1. The government carried out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.

2. The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed *linkage* between the public enterprises on the one hand and the capital market on the other.

3. The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding.

4. The Department of Public Enterprise and the Finance Ministry adopted techniques and methods which resulted in far lower realisation than justified.

On account of all these reasons, ***there was considerable "under-pricing" of public enterprises shares resulting in considerable loss to the government.*** To illustrate, consider the under pricing in the first two rounds. In Report No. 14 of 1993, the Comptroller and Auditor General of India pointed out that in these two rounds, the extent of loss to the government in percentage terms varied from 127 per cent in the case of HPCL (its share having been sold for Rs. 243 against the market price of Rs. 550) to as high as 616 per cent in the case of NLC (its share having been sold for Rs. 11 against the market price of Rs. 82). The average loss consequent upon the underpricing comes to about 256 per cent. If we apply this percentage to the divestiture proceeds for 1991-92 and 1992-93 we find that the potential proceeds would have been Rs. 12,554 crore as against the actual realisation of only Rs. 4,951 crores The same problem of underpricing continued in later rounds also.

Utilisation of Money from Disinvestment

As shown above, the public sector equity has been sold for a fraction of what it could actually fetch. However, this is only one part of the story .The entire manner in which the proceeds from disinvestment have been used is objectionable. When the programme of disinvestment was initiated in 1991-92, the Finance Minister had stated that a part of the proceeds would be used for providing resources in the NRF (National Renewal Fund) which can be used for various schemes of assistance to workers in the unorganized sector. Moreover, these "non-inflationary resources would also be used to fund...special employment creating schemes in backward areas". Similar sentiments were expressed in various Budget Speeches of the Finance Ministers in different years. However, the actual experience with the utilisation of disinvestment proceeds during the last decade and a half belies all these declarations. ***The government has used the entire proceeds from disinvestment to offset the shortfalls in revenue receipts and thus reduce the fiscal deficit. Thus the resource generated from the disinvestment of PSUs have been used to meet current consumption needs. This amounts to frittering away of valuable public assets. It is like selling family silver to support a profligate lifestyle.*** Moreover, once a PSU is privatised, the government is deprived of the future yields from this enterprise. This could be a large long-term loss in the case of profit generating PSUs. This points to the shortsightedness of the government's disinvestment programme.

Others Criticisms of Privatisation

1. It is often assumed that following privatisation, markets arise quickly to fill up the gap whereas the fact is that many government activities arise because markets have *failed* to provide essential services. As stated in Chapter 33 many PSUs were set-up in India in the post-Independence period in those fields in which the private sector was either not able to set-up units because of paucity of resources or was simply not interested because of the long gestation period and/or low profit generation possibilities. As argued by C.P. Chandrasekhar and Jayati Ghosh, "Public sector enterprises are not pure profit-making machines, but instruments used by governments to achieve a range of objectives. These could vary from closing infrastructure gaps that may remain if investment was purely private to ensuring access to products crucial to development at appropriate prices. This would imply that investments are made even in areas where profits are low or non-existent because of the external benefits such projects deliver or that profits are foregone in order to keep prices down in pursuit of other objectives. To ignore such possibilities and make profits, which contribute non-tax revenues to the government, the sole reason for establishing PSUs, is to conceal the actual grounds on which public capital formation has occurred in post Independent India or elsewhere in the world."[6]

2. One of the genuine fears of labour is that ***privatisation is bound to result in unemployment.*** Most of the privatisation experiments around the globe are testimony to the fact that this indeed does happen. The Government of India has been repeatedly harping on the tune that as a result of privatisation there has only

been a 'marginal' retrenchment of labour.[7] However, the fact of the matter is that there is a strong pressure from the corporate sector to 'reform' labour laws to enable it to hire and fire workers as it wishes and indications are that the government is falling in line. This means that the future employment scenario for labour is a cause of worry. The fear of retrenchment and consequent unemployment is all the more as there is no safety net scheme for labour worth the name. Moving people from low-productivity jobs in State enterprises to unemployment does not increase a country's income, and it certainly does not increase the welfare of the workers.

The above dangers are all the more serious in those cases where a PSU is sold to a foreign company as the latter will be more interested in maximising the stock market value for its shareholders rather than worrying about the interest of local labour.

3. ***At times, sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly.*** In such cases, inefficiencies and monopoly power will merely be transferred to the private sector, with the costs being borne by the consumers. Or, "monopolistic exploitation by efficient private owners replaces the inefficiencies of public ownership."[8] This danger is particularly present in the case of public utilities. For example, in Cochabamba, Bolivia's third largest city, water supply was privatised and sold to a foreign consortium Aguas del Tunari in 1999. The consortium resorted to huge increases in tariffs and at the same time, put restrictions on the use of water. This caused widespread resentment provoking riots. As a result, the government had no option but to put an end to the contract.

4. We have already discussed the issue of undervaluation of assets of PSUs earlier. Such ***undervaluation points to the prevalence of widespread corruption on the one hand, and complicity between sections of the government and particular business groups on the other hand (in the case of strategic sales).*** In this context, the comments of Joseph Stiglitz are pertinent, "Perhaps the most serious concern with privatisation, as it has so often been practiced, is corruption. The rhetoric of market fundamentalism asserts that privatisation will reduce what economists call the "rent-seeking" activity of government officials who either skim off the profits of government enterprises or award contracts and jobs to their friends. But in contrast to what it was supposed to do, privatisation has made matter so much worse that in many countries today privatisation is jokingly referred to as "briberisation". If a government is corrupt, there is little evidence that privatisation will solve the problem. After all, the same corrupt government that mismanaged the firm will also handle the privatisation."[9]

5. One of the important arguments in favour of privatisation of PSUs is the belief that this would improve their performance. However, some critics have pointed out that there is no positive relationship between ownership and performance. Therefore, according to them, the belief that privatisation, by itself, leads to better performance is questionable. For instance, Pranab Bardhan and John E. Roemer state: "Our claim is that competitive markets are necessary to achieve an efficient and vigorous economy, but that full-scale private ownership is not necessary for the successful operation of competition and markets."[10] The experience of China shows that to improve the efficiency of inefficient units it is necessary to create competitive market structure. ***It is a competitive environment, rather than ownership, that promotes allocative efficiency.***

NOTES

1. Bimal Jalan, *India's Economic Policy* (New Delhi, 1996), p.31
2. Statement on Industrial Policy, 1991, reproduced in Government of India, *Handbook of Industrial Policy and Statistics, 2001,* pp.12-13.
3. Anil K. Makhija, "Privatisation in India", *Economic and Political Weekly.*. May 20, 2006, pp. 1948-9.
4. Suresh D. Tendulkar and T.A. Bhavani, *Understanding Reforms-Post* 1991 *India,* (New Delhi, 2007), p. 136.
5. Sunil Mani, "Economic Liberalisation and the Industrial Sector," *Economic and Political Weekly,* May 27, 1995, p. M-45, Table 7 on p. M-41 and Table 8 on p. M-42.
6. C.P. Chandrasekhar and Jayati Ghosh, *The Market That Failed : A Decade of Neoliberal Economic Reforms in India* (New Delhi, 2002), p. 95.
7. Government of India, *Economic Survey, 2002-03* (Delhi, 2003), p. 150.
8. UNDP, *Human Development Report,* 1993 (New York, 1993), p. 49.
9. Joseph Stiglitz, *Globalization and Its Discontents* (The Penguin Press, 2002), p. 8.
10. Pranab Bardhan and John E. Roemer, "Market Socialism: A Case for Rejuvenation," *Journal of Economic Perspectives,* Vol. 6, No.3, 1992.

CHAPTER

36 MODERN CORPORATIONS AND THE INDIAN COMPANY LAW

Modern Corporations
- The Basic Characteristics of Big Corporations

The Company Law
- Governing Act : The Companies Act, 1956 • Administration of the Companies Act, 1956 • What is a Company?
- Characteristics of a Company

Types of Companies
- According to the Mode of Incorporation • On the Basis of Number of Members • On the Basis of Liability of Members
- According to Ownership of the Company • According to Nationality of the Company • According to Control of Management

Formation of A Company
- Memorandum of Association • Doctrine of Ultra Vires • Articles of Association

Raising of Capital
- Prospectus • Share Capital • Borrowing and Debentures

Management and Administration
- Directors • Managing Director • Manager • Secretary

Meetings and Resolutions
- Company Meetings • Resolutions

Winding-up of Companies

Joint stock company which is also known as corporation is the nucleus of all business activities in the modern economy. In the earlier phase of the development of the capitalist system the government rarely granted permission for the setting up of corporations. Now-a-days in all capitalist countries a joint stock company or a corporation can be easily established under the Companies Act and thus corporation has become the most important industrial unit. However, all corporations do not enjoy an equal measure of power. Whether it is a developed capitalist country like the USA or an underdeveloped country like India, every where the major chunk of capital is in the hands of a few giant corporations who are in a position to exercise considerable control over industrial production and its sale.

MODERN CORPORATIONS

In the modern capitalist system there is no longer any place for the type of capitalist found during the eighteenth and the nineteenth centuries who besides exploitation used every kind of stinginess to accumulate capital and thereby expanded his business. In the words of Paul A. Baran and Paul A. Sweezy, ***"The real capitalist today is not the individual businessman but the corporation. What the businessman does in his private life, his attitude towards the getting and spending of his personal income—these are essentially irrelevant to the functioning of the system. What counts is what he does in his company life and his attitude towards the getting and spending of the company's income."***[1]

In the capitalist economy, the process of capital accumulation has become institutionalised ever since the

place of individual capitalist has been taken over by the corporation capitalist. The primary function of the capitalist is the accumulation of capital through which the economy gains a momentum. The corporation which is an integral part of the capitalist economy of today is not an enlarged version of the sole proprietor found in the incipient stage of capitalism. In spite of the fact that just like the sole proprietor of earlier times ***the modern corporation too tries to maximise its profits and in order to achieve this, does every possible thing to accumulate more capital, it differs from individual capitalist in two important respects:***

(*i*) ***The life span of the corporation is much bigger than that of the individual capitalist, and***
(*ii*) ***The corporation is more rational in its decision making.***

The life span of the corporation is long not just from a legal point of view. The main reason which explains its long life span is the large amount of capital which it has and which is invested in such a complex manner that there is not much room left for transferring it from one avenue to the other. As far as rationality in decision making by corporations is concerned, it can be explained by the help which they get while taking decisions from the principles of cost accounting and budget analysis, data collection and processing and managerial consulting.

The Basic Characteristics of Big Corporations

The long life span and rationality in decision making by the modern giant corporations have led to emergence of two important characteristics in their outlook and behaviour:

(*i*) ***to undertake efforts to guard themselves in a planned manner against elements of risk, and***
(*ii*) ***to avoid competing with other members of the corporate world.***

As far as the risk element is concerned, the capitalists belonging to the earlier phase of capitalism did not even have the ability to assess the degree of risk faced by them. In fact, they also lacked the habit of assessing in advance the extent of risk they had to deal with. Moreover, the sole proprietors due to their short life span were in a great hurry to move up the economic ladder. Modern corporations on the other hand, because of their much longer life span, never feel such an urgency. They take decisions only after analysing the data related to their branch of activity. It is this reason why a modern corporation is neither an inventor or innovator like the earlier individual capitalist. T.K. Quinn, a former Vice President of General Electric states, "I know of no original product invention, not even electric shavers or heating pads, made by any of the giant laboratories or corporations, with the possible exception of the household garbage grinder...The record of the giants is one of moving in, buying out and absorbing the small creators."[2]

The giant corporations treat other important members of the corporate world with adequate respect. As a matter of fact, while they are forever trying to destroy the small producers, they usually do not compete among themselves. This phenomenon is explained by the fact that when in an industry, three or four large companies control more than 50-60 per cent of the total output, then every company is well placed to avenge others. In such a situation the companies find it in their own interest to adopt the policy of co-respect in place of competition.

From a legal point of view it is the shareholders of a modern big corporation who are its rightful owners. Of the many lakh shareholders of a big corporation more than half of them have on an average only 15 to 20 shares. Very often the people who have less than 1,000 shares do not even care to go to attend the annual meeting of shareholders. In fact, a handful of people who own 15-20 per cent of the total shares control the functioning of the company. Generally in the USA, a small group which has about 20 per cent of the shares of the company exercises complete control over the corporation while the majority of shareholders remain unorganised and indifferent and are therefore not in a position to do anything. In this way, ***a corporation is invariably in the hands of a few persons and carries on its day to day management with the help of trained people. According to J.K. Galbraith, a fully developed firm of today uses it techno-structural capabilities to shape the consumer demand in line with its production pattern.*** This has affected the capitalist economy by changing its centres of economic and political power. In order to alter consumer demand in accordance with the kind of goods produced by it, the corporation finds it necessary to win over the trust of the people and influence their demand pattern with the help of services rendered by experts in the fields of technology, planning and organisation. In other words, the modern giant corporation desiring to maximise its profits has brought into use its massive size to destroy the sovereignty enjoyed by the consumer in the past.

J.A. Schumpeter has been an ardent admirer of big corporations. According to him, the standard of living of the people improved mainly during the period when the big business was completely unfettered. However, Paul A. Samuelson differs from this viewpoint and contends that ***improvements in productivity are generally***

brought about in an environment of competition. Also, most fundamental inventions have come about through the efforts of people in their individual capacity and small companies.

Nowadays the activities of big corporations are looked upon with suspicion and are also criticised. In a large number of countries there is a demand for regulating the activities of big corporations. The big companies have now been acquiring a multinational character. Galbraith maintains that big industrial units are part of American life. However, the socio-cultural system of that country has generated certain forces to keep the power of such units under control. Galbraith has termed these forces countervailing powers.

THE COMPANY LAW

Gonverning Act : The Companies Act 1956

The Companies Act, 1956 became operative with effect from April 1,1956. This Act presents the whole body of the company law. The Act contains 658 sections and XV Schedules and numerous forms. The Companies Act, 1956 is both a consolidating and amending Act. It provides for the formation of company, and states powers and responsibilities of the directors and managers. The Companies Act also provides for raising of capital, management and administration of company, holding company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and regulating and winding up of companies in India.

The Companies Act 1956 applies to the whole of India and to all types of companies whether registered under this Act or an earlier Act. The Companies Act, 1956 has been drastically amended by the Companies (Amendment Act, 2000), the Companies (Amendment) Act 2001, and Companies (Amendment) Act 2002. According to these amendments subtantially new provisions have been inserted into the Indian Companies Act, 1956, a number of provisions have been entirely omitted or have been amended.

Administration of the Companies Act, 1956

The Central Government has been entrusted with the responsibility for overall administration of the Companies Act. It acts through the department of company affairs. With a view to ensuring greater efficiency in day-to-day administration of the Companies Act, an administrative authority namely the Board of Company Law Administration, popularly known as ***the Company Law Board was set up in 1964 by the Central Government.*** The Company Law Board is a quasi-judicial body. It has been vested with powers and functions which are judicial and administrative in nature. Most of the routine functions of the Company Law Board are performed by the Registrar of Companies who is appointed in each State. The Company Law Board has set up regional offices at Mumbai, Chennai, Kolkata and Kanpur. The Regional Directors and Registrars of companies at various places function under the control of the Company Law Board.

What is a Company?

We have discussed the basic characteristics of a modern corporation and its role in the present day capitalist economy. Now we venture to define company in a legal sense and explain its characteristics. We shall also discuss the classification of companies.

Haney has given a precise legal definition of a company. He states, "A company is an incorporated association, which is an artificial person created by law, having a separate entity with a perpetual succession and a common seal."[3] Justice Lindley's definition of a company is both clear and comprehensive. In his words, "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."[4]

The Companies Act, 1956 states that a company means a company formed and registered under the Act or an existing company *i.e.* a company formed and registered under any of the previous company laws. This definition of a company has been amended by the Companies (Amendment) Act 2000. Prior to amendment of 2000, certain private companies were considered to be deemed public companies on the basis of their shareholding pattern or turnover. But the Companies (Amendment) Act 2000 dropped the provision of recognising deemed public companies.

Thus we may define a company as follows :

Company is a voluntary association of persons formed for the purpose of doing business, having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from those of the members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession.[5]

Characteristics of a Company

From the above definitions, the following characteristics of a company emerge:

1. Incorporated association. ***A company is legally required to be incorporated or registered under the prevalent Companies Act of the country.*** Under Section 11 of the Indian Companies Act, registration is compulsory for all the associations or partnerships having more than 20 persons formed to carry on any business (10 in the case of banking business) with an object of making profits.

2. Artificial legal person. A company does not possess physical attributes of a natural person. It is created by a legal process and thus exists only in the eyes of law. It is thus invisible and intangible and has no body, no soul and no conscience. However, for legal purposes a company is a legal entity just like a natural person and has rights and duties at law. The Supreme Court of India has aptly defined the legal status of a company in the following words:

"The corporation in law is equal to a natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and can be sued exclusively for its own purpose; the liability of the members or shareholders is limited to the capital invested by them, similarly the creditors or the members have no right to the assets of the corporation."[6]

3. Common seal. ***Since company is an artificial person, it cannot sign documents for itself.*** It functions through natural persons who are usually directors. However, a company having a legal entity is bound by those documents which are signed by the company CEOs and carry the seal of the company. Use of common seal is a legal requirement. Under the Indian Companies Act, any document bearing the common seal of the company and duly witnessed by at least two directors of the company is legally binding on the company.

4. Perpetual existence. ***A company's existence is stable. Its life does not end with the retirement, insolvency or death of any or all director(s) or shareholder(s).*** The perpetual existence of the company is preserved by the provision for transferability of shares in case of a shareholder who wants to drop out and also for transmission of shares to the successor(s) in case a shareholder dies. L.C. Gower while referring to an interesting case states, "During the war all the members of one private company, while in a general meeting, were killed by a bomb. But the company survived : not even a hydrogen bomb could have destroyed it."[7] ***A company's existence depends on law. Law creates a company and only law can dissolve it.***

5. Limited liability. ***Although law provides for creating a company with unlimited liability,*** the companies with limited liability are most common. The limited liability implies that the liability of the shareholders is limited to the amount unpaid on their shares irrespective of the debt obligations of the company. This implies that even in cases when a company suffers heavy losses and incurs large debt obligations, the personal property of the shareholders cannot be seized for repaying the debts of the company, provided shares are fully paid up.

6. Transferability of shares. ***Shareholders of a public company can freely transfer their shares to whomsoever they like without seeking permission*** from the company. In private company there are some restrictions on the right to transfer shares under Section 3 (1) (*iii*) of the Companies Act. But absolute restriction on the right of the members to transfer shares laid down in the company's Articles of Association shall be void.

TYPES OF COMPANIES

Companies are classified from different points of view. The most common classifications are as follows:

- **According to the Mode of Incorporation**
  1. Statutory company
  2. Incorporated or registered company
- **On the Basis of Number of Members**
  1. Private company
  2. Public company

- **On the basis of Liability of Members**
  1. Companies limited by shares
  2. Companies limited by guarantee
  3. Unlimited companies
- **According to Ownership of the Company**
  1. Private sector company
  2. Government company
- **According to Nationality of the Company**
  1. Domestic company
  2. Foreign company
- **According to Control of Management**
  1. Holding company
  2. Subsidiary company

Types of Companies According to the Mode of Incorporation

Companies may be classified according to mode of their incorporation as: (1) Statutory company, and (2) Incorporated company.

1. Statutory company. A statutory company is incorporated by a Special Act passed by the legislature of the Centre or the State. Companies meant to carry on business of national importance are created in this way. In India, the RBI, State Bank of India, Unit Trust of India, Food Corporation of India and Life Insurance Corporation are some examples of statutory companies. These companies are governed by the provisions of the Special Acts under which they are formed. At the same time, such provisions of the Companies Act 1956 that are not inconsistent with the provisions of the Special Acts apply to them.

2. Incorporated or registered company. An incorporated or registered company is one that is registered under the Companies Act. All the Indian companies operating in this country except the statutory companies have been formed in this way. These companies are governed by the provisions of the Indian Companies Act, 1956. However, most of the operations of Electric Supply, Banking and Insurance Companies are governed largely by the provisions of their Special Acts—the Electric Supply Act, 1948, the Banking Regulation Act, 1949 and the Insurance Act, 1938, though these companies are incorporated under the Companies Act, 1956. The provisions of the Companies Act are applicable to these companies only to the extent they are not inconsistent with the provisions of the Special Act governing them.

Incorporated or registered companies may be further classified in two ways: (A) ***On the basis of number of members;*** and (B) ***On the basis of liability of members.***

Types of Registered Companies on the Basis of Number of Members

Registered companies on the basis of number of members may be classified as (1) private company, or (2) public company.

1. Private company. As per Section 3(1) (*iii*) as amended by the Companies (Amendment) Act, 2000, a private company is one which has a minimum paid up capital of Rs. one lakh or such higher paid up capital as may be prescribed. Such a company by its Articles of Association, (*i*) restricts the rights of the members to transfer shares, (*ii*) limits the number of members to fifty, (*iii*) prohibits any invitation to public to subscribe for any shares or debentures of the company, and (*iv*) prohibits invitation or acceptance of deposits from persons other than its members, directors or their relatives. Prior to amendment of 2000 in the Companies Act, certain private companies were regarded as deemed public companies. However, provision relating to deemed public companies was dropped in the Companies (Amendment) Act 2000. ***A private company can be formed by a minimum of two members.*** Such a company must add the word 'Private' to its name.

2. Public company. According to Section 3(1) (*iv*) as amended by the Companies (Amendment) Act, 2000, a public company is one that (*i*) is not a private company, (*ii*) has a minimum paid up capital of Rs. five lakh or such higher paid up capital, as may be prescribed, and (*iii*) is a subsidiary of a public company.

Elaborating clause (*i*) of the above definition, a public company is one which (*a*) does not have any restriction on transfer of shares, (*b*) does not restrict the maximum number of members, (*c*) can invite public to subscribe its shares and/or debentures, and (*d*) can invite and/or accept deposits from the public.

The public company must have a minimum of seven members.

Classification of Registered Companies on the Basis of Liability of Members

The Companies Act has provided for registration of three types of companies on the basis of liability of members: (1) companies limited by shares, (2) companies limited by guarantee, and (3) unlimited companies.

Each of these types of companies may be a 'public company' or a 'private company'.

1. Companies limited by shares. 'A company limited by shares' is one liability of whose members is limited by its Memorandum to the amount, if any, unpaid on the shares. Such a company is also known as limited liability company. This liability of members can be enforced any time during the company's existence or its winding up.

2. Companies limited by guarantee. A company having the liability of its members limited by its Memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up is termed 'a company limited by guarantee'. The amount guaranteed by each member cannot be demanded during the existence of the company.

3. Unlimited companies. 'An unlimited company' is one which has no limit on the liability of its members. This implies that the liability of each member extends to his or her personal property in proportion to his or her share in the capital of the company. The liability of a member is however enforceable even in this case only at the time of winding up of the company. An unlimited company may or may not have share capital.

Types of Companies According to Ownership of the Company

On the basis of ownership, companies are divided into (1) Private sector companies or non-government companies and (2) Government companies commonly known as public sector companies. We have already discussed private sector companies which are both private and public companies. These may be limited or unlimited liability companies.

As far as government company is concerned it is defined in Section 617 of the Companies Act as "any company in which not less than 51 per cent of the paid up share capital is held by the Central government or by any State government or governments or partly by the Central government and partly by one or more State governments and includes a company which is a subsidiary of a government company as thus defined."

A government company is to be registered under the Companies Act. It is incorporated either as a public or private company. The auditor of a government company is appointed by the Comptroller and Auditor General of India who has the power to direct the Company's auditor in matters relating to audit. A government company assumes the form of mixed enterprises where public alongwith government is allowed to subscribe to the capital of a company.

Types of Companies According to Nationality of the Company

On the basis of country of incorporation, companies are classified into (1) Domestic Companies, and (2) Foreign Companies. All companies incorporated in India, both in public and private sectors are domestic companies. In contrast, a foreign company is incorporated outside India but has a place of business in India.

A foreign company is required to furnish to the Registrar the following documents within 30 days of the establishment of the business in India:

1. A certified copy of the Charter, Statute, Memorandum and Articles of the Company, containing the constitution of the company.
2. The complete address of the Registered office of the company.
3. A list of directors and secretary of the company giving name in full, usual residential address, nationality, other business and particulars of other directorship(s) held by him/them.
4. The names and addresses of any person of persons resident in India authorised to accept notices and service or legal process on behalf of the company.
5. Full address of the office which is company's principal place of business in India.

The obligations of a foreign company in respect of accounts are almost the same as those of an Indian company.

Types of Companies According to Control of Management

Companies may be classified on the basis of control of management as (1) Holding companies and (2) Subsidiary companies.

Holding Company. Section 4(4) of the Companies Act defines a holding company. It states, "A company shall be deemed to be the holding company of another, if that other is its subsidiary."

Subsidiary Company. A company shall be deemed to be subsidiary of another company in the following cases:

(*i*) If one company controls the composition of the Board of Directors of another, the latter is a subsidiary company of the former.

(*ii*) If one company holds more than half of the shares in another company, the latter is considered to be the subsidiary company of the former.

(*iii*) If a company is subsidiary of some company which is subsidiary of another company, then the first mentioned company becomes a subsidiary of the last mentioned company.

FORMATION OF A COMPANY

Formation of a company is completed in four stages which are:

1. Promotion
2. Incorporation or Registration
3. Capital Subscription
4. Commencement of business.

In respect of a public company having a share capital, the process of formation involves all the four stages. However, for the formation of a private company or a public company not having any share capital only first two stages are relevant. These companies are entitled to commence business immediately after obtaining a certificate of incorporation.

1. Promotion. ***Promotion is the first stage in the formation of a company.*** It is defined by C.W. Gerstenberg as "the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits."[8] Any person who takes initiative and undertakes these functions is called promoter. For the formation of a company promotion work may be done by an individual, an association of persons, a firm or even a company.

2. Incorporation or registration. Any seven or more persons may form an incorporated public company for a lawful purpose, with or without liability. Two or more persons can form an incorporated private company. Before the registration of the company, it is desirable to find out from the Registrar of Companies if the proposed name of the company is approved.

If the name of the company is approved by the Registrar of Companies, the promoter may file the following documents duly stamped with the necessary fees with the former.

(1) The ***Memorandum of Association*** duly stamped and signed by the subscribers and witnessed.

(2) The ***Articles of Association*** properly stamped, duly signed by the subscribers to the Memorandum of Association and witnessed. A company with limited liability need not have its own Articles of Association. It may instead adopt Table A in Schedule 1 to the Act.

(3) The ***agreement,*** if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager.

(4) A ***list of the directors*** who have agreed to become the first directors of the company, their written consent to act as directors and take up qualification shares.

(5) A ***declaration*** stating that all the legal requirements of the Companies Act and other formalities precedent to incorporation have been complied with. Such declaration must be signed by any of the following persons:

(a) an advocate of the Supreme Court or a High Court; or

(b) an attorney or a pleader entitled to appear before a High Court; or

(c) a Secretary or a chartered accountant in whole-time practice in India who is engaged in the formation of the company; or

(d) a person named in the Articles as director, manager or secretary of the company.

The notice of address of the registered office of the company may be filed within 30 days of incorporation.

After satisfying himself that the statutory requirements regarding registration have been duly complied with, the Registrar of companies issues a 'certificate of incorporation.'

3. Capital Subscription. A private company or a public company not having share capital can start business immediately after the incorporation. However, in case of a public company having a share capital two more stages are to be covered before it can start business. These stages are ***'capital subscription stage'*** and ***'commencement of business stage'***.

The task of obtaining the necessary capital for the company comes under the capital subscription stage. The Securities and Exchange Board of India (SEBI) regulates the issue of capital to the public. The SEBI has laid down guidelines which a company wanting to raise capital from the public must comply with.

4. Commencement of business. A public company having a share capital and issuing a *prospectus* inviting the public to subscribe to its shares will file the following documents with the Registrar before it can get the certificate of commencement of business:

(*a*) The declaration that allotment up to minimum subscription has been made.

(*b*) The declaration that payment of application and allotment money by every director has been made.

(*c*) The declaration that there is no liability to repay any money to applicants for shares or debentures.

(*d*) The statutory declaration with the Registrar that the above requirements have been complied with.

A public company not issuing a prospectus to the public has only to file documents listed under points (*b*) and (*d*) alongwith a copy of 'the statement in lieu of prospectus'.

The Registrar after scrutinising these documents, if satisfied, shall issue a certificate certifying therein that the company can start business.

Memorandum of Association

The Memorandum of Association is a fundamental document from the point of view of the proposed company. Under Section 2 (28) of the Companies Act, "Memorandum means the Memorandum of Association of a Company as originally framed or as altered from time to time in pursuance of any previous company laws or of this Act."

The purpose of the Memorandum of Association is two-fold:

1. The prospective shareholders will know the purpose for which the company intends to use their money. It thus indicates the risk involved in making investment.

2. The outsiders dealing with the company shall know the objects of the company and thus decide whether the contractual relation in which they wish to enter with the company is within the objects of the company.

Section 13 of the Companies Act deals with the contents of the Memorandum of Association. The Memorandum must contain the following clauses:

1. The name of the company: With 'Limited' as the last word of the name in the case of public limited company and with 'Private Limited' as the last words of the name in the case of a private limited company.

2. The name of the State in which registered office of the company is situated. This is required in order to fix the domicile of the company.

3. The objects of the company are to be stated in a classified form as:

(*a*) the main objects of the company that it will pursue on its incorporation and objects incidental or ancillary to the attainment of the main objects; and

(*b*) other objects of the company which are not included in (*a*).

4. In case of companies other than trading companies with objects not confined to state in which it has the registered office, the states to which the objects extend.

5. The Memorandum of a company having limited liability either limited by shares or by guarantee must state that the liability of its members is limited.

6. In the case of a company having share capital, the Memorandum shall state the amount of the share capital with which the company is to be registered and the division thereof into shares of a fixed amount. The capital with which a company is registered is called registered or authorised capital of the company.

7. The Memorandum ends with the association clause which states that the subscribers whose names and addresses are given, desire to form the company and agree to take shares in it.

Doctrine of Ultra Vires

A company is legally entitled to do all such things as are essential to the realisation of its objects stated

in the Memorandum and authorised to be done by the Companies Act. The company may also do things which are fairly incidental to its objects. All other things are beyond the powers of the company and thus ultra vires. The doctrine of ultra vires implies that those transactions or acts not permitted under the Companies Act and are outside the ambit of the object clause shall be treated as beyond the legal authority and power of the company. The purpose of these restrictions is to protect investors in the company and also the creditors.

The doctrine of *ultra vires* may be summed up as follows:

1. When a transaction legal in itself but outside the ambit of the objects clause in the Memorandum is said to be *ultra vires* the company. Even the whole body of shareholders cannot rectify a transaction or an act *ultra vires* the company.

2. If an act is *ultra vires* the directors but within the scope and powers of the company, it can be ratified by the shareholders by passing a resolution in the general body meeting.

3. An act may be *ultra vires* the Articles of Association. Such an Act can be ratified by altering the Articles by a special resolution in a general body meeting.

Articles of Association

The Articles of Association also called just Articles are the rules, regulations and bye-laws relating to management of the internal affairs of the company. They are framed to carry out the objects as stated in the Memorandum of Association. The Articles are subordinate to the Memorandum and are thus next in importance to the latter. In framing the Articles of a company it is to be seen that regulations framed do not go beyond the provisions of the Memorandum and also do not violate the Companies Act.

The Articles of Association usually deal with the rules and regulations on the following matters:

1. The extent to which regulations contained in Table A in Schedule 1 to the Companies Act are applicable. Table A which is a model of 99 articles given in Schedule 1 automatically applies to a public company limited by shares if it does not get its own Articles registered. If a company gets its Articles registered but is silent on certain points, Table A will still apply automatically on all such points.
2. Share capital, rights of shareholders, variation of these rights, payments of commissions, share certificates.
3. Lien on shares, calls on shares, transfers of shares, transmission of shares, forfeiture of shares, conversion of shares into stocks, share warrants.
4. Alteration of capital.
5. General meetings and proceedings thereat, voting rights of members, proxis and polls.
6. Appointment, powers, duties, qualification and remuneration of directors.
7. Manager and secretary-appointments, powers, duties etc.
8. Dividends and reserves, accounts, audit and borrowing powers, capitalisation of profits.
9. Arbitration provisions, if any.
10. Winding up.

Companies have extensive powers to alter their Articles of Association. Section 31 states that a company may alter its Articles as often as required. Any clause in Articles which prohibits alteration in Articles is invalid because prohibiting changes in Articles of Association is contrary to the Companies Act. However, there are certain limitations on alterations in the Articles of Association. We state these limitations below:

1. Alteration must not be inconsistent with the Companies Act.
2. Alteration must not be inconsistent with the conditions contained in the Memorandum of Association.
3. Alteration must not sanction anything illegal.
4. Alteration must not be in conflict with the alteration ordered by the Company Law Board.
5. Alteration must be for the benefit of the company.
6. Alteration must not deprive any person his rights under a contract.
7. Alteration must not increase the liability of the company.
8. Alteration must not constitute a fraud on the minority.
9. Alteration can be made only by a special resolution.
10. Alteration may be with retrospective effect.

RAISING OF CAPITAL

A company needs capital in order to perform its activities. The capital is raised by a ***public company by***

issue of prospectus. A private company is prohibited from making any invitation to the public to subscribe for any shares and/or debentures of the company. Hence, private company does not issue a prospectus.

Prospectus

Section 2(36) defines a prospectus as "any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate."

Prospectus is essentially a window through which the potential investor can look into the soundness of the company venture. Hence the Companies Act directs the fullest disclosure of all material and essential particulars in a prospectus.

Section 56 lays down that every prospectus issued (*a*) by or on behalf of the company or (*b*) by or on behalf of an person engaged in the formation of a company, shall

(1) state the matters specified in Part I of Schedule II, and

(2) set out reports specified in Part II of Schedule II

These provisions will however be subject to the provisions contained in Part III of Schedule II.

Matters specified in Part I of Schedule II. The important contents of prospects under this head are—general information, capital structure of the company, terms and particulars of the present issue, history of the company, management, project and the company's future prospects, particularly in regard to the company and other listed companies under the same management, outstanding litigation and management perception of risk factors.

Reports specified in Part II of Schedule II. Under this head general information such as consent of directors, auditors, solicitors/advocates, managers to issue, Registrar of Issue, bankers to company, bankers to issue and experts, experts' opinion, authority for the issue and details of resolution passed for the issue and procedure and time schedule for allotment and issue of certificates is provided. In addition to general information, financial information in the form of report of the auditors and reports by the accountants are provided.

Statement in Lieu of Prospectus

A public company having a share capital may sometimes decide not to approach the public to secure the capital because it hopes to raise it privately. In such a case, the company may not issue a prospectus. Instead it will have to file 'a statement in lieu of prospectus' with the Registrar.

Requirements of SEBI. A public company is required to submit its offer document to SEBI before delivering it to the registrar. SEBI will issue its observation letter within 21 days which will remain valid for 365 days from the day it is issued.

Registration of Prospectus. A copy of the prospectus, before it is printed for mass circulation, is to be submitted to the Registrar for his approval. Every person who is named as a director or proposed director in the prospectus should sign the prospectus implying that he has given his consent to issues the prospectus. Within a period of ninety days from the date on which a copy of it is being submitted for the registration, the company has to issue the prospectus to the public.

Share Capital

Share capital refers to the capital raised by a company by the issue of shares. The word capital in connection with a company is used to mean ***authorised, issued and subscribed or called up, paid-up or reserve capital.***

Authorised capital is the nominal value of the shares which a company is authorised to issue by its Memorandum of Association.

Issued capital is the nominal value of the shares which are offered to public for subscription. It can never exceed the authorised capital.

Subscribed capital is that part of the issued capital which is taken up by the public.

Called up capital refers to that part of the capital which has been called.

Paid-up capital is that part of issued capital which has been paid-up by the shareholders.

Uncalled capital is the remainder of the issued capital which has not been called.

Reserve capital is that part of uncalled capital which can be called only in the event of the winding up of the company.