

12 COMMON ERRORS OF LIMITED LIABILITY COMPANY OWNERS

It is not news to you that Limited liability companies are distinct juristic entities with perpetual succession who require alter egos in the form of directors and shareholders to shape their structure and future. The news is that this article seeks to highlight some common errors made by these alter egos.

Pre-incorporation errors

Some of the decisions taken before the company is incorporated can and do affect the fortunes of the company.

(1) Wrong Name:

Wrong choice of name can affect the fortunes of your company. The name choice for a company depends on the vision for that company. Firstly, a personalized name e.g Ayuli Jemide Limited may give the immediate impression that the company is a one man business and may have a potential to stifle the growth of your company. Secondly, if you are incorporating a company as a vehicle for diverse businesses please do not choose a restrictive name. Prefer a versatile name that can wear many caps. E.g XYZ Limited would be preferred to XYZ pharmaceuticals Limited. The latter name put before a tenders board for an oil service contract to supply drilling equipment may raise the question of the competence of a pharmaceutical company to supply drilling tools. However if you intend to restrict the company to pharmaceuticals as its core business you earn some mileage by using the word “pharmaceuticals”. Your company gains instant recognition and credibility in its line of business. Lastly it would be an advantage if your company name is easy to pronounce and remember. You may consider naming something else after the name of your 17 letter hometown or grandmother.

(2) Infant Subscriber:

People often want their infant children (particularly their sons) to be included as the second subscriber to their company whilst it is being incorporated. The law expects every company to have a minimum of 2 directors and does not recognise infants to be capable of being one of the two. The Companies and Allied Matters Act 1990 however provides that where the company has at least two adults as subscribers then an infant may be included.

(3) Poor understanding of Nominal Share Capital:

Many people erroneously equate the wealth of their company to the nominal share capital of the company. On giving incorporation instructions they are gearing to hit the millions in nominal share capital. This may be applicable to the extent that shareholders contributions (paid up share capital) may be equivalent to the total nominal share capital or a fair portion. However where shareholders funds are not forthcoming (particularly with small private start up companies) a lower share capital is advised to save on Stamp Duty which is assessed on the value of share capital. Use

the savings to beef up your working capital. Remember that share capital can always be increased as the business progresses. You may also consider issuing your shares at a premium to reduce the stamp duty. There are however several situations where the share capital of a start up company requires a minimum value e.g If the company would be applying for expatriate quota - N10 Million. Incorporating a Bank - N25 Billion (I am sure you know this one) and a host of others.

(4) Off the shelf Memorandum and Articles of Association

Almost all the time persons incorporating companies (and some lawyers) pick the Memorandum & Articles of Association off the shelf and adopt its contents save the change of names and addresses. Many company owners are in possession of Memorandum & Articles they have never read. However these off the shelf Memorandum & Articles become a problem when they are about to borrow urgent funds for a major deal and the bank finds that borrowing powers are absent in the Memorandum or when a major dispute arises amongst the board members and some discover that the quorum for meetings is 2 directors in a company of 10 directors. Mischief would thrive with a provision like that! What of the mode for transmission of shares? Many shareholders and directors only get to know what the Articles say about transmission of shares on the demise of one of them. We can go on and on!

(5) Incomplete documentation after incorporation.

Many times agents and lawyers incorporating companies provide the Certificate of Incorporation to the client. Then he sets out to open a bank account only to be told that he requires certified true copies of other documents and he goes back losing time and money to procure the other documents. Always negotiate with the lawyer the procurement of Certified True copies of Particulars of Directors, Memorandum & Articles of Association, and Allotment of Shares in addition to the Certificate of Incorporation. Some law firms would even throw in a complimentary company seal in addition to the Certified True Copies.

(6) Shareholders Agreement.

In a situation where the company being incorporated is a joint venture between different companies or persons, the need to have a shareholders agreement is often taken for granted. The Shareholders Agreement should capture the basis of the entire relationship. It is the Shareholders Agreement that deals with profit sharing, termination, conflicting business, ethics etc. Also while you are at it, ensure that the relevant portions of the Shareholders Agreement that coincide with the usual headers in the Articles of Association are not in conflict. In the event of a conflict the Articles will be the subsisting document.

Post Incorporation Errors

(7) Failure to pay Annual Returns

Many company owners are oblivious of the need to pay annual returns every year for the company. Majority become aware of annual returns only when they seek to transact on their file at the Corporate Affairs Commission and there is the request for annual returns receipts. The annual returns and the yearly penalties can accumulate over the years into a tidy sum. Some small private company owners have been known to find it more expedient financially to incorporate a new company than pay the

arrears on annual returns. Note that many actually pay but forget to keep the receipts. This can prove just as bad when CAC depends on your records.

(8) Bringing on a new director for a particular transaction without working out an exit strategy.

Very often parties require a particular person on their board for leverage on a particular transaction they are bidding for. They instruct that such a person should be made a director or shareholder without planning the exit strategy for such a person after the deal is done. If the company begins to prosper thereafter the circumstantially appointed director may become a thorn. One major exit strategy used is to ask the party in question sign a letter of resignation and share transfer documents in advance.

(9) Taking diverse risks with your one and only company

You may have heard the phrase “spread your risk”. It is a usual business principle not to put all your eggs in one basket. In the light of this it is advisable for versatile and diverse businessmen to incorporate a different company for each business line. The transactional liabilities of one company should be kept separate from the other.

(10) Poor use of a properly constituted Board of Directors.

The major reason why small private businesses do not have a functional board of directors is that they fail to distinguish between directors and shareholders. A director need not be a shareholder. Therefore you can appoint directors to your company who may not have a share in your profits, but are entitled to director’s emoluments, sitting fees and other privileges. For any company, whether small, growing or successful a gathering of astute minds at Board meetings provides not just a good brainstorm pool, but increases your network and sets up an accountability system. The budget for director’s emoluments of many companies is a drop in the ocean compared to the gains of having a board of experienced hands. The board of directors is one of the advantages of owning a limited liability company and not taking the advantage is as good as having registered a sole proprietor business name.

(11) Buying company property in a personal name

Several people own a company which they use for business but prefer to buy all company properties in the personal name of the Chairman/CEO. Why? My guess is that it perhaps gives a sense of personal ownership and control. This purchase method does not grow the company assets and the company generally. To buttress this I recall a conversation I had with a top level manager of one of the big three banks in Nigeria and he lamented that a lot of the funds set aside for Small and Medium Enterprise loans are yet to be utilised because many companies fail to meet the minimum asset base prerequisite. He went on to say that a lot of the company owners bought property for company use but registered it in their personal names so these could not be included as part of the company assets without some form of transfer or legal process. Need I say more on this?

(12) Do you have a Company Secretary?

When you hear of a Company Secretary do you think of the lady at the front desk who does the typing and keeps the petty cash accounts? The Company Secretary under the Companies Act is a different person. The Act in S293 requires every company to have a Company Secretary, but many companies fail to file the statutory form appointing a

Company Secretary. Apart from meeting legal expectations, there are advantages in having a Company Secretary. Chief amongst them is continuity in documentation of your meetings and the filings at the Corporate Affairs Commission. Your Company Secretary becomes a reserve for your corporate history. If you hire a professional you also gain useful insight on company procedure from time to time.

You can always get more out of the entire concept of owning a limited liability company. Do not settle for less!

Ayuli Jemide, is a partner with Detail Solicitors.