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FORMATION OF A COMPANY

Question 1:

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

ANSWER:

Promotion refers to the process of innovating or discovering the idea of formation of a company and developing it into a concrete form. It is the very first stage in the process of formation of a company. It starts when an individual or a group of individuals discovers an idea about a business that has the potential to be converted into a successful business opportunity. If they proceed further to form a company, then they are said to be the promoters of the company. Thus, in simpler terms, a promoter is one who takes the initiative to form a company with reference to a given idea or project and takes the steps necessary to fulfil this purpose. Besides discovering the business opportunity, the promoter is responsible for analysing the future prospects of the company and acquires the inputs necessary to establish the company, such as labour, capital and machinery. In this regard, the following are the legal liabilities of the promoters towards the company, which highlight their legal position with respect to the company.

(i) The promoters are neither the trustees nor the agents of the company that they are forming. This is because the company does not exist as a legal entity before its incorporation.

(ii) They cannot make any secret profits by making deals on behalf of the company.

(iii) They are legally liable for any untrue statement filed in the prospectus of the company.

(iv) The promoters cannot claim the expenses incurred by them during the promotion of the company.

(v) The company may or may not indemnify the promoters for the payments made before its incorporation. The company may choose to allot shares to them in order to compensate for their services.

Question 2:

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

ANSWER:

A promoter is a person who takes the initiative to form a company with reference to a given idea or a project and also takes the steps necessary to fulfil this purpose. Besides discovering the business opportunity, the promoter is also responsible for analysing the future prospects of the company and acquiring the inputs necessary, such as labour, capital and machinery, to run the company successfully.

The following steps are taken by the promoters for the promotion of the company.

(i) Conceiving a business idea: First, a promoter discovers the idea for the formation of a company. If this idea is good enough to be considered and worth investing in, then its profitability or economic feasibility is analysed.

(ii) Checking the feasibility of the idea: As the idea may or may not be feasible enough to be converted into a successful business, it has to be studied in detail depending on its nature. In this regard, the following studies are made with the help of chartered accountants, engineers, accountant, etc.

(a) Technical feasibility: In some cases, the idea may be good enough but technically unfeasible. This may happen if the technology or raw material required to execute the project is not easily accessible. Therefore, the technical feasibility of the idea has to be considered before proceeding further.

(b) Financial feasibility: Every organisation requires capital to start functioning and sustain itself. The promoters have to assess the cost of implementing the idea. Thus, in case the cost of the project is huge and the project cannot be financed within the funds available, then the idea may have to be dropped.

(c) Economic feasibility: In some cases, the project may be technically and financially feasible but the probability of its success may be very low. In such cases, too, the idea will have to be given up.

(iii) Selecting the company's name: Once the decision to establish a company is made, the promoters need to select a name for it. For securing approval for the proposed name, an application has to be submitted to the registrar of companies of the state concerned. This application must contain at least three names in the order of their preference. This is because, in some cases, it may happen that the name most preferred may not be approved if another company by the same name already exists. Thus, in such cases, an alternative name that is proposed is approved.

(iv) *Selecting the members to sign the memorandum of association (MoA):* The promoters are required to select the members for signing the MoA. In this regard, the members who generally sign the MoA become the first directors of the company.

(v) *Appointing professionals:* The promoters are required to appoint professionals—bankers, brokers, solicitors and underwriters—for preparing the documents necessary for the company. The details of the number of shares allotted to each shareholder, along with his or her addresses for correspondence, are submitted to the registrar.

(vi) *Preparing all the documents necessary:* After the appointment of professionals, the promoters are required to submit the legal documents necessary (such as the MoA, articles of association and consent of directors) to the registrar of companies.
