NCERT SOLUTIONS

CLASS - 11th



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Class :11th

Subject : Business Studies

Chapter : 7

Chapter Name : Formation of a company

Q1 Minimum number of members to form a private company is

(a) 2

(b) 3

(c) 5

(d) 7

Answer. (a) 2

Page : 182 , Block Name : Multiple Choice Questions

Q2 Minimum number of members to form a public company is

(a) 5

(b) 7

(c) 12

(d) 21

Answer. (b) 7

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Q3 Application for approval of name of a company is to be made to

(a) SEBI

(b) Registrar of Companies

(c) Government of India

(d) Government of the State in which Company is to be registered

Answer. (b) Registrar of company

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Q4 A proposed name of Company is considered undesirable if

(a) It is identical with the name

(b) It resembles closely with of an existing company the name of an existing company

(c) It is an emblem of Government

(d) In case of any of the above

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Answer. (d) In case of any of the above

Page : 183 , Block Name : Multiple Choice Questions

Q5 A prospectus is issued by

(a) A private company

(b) A public company seeking investment from public

(c) A public enterprise

(d) A public company

Answer. (d) A public company

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Q6 Stages in the formation of a public company are in the following order

(a) Promotion, Commencement

(b) Incorporation, Capital of Business, Capital Subscription, Promotion Subscription, Incorporation,

(c) Promotion, Incorporation,

(d) Capital Subscription, Capital Subscription

Answer. (c) Promotion, Incorporation

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Q7 Preliminary Contracts are signed

(a) Before the incorporation

(b) After incorporation but before capital subscription

(c) After incorporation but before

(d) After commencement of commencement of business

Answer. (a) Before the incorporation

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Q8 Preliminary Contracts are

(a) binding on the Company

(b) binding on the Company, if ratified after incorporation

(c) binding on the after incorporation Company

d) not binding on the Company

Answer. d) not binding on the Company

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Q1 It is necessary to get every company incorporated, whether private or public.

Answer. True

Page : 183 , Block Name : True/ False

Q2 Statement in lieu of prospectus can be filed by a public company going for a public issue.

Answer. False

Page : 183 , Block Name : True/ False

Q3 A company can commence business after incorporation.

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Answer. False

Page : 183 , Block Name : True/ False

Q4 Experts who help promoters in the promotion of a company are also called promoters.

Answer. False

Page : 183 , Block Name : True/ False

Q5 A company can ratify preliminary contracts after incorporation.

Answer. False

Page : 183 , Block Name : True/ False

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

Answer. False

Page : 184 , Block Name : True/ False

Q7 ‘Articles of Association’ is the main document of a company.

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Answer. False

Page : 184 , Block Name : True/ False

Q8 Every company must file Articles of Association.

Answer. False

Page : 184 , Block Name : True/ False

Q9 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.

Answer. False

Page : 184 , Block Name : True/ False

Q1 Name the stages in the formation of a company.

Answer. Formation of a company is a complex activity involving completion of legal formalities and procedures. To fully understand the process one can divide the formalities into three distinct stages, which are: (i) Promotion; (ii) Incorporation and (iii) Subscription of capital.

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

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Answer. 1. The Memorandum of Association duly stamped, signed and witnessed. In case of a public company, at least seven members must sign it. For a private company however the signatures of two members are sufficient. The signatories must also give information about their address, occupation and the number of shares subscribed by them.

2. The Articles of Association duly stamped and witnessed as in case of the Memorandum. However, as stated earlier, a public company may adopt Table A, which is a model set of Articles, given in the Companies Act. In that case a statement in lieu of the prospectus is submitted, instead of Articles of Association.

3. Written consent of the proposed directors to act as directors and an undertaking to purchase qualification shares.

4. The agreement, if any, with the proposed Managing Director, Manager or whole-time director.

Page : 184 , Block Name : Short Answer Questions

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

Answer. A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies. A prospectus is 'any document described or issued as a prospectus including any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any securities of, a body corporate'. In other words, it is an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company. Investors make up their minds about investment in a company primarily on the basis of the information contained in this document. Therefore, there must not be a mis-statement in the prospectus and all material significant information must be fully disclosed.

Page : 184 , Block Name : Short Answer Questions

Q4 Briefly explain the term 'Return of Allotment'.

Answer. In case the number of shares allotted is less than the number applied for, or where no shares are allotted to the applicant, the excess application money, if any, is to be returned to

applicants or adjusted towards allotment money due from them. Allotment letters are issued to the successful allottees. 'Return of allotment', signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment. A public company may not invite public to subscribe to its securities (shares, debentures etc.). Instead, it can raise the funds through friends, relatives or some private arrangements as done by a private company. In such cases, there is no need to issue a prospectus. A 'Statement in Lieu of Prospectus' is filed with the Registrar at least three days before making the allotment.

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

Answer. SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for the disclosure of information and investor protection. A public company inviting funds from the general public must make adequate disclosure of all relevant information and must not conceal any material information from the potential investors. This is necessary for protecting the interest of the investors. Prior approval from SEBI is, therefore, required before going ahead with raising funds from public.

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Page : 184 , Block Name : Short Answer Questions

Q1 What is meant by the term 'Promotion'. Discuss the legal position of promoters with respect to a company promoted by them.

Answer. Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. Thus, it begins with somebody having discovered a potential business idea. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company. Promoters of a company enjoy a fiduciary position with the company, which they must not misuse. They can make a profit only if it is disclosed but must not make any secret profits. In the event of a non-disclosure, the company can rescind the contract and recover the purchase price paid to the promoters. It can also claim damages for the loss suffered due to the non-disclosure of material information.

Promoters are not legally entitled to claim the expenses incurred in the promotion of the company. However, the company may choose to reimburse them for the pre- incorporation expenses. The company may also remunerate the promoters for their efforts by paying a lump sum amount or a commission on the purchase price of property purchased through them or on the shares sold. The company may also allot them shares or debentures or give them an option to purchase the securities at a future date.

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Q2 Explain the steps taken by promoters in the promotion of a company.

Answer. (i) Identification of business opportunity: The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential. Such opportunity is then analysed to see its technical and economic feasibility.

(ii) Feasibility studies: It may not be feasible or profitable to convert all identified business opportunities into real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start. Depending upon the nature of the project, the following feasibility studies may be undertaken, with the help of the specialists like engineers, chartered accountants etc., to examine whether the perceived business opportunity can be profitably exploited.

(a) Technical feasibility: Sometimes 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. For example, in our earlier story suppose Avtar needs a particular metal to produce the carburettor. If that metal is not produced in the country and because of poor political relations, it can not be imported from the country which produces it, the project would be technically unfeasible until arrangements are made to make the metal available from alternative sources.

(b) Financial feasibility: Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up. For example, one may think that developing townships is very lucrative.

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Q3 What is a ‘Memorandum of Association’? Briefly explain its clauses.

Answer. 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:

(i) The name clause: This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.

(ii) Registered office clause: This clause contains the name of the state, in which the registered office of the company is proposed to be situated. The exact address of the registered office is not required at this stage but the same must be notified to the Registrar within thirty days of the incorporation of the company.

(iii) Objects clause: This is probably the most important clause of the memorandum. 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. The main objects for which the company is formed are listed in this sub- clause. It must be observed that an act which is either essential or incidental for the attainment of the main objects of the company is deemed to be valid, although it may not have been stated explicitly.

(iv) Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them. For example, if a shareholder has purchased 1000 shares of `10 each and has already paid ` 6 per share, his/ her liability is limited to ` 4 per share. Thus, even in the worst case, he/she may be called upon to pay ` 4, 000 only.

(v) Capital clause: This clause specifies the maximum capital which the company will be authorised to raise through the issue of shares. The authorised share capital of the proposed company along with its division into the number of shares having a fixed face value is specified in this clause.

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Q4 Distinguish between ‘Memorandum of Association’ and ‘Articles of Association.’

Answer.

Basics of distinction	Memorandum of Association	Article of Association
Objective	It forms a objective for which the company formed.	Article of Association rules of internal management of the company. They indicate how the objective of company to be attained.
Position	It is the main document of the company and is subordinate to the company Act.	This is subsidiary document and it is subordinate to both Momentum of Association and the company Act.
Relationship	It defines the relationship of the company to the outsiders.	Article define the relationship of the members and the company.
Validity	Act beyond the Memorandum of Association are invalid and cannot be ratified even by unanimous vote of the member.	Act which are beyond article can be ratified by the members provided they do not violate the Memorandum.
Necessity	Every company has to file a memorandum of Association.	It is not compulsory to file Article of Association for public Ltd.

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Q5 What is the meaning of ‘Certificate of Incorporation’?

Answer. After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company. The application for registration must be accompanied with certain documents about which we have

already discussed in the previous sections. The Registrar upon submission of the application along with the required documents has to be satisfied that the documents are in order and that all the statutory requirements regarding the registration have been complied with. However, it is not his duty to carry out a thorough investigation about the authenticity of the facts mentioned in the documents. When the Registrar is satisfied, about the completion of formalities for registration, a Certificate of Incorporation is issued to the company, which signify the birth of the company. The certificate of incorporation may therefore be called the birth certificate of the company.

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Q6 Discuss the stages of formation of a company?

Answer. Formation of a company is a complex activity involving completion of legal formalities and procedures. To fully understand the process one can divide the formalities into three distinct stages, which are: (i) Promotion; (ii) Incorporation and (iii) Subscription of Capital

Promotion

Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity. Thus, it begins with somebody having discovered a potential business idea. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company.

Incorporation

After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company.

Capital Subscription

A public company can raise the required funds from the public by means of issue of securities (shares and debentures etc.). For doing the same, it has to issue a prospectus which is an invitation to the public to subscribe to the capital of the company and undergo various other formalities. The following steps are required for raising funds from the public:

(i) SEBI Approval: SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for the disclosure of information and investor protection. A public company inviting funds from the general public must make adequate disclosure of all relevant information and must not conceal any material information from the

potential investors. This is necessary for protecting the interest of the investors. Prior approval from SEBI is, therefore, required before going ahead with raising funds from public.

(ii) Filing of Prospectus: A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies. A prospectus is 'any document described or issued as a prospectus including any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any securities of, a body corporate'.

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