

UNIT 2: FORMATION OF A COMPANY

PROMOTER

“Promoter” means a person—

- (a) Who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- (b) Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity

FUNCTIONS OF A PROMOTER

Professional promoters

There are firms which specialise in company promotion, including its incorporation and flotation, before handing it over to the shareholders or their representatives for the company.

Occasional promoters

These promoters take interest in floating some companies. They are not engaged in promotion work on a regular basis. They take up the promotion of some company and once it is over they go to their original profession. For instance, engineers, lawyers etc. may float some companies.

Entrepreneur promoters

They are both promoters and entrepreneurs. They conceive the idea of a new business unit, do the groundwork to establish it and may subsequently become a part of the management.

Financier promoter

Some financial institutions, like investment banks or industrial banks, may take up the promotion of a company with a view to finding opportunities for investment.

INCORPORATION OF COMPANY- UNDER SECTION 7 OF COMPANIES ACT 2013 READ WITH THE COMPANIES (INCORPORATION) RULES 2014

For incorporation of a company following steps is required to be followed:-

1. First of all the company should obtain the Digital signature of at least one person out of Managing Director, Manager or secretary of the company as now a day's various documents are required to be signed online which is possible only through DSC.
2. That after the company should apply for the DIN allotment for the persons who are going to be appointed as a director of the company. In case the person already holding a DIN then no such application is required to be made
3. That after the company should make an application in Form No. INC 1 to the registrar for the reservation of the name of the proposed company. The Registrar on receipt of such application reserved the name for a period of 60 days from the date of application. However if after reservation of the Name by the Registrar it was found that the name was reserved by providing wrong information then if the company has not been incorporated then the reserved name will be cancelled and the person who has made the application for reservation of the name shall be liable with a penalty which may extend to Rs. 1 lakh. However if the company is incorporated with the reserved name then the Registrar after giving an opportunity of being heard may either direct the company to change the name within a period of three months by passing an ordinary resolution and take action for striking of the name of the company from the register of the company or make a petition for winding of the company.
4. Next the company should draft the MOA and AOA as provided u/s 4 and 5 of the Companies Act 2013.
5. Now the company should make an application to the Registrar within whose jurisdiction the registered office of the company is going to be situated in Form No. INC 2 (in case of One Person Company) and INC-7(other than One person Company). This form shall be filed within 60 days of making an application in Form No. INC 1. Along with this form the company should file following documents:-

i) MOA and AOA of the company: — these documents shall be signed by all the subscribers to the MOA of the company stating therein the name, address, description and occupation in presence of at least one witness who shall attest the signature and shall likewise sign and should state his name, address, description and occupation. The Chartered accountant can also attest the signature of subscribers. One witness can attest the signature of all the subscribers. However if the subscriber to the MOA is illiterate , the subscriber should place his thumb impression in place of signature and the another person should write his name and the no. of shares held by him below the mark and the person doing this shall also authenticate this by his own signature. In case of the illiterate subscriber the person authenticating the thumb impression shall read and explain the contents of MOA and AOA to the subscriber and make an endorsement to this effect in MOA and AOA.

In case the subscriber to the MOA is a body corporate then in that case MOA should be signed by the person authorized by the Board of Directors by a resolution. But the person authorized by the BOD shall not be the subscriber to the MOA in his individual name.

In case the subscriber to the MOA is LLP then it should be signed by the partner authorized by all the partners by passing a resolution. In this case also the partner authorized should not be a subscriber in his individual name.

ii) A declaration in Form No. INC 8 by an Advocate , a Chartered Accountant , Cost Accountant or Company Secretary in practice who is carrying out the registration activities and by a person who may be director , manager or secretary of the company that all the requirements for registration of the company as per this act has been complied with.

iii) An affidavit n Form No. INC 9 shall be submitted by each of the subscribers to the MOA and the person who is named as first director of the company in AOA. This shall state that they have not been convicted to any offence in respect of the promotion , formation or management of any company and that he has not been found guilty of any fraud to any company under this act ot the previous companies act during the preceding five years and the documents submitted for registration are true and correct to the best of his knowledge and belief.

iv) Address for correspondence till the registered office is established.

6. The registrar on the basis of such documents will register the documents in the register and will issue a certificate of registration in Form INC 11.

7. The Registrar shall from the date mentioned in the Certificate of Incorporation will issue a Corporate Identification No. to the company

8. The Company shall maintain all the documents originally filed with the registrar at the registered office of the company till the date of its dissolution.

9. In case the information provided for registration is false or misleading or the registration obtained by proving some wrong or misleading statement then the person named as first director or every subscriber to the MOA and their witness shall be liable for action u/s 447

10. In case of such fraudulent obtaining of the Registration the Tribunal may on an application made to it after being satisfied may :-

i) Pass such order for regulation of the management of the company including changes in MOA or AOA or such other changed in Public Interest, in the interest of the company and its members.

j) Direct that the liability of the members shall be unlimited

k) Pass order for the winding up of the company

l) Direct removal of the name of the company from the Register of the Companies

m) Pass such other order as it may think fit.

Provided that before passing an order the Tribunal shall give reasonable opportunity of being heard to the company and shall take into consideration the transactions entered into by the company and corresponding liabilities.

FUNCTIONS OF PROMOTERS

The functions of a promoter may include:

Discovery of a business idea

The first stage in company promotion is the generation of new ideas. It is the promoter who conceives the idea of setting up a business, and makes an

assessment of the viability of a particular aspects business be it technical feasibility, financial feasibility, economic feasibility and also incorporation of company.

Detailed investigation

Promoters undertakes a detailed investigation of the viability, profitability and future prospects of the growth of the proposed activity, and may seek the help of specialists such as lawyers, accountants, cost accountants, a company secretary, and engineers. Organisations engaged in market research and other specialised agencies. Specialists are in a position to make an objective analysis of their own areas which may help the promoters. Decisions have to be taken regarding the size, location, layout, manpower etc.

Assembling the factors of production

If the proposed endeavour gives promise of success and the promoter is willing to undertake the risk of forming the business, step must be taken to assemble various factors of production, such as land, labour, capital and managerial personnel. Assembly of resources involves making contracts for the purchase of these resources. Promoters organise the resources to convert the idea into a reality by forming a company.

Entering into preliminary contract

The promoter may enter into contracts with third parties in anticipation of the registration of a company; but after registration, the company must approve or confirm these contracts.

LEGAL POSITION OF A PROMOTER

The promoter is neither a trustee nor an agent of the company because there is no company yet in existence. The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed.

From the fiduciary position of promoters, the two important results follow:

(1) A promoter cannot be allowed to make any secret profits. If it is found that in any particular transaction of the company, he has obtained a secret profit for himself, he will be bound to refund the same to the company.

(2) The promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If he contracts to sell his own property to the company without making a full disclosure, the company may either repudiate/rescind the sale or affirm the contract and recover the profit made out of it by the promoter.

A promoter who wishes to sell his own property to the company must make a full disclosure of his interest.

The disclosure may be made:

- (i) To an independent Board of Directors, or
- (ii) In the articles of association of the company, or
- (iii) In the prospectus, or
- (iv) To the existing and intended shareholders directly.

If the promoter fails to discharge the obligation demanded of his fiduciary position the company may rescind the contract or may in the alternative choose to take advantage of the contract and sue the promoter for damages for breach of his duty to the company.

Secret profits on the sale of property can be recovered from a promoter only when the property was bought and sold to the company while he was acting as a promoter.

MEMORANDUM OF ASSOCIATION

A Memorandum of Association (MoA) represents the charter of the company. It is a legal document prepared during the formation and registration process of a company to define its relationship with shareholders and it specifies the objectives for which the company has been formed. The company can undertake only those activities that are mentioned in the MoA. As such, the MoA lays down the boundary beyond which the actions of the company cannot go.

MoA consists of the following clauses:

1.Name Clause: This clause specifies the name of the company. The name of the company should not be identical to any existing company. Also, if it is a

private company, then it should have the word 'Private Limited' at the end. And in case of public company public company, then it should add the word "Limited" at the end of its name.

2. Registered Office Clause: This clause specifies the name of the State in which the registered office of the company is situated. This helps to determine the jurisdiction of the Registrar of Companies. The company is required to inform the location of the registered office to the Registrar of Companies within 30 days from the date of incorporation or commencement of the company.

3. Object Clause: This clause states the objective with which the company is formed. The objectives can be further divided into following 3 subcategories:

Main Objective: It states the main business of the company

Incidental Objective: These are the objects ancillary to the attainment of main objects of the company

Other objectives: Any other objects which the company may pursue and are not covered in above (a) and (b)

4. Liability Clause: It states the liability of the members of the company. In case of an unlimited company, the liability of the members is unlimited whereas in case of a company limited by shares, the liability of the members is restricted by the amount unpaid on their share. For a company limited by guarantee, the liability of the members is restricted by the amount each member has agreed to contribute.

5. Capital Clause: This clause details the maximum capital that a company can raise which is also called the authorized/nominal capital of the company. This also explains the division of such capital amount into the number of shares of a fixed amount each.

6. Nominee Clause - In the case of a One Person company, this clause mentions the name of one subscriber who in the event of death of the owner will become the member of the company.

ARTICLES OF ASSOCIATION

Definition –Articles

As per Section 2(5) of the Companies Act, 2013 “Articles” means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act.

The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company.

Form of Article:

The articles of a company shall be in respective forms as outlined below;

S.No	Table	Form
1	Table F	AOA of a company limited by shares
2	Table G	AOA of a company limited by guarantee and having share capital
3	Table H	AOA of a company limited by guarantee and not having share capital
4	Table I	AOA of an unlimited company and having share capital
5	Table J	AOA of an unlimited company and not having share capital

A company may adopt all or any of the regulations contained in the model articles applicable to such company.

CONTENTS OF ARTICLES

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

Exclusion wholly or in part of Table F.

1. Adoption of preliminary contracts.
2. Number and value of shares.

3. Issue of preference shares.
4. Allotment of shares.
5. Calls on shares.
6. Lien on shares.
7. Transfer and transmission of shares.
8. Nomination.
9. Forfeiture of shares.
10. Alteration of capital.
11. Buy back.
12. Share certificates.
13. Dematerialisation.
14. Conversion of shares into stock.
15. Voting rights and proxies.
16. Meetings and rules regarding committees.
17. Directors, their appointment and delegations of powers.
18. Nominee directors.
19. Issue of Debentures and stocks.
20. Audit committee.
21. Managing director, Whole-time director, Manager, Secretary.
22. Additional directors.
23. Seal.
24. Remuneration of directors.
25. General meetings.
26. Directors meetings.

27. Borrowing powers.

28. Dividends and reserves.

29. Accounts and audit.

30. Winding up.

31. Indemnity.

32. Capitalisation of reserves.

Utmost caution must be exercised in the preparation of the articles of association of a company.

DIFFERENCE BETWEEN MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

BASIS FOR COMPARISON	MEMORANDUM OF ASSOCIATION	ARTICLES OF ASSOCIATION
Meaning	Memorandum of Association is the charter of the company	Articles of Association is a document containing all the rules and regulations that governs the company.
Defined in	Section 2 (56)	Section 2 (5)
Type of Information contained	Powers and objects of the company.	Rules of the company.
Status	It is subordinate to the Companies Act.	It is subordinate to the memorandum.
Retrospective Effect	The memorandum of association of the company cannot be amended retrospectively.	The articles of association can be amended retrospectively.
Major contents	Memorandum defines the objects and powers of the company. It fixes up the	Articles from the bye-laws of the company and provide

BASIS FOR COMPARISON	MEMORANDUM OF ASSOCIATION	ARTICLES OF ASSOCIATION
	scope and the extent of the activities of the company.	those regulations by which the objects and powers of the company can be carried out.
Alteration	Alteration can be done, after passing Special Resolution (SR) in Annual General Meeting (AGM) and previous approval of Central Government (CG) or Company Law Board (CLB) is required.	Alteration can be done in the Articles by passing Special Resolution (SR) at Annual General Meeting (AGM)
Relation	Defines the relation between company and outsider.	Regulates the relationship between company and its members and also between the members inter se.
Acts done beyond the scope	Absolutely void	Can be ratified by shareholders.

ALTERATION IN ARTICLE OF ASSOCIATION

STEP-I

Convene A Board Meeting: To alter the Article of association of Company By giving Notice of at least 7 days.

STEP: II

Hold the Board Meeting:

At the Board meeting, the given resolutions must be passed:-

Get Approval to Alteration in Article of Association and recommending the proposal for members' consideration by way of special resolution.

Fixing the date, time, and venue of the general meeting and authorizing a director or any other person to send the notice for the same to the members.

Provisions of the Section 101 of the Companies Act 2013 provides for issue of notice of EGM in writing to below mentions atleast 21 days before the actual date of the EGM :

- I. All the Directors.
- II. Members
- III. Auditors of Company

The notice shall specify the place, date, day and time of the meeting and contain a statement on the business to be transacted at the EGM.

STEP-III

Convene a general meeting:

Check the Quorum.

Check whether auditor is present, if not. Then Leave of absence is Granted or Not. (As per Section- 146).

Pass Special Resolution.[Section-114(2)]

Approval of Alteration in AOA.

STEP-IV

Filing and fees:

- I) File FORM NO. MGT-14 (Filing of Resolutions and agreements to the Registrar under section 117) with the Registrar along with the requisite filing within 30 days of passing the special resolution, along with given documents:-
- II) Certified True Copies of the Special Resolutions along with explanatory statement;
- III) Copy of the Notice of meeting send to members along with all the annexure;
- IV) A printed copy of the Altered Article of Associations.

BOOK BUILDING

Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery.

It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer.

The following are the important points in book building process:

1. The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.
2. The Issuer specifies the number of securities to be issued and the price band for the bids.
3. The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
4. The syndicate members put the orders into an 'electronic book'. This process is called 'bidding' and is similar to open auction.
5. The book normally remains open for a period of 3 to 10 days.
6. Bids have to be entered within the specified price band.
7. Bids can be revised by the bidders before the book closes.
8. On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
9. The book runners and the Issuer decide the final price at which the securities shall be issued.
10. Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.
11. Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

PROSPECTUS

Meaning: In other words, it is a document which invites deposits from the public or invites offers from the public for the subscription of shares in, or debentures of, a company.

MATTERS TO BE STATED IN PROSPECTUS/CONTENTS OF PROSPECTUS

A)

1. Every prospectus issued by a public company shall be **dated and signed**.
2. **Names and addresses of the registered office** of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters.
3. **Dates of the opening and closing of the issue**
4. **Declaration** about the issue of allotment letters and refunds within the prescribed time
5. A **statement by the Board of Directors** about the separate bank account
6. Details about **underwriting of the issue**;
7. **Consent of the directors, auditors, bankers** to the issue, expert's opinion
8. The **authority for the issue** and the details of the resolution passed
9. Procedure and time schedule for allotment and issue of securities;
10. **Capital structure** of the company in the prescribed manner;
11. **Main objects of public offer**, terms of the present issue and such other particulars
12. Main objects and present business of the company and its location, schedule of implementation of the project;
13. Particulars relating to—
 - (A) **Management perception of risk factors** specific to the project;
 - (B) **Gestation period of the project**;
 - (C) **Extent of progress** made in the project;
 - (D) **Deadlines** for completion of the project; and
 - (E) Any litigation or **legal action pending** or taken by a Government

B) REPORTS IN PROSPECTUS

1. **Reports by the auditors** of the company with respect to its profits and losses and assets and liabilities.

2. **Reports relating to profits and losses** for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries

3. Reports made in the prescribed manner by the auditors upon the profits and losses of the business of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus:

4. Reports about the business or transaction to which the **proceeds of the securities are to be applied directly or indirectly;**

C) DECLARATION

1. Make a declaration about the **compliance of the provisions of this Act** and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act.

2. The date indicated in the prospectus shall be deemed to be the date of its publication.

7. The **Copy of the Prospectus must be registered** with the Registrar Of Companies, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

8. Every prospectus issued shall on the face of it,—

(a) state that a copy has been delivered for registration to the Registrar as required

(b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

9. The Registrar shall not register a prospectus unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

10. No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar.

CONTRAVENTION

(1) If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

STATEMENT IN LIEU OF PROSPECTUS

Statement in lieu of prospectus is a document issued by the company when it does not offer its securities for public subscription.