

## Class XI Business Studies

### Chapter 7 Formation of a company

#### Revision Notes

#### Formation of Company

- Formation of a company is a complex activity involving completion of legal formalities and procedures
- Involves three distinct stages, which are:
  - Promotion;
  - Incorporation
  - Subscription of capital
- Private company as against the public limited company is prohibited to raise funds from public, it does not need to issue a prospectus and complete the formality of minimum subscription

#### Promotion of 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.
- It is the first stage in the formation of a company

#### Promoter

According to Section 69, a 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. However, it is provided that nothing in this subclause shall apply to a person who is acting merely in a professional capacity.

#### Functions of Promoter

##### **1. Identification of 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.
- Opportunity is then analysed for its technical and economic feasibility.

##### **2. Feasibility studies**

- It may not be feasible or profitable to convert all identified business opportunities into real projects. The promoters, therefore, undertake detailed feasibility studies
- the following feasibility studies may be undertaken:
  - Technical feasibility: 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
  - Financial feasibility: Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If not able to arrange funds, then project needs to be given up
  - Economic feasibility: Project is technically viable and financially feasible but the chance of it being profitable is very little.

### **3. 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
- Proposed name is not accepted but some alternate name may be approved.
- Three names in order of their priority are given in the application to the Registrar of Companies

### **4. 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.
- People signing memorandum are also the first Directors of the Company.
- Their written consent to act as Directors and to take up the qualification shares in the company is necessary.

### **5. 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

### **6. Preparation of necessary documents:**

- The promoter takes up 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.

### Documents required to be submitted

#### Memorandum of Association

- It defines the objectives of the company.
- No company can legally undertake activities that are not contained in its MoA
- MoA contains following clauses:
  - Name Clause: contains the name of the company which has already been approved by the Registrar of Companies
  - Registered office clause: contains the name of the state, in which the registered office of the company is proposed to be situated. Exact address is not required but the same must be notified to the Registrar within thirty days of the incorporation of the company.
  - 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
  - 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. The authorised share capital of the proposed company along with its division into the number of shares having a fixed face value is specified

#### Articles of Association

- They are the rules regarding internal management of a company.
- These rules are subsidiary to the Memorandum of Association and hence, should not contradict or exceed anything stated in the Memorandum of Association
- According to section 2(5) of The Companies Act, 2013, 'articles' means the article 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

#### Consent of Proposed Directors

- Apart from the Memorandum and Articles of Association, a written consent of each person named as a director is required confirming that they agree to act in that capacity and undertake to buy and pay for qualification shares

#### Agreement

- The agreement which the company enters with individual as Director or a whole time Director or Manager is another document which is required to be submitted to the Registrar for getting the company registered under the Act

#### Statutory Declaration

- A declaration stating that all the legal requirements pertaining to registration have been complied with is to be submitted to the Registrar with the above mentioned documents for getting the company registered under the law.

#### Receipt of Payment of fee

- Necessary fees has to be paid for the registration of the company.
- The amount of such fees shall depend on the authorised share capital of the company

### **Position of Promoter**

- Promoters of a company enjoy a fiduciary position with the company, which they must not misuse.
- They can make a profit only if it is disclosed but must not make any secret profits.
- In the event of a non-disclosure, the company can rescind the contract and recover the purchase price paid to the promoters.
- It can also claim damages for the loss suffered due to the non-disclosure of material information.
- Promoters are not legally entitled to claim the expenses incurred in the promotion of the company. However, the company may choose to reimburse them for the pre incorporation expenses.
- The company may also remunerate the promoters for their efforts by paying a lump sum amount or a commission on the purchase price of property purchased through them or on the shares sold.
- The company may also allot them shares or debentures or give them an option to purchase the securities at a future date

### **Incorporation**

- The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company.
- The application for registration must be accompanied with certain documents. They are:
  - The Memorandum of Association duly stamped, signed and witnessed. In case of a public company, at least seven members must sign it. For a private company however the signatures of two members are sufficient
  - The Articles of Association duly stamped and witnessed as in case of the Memorandum
  - Written consent of the proposed directors to act as directors and an undertaking to purchase qualification shares.
  - The agreement, if any, with the proposed Managing Director, Manager or whole-time director.
  - 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. This must be duly signed.
  - 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.

### **Effect of the Certificate of Incorporation**

- A company is legally born on the date printed on the Certificate of Incorporation.
- It becomes a legal entity with perpetual succession on such date. It becomes entitled to enter into valid contracts.
- The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company

### Capital Subscription

The following steps are required for raising funds from the public:

1. **SEBI Approval:**
  - 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 and must not conceal any material information from the potential investors.
2. **Filing of Prospectus:**
  - A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies.
  - A prospectus is 'any document described or issued as a prospectus including 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 of, a body corporate'.
3. **Appointment of Bankers, Brokers, Underwriters:**
  - Raising funds from the public is a stupendous task. The application money is to be received by the bankers of the company.
  - The brokers try to sell the shares by distributing the forms and encouraging the public to apply for the shares. Underwriters undertake to buy the shares if these are not subscribed by the public
4. **Minimum Subscription:**
  - In order to prevent companies from commencing business with inadequate resources, it has been provided that the company must receive applications for a certain minimum number of shares before going ahead with the allotment of shares. According to the Companies Act, this is called the 'minimum subscription'.
  - Applications received for the shares are for an amount less than 90 per cent of the issue size, the allotment cannot be made and the application money received must be returned to the applicants.
5. **Application to Stock Exchange:**
  - An application is made to at least one stock exchange for permission to deal in its shares or debentures.
  - If such permission is not granted before the expiry of ten weeks from the date of closure of subscription list, the allotment shall become void and all money received from the applicants will have to be returned to them within 8 days
6. **Allotment of Shares:**
  - Till the time shares are allotted, application money received should remain in a separate bank account and must not be used by the company.
  - In case the number of shares allotted is less than the number applied for, or where no shares are allotted to the applicant, the excess application money, if any, is to be returned to applicants or adjusted towards allotment money due from them.
  - Allotment letters are issued to the successful allottees. 'Return of allotment', signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment

*Difference Between Memorandum of Association and Article of Association*

<b>BASIS OF DIFFERENCE</b>	<b>MEMORANDUM OF ASSOCIATION</b>	<b>ARTICLE OF ASSOCIATION</b>
<b>OBJECTIVES</b>	Memorandum of Association defines the objects for which rules of internal the company is formed.	Articles of Association are management of the company. They indicate how the objectives of the company are to be achieved
<b>POSITION</b>	This is the main document of the company and is subordinate to the Companies Act.	This is a subsidiary document and is subordinate to both the Memorandum of Association and the Companies Act.
<b>RELATIONSHIP</b>	Memorandum of Association defines the relationship of the company with outsiders.	Articles define the relationship of the members and the company
<b>VALIDITY</b>	Acts beyond the Memorandum of Association are invalid and cannot be the ratified even by a unanimous vote of the members.	Acts which are beyond Articles can be ratified by members, provided they do not violate the Memorandum
<b>NECESSITY</b>	Every company has to file a Memorandum of Association.	It is not compulsory for a public ltd. company to file Articles of Association. It may adopt Table F of The Companies Act, 2013