


Financial Accounting
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Lecture – 2
1.2 Company form of business

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The image shows a video lecture interface. On the left, a red rounded rectangle contains the text 'Financial Accounting' and 'Dr. Puran Singh' below it. In the top right corner, there is a circular logo with a star-like pattern and the text 'NPTEL' underneath. A black horizontal bar across the middle contains the text '1.2 Company form of business'. In the bottom right corner, there is a video feed of a man with a beard and glasses, wearing a white turban and a dark blue shirt. In the bottom left corner, there is a logo for 'Indian Institute of Technology Mandi' featuring a stylized building and the text 'Indian Institute of Technology Mandi'.

In this video, I am going to talk about the company form of business. Now the business can take different legal forms, but the company form is of more importance in this course because the discussion on recording, classifying and summarizing the transactions, is going to be discussed from the point of view of a company. So, let us look at the contents of this section.

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- 1.2.2 Types of Companies ✓
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The slide includes the Indian Institute of Technology Mandi logo and the NPTEL logo in the top right corner. A video inset in the bottom right shows a man with a beard and glasses, wearing a white turban, speaking.

We will discuss: what is a company? How do you distinguish it from the other forms of business? We will talk about different types of companies, we will specifically try to distinguish between private companies and public companies. And then, we will do a quick visual test: if you have to figure out if a given company falls into the category of private company or a public company, how would you do that? So, let us get started.

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1.2.1 What is a company?

Real Legal Person	Artificial Legal Person (Company)
→ Conceived by parents through a biological process	→ Conceived by promoters through a cognitive process
→ Child registration: Name, Gender, DoB, Parents name, address, Religion	→ Company registration: Name, Promoters, Date of registration, Address, Reason for registration
→ Cultural, Social Practices, Social Norms	→ <u>Mishra Anand</u>
→ Decision making by parents until adulthood	→ Decision making by promoters always
→ Can enter into contracts, can be sued	→ Can enter into contracts, can be sued
→ Transition into adulthood, decision making	→ Always dependent on promoters, management
→ Parents, Guardians, Relatives, friends, mentors	→ Shareholders, Board, Management, Employees
→ Law of the land	→ Companies Act 2013
→ Parent - Child issues	→ Agency problem: Shareholders - Managers
→ Ethnicity, Origin	→ Public sector company, Private sector company

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What is a company? Now, I would like to clarify this question, answer this question using an analogy of a real person and an artificial legal person. So, an artificial legal person is what the

company is. A company is an artificial legal person. You and I, on the other hand, are real legal persons. We are real persons and there is a legal identity we all hold like nationality, citizenship: we have an identity card to say we are a real person and so on. Can we distinguish between the two?

Using the analogy of a real person, I will try to illustrate to you why a company is called an artificial legal person. Now a real person is conceived through a biological process and analogical to that is an artificial legal person that is the company which is conceived by the parents who are called promoters through a cognitive process. All of us could become partners and if we want to start a business that is a cognitive process of thinking about the sector of the business, strategy for the business, where are we going to sell, marketing and all of that. So, it is a cognitive process taken by the promoters who set up the company.

Now when you have a child, you want to register the child so that it is recognized in the National Register of Citizens. So, you have to name your child, you have to tell the government: you go to a hospital, you do a birth registration. So, you have to tell them the gender, date of birth, parents name, address, religion, caste and there are many other details which are required to register an individual in a country. Similarly, the company will need to be registered, you give a name to the company and this name stays unique. It is registered, it is listed in a register of names of all the companies.

You tell them who the parents are- the promoters; then the company is registered then the company is born. The company has to have a registered address as well and the reason for registration. Now this is what is the difference between a real person and an artificial legal person. We also have to tell the government that this is why this artificial legal person is being created by the promoters. We will talk more about it as we move further.

Now, an individual, a real person, belongs to a culture, and follows some social practices. There are certain social norms, ethics and morals which you are bound by. You may or may not follow it, but there is a stated or unstated code of conduct which you have. Similarly for an artificial legal person, which is the company, you have a memorandum of association and articles of association. These are two detailed documents which tell anybody this is what the company is called, this is the objective of this company, these are the people who will run the company. So, all of that is in the memorandum of association.

Then in order to achieve the objectives given in the memorandum of association: how is the company going to function? How is the company going to make various decisions? Which person in the company is going to have, what power? All of that is presented in a document called article of association. Now do not worry about the details of these documents, I am only trying to contrast between the culture and social norms that a real person will have and those that an artificial legal person, the company, will have.

Decision making is done by parents till the time the real person is a minor; in case of a company you never call a company an adult or a minor - the decision making is done by the promoters, always. And there are more decision-making bodies which I will talk about in a bit. This individual once becomes an adult can enter into legal contracts, can enter into transactions, can start a business, can take admission in a school and college and so on. The person can be sued if this person does not follow the rules and regulations of the land or if he violates any cultural norms, social norms according to the laws of the land, the person can be sued. Similarly, an artificial, legal person, the company can also enter into contracts and can be sued.

Now, the person can transition into adulthood and then take the decisions for himself or herself. However, the company will always be dependent upon its promoters and the promoters can further hire a team of management which can take decisions on the behalf of the company. Company will never come to life; a company will never make its own decisions. It is an artificial legal person; the real person is going to drive the artificial legal person here.

Then for an individual, you have parents, you have guardians, you have relatives, friends, mentors; various parties interested parties who are interested in the good upbringing of this person: guiding this person, making sure the person succeeds. Likewise for an artificial legal person, you have shareholders. These are the people who invest money in the company. Your parents invest money in you know for education and everything in the beginning. Likewise, shareholders invest money in a company. Shareholders elect a board, as I said in the last video, to run the company. It is like a guardians of shareholders- then the board elects a management to run day to day operations of the company and then management further hires employees to do nitty-gritties, daily tasks, small things, big things in the company.

So, this is how the community of an artificial legal person is different from a real legal person. Then for a real, legal person, you have the law of the land. There are a number of laws regarding how you should behave, react, and so on. Likewise, there is a Companies Act for companies,

then there are, if you think a little bit further, parent-child issues, there are ego issues. Children grow up, parents have expectations all of that; all of us deal with that.

Likewise, there are issues between the shareholders, the promoters, the management and the employees of the company. These issues are given a name: agency problem. So, the agency problem basically states that you and I are investors in a company, but we do not run the company, the company is run by the management.

Now, management should ensure that the company is run as we expect it to be run like parents expect their children to behave and act and as per their desires or pick up a career of their choice. So, there is conflict in the families: likewise, there is conflict in companies as well. The conflict is called the agency problem. It is a big research area as well.

But I will not talk a lot about it. Here you have ethnicity and origin- a person comes from a specific community. It is born in a country; it has an origin, and all of those things likewise that you can relate to the ethnicity of a real person you relate to a company by it being either a public sector company or a private sector company. That is the kind of ethnicity of a company and I am going to talk about these two types of companies in more detail.

So, I hope through this analogy, you are able to understand what a company is as a legal person. It has an identity which exists in the eyes of law and the company has certain rights, it can do certain things- it can be sued and so on. Let me now talk about the ethnicities of companies.

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1.2.2 Types of Companies

Company

- Not Promoted by Government
 - Private Sector Company
 - E.g. RIL, Infosys, MakeMyTrip, Zomato
- Promoted by Government
 - Public Sector Company
 - E.g. ONGC, IOC, Air India, BSNL

1. Private Company: MakeMyTrip, Zomato

- a. Shares held by private individuals

2. Public Company: RIL, Infosys

- a. Shares held by general public

NPTEL

Now, a company may or may not be promoted by the government. Government, we all understand, the company elected government and so on. So, I take these two broad categories to better illustrate the categorization of the companies.

If a company is promoted by the government and promoted means the parent is the government. Government is the one who puts in all the money in the upbringing of this child called a company. When the government promotes the company, it is called a public sector company. Note these two words **public** and **sector**. When you say public sector government represents the public and the public's money is with the government.

Government puts the money in that company; hence it is going to be called a people's company or a public sector company. We never call it a public company; it is called a *public sector company*. Public sector refers to the government sector. On the other side, there are private sector companies. Again, I am using these two words together. When you segregate these two words and you use only private- it could mean something else; you use only public, it could mean something else.

Private sector means it is not government: it's somebody else. It can be you and me or any other real person or any artificial legal person can also invest in another company. So, all of that which is not government, if they start a company, it is going to be called a private sector company. Examples of public sector companies are ONGC, IOC- Indian Oil Corporation, Air India, BSNL- all these companies are government owned companies. So, you can also call them government owned companies. Government holds more than 50 percent; at least 51 percent shares in these companies meaning majority of investment is by the government. So, the government can take a decision, whosoever puts in more money has more votes on a decision that is made: more on that later. So, for the private sector companies, the examples are Reliance Industries, Infosys, MakeMyTrip- all these companies are private sector companies.

Government has not put money in these companies; note that the government might have put some money, but it may only be 10 percent of the total money invested in, let us say, Infosys- that does not give the government a right to make decisions in this company. So, while the government can invest in any company, it is called a public sector company only if the government owns more than 50 percent.

So, now let me deep dive into private sector companies. Private sector companies may have two categories. First is called a private company. Note that I have removed the word sector here and now when I use private and company together in this company, you have private individuals who have invested money and or hold shares in the ownership. I will clarify the word *share* in future videos. But shares held by the private individuals means that private individuals like you and me can invest money in this company and this company will be called a private company. For example, MakeMyTrip. So, let me go to the second category and then you will be able to contrast it to the private company.

Second category is called a *public company*. Note that I am not using a public sector company, I am saying public company. What is a public company? When the shares; shares means the investment, share in investment, the ownership is by the general public. So, see the contrast: private individuals and public. What is a private individual and what is a general public? Private individual would be like I talk to my friends and family and say I want to start a company- do you want to invest money in the company and become the owner, part owner of this company? That will be a private transaction between private individuals. But if I put out an advertisement in the newspaper saying hey everyone, I am starting a company or I already have a company and I invite everybody to invest money in my company, then it would mean inviting the general public as per the companies act.

There is also a definition of what is a general public. It is that if you advertise to more than 50 people at a time- and these rules change from time to time- it is called a public invitation and private companies cannot do such public invitation.

So, you cannot advertise in public. So, you have to meet people individually and then raise money for your company which is called private placement. So, this is the distinction between a private company and public company.


So, again to summarize, there can be two broad categories of companies: promoted by the government. not promoted by the government. Within the category of not promoted by the government you have two categories: private companies and public companies.

So, we will talk more about the distinction between private and public and how these two companies function differently; that is the next topic.

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1.2.3 Private company versus Public Company

Basis	Private Company	Public Company
Shareholders	2-200 ✓	7-unlimited ✓
Name	Must suffix 'Private Limited' to the name ✓ <i>Mysora</i>	Must suffix 'Limited' to the name ✓ <i>KIC</i>
Invite to public to invest	Not allowed ✓	Allowed ✓
Transferability of shares	Restricted ✓	Free ✓
Directors	2 ✓	3 ✓
Women directors	No compulsion ✓	One women director compulsory if capital >100 Cr or Turnover >300 Cr ✓
Small shareholder director	No compulsion ✓	Compulsory if 1/10 of shareholders or 1000 small shareholders (whichever is lower), give notice to company ✓
AGM	Not Compulsory ✓	Compulsory to hold a statutory AGM ✓
Key Managerial personal	Exempt ✓	Required to appoint key managerial staff: CEO, MD, etc ✓
Rotation	Not compulsory ✓	Two-third of directors are rotational, one third rotate every year ✓
Managerial Remuneration	No restrictions ✓	<11% of net profits, <5% of net profit to MD ✓
Disclosures	Limited disclosures ✓	Disclosure requirements about operations, financials, etc. ✓



So, there are a number of legal distinctions in terms of what private companies can do or cannot do, what public companies can do or cannot do and how these companies can be founded. Let me quickly run through some of the important points.

Now, in terms of shareholders, how many investors can a company have? There are different limits for the two types of company: I am just skipping through these less important points. Name of the company: *private limited company* must be suffixed to the name like *MakeMyTrip private limited*; all the companies which have written private limited against their name are the private companies.

On the other hand, the public companies do not need to write *private*. So, they can just write limited, for example, Reliance Industries Limited. In the name Reliance Industry Limited, there is no private written. So, it is a public company. On the other hand, MakeMyTrip private limited is a private company. That is how you can distinguish between private and public companies.

Let us look at the name, what is the detailed name of the company, how do they mention it and then you can identify if it is a private company or a public company: if the invite to the public to invest is allowed or not allowed. I discussed the transferability of shares. So, let me just quickly say that directors, women directors, managerial remuneration, these are various legal points and there can be a list of several more points.

But the purpose of this slide is to tell you that these companies are significantly different in terms of how they operate, what each is allowed/ not allowed to do, how they should function and so on. There is a significant amount of difference and I will upload some study material for you to go through, but the important point, from the point of view of this course, is disclosures.

Now, private companies and public companies have different regulations about how much information they need to disclose to the public. While private companies have less regulations, the public companies have more compliances.

Public companies are required to disclose all the financial information to the public. Why? Because the public has invested money in these companies. They are the shareholders; they are the part owners of the company. Therefore, all the public companies have to disclose their financial results, their operating results on their websites.

So, that the general public can look at those financials and make their decisions with respect to whether they want to stay invested in the company, or do they want to exit the company or many other decisions they might want to take. So, I say that this point is more important because we are in the course on financial accounting and we need to understand what disclosures have to be made in the financial reports and how these disclosures are to be made. There are also standard formats for making those disclosures.

So, just to sum up this slide, I am saying private companies and public companies are different, they are governed by different regulations. The key difference being public companies have to disclose much more compared to the private company.

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Now, let me also quickly contrast these two forms of companies, private company and public company to you know a couple of other forms of business, like partnership and sole trader. And I show this on a continuum, basically to say that a sole trader does small business and a public company does comparatively much more business and partnership and private company are somewhere in between.

It is also possible that a partnership is doing higher business than a private company- that is possible, but typically this is how the general progression looks like. Let me take a few parameters to say what is represented on this line.

Resources: as you move from being an individual shopkeeper, small businessmen to having more people in the partnership, to a private company, to a public company where you have all the public subscribe to your shares and become the investors, you have more resources. As you go from left to right, you have more resources at your disposal, the complexity of the organization increases as you move from left to right.

The compliances which you are required to do, they go up in number, in complexity; the disclosure requirements are much more for the company form of business as per the size of organization. And of course, the need for accounting, that is where the course comes in, need for accounting for larger businesses becomes much more because you have so many resources. You have legal responsibilities, disclosure requirements and that is where the whole system of accounting comes in and fills the need of why, where the companies have to follow the

procedure, processes, compliance and be up to the standards in preparing the financial statements and disclosing the financial results.

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The image shows a presentation slide titled "1.2.4 Visual test to identify public companies". The slide features a screenshot of the Reliance Industries website. The website's navigation menu includes "The Reliance Story", "Our Company", "Our Business", "Sustainability", "Innovation & R&D", "Investor Relations", "Careers", and "eES". The "Investor Relations" link is circled in red. Below the navigation menu, there are several menu items: "Financial Reporting", "Shareholder Information", "Chairman's Communication", "Investor Contacts", "Business Management", "Downloads", "Corporate Announcements", and "News". "Financial Reporting" and "Shareholder Information" are also circled in red. The word "Public Companies" is written in red cursive above the website screenshot. In the top right corner of the slide, there are logos for "Indian Institute of Technology Kharagpur" and "NPTEL". In the bottom right corner, there is a video feed of a man wearing a white turban and glasses, looking down.

Finally, a couple of minutes on how do you identify if a company is a public company? I told you one method. You look at the name: if the name says Reliance Industries and limited, that means public company, if the name says Reliance Industries private limited, then it's a private company.

Then a couple of other things that you could do quickly. Go to the website of any company and you would see an investor relations tab: this is true for typically public companies. In order to identify any public company, go to the website, see if there is an investor relationship tab; they can call it something else as well, but investor word is actually quite prevalent. And then you have all the financial reports, shareholder information and so on ok.

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1.2.4 Visual test to identify public companies

Is this company's share traded on a stock exchange?

Yes- Public Company

The slide features the Indian Institute of Technology Mandi and NPTEL logos in the top right corner. A video feed of a man with a beard and glasses, wearing a white turban, is visible in the bottom right corner.

You can click on financial reporting and then you could look at the financial statements. Another test that you could do is ask this question: are the company's shares traded on stock exchange? Now without addressing what is stock exchange, what is trading of shares and so on, let us not get into that.

If a company's shares are traded on a stock exchange or listed on a stock exchange, it is a public company. Most public companies- almost all public companies - have their shares on a stock exchange. You can simply Google it and find the list of these stock exchange listed companies.

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1.2.4 Visual test to identify public companies

Google

List of listed companies in India

- List of listed companies in India
- List of listed companies in India **near**
- List of listed companies in India **excel**
- List of **public** companies in India

The slide features the Indian Institute of Technology Mandi and NPTEL logos in the top right corner. A video feed of the same man as in the previous slide is visible in the bottom right corner.

So, just do that and these are different ways of finding data. That is it in this video. I wanted to bring you up to speed on what is a company and what is a private company, what is a public company.

I will see you in the next video.