

## 3 Using a Company

### 3.1 Introduction

The two types of limited liability companies available for use by social enterprises are: the company limited by shares (CLS) and the company limited by guarantee (CLG). The CLG is a structure for non-profit distribution, thus many are also charities or trade associations.

CLSs are divided into private companies (which make up the great majority) and public limited companies (plcs) which can offer their shares to the general public. Many (but not all) plcs are quoted on the stock market so that their shares can be easily bought and sold.

### 3.2 Key features of social enterprise companies

**3.2.1** All limited liability companies have an 'objects' clause. This sets out the company's aims or purposes e.g., to operate the business of recycling furniture. It is possible to state that the object of the company is to carry on business as a 'general commercial company' in which case it may carry on any trade or business and do all such things as are incidental or conducive to carrying on any such trade or business. For a social enterprise, however, a more particular definition of the objects may well be desirable. For a charitable social enterprise the objects must be exclusively charitable (see Chapter 5).

**3.2.2** The social or public interest which the social enterprise company aims to meet is usually underpinned by a constitutional requirement that the profits of the company are (unlike those of a commercial company) not to be paid out to the members by way of dividends, but instead have to be retained for application towards the company's social or public purpose.

For charitable social enterprises this is essential and invariable. For other social enterprises consideration could be given to extending the non-profit distribution provision by specific constitutional drafting, for example, to provide comfort to prospective funders.

There may also be provision (as required for all charitable companies) that in the event of dissolution of the company any surplus will not be divided among the members but will go to a social or public purpose. In certain circumstances, such a 'non-profit distribution clause' will allow specific communities or categories of members who need support to benefit from an ultimate distribution of surplus. In some cases some profits may be distributed. However, in all cases the crucial feature of a social enterprise is that it is primarily seeking to achieve a social purpose – even if some profits get distributed in contrast to the primary aim of a commercial company which is to enhance the value of the company for the benefit of its shareholders.

**3.2.3** Companies are legal entities, so that individual directors and shareholders are not exposed to personal liability (except in exceptional limited circumstances).

**3.2.4** A company's constitution is contained in two documents:

- **The Memorandum of Association** which contains the objects and powers, and may contain a non profit distribution clause in the case of a social enterprise, the amount of the share capital in a CLS, or of the members' guarantee in a CLG.
- **The Articles of Association** which sets out the internal management structure and procedures i.e. the roles of members and directors and procedures for their appointment and removal and for the conduct of meetings, etc.

### 3.3 Power structures

**3.3.1** All companies have a two-tier power structure. In a CLS (subject to contrary provision) the shareholders have the powers to:

- Elect and dismiss the board of directors.
- Appoint or dismiss the auditors.
- Change the Memorandum and Articles of Association by special resolution (i.e. a resolution passed by 75% of the shareholders present and voting at a meeting of which at least 21 clear days notice has been given).
- Approve the payment of dividends.

**3.3.2** In a CLG, the members have the same powers as the shareholders of a CLS except that the CLG cannot declare a dividend because it has no share capital.

**3.3.3** The managerial tier in the power structure, in both the CLS and the CLG, is the board of directors. The directors are typically appointed by the shareholders/members. Typically, again, some of them will retire each year at the annual general meeting, thus submitting themselves to re-election. A maximum continuous period in office may be prescribed.

**3.3.4** In some cases the members/shareholders and the directors are the same people and the board may, in practical terms, operate without the formal check of accountability provided by the second tier.

### 3.4 Officers

**3.4.1** Every company will designate one of the directors as a chairperson (even if only meeting by meeting) and have a company secretary. The chairperson is normally elected by the board of directors. He or she serves as the first among equals and may have a casting vote in the event of deadlock. The company secretary is usually responsible to the board for basic company law compliance, such as maintaining the company's

statutory books and attending to routine filing obligations. It is usual for the board to delegate management functions to a managing director (who is usually not subject to retirement by rotation) or the senior employee below board level ('the Chief Executive'). It is usual to have another director who is specially responsible for the company's financial affairs.

### 3.5 Duties and liabilities of directors

**3.5.1** The directors of a company have a duty to act in its interests and to exercise reasonable care in their management functions. However, a director is entitled to rely on fellow directors in the absence of grounds for suspicion. These duties are owed to the company and directors are not normally exposed to third party claims. However, this can arise, for example, in an instance of wrongful trading. It is possible to take out directors and officers' liability insurance to cover such potential liabilities in the absence of fraud, or other bad faith.

**3.5.2** In the case of a public company or a private company which is a subsidiary of a public company, the age limit for serving as a director is 70.

### 3.6 Board structures

**3.6.1** Board structures may be constructed to suit the particular company, but generally divide into three types:

- **Oligarchy** – where the shareholders/members are the same people as the directors and new appointments are therefore made by the board. To preserve the structure it should be clear that when someone ceases to be a director, they also cease to be a member (in a CLG) or that they must offer their shares to the remaining shareholders in accordance with a prescribed procedure (in a CLS).
- **Representative Oligarchy** – where members or shareholders are not individuals but organisations, e.g., a local authority; a charity

etc. Each member/shareholder then appoints an individual to serve as director. The directors serve as long as the organisation appointing them wishes. It is possible to build in safeguards requiring the member organisations to review their appointment every three years, to put a time limit on the period of office of directors and to require the member organisation to replace its director if the majority of the other directors request it to do so.

- **Elected by Membership** – where there is a true distinction between the member/shareholders and the directors. The membership/shareholder group is wider than the directors and they elect the board. It is possible to provide for different stakeholder groups/members to elect directors to represent their interests e.g. a group of local authorities can elect one director etc.

### 3.7 Incorporation

**3.7.1** Incorporating a CLS or a CLG is very simple. There are often standard forms of Memorandum and Articles of Association that can be used. Once you have agreed your constitution, an application to incorporate is submitted and is processed by Companies House within seven days. The incorporation fee is £20. A same day incorporation costs £80.

### 3.8 Regulation

**3.8.1** The best things in life may be free, but limited liability is not one of them. The price payable for limited liability is public disclosure. In contrast the internal affairs of a sole trader's business, partnership or unincorporated association may be kept secret. The key disclosures are:

- An annual return which has to be forwarded to the Registrar within 42 days of the annual general meeting plus a £15 fee.

- Audited accounts which have to be filed with the Registrar within 10 months of the end of its financial year. If a company's turnover is less than a £1 million per annum (or £250,000 for a charitable company), it does not have to produce audited accounts. However, it may be desirable to have them audited anyway to give assurance to external supporters, financiers etc.
- Details of changes of directors and the company secretary constitutional amendments and other disclosable matters have to be filed within 14 days.

### 3.9 Financing

**3.9.1** A limited company can mortgage its assets to a lender in a wider and more flexible way than an unincorporated association, partnership or sole trader can (with strict disclosure obligations).

**3.9.2** A mortgage by a company (usually called a charge) over land, vehicles and other property has to be registered at Companies House within 21 days of its creation. Only a mortgage by an unincorporated business over property has to be registered which means it is easier for lenders to check up on how much security a limited company has given, compared with an unincorporated business.

**3.9.3** Unlike unincorporated businesses, limited liability companies can give a 'floating charge' which applies to assets which keep on changing or fluctuating e.g., stock or debtors. The floating charge hangs like a net above the assets charged. At the moment the charge is triggered ('crystallises' in legal jargon), the net drops and covers all the charged assets at that moment. So, for example, all the stock which is owned by the company (and not subject to a prior charge) at the moment the floating charge is triggered becomes security for the debt due to the lender and secured by the floating charge. The floating charge is only triggered when certain conditions set out in the terms of the charge or loan facility under which the charge was given take effect.

### 3.9.4 Share capital – companies limited by shares

- Each company limited by shares divides its share capital into shares of fixed amounts. The usual share capital for a small limited company is £100. This is known as the company's authorised share capital.
- The authorised share capital is divided into shares or units. The shares can have a nominal, face or par value (which all mean the same) of any amount between 1p and £100 (or even higher) but it is normal to give the shares a nominal value of £1. Hence, it will be normal in the case of a limited company with an authorised share capital of £100 for its capital to be divided into 100 shares with a nominal value of £1 each. If 50 of the shares were issued, the limited company would have an authorised share capital of £100, an issued share capital of £50 and un-issued share capital of £50.

- Shares are also known as equity or risk capital. Ordinary shares usually carry the main financial risk if the limited company is unsuccessful because, if a company goes into liquidation, the ordinary shareholders are the last people to get their money back. Shares also carry the greatest prospect of financial reward if the company is successful. The ordinary shareholders are rewarded by dividends paid when distributable profits are available.

### 3.9.5 Preference shares

Preference shares carry preferential rights over ordinary shares, but carry less potential for reward. Their principal features are:

- **Type of dividend** – preference shares are usually described as, for example, 4% preference shares. This means that for each £1 invested a dividend of 4% per annum is paid. Hence, the dividend is fixed, rather like an interest rate. However, unlike a loan the

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### Company Limited by Shares: Aspire Group

Aspire is a social enterprise selling fair trade catalogues that creates full time employment for homeless and other socially excluded people. Aspire employees deliver the catalogues to over 1 million UK homes and they are paid between £150-£170 per week. In 2002 the organisation had a turnover of over £1,000,000 and employed 150 homeless people in the UK and as many fair-trade producer groups overseas. Since its birth in Bristol in May 1999, Aspire has shown a strong entrepreneurial ethos and has strived to become a self-sustainable commercial business. Currently, Aspire has major expansion plans that include the establishment of new 'branches' in several major UK cities, as well as the potential development of new business units such as market stalls, cafes and shops.

Aspire was initially incorporated as a company limited by shares both to emphasise the company's identity as a commercial business and to enable the business to raise the necessary funds to finance its ambitious expansion plans. Whereas their legal structure allowed them to raise the necessary capital through a venture capitalist and other commercial investors, it also inhibited borrowing from some community development financial institutions (CDFIs) and financing from the charitable sector.

In order to overcome these limitations, Aspire has now set up a charity as an overall umbrella that owns 100% of the company's shares. Investment in the catalogue company remains as subordinated loan stock as well as redeemable and non-redeemable preference shares.

dividend on preference shares can only be paid if profits are available for distribution.

- **Cumulative preference shares** – In this case if dividends are not paid in one year, the arrears of dividend accumulate and may be paid in later years.
- **Redeemable preference shares** – These shares are issued for a fixed period e.g., ten years, and at the end of the ten year period, the company redeems them by paying back the initial capital.
- **Convertible redeemable preference shares** – In this case the shareholder can call upon the company to convert the preference shares into ordinary shares. Hence, an investor having received fixed rate dividends during the high risk early years in preference shares, can switch to high yield ordinary shares. The rate of conversion is normally the result of negotiation and is set out in the Articles of Association.

### 3.9.6 Dividends

Dividends on preference shares are paid before the dividends on ordinary shares. Dividends can only be paid if there are profits available for distribution. If the company has accumulated losses on its balance sheet, it has to accumulate sufficient profits to expunge the losses before making a distribution.

### 3.10 Disqualification

A person may be disqualified from being a director of a company by court order. This will be given where a director has:

- Been ruled to be unfit to be concerned in the management of a company.
- Been convicted of certain criminal offences.

### 3.11 Changing the Memorandum and Articles of Association

Most clauses contained in the Memorandum and all the Articles of Association can be changed by special resolution (one passed by a 75% majority in a members' meeting).

### 3.12 Group structure

A CLS or CLG can become the sole member or shareholder in another CLG or CLS which is established as its subsidiary.

### 3.13 Companies limited by guarantee

**3.13.1** In a CLG there are no shareholders. The members give a 'guarantee' to cover a company's liability. However, the guarantee is nominal, normally being limited to £1. A CLG offers the possibilities of a democratic one member, one vote system. The members normally only meet once a year at the annual general meeting when they exercise the powers outlined in paragraph 3.3.1. Most CLGs contain a non-profit distribution clause and therefore the members do not have a right to a share in dividends or any surplus on the winding up of a company. It is possible to give members greater powers so that they are consulted by the directors on more issues and the distinction between the directors and the members can be reduced. However, one has to be careful in doing this to ensure that one does not give so many powers to the members that they become, in fact, directors and liable as such.

**3.13.2** It is possible to create different categories of membership if desired, such as local authority members representing local authorities, user members representing users etc.