Chapter 7: Corporate Organisation, Finance and Trade

Exercises — Exercises

Q1 Name the stages in the formation of a company.

The formation of a company passes through three distinct stages: (i) Promotion, (ii) Incorporation and (iii) Subscription of capital. Promotion is the first stage, where a business idea is conceived and the steps to form a company are taken. In incorporation, the promoters apply to the Registrar of Companies and obtain the Certificate of Incorporation. Capital subscription is needed only by a public company that raises funds from the public. A private company is prohibited from inviting the public to subscribe, so it passes through only the first two stages.

Q2 List the documents required for the incorporation of a company.

The application for incorporation is filed with the Registrar of Companies along with these documents: (1) Memorandum of Association, duly stamped, signed and witnessed; (2) Articles of Association, similarly stamped and witnessed (a public company adopting Table F submits a statement in lieu of prospectus instead); (3) written consent of the proposed directors to act as directors and to buy qualification shares; (4) the agreement, if any, with a proposed Managing Director, Manager or whole-time director; (5) a copy of the Registrar's letter approving the company name; (6) a signed statutory declaration that all legal requirements have been complied with; (7) a notice of the exact address of the registered office, which may be filed within 30 days of incorporation; and (8) documentary evidence of payment of the registration fees.

Q3 What is a prospectus? Is it necessary for every company to file a prospectus?

A prospectus is any document, notice, circular or advertisement that invites deposits from the public, or invites the public to subscribe to or purchase the securities (shares, debentures etc.) of a body corporate. It is an invitation to the public to invest, and investors decide mainly on the information it contains, so it must carry no mis-statement and must disclose all material information. It is not necessary for every company to file a prospectus. A private company cannot raise funds from the public, so it need not issue one. A public company that raises funds from friends or relatives, and not from the public, files a statement in lieu of prospectus with the Registrar at least three days before allotment of shares.

Q4 Briefly explain the term 'Return of Allotment'.

Return of allotment is a statement submitted to the Registrar of Companies after shares have been allotted. It gives the names and addresses of the shareholders and the number of shares allotted to each. It is signed by a director or the secretary of the company and must be filed with the Registrar within 30 days of allotment. It is the last step of the capital subscription stage, after allotment letters have been issued to the successful applicants.

Q5 At which stage in the formation of a company does it interact with SEBI.

A company interacts with SEBI (Securities and Exchange Board of India) at the capital subscription stage, the third stage of formation. A public company that wants to raise funds from the general public by issuing shares or debentures must first obtain prior approval from SEBI. SEBI has issued guidelines on disclosure of information and investor protection, and the company must disclose all relevant information and conceal nothing material from potential investors. SEBI approval is the first step in raising funds from the public. A private company does not go through this stage.

Q6 What is meant by the term 'Promotion'. Discuss the legal position of promoters with respect to a company promoted by them.

Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking the initiative to form a company so that the business opportunity can be exploited in practice. The persons who do this, whether an individual, a group of persons or even a company, are called promoters. They examine the feasibility of the idea, assemble the men, materials, machinery, managerial abilities and finance, prepare the documents and get the company registered.

Legal position of promoters: Promoters are neither agents nor trustees of the company. They cannot be agents because the company has not yet been incorporated, and they are not trustees either. They are personally liable for contracts made on the company's behalf before incorporation, unless the company later chooses to honour them. Promoters hold a fiduciary position, so they must not misuse it. They may make a profit only if it is disclosed and must not make any secret profit. If they do not disclose it, the company can rescind the contract, recover the purchase price paid to the promoters and claim damages. Promoters cannot legally claim their promotion expenses. The company may, however, reimburse the pre-incorporation expenses, pay a lump sum or commission, or allot them shares or debentures.

Q7 Explain the steps taken by promoters in the promotion of a company.

Before the steps below, promoters identify a business opportunity and test its technical, financial and economic feasibility with the help of experts. If the results are positive, they proceed as follows.

(i) Name approval: They select a name and apply to the Registrar of Companies of the state of the proposed registered office. They give three names in order of priority. A name that is identical or too similar to an existing company's, or misleading, is rejected.
(ii) Fixing signatories to the Memorandum: They decide who will sign the Memorandum of Association. These people are usually the first directors, and their written consent to act as directors and to take qualification shares is needed.
(iii) Appointment of professionals: They appoint professionals such as mercantile bankers and auditors to help prepare the documents to be filed with the Registrar.
(iv) Preparation of necessary documents: They prepare the Memorandum of Association, the Articles of Association and the consent of the directors. They also prepare the agreement with a managing or whole-time director, if any, and the statutory declaration.

Q8 What is a 'Memorandum of Association'? Briefly explain its clauses.

The Memorandum of Association is the most important document of a company, as it defines the company's objectives. No company can legally undertake an activity that is not contained in it. It has the following clauses:

(i) Name clause: the name of the company, already approved by the Registrar.
(ii) Registered office clause: the state in which the registered office will be situated. The exact address must be notified to the Registrar within thirty days of incorporation.
(iii) Objects clause: probably the most important clause. It states the purpose for which the company is formed, and acts beyond these objects are not valid. Acts essential or incidental to the main objects are valid.
(iv) Liability clause: limits the members' liability to the amount unpaid on their shares.
(v) Capital clause: states the maximum (authorised) share capital and its division into shares of fixed face value.

It must be signed by at least seven persons for a public company and two for a private company.

Q9 Distinguish between 'Memorandum of Association' and 'Articles of Association.'

The two documents differ on the following bases.

1. Objective: The Memorandum defines the objects for which the company is formed. The Articles are the rules of internal management and show how those objects are to be achieved.
2. Position: The Memorandum is the main document of the company and is subordinate only to the Companies Act. The Articles are a subsidiary document, subordinate to both the Memorandum and the Act.
3. Relationship: The Memorandum defines the relationship of the company with outsiders. The Articles define the relationship between the members and the company.
4. Validity: Acts beyond the Memorandum are invalid and cannot be ratified even by a unanimous vote of members. Acts beyond the Articles can be ratified by the members, provided they do not violate the Memorandum.
5. Necessity: Every company must file a Memorandum. A public company need not file Articles and may adopt Table F of the Companies Act, 2013.

Q10 What is the meaning of 'Certificate of Incorporation'?

The Certificate of Incorporation is the document the Registrar of Companies issues when he is satisfied that the documents are in order and all statutory requirements for registration have been met. It signifies the birth of the company, so it is called the birth certificate of the company. The company is legally born on the date printed on it. From that date it becomes a legal entity with perpetual succession and can enter into valid contracts. The Registrar also allots a Corporate Identity Number (CIN). The certificate is conclusive evidence that the company legally exists, whatever flaw there may be in the registration. Even a company registered with illegal objects cannot have its birth questioned, and the only remedy is to wind it up.

Q11 Discuss the stages of formation of a company?

A company is formed in three stages.

1. Promotion: This starts with a business idea. Promoters carry out technical, financial and economic feasibility studies. They then get the name approved, fix the signatories to the Memorandum, appoint professionals and prepare the documents: Memorandum, Articles, consent of directors, agreement with managing or whole-time director if any, and statutory declaration.

2. Incorporation: The promoters apply to the Registrar of Companies with the documents and the registration fee. After scrutiny, the Registrar issues the Certificate of Incorporation, which is conclusive evidence of the company's legal existence. A private company can commence business after this. Under the chapter's text, a certificate for commencement of business is to be obtained within 180 days of incorporation.

3. Capital subscription: This applies to a public company raising funds from the public. The steps are SEBI approval, filing the prospectus with the Registrar, and appointing bankers, brokers and

underwriters. They also include ensuring minimum subscription (90 per cent of the issue size), applying to a stock exchange for listing, allotting shares and filing the return of allotment within 30 days.