



# *Business Studies Notes PDF*

*On*

*Formation of a Company*

*(Class - 11 / Chapter- 7)*

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.

### **Promotion of a Company**

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 the particular shape can be given to exploiting the available business opportunity.

### **FUNCTIONS OF A PROMOTER:**

**(i) Identification of Business Opportunity:** The foremost activity of a promoter is to identify a first and business opportunity.

**(ii) 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 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 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.

**(iii) Name Approval:** Having decided to launch a company, the promoters have to select a name for it and submit. 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.

**(iv) 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.

**(v) 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.

**(vi) Preparation of Necessary Documents:** The promoter takes up steps to prepare certain legal documents. Which have to be submitted under the law. The Memorandum of Association, Articles of Association, and Consent of Directors are the documents required.

### **DOCUMENTS REQUIRED TO BE SUBMITTED:**

**A. Memorandum of Association:** 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. As per section 2(56) of The Companies Act, 2013 “memorandum” means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. The Memorandum of Association contains different clauses, which are given as follows:

- **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.
- **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 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.

#### **B. 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.

#### **C. Consent of Proposed Directors**

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

#### **D. 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.

#### **E. 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.

#### **F. 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 Promoters:**

Promoters undertake various activities to get a company registered and get it to the position of commencement of business. But they are neither the agents nor the trustee of the company. They can't be the agents as the company is yet to be incorporated.

#### **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.

**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 indisputable documentation of a company's regular incorporation.

**CAPITAL SUBSCRIPTION****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**

- A copy of the prospectus or statement of lieu of prospectus is filed with the Register of companies.
- 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.

**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 distributing the forms and encouraging the public to apply for the shares. Underwrites undertake to buy the shares if these are not subscribed by the public.

**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**

- An application is made to at least one stock exchange for permission to deal 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
<b>Objectives</b>	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.
<b>Position</b>	This is the main document of the company and is subordinate to the companies Act.	This is a supporting 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 clarify the members' and company's connection.
<b>Validity</b>	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.
<b>Necessity</b>	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.

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