

## **Chapter 7**

### **Formation of a Company**

#### **Multiple Choice Questions**

Q. 1 Minimum number of members to form a private company is

A. 2

B. 3

C. 5

D. 7

Answer:

The Memorandum of Association must be signed by at least two persons in case of a private company.

Q. 2 Minimum number of members to form a public company is

A. 5

B. 7

C. 12

D. 21

Answer: The Memorandum of Association must be signed by at least seven persons in case of a public company.

Q. 3 Application for approval of name of a company is to be made to

A. SEBI

B. Registrar of Companies

C. Government of India

D. Government of the State in which Company is to be registered

Answer: The promoters have to select a name for the company and submit an application to the registrar of companies of the state in which the registered office of the company is to be situated for its approval.

Q. 4 A proposed name of the Company is considered undesirable if

- A. It is identical with the name of an existing company
- B. It resembles closely with the name of an existing company
- C. It is an emblem of Government of India, United Nations etc.
- D. In case of any of the above

Answer:

A name is considered undesirable in the following cases: (a) if it is identical with or too closely resembles the name of an existing company (b) if it is misleading. It is so considered if the name suggests that the company is in a particular business or it is an association of a particular type when it is not true. (c) If it is violative of the provisions of 'The Emblem and Names (Prevention of Improper Use) Act 1950, as given in the schedule to this Act.

Q. 5 A prospectus is issued by

- A. A private company
- B. A public company seeking investment from public
- C. A public enterprise
- D. A public company

Answer:

A prospectus is 'any document used as an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company.

Q. 6 Stages in the formation of a public company are in the following order

- A. Promotion, Commencement of Business, Capital Subscription, Incorporation,
- B. Incorporation, Capital Subscription, Promotion
- C. Promotion, Incorporation, Capital Subscription,
- D. Capital Subscription, Promotion, Incorporation

Answer:

A company is legally ready to commence business is referred to as stages in the formation of a company, such stages are- Promotion, Incorporation, Capital Subscription.

Q. 7 Preliminary Contracts are signed

- A. Before the incorporation
- B. After incorporation but before the capital subscription
- C. After incorporation but before the commencement of business
- D. After commencement of business

Answer:

During the promotion of the company, promoters enter into certain contracts with third parties on behalf of the company. These are called preliminary contracts or pre-incorporation contracts.

Q. 8 Preliminary Contracts are

- A. Binding on the Company
- B. Binding on the Company, if ratified after incorporation
- C. Binding on the Company, after incorporation
- D. Not binding on the Company

Answer: Preliminary Contracts are not legally binding on the company. A company after coming into existence may, if it so chooses, decide to enter into fresh contracts with the same terms and conditions to honour the contracts made by the promoters.

### **True/False**

Q. 1 It is necessary to get every company incorporated, whether private or public.

Answer:

True

Q. 2 Statement instead of the prospectus can be filed by a public company going for a public issue.

Answer:

False

Q. 3 A company can commence business after incorporation.

Answer:

True

Q. 4 Experts who help promoters in the promotion of a company are also called promoters.

Answer:

False

Q. 5 A company can ratify preliminary contracts after incorporation.

Answer:

False

Q. 6 If a company is registered based on fictitious names, its incorporation is invalid.

Answer:

False

Q. 7 'Articles of Association' is the main document of a company.

Answer:

False

Q. 8 Every company must file Articles of Association.

Answer:

False

Q. 9 If a company suffers heavy issues and its assets are not enough to pay off its liabilities, the balance can be recovered from the private assets of its members.

Answer:

False

### **Short Answer**

Q. 1 Name the stages in the formation of a company.

Answer:

The steps which are required by a company to commence business are referred to as stages in the formation of a company. This can be divided into three distinct stages, which are: (i) Promotion; (ii) Incorporation and (iii) Subscription of capital.

Q. 2 List the documents required for the incorporation of a company.

Answer:

The documents required for the incorporation of a company are as follows:

- The Memorandum of Association duly stamped, signed and witnessed.
- The Articles of Association duly stamped and witnessed as in case of Memorandum.
- A copy of the Registrar's letter approving the name of the company.
- A statutory declaration affirming that all legal requirements for registration have been complied with.
- A notice about the exact address of the registered office may also be submitted along with these documents.
- Documentary evidence of payment of registration fees.

Q. 3 What is a prospectus? Is it necessary for every company to file a prospectus?

Answer:

A prospectus is 'any document or an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company. This 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 securities.

A Prospectus is necessary for every company as it can invite the public to buy or invest in its shares.

Q. 4 Briefly explain the term 'Return of Allotment'.

Answer:

Return of Allotment is a statement submitted to the Registrar which contains the names and address of shareholders and the number of shares allotted to each shareholder. It is signed by the Director or secretary within 30 days of allotment. Return of Allotment shows that the company has received the minimum subscription.

Q. 5 At which stage in the formation of a company does it interact with SEBI?

Answer:

At the third stage in the formation of a company it interacts with SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for the disclosure of information and investor protection. A public company inviting funds from the general public must make adequate disclosure of all relevant information for which a prior approval from SEBI is, required raising funds from the public.

### **Long Answer**

Q. 1 What is meant by the term 'Promotion'? Discuss the legal position of promoters with respect to a company promoted by them.

Answer:

Promotion of a Company is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form a company so that it can give shape to the available business opportunity.

The legal positions of promoters concerning a company are as follows-

- Promoters undertake various activities to get a company registered and get it to the position of commencement of business. But they are neither the agents nor the trustees of the company.
- They are not the agents as the company but they are personally liable for all the contracts which are entered by them, for the company before its incorporation
- Promoters of a company can make a profit by making deals secretly on behalf of a company.
- Promoters are not legally entitled to claim the expenses incurred in the promotion of the company.

- The company may allot some shares and give them an option to purchase the securities at a future date.

Q. 2 Explain the steps taken by promoters in the promotion of a company.

Answer:

The steps taken by promoters in the promotion of a company are as follows:

- (i) Identification of business opportunity: The first and foremost activity of a promoter is to identify a business opportunity
- (ii) Feasibility studies: The promoters undertake detailed feasibility studies to investigate all aspects of the business they intend to start. Depending upon the nature of the project, the following feasibility studies may be undertaken, with the help of the specialists like engineers, chartered accountants etc., to examine whether the perceived business opportunity can be profitably exploited.
  - (a) Technical feasibility: Sometimes an idea may be good but technically not possible to execute. It may be so because the required raw material or technology is not easily available. For example, if the raw material is not produced in the country and it cannot be imported because of poor political relations then the project would be technically unfeasible until arrangements are made to make it available from alternative sources.
  - (b) Financial feasibility: Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up
  - (c) Economic feasibility: Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being



profitable is very little. Promoters then take the help of experts to conduct these studies.

When these investigations show positive results, then the promoters may decide to actually launch a company and move to further steps such as promoters have to select a name for the company and submit, an application to the registrar of companies of the state in which the registered office of the company is to be situated After that Promoters have to decide about the members who will be signing the Memorandum of Association of the proposed company. The promoters assist certain professionals such as mercantile bankers, auditors etc. in the preparation of necessary documents which are required to be with the Registrar of Companies. The promoter takes up various steps to prepare certain legal documents, which have to be submitted under the law, to the Registrar of the Companies for getting the company registered. These documents are Memorandum of Association, Articles of Association and Consent of Directors.

Q. 3 What is a 'Memorandum of Association'? Briefly explain its clauses.

Answer:

Memorandum of Association defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association. As per section 2(56) of The Companies Act, 2013 "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 law or this Act".

The Memorandum of Association contains different clauses, which are given as follows:

(i) The name clause: This clause contains the name of the company with which the company will be known, that has been already been approved by the Registrar of Companies.

(ii) Registered office clause: This clause contains the name of the state, in which the registered office of the company is proposed to be situated.

(iii) Objects clause: This is probably the most important clause of the memorandum. It defines the purpose for which the company is formed. A company is not legally entitled to undertake an activity, which is beyond the objects stated in this clause.

(iv) Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them.

(v) Capital clause: This clause specifies the maximum capital which the company will be authorized to raise through the issue of shares. The authorized share capital of the proposed company along with its division into the number of shares having a fixed face value is specified in this clause.

The Memorandum of Association must be signed by at least seven persons in case of a public company and by two persons in case of a private company

Q. 4 Distinguish between ‘Memorandum of Association’ and ‘Articles of Association.’

Answer:

The differences between Memorandum of Association’ and ‘Articles of Association are as follows:

S. No.	Basic difference	Memorandum of association	Articles of association
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1.	Objective	Memorandum of association defines the objects for which the company is formed.	Articles of association define the objects for which rules of internal management of the company. They indicate how the objective of the company are to be achieved.
2.	Position	<p>This is the main documents</p> <p>Association and is</p> <p>Subordinate companies act.</p>	<p>This is a subsidiary</p> <p>Of the company and is to the subordinate to both the companies act. Memorandum of association.</p>
3.	Relationship	Memorandum of association defines the relationship of the company with outsiders.	Articles of association defines the relationship between members and the company.

4.	Validity	Acts beyond memorandum of association are invalid and cannot be ratified even by a unanimous vote of the members.	The acts beyond the articles of association can be ratified by the members, provided they do not violate the memorandum.
5.	Necessity	Every company has to file a memorandum of association.	It is not compulsory for a public ltd. Company to file articles of association.

Q. 5 What is the meaning of ‘Certificate of Incorporation’?

Answer:

When the Registrar is satisfied with the formalities for registration, a Certificate of Incorporation is issued to the company, which signify the birth of the company. The certificate of incorporation may, therefore, be called the birth certificate of the company. The promoters make an application for the incorporation of the company. The application for registration must be accompanied by certain documents and submitted to the Registrar of office.

The application for registration must be accompanied by certain documents that are-

- The Memorandum of Association duly stamped, signed and witnessed. The signatories must also give information about their address, occupation and the number of shares subscribed by them.

- A copy of the Registrar's letter approving the name of the company
- A statutory declaration that all legal requirements for registration have been complied with. This must be duly signed.
- A notice about the exact address of the registered office may also be submitted along with these documents. However, if the same is not submitted at the time of incorporation, it can be submitted within 30 days of the receipt of the certificate of incorporation.
- Documentary evidence of payment of registration fees is to be provided.

Q. 6 Discuss the stages of formation of a company?

Answer:

➤ The stages of formation of a company are as follows-

1. Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. The promoter is said to be the one who undertakes to form a company about a given project and to set it going and who takes the necessary steps to accomplish that purpose.

➤ Steps in Promotion

- i. Approval of the company's name is taken from the Registrar of Companies
- ii. Signatories to the Memorandum of Association are fixed
- iii. Certain professionals are appropriated to assist the promoters
- iv. Documents necessary for registration are prepared

➤ Necessary Documents

- a. Memorandum of Association

b. Articles of Association

c. Consent of proposed directors

d. The agreement, if any, with proposed managing or whole-time director

e. Statutory declaration

2. After completing the aforesaid formalities, an application is made by promoters to the Registrar of Companies along with necessary documents and registration fee. The Registrar, then scrutiny the documents and issue certificate of incorporation. The certificate of incorporation is conclusive evidence of the legal existence of the company.

3. Capital Subscription A public company can raise the required funds from the public using the issue of securities (shares and debentures etc.). For doing the same, it needs to take the following steps for fundraising:

(i) SEBI approval;

(ii) File a copy of the prospectus with the Registrar of Companies;

(iii) Appointment of brokers, bankers and underwriters etc.

(iv) Ensure that minimum subscription is received;

(v) Application for listing of company's securities;

(vi) Refund/adjust excess application money received;

(vii) Issue allotment letters to successful applicants; and

(viii) File return of allotment with the Registrar of Companies (ROC).

