

Revision Notes

Class – 11 Business Studies

Chapter 7 – Formation of a Company

Formation of Company

- Formation of a Company is a time-consuming process that requires the completion of numerous legal formalities and processes,
- There are three important steps in this process:
 - A. Promotion
 - B. Incorporation
 - C. Subscription of capital
- Unlike a public limited company, which is forbidden from raising funds from the public, a private corporation is not required to produce a prospectus or complete the formalities of a minimum subscription.

A. Promotion of company

- It entails conceptualizing a business idea and taking the initiative to start a company so that the available business opportunity can be put into practice.

Promoter

- The term Promoter is defined in Section 2(69) of the Companies Act 2013 as
 - 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
 - who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

- in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

Functions of Promoter

1. 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.

2. 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.

3. 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.

4. 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.

5. 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.

6. 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.

Documents required to be submitted

There are six documents in total, they are:

1. Memorandum of Association

- It identifies the company's goals. The Memorandum of Association is 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.

- No corporation can legally engage in activities that are not outlined in its memorandum of association.
- The following clauses are included in the MoA:
 - **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.

2. Articles of Association

- They are the rules that govern a company's internal management.
- These regulations are an addendum to the Memorandum of Association; they should not conflict with or supersede anything in the Memorandum of Association.

- According to Section 2(5) of the Companies Act, 2013, "articles" refers to a company's articles of organization as initially drafted, as amended from time to time, or as implemented in accordance with any previous company law or this Act.

3. Consent of Proposed Directors

- In addition to the Memorandum and Articles of Association, everyone nominated as a director must sign a written permission stating that they accept to function in such capacity and agree to purchase and pay for qualification shares.

4. Agreement

- Another document that must be presented to the Registrar for the company to be registered under the Act is the agreement that the firm forms with an individual as a Director or a full-time Director or Manager.

5. Statutory Declaration

- A declaration confirming that all legal conditions for registration have been met must be presented to the Registrar along with the above-mentioned documents for the company to be legally registered.

6. Receipt of Payment of Fee

- The necessary payments for the company's registration must be paid.
- The amount of such fees will be determined by the company's authorized share capital.

Position of Promoter

- A firm's promoters have a fiduciary relationship with the company, which they must not abuse.
- They can only make a profit if it is publicly revealed; they cannot make any hidden gains.
- In the event of non-disclosure, the company has the right to cancel the contract and reclaim the money paid to the promoters.
- It can also sue for damages or losses incurred because of material information not being disclosed.
- Promoters do not have the legal right to claim expenses incurred in the company's promotion. The company, on the other hand, may choose to reimburse them for their pre-incorporation costs.
- The corporation may also pay the promoters a lump sum payment or a commission on the purchase price of property obtained through them or on the shares sold as compensation for their efforts.
- The corporation may also provide them stock or debentures or give them the opportunity to buy the securities later.

B. Incorporation

- The application must be filed with the Registrar of Companies in the state where the company's registered office will be located.
- A registration application must be accompanied by specified papers. They are as follows:
 - A duly stamped, signed, and witnessed Memorandum of Association. In the case of a public business, it must be signed by at least seven members. However, two members' signatures are sufficient for a private company.
 - As with the Memorandum, the Articles of Association must be legally stamped and witnessed.
 - The prospective directors' written approval to serve as directors, as well as an agreement to purchase qualification shares.

- The prospective Managing Director, Manager, or full-time director has reached an agreement if one exists.
- A copy of the letter from the Registrar authorizing the company's name.
- A legislative declaration attesting to the fact that all registration requirements have been met. This document must be properly signed.
- Along with these documents, a notification containing the exact address of the registered office may be submitted.

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.

C. Capital Subscription

- 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.

Process of Capital Subscription:

1. SEBI Approval

- SEBI (Securities and Exchange Board of India), our country's regulatory body, has developed recommendations for information disclosure and investor protection.

- A public firm seeking funding from the public must make full disclosure of all relevant facts to potential investors and must not withhold any material information.

2. Filing of Prospectus

- Section 2(70) of the Companies Act of 2013 defines a prospectus as. “Any document that is described or issued as a prospectus” is how a prospectus is defined. This includes any notification, circular, advertisement, or other document that serves as an invitation to public offers.
- The Registrar of Companies receives a copy of the prospectus or a statement in lieu of the prospectus. A Statement in Lieu of Prospectus is submitted with the Registrar of Companies (ROC) when a company does not issue a prospectus to the public for the subscription of the shares.
- All of the directors or their authorised agents must sign the declaration in writing. It's similar to a prospectus, with the exception that it's only a few pages long.

3. Appointment of Bankers, Brokers, Underwriters

- Raising money from the general people is a huge undertaking. The money for the application will be received by the company's bankers.
- The brokers try to sell the shares by handing out application forms and pushing others to apply. If the public does not subscribe to the shares, the underwriters promise to buy them.

4. Minimum Subscription

- To prevent enterprises from starting into business with insufficient resources, the company must obtain applications for a particular minimum number of shares before proceeding with the issuance of shares. This is referred to as the 'minimum subscription' under the Companies Act.

- If the number of applications for the shares received is less than 90% of the issue size, the allocation cannot be made, and the application money must be refunded to the applicants.

5. Application to Stock Exchange

- At least one stock exchange is approached for approval to trade in its shares or debentures.
- If such approval is not obtained within ten weeks of the subscription list's closing date, the allotment becomes worthless, and any money received from applicants must be returned to them within eight days.

6. Allotment of Shares

- The money received for the application should be kept in a separate bank account and not used by the company until the shares are distributed.
- If the number of shares allocated is fewer than the number applied for, or if no shares are assigned to the applicant, any excess application money must be returned to the applicants or applied to allotment money owed to them.
- Successful allottees receive their allotment letters. Within 30 days of allotment, a 'return of allotment' signed by a director or secretary is filed with the Registrar of Companies.

Difference Between Memorandum of Association and Article of Association

Basis of Difference	Memorandum of Association	Article of Association
Objectives	The purposes for which the company's internal rules are developed are defined in the	The company's management is governed by the articles of association. They describe how the

	Memorandum of Association.	company's goals will be met.
Position	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.
Relationship	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.
Necessity	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.