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## Introduction to Formation of a Company

Modern business requires substantial capital and faces increasing competition and technological changes, which raise risks. Consequently, the company form of organisation is preferred for medium and large businesses.

The process from conceiving a business idea to legally starting a company is called the stages in the formation of a company. The individuals undertaking these steps and risks are called promoters.

This chapter explains the stages and steps involved in forming a company, providing a clear understanding of the process.

**Example:** Avtar, an engineer, developed a carburettor that reduces petrol consumption by 40%. He wants to produce it on a large scale and needs significant funds. He considers different business forms and decides to form a company due to the large capital requirement and risk involved.

### Quick Reference

- Company formation involves legal formalities and procedures.
- Promoters are those who initiate and take risks to form the company.
- Company form is preferred for large scale and risky businesses.

### Glossary

- **Promoters:** Individuals who take steps to form a company and assume associated risks.

- **Company Formation:** The process of legally establishing a company.

## Stages in Formation of a Company

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The formation of a company involves three main stages:

- **Promotion:** Conceiving the business idea and initiating company formation.
- **Incorporation:** Legal registration of the company with the Registrar of Companies.
- **Subscription of Capital:** Raising funds by issuing shares and debentures (applicable mainly to public companies).

Note: Private companies do not raise funds from the public and thus do not require issuing a prospectus or minimum subscription.

### Quick Reference

- Promotion, Incorporation, and Capital Subscription are key stages.
- Private companies have simpler procedures compared to public companies.

### Glossary

- **Incorporation:** The legal process of registering a company.
- **Subscription of Capital:** Process of raising funds by issuing securities.

## Promotion of a Company

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Promotion is the first stage in company formation. It involves:

- Conceiving a business idea.
- Analyzing its feasibility.
- Assembling resources.
- Preparing necessary documents.
- Getting the company registered.

Promoters are persons or groups who undertake these activities and assume risks.

### Definition of Promoter (Section 69)

- Named in prospectus or annual return.
- Controls company affairs directly or indirectly.
- Board of Directors acts on their advice, except professionals acting in their capacity.

### Functions of Promoters

1. **Identification of Business Opportunity:** Discovering potential profitable business ideas.
2. **Feasibility Studies:** Assessing technical, financial, and economic viability.
  - *Technical Feasibility:* Availability of technology and raw materials.
  - *Financial Feasibility:* Availability of funds and investment potential.
  - *Economic Feasibility:* Profitability prospects.
3. **Name Approval:** Applying to Registrar of Companies for company name approval.
4. **Fixing Signatories:** Selecting members to sign the Memorandum of Association.
5. **Appointment of Professionals:** Engaging bankers, auditors, and legal experts.
6. **Preparation of Documents:** Drafting Memorandum and Articles of Association, and other required documents.

## Name Clause – Undesirable Names

- Identical or similar to existing company names.
- Misleading about the nature of business.
- Violates Emblem and Names (Prevention of Improper Use) Act, 1950.

## Documents Required for Registration

- **Memorandum of Association (MOA):** Defines company objectives and structure.
- **Articles of Association (AOA):** Rules for internal management.
- **Consent of Proposed Directors:** Written agreement to act as directors.
- **Agreement:** Contracts with Managing Director or other key personnel.
- **Statutory Declaration:** Legal compliance statement signed by authorized persons.
- **Receipt of Payment of Fees:** Proof of registration fee payment.

## Memorandum of Association Clauses

1. **Name Clause:** Approved company name.
2. **Registered Office Clause:** State of registered office.
3. **Objects Clause:** Purpose and activities of the company.
4. **Liability Clause:** Limits members' liability to unpaid share amount.
5. **Capital Clause:** Maximum authorised share capital.

**Example:** A shareholder with 1000 shares of Rs 10 each, having paid Rs 6 per share, has a liability of Rs 4 per share, totaling Rs 4,000.

## Articles of Association Contents

- Rules on share issuance, transfer, calls, forfeiture, and nomination.

- Directors' appointment, meetings, powers, and remuneration.
- General meetings, audit, dividends, borrowing powers, and winding up.

## Position of Promoters

- Not agents or trustees of the company before incorporation.
- Personally liable for pre-incorporation contracts unless ratified.
- Must disclose profits; secret profits can be rescinded by the company.
- Not entitled to claim promotion expenses unless reimbursed by the company.

## Quick Reference

- Promoters initiate company formation and assume risks.
- MOA and AOA are key legal documents.
- Proper name approval is essential.
- Promoters have fiduciary duties and liabilities.

## Glossary

- **Memorandum of Association:** Document defining company objectives and scope.
- **Articles of Association:** Rules governing internal management.
- **Promoter's Liability:** Responsibility for contracts before company incorporation.

## Incorporation of a Company

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Incorporation is the legal process of registering a company with the Registrar of Companies (ROC). The promoters submit an application along with required documents and fees.

### Documents Submitted for Incorporation

1. Memorandum of Association signed by required members.
2. Articles of Association duly stamped and witnessed.
3. Written consent of proposed directors.
4. Agreement with Managing Director or key personnel, if any.
5. Registrar's approval letter for company name.
6. Statutory declaration of legal compliance.
7. Notice of registered office address.
8. Proof of payment of registration fees.

Upon satisfaction, the Registrar issues the Certificate of Incorporation, which is the company's birth certificate and conclusive evidence of its legal existence.

From the date on the certificate, the company becomes a legal entity with perpetual succession and can enter into contracts.

## Preliminary Contracts

Contracts entered into by promoters before incorporation are called preliminary contracts. These are not binding on the company unless it chooses to adopt them. Promoters remain personally liable for these contracts.

## Director Identification Number (DIN)

Individuals intending to become directors must apply for a DIN from the Central Government. Each individual can have only one DIN.

## Quick Reference

- Incorporation requires submission of legal documents and fees.
- Certificate of Incorporation confirms company's legal existence.
- Preliminary contracts are promoter liabilities unless adopted by the company.
- DIN is mandatory for directors.

## Glossary

- **Certificate of Incorporation:** Legal proof of company registration.
- **Preliminary Contracts:** Contracts made by promoters before company formation.
- **Director Identification Number (DIN):** Unique number allotted to company directors.

## Capital Subscription

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Capital subscription is the process by which a public company raises funds from the public by issuing securities such as shares and debentures.

## Steps in Raising Capital

1. **SEBI Approval:** Obtain prior approval from Securities and Exchange Board of India to protect investors.
2. **Filing Prospectus:** Submit a prospectus or statement in lieu of prospectus to the Registrar of Companies. This document invites the public to subscribe to securities.
3. **Appointment of Bankers, Brokers, Underwriters:** Bankers receive application money; brokers sell shares; underwriters guarantee subscription by buying unsubscribed shares.

4. **Minimum Subscription:** At least 90% of the issue size must be subscribed before allotment. Otherwise, money is refunded.
5. **Application to Stock Exchange:** Apply for permission to list securities on stock exchanges.
6. **Allotment of Shares:** Shares are allotted to applicants; excess money is refunded or adjusted.
7. **Return of Allotment:** File a return of allotment with the Registrar within 30 days.

## One Person Company (OPC)

An OPC is a company with a single member, introduced under the Companies Act, 2013 to encourage micro businesses and entrepreneurship.

### Characteristics of OPC

- Only a natural Indian citizen resident in India can incorporate an OPC.
- One person can incorporate only one OPC and be nominee in only one OPC.
- Minors cannot be members or nominees.
- OPC cannot carry out non-banking financial investment activities.
- Conversion to other company types is restricted for two years unless capital or turnover thresholds are exceeded.

### Quick Reference

- Public companies raise capital by issuing securities to the public.
- SEBI regulates public issues to protect investors.
- OPC allows single-person ownership with limited liability.

### Glossary

- **Prospectus:** Document inviting public to subscribe to company securities.
- **Underwriters:** Entities guaranteeing subscription of shares.
- **One Person Company:** Company with a single member enjoying limited liability.

## Summary of Formation of a Company

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Formation of a company involves three main stages:

1. **Promotion:** Identification of business opportunity, feasibility studies, name approval, fixing signatories, appointing professionals, and preparing documents.
2. **Incorporation:** Submission of documents and fees to Registrar of Companies, issuance of Certificate of Incorporation, and obtaining Director Identification Numbers.

3. **Capital Subscription:** For public companies, raising funds through public issue of securities following SEBI guidelines, minimum subscription, allotment, and listing.

Promoters play a crucial role but have personal liabilities before incorporation. The Memorandum and Articles of Association are key legal documents defining the company's objectives and internal rules.

One Person Company is a new concept allowing single ownership with limited liability, encouraging entrepreneurship.

## Key Terms

- Promotion
- Prospectus
- Commencement of Business
- Memorandum of Association
- Incorporation
- Articles of Association
- Capital Subscription