Corporate Law (Bansode sir)
B.com. II Year

Komal Xerox

1. JOINT STOCK COMPANY

Introduction

The Corporate Law is a major branch of Law dealing with all matters/aspects related to companies. Hence, it is also popularly known as Company Law. The industrial revolution in England in the 18th century brought about radical or revolutionary changes in the field of commerce and industry. These changes proved the inadequacy of the partnership firm of an orgnisation. The large scale production, that too in anticipation of ever-growing demand is only possible with the use of modern machinery. As a result the domestic system of production was replaced by factory system. Huge capital was required to purchase machinery and also to conduct day to day operation of business. It means, both fixed and working capital requirement of the business increases tremendously. The improvement of the means of transport created national and international market.

The principle of labour division was introduced in factories which in turn helped to promote skill and specialization. All these change necessitated a new form of an orgnisation, which will remove the drawbacks of sole trading concern and partnership form of orgnisation. Therefore, Joint Stock company came into existence as a new form of orgnisation. Nowadays, a joint stock company is the most popular form of orgnisation in the market. It is a

voluntary association of many persons who contribute capital by the purchase of shares constituting the common stock with a view to carrying on certain lawful business to earn profit for the benefit of the members. It is an artificial person created by the process of law. The association must be registered under the Companies Act, 1956. A person buying the shares of a company is called a shareholder who owns a part of the company. A joint stock company is a capitalist form of business organisation because its main aim is to earn profit.

1.1 Corporate Law in India: A Brief History:

The history of the Corporate Law in India dates back with the Joint Stock Companies Act 1850. This act was passed for the first time providing for the registration of joint stock companies in India. This act was passed by referring the English Joint stock companies Act of 1844. Before independence, a large majority of companies operating in India were the companies registered in England. However, due to the extensive growth of trade and commerce in India, the British, Government realized the necessity of Act, permitting the commencement of companies in India. The Supreme Court of India and High Courts of Mumbai, Kolkata and Chennai were authorized to order the registration of companies under the Act of 1850. However the special right of limited liability of the shareholders was introduced by the joint stock companies Act of 1857. Thereafter, a comprehensive Company Act for Indian companies was passed in 1866. It included the amendments of law relating to incorporation, regulation and winding up of trading companies.

This Act was renewed in 1882 and amended from time to time. The Indian companies Act of 1913 was passed by

considering the English companies Act of 1908. This act was also amended and recast from time to time. The Government of India appointed a company law committee on 25th October 1950, under the chairmanship of Shri C.H. Bhabha to report on the working of companies Act of 1913 and to suggest necessary changes in relation to developing trade and commerce in the country. The committee made a detailed scrunity and submitted its report in 1952 recommending major amendments in the company law. The Government accepted its recommendations and the companies Act 1956 were passed. Now the law relating to companies is governed by this act which came into force on 1st April 1956 and extended to the whole of India. Recently, it has been amended in 2002 and 2006.

1.2 Objectives of Corporate Law

The corporate law governs different asspects of the companies. It has many objectives as summarized below:

1. To protect the interest of investors.
2. To protect the interest of creditors.
3. To help the growth of companies on healthy business lines.
4. To ensure that the activities of the companies are carried on in the interest of our economic and social policy which the country has accepted.
5. To determine maximum standards of business integrity.
6. To stop misconduct and malpractices on the part of the company management.
7. To enforce proper performance of duties by persons responsible for the managements of companies.
8. To empower the Government to investigate and properly manage the affairs of the company.

1.3 Meaning of Joint Stock Company

A joint stock company, in simple words, is an association registered under the Companies Act. The members who form the company, pool their resources (i.e. funds) to carry on a business. *'Joint stock'* means capital funds held in common and usually divided into shares. In a company, the funds to carry on business are obtained by selling shares to a number of individuals. A joint stock company is thus an incorporated voluntary association in the form of an artificial legal person, created by law, having an independent legal entity, with a perpetual succession, a common seal and common capital comprising transferable shares carrying limited liability. Some of the representative definitions of joint stock company are given below:

1. **Prof. H. L. Haney** defined a joint stock company as, "A voluntary association of individuals for profit, having its capital divided into transferable shares, the ownership of which is the condition of membership".
2. **Lord Justice Lindley** defined a joint stock company as, "A voluntary organisation of many persons who contribute money or money's worth to a common stock and employ in some trade or business and who share the profit or loss arising therefrom."
3. **The Companies Act 1956** under Section 566, defines a joint stock company as, "A company having a permanent paid-up or nominal share capital of fixed amount, divided into shares, also of fixed amount, as held and transferable as stock, or divided and held partly in one way and partly in the other, and formed on the principle of having for its members, the holders of those shares or that stock and no other persons".

4. **Former Chief Justice Marshal of U.S.A.** has defined a company as "A person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence"

1.4 Characterstics / Features of Company

On the basis of different definitions, the main features of a joint stock company can be explained as under:

1. **Compulsory registration:** A company cannot be formed without registration. Registration process implies the entry the name of company in the register maintained by the Registrar who issues a certificate with registration number to that effect. The incorporation or registration is compulsory for a joint stock company as per the provisions of the Companies Act 1956.
2. **Artificial person:** A joint stock company is the creation of law. When a company is registered, it is separated from its shareholders and it receives independent statutory status. It can act like human being in the eyes of law though it has no physical existence. Therefore it is called an artificial legal person. All its affairs are administered by a Board of Directors who are elected from among its members.
3. **Voluntary association:**The Membership of company is not compulsory but voluntary. Association means a group of person having a common purpose or interest. Any person irrespective of caste, creed, religion and economic status can become a member of a company by getting its shares.
4. **Separate legal entity:**The existence of a registered company is separate and independent from its members.

The company can acquire and dispose of property, enter into contracts, borrow money, file a suit against a third party and can be sued in a court of law in its own name.

5. **Capital contribution:** The company can raise its capital by issuing the shares. The members contribute money to a common stock known as the share capital of the company. It consists of a number of small parts of a fixed denomination, called a share.
6. **Common seal:** The company has a common seal which is used as a substitute for its signature The Companies Act provides that every company must have its own seal, known as the "Common Seal" and get it registered. The common seal is used as the official signature of the company.
7. **Perpetual succession:** A company is an artificial person created and dissolved only by the process of law. Its existence and continuation are not affected by death, retirement, insolvency or insanity of its member or members. Life of the company is independent of the lives of its members.The perpetual succession lends stability and long life to a company.
8. **Number of members:** Private company should have at least two members and not more than fifty members. But public company should have minimum 7 members and no restriction on the upper limit.
9. **Lawful business:** The company undertakes one or other kind of lawful business for the purpose of earning profits. The business undertaken by a joint stock company should not be contrary to the public interest. A company cannot be formulated for a charitable purpose.
10. **Limited liability:** The liability of shareholders is limited to the extent of the face value of the shares held by him.

If the shares are fully paid-up, there is no further liability on the part of the shareholders. In the event of liquidation of the company, the personal property of shareholders cannot be attached by the creditors of the company in settlement of debts.

11. **No business secrecy:** The business secrecy cannot be maintained in the company because the business decisions are taken in a company by the Board of Directors through discussions at the Board Meetings. Even in the case of a public company, the final accounts, duly audited, are to be published therefore the financial secrecy cannot be maintained
12. **Statutory obligations:** There are lot of Statutory obligations in the formation and management of company. The Companies Act requires that every company must file returns, publish annual accounts and the balance sheet and hold meetings at regular intervals.
13. **Transfer of shares:** This characteristics of a company is recognized by section 82 of the companies Act. In the case of a public company, the shares are freely transferable. The shares can be bought and sold in the open market. Transferability of shares enables a shareholder to get back his capital easily by selling in the open market (Stock Exchange). The shares of the private company are non-transferable.
14. **Separation of ownership from management:** The ownership of the company remains with the shareholders and the management is in the hands of directors of company.The owners of a company do not take part in its management.

1.5 Importance of Company

The significance of a company is highlighted as under:

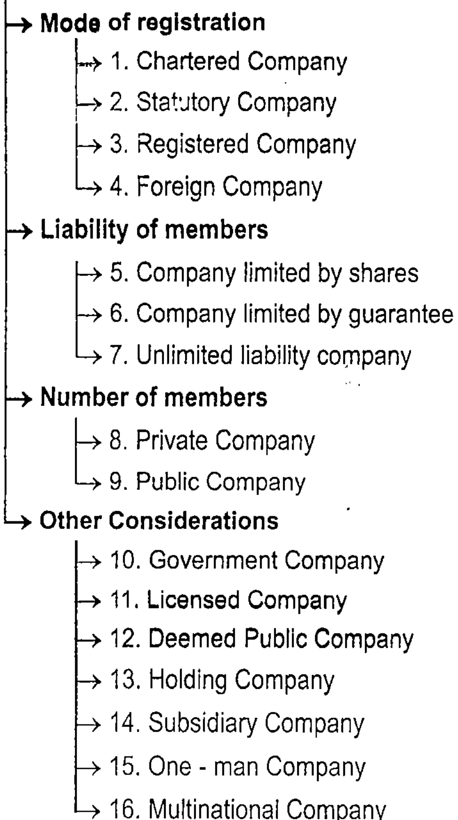
1. **Legal status:** The company is an artificial legal person, created by law having an independent legal entity. The company cannot be dissolved by any reasons like death, insanity, insolvency, etc. of the members, till it is wound up. This stability of existence enables a company to undertake long term projects.
2. **Limited Liability:** The company members are not personally liable for the debts of the company. The liability of the shareholders of a company is limited to the facevalue of the shares. Hence, the company can undertake greater risks because the liability of the members is limited.
3. **Public confidence:** Statutory controls, filing of returns, publication of audited accounts, maintenance of statutory books, policy decisions on important issues in Annual General Meetings through discussion and approval, etc. help to create public confidence in this form of organization.
4. **Huge capital:** The company can raise a huge capital in a short period through different sources such as (i) the issue of shares, debentures and bonds, (ii) accepting public deposits and (iii) borrowing from the banks.
5. **Open membership:** There is no maximum limit to the number of members in public limited company. This enables a company to raise a large amount of capital. It also helps to spread losses over a large number of heads and, thus, minimises the density of losses and risks.
6. **Democratic Management:** The shareholders elect their representatives, called the Directors, who form themselves into a body called the Board of Directors for

managing the affairs of the company. The Directors derive their authority from the shareholders and are accountable to them. Hence the affairs of the company are managed on democratic manner.

7. **Tax relief:** The company as a separate unit pays tax at a reduced rate in comparison with the sole trading and partnership organisation.
8. **Large-scale Economies:** The business operations of a company are usually on a large-scale. It is, therefore, possible to get the benefits of large-scale economies. Better quality of goods, large-scale purchases of raw materials at lower costs, use of the latest economical and efficient technology, etc. lower down the cost of production.
9. **Expert personnel:** Experts services from skilled personnel can be possible in Joint Stock Company. A company can employ the professional personnel who have specialised training and expertise in different fields such as engineering, computer software, accountancy, financial management, marketing, public relations, etc. The services of these experts help to attain higher levels of efficiency which may lead to higher profitability of the company and handsome dividend to the shareholders.
10. **Socially desirable:** The companies are socially desirable because of some benefits to the society like, it provides an opportunity of investment to many people as well as it provides employment to a large number of people.
11. **Advantages of shares:** A common man can invest in the shares of a company because the price of share is small. The shares of public company are freely transferable. They can be bought and sold in the share market, i.e. the stock exchange.

1.6 Classification (Types) of Companies

The companies are classified into different types on the basis of its mode of registration, Liability of members, Number of members and Other Considerations etc.They are shown in the chart below :



1. Chartered Company :

The chartered companies are governed by the provisions of the special charter, under which they are formed. A chartered company is one which is created by and under a Royal Charter issued by the Head of the State (King or

Queen). The constitution, area and field of operation, powers and objectives, liabilities, rights and duties of the Directors, period of the company, its nature, functions, etc. are defined in the charter. The state is the controlling body of this company. Such a company has a legal status and recognition. The chartered companies were established in many European countries during the 17th and 18th centuries. Such companies were popular in the olden days before any Act relating to the companies was passed. The East India Company, the Chartered Bank of Australia, the Bank of England, etc. are the examples of chartered companies. In a democratic country like India, such a company cannot be formed, because there is no existence of monarchy. Even in England, this form of organisation is now rarely found.

2. Statutory Company :

The statutory companies are also known as corporations. The main aim of such company is to serve general public. The company which is created and established by the provisions of a special Act passed in Parliament by the Central or State Legislature for a particular type of commercial activity is called a statutory company. Such companies run and operate as per the provisions of the Statutory Act. Such companies are also known as corporations. The main aim of these companies is to provide services to the public at a low cost and protect the poor from the exploitation by big monopolies working under the private sector. Railways, transport and electric supply companies, the Reserve Bank of India, the Life Insurance Corporation of India, Maharashtra State Road Transport Corporation, Unit Trust of India, etc. are the examples of statutory companies working in India.

Statutory company need not have its own Memorandum

of Association. It need not use the word 'Limited' at the end of its name. The liability of the members of the Statutory Company is limited to the nominal value of the shares held by them. Such a company is managed by a Board of Directors, nominated by the Government. It enjoys autonomy in respect of financial matters. It is answerable to the Parliament for its acts. The audit of such a company is carried out under the supervision and control of the Auditor General of India. A change in the structure of statutory company is possible only by amending the special Act under which it is created

3. Registered Company :

Registration of a joint stock company is compulsory. A Registered Company is one which is formulated and established as per the provisions of the Companies Act, 1956, or as per the provisions of the earlier relevant Act. Since, registration is compulsory for a company in India, all the existing companies except the statutory companies, are registered companies and are therefore, governed by the Companies Act 1956. The Act provides specific procedure for the registration of the company. Registration of company is possible only when certain basic documents such as the Memorandum of Association and the Articles of Association are filed with the Registrar. These important documents provide guidelines for the external communication and internal regulations of the company respectively. Registered companies are further subdivided into three categories:

(a) Companies limited by shares

(b) Companies limited by guarantee and

(c) Unlimited companies. They may also be private companies or public companies.

4. Foreign Company :

The company which is incorporated outside India is known as foreign company. According to the provisions of the Companies Act, 1956, a company which is incorporated and established outside India, but has a place of business in India is called a foreign company. It is incorporated and established in a foreign country under the law relating to the formation of the companies in that country. A foreign company is established with various objectives and aims. According to the provisions of Section 592, of the Companies Act, 1956, a foreign company must submit the following documents to the Registrar of Companies within 30 days of its establishment of the business in India:

(a) A certified copy of the Charter of Statute or Memorandum and Articles of the Company.

(b) The names and addresses of persons, resident in India who are authorised to accept documents in India on behalf of the company.

(c) A list of Directors and the Secretary of the company, giving name, address, nationality, business, details of other directorships held by a Director in every individual case.

(d) As per Section 595, every foreign company shall state the name of the company, the place of business and the name of the country in which it is incorporated on its every document and letter.

(e) The full address of the principal place of business in India.

(f) According to Section 594 of the Companies Act, 1956, every foreign company is required to submit every year three copies of the Profit and Loss Account and the Balance Sheet to the Registrar.

(g) The full address of the Registered Office of the company situated abroad

Finally, the Act requires that, as and when any change takes place in the above particulars, it must be communicated to the Registrar within the prescribed time limit. The Act also prescribes penalties for failure to comply with any of the foregoing provisions.

5. Company limited by shares [Sec.12(2)(a)]:

A company limited by shares is such type of registered company in which the liability of the members or shareholders is to the extent of face value of shares held by him. This type of company is popular among the investors because their financial liability is limited. Such a company must include the word 'Limited' at the end of its name. Most of the companies in India belong to this category. Reliance, Mahindra and Mahindra, Larsen and Toubro, etc. are the examples of company limited by shares. A company limited by shares may either be a private company or a public company.

6. Company limited by guarantee [sec.12(2)(b)]:

A company limited by guarantee is a company in which the liability of each member is limited to the extent of the guarantee given by him or to the extent of the share amount due from him. The amount payable by each member is mentioned in the Memorandum of Association or Articles of Association of the company. The amount so payable is called the guarantee amount. The members of this company promise to pay the amount of guarantee only in the event of the insolvency or dissolution of the company. The members give a guarantee about the payment of the share amount [illegible]. In other words, the liability of the members arises only in the

event of the winding-up of the company and not during the lifetime of the company. A company limited by guarantee is generally formed to promote art, literature, sports, education, religion or such other non-trading purposes. Such a company generally does not have a share capital. It collects finance through entrance fees and subscriptions to carry out the day-to-day activities

7. Unlimited liability company [Sec.12(2)(c)]:

A registered company in which the liability of a member is unlimited, is known as a company with unlimited liability. In the event of insolvency of the company, the members of such a company are personally liable for the repayment of the loan, debts, etc. of the company. It is like a partnership firm in which the liability of every partner is unlimited. Such a company may or may not have a share capital. If such a company has a share capital, it may either be a public company or a private company. An unlimited company can be converted into a limited company. Such companies do not exist in India due to the fear of possible loss of investment.

8. Private Company:

According to the provisions of [Section 3 (i) (iii)] of the Companies Act, 1956, a private company is a company which by its Memorandum of Association and the Articles of Association:

(a) Limits the maximum number of members to fifty, excluding the past and the present employees of the company.
(b) Prohibits an invitation to the public for the purchase of shares or debentures; and
(c) Restricts the right of members to transfer the shares.

The name of a private company must include at the end

of its name the words "Private Limited" or the abbreviations "Pvt. Ltd." The main features of a private limited company are as below: (i) It does not require a Certificate for the Commencement of Business. It can commence business immediately on incorporation, i.e. on obtaining the Certificate of Incorporation. (ii) A private company can be formed even by two members. The maximum number of members is fifty. But the past and the present employees are not to be counted among these fifty. (iii) Private company need not hold a Statutory Meeting or file a Statutory Report with the Registrar. (iv) Private company can allot shares even before the minimum subscription is subscribed to or paid for. (v) Private company must have at least two Directors. The Directors are not subject to retirement by rotation. It is not necessary for the Directors to buy qualification shares. (vi) A private company can be converted into a public company by passing a special resolution by which the Articles of Association are changed. (vii) Such company does not invite the members of the public to subscribe to its shares. Because of this fact, it need not prepare and file a 'Prospectus' or a 'Statement in lieu of a prospectus' with the Registrar.

9. Public Company:

As per the provisions of [Section 3(1)(iv)] of the Companies Act, 1956, a public company means a company which is not a private company. On the basis of the above definition, it is implied that a public company is one which (a) does not restrict the right of the members to transfer their shares freely; (b) does not limit its membership to fifty; (c) can issue a prospectus to invite the public to subscribe for its shares and debentures. The main features of a public company may be stated as under:

(i) The minimum number of members required to form a public limited company is seven. However, there is no restriction on the maximum number of members.

(ii) The shares of a public company are freely transferable

(iii) A public company can issue a prospectus to invite the public for subscription to its shares or debentures. If it does not intend to invite the public to purchase its shares or debentures, it has to file a statement called 'Statement in lieu of Prospectus' with the Registrar of Companies.

(iv) Such company has to obtain a 'Certificate to Commence Business' before commencing its business activities.

(v) Public company must have a minimum of three Directors. They are subject to retirement by rotation. The Directors are required to purchase qualification shares.

(vi) The public company must hold a Statutory Meeting and must file the Statutory Report with the Registrar.

(vii) A public company is suitable for conducting business activities on a large scale.

10. Government Company:

These companies were formed on the socialistic pattern of the society. According to the provisions of the Companies Act, 1956, a Government company is that company in which 50 % or more than 50 % of the paid-up share capital is held by the Central Government or State Government or partly by one or more State Governments and partly by the Central Government. It is called a Government company as the majority of the power remains in the hands of Government by holding not less than 50% of voting power. The subsidiary company of a government company is also a Government company. A Government company can be a private company

or a public company, depending on the total number of members of the company. A Government company functions just like any other company except for some special features. Its accounts are audited by the Auditors appointed by the Auditor General of India. Its annual report along with the audit report and comments thereon has to be laid before both the houses of Parliament or state legislature or both as the case may be.

A Government company is registered under the Companies Act and as such it is governed by the Companies Act. But the Central Government by notification in the Gazette may exempt a government company from some of the provisions of the Act from time to time. Though the majority of the capital is held by the Government, employees of the company are not treated as Government servants. Some of the examples of such companies are Hindustan Machine Tools (HMT), Bharat Heavy Electricals Ltd. (BHEL), Rashtriya Chemicals and Fertilizers (RCF), etc.

11. Licensed Company:

A licensed company is one which is incorporated under the Companies Act, after obtaining a license from the Central Government. The Central Government issues a license to any company or association, which is formed for promoting art, culture, education, sports, religion, charity, commerce, or any other useful object, etc. Such a company does not have any profit motive. If at all, any profit or surplus is earned by such a company, it is not utilised for distributing dividends to its members but for the promotion of the objects of the company. It may or may not have a share capital. It may be a public or private company. The license may at [illegible] by the Central Government if the fundamental conditions of the license are violated. This company enjoys certain

privileges and exemptions. It need not add the word 'Limited' or 'Private Limited' at the end of its name. It gets exemption in the payment of stamp duty at the time of registration.

12. Deemed Public Company:

The Companies Act, 1956 as amended in 1960 introduced this new class of companies. This was done with a view to dealing with those private companies which were private in form but public in content. Such private companies were found abusing the privileges of private companies. The Act, therefore, made the following provisions to curb these practices:

(a) According to Section 43 A, if 25 % or more of the paid-up capital of a private company is held by one or more public companies, then that private company shall be deemed to be a public company.

(b) In 1974, a further provision was made by which it was stipulated that if the average annual turnover of a private company is rupees one crore or more, it shall be deemed a public company.

(c) Similarly, if 25 % or more of the paid-up capital of a public company is held by a private company, then that private company shall be deemed a public company.

These amendments have become useful in controlling private companies in the larger interest of the public.

13. Holding Company :

A company exercising control over another company is called a 'Holding Company' and the company, over which the control is exercised is called the subsidiary company. A company, being an artificial person, can purchase shares or debentures of another company in the ~~same~~ manner as any

other person can do. If a company holds or controls the majority of shares of some other company, it is called a Holding Company. A company which works under the power, control and supervision of the holding company is called a Subsidiary Company. As per the provisions of [Section 4 (4)] of the Companies Act, 1956, "A company shall be deemed to be the holding company of another if that other is its subsidiary." A public or private company may be a holding company. A holding company may be an unlimited or a limited company.

14. Subsidiary Company:

A company is deemed to be a subsidiary of another if the other company controls the majority composition of its Board of Directors with the sole object of controlling its management; or That the other company holds more than 50% of its equity capital; or It is a subsidiary of any other company which is that other company's subsidiary. It may be noted that the holding and subsidiary companies are relative terms. A company may be holding company and at the same time a subsidiary company of another company. A holding company and a subsidiary company maintain their separate legal existence and identity. In India, in the public sector, the State Trading Corporation has a number of subsidiary companies.

15. One man company:

In this type of company the entire paid-up share capital is held by one person and the remaining is held by his friends, relatives, nominees that company is called as one man company. The minimum number of members in the case of a private company is two and in the case of a public company is seven. The Act has thus fixed the minimum for the membership but there is no provision in the Act regarding

the maximum number of shares that a member can hold, except in the case of a private company where the maximum membership is 50. It is therefore possible for a person to hold the majority of shares. A company which is managed, regulated and controlled by a single individual by holding almost all its shares is called one man company. This company will not lose its identity or legal existence, if it fulfills the minimum requirements of registration. Usually a private company is a one man company, although a public company can also be a one man company. Whether a member takes up 1,000 shares or just 1 share, he is considered a member. Because of this provision, it is possible for a person to meet the minimum requirement of membership and yet to control majority of shares and thereby to dominate the affairs of the company.

16. Multinational Company:

At present multinational companies are quite popular in the world because they make available a variety of goods and services for consumption in order to raise the standard of living of the people. They facilitate movement of goods, services, technology, technical know-how, from their own country to their host country. They also create large employment opportunities in their host countries. A multinational company (MNCs) is one which is incorporated and established in one country but has its business units in many different countries of the world. The main office of a multinational company is in one country but its activities are spread over in more than one country. It is established in a particular country in accordance with the law of that country. The business units or the companies are registered in different countries just as other local companies. The business units or its branches abroad function under the control of the main

company. For routine administration, local staff is employed but the policy matters are decided under the control of the main company. For this purpose, local shareholders are kept in a minority.

The multinational companies are generally established in developed countries like U.K., USA, Japan and they conduct business activities in other countries of the world Colgate Palmolive, Hindustan Lever, International Business Machines (IBM) Siemens, Bata, Proctor and Gamble, Brooke Bond, Nestle, Coca Cola are some of the well-known MNCs operating in India. A multinational company makes a huge investment and earns huge profits by producing the goods at the minimum cost and selling them at the maximum price. However, they transfer a large amount of profit to their country, which is many times more than their investment. They also exercise political influence over their host country.

1.7 Advantages of Joint Stock Company

The advantages of joint stock company are specified below:

1. **Efficient management:** The day-to-day management of a company is generally efficient. A company has ability to employ professional personnel. Although general business policy is laid down by a company's Board of Directors, the work of day-to-day administration is handover to the professional experts, who can provide efficient management.
2. **Limited liability:** The liability of the shareholders is limited to the face value of the shares held by them. Therefore most of the investors showing their interest to invest in the share capital of the company.
3. **Transfer of shares:** It is one of the important [illegible]

of company. The shares can be easily bought and sold in the stock exchange markets. The shares of a public company are freely transferable.

4. **Division of risk:** In joint stock company the risk is divided among the lot of shareholders. The risk of loss is spread over in a large number of investors due to the large membership.
5. **Heavy capital:** A company can raise heavy capital through, the issue of shares and debentures, accepting public deposits and borrowing from the banks. A common man can invest in shares due to smaller denomination of shares.
6. **Public confidence:** Certain features of the company such as government regulations and control over the affairs of the company, publicity of final accounts and stability of existence enable the company to gain public support and confidence.
7. **Social benefits:** The joint stock company is socially desirable because it provides employment opportunities, scope for savings, large-scale production, supply of quality products at lower price, etc.
8. **Stability and continuity:** A company has a permanent existence. It has a separate legal status. Its stability and continuity does not affect in the event of death, retirement, insolvency, insanity of its members.
9. **Democratic functioning:** The decisions taken at company meetings by majority of votes. A company's business affairs are administered by a Board of Directors elected from among its shareholders.
10. **Large-scale business:** A company has ability to collect huge capital. Therefore it can undertake production on a

Komal Xerox

Chapter 2 Incorporation

B.Com II Year

Prepared by- Prof. S.D. Bansode

- **Introduction and Meaning:**

The idea of carrying on a business which can be profitably undertaken is conceived either by a person or by a group of persons who are called promoters. After the idea is conceived, the promoters make detailed investigations to find out the weaknesses and strong points of the idea, to determine the amount of capital required and to estimate the operating expenses and probable income. The term 'promoter' is a term of business and not of law. It has not been defined anywhere in the Act, but a number of judicial decisions have attempted to explain it.

- **Definitions:**

According to Justice C. Cockburn. "Promoter is one who undertakes to form a company with reference to a given object and to set it going, and who takes the necessary steps to accomplish that purpose."

According to Guthmann and Dougall. "Promoter is the person who assembles the men, the money and the materials into a going concern."

From these definitions of promoter it is concluded that:
"Promoter is the person who originates the idea for formation of a company and gives the practical shape to that idea with the help of his own resources and with that of others."

- **Legal Position of Promoters:**

Promoters are deeply involved in incorporation process of company so a pertinent question arises what is the legal position of the promoters in the company. Promoters are not agents as before incorporation the company is non est (does not exist) in the eye of law so there can be no principal. They are also not trustees, as company is not a beneficiary. They are in fiduciary capacity as in Erlanger v. New Somrero phosphate co. Ltd. 3 Cairns LJ said that, "The promoters undoubtedly stand in a fiduciary position. They have in their hand the creation of the company. They have the power of defining how and when and in what shape and under whose supervision it shall come in to existence and begin to act as a trading corporation."

- **Functions, Duties and Liabilities:**

Functions of a Promoter:

1. To conceive an idea of forming a company and explore its possibilities.

2. To conduct the necessary negotiation for the purchase of business in case it is intended to purchase as existing business. In this context, the help of experts may be taken, if considered necessary.

3. To collect the requisite number of persons (i.e. seven in case of a public company and two in case of a private company) who can sign the 'Memorandum of Association' and 'Articles of Association' of the company and also agree to act as the first directors of the company.

4. To decide about the following:

(i) The name of the Company,
(ii) The location of its registered office,
(iii) The amount and form of its share capital,
(iv) The brokers or underwriters for capital issue, if necessary,
(v) The bankers,
(vi) The auditors,
(vii) The legal advisers.

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

- **Rights of Promoter:**

The rights of promoters are enumerated as follows:

1. Right of indemnity:

Where more than one person act as the promoters of the company, one promoter can claim against another promoter for the compensation and damages paid by him. Promoters are severally and jointly liable for any untrue statement given in the prospectus and for the secret profits.

2. Right to receive the legitimate preliminary expenses:

A promoter is entitled to receive the legitimate preliminary expenses which he has incurred in the process of formation of the company such as cost of advertisement, fee of solicitor and surveyors. The right to receive the preliminary expenses is not a contractual right. It depends upon the discretion of the directors of the company. The claim for expenses should be supported by vouchers.

3. Right to receive the remuneration:

A promoter has no right against the company for his remuneration unless there is a contract to that effect. In some cases, articles of the company provide for the directors paying a specified amount to promoters for their services but this does not give the promoters any contractual right to sue the company. This is simply an authority vested in the directors of the company. However, the promoters are usually the directors, so that in practice the promoters will receive their remuneration.

- **Duties of a Promoter:**

The following are the important duties and liabilities of a promoter:

1. Duty to Disclose

The promoter is under a duty to disclose fully all the material facts relating to the formation of a company.

2. Not to Make any Secret Profit

The promoter, as a rule, should not make any secret profit at the expense of the company, which is being promoted by him.

3. Duty to Give Benefits of Negotiations to the Company

The promoter, as soon as he starts to act for the formation of the proposed company should give to the company the benefit of all negotiations or contracts entered into by him in respect of the company.

4. Not to make Unfair Use of his Position

The promoter enjoys extensive powers. Therefore, he should not make unfair use of his position or the powers vested in him. Any unfair exercise of power shall render him liable to the company.

5. Duty of promoter against the future allottees:

When it is said the promoters stand in a fiduciary position towards the company then it does not mean that they stand in such relation only to the company or to the signatories of memorandums of company and they will also stand in this relation to the future allottees of the shares.

- **Liabilities of Promoter:**

The liabilities of promoters are given below:

1. Liability to account in profit:

As we have already discussed that promoter stands in a fiduciary position to the company. The promoter is liable to account to the company for all secret profits made by him without full disclosure to the company. The company may adopt any one of the following two courses if the promoter fails to disclose the profit.

(i)The company can sue the promoter for an amount of profit and recover the same with interest.

(ii) The company can rescind the contract and can recover the money paid.

2. Liability for mis-statement in the prospectus:

Section 62(1) holds the promoter liable to pay compensation to every person who subscribes for any share or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. Sec. on 62 also provides certain grounds on which a promoter can avoid his liability. Similarly Sec. 63 provides for criminal liability for mis-statement in the prospectus and a promoter may also become liable under this section.

The promoter may also be imprisoned for a term which may extend to two years or may be punished with the fine upto Rs. 5,000 for untrue statement in the prospectus. (Sec. 63).

3. Personal liability:

The promoter is personally liable for all contracts made by him on behalf of the company until the contracts have been discharged or the company takes over the liability of the promoter.

The death of promoter does not relieve him from liabilities.

4. Liability at the time of winding up of the company:
In the course of winding up of the company, on an application made by the official liquidator. the court may make a promoter liable for misfeasance or breach of trust. (Sec. 543).

Further where fraud has been alleged by the liquidator against a promoter, the court may order for his public examination. (Sec. 478).

Preliminary Contracts/Pre-Incorporation Contracts Made by the Promoters:
Preliminary contracts are those contracts which are made by the promoters with different parties on behalf of the company yet to be incorporated. Such contracts are generally entered into by promoters to acquire some property or right for and on behalf of the company to be formed.

The promoters enter into preliminary contracts, generally as agents or trustees of the company. Such contracts are not legally binding on the company because two consenting parties are necessary to a contract whereas the company is nonentity before incorporation.

The company has no legal existence until it is incorporated. It therefore follows:

1. That when, the company is registered, it is not bound by the preliminary contract.

2. That the company when registered cannot ratify the agreement. The company was not a principal with contractual capacity at the time of contract. A contract can be ratified only when it is made by an agent for a principal who is in existence and who is competent to contract at the time when the contract is made.

3. That if the agent undertook any liability under the agreement, he would be personally liable notwithstanding that he is described in the agreement as an agent and that the company may have attempted to ratify the agreement.

4. The company cannot enforce the preliminary agreement.
The preliminary contracts made by promoters generally provided that if the company adopts the agreement the promoter's liability shall cease and if the company does not adopt the agreement within a certain time either party may rescind the contract. In such a case promoter's liability would cease after the lapse of fixed time.

❖ Remuneration to the Promoter

Strictly speaking, the promoter has no right to claim any remuneration. But in practice, the promoter is allowed to take reasonable remuneration for his services. Generally, he is paid in any one of the following ways:

1. He may be paid a lump sum in cash.

2. He may be given fully paid up shares in the company or partly in cash and partly in shares or debentures.

3. He may be paid a commission on the shares sold.

4. If he sells his own business he may be paid on the basis of the profit disclosed by him.

5 DOCUMENTS RELATED TO THE FORMATION OF JOINT STOCK COMPANY

5.1 Introduction
5.2 Memorandum of Association
5.3 Articles of Association
5.4 Prospectus
5.5 Statement in lieu of Prospectus
5.6 Distinction between
A) Memorandum of Association and Articles of Association
B) Prospectus and Statement in lieu of Prospectus

5.1 INTRODUCTION

A Joint Stock Company prepares certain documents at the time of its formation. Such documents need to be submitted to the Registrar. The procedure of formation gets completed only when these documents are approved by the Registrar. These documents are not only important for formation of the company but are useful at every stage of business. The secretary of the company plays an important role in preparation and filing of these documents. The following three documents are very significant.

1) Memorandum of Association.
2) Articles of Association.
3) Prospectus/Statement in lieu of Prospectus.

Unit Objectives:

After studying this chapter, you should be able to understand:

- Meaning and contents of Memorandum.
- Meaning and contents of Articles.
- Meaning and contents of Prospectus.
- Meaning of Statement in lieu of Prospectus.

5.2 MEMORANDUM OF ASSOCIATION

The first step in the formation of company is to prepare 'Memorandum of Association' (M/A). It is to be filed with the Registrar of Companies for the purpose of incorporation of a company. It is a very important document. It is the foundation on which structure of a company is built up. It is a primary and supreme document of company.

Definition:

1) **Sec2 (28) of Companies Act 1956:** "Memorandum means Memorandum of Association of Company, as originally framed and as altered from time to time in pursuance of any previous company law or this Act".

2) **Lord Cairns:** "Memorandum of Association is the fundamental document of the company. It is foundation on which structure of company stands. It lays down limitations of it's activities".

In short, Memorandum defines the relationship of a company with the outside world. It shows aims and objectives of the company. In fact, it fixes the area of its operation and range of business activities.

Memorandum is rightly described as almost an unalterable document. A company can not easily change any provision stated in the Memorandum. It is because such change may affect the interests of shareholders, creditors and general public. Thus memorandum is the most stable and semi-permanent document. It is **compulsory** for every company. It is, therefore rightly called **'Constitution'** or **'charter'** of the company. It is primary, basic and fundamental document.

Memorandum of Association is prepared according to the provisions of 'Companies Act 1956'. It is printed and divided into paragraphs numbered serially.

Features:

1. Memorandum states the nature of business activities to be conducted by company.
2. It informs about scope of activities of the company.
3. It is prepared by promoters of company.
4. It is signed by at least 7 persons in case of public company and 2 persons in case of private company.
5. It is submitted to the Registrar of Companies for the registration i.e. for getting 'Certificate of Incorporation'.
6. All companies must prepare their own Memorandum of Association.
7. It defines the relationship between the company and outsiders.
8. It is almost unalterable charter of the company because change can be made with a great difficulty.
9. It is a public document. Hence it can be inspected by any individual as and when necessary.
10. Any act done beyond the powers of memorandum, ultra-vires the company.

Contents of Memorandum of Association:

1. **Name Clause:** This is the first clause in the memorandum. It contains the name of the company. A company can choose any suitable name subject to the following restrictions:
   a) Company can not adopt a name which is identical with the name of existing companies.
   b) The words like 'Government', 'State', 'Muncipality' should not be included in the name of the company.
   c) The name of public company must contain word 'Limited' at it's end, and name of private company must end with words 'Private Limited'.
   d) The name should not be suggestive of support of any political party.
   e) The name should not be objectionable under the provisions of the Emblems and Name Act 1950.
   f) The name should not be related with a person, a leader or a party.
   g) At least three names are to be suggested.

Alteration of Name of Company:

A company can change its name whenever it wants. It can do so by adopting the procedure given below:

a) By passing a special resolution in general meeting.

b) By obtaining the approval of Central Government in writing.

2. **Domicile Clause:** It is the second clause in the memorandum. It provides the name of **State** in which registered office of the company is situated. Address of the registered office is important because –

a) It ascertains nationality of the company.

b) It shows the place where registers, document and papers etc. relating to company must be kept.

c) It shows where all notices and other communications can be sent.

d) It specifies jurisdiction of the court.

Alteration of Domicile Clause:

The procedure for changing location of registered office is as follows:

a) A special resolution is passed in the general meeting, if company changes registered office from one place to another, in the same Sate. A copy of special resolution is filled with the Registrar within 30 days of passing.

b) If company shifts its office from one state to another then a special resolution is passed in the general meeting and copy of it is filed with the Registrar within 30 days. In addition to this, a confirmation order from 'National Company Law Tribunal' is obtained.

3. **Object Clause:** This is third clause in the memorandum. It is most important clause since it defines the objects of company. It indicates scope of activities of the company. A company can not do anything beyond its objects.

Object clause serves double purpose:

a) It is quite essential that shareholders should know the purpose for which their money is going to be used by the company.

b) Even creditors feel secure if they know that their funds are not utilised for any unauthorised activity.

The objects of company must be legal. They must be as per the provisions of 'Companies Act 1956'. They must not be against public interest.

Parts of object Clause:

a) Main objects: These are the primary objects for which company is formed.

b) Incidental object: These are the secondary objects, achieved along with main objects.

c) Other objects: These objects are not included in (A) and (B).

Alteration of Object Clause:

The Companies (Amendment) Act 1996, has simplified the procedure to alter object clause. Now alteration of object clause requires passing of a special resolution in the general meeting. A copy of special resolution is filed with the Registrar within 30 days of it's passing.

4. **Liability Clause:** This is the fourth clause in the memorandum. This clause states the nature of liability of members. It states that liability of every shareholder is limited to the face value of share or shares held by him. This means the shareholders are liable to pay unpaid amount on their shares. For example, If a shareholder has paid ₹ 75 on his share of ₹ 100, his liability is up to ₹ 25 only i.e. unpaid balance on the share.

However, in the initial stages, the liability of directors/ managing directors, may be made unlimited, if agreed upon. In such case private property of directors is at stake. This gives security to the company's business and creates confidence in the minds of investors and creditors.

In case of a company limited by guarantee, this clause will state the amount which every member undertake to contribute, in the event of liquidation of company.

Alteration of Liability Clause:

The liability of members can be increased only if the concerned member agrees in writing.

The liability clause may be altered so as to make liability of directors unlimited, if authorised by 'Articles of Association'. The director has to give consent in writing to this effect. For this purpose a special resolution is passed and a copy of it is to be filed with the Registrar within 30 days of passing the resolution.

5. **Capital Clause:** This is the fifth clause in the Memorandum of Association. It states the total amount of share capital, with which a company is registered i.e. 'Authorised Capital' of the company. It also mentions types of shares, their number, face value etc. Where the capital is divided into different classes of shares, it has to mention the rights attached to each class of shares. The Companies Act 1956 permits issue of two types of shares – (1) Equity Shares (2) Preference Shares.

Alteration in Capital Clause:

A company can alter its share capital, if authorised by 'Articles of Association'. The company can alter share capital in the following ways –

a) Increase in share capital by issue of new shares.
b) Reduction in share capital.
c) Reorganisation of capital structure.
d) Conversion of shares into stock.

In order to increase the share capital, a company has to pass only ordinary resolution.

In order to reduce or reorganise the share capital a company has to pass a special resolution and obtain court sanction.

6. **Association (Subscription) Clause:** This is the last clause of Memorandum. It contains a declaration by signatories of memorandum, that they are subscribing their signatures to Memorandum of Association. This clause also covers the names, addresses, occupations of the subscribers. It also state that the signatories have agreed to purchase atleast one share of the company. It may state the number of shares agreed to be purchased by signatories and it also contains their signatures..

Alteration to Association Clause:

Alteration to association clause is not possible.

FORM OF MEMORANDUM OF ASSOCIATION:

MEMORANDUM OF ASSOCIATION
Sec. 14 Table B

1. **Name Clause:** The name of company is 'JAY CEMENT COMPANY LIMITED'.

2. **Domicile Clause:** The registered office of the company will be situated in Maharashtra.

3. **Object Clause: Main Object:** The main object for which the company is established is 'Manufacturing of cement'. **Incidental Object:** The object incidental of above main objects are acquisition and setting up of machinery, marketing of finished products etc. **Other Objects:** The other object for which company is established are manufacturing of steel and steel related products.

4. **Liability Clause:** The liability of members is limited.

5. **Capital Clause:** The share capital of company is ₹ 100 crores, divided into 100 lakh equity shares of 100/- each.

6. **Association Clause:** We, the several persons, whose names and addresses are subscribed are desirous of being formed into a company in pursuance of this M/A, we respectively agree to take the number of shares in the capital of company set opposite our respective names.

Name & Address of Subscribers	Number of Shares taken by each & Sign	Witness to the Signature
1. Mr. A.B. Shah, Mumbai	1200	
2. Mr. S.S. Kothari, Pune	1000	
3. Mr. C.M. Rathod, Thane	1500	Mr. A.K. Rao
4. Mr. R.S. Samant, Sangli	1250	
5. Mr. S.S. Mahajan, Satara	250	
6. Mr. H.K. Joshi, Kolhapur	100	
7. Mr. B.M. Soni, Karad	100	
	5400	

(Place) (Day) (Date & Month)

Dated at .... the .... day of .... 2011.

Common Seal

- Form your own hypothetical public limited company and draft its Memorandum of Association.

5.3 ARTICLES OF ASSOCIATION

Articles of Association is second important document, which the promoters have to prepare, before registration. It is filed with the Registrar at the time of registration of the company. It contains rules and regulations for internal management of the company. It constitutes a contract between the company and its members. Outsiders are not concerned with the Articles of Association.

Definition:

1. **Sec 2 (2) of Companies Act 1956, defines:** "Article means the articles of association of a company originally framed or as altered from time to time in pursuance of any previous company law or this Act".

2. **Lord Justice Bowen:** "The articles of association are internal regulations of company and are for the benefits of shareholders".

Thus, articles are rules and regulations of a company, framed for internal management of it. They deal with rights of members of the company.

Articles are **subordinate** to the Memorandum of Association. Memorandum lays down the objects and purposes for which the company is formed, whereas Articles of Association defines how the business of company should be carried on.

Memorandum of Association limits the area of activities of the company, beyond which it can not go. Inside this area, regulations are made for the own management of the company.

Thus, Articles are governed by Memorandum of Association. A Memorandum of Association states the objectives and Articles of Association suggests the manner in which these objects can be achieved.

Preparation of Articles of Association:

Sec 26 of the Companies Act 1956, provides that a public company may prepare its own Article of Association. But it is not compulsory to prepare and file its own articles. If a public company does not prepare its own Articles of Association, it can adopt **'Table A'** of the Companies Act. Table-A is a set of 99 articles/bylaws given in the Act. Thus, promoters of a public company may adopt Table-A and need not prepare and file Articles of Association with the Registrar.

The preparation and filing of Articles of Association is compulsory in case of a private company, company limited by guarantee and an unlimited company. The Articles of Association shall be signed by the subscribers to the Memorandum of Association. It shall be printed, divided in paragraphs, serially numbered. It shall contain addresses, occupations etc. of the signatories.

Contents of Articles of Association:

1. Share capital, rights of members.
2. Call on shares.
3. Transfer, transmission of shares.
4. Lien on shares.
5. Conversion of shares into stock.
6. Share warrants.
7. General Meetings.
8. Voting by members.
9. Directors, their qualification shares, appointment, remuneration etc.
10. Board meetings.

11. Managers, managing director and secretary, their appointment, remuneration, removal etc.
12. Dividend and Reserves.
13. Books of Accounts and Audit.
14. Capitalisation of profit.
15. Borrowing power of company.
16. Company Investments.
17. Common Seal.
18. Notices.
19. Winding up.

Alteration of Articles of Association:

Sec 31 of the Companies Act 1956 provides that a company can alter its articles at any time and any number of times by passing a special resolution in the general meeting. A copy of resolution should be filed with the Registrar within 30 days of passing. If any article has been altered, such alteration should be incorporated in every copy of Articles of Association. The altered copy of Articles should be made available within **7** days of such alteration to the members.

Limitations for alteration in the Articles of Association:

Though a company has wide powers to alter its Articles, there are some **restrictions** on such alteration.

They are given below:

1. The alteration must be just and equitable. It must be in good faith of the company for the benefit of the company.
2. An article can not be altered so as to deprive the rights of minority shareholders.
3. The alteration of Articles must not be contrary to the provisions of the Companies Act and the provisions of Memorandum of Association.
4. The alteration in Articles must not sanction any illegal act.
5. The alteration of Articles will have to be made only by special resolution.

5.4 PROSPECTUS

The first step to be taken by the promoters of public company, immediately after its registration is to collect capital. The directors, therefore, proceed to collect capital by issuing 'Prospectus' to the public. It is a document which gives all essential information about every aspect of the company. It shows future prospects of the company. It invites the public to purchase shares or debentures of the company. It may be called silent salesman of the company.

Definition of Prospectus

~~Sec (2) (36)~~ of the Companies Act 1956

A prospectus means any document described or issued as a 'Prospectus', and includes any notice or circular, advertisement or other document inviting deposits from the public or inviting offers from the public for subscription or purchase of any shares or debentures of "body corporate".

Thus prospectus is an official invitation to the public to subscribe to shares or debentures of a company. Such invitation may be in the form of a notice, a circular, an advertisement etc. The only requirement is that the invitation must be made to public in writing. The prospectus must have following ingredients:

1) **Prospectus must be in writing:** An oral invitation to purchase shares or debentures of company is not a prospectus. Even an advertisement on a television or in film is not a prospectus. Prospectus always must be in writing.

2) **Invitation to Public:** If an invitation is made to friends or relatives of directors, to purchase shares, it is not prospectus. A document is a prospectus, if it is an invitation to the **public** to subscribe to the shares of a company.

3) **Subscription:** The word subscription means 'taking shares for cash'. If a document offers shares in exchange of (old) shares, it is not prospectus.

4) **Sale of Shares or Debentures:** The prospectus must invite offers from public for subscription of shares or debentures.

In brief, prospectus is an invitation sent to the public requesting it to subscribe to the securities of the company. It is issued by public limited companies only.

Legal requirements relating to issue of Prospectus:

1. Prospectus is issued after formation of a company.
2. Prospectus must be dated. The date is the date of publication of prospectus.
3. Prospectus must be signed by proposed directors of company.
4. A copy of prospectus must be filed with the Registrar.
5. Prospectus must be accompanied by a blank application form.
6. Prospectus must be issued to the public within **90** days from the date of filing it with Registrar of Companies.

Contents of Prospectus:

1. Name of the Company.
2. Address of registered office of the company.
3. Capital structure of the company.
4. Classes of shares, their face value, amount payable on application and allotment.
5. Name of stock exchange on which shares are listed.
6. The main object of company and future prospects of company.
7. Nature of business of company.
8. Future plans of company.
9. Location of factory.
10. Particulars of assets.
11. Information about – promoters, managing director, manager, banker, broker, solicitor, underwriters etc.
12. Interest of Directors.
13. Rights of Directors regarding allotment, etc.
14. Preliminary contracts.
15. Minimum subscription amount.
16. Procedure for application of shares.
17. Opening and closing dates of subscription list.
18. Date and signatures of all Directors.

Liability in case of Prospectus

A prospectus must be prepared very carefully. It must be accurate. It should contain true and correct information. There must be full and honest disclosure of all essential facts.

A prospectus should not contain mis-leading or exaggerated information. It should not omit to disclose any fact.

The Directors and promoters of company are personally liable for mis-statement in the prospectus.

Liability for mis-statement or omission of facts in the prospectus:

A) **Civil Liability**

1. Investor can apply to the court for cancellation of contract for purchase of shares.
2. Affected shareholders can sue company for damages or losses due to mis-presentation in the prospectus.
3. Every director and promoter is liable to pay compensation to affected investor for the loss sustained.

B) **Criminal Liability:** According to Sec 63 of Companies Act, if prospectus contains untrue statement, then every person, authorized to issue prospectus, is punishable with imprisonment up to **two years** or fine up to ₹ 5,000/- or both.

5.5 STATEMENT IN LIEU OF PROSPECTUS

When a company collects capital from among its promoters, directors, their friends and relatives, it does not approach public for securing capital. In this situation, Sec70 of the Companies Act provides that if no prospectus is issued, a statement called 'Statement in lieu of Prospectus' must be filed with the Registrar for registration.

The statement in lieu of prospectus must be duly signed by all persons named therein as directors. This statement contains similar information as per the prospectus. It has to be filed with the Registrar of Companies at least 3 days prior to allotment of shares.

5.6 DISTINCTION BETWEEN

A. Memorandum of Association and Articles of Association:

Points	Memorandum of Association	Articles of Association
1. **Meaning**	It is a charter of the company. It defines the aims and objects for which company is formed.	It is a document containing rules and regulation for the internal management of the company.
2. **Status**	It is primary and supreme document of company. It is life giving document	It is secondary document. It is subordinate to Memorandum.
3. **Objectives**	It defines the scope of activities of the company. It fixes the area of it's operation.	It lays down rules for internal working of company.
4. **Relationship with Company**	It defines relation between the company and outsiders e.g. sellers, buyers, debtors creditors etc.	It defines the relation between the company and members. It has nothing to do with outsiders.

5. Preparation	Every company must prepare and file it own memorandum for the purpose of registration. It is compulsory for all types companies.	Every company must prepare and file it's own Articles. But a public company can adopt Table A as it's Articles.
6. Alterations	The process of alteration of Memorandum is complicated. It is possible only if members agree and sanction of Central Government, Court or Company Law Board is obtained.	The process of alteration of Articles is simple. It must be subject to provisions of Companies Act and Memorandum.

B. Prospectus and Statement in Lieu of Prospectus:

Points	Prospectus	Statement in Lieu of Prospectus
1. Meaning	Prospectus contains an invitation to the public to subscribe for shares and debentures of company	It is similar to prospectus, but does not invite public to subscribe for capital. It is prepared to comply with the provisions of Companies Act 1956
2. Purpose	It is used for publicity as well as filing with the Registrar.	It is used only for the filing with the Registrar.
3. Need	It is required when company raises capital from public.	It is required when capital is raised privately. It is needed only for the filing purpose.
4. Suitability	Large public limited companies issue prospectus to collect huge capital.	Small public companies can raise capital privately. They prepare this statement for filing with the registrar.
5. Publicity	It gives wide publicity to the company.	It is filed with the registrar and it is not advertised.
6. Filing with Registrar	90 days prior to issue to public.	3 days prior to allotment of shares.

SUMMARY

Every company needs to file certain documents for the registration purpose. They are –

1. Memorandum of Association
2. Articles of Association
3. Prospectus
4. Statement in lieu of prospectus

Memorandum of Association is the constitution of company. It lays down aims and objectives of company.

Articles of Association is secondary document. It lays down rules and regulation for internal management.

Prospectus is issued by public company to raise capital. It is an invitation to public to subscribe for capital.

Statement in lieu of prospectus is prepared for filing purpose only.

Key Terms

Memorandum of Association	:	Constitution or charter of company.
Name Clause	:	Contains name of company.
Domicile Clause	:	Name of state where registered office of company is situated.
Object Clause	:	Indicates scope of activities of company.
Liability Clause	:	States the nature of liability of members and Directors
Capital Clause	:	States total amount of share capital or Authorised Capital of Company.
Subscription Clause	:	Name, address etc. of signatories to Memorandum.
Articles of Association	:	Rules and regulations for internal management.
Table A	:	A set of 99 articles.
Prospectus	:	Invitation to public to purchase shares of public company.
Statement in lieu of prospectus	:	A document prepared for filing with registrar when capital is raised privately.

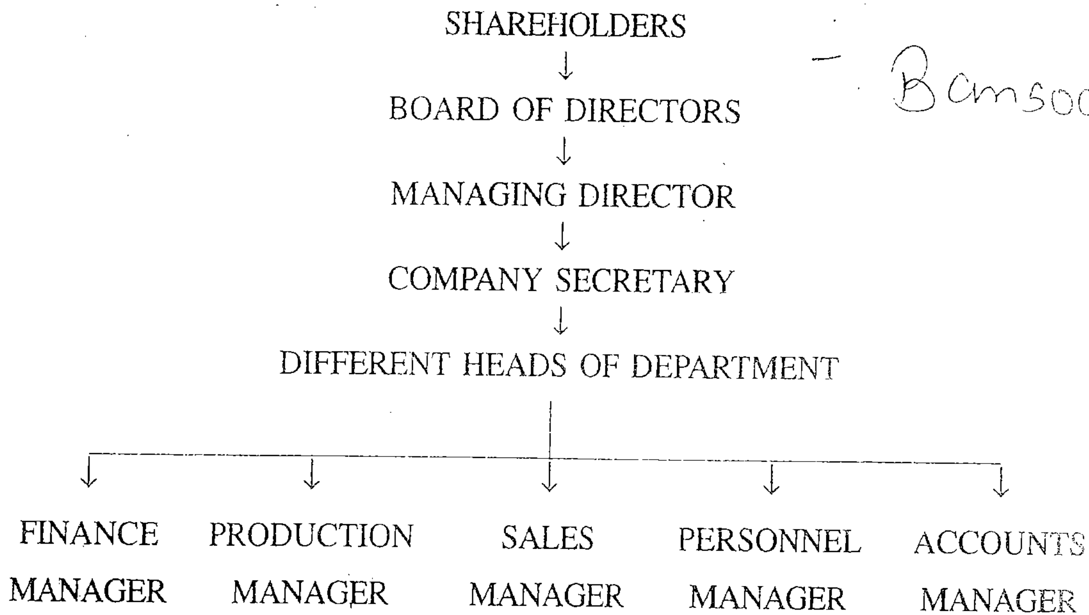
EXERCISE

Q.1 A Select the correct answer from the possible choices given below and rewrite the statements.

1. The .... is primary and supreme document of the company.
   a) Memorandum b) Articles c) Prospectus
2. The rules regarding internal management are given in the ....
   a) Articles of Association b) Prospectus c) Memorandum
3. A .... is called as silent salesman of a company.
   a) Prospectus b) Table 'A' c) Articles
4. A public company may adopt .... in place of Articles of Association.
   a) Memorandum b) Table 'A' c) Prospectus
5. A public company must publish .... for raising capital.
   a) Memorandum b) Statement in lieu of prospectus c) Prospectus

ORGANIZATION STRUCTURE OF A JOINT STOCK COMPANY

The structure of a Joint Stock Company is as follows:



7.1 SHAREHOLDER

A shareholder is a person who holds or owns a share or shares of a company. Shareholders supply necessary capital to the company by purchasing the shares and also bear the risk of company's business.

The shareholders are large in number and scattered over a large area. They cannot participate in the day to day management of the company. So they elect the Board of Directors to manage the company. They also control the company by participating and voting at the general meetings.

7.1.1 MEANING:

The words 'shareholders' and 'members' are generally used interchangeably. However there is a technical difference between the two words. A shareholder is a person who holds the shares of a company but his name may not appear in the Register of Members and may not be a member of the company.

Section 41 of the Companies Act defines a member of a company as:

a) A person who has signed the Memorandum of Association.

b) Every other person who agrees in writing to become a member of a company and whose name is entered in the register of members.

c) Every other person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the Depository.

Who can become a Member?

i) A major person (above 18 years) with sound mind and not disqualified by law and who is competent to enter into a contract can become a member of the company.

ii) A company can become a member of another company, if allowed by its Memorandum of Association.

iii) A Partnership Firm cannot be a member but the partners may be registered as joint holders of shares in a company.

iv) A Hindu Undivided Family can purchase shares through the karta i.e. the karta alone shall become the member.

v) A non-resident of the country (NRI) can become a member with suitable permission of the Reserve Bank of India.

vi) A trustee of a registered trust can personally become a member of the company, by purchasing the shares in his own name but the trust cannot be a member of the company.

vii) A registered society can hold shares and become a member in its own name.

7.1.2 ACQUISITION OF MEMBERSHIP:

A. person can acquire membership in any of the following ways:

a) **By Subscription:** The persons who subscribe to the Memorandum of Association shall be deemed to have agreed to become the members of the company and on its registration shall be entered as members in the Register of Members.

b) **By Application and Allotment:** A person who applies for the shares of the company through public issues, is allotted shares by the Board of Directors and the same is communicated through the Letter of Allotment. After making the payment of allotment money, the name of that person will appear in the Register of Members.

c) **By Agreeing to Purchase Qualification Shares:** A person who has signed an undertaking to take up and pay for the qualification shares to become a director of the company is also deemed to have become a member automatically on the registration of the company.

d) **By Transfer of Shares:** A person can become a member of the company by purchasing the shares from an existing shareholder of the company. The transfer must be made according to the procedures laid down by the Articles of the company and the name must be entered in the Register of Members.

e) **By Transmission of Shares:** A person can become a member by virtue of transmission of shares. In case of death, insolvency or lunacy of a shareholder, his legal heir, or successor automatically becomes a member of the company.

f) **By conversion of Share Warrant into Share Certificate:** A person can become a member if he surrenders his share warrant and gets it converted into share certificate and also gets his name entered in the Register of Members.

g) **By Allotment of Shares for consideration other than cash:** A person can become a member by accepting fully paid or partly paid shares as a consideration for the services rendered by him to the company. His name must be entered in the Register of Members.

h) **By the Principle of Estoppel:** A person can become a member by the 'Principle of Estoppel' i.e. his name appears in the Register of Members even after disposal of his shares, and he exercises all membership rights i.e. attends meetings, accepting dividends and does not take any step to remove his name from the Register of Members. Such a person is responsible for the liabilities of membership.

- All members are shareholders of the company but all shareholders may not be members of the company. Do you agree with this statement? Justify.

7.1.3 RIGHTS OF MEMBERS:

The rights of the member may be classified into two broad categories.

A) Individual/Personal Rights

B) Group/Collective Rights

A) Individual Rights

Right to:

1) Receive notices of company meetings i.e. Annual, Statutory and Extra Ordinary general meetings, right to attend meetings, vote and pass resolutions.
2) Receive share certificates within the prescribed time limit.
3) Appoint proxy and exercise their voting rights through proxy.
4) Receive annual reports, auditors reports, statutory reports, annual accounts etc. on his registered address.
5) Transfer the shares as per the provisions of the Articles of Association.
6) Receive dividend when declared in the general meeting of the shareholders.
7) Receive bonus shares whenever issued by the company.
8) Inspect the statutory books of the company free of charge at the registered office and also take extracts from these books.
9) Obtain copies of Memorandum of Association and Articles of Association on request and payment of the prescribed fees.
10) Be registered as a member and have his name on the Register of Members.
11) Share in the surplus assets of the company at the time of winding up of the company.

B) Collective Rights: These rights are exercised collectively by the shareholders

Right to:

1) Appoint or remove the directors of the company.
2) Appoint/re-appoint the auditor of the company.
3) Alter, change or modify the Memorandum of Association and Articles of Association.
4) Adopt Annual Accounts, Auditor's Report in the Annual General Meeting.
5) Convene an extra-ordinary general meeting to discuss certain important and urgent matters.
6) Approve the issue of shares at discount, issue of bonus shares, rate of dividend declared by the Board of Directors.
7) Allow the Directors to accept an office of profit.
8) Approve reconstruction, amalgamation schemes of the company.
9) Approve alteration, reduction and re-organization of the capital.
10) To appoint sole selling agents.

7.1.4 TERMINATION OF MEMBERSHIP:

The membership of a person can be terminated in any one of the following ways.

a) **Transfer:** If the shareholder transfers his shares through the instrument of transfer and the transfer is duly registered in the name of the other person in the books of the company.

b) **Issue of Share Warrant:** The share certificate is converted into share warrant, if permitted by the Articles of Association.

c) **Transmission:** When the shareholder dies, or becomes lunatic or insolvent the shares are transmitted to his legal representative.

d) **Redemption of Preference Shares:** When the redeemable preference shares are redeemed, then the name is removed from the Register of Members.

e) **Right of lien by the Company:** When the company disposes of the shares by giving a 14 days notice to the debtor members in discharge of his debt to the company.

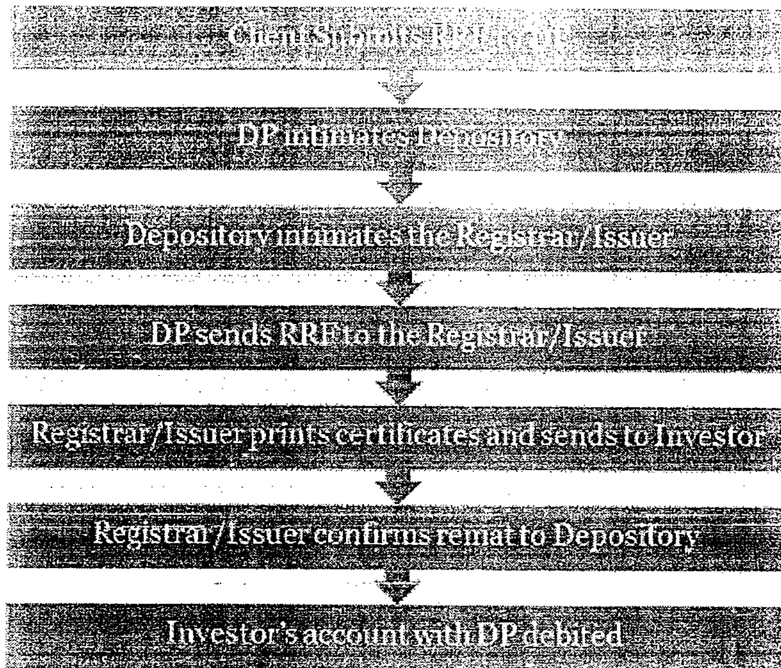
f) **Liquidation of the Company:** On winding up of the company all the members lose their membership rights in the company.

Rematerialization of Shares:

Rematerialization is the process of conversion of electronic holdings of securities into physical certificate form. For rematerialization of scrips, the investors have to fill up a **Remat Request Form (RRF)** and submit it to the depository participant.

The DP forwards the request to depository after verifying the investor's balances. Depository in turn intimates the Registrars and Transfer Agent or the issuer company. RTA/company prints the certificates and despatches the same to the investors.

"The process of converting <u>Electronic form of securities into Physical form</u> is called rematerialization".



Rematerialization Process

Comparison Chart

BASIS FOR COMPARISON	DEMATERIALIZATION	REMATERIALIZATION
Meaning	**The process of converting Physical form of securities into Electronic form is called dematerialization.**	**The process of converting Electronic form of securities into Physical form is called rematerialization.**
Shares	Doesn't possess distinctive number	Possess distinctive number
Form of Trading	Paperless	Paper
Account Maintenance	Depository Participant	Company

Conclusion

Rematerialization is diametrically opposite of dematerialization, which allows an investor to turn its shareholdings in electronic form into physical one. Both the processes need at least 30 days for completion.

Dematerialization and Rematerialization of Securities

Dematerialization of Shares:

Dematerialization is the process wherein share certificates or other securities held in physical form are converted into electronic form and credited to **Demat account** of an investor opened with a depository participant.

"The process of converting <u>Physical form of securities into Electronic form</u> is called dematerialization".

The demat account offers a number of benefits to the investor as he is not required to keep the shares or other securities in safe custody eliminating the risk of fire, theft, loss in transit, delay in transfer, bad delivery, fake or forged shares etc.

- SEBI has made compulsory trading of shares of all the companies listed in stock exchanges in demat form with effect from **2nd January, 2002.**
- Hence, if the investor wants to trade in respect of the companies which have established connectivity with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL), he may have to open a beneficiary account with a depository participant of his choice. The procedure of opening a demat account with DP is similar to opening an account with a bank.

Steps Involved in Dematerialization:

The following steps are involved in dematerialization of

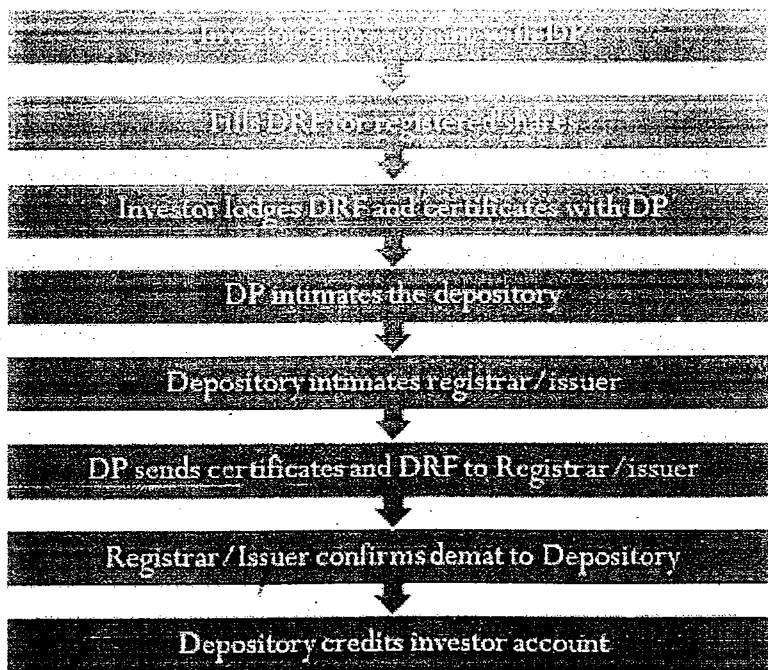
- 1.The investor has to open a beneficiary account with a depository participant (DP) of his choice to hold shares in demat form and undertake scripless/Electronic trading.
- 2.Investor has to submit **Demat Request Form (DRF)** and share certificates to DP who in turn will check whether securities are available for demat.
- 3.The investor should deface the share certificates by stamping 'Surrendered for Dematerialization' and DP will punch two holes on the name of the company and draw two parallel lines across the face of the certificate.
- 4.Depository participant enters the demat requests in the system to be sent to depository. DP despatches the physical certificates along with the demat request form to the Registrar and Transfer Agent (TRA) or issuer company.

- 5.Depository records the details of the electronic requests in the system and forwards the request to RTA or Issuer Company.

- 6.RTA or the issuer company on receiving the electronic request and the physical documents verifies and checks them. Once the RTA/company finds that the documents are in order, dematerialization of the securities is electronically confirmed to the depository.

- 7.Depository credits the dematerialized securities to the beneficiary account of the investor and intimates the DP electronically. The DP then issues a statement of transaction to the client.

An investor can close a demat account by giving an application in the prescribed form.



Dematerialization Process

13. The Articles of Association defines the relationship between the company and its ...

    (a) **members** (b) outsiders (c) creditors (d) debtors

14. ... is almost an unalterable document of the company.

    (a) Memorandum of Association

    (b) Articles of Association

    (c) Prospectus

    (d) Statement in lieu of Prospectus

15. The rules regarding the internal management of the company are given in ...

    (a) Memorandum of Association

    (b) Articles of Association

    (c) Prospectus

    (d) Statement in lieu of Prospectus

16. The Domicile Clause of the Memorandum of Association mentions the ... of the company.

    (a) head office (b) nationality

    (c) place of business **(d) registered office**

17. A ... company need not file a Prospectus or Statement in lieu of Prospectus with the Registrar.

    (a) public **(b) private** (c) government (d) statutory

18. ... may be called a silent salesman of the shares and debentures of a company.

    (a) A Memorandum of Association (b) Articles of Association

    (c) A Prospectus (d) A Statement in lieu of Prospectus

19. Unlimited companies do not mention the ... clause in the Memorandum of Association.

    (a) Liability (b) Name (c) Domicile (d) Objects

20. Statement in lieu of Prospectus is prepared for the purpose of ... ..

    (a) Publicity (c) invitation to the public to buy shares

    (b) issue of shares **(d) filing with the Registrar of Companies**

☆☆☆

4. FINANCIAL STRUCTURE OF COMPANY

Introduction

Capital is necessary for financing all kinds of business activities of a company. Every business organization needs funds or finance for its business operations. "An amount of money which is required to start the business or invested in the business is known as capital." The capital requirement of the business organization depends upon its size and the nature of the business. The capital of the business may be long term or short term in nature. It may be owned capital or borrowed capital. Owned capital is provided by the members who are the owners of the company. Owned capital can be raised by the issue of shares. Borrowed capital is raised through issuing debentures. The capital structure of Joint Stock Company is in the form of shares and debentures.

Share capital is owned capital which is also known as permanent capital. Share capital is divided in to large number of parts or units. Each such part is known as a share. Following are the sources of capital formation of the company

A] **Internal Sources:**

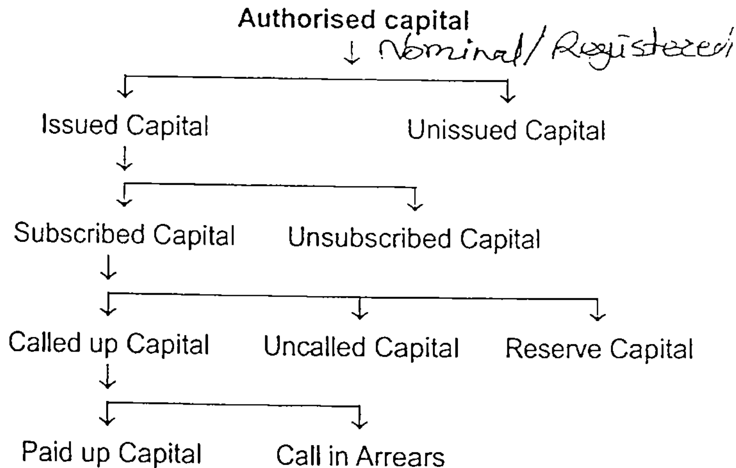
i) depreciation ii) Reserve fund

B] **External sources:**

1) Issue of shares 2) Issue of debentures

3) Deposits 4) Loans

4.1 Capital Structure of Company



(1) **Authorised Capital or Nominal Capital or Registered Capital:** It is the maximum amount of capital which is stated in the Capital clause of the Memorandum of Association of the company. When the Memorandum of Association is registered with the Registrar of Companies, authorised capital is termed as Registered Capital. It can be raised by a company by issuing shares to the public. It includes the total capital requirement of the company for present as well as future needs. It is also called Nominal Capital.

(2) **Issued Capital:** It is that part of authorised capital which is offered by the company to the public for subscription. Generally a company does not issue the entire authorised capital. It issues only a part of the authorised capital to the public and remaining is kept as reserve capital for future requirements of the company.

(3) **Unissued Capital:** As a joint stock company issues only a part of the authorised capital to the public for subscription, the balance left unissued is called unissued capital i.e. the part of the authorised capital which is not issued to the public for subscription. It may be issued as and when required by the company.

(4) **Subscribed Capital:** When a company issues capital to the public, it is subscribed by the public i.e. Public applies for the shares of the company. It may be more, less than or equal to issued capital. Thus the part of issued capital which is actually subscribed by the public is called subscribed capital.

(5) **Unsubscribed Capital:** The part of the issued capital which is not subscribed by the public is called unsubscribed capital. In other words we can say that the part of the issued capital for which no response is received from the public is known as unsubscribed capital. It happens when the applications received are less than the shares issued to the public for subscription.

(6) **Called-up Capital:** A company may not collect the entire amount of capital subscribed by the public at once. It may collect the amount due in installments which are called calls on shares. The company calls only a part of the nominal value of shares issued to the public. This amount which is called up by the company from the public to be paid up is known as Called up Capital.

(7) **Uncalled Capital:** As the share capital of the company is collected in installments by making calls on shares, the amount which is not called by the company to be paid up is called uncalled capital. It may be called up by the company as and when required.

(8) **Reserve Capital:** Sometimes a company may not require the entire amount of capital. So instead of calling up the entire amount of share capital it may keep some reserve for meeting contingencies arising at the time of winding up of the company. This capital is called reserve capital. It is also called uncallable capital.

(9) **Paid up Capital:** When the company makes calls on shares (demand on shares) the public makes the payment of the calls demanded by the company. The amount of the share capital which is actually paid by the public is called paid up capital.

(10) **Calls in arrears:** When the amount of the capital demanded by the company i.e. the call made by the company is not paid by the shareholder, it is called calls in arrears i.e. the unpaid amount of the calls on shares made by the company.

4.2 Share: Meaning and Definition

Capital of the Joint stock company includes a large number of shares having specific face value or nominal value. Share capital is divided into large number of parts or units. Each such part is known as a share. Due to small value of shares people can invest according to their investing capacity. Hence it is aptly said that, "A share is a share in the share capital of the company". A person who purchases or holds shares in a company is called as Share-holder. As share capital is ownership capital, status of a shareholder, is the owner of the company. Thus shareholders are the owners of the company. When the amount on share is paid, a company issues a document of ownership of property in shares under the company's seal and signature which is called as a 'Share

Certificate'. Thus a share certificate is a proof or document of evidence of holding shares. A share is one of the units into which the capital of company is divided. When the interest of shareholder is measured in terms of money is known as share.

Characteristics / Features of Shares:

i. Each share is of a fixed nominal or face value payable by its holder in money or in kind.

ii. A share is a part of sub-division of the share capital of a Company.

iii. By virtue of section 83 each share bears a distinctive number. Each share certificate shows the distinctive numbers of the shares covered by it.

iv. A share confers certain rights on its holder, such as right to receive dividend, right lo attend shareholder's meetings, right to vote at such meetings, right to transfer the share etc.

v. According to section 82 a share in a Company is movable and transferable property. The procedure for its transfer has to be laid down in the Company's Articles of Association.

vi. A shareholder is a part owner of the Company. So all shareholders are joint owners of the Company.

vii. A share also places on its holder certain liabilities.

viii. A shareholder is also called member of the Company as his name appears in the Register of Members required to be maintained by the Act.

ix. A share can be issued at par, at premium or at discount.

x. A share is also termed as ownership security and the entire share capital of a Company is known as its "Owned Capital".

xi. A share cannot be transferred in parts. Whenever the

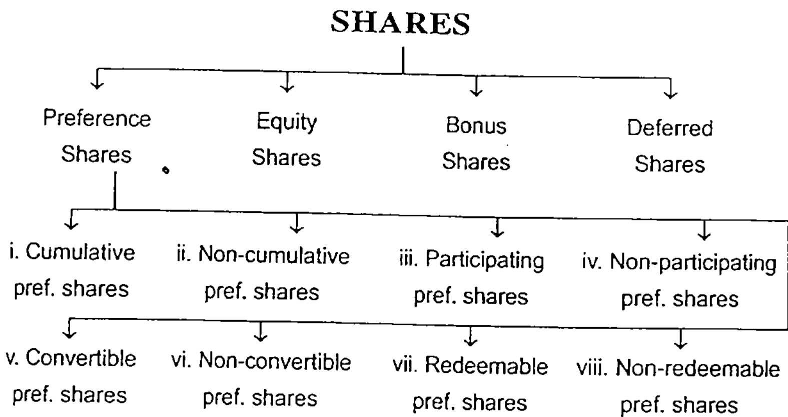
bolder wants to transfer it in the name of another person, must transfer it in full. But when share is represented by stock it can be transferred in parts.

xii. A share holder gets return on his investment in the form of dividend. The rate of dividend depends on the profits made by the Company.

xiii. The Share certificate is a documentary evidence of shareholders ownership of share of the company.

4.4 Types of Share

There are different types of shares such as:



1. Preference Shares:

These are the shares which have preferential rights in the Company. These preferential rights are (1) as to the payment of dividend at a fixed rate during the life time of a Company and (2) as to the return of capital on winding up of the company. Thus preference shareholders have some preference over the equity shareholders. Also in case of

winding up of the Company. their capital is paid back first and then the equity shareholders are paid. Preference Shareholders can not exercise their voting right on all the matters. They can vote only on the matters affecting their own interest. These shares are suitable to the investors who want to have security of fixed rate of dividend and refund of capital in case of winding up of the Company.

Features of Preference Shares:

i. **Fixed dividend:** They have a fixed rate of dividend, hence they are called fixed income securities. Thus whether the Company has loss or high profits, they are entitled only a fixed rate of dividend.

ii. **Return of Capital:** They also have the first preference or prior right among all shareholders to get back their capital at the time of winding up of the Company.

iii. **Non-participation in Prosperity:** On account of fixed dividends, these shares do not have any chance to share in the prosperity of the Company's business, (except in case of participating preference shares)

iv. **Return on Investment:** As the name indicates they have the first preference to get a return on the investment, i.e. to a share in the Company's profits among all shareholders.

v. **Non-participation in Management:** Preference shareholders do not enjoy voting right and have no voice in the management of the Company's affairs when they are being directly affected.

Kinds of Preference Shares:

The different kinds of preference share are as follows:

(1) **Cumulative Preference Shares:** are those types of

preference shares in which the dividend is accumulated. They get arrears of dividend. These shares get the dividend for the past years also if it was not paid in the past.

(2) **Non Cumulative Preference Shares:** are those types of preference shares on which the dividend is not accumulated. Dividend is paid regularly. They can get dividend only for the current year i.e. Dividend not paid in a particular year is lost forever.

(3) **Convertible Preference Shares:** are those type of Preference Shares which can be converted into equity shares at the option of the shareholder.

(4) **Non Convertible Preference Shares:** arc those types of Preference Shares which cannot he converted into equity shares.

(5) **Participating Preference Shares:** arc those types of preference shares which participate in the surplus profits made by the company i.e. In addition to dividend they get a share in the profits made by the company. They also get a fixed rate of dividend.

(6) **Non-participating Preference Shares:** are those which do not participate in the surplus profits of the company i.e. they get their dividend but they have no share in the profits made by the company.

(7) **Redeemable Preference Shares:** are those which are paid back after a specific period i.e. the amount is refunded after a stipulated period of time is over.

(8) **Irredeemable Preference:** Shares are those which arc paid only at the lime of winding up of the company only if the company is winding up then only they are paid their money. Now, the Government has prohibited the Companies limited by shares to issue irredeemable shares

in accordance with the recommendations of the Sachar Committee. The Companies (Amendment) Act, 1988, has introduced a New Subsection 5(A) to Sec. 80 of the Act.

2. Equity Shares or Ordinary Shares:

According to the Indian Companies Act, 1956, section 85(2), shares which are not preference shares are equity shares or ordinary shares. Generally, a company raises its long term capital by issuing equity shares or ordinary shares. As the name suggests, these are the shares which are ordinary in the course of the company's business. Equity shareholders get dividend which is fluctuating as it is paid after making payment of interest and fixed rate of dividend on the preference shares. Also in case of winding up of company equity shareholders are the last one to get the amount of their share capital back after making all other payments.

Features of Equity Shares:

The main features of Equity Shares are presented below:

(1) **Risk Capital:** The prospect of getting dividend entirely depends upon the profits of the Company. The payment of dividend is not guaranteed. Secondly, when the Company is wound up, equity capital is returned only after the creditors, debenture holders and preference shareholders are paid off. The equity shareholders have the last claim on the assets of the Company.

(2) **Fluctuating Dividend:** The rate of dividend on these shares is not fixed. It depends on the profitability of the Company. The dividend is paid after making the following payments(i) Expenses of running the business.(ii) Tax to the government.(iii) Interest to the debenture holders.(iv) Fixed rate of dividend on

preference shares.(v) Provision for reserves etc.Then, the balance amount is left for Equity shareholders. Sometimes they have to go without dividend.

(3) **Capital Appreciation:** The nominal or par-value of the equity share is fixed but the market value fluctuates. The market value mainly depends upon profitability and prosperity of the Company: Higher rate of dividend is paid with, higher rate of profit, the shareholders' capital is appreciated through an appreciation in the market value of shares.

(4) **Voting Rights:** Equity shareholders have a statutory right to vote at the general meetings. By exercising the voting rights, they can participate in the management and affairs of the Company. They can exercise the voting rights by appointing a proxy also. They are allowed to vote on all matters discussed at the general meetings. They can influence the decision of the management. Voting rights of a member generally depends on the number of shares held by him and the amount paid on such shares.

(5) **Transfer of Shares:** Subject to the provisions of Articles of Association, equity shares of a Public Ltd. Co. are freely transferable. Shares are listed in Stock Exchange so they can be easily transferred by taking necessary steps and informing the Company about the transferor shares.

(6) **Benefit of Bonus Shares:** Joint Stock Companies which make huge profits, issue bonus shares to their ordinary shareholders out of accumulated profits. These shares are issued free of cost in proportion to the number of existing equity shares held by them. Thus the capital investment of ordinary shareholder tends to grow on its own. This benefit is available only to equity shareholders.

(7) **Benefit of Right Issue:** When a Company makes fresh issue of shares, the equity shareholders arc given certain rights in the Company. The Company has to offer the new shares first to the equity shareholders in proportion to their existing share holding. In case, they do not take up the shares offered to them, the same can be issued to others.

(8) **Irredeemability:** Equity shares are always irredeemable. This means equity capital is not returnable during the life time of a Company.

(9) **Participation in prosperity:** Since the rate of dividend on equity shares depends on the profitability of the Company, these shareholders get ample opportunity to participate in the prosperity of the Company.

(10) **Participation in Management:** Equity shareholders enjoy normal voting rights and hence they have voice in the management of the Company's affairs.

3. Bonus Shares:

These are the special type of shares. They are issued to existing shareholders in proportion to their present holdings. They are given free of cost as gift to the present shareholders. Thus, bonus shares are extra or additional shares. When the Company decides to capitalise reserve, instead of making payment of dividend, certain shares equal to that value are issued. Such shares are called Bonus Shares.

Conditions for the Issue of Bonus Shares:

(i) There must be sufficient amount of undistributed profits.

(ii) Articles of the Company must permit for such an issue.

(iii) Apt resolution must be passed by the Board of Directors.

(iv) Shareholders must give formal approval to such issue of

bonus shares.

(v) Necessary permission must be obtained from the Controller of Capital Issue under the Capital Issues Control Act, 1947.

It is not a type of shares but it is a part of equity shares, or a privilege given to equity shareholders.

4. Deferred Shares:

The promoters of the Company are the pioneer members or founder members of the joint stock company. They play a very important role in the formation and floatation of Joint Stock Company. They complete legal formalities and provide valuable services. Certain shares arc given to them for the work done by them. Such shares are known as 'Deferred Shares'. However in India, the Indian Company's Act of 1956, doesn't provide for the issue of deferred shares. Therefore, joint stock companies in India do not issue Deferred Shares.

Terms of Issue of Shares:

A company may issue shares at par, at premium or at a discount.

(1) **Issue of shares at par:** Shares are said to be issued at par when the subscribers are required to pay only the amount equivalent to the nominal value or face value of the shares issued e.g. if the face value of a share is Rs. 100 and is issued at a price of Rs. 100, it is said that the shares are issued at par.

(2) **Issue of Shares at premium:** Sometimes the company may issue its shares at a price higher than the nominal value of the share, it is said that the shares are issued at a premium e.g. If the face value of a share is Rs. 100 but

it is issued at Rs. 115 by the Company. It is issue of shares at a premium of Rs. 15 which may be transferred to the "Share premium A/c".

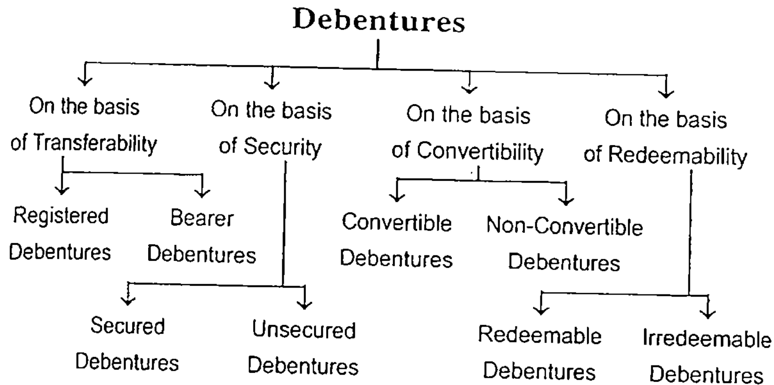
(3) **Issue of shares at discount:** Sometimes the company issues its shares at a less price than the face value of shares, the shares are said to be issued at a discount, e.g. the face value of share is Rs. 100 but the Company issues it at a price of Rs. 90, the share is being issued at a discount of Rs. 10. A company can issue shares at a discount only after the completion of one year from the commencement of the business.

4.5 Debentures

The term *debenture* may be defined as certificate of loan issued by the company, which creates or acknowledges an indebtedness of the company. A Joint Stock Company needs additional funds for meeting working capital requirements. Such needs are temporary in nature. So company raises funds by borrowing from the public. Such loans from the public are termed as Borrowed Capital. A Debenture is an acknowledgment of such debt or loan. Face value of debenture is generally higher and the period of repayment depends upon the nature of the requirement.

One who invests in debenture capital or holders of debenture is called as Debenture holder. As he is a financer or lender, his status is the creditor of the company. A Joint stock company pays interest at fixed rate as a return on investment in debentures. A title to debentures or a document of evidence of investment in debenture issued under the company's seal is called as 'Debenture Certificate'. It contains a contract for repayment of borrowed amount. A debenture is

an instrument of credit a bond of indebtedness or a acknowledgement of debt issued by a company under its common seal. A debenture is a document issued by a company as an evidence of a debt due from the company, with or without a charge on the assets of the company. Nowadays debentures are very popular among the investors. There are different kinds of debentures.



4.6 Kinds of Debentures

Debentures are classified into different types on the basis of qualities / aspects like tansferability, security, convertibility and redeemability as discussed below:

4.6.1 Transferability:

1) **Registered Debentures:** Registered debentures are those in respect of which the names, addresses and particulars of holdings of debenture holders are entered in a register kept by the Company. Such debentures are treated as non-negotiable instruments and interest on such debentures are payable only to registered holders of debentures. The transfer of ownership of such debentures is possible only through a regular instrument of transfer which is duly signed by the transferor and transferee. Paper stamp duty is required to be paid for transfer. Interest on such debentures, is paid on interest warrant or coupon warrant which are negotiable in which case interest is payable to the bearer of the coupons.

2) **Bearer Debentures:** The very name indicates that such debentures are payable to bearer and are deemed to be negotiable instruments. Such debentures are not recorded in the register of debenture holders. Those debentures are regarded as negotiable instruments and it possesses the following qualities: (i) Such Debentures can be transferred by mere delivery. No formality of executing a, transfer deed is necessary.(ii) A person transferring a bearer debenture need not give any notice to the Company to this effect.(iii) When such debentures are transferred, stamp duty need not be paid. (v) Interest coupons are attached to each debenture and are payable to bearer.

4.6.2 Security:

3) **Secured Debentures (Mortgage Debentures):** Secured Debentures are those which are secured by some charge on the property or assets of the Company. The charge or mortgage may be fixed or floating and they may be fixed mortgage debentures or floating mortgage depending upon the nature of charge under the category of secured debentures. In case of fixed charge, the charge is created on a particular asset such as plant, machinery etc. These assets can be utilised for payment in case of default. In case of floating charge, the charge is created on the general assets of the Company. A mortgage deed is executed by the Company. If the Company fails to pay

the principal amount and the interest, they have the right to recover the same, from the assets mortgaged.

4) **Unsecured Debentures: (Simple or Naked Debentures):** Such Debentures do not create any charge on the assets of the Company. There is no security for repayment of principal amount and payment of interest. The only security available to such debenture holders is the general solvency of the Company. Therefore, the position of these debenture holders at the time of winding up of the Company will be like that of the unsecured creditors.

4.6.3 Convertibility:

5) **Convertible Debentures:** These debentures have an option to convert them into equity or preference shares at stated rate of exchange after a certain period. If the holders exercises the right of conversion they cease to be lender to the Company and become members. Thus convertible debentures may be referred as debentures which are convertible into shares at the option of the holders after a specified period.

6) **Non-convertible Debentures:** These debentures cannot be converted into either equity.shares or preference shares. Such debentures have no option or right to convert them in to shares. They can play only one role in the company as a debentures only.

4.6.4 Redeemability:

7) **Redeemable Debentures:** These debentures are issued by the Company for a specific period only. On the expiry of period debenture capital is redeemed or paid back. Generally, the Company creates a special reserve account known as Debenture Redemption Reserve Fund for the

redemption of such debentures. The Company makes the payment of interest regularly. Under Section 121 of the Indian Companies Act 1956, redeemed debentures can be re-issued.

8) **Irredeemable Debentures:** These debentures arc also known as perpetual debentures. Such debentures are issued for an indefinite period. The debenture capital is repaid either at the option of the Company by giving previous notice to that effect or at the winding up of the Company. The interest is regularly paid on these debentures.

Features of Debentures:

The features of debentures are briefly highlighted as under: (i) Debenture is an acknowledgment of debt issued by a company under its common seal. (ii) Debenture holder is the creditor of the company. (iii) Debenture holders get interest at a fixed rate. (iv) Debenture holders cannot participate in the management. (v) Debenture holders have no voting rights. (vi) When the company winds up the debenture holders are settled first. (vii) Joint Stock Company can purchase its own debentures from debenture holders. (viii) Debentures can be issued at any time by all companies private or public. (ix) Investment in debentures is safe and profitable. (x) There are various kinds of debentures.

4.7 Share Certificate

A share certificate is a document of title to shares issued by the company under its common seal. This document is a proof that the person whose name appears on it is the holder of the shares mentioned in it. It can be transferred by following the procedure given in the articles of the issuing company.

Contents of Share Certificates:

A share certificate must contain the following information: (i) Name of the Company. (ii) Serial number of the certificate. (iii) Name and address of shareholder or joint shareholder. (iv) Number and class of shares. (v) The distinctive numbers of shares held. (vi) The face value and the amount paid on each shares. (vii) The date of issue of certificate. (viii) The seal of the company. (ix) The authorised capital of the Company. (x) The signatures of two directors and the Company secretary. Thus, it is a document of the shares issued by the Company under its common seal, signed by at least two directors and counter-signed by the secretary on the authority of a Board resolution. It is an official declaration of the Company that the person mentioned therein is the bonafide holder of shares of the Company.

Issue of Share Gertificagte:

A share certificate is issued under these circumstances:

(a) when the letter of allotment is received from the allottee.
(b) in case of transfer of shares from shareholder to a new party.
(c) when the transmission of shares is duly registered with the company.
(d) when the share warrant is surrendered for cancellation.
(e) when the original share certificate is lost or destroyed.
(f) when there is partial transfer of shares.

Time-Limit for Issue of Share Certificates:

As per Section 113 of the Indian Companies Act, 1956, a share certificate must be issued to the allottee within three months from the date of allotment or within two months after

the application for the registration of the transfer of any shares. unless the terms of issue provide otherwise. In the event of default in compliance with this requirement, the Company and every officer who is knowing in default shall be liable to a fine, not exceeding Rs.500 per day so long as the default continues.

4.8 Share Warrant

Share certificate is a bearer document and is transferable by mere delivery. It may be noted that a share warrant is the substitute for a share certificate. It is a bearer document of title to shares of the company. No register of members is maintained against share warrants. A share warrant is negotiable instrument or bearer document. Share warrant can be issued by public companies only. Share warrant is issued in respect of fully paid shares. Prior sanction from government is necessary. Dividend is paid through the Dividend coupons. Shares mentioned as share warrant are not considered as qualification shares for directorship of a company.

Conditions for Issue of Share Warrant (Section 114):

(i) A public company only can issue share warrants. (ii) A private company is not permitted to issue share warrant. (iii) Articles of Association of the company should authorise issue of share warrant. (iv) Prior permission from the central government is necessary for the issue of share warrant. (v) Share warrant can be issued only in respect of fully paid shares. (vi) A share warrant is issued at the request by a member and not by the company at its own initiative.

4.8.1 Procedure of Issue of Shares

A company limited by shares issues shares to the public and raised capital by issuing prospectus. The company has to

adopt following procedure for the issue of shares.

1) **Appointment of Bankers:** When the company issues prospectus to the public, it has to make the appointment of bankers of company to receive the application money, allotment money and call money on the shares on behalf of the company. Under Section 69 (4) of the companies Act, all moneys received with the applications for shares have to be deposited in a special account to be opened for the purpose with a scheduled bank.
2) **Appointment of underwriters:** The promoters and the directors of the company have to make necessary arrangement for the underwriting of shares before they are issued to public. The underwriters act as insures against under-subscription for by the public. The investment companies, investment trust, state trading corporations, financial institutions, commercial banks act as underwriters.
3) **Listing of shares on stock exchange:** A stock exchange is an organized, regulated market where shares and debentures of a company can be easily bought and sold. If the shares of a company are quoted on a stock exchange, they can be easily marketed. Listing of a stock exchange. Only listed securities can be quoted on the stock exchange. Once shares are listed, the issue of shares gets quick public response and the securities enjoy good marketability.
4) **Approval and filing of prospectus:** Under section 60 of the companies Act 1956, a prospectus must not be issued unless a copy of it, signed by every director has been delivered to the Registrar for registration before the date of its publication. Every copy of the prospectus must point out at the top an endorsement that a copy of the prospectus has been filed with the Registrar.

5) **Publicity and issue of prospectus:** The prospectus should be issued within 90 days of the filing of a copy of it to the Registrar. The prospectus may be issued either by newspaper advertisement or otherwise. The copies of the prospectus should be made available at company's bankers and its head office. The every form of application for shares should be accompanied with a copy of prospectus. Where different classes of shares are issued, the application form for each class will have a different colour, and subscribers will be requested to forward a separate remittance for each class. This helps for quick identification, easy sorting and smooth filing of applications.
6) **Receiving of Application:** The prospective subscribers are requested to forward their applications duly filled in and signed by them, directly to the company's bankers or the authorized share brokers. Section 69 provides that the amount payable on application on each share shall not be less than 5% of the nominal value of the share. On receipt of the applications the bank issues receipts for the moneys to the applicants and credits the share application account of the company with the amount.
7) **Scrutiny and sorting of applications:** As soon as the company receives applications the irregular and incomplete application forms are rejected. The applications are sorted out according to different kinds of shares offered. For quick and easy sorting, application forms of different colours are used to distinguish clearly differently types of shares and debentures. The application forms may be sorted (a) In the alphabetical order of the names of the applicants (b) According to the number of shares applied for.

8) **Preparation of Application and allotment Sheets:** After the applications are classified as mentioned above, the details of each application are entered in the allotment sheet/Allotment register. The subscribers to the memorandum will be entered first. Each application is serially numbered. All entries on the sheet must be finally checked with application forms and with the bank pass book or bank list.

9) **Board meeting:** After receiving applications for shares, a meeting of Board of directors is conducted. The board will consider the report of allotment committee. All applications and allotment sheet are placed before the meeting for consideration and approval. Board of directors adopts the report with necessary changes if any by passing a resolution of allotment.

4.8.2 Allotment of Shares

Allotment may be defined as the act of distributing shares of a company to different persons who have made applications for shares in the company. Allotment is the formal contract of membership of a company.

Procedure of allotment of shares:

The procedure of allotment of shares involves the following steps:

1) **Allotment committee:** Board of directors of the company is the authority to allot shares. They may appoint a special committee for deciding basis of allotment. The committee submits a report on equitable and fair allotment of shares. Allotment may be made on priority basis or by lottery system.

2) **Board meeting:** After receiving applications for shares, a meeting of Board of directors is conducted. The board will consider the report of allotment committee. All applications and allotment sheet are placed before the meeting for consideration and approval. Board of directors adopts the report with necessary changes if any by passing a resolution of allotment.

3) **Authority to secretary:** The company secretary play an important role in the procedure of allotment of shares. In the same board meeting a resolution is passed by which a secretary is authorized to send letters of allotment or regret to the applicants.

4) **Letter of allotment or regret:** A letter of allotment is that which inform on applicant that he has been allotted the shares of the company. This letter needs to the preserved for its exchange against the share certificate. A letter of regret is that which informs the applicant that he has not been allotted any shares in the company and his application money is refunded.

5) **Shareholders register:** The company secretary then prepares the register of members. He records name of shareholders, his address, occupation, Number of shares allotted, amount of shares etc. in shareholders register. It is one of the important documents of the company.

6) **Returns of allotment:** The table or chart or statement which shows the detail information about allotment of shares is known as return of allotment. The secretary prepares a return of allotment and files it with the registrar of companies within one month of allotment of shares.

7) **Issue of share certificate:** The secretary then prepares the new share certificate and it should be signed by at

least two directors of the company. The new share certificates are sent to allattees against the surrounded of their allotment letters.

4.8.3 Transfer of Shares

Transfer of shares involves transfer of ownership in share property from the transferor or seller to the transferee or buyer and corresponding change in the Register of members. In public limited company shares are transferable like movable property. Shareholder of the company can transfer his shares by way of sale or gift. Transfer deed is required to be prepared by transfer and transferee at the time of transfer to shares. Section III-A specifically declares that the shares of a public company shall be freely transferable. However the manner of transfer may be prescribed by articles of association of a company.The procedure of transfer of shares is as below:

1) **Prescribed transfer form:** Every share transfer should be made in the prescribed printed form which is available at a share brokers office.
2) **Endorsement of presentation date:** Before the transfer form is signed by the transferor or his agent it has to be presented to the prescribed authority namely the Registrar of companies who will endorse their on the date of presentation.
3) **Transferor signature and stamp duty:** The transfer form must be signed by the transferor. On the basis of market value stamp duty is affixed on it.
4) **Receipt of transfer by transferee:** The transferor or his broker hands over the completed transfer form, signed, dated and stamped and the relative share certificate to the transferee or his broker.

5) **Deposit of Transfer for Registration before the time limit:** The purchaser or transferee must sign the transfer form and complete it in all respect. The transfer form and the share certificate must be deposited at the companies registered office before the expiry of the prescribed time limit.
6) **Scrutiny of Transfer:** The secretary then conducts the scrutiny of the transfer form at this stage the following points are checked. (a) Whether name, address etc. of the parties are correctly entered (b) Amount of consideration is reasonable (c) stamp duty is correctly paid (d) Both the parties have signed (e) Due witnesses are given (f) No unpaid calls are standing against the transfer (g) Transfer form is properly dated etc.
7) **Issue of Transfer Receipt:** After the final examination is compete, if everything is in order, the secretary issues a transfer receipt to the transferee or his broker who has lodged the transfer for registration.
8) **Notice of transfer:** The secretary will issue the notices of registration of transfer to both the parties. These notices are sent to avoid the registration of forged transfer.
9) **Entries in Transfer Register:** All particulars of transfer are tallied with the relative share certificate, the certificate is marked cancelled and the necessary entries are made in the Register of transfer.
10) **Transfer Resolution:** As soon as the period of notice of transfer expires, the secretary will place the matter before the directors. The board will consider the transfer and may approve it by passing a resolution of transfer.
11) **Registration of Transfer:** The company secretary registers the transfer of shares. The name of the transfer

is removed from the register and that of the name of transferee is entered in the register.

12) **Issue of new share certificate:** A new share certificate is issued to the transferee in exchange for the transfer receipt on or after prescribed date and the transferee becomes the member of the company.

Kinds of Transfer of Shares:

1) **Blank Transfer:** When the name of transferee is not mentioned in the instrument of transfer it is called a Blank Transfer. Only the transferor puts his name and signature on the transfer form and hands it over to the transferee along with the share certificate, but leaving the columns of the name and signature of the transferee blank. The shares can be sold to any party with the help of this type of transfer without any difficulty and without getting the transfer registered with the company. In this way lengthy formalities of transfer can be avoided. Similarly, the payment of stamp duty can also be saved. The last transferee who desires to become a member puts his name on the instrument of transfer and submits it's along with the concerned share certificates to the company's registered office for the transfer.

2) **Forged Transfer:** An instrument of transfer on which the signature of the transferor is not original is called a forged transfer. Such a transfer is void in the eyes of the law. It does not confer any title to the transferee even if he is bonafied purchaser for value. The original shareholder continues to be the member of the company and hence he is entitled to the forged transfer, may involve a company in a financial loss. Utmost care must be taken by the secretary while registering transfer of

shares, to reduce chances of forged transfers.

3) **Partial Transfer:** While a holder of the share, transfer same of his shares to another person by keeping remaining shares with him is known as partial transfer.

4) **Complete Transfer:** When shareholder of a company transfer his entire or total shares to the another person in such case it is known as complete transfer.

Restrictions on Transfer of Shares:

A] Restrictions in Articles of Company:

The Articles of a company may empower the Board of directors to reject transfer of shares on the following grounds:

1) **Poor Buyer:** When partly paid shares are to be transferred to a transferee to whom the directors do not want to approve, the transferee may be financially weak and incapable of paying calls.

2) **Minor purchaser:** The Board of director may reject the transfer of shares when partly paid shares are to transferred to a minor. Because A minor is legally unfit to enter into any contract and he is entitled to reject the contract at any time so that the company can not take any legal action against him to recover an outstanding calls.

3) **Unpaid calls:** When a call is unpaid against the shares which are to be transferred. The transferor is liable to pay the outstanding calls, and Board may decline to register the transfer as long as the transferor does not pay the overdue call.

4) **Debtor Transferor:** When the shareholder is a debtor of a company and the company's lien on shares has to be enforced, the Board may reject the transfer of shares unless the transferor pays off his debts. As soon as the

shareholder pays his debts the company may register the transfer.

5) **Defective Transfer:** When the instrument of transfer is incomplete, defective, irregular or is not properly stamped, the Board requests the parties concerned to submit a proper, regular and completed transfer form.

6) **Just Reasons:** For any other just and equitable reasons, the Board of director has special power to reject the transfer of shares on any other ground in the general interest of the company.

B] Restrictions, if Listing of shares in stock exchange:

1) If the shares transfer form is not properly filled.
2) If the form is not properly signed and stamped.
3) If share certificates are not attached with the transfer form.
4) If the legal formalities to transfer of shares are not followed.
5) If such transfer is against to the company and public interest.
6) If the transfer is restricted by the court.

C] Restrictions by central Government:

D] Restrictions by Reserve Bank of India:

4.8.4 Transmission of Shares

Transmission of shares means transfer or passing of ownership of shares by the operation of law from the member to his legal heir or legal representative in case of such events as death, insolvency and lunacy. Effect of transmission is that the property is transferred to the legal representative. The legal representative has to produce a certificate of succession for the valid transmission. No stamp duty is payable for transmission of shares.

Reasons for Transmission:

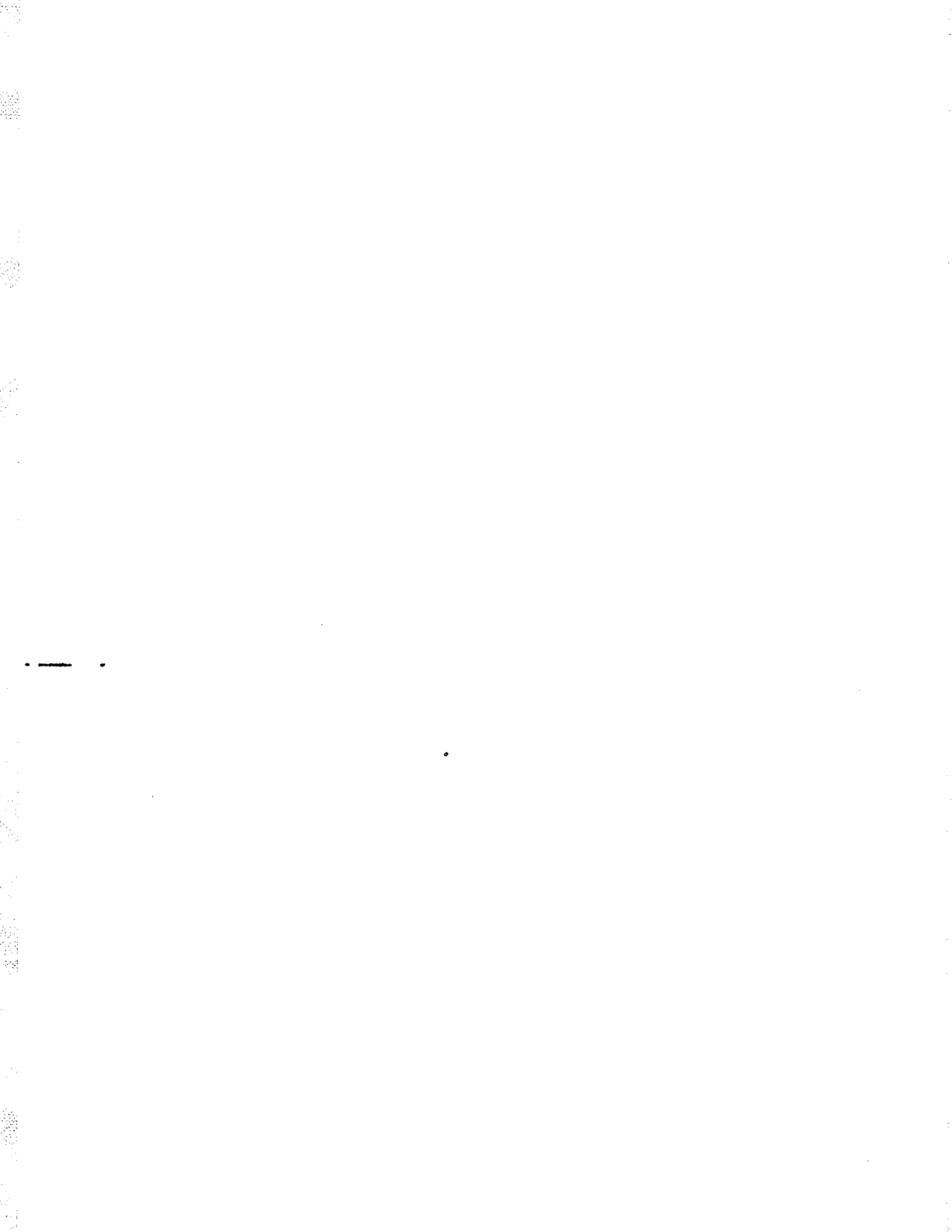
1) **Death:** In case of death of a shareholder the shares are transmitted to an executor or administrator. If the shareholder had made a will in his life time, it is the executor named in the will who is entitled to the shares. In the absence of a such a will, shares are transmitted to the administrator who happens to be the nearest relation of the deceased.

2) **Insolvency:** If a shareholder is declared bankrupt by a court of law, his shares are transmitted to the official receiver appointed by the court to sell the property of the bankrupt and apply the proceeds towards discharge of his debts.

3) **Lunacy:** When a shareholder is declared a person of unsound mind (lunatic) his shares are transmitted to his legal representative as decided by a court.

Procedure of Transmission:

1) The legal representative of the shareholder has to make a request to the company to register his name as a member.
2) He has to enclose the relevant share certificate and the succession certificate with his application.
3) The legal representative has to paid estate duty on the property of the deceased shareholder.
4) Board of the directors of a company passed resolution for transmission of shares.
5) After the approval by the board, the company secretary deletes the name of deceased member and in its place enters the name of the legal representative in the register of the members.
6) If the shares are partly paid up, then the calls are made



Corporate Law

III - Sem. B.Com II 'A' 'B' 'C' 'D' 'E'

- Bansode S. D.

Chapter 1.

★ Multiple Choice Questions (MCQ):

1. Which of the following statements is correct?

   (a) The Companies Act, 1956 extended to the whole of India.

   (b) The Companies Act, 1956 extended to the whole of India except the State of Jammu and Kashmir.

   (c) The Companies Act, extended to those states which give their consent in writing to the Central Government.

   (d) None of the above.

2. The date on which the Companies Act, 1956 came into force is ...

   (a) 31st March, 1956 **(b) 1st April, 1956**

   (c) 31st March, 1957 (d) 1st April, 1957

3. The history of the Indian Company Law dates back to the year ...

   (a) 1850 (b) 1908 (c) 1913 (d) 1956

4. The privilege of limited liability was introduced in the Indian Company Law, in the year of ...

   (a) 1850 **(b) 1857** (c) 1927 (d) 1956

5. A company having main office in one country but carrying on

business activities in different countries is known as a ...

(a) foreign company (b) folding company

(c) subsidiary company **(d) multinational company**

6. Which of the following is not the characteristic of a public company?

   (a) It has a separate legal entity.

   (b) It has a perpetual succession.

   (c) It has a common seal and separate property.

   (d) Its shares are non-transferable.

7. A statutory company/corporation is incorporated by ...

   (a) An Act of Parliament (b) An Act of State Legislature

   (c) Under the Companies Act,1956 **(d) Either (a) or (b)**

8. A government company is one in which 51% or more of the paid up share capital is held by ...

   (a) Central Government alone (b) State Government alone

   (c) Central and State Governments jointly **(d) any of the above**

9. A private company is deemed to be a public company under Section 43A of the Companies Act when its annual turnover is ...

   (a) Rs.5 crores (b) Rs.10 crores (c) Rs.20 crores **(d) Rs.25 crores**

10. The management of a joint stock company is vested with ...

    (a) Chairman (b) Shareholder

    (c) Board of Directors (d) Secretary

11. Registration of a joint stock company is ...

    (a) optional **(b) compulsory** (c) advantageous (d) unnecessary

12. A joint stock company has a high ...

    (a) tax liability **(b) capital raising power**

    (c) flexibility (d) profitability

13. A joint stock company suffers from ...

    (a) paucity of funds **(c) lack of managerial expertise**

    (b) limited liability (d) excessive legal control

14. In a private company the maximum number of members is ...

    (a) ten (b) twenty (c) thirty **(d) fifty**

15. The minimum number of members for Public Ltd. Company is ...
    (a) two (b) seven (c) ten **(d) eleven**
16. A company limited by guarantee is formed for ... purposes.
    (a) trading (b) political **(c)non-trading** (d) speculative
17. The minimum number of Directors in a public limited company is ...
    (a) three (b) five (c) ten (d) two
18. A public company can start its business only when it gets ... .
    (a) the Certificate of Incorporation
    (b) the Certificate to Commence Business
    (c) minimum subscription from shareholders
    (d) permission from the Central Government
19. A company incorp. under a special Act of Parliament is called a ...
    (a) government company (b) registered company
    (c) statutory company (d) chartered company
20. A company incorporated in England under special Royal Charter issued by the King was called ...
    (a) statutory company **(b) chartered company**
    (c) registered company (d) unlimited company
21. A government company is the one in which the share capital contributed by the government is not less than ...
    (a) 25% (b) 40% **(c) 51%** (d) 35%
22. In a non-profit-making company without share capital, the liability of its members is ...
    (a) limited by shares **(b) limited by guarantee** (c) unlimited (d) nil
23. A ... company restricts the right of members to transfer his shares.
    (a) public **(b) private** (c) statutory (d) chartered
24. A private company must have at least ... Directors / Members.
    (a) two (b) three (c) seven (d) ten
25. The Securities and Exchange Board of India is established in ...
    (a) 1918 (b) 1978 **(c) 1988** (d) 1992

☆☆☆

Chapter 2.

★ Multiple Choice Questions (MCQ):

1. A company comes into existence, when ...

   (a) After getting certificate of Incorporation.

   (b) the 'memorandum of association' is submitted for registration

   (c) it is registered under the Companies Act, 1956.

   (d) it establishes its registered office and starts functioning therefrom.

2. If at the time of registration, a company limited by shares does not file articles of association with the Registrar, then ...

   (a) The company cannot be registered without this document.

   (b) The company is deemed to have adopted 'Table A'

   (c) The company is deemed to have become a company with unlimited liability.

   (d) The directors become liable to be punished with fine at the rate of Rs. 50 for each day during which the default continues.

3. On 14th July, the Registrar of Companies issued a certificate of incorporation, but it was dated 10th July instead of 14th July. From which date the company will legally come into existence?

   (a) 10th July (b) 14th July (c) 31st July (d) None of These

4. A public company having a share capital can start its business on obtaining ...

   (a) Certificate of incorporation and approval of Company Law Board.

   (b) 'Certificate of statutory declaration.

   (c) 'Certificate to commence business'.

   (d) Approval of High Court.

5. The company is said to have come into being ...

   (a) when the Registrar issues the Certificate to Commence Business.

   (b) when the Registrar issues the Certificate of Incorporation.

   (c) when the issued capital is fully subscribed.

   (d) when the Central Government gives permission.

6. The decision for getting the shares listed on the stock exchanges is to be taken by the ...

   (a) Secretary (b) Promoters **(c) Board of Directors** (d) SEBI

7. The person who discovers the idea of business opportunity is called ...
   (a) Promoter (b) Secretary (c) Chairman (d) Director
8. A private company cannot start its business till it gets ...
   (a) the Certificate to Commence Business
   (b) the Certificate of Incorporation
   (c) the minimum subscription
   (d) sanction from the Central Government
9. A company cannot make allotment of shares unless ...
   (a) the prospectus is filed.
   (b) the minimum subscription is collected.
   (c) the subscribed capital is fully collected.
   (d) permission is obtained from the Stock Exchange.
10. The minimum subscription is guaranteed by ... .
    (a) a shareholder (b) banks **(c) underwriters** (d) promoters
11. If the company cannot obtain the minimum subscription within ... days from the date of issue of the prospectus, the application money will have to be refunded.
    (a) 30 **(b) 60** (c) 90 (d) 120
12. If a company fails to commence business within ... of its incorporation, the court may order for the winding-up of the company.
    (a) 3 months (b) 6 months (c) 9 months **(d) A year**
13. A public company cannot start its business till it gets ...
    (a) the Certificate to Commence Business.
    (b) the Certificate of Incorporation.
    (c) the minimum subscription.
    (d) sanction from the Central Government.

☆☆☆

Chapter 3.

detailed study.

★ Multiple Choice Questions (MCQ):

1. The Registered Office Clause of memorandum of association contains ...

   (a) the name of the State in which the registered office of the company is to situate.

   (b) the name of the city/town only and not that of the State.

   (c) the name of Registrar of Companies.

   (d) the complete postal address.

2. The capital with which the company is registered is called the

   (a) Subscribed capital **(b) Nominal or authorised capital**

   (c) Working Capital (d) none of these

3. The procedure for change of registered office from one city to another within the same state is by passing

   (a) ordinary resolution and approval of Company Law Board.

   (b) special resolution and approval of Central Government.

   (c) ordinary resolution only

   (d) special resolution only.

4. The procedure for alteration of the object clause of memorandum is by passing

   (a) special resolution and confirmation of the Company Law Board.

   (b) special resolution and confirmation of the Court.

   (c) special resolution only. (d) ordinary resolution only.

5. For which of the following companies it is not obligatory to have articles of association?

   (a) Public companies limited by shares,

   (b) Public companies limited by guarantee,

   (c) Private limited companies.

   (d) Unlimited companies.

6. The general procedure for alteration of articles of association is by passing ...

   (a) special resolution. (b) ordinary resolution.

   (c) special resolution and approval of CLB

   (d) ordinary resolution approval of court.

7. A prospectus is required to be issued to the public, within

   (a) 30 days after the copy of prosopectus is filed with the Registrar.

   (b) 60 days after the copy of prospectus is filed with the Registrar.

   (c) 90 days after the copy of prospectus is filed with the Registrar.

   (d) 90 days after the copy of prospectus is filed with the CLB.

8. The constitution of a company is described by its ...

   (a) Articles of Association **(b) Memorandum of Association**

   (c) Prospectus (d) Bye-laws

9. No company under the Companies Act can be registered without ...

   (a) Its Articles of Association

   (b) Its Memorandum of Association

   (c) Its Prospectus

   (d) The approval of the Central Government

10. An act ultra vires the Memorandum of Association is ... ...

    (a) wrong **(b) valid** (c) void (d) illegal

11. The ... clause in the Memorandum of Association defines the boundaries for the activities of the company.

    (a) Name (b) Domicile (c) Capital **(d) Objects.**

12. Articles of Association is a ... document.

    (a) principal **(b) subordinate** (c) fundamental (d) redundant

13. The Articles of Association defines the relationship between the company and its ...

    (a) members (b) outsiders (c) creditors (d) debtors

14. ... is almost an unalterable document of the company.

    (a) Memorandum of Association

    (b) Articles of Association

    (c) Prospectus

    (d) Statement in lieu of Prospectus

15. The rules regarding the internal management of the company are given in ...

    (a) Memorandum of Association

    (b) Articles of Association

    (c) Prospectus

    (d) Statement in lieu of Prospectus

16. The Domicile Clause of the Memorandum of Association mentions the ... of the company.

    (a) head office (b) nationality

    (c) place of business **(d) registered office**

17. A ... company need not file a Prospectus or Statement in lieu of Prospectus with the Registrar.

    (a) public **(b) private** (c) government (d) statutory

18. ... may be called a silent salesman of the shares and debentures of a company.

    (a) A Memorandum of Association (b) Articles of Association

    (c) A Prospectus (d) A Statement in lieu of Prospectus

19. Unlimited companies do not mention the ... clause in the Memorandum of Association.

    (a) Liability (b) Name (c) Domicile (d) Objects

20. Statement in lieu of Prospectus is prepared for the purpose of ... ..

    (a) Publicity (c) invitation to the public to buy shares

    (b) issue of shares **(d) filing with the Registrar of Companies**

☆☆☆

Chapter 4, 5.

... (MCQ).

1. The company can consolidate its shares into shares of larger amount, and sub-divide its shares into shares of smaller amount by passing ...

   (a) ordinary resolution.

   (b) ordinary resolution and confirmation of court.

   (c) special resolution.

   (d) special resolution and confirmation of court.

2. The procedure for reduction of share capital is by passing a special resolution and obtaining confirmation of

   (a) Company Law Board. **(b) Court**

   (c) Central Government (d) SEBI

3. The power of rectification for register of members vests with the ...

   (a) Court **(b) Company Law Board**

   (c) Central Government (d) Board of Directors.

4. Which of the following statements is correct?

   (a) A debenture-holder does not have any right to vote at any meeting.

   (b) The company cannot issue irredeemable debentures.

   (c) The debentures can also be redeemed at discount.

   (d) The redeemed debentures cannot be issued again by the company.

5. The company must maintain a register of debenture-holders, if the number of company's debenture-holders exceed ...

   (a) 30 (b) 40 **(c) 50** (d) 60

6. The person who holds shares of a company is a ...

   (a) Member (b) Director **(c) Shareholder** (d) Chairman

7. The rights of members of a company are to be found in the ...

   (a) Memorandum of Association (b) Articles of Association

(c) Register of Members **(d) Companies Act**

8. A ... has a right to appoint proxy on his behalf to attend and vote at the General Meetings of a company.

   (a) Shareholder (b) Chairman (c) Director **(d) Member**

9. The ... has a right to attend and vote at the General Meetings of a company.

   (a) Member (b) Secretary (c) Auditor (d) Solicitor

10. A person becomes a member of a company when ... ...

    (a) he agrees in writing to buy shares.

    (b) he buys shares.

    (c) he inherits the shares of a deceased member.

    (d) his name is entered in the Register of Members.

11. Membership of a person in a company comes to an end when ...

    (a) his shares are forfeited for non-payment of calls.

    (b) the share certificate is lost. (c) he dies.

    (d) he becomes insolvent.

12. An index of members must be maintained by a company when its membership exceeds ...

    (a) 20 **(b) 50** (c) 75 (d) 100

13. A person who is a subscriber to the Memorandum of Association of a company is called a ...

    (a) Shareholder **(b) Member** (c) Director (d) Manager

14. Every person domiciled in India will be a major when he completes ... years of age.

    (a) 16 (b) 20 **(c) 18** (d) 25

15. ... of shares means voluntary return of shares by a shareholder to the company for cancellation.

    (a) Forfeiture **(b) Surrender** (c) Transfer (d) Transmission

☆☆☆