

Law and Practice of Governance in the Ethiopian Share Companies

By

Abiyou Girma

Faculty of Law

1. General overview of business and business persons

Business is the provision of product and/or service to satisfy customer requirements. It is also a situation where by trader delivers good and service for profit. According to Article 124 of Ethiopia Commercial Code of 1960, it is an incorporeal movable consisting of all movable property brought together and organized for the purpose of carrying out any commercial activities specified in its article 5. Activities of trade in article 5 of the commercial code may be owned and operated by sole proprietors or by commercial business organizations. Although Joint Venture, General Partnership and Limited Partnership shall engage in activities enumerated in Article 5 owing to their object, Private Limited Company and Share Company are always deemed to be commercial business organization on the account of their form. An ordinary partnership may not undertake those activities stated in article 5 of the commercial code in the wording of article 213 (1) .If an ordinary partnership engages in commercial business it shall be considered as General Partnership as stated in sub article two of article 213.

2. Share companies and their importance

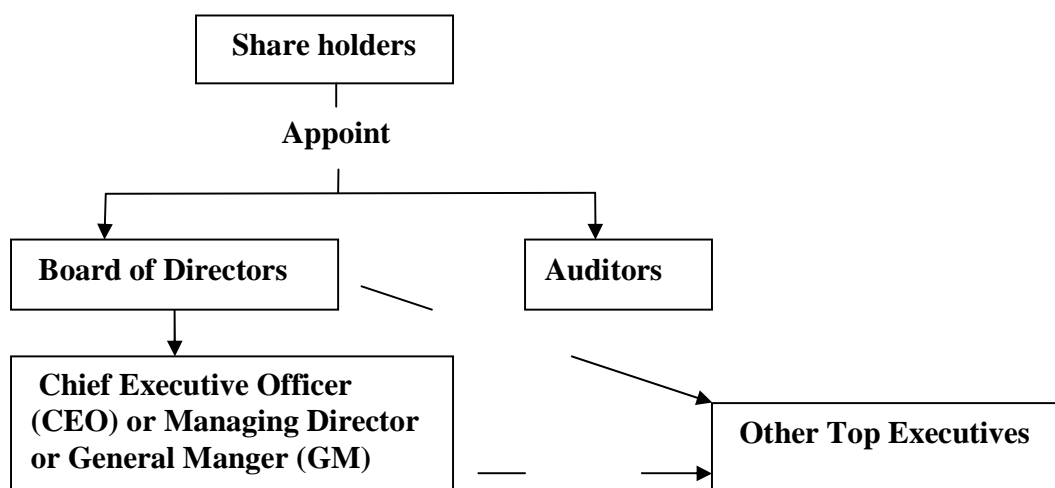
This paper tries to investigate the law and practice of governance in the context of share companies. A share company is a legal entity that often has similar rights in law to those of natural person. This means a share company can open a bank account, own property and do business, all under its own name. Article 304(1) and (2) of the Commercial Code define it is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by its assets and members of a Share Company are liable only to the extent of their share holdings. Simply it is a Commercial business organization owned by a group of share holders, each of whom normally enjoys limited liability. As a result of these, it is called an indigenous device for obtaining individual

profit without individual responsibility. The existence of a Share Company is based on capital and no personal identity of shareholders. Therefore, it is possible to say that a share company is a capital company.

Revenue in terms of tax with verifiable procedure and documentation, reduction of unemployment, accessibility to ensure compliance with law and regulations, introduction of modern management and technology and creation of an avenue for substantial investment among other are advantages of having a share company. For the success and growth of a Share Company, its manageable operation is a determinant factor. Having a very organized and effective management organ that can properly combine human, material, financial and time resource of the company is very essential.

3. Management of Share Companies; organs and problems

Considering the aforementioned advantages and other factors, the 1960 Commercial Code of Ethiopia has many provisions on how a Share Company is managed. Having a very organized and effective management organ that can combine human, material, financial and time resource of the company is very essential for the share company. As a result, there are four widely accepted organs of management in a Share Company who have a role of management .These are shareholders meeting, board of directors, top executives and auditors.



3.1 Shareholders Meeting

The first organ of management is shareholder meeting. Share holders (members) of a Share Company exercise their managerial role through their meeting. Shareholders meeting are of two types; General and Special. The general meeting of shareholder is divided into Ordinary and Extra ordinary. Using their voting rights, shareholders exercise managerial role by passing resolutions. The main function of ordinary general meeting includes appointment or removal of directors and auditors, deciding on the amount of remuneration of directors and auditors, listening to reports of directors and auditors and making decision accordingly. There are also many other powers and duties of ordinary general meeting. Extra ordinary general meeting decide on extra ordinary matters like amending the memorandum and article of association of the company, changing nationality of the company, requiring shareholders to increase their investment etc. Special meeting, on the other hand, are meetings called to decide on matters that concern share holders of a specific class. Generally, general meeting of shareholders has a role of managing a share company through its solutions.

3.2 The Office of Board of Directors

The second organ of management in Share Company is the office of board of directors. It is the most important and key organ in the management of Share Company. Board of direction is responsible for decision making in their major business and overseeing the general affairs of the company. As the Commercial Code of the Federal Democratic Republic of Ethiopia implies the role of the directors in managing a Share Company is by far the most significant type of management than any other organs in Ethiopia.

Boards of directors have their own power and duties they carry out in managing a Share Company. The power and duties of directors emanates from the law (Commercial Code), Memorandum of Association, Article of Association and Resolution of shareholders meeting. Board of directors may use their power and duties for conservative and proper purpose as well as for improper ends. To tackle this improper use of power, there are civil and criminal liabilities in the Commercial and Criminal Codes respectively.

3.2.1 Who may qualify for the post of board of director?

Regarding qualification, different jurisdictions have various requirements. However, the Ethiopian Commercial Code seems to leave the matter to shareholder's discretion to appoint directors and peoples that they believe will run the company well on their behalf. This does no mean that the Commercial Code does not lay down any academic, technical or professional qualification for appointing directors.

As the National Bank of Ethiopia (NBE) is the organ bestowed with the authority to issue directives to regulate the financial industry , i.e. Banking, insurance and other financial institutions, it has issued directives that require qualification from directors of bank or insurance Share Companies in accordance with Article 41 of the Monetary and Banking Proclamation No. 83/1994, Article 36 of the Licensing and Supervision of Banking Business Proclamation No.84/1994, Article 42 of the Licensing and Supervision of Insurance Business Proclamation No.86/1994. The national Bank of Ethiopia issued Licensing and Supervision of Banking Business Directive No. SBB/1/1994 and Licensing and Supervision of Insurance Business Directive No. SIB/1/1994. Article 5.1 of both directives require a board member of bank or insurance share companies at least to complete high school education and should have an ability to read and grasp contents of report especially financial statements. Article 5.2 of both directives also require member of the board to have adequate managerial experience in business, and/or similar organization as a qualification for being appointed as board of directors. Additionally, in the wording of Article 5.3 of both directives, in order for a person to be a member of the board of directors, he/she should be at the age of 30 or above.

The Commercial Code, in its Article 347 (1), strictly requires Share Companies to be managed by shareholders only. In other words, for a person to be member of a board of director he/she has to be a shareholder of that Share Company. The rational behind the law indicates that a Share Company has to be managed only by shareholders just to create a sense of ownership in the managerial organ.

Currently, qualifications of directors of bank and insurance Share Companies are determined by those directives of NBE. Keeping this in mind, NBE has issued a new directive (i.e., Directive No. SBB/39/2006) which indicates required qualification of directors for a Bank Share Company which will be enforceable from July 2007 onwards. This directive requires directors:

- to have a minimum qualification of first degree (at least 75% of them) and the remaining 25% high school complete.
- to have experience in managerial post especially in the banking industry &
- not to work in other similar financial institutions simultaneously among others.

The same kind of directive is expected to be issued by the National Bank of Ethiopia for insurance Share Companies.

Issuing subsidiary legislations now called “directives” through delegated power should be published in the official Negarit Gazette since it is intended to have the force of law. But, the directives of NBE are not published in the official Negarit Gazette and are not accessible to the public (except financial institutions). Secondly, many persons including the researcher and banks argue that the directive (SBB/39/2006) has curtailed the discretion of share holders (investors) of Bank Share Companies to elect or reelect directors beyond a certain number of years as they wish. It is also believed that even though the NBE has delegated powers to issue directives, it should only be used for the proper performance of the provision of the main law (Commercial Code). But, the directives have rejected some of the provisions of the main law (Commercial Code). For instance, Article 450 (4) of the Commercial Code allows Share holders to reelect directors as they wish where as the directive prohibit directors not to serve more than 6 (six) years which allows only one reelection of directors.

One of the top officials of NBE, Ato Getahun Nana, argued on his part that since the NBE has an obligation and power to control the financial and economic problems especially on problems of financial flows, it had used its power and issued the directive for healthy performance and service of banks. He also added that the directive of NBE

does not reject any provision of the Commercial Code. Other also argues is favor of the directive of NBE saying the academic qualification of directors improves the quality of services of banks render to the public.

3.3 The Office of Top Executives (Management Team)

The third organ of management of a Share Company is the office of top executives. The office of board of directors is especially concerned with policy formulation, broad planning and philosophy of action. The executive functions are usually delegated by the board to the management group or Top Executives. Top executives are persons who are responsible in undertaking of execution of policies of a Share Company. After the board of directors and shareholders meeting has prepared policies of a Share Company, its execution is left to the tope executives. Top executives principally execute the policy of a Share Company. But some times they additionally involve in other activities like initiation of development of policies and other activities. In addition to the function of execution, members of the top executive involve in the initiation of development of policies relating to changes in the capital structure, new products, expansion, price polices and labor relations, among others. The role of the board is to duly consider them and give it approval.

3.3.1 Who are the persons included in the top executives?

The Commercial Code of the land is silent in this regard. But, there are three possibilities of becoming top executives.

- It can be filled by a person from the board of directors. In such case, a director who is member of the top executive is called executive directors.
- It can be filled by employed mangers outside of the board of directors and
- It can be filled both by board of directors and employed managers.

For top executives to undertake their execution of policies of a Share Company in a very organized manner there must be one person as a Chief Executive Officer. A Chief Executive Officer (CEO) or Chief Executive is the ... executive officer, in charge of total management of corporation, company, organization and/or agency.

3.3.2 Who can be appointed as Chief Executive among executives?

As it is explained earlier, the post of top executives can be filled either by board of directors or employed managers or by both. Due to this fact, the CEO can be elected either from the board of directors or employed managers. A CEO elected among the board of directors (i.e. from executive directors) is called Managing Director whereas a CEO elected from employed managers are called General Manager (GM).

Generally, a CEO is a person who manages the affairs of a company as a whole-time officer and who is entrusted with the substantial power of management including power to base decision on some policy matters like pricing of products, adoption of new techniques, buying and selling of raw materials, appointment of employees. In Ethiopia, a CEO may be named like Managing Director, General Manager, and President etc. Different organizations also give different titles for their CEO. For instance, Ethiopian Insurance Corporation uses the title Managing Director, United Bank Share Company uses the name President and Nile Insurance Share Company call their CEO as General Manager. From this, we can understand that there is no single nationally accepted title or naming of the CEO in Ethiopian organizations. But in developed nations like the United States, United Kingdom and Spain there is a uniformly accepted name of a CEO. That is in the United States the term President is commonly used, whereas, in the UK Managing Director is widely used and in Spain the usual name is Director General.

General Manager of a Share Company is employed by the board of directors. The Commercial Code didn't put the term Managing Director. But, this does not mean that Executive Directors can not be a CEO. Article 348 (4) of the Commercial Code of Ethiopia allows Executive Directors to be CEO (Managing Director). And such an appointment is made by the board of directors. Regarding the organ that appoints members of the top executives the Commercial Code is silent. It only indicates the organ that appoints a CEO.

3.3.3 What is the quality (criteria) for assuming the part of a CEO?

Regarding qualification of the CEO, it is stated in the Commercial Code that shareholders have the full right of assigning persons they believe who will manage the company. But, exceptionally, bank and insurance Share Companies are required to comply with directives of the National Bank of Ethiopia (NBE) to appoint a CEO. For a person to be CEO of bank and/or Insurance Share Companies, he/she must fulfill the required qualifications stated in directives No. SBB/1/1994 and SIB/1/1994 respectively. The first criterion is a minimum of first degree or equivalent in a relevant field. Additionally, a minimum of 10 years of reputable managerial experience in financial or related institutions at a senior level with sufficient managerial skills in the banking and insurance industry is required. Being a minimum of 35 years of age and preferably married or responsible to a family are the remaining qualifications of which the NBE through its directives require for the post of CEO.

Practically, there are also other additional qualifications required by some bank and insurance Share Companies. For instance, as far as my personal observation in the Nile Insurance Share Company is concerned, there are three criteria in the Article of Association to appoint a General Manager. Firstly, Fulfillment of Qualifications of NBE directive is required. Secondly, the general Manager should have not been a shareholder in a bankrupted Share Company. And even s/he should have not been a sole proprietor in a bankrupted business. Thirdly, Nile Insurance Share Company requires a person who has not been convicted in criminal proceeding of the court system except in violation of directive.

The legal problem in relation to management of share Company is that the commercial Code allows one and the same person to hold the post of board of directors (Article 347(1)), Chairman of the board (article 348(1)), Chairman of the meeting (Article 404(1), 411 (1), 412, 413), member of top executive officer (Managing Director) (Article 348 (4) a contrario interpretation and Chief Executive Officer (Managing Director) (Article 348 (4) a contrario interpretation). Simply the Ethiopian Commercial Code allows one and the same person to wear four or more hats at the same time in the management organ.

This kind of fusion of power by single individual opens the way to abuse the assets of a Share Company .This is because holding of four or more managerial posts by single individual at the same time allows a person to exercise all the power. These excess of power encourage a person to extravagantly use the assets of a Share Company. For the instance, in the case of Agremic Ethiopia Share Company versus Leulsegede Bekele argument, the plaintiff Agremic Ethiopia Share Company claimed 540,280.01 birr from its former founder, shareholder, board member, and managing director Leulsegede Bekele. The plaintiff alleged that the defendant has abused his power and adduced evidence to prove that. The defendant also responded to those allegations of the plaintiff with evidence. The federal high court civil bench, after having an investigation of the litigation and evidence of the litigants, has decided that Leulsegede Bekele has abused his power and held him liable to pay 53,205.61 birr companion to the plaintiff. The plaintiff was not satisfied with the decision of the court and took on appeal from this decision to Federal Supreme Court and the case was pended. From this case, we can realize that the fusion of power by single individual opens the way for abuse of resources of a company.

3.4 The Office of Auditors

The fourth and last organ of management in a Share Company is the office of auditors. The office of auditors' checks transaction of a business with its books of accounts and evidence in a view to find out the arithmetical accuracy of the accounts, the correctness and truthfulness of the transactions records. As a result, it can be said that auditors manage a Share Company with regarded to its financial matter. The only situation in which auditors manage a Share Company is whenever there is no surviving member of board of directors in a Share Company.

Since the basic functions of auditors are related to confirming or certifying the truthfulness of financial document of a Share Company, there are two points that are supposed to be raised. These are in what way do auditors confirm the correctness and accuracy of financial documents? Does a mere check of arithmetical accuracy of financial documents is enough to say that there is a correct and accurate financial document? The Commercial Code of the country is silent in this regard. But in some developed

jurisdictions a mere check of arithmetical accuracy of financial documents is not enough. Auditors are also expected to examine books not merely for the purpose of finding out what does they show but also for the purpose of satisfying themselves that they show a true financial position of the company. The other point is in confirming financial document how much of standard is needed from auditor to believe that an item of certain financial document is correct or accurate? Here the Commercial Code does show any kind of standard from auditors in their duty of confirming financial document. But in the other countries auditors are required by the law to show reasonable man (person) standard when applied to professionals in confirming financial documents.

Keeping the legal problems in mind, the practical problem that magnifies or amplifies this legal problem are institutions like the Ministry of Trade and Industry, the office of auditors and shareholders themselves (especially auditors) which are not practically capable of controlling member of board of directors and other officers of a Share Company. Considering these legal and practical problems, a person wearing at least three or four of the hats in a Share Company has a chance of abusing assets of the company. The reason for failure to control the directors or other posts of management by auditors is auditors may perform their task in an improper and dishonest manner either in collaboration with the management organ or independent of management organ.

To tackle this kind of improper and dishonest performance of auditors', shareholders representing at least one tenth of the share issued can as a right require the Ministry of trade and industry to appoint or more qualified inspector or control and check the auditors' act where there is a resolution of General Meeting or an Order of the court pursuant to Article 382 of the Commercial Code. There is no other mechanize of controlling auditors' except the expert appointed by the ministry. For the shareholders themselves to know or suspect the improper and dishonest acts and omissions of not only auditors but also directors, it takes too long time. Therefore, there is a need to search for other mechanisms of protection against improper and dishonest act of auditors'. As a response to this, the Commercial and Criminal Codes stipulate provisions with respect to auditors' liability both civilly and criminally.

4. Conclusion

The finding of the study shows that there is a legal and practical problem in relation to governance of Share Companies in Ethiopia. The legal problem blended with other practical problems have paved the way for a person to exploit and abuse the assets of Share Company; Specially; allowing one and the same person to wear for four or more hats at the same time encourages a person to abuse power.

5. Recommendations

Having thoroughly analyzed the legal and practical problem surrounding Share Companies in Ethiopia, the researcher would like to recommend the following points.

- In some European union member countries, there are two separate boards, one executive board employed to run the day-to day business and one supervisory board for control purpose (elected by the shareholder). In these countries, the Chief Executive Officer (CEO) presides over the executive board and chairman (of the supervisory board) presides over the supervisory board and these two roles will always be played by different persons. This ensures a separation between management by the executive board and governance by the supervisory board. This allows for clear line of authority. The aim is to prevent conflict of interest and power concentration in the hands of one person.
- In North America and Europe the post of board of directors is classified into part-time and full-time directors. Both the full-time and part-time directors are usually the shareholders and the part-time directors do not fully play functions of management. That is why they are part time directors. Classifying directors into part-time and full-time reduce the possibility of having fusion of power in a Share Company.
- The NBE, in its very recent directive (SBB/39/2006), has clearly prohibited one and the same person from being a Chairman of the board and CEO of the executive at the same time. This directive is applicable for banks, and the same kind of directive is expected to be issued for Insurance Share Companies. This experience is really important in avoiding fusion of power. Applying the same provision for all Share

Companies (including non-financial institution will avoid the problem of fusion of power.

- In the United States of America and in some other developed nations, there is a new concept and practice in the sphere of audit called management audits. Management audit is an attempt to evaluate the performance of various management processes and functions by a management auditor. It is an audit to examine, review and appraise the various policies and actions of management on the basis of the objective standard. Management audit is a management to ascertain that proper decision-making process has been done to achieve the organization goals. Amending the Commercial Code with this view by including the recommendation points may assist to avert problem of management in Share Companies. This would specially alleviate the problem in the area of legal problem. But, if is not possible to amend the Commercial Code, the point below could address the problem.
- Avoiding fusion of power as per the Article of Association or Memorandum of Association is imminent. That is, even through the law(Commercial Code) has allowed one and the same person to hold many powers, Shareholders can avoid such fusion of power by restricting a person's power through their Article of Association and Memorandum of Association.