders and two directors. The minimum requirement with respect to authorised or paid up capital of ₹1,00,000 has been omitted by The Companies (Amendment) Act, 2015 w.e.f. 29th of May, 2015. Another crucial condition of a private limited company is that it by its articles of association restricts the right to transfer its shares & also prohibits any invitation to the public to subscribe for any securities of the company. Maximum of 200 persons can become shareholders in a private company. The name of private company should be suffixed with pvt ltd or (p) ltd. Ex. Scientific publishing services private Limited, Chennai. A private Limited company can be formed in three variations.

- (a) as a private limited company; (b) As a small private limited company; (c) As a One Person Company (OPC).

b. Public Company

Public Company means a company which is not a private company. A public company may be said to be an association which

- (i) consists of at least 7 members.
- (ii) has a minimum paid-up capital of ₹5,00,000 or such higher paid up capital as may be prescribed.
- (iii) is a subsidiary of a company which is not a private company.
- (iv) does not restrict the right to transfer its shares.



(v) does not prohibit any invitation to subscribe for any shares or debentures of the company.

(vi) does not prohibit any invitation or acceptance of deposits. (The name of public company should be suffixed with ltd. Ex.National Aluminium company Limited, Chennai)

3. Classification of Companies on the basis of Liability

a. Company Limited by Shares

A company limited by shares is a company in which the liability of its members is limited by its Memorandum to the amount (if any) unpaid on the shares respectively held by them. The companies limited by shares may be either public companies or private companies. If a member has paid the full amount of shares, then his liability shall be nil.

Thus two main features of a company limited by shares are as follows:

- (i) The liability of its members is limited to the amount (if any) remaining unpaid on the shares held by them.
- (ii) Such liability can be enforced either during the lifetime of the company or during the winding up of the company.

b. Company Limited by Guarantee

A company limited by guarantee is a company in which the liability of its members is limited by its Memorandum to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Such companies are generally formed for the promotion of Commerce, Art, Science,

Religion, Charity or any other useful object. The companies limited by guarantee may be either private companies or public companies.

c. Unlimited Company

An unlimited company is a company in which the liability of its members is not limited by its Memorandum. In other words, the liability of members is unlimited i.e., there is no limit on the liability of members. The members of such companies may be required to pay company's losses from their personal property. Because such companies have separate legal entity, its creditors cannot file a suit against the members directly. The creditors will have to apply to the court for the winding up of the company and then the liquidator will direct the members to contribute to the assets of the company to pay off its liabilities.

4. Classification of Companies on the Basis of Control

a. Government Companies

A public enterprise incorporated under the Indian Companies Act, 1956 is called a government company. These companies are owned and managed by the central or the state government. Section 617 of the Companies Act, 1956 defines "Government Companies" as any company in which not less than 51% of the [paid-up share capital] is held by.

- 1. The Central Government; or
- 2. Any State Government or Governments; or
- 3. Partly by the Central Government and partly by one or more State Governments.



A subsidiary of a Government company shall also be treated as a Government company. These companies are registered as private limited companies though their management and their control vest with the government. This is a type of organization where both the government and private individuals are shareholders. Sometimes these companies are called as a mixed ownership company.

Examples: Steel Authority of India, Indian Oil Corporation, Oil and Natural Gas Corporation, Bharath Heavy Electricals.

b. Holding Companies

As per Section 2(87) “subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

c. Subsidiary Companies

“Subsidiary company” or “Subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company.

- (i) controls the composition of the Board of Directors; or

- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Examples: H Ltd., holds more than 50% of the equity share capital of S Ltd. Now H Ltd., is the holding company of S Ltd., and S Ltd., is the subsidiary of H Ltd.

5. Classification of Companies on the Basis of Nationality

a. Domestic Companies

A company which cannot be termed as foreign company under the provision of the Companies Act should be regarded as a domestic company.

b. Foreign Companies

A foreign company means a company which is incorporated in a country outside India under the law of that country. After the establishment of business in India, the following documents must be filed with the Registrar of Companies within 30 days from the date of establishment.

- (i) A certified copy of the charter or statutes under which the company is incorporated, or the Memorandum and articles of the company translated into English.
- (ii) The full address of the registered office of the company.
- (iii) A list of directors and secretary of the company.
- (iv) The name and address of any person resident of India who is authorised to accept, on behalf of the company, service of legal process and any notice served on the company.

- (v) The full address of the company's principal place of business in India.

c. Multi National Companies

A Multi National Company (MNC) is a huge industrial organisation which,

- (i) Operates in more than one country
- (ii) Carries out production, marketing and research activities on international Scale in those countries.
- (iii) Seeks to maximise profits world over.

A domestic company or a foreign company can be a MNC.

Examples: Microsoft Corporation, Nokia Corporation, Nestle, Coca-Cola, International Business Machine, Pepsico, Sony Corporation.

6.03 Memorandum of Association

A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability

company to define its relationship with shareholders. It reveals what powers it has and what activities the company is permitted to undertake. Any act of the company outside the scope outlined in its memorandum is said to be ultra virus and is not binding on it. It is the constitution of the company in its relation to the outside world. It is a public document and any person dealing with the company is presumed to have sufficient knowledge of it. It is the primary document of a company.

Contents

1. Name Clause

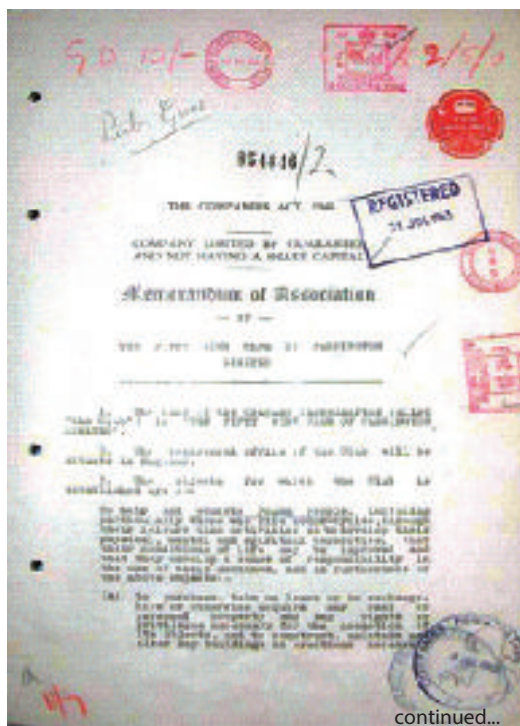
The name clause requires to state the legal and recognized name of the company. The company name is allowed to be registered if it does not bear any similarities with the name of an existing company.

2. Situation Clause

The registered office clause requires to show the physical location of the registered office of the company. It is required to keep all the company registers in this office. The registered office should be established prior to commencing business activities.

3. Objective Clause

The objective clause requires to summarize the main objectives for establishing the company with reference to the requirements for shareholding and use of financial resources. It is required to state the ancillary objectives; that is, those objectives that are required to facilitate the achievement of the main objectives. The objectives should be free of any provisions or declarations that contravene laws or public good.



4. Liability Clause

The liability clause requires to state the extent to which shareholders of the company are liable to the debt obligations of the company in the event of the company dissolving. There are companies limited by shares and limited by guarantee.

5. Capital Clause

The capital clause requires to state the company's authorized share capital, the different categories of shares and the nominal value (the minimum value per share) of the shares. It is also required to list the company's assets under this clause.

6. Association Clause

The association clause confirms that shareholders bound by the MOA are willingly associating and forming a company. It is required seven members to sign an MOA for a public company and not less than two people for a MOA of a private company. The signing must be done in the presence of witness who must also append his signature.

6.04 Articles of Association

The Articles of Association (AOA) is a document that contains the purpose of the company as well as the duties and responsibilities of its members. It is an important document which needs to be filed with the Registrar of Companies. These are the bylaws of a company that defines the mode and manner in which the company's business is to be carried on. In the Companies Act, Table A Prescribes model for the articles of the companies. Table A is a document

containing rules and regulations for the internal management of a company. A company which does not have separate AOA may adopt Table A.

Contents

- (i) Amount of shares, capital, value and type of shares
- (ii) Rights of each class of shareholders regarding voting, dividend, return of capital
- (iii) Rules regarding issue of shares and debentures
- (iv) Procedures as well as regulations in respect of making calls on shares.
- (v) Manner of transfer of shares
- (vi) Declaration of dividends
- (vii) Borrowing powers of the company
- (viii) Rules regarding the appointment, remuneration, removal of directors
- (ix) Procedure for conducting proxy, quorum, meetings etc.,
- (x) Procedures concerning keeping of books and audits
- (xi) Seal of the company
- (xii) Procedures regarding the winding up of the company.

6.05 Prospectus

According to Section 2(36) of the Companies Act, any document inviting the public to buy its shares or debentures comes under the definition of prospectus. It also applies to advertisements inviting deposits from the public.

Contents

A prospectus is “the only window through which a prospective investor can look into the soundness of a company’s venture”. Hence it must specify at least the following matters as per Schedule II:

- (i) The prospectus contains the main objectives of the company, the name and addresses of the signatories of the Memorandum of Association and the number of shares held by them.
- (ii) The name, addresses and occupation of directors and managing directors.
- (iii) The number and classes of shares and debentures issued.
- (iv) The qualification share of directors and the interest of directors for the promotion of company.
- (v) The number, description and the document of shares or debentures which within the two preceding years have been agreed to be issued other than cash.
- (vi) The name and addresses of the vendors of any property acquired by the company and the amount paid or to be paid.
- (vii) Particulars about the directors, secretaries and the treasures and their remuneration.
- (viii) The amount for the minimum subscription.
- (ix) If the company carrying on business, the length of time of such businesses.
- (x) The estimated amount of preliminary expenses.
- (xi) Name and address of the auditors, bankers and solicitors of the company.
- (xii) Time and place where copies of balance sheets, profits and loss account and the auditor’s report may be inspected.
- (xiii) The auditor’s report so submitted must deal with the profit and loss of the company for each year of five financial years immediately preceding the issue of prospectus.
- (xiv) If any profit or reserve has been capitalized, the particulars of such capitalization will be stated in the prospectus.

Key Terms

Guarantee
Memorandum of Association
Prospectus
Common seal
Perpetual succession
Artificial person



For Own Thinking

1. Name any 2 Government owned Joint Stock Company.
2. Name any 2 Joint stock company with private ownership.
3. Name any 2 Private ownership with Foreign participants.



For Future Learning

Collect advertisements of three different companies inviting the public to subscribe their shares. Compare their contents regarding following points

Articles	Company A	Company B	Company C
Name			
Objectives			
Types of shares to be subscribed			
Total amount of issue			
The issue price of each share			

Should they set up a public limited company for the purpose? If so, how should they go about it? If not, what alternative would you suggest? What formalities will be required of Ashok and his associates if they choose the alternative form of organization suggested by you?

Case 2: Collect any 10 items of daily use (Packed items) and list the names of the companies manufacturing those items. Classify those companies as public and private limited companies. Which of them are Multinational Companies?



Exercise



Case Study

Case 1: Ashok is an industrial designer by training. He had the opportunity to learn the technology of fibre glass manufacture while he was in Germany for his training. He plans to set up a plant for the manufacture of fibre glass in India and is able to interest some financiers and technologists. It is estimated that the initial investment in the plant will be of the order of ₹50 lakhs. Ashok and others decide to set up a company for the purpose.

1. Choose the Correct Answer

1. The relationship between outsiders and the company is defined in _____

- a) Prospectus
- b) Articles of Association
- c) Memorandum of Association
- d) Certificate of Incorporation

2. Table A of the Companies Act is a _____

- a) Model minutes book
- b) Model form of Balance Sheet
- c) Model of AOA
- d) Model of MOA



3. Which of the following is created by a Special Act of Parliament or in State Assemblies?

- a) Chartered company
- b) Foreign company
- c) Government company
- d) Statutory company

4. The Board of directors of a company is elected by _____

- a) Creditors
- b) Debtors
- c) Debenture holders
- d) Share holders (members)

5. Companies established as a result of a charter granted by the King or Queen of a country is called _____

- a) Chartered companies
- b) Statutory companies
- c) Registered companies
- d) Foreign companies

Answers

1. c 2. c 3. d 4. d 5. a

II. Very Short Answer Questions

1. What are the different types of companies?
2. Define a Company.
3. What is meant by Limited liability?
4. Explain any two characteristics of a company.
5. What is meant by Chartered Company?

III. Short Answer Questions

1. What are the advantages of Companies? (any 3)
2. What is meant by Government Company?
3. What is meant by Foreign Company?

IV. Long Answer Questions

1. What are the contents of Memorandum of Association? (any 5)
2. What are the contents of Articles of Association? (any 5)
3. What is meant by Multi National Company?

Reference

1. Sundar, K 2017, Business Organisation
2. www.company-formation.co.in