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Long Answer Questions

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

Answer:

Promotion is the first stage in the formation of a company. It involves conceiving a business opportunity and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. Thus, it begins with somebody having discovered a potential business opportunity. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company.

The legal position of promoters with respect to a company promoted by them are:

- The promoters are neither the trustees nor the agents of the company that they are forming. This is because the company does not exist as a legal entity before its incorporation.
- They cannot make any secret profits by making deals on behalf of the company.
- They are legally liable for any untrue statement filed in the prospectus of the company.
- The promoters cannot claim the expenses incurred by them during the promotion of the company.
- The company may or may not indemnify the promoters for the payments made before its incorporation. The company may choose to allot shares to them in order to compensate for their services.

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

Answer:

Promoter is a person who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose. The steps taken by promoters in the promotion of a company are:

- Identification of business opportunity: The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential.
- Feasibility studies: All the identified business opportunities may not be feasible or profitable as real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start with the help of chartered accountants, engineers, accountant, etc.. Various types of feasibility includes:
 - 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. Therefore, the technical feasibility of the idea has to be considered before proceeding further.

- Financial feasibility: Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the project cannot be financed within the fund available then idea may have to be dropped.
- 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. So, the idea will have to given up.
- Name approval: The promoters have to select a name for it 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. The proposed name may be approved if it is not considered undesirable. In such cases the proposed name is not accepted but some alternate name may be approved. Therefore, three names, in order of their priority are given in the application to the Registrar of Companies.
- Fixing up Signatories to the Memorandum of Association: Promoters have to decide about the members who will be signing the Memorandum of Association of the proposed company. Generally, who sign the MoA become the first directors of the company.
- Appointment of professionals: Certain professionals such as mercantile bankers, auditors etc., are appointed by the promoters to assist them in the preparation of necessary documents which are required to be with the Registrar of Companies. The details of the number of shares allotted to each shareholder, along with his or her addresses for correspondence, are submitted to the registrar.
- Preparation of necessary documents: The promoter takes up steps to prepare certain legal documents includes Memorandum of Association, Articles of Association and Consent of Directors, which have to be submitted under the law, to the Registrar of the Companies for getting the company registered.

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

Answer:

Memorandum of Association is the most important document as it defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association. The Memorandum of Association contains different clauses, which are:

- The name clause: This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.
- Registered office clause: This clause contains the name of the state, in which the registered office of the company is proposed to be situated.
- Objects clause: 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. It can be divided into two types:
 - The main objects: The main objects for which the company is formed are listed in this sub-clause.
 - Other objects: Objects not included in the main objects could be stated in this sub-clause.
- Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them.
- Capital clause: This clause specifies the maximum capital which the company will be authorised to raise through the

issue of shares.

- Association clause: In this clause, the signatories to the Memorandum of Association state their intention to be associated with the company and also give their consent to purchase qualification shares.

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

Answer:

Basis of difference	Memorandum of Association (MoA)	Articles of Association (AoA)
Objective	The MoA defines the character of a company and the scope of its activities.	The AoA defines the rules and regulation of the company.
Position	It is the main document of a company which is subordinate to the Companies Act.	It is the subsidiary document of a company which is subordinate to both MoA and the Companies Act.
Relationship	The MoA establishes the relation between the company and outsiders.	The AoA defines the relation of the company with its members.
Alteration	Altering the MoA requires the approval of a statutory authority.	The AOA can be easily altered by passing a resolution.
Ratification	Acts beyond MoA cannot be ratified.	Acts beyond the AoA can be ratified by the members if they do not violate the MoA.
Necessity	It is a necessary document.	It is a secondary document.

5. What is the effect of conclusiveness of the 'Certificates of Incorporation' and 'Commencement of Business'?

Answer:

Effect of Certificates of Incorporation:

- A company becomes a legal entity with perpetual succession on the date printed on the Certificate of Incorporation. After conclusiveness of the certificate of incorporation, the company becomes entitled to enter into valid contracts.
- The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation and legal existence of a company even if there is any flaw in its registration process.
- A company can immediately commence its business once its certificate of incorporation is issued. Thus, the certificate of incorporation is conclusive evidence of the existence of a company. As a result, the birth of the company cannot be questioned if it has the certificate of incorporation.

Effect of Certificate of Commencement of Business:

- The certificate of commencement of business is issued by the registrar of companies when all the documents submitted by the company are found satisfactory.
- The commencement of business certificate acts as definite proof for the company that it has the legal right to do business.
- The formation of a public company is completed once it is granted the certificate of commencement of business. Thus, the business activities of the company cannot be questioned as it is legally allowed to start its business after getting the certificate.

6. Is it necessary for a public company to get its share listed on a stock exchange? What happens if a public company going for a public issue fails to apply for a stock exchange for permission to deal in its securities or fails to get such permission?

Answer:

Yes, it is mandatory for every public company to be listed on a stock exchange. The public company is required to send an application to at least one stock exchange to get registered. Once it is listed, the company is allowed to offer its shares in order to

become public. However, initially the company may offer only a small percentage of its shares to the public.

If a public company going for a public issue fails to apply to a stock exchange for permission to deal in its securities or fails to get such permission before the expiry of ten weeks from the date of closure of subscription list, the allotment of shares done by the company shall become void and all money received from the applicants will have to be returned to them within eight days.

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