

## Chapter 7: Formation of a Company

NCERT · Class 11 · Business Studies

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### Textbook exercises

#### Question 1

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

#### Solution

Ans: True.

Every company must be incorporated since it can only lawfully begin doing business after it has been registered with the registrar of companies.

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#### Question 2

**Statement in lieu of prospectus can be filed by a public company going for a public issue.**

#### Solution

Ans: False.

A prospectus must be filed with the Registrar of Companies by a public limited company seeking applications from the general public to subscribe to its shares or debentures.

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#### Question 3

**A private company can commence business after incorporation.**

#### Solution

Ans: False.

After incorporation, not every firm is able to begin operations. Only when a private business is incorporated does it become a legal entity. As a result, only a private firm may start doing business right

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away after formation.

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#### Question 4

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

#### Solution

Ans: False.

A promoter is a person who comes up with the concept for forming a firm and takes actions to make it happen. Experts who assist promoters in marketing a firm, on the other hand, are not called promoters. They are just there to help the promoters.

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#### Question 5

**A company can ratify preliminary contracts after incorporation.**

#### Solution

Ans: False.

The company's preliminary contracts, often known as pre-incorporation contracts, are not legally enforceable. A preliminary contract cannot be ratified by a firm.

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#### Question 6

**If a company is registered on the basis of fictitious names, its incorporation is invalid.**

#### Solution

Ans: False.

A company's incorporation is null and void, if it is based on fake names. This is due to the fact that once a certificate of incorporation is granted, it cannot be challenged.

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### Question 7

**'Articles of association' is the main document of a company.**

#### Solution

Ans: False.

The company's principal document is not the 'Articles of Association.' The memorandum of association, on the other hand, is a company's most significant document.

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### Question 8

**Every company must file Articles of Association.**

#### Solution

Ans: False.

It is not necessary for every business to submit articles of association (AOA). The firm may use Table A of the Companies Act instead of AOA.

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### Question 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.**

#### Solution

Ans: False.

A company's shareholders are responsible only up to the amount of unpaid dividends on the shares they own.

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### Question 10

**Name the stages in the formation of a company.**

## Solution

Ans: The different stages in the formation of company are:

- Promotion
- Incorporation
- Subscription of capital
- Commencement of Business

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## Question 11

List the documents required for the incorporation of a company.

## Solution

Ans: The documents needed for registration for incorporation.

- Memorandum of Association: The Memorandum of Association duly stamped, signed, and witnessed. In the case of a public business, it must be signed by at least seven members. For a private business, however, two members' signatures are sufficient.
- Articles of Association: As with the Memorandum, the Articles of Association must be legally stamped and witnessed. This is also a very important document for the company that describes the way through which the objectives of MOA could be achieved.
- Director's Approval: The prospective directors' written approval to serve as directors, as well as an agreement to purchase qualification shares. The proposed Managing Director, Manager, or whole-time director's agreement, if any also needed.
- List of Directors: The names, addresses and all the details of the persons who have agreed to become and work as directors are provided.
- Registrar's Letter: A copy of the Registrar's letter approving the name of the company.
- Statutory Declaration: A statutory declaration attesting to the fact that all registration requirements have been met. This must be duly signed.
- Documentary Evidence: Documentary evidence of payment of registration fees.

- Prospectus: If a company wants to raise money from the public, prospectus is also needed.
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### Question 12

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

#### Solution

Ans: A prospectus is a company's announcement or invitation to the general public to subscribe for or acquire the company's shares or debentures. The initial public offering (IPO) is the process through which a public business can raise the money it requires.

It is not necessary for every company to file a prospectus, as a private business does not need to submit a prospectus since it is barred from collecting capital from the public. A prospectus is only necessary for a firm that needs to obtain cash from the general public by issuing shares or debentures.

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### Question 13

**Briefly explain the term 'Return of Allotment'.**

#### Solution

Ans: Return of Allotment is a statement in which the names, addresses, the number of shares allotted to the shareholders is mentioned. It is signed by a director or secretary and is filed with the Registrar of Companies(ROC) within 30 days of allotment. It shows that the company has received the minimum subscription.

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### Question 14

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

#### Solution

Ans: A company interacts with SEBI (Securities and Exchange Board of India) in the third stage of formation of the company, that is Capital Subscription, as SEBI clearance is required to raise funds from the public. The company is supposed to abide by the rules and guidelines provided by SEBI so as to protect the investors' interests. Thus, it is necessary for the company to get SEBI's approval before

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proceeding with capital subscription.

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### Question 15

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

### Solution

Ans: Promotion is the preliminary step in the formation of a company. Promotion of company means taking all the necessary steps to incorporate a company as per the provision of the Company Act, 2013. The persons undertaking the task of promotion are called Promoters. A promoter can be an individual, a partner, a company, an association or a syndicate.

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. Promoters are the ones who come up with the idea of starting a business.
  - They are expected to disclose profits, if any, made during the contracts executed by him on behalf of the company he promotes.
  - They are responsible for the preparation of various documents needed for the incorporation of a company
  - Promoters can be nominated as first directors of the company.
  - They are not supposed to make any secret profit while promoting a company.
  - A company may choose to allot shares to them in order to compensate for their services.
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### Question 16

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

### Solution

Ans: Promoter is a person who undertakes the process of promotion of a company. And who takes the necessary steps to accomplish that purpose.

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The steps are:

#### A. Identification of Business Opportunity

- The opportunity could be in the form of developing a new product or service, making a product available through a new channel, or any other investment opportunity.
- The technical and economic feasibility of the opportunity is next assessed.

#### B. Feasibility Studies

- Converting all potential business ideas into actual projects may not be viable or lucrative. As a result, the promoters do extensive feasibility assessments.
- The feasibility studies listed below may be carried out:
  - Technical Feasibility: An excellent idea may be technically impossible to implement. It could be due to a lack of readily available raw materials like material, labour, location, infrastructure, or technology.
  - Financial Viability: Every company activity necessitates the use of capital. The promoters must calculate the amount of money needed to pursue the recognised business idea. If money cannot be secured, the project must be abandoned.
  - Economic Feasibility: The project might be technically and financially possible, but it may have a slim possibility of being profitable. Hence this step focuses on the cost-benefit analysis of the company to find out its future viability.
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### C. Name Approval

- The promoters must choose a name for the company and file an application for approval to the registrar of companies in the state where the firm's registered office will be located.
- If the proposed name has been rejected, an alternate name may be accepted.
- In the application to the Registrar of Companies, three names are submitted in priority order.

### D. Fixing up Signatories to the Memorandum of Association:

- The members who will sign the proposed company's Memorandum of Association must be decided by the promoters.
- Those who sign the memorandum are also the company's first directors.
- Their signed consent to serve as Directors and to purchase the company's qualification shares is required.

### E. Appointment of Professionals:

- The promoters select specialists such as mercantile bankers, auditors, and others to assist them in preparing the essential documents that must be filed with the Registrar of Companies.

### F. Preparation of Necessary Documents:

- The promoter takes measures to prepare necessary legal documents that must be submitted to the Registrar of Companies for the company to be registered under the law.
- The Memorandum of Association, Articles of Association, and Consent of Directors are the documents required.

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## Question 17

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

## Solution

Ans: Memorandum of Association is a primary document of a company as it state the objectives of the company. The Memorandum is a document which describes the constitution of the company and its rights or privileges. The Memorandum of Association contains different clauses, which are:

The clauses of MOA are:

- Name Clause: This section contains the name of the business that has already been approved by the Registrar of Companies.
- Registered Office Clause: It specifies the state in which the company's registered office is proposed to be located. Although an exact address is not required, it must be provided to the Registrar within thirty days of the company's formation.
- Object's Clause: This specifies the reason for the company's formation. A firm is not legally permitted to engage in any action that is not related to the objectives set forth in this clause.
- Liability Clause: This clause restricts the members' liability to the amount owed on the shares they own.
- Capital Clause: This clause establishes the maximum amount of capital that the company may raise through the issuance of shares. The proposed company's permitted share capital, as well as its partition into the number of shares with a fixed face value, is defined.
- Subscription Clause: The subscription provision, which is the sixth and last clause of the MOA, shall declare the subscribers' intent to incorporate the company and agree to take shares in the firm based on the number stated in the Memorandum.

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## Question 18

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

## Solution

Ans: The difference between Memorandum of Association' and 'Articles of Association is as follows:

| Basis of | Memorandum of Association | Article of Association |
|----------|---------------------------|------------------------|
|          |                           |                        |

|                  |                                                                                                                                 |                                                                                                                                         |
|------------------|---------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| Differe<br>nce   |                                                                                                                                 |                                                                                                                                         |
| Objecti<br>ves   | The purposes for which the company's internal rules are developed are defined in the Memorandum of Association.                 | The company's management is governed by the articles of association. They describe how the company's goals will be met.                 |
| Positio<br>n     | This is the company's primary document, and it is governed by the Companies Act.                                                | This is a supporting document that exists alongside the Memorandum of Association and the Companies Act.                                |
| Relatio<br>nship | The company's interaction with outsiders is defined by the Memorandum of Association.                                           | Articles clarify the members' and company's connection.                                                                                 |
| Validity         | Acts that go beyond the Memorandum of Association are void and cannot be ratified by the members even if they vote unanimously. | Members can ratify acts that go beyond the Articles as long as they don't contradict the Memorandum.                                    |
| Neces<br>sity    | A Memorandum of Association is required for every business.                                                                     | Articles of Association are not required to be filed by a public limited business. Table F of the Companies Act of 2013 may be adopted. |

### Question 19

**What is the meaning of 'Certificate of Incorporation'?**

### Solution

Ans: Certificate of Incorporation is like the birth certificate of the company as the company comes into existence from the date mentioned in the certificate. The company now become a legal person distinct from its members. It becomes a corporate body having perpetual succession from the date of its incorporation. 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. The Company can sue and be sued upon others in its own name.

## Effect of the Certificate of Incorporation

- The date inscribed on the Certificate of Incorporation marks the beginning of a company's legal existence.
- On that date, it becomes a legal entity with eternal succession. It gains the ability to enter legally binding contracts.
- The Certificate of Incorporation is indisputable documentation of a company's regular incorporation.

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### Question 20

**Discuss the stages of the formation of a company?**

### Solution

Ans: Formation of a company means registering or incorporating a company with the Registrar of companies in the state where the company's registered office is to be located.

Following are the stages in formation of a company

#### A. Promotion:

- Promotion of a company means taking all the necessary steps to incorporate a company as per the provision of the act. It begins with somebody having discovered a potential business idea.
- The persons undertaking the task of promotion are called Promoters. A promoter can be an individual, a partner, a company, an association or a syndicate.
- He fulfils the following function:
  - Identification of business opportunity:
  - Feasibility studies:
  - Name approval:
  - Assembling the Memorandum of Association Signatories:
  - Appointment of professionals:

- Preparation of necessary documents:

- Identification of business opportunity:
- Feasibility studies:
- Name approval:
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- Preparation of necessary documents:

## B. Incorporation:

- Depending upon the objects of the company, scale of operation, amount of capital needed, etc. The promoters decided whether to form a public company or a private company.
- The application for registration of a company should be presented to the Registrar of Companies in which the business office of the company is to be situated.
- The date inscribed on the Certificate of Incorporation marks the beginning of a company's legal existence.
- On that date, it becomes a legal entity with eternal succession. It gains the ability to enter legally binding contracts.
- The Certificate of Incorporation is indisputable documentation of a company's regular incorporation.

## C. Commencement of Business:

- A public company and Private Companies not having a share capital can commence its business activities immediately after it has received the Certificate of Incorporation from the Registrar of companies.
- SEBI clearance is required to raise funds from the public. The Registrar of Companies will receive a copy of the prospectus or a statement in lieu of the prospectus. Bankers, brokers, underwriters, and other professionals are hired.

- A request for approval to trade in shares or debentures must be made to the stock exchange.
  - The company is also required to file verification of its registered office with the Registrar.
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### Question 21

**Find out from the office of the Registrar of Companies, the actual procedure for the formation of companies. Does it match with what you have studied? What are the obstacles which companies face in getting themselves registered?**

### Solution

Ans: The Companies Act of 1956 establishes guidelines for the formation of both public and private corporations. Yes, it matched with what we have studied in the book.

Obstacles while registering a company:

- Name availability, as at least 6 names have to be provided, as the proposed names could be rejected if that name is already registered.
  - Choosing the business type, as private limited, public limited, limited liability partnership, sole proprietorship, franchise, partnership, etc.
  - Ensuring the authenticity and accuracy of data in supporting documents while registering.
  - Deciding about the share structure, class of shares, types of shares etc.
  - Framing a well-defined business description.
  - Getting the DIN number.
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