CHAPTER 7

Formation of a Company

VERY SHORT ANSWER TYPE QUESTIONS :

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

Solution: The following are the stages in the formation of a company:

1. Promotion: This step deals with idea generation and implementing it as a company.

2. Incorporation: This stage consists of applying for the certificate of incorporation and obtaining the same. After the certificate is received, a company becomes a valid entity in the books of law.

3. Issuing of shares and debentures: This stage involves raising capital in the form of issuing stocks and debentures to the public.

4. Business commencement: In this stage, the formalities are completed, and the company commences business.

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

Solution: The following documents are required to be submitted:

1. MoA or Memorandum of Association

2. AoA or Article of Association

3. Director's approval confirming that they will be functioning as the Director and buy qualification shares.

4. An agreement with the Managing Director or someone who is going to be given the post of Director.

5. A letter from the registrar containing approving the name of the company.

6. A statutory declaration stating that all legal registration requirements have complied.

7. A notice stating the exact address of the office. (It can also be submitted within 30 days of being incorporated.)

8. Payment evidence of registration fees in the form of a document.

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

Solution: A prospectus is an invitation from a company to the general public informing about the availability to purchase or subscribe to shares and debentures issued by the company. IPO, also known as Initial Public Offering, is a source of raising funds from the public. But, in the case of a private company, there is no need to file a prospectus as private companies are restricted from issuing IPO. A prospectus can be required if the aim is to generate funds from the public. Private companies are not required to file a prospectus.

4. Briefly explain the term 'Return of Allotment?

Solution: A statement submitted to the Registrar containing names and addresses of shareholders with the number of shares that are allotted to each of them is called a Return of Allotment. It needs to be signed by the Director or a Secretary within 30 days of the allotment. It shows that the company has received the minimum necessary subscription.

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

Solution: The stage of capital subscription is the stage where a company needs to interact with the Securities and Exchange Board of India (SEBI). The interaction is required because, during this phase, the company looks to raise capital from the public by issuing shares and debentures. For issuing such shares, the company has to follow the rules set by SEBI, so it becomes essential to obtain approval from SEBI before issuing shares or moving ahead with the capital subscription.

LONG ANSWER TYPE QUESTIONS:

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

Solution: The process of conceiving or developing an idea of business and taking the initial step towards converting it into a company so that the idea can be converted into a business project is called promotion, and the people who take those initial steps are known as promoters of the company.

A promoter, apart from developing the business idea, also needs to analyse the prospects in future and take necessary steps to fulfil the purpose. The promoter needs to arrange labour, machinery and capital. So here are some of the legal liabilities that a promoter has towards the company:

1. A promoter is neither an agent nor a trustee of the company, as prior to getting incorporated, a company does not exist as a legal entity.

2. Promoters cannot make secret profits by making deals acting on behalf of the organisation or company.

3. The promoters can be held legally liable for any untrue statement that will be filed in the company prospectus.

4. Expenses incurred by promoters during the promotion of the company cannot be claimed.

5. The promoters are not, may or may not be, considered for payments before a company gets incorporated. Based on the company's discretion, they may be allotted shares to compensate for their exemplary services.

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

Solution: A promoter is a person who takes up the initiative of forming a company based on a business idea and takes the necessary steps to ensure the purpose is met. A promoter has to do the following things to promote the company:

1. Identifying the business opportunity: The first step for a promoter is to identify a business opportunity and then analyse whether it is worth investing in.

2. Checking the feasibility of the idea: The idea that came to mind might not be feasible enough that it can be translated into a business. For this, some detailed study should be done, and for this, the following types of checks should be done:

i. Technical feasibility: In some ideas, the technical feasibility may be less, the reason for such can be the technology, or the kind of raw material required for executing the project is not easily available. So, this part needs to be taken care of.

ii. Financial Feasibility: All businesses require initial capital to get started and sustain in the market. Also, the promoters need to determine the cost that needs to be borne for implementing the idea. Therefore, if there is a fund crunch and the project cost is humongous, the plan needs to be changed.

iii. Economic feasibility: In some cases, the probability of success can be very low in spite of all other factors working in favour; that part also needs to be considered.

3. Choosing company name: As soon as a decision to establish a company is taken, the promoters select a name for it. To get the approval of the proposed name, the application needs to be submitted to the Registrar of Companies of the State. The application should contain three names in order of preference as the possibility of similar names may exist.

4. Choosing members to sign MoA: A promoter needs to choose members who will sign the Memorandum of Association (MoA) and will become the Directors of Company.

5. Selecting professionals: The promoters should hire professionals who will be preparing the necessary documents for the company; these professionals can be bankers, solicitors, brokers and underwriters.

6. Getting documents ready: After all professionals are appointed, the promoter submits all the prepared documents to the registrar of companies.

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

Solution: One of the essential documents in the formation of a company is the Memorandum of Association or MoA. It shows the main objectives of the company and its goals in the long term.

The MoA regulates the incorporated company's activities, such that it can undertake activities that are mentioned in MoA. The number of persons signing the form varies as per the type of company (seven in the case of a public company while two members for private). The main clauses of MoA are as follows:

1. Name: It should include the name of the company that has been approved by the Registrar of Companies.

2. Registered Office: The clause mentions the address and name of the company in which it is situated. Name-giving is not mandatory, but it is essential to submit the company name within 30 days of its incorporation.

3. Objects clause: Most important clause while filling MoA is it defines the objectives for which a company is raised. Any activity cannot be undertaken that is not stated in the objects clause. There are two types of object clauses, namely, main objects and other objects.

4. Liability clause: This clause is all about the liability of each shareholder as per the amount invested by them or the shares they own.

5. Capital clause: It refers to the clause of raising authorised capital by issuing shares.

6. Association clause: It contains the statement by those who sign the MoA and who accept the MoA and also the consent of buying qualification shares.

4. Distinguish between the 'Memorandum of Association' and the 'Articles of Association'?

Solution:

Basis of Comparison	**Memorandum of Association (MoA)**	**Articles of Association (AoA)**
Meaning	It is a document that contains all essential information required for company incorporation.	It is a document containing the rules and regulations of the company.
Objectives	Defines the scope of activities and character of the company.	It defines the rules and regulations of the company.
Position	Serves as the main document of the company and is subordinate to the Companies Act.	A subsidiary document that is subordinate both to the MoA and the Companies Act.
Relationship	Defines the relationship between outsiders and the company.	Defines the relationship between the company and its members.
Validity	Acts that are beyond MoA cannot be ratified.	Acts that are beyond AoA can be ratified if it does not violate MoA rules.
Necessity	It is a must for every company.	Not that important.
Alteration	A statutory authority approval is necessary for altering MoA.	Articles can be altered by passing a special resolution by the members.

5. What is the meaning of a Certificate of Incorporation?

Solution: A company becomes a legal entity by the date printed on the Certificate of Incorporation. A company can go into valid contracts after the conclusiveness of the Certificate of Incorporation. It acts as evidence of the legal existence of a company and the regularity of the incorporation.

A company becomes a legal entity once the Certificate of Incorporation is issued. A private company can immediately start a business and raise funds from relatives, friends or through some arrangement and can start a business, while a public company has to undergo two more steps to complete its formation.

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

Solution: The following stages are there in the formation of a company:

1. Promotion: This step deals with idea generation and implementing it in the form of a company.

2. Incorporation: This stage consists of applying for the Certificate of Incorporation and obtaining the same; after the certificate is received, a company becomes a valid entity in the books of law.

3. Issuing of shares and debentures: This stage involves raising capital in the form of issuing stocks and debentures to the public.

4. Business commencement: In this stage, the formalities are completed, and the business is commenced by the company.

Concepts covered in this chapter

Listed below are the concepts which are covered in Chapter 7 of NCERT Class 11 Solutions Business Studies –

- Business finance
- Formation of company
- Promotion of a company
- Functions of promoter
- Documents required to be submitted
- Position of promoters
- Incorporation
- Effect of the certificate of incorporation
- Capital subscription
- Commencement of business
- Preliminary contracts
- Provisional contracts