

LEGAL INFRASTRUCTURE FOR CAPITAL FORMATION IN PRIVATE ENTERPRISE

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Objectives

- *To briefly scan the legal regime in relation to **Capital Formation***
- *To indicate the thrust of a legal infrastructure in emerging **Free Market Economy***



Presentation Outline

- I. Sources of Capital Formation
- II. Form and Nature of Business Organizations
- III. Commercial Register
- IV. Securities Market
- V. Consolidation and Business Exit



I. Sources of Capital Formation

The Primary sources of Capital formation are:

1. Reinvestment of Profit
2. Bank Borrowing
(Intermediation through the Banks)
3. Dealing in Securities
Chiefly Shares & Bonds

IN ALMOST ALL ECONOMIES, THE DOMINANT CHANNEL OF INTERMEDIATION IS THROUGH THE BANKS.



II. Form and Nature of Business Organizations

There are six business organizations according to the Commercial Code of Ethiopia (1960) :

1. *Ordinary Partnership*
2. *Joint Venture*
3. *General Partnership*
4. *Limited Partnership*
5. *Companies Limited by Shares*
6. *Private Limited Companies*



II. Form and Nature of Business Organizations

Some of the differences pertain to:

1. *Capital Base and Number of Owners*
2. *Transferability of Shares*
3. *Liability of owners to TP*
4. *Maintenance of Accounts and Auditing*
5. *Membership Structure and Form of Governance*
6. *Degree of regulation by the government*
7. *Registration Process and Publicity, MoA and AoA*



II. Form and Nature of Business Organizations

Company Limited by Shares

- ❑ *A Share Company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company (article 304/1); and the members' liability is limited only to their shareholding 304/2) –*
(But what does shareholding indicate here ?)
- ❑ *Shares are highly regulated by the government as compared to the other forms of organizing business.*
- ❑ *Appointment of Auditors is compulsory*



II. Form and Nature of Business Organizations

- ❑ *The minimum capital is Birr 50,000*
- ❑ *A minimum of five persons are required to establish it*
- ❑ *It could be established by a restricted group of investors or by issuing shares to the public*
- ❑ *At least $\frac{1}{4}$ of the par value of shares will have to be paid up and deposited in a bank (312/1 (b))*
- ❑ *Insurance and Banking ventures can be undertaken only by way of 'Share Companies'*



II. Form and Nature of Business Organizations

Private Limited Company

- ❑ *A company whose members are liable only to the extent of their **contributions***
- ❑ *Membership is between 2 and 50 persons*
- ❑ *The company shall not issue transferable securities in any form.*
- ❑ *All transfer of shares outside the company shall be approved by members with at least $\frac{3}{4}$ of the capital*
- ❑ *The capital shall not be less than Birr 15,000*
- ❑ *It shall be managed by one or more managers, Article 525/1*
- ❑ *A distinction is made between a company with less than 20 members and more*



II. Form and Nature of Business Organizations

Some possible upcoming changes

- ❑ *Minimum capital for Share companies to be raised*
- ❑ *PLCs to be regulated more and transparency to be required:
ex; Auditing, Depositing of Initial capital*
- ❑ *One man company could be established – doing away with the need to institute a 'straw person'*
- ❑ *All business organizations will have a written instrument of establishment (Joint Ventures does not need to have)*
- ❑ *Reinstitution of the requirement of publication in the Commercial Gazette for companies.*



III. Commercial Register

According to the Law

- ❑ *The Commercial Code, 1960, envisaged the establishment of the following:*
 - *local and central registers*
 - *A registration official (with attending potential for liability suit)*
 - *A Commercial Gazette (Article 87)*
- ❑ *The CC stipulates that any person is entitled to an extract on payment of a prescribed fee.*
- ❑ *Traders are obliged by law to register changes in significant elements*



III. Commercial Register

Current Practice

- ❑ *All traders are registered and Trade Registration certificate issued (Proclamation 376/2003)*
- ❑ *A Trader could have a multiple of Trading licenses while he/she could have only one registration certificate*
- ❑ *There is no a central or a local register of trade which provides information to **interested parties** and open for **public inspection**.*
- ❑ *Currently, Trade Names, Trade Marks, Patent registrations are centrally carried out and hence protection duly given.*
- ❑ *Generally, Trade Registration at trade licensing offices falls short of the intended benefits envisaged by the CC of 1960.*



III. Commercial Register

Features of a Modern Commercial Register

- ❑ *A unified and integrated system at all levels – Federal, Regional and Woreda*
- ❑ *Designed to interact with other systems and entities such as tax authorities, customs, statistical agencies, financial institutions etc.*
- ❑ *Linked with a unique national company identification number*
- ❑ *A cross section of beneficiaries: investors, information brokers, government, membership organizations, civil societies, journalists, researchers, academia, individual citizens and employees.*
- ❑ *Simplified, transparent & least cost registration process*



III. Commercial Register

Information in Commercial Register could contain:

- ❑ *Trade Name*
 - ❑ *Trade mark, patents, etc*
 - ❑ *Business Licenses*
 - ❑ *Ownership and share distribution*
 - ❑ *Directors List and Qualification*
 - ❑ *Authorized signatories*
 - ❑ *Products and Services*
 - ❑ *Capital, annual turnover, etc.*
 - ❑ *Annual Financial Reports etc,*
-
- ❑ *A balancing of Confidentiality/Privacy and public/TP interest is essential in the design of a Commercial Register*



IV. Securities Market

General

- ❑ Markets in which Treasury Bills, Bonds, Equity Shares and Debentures are traded.

- ❑ The transaction in securities is split in to:
 - ❑ Primary Transaction
 - ❑ Secondary Transaction

- ❑ The modalities for regulation of Securities Market are:
 - ❑ Association of Security dealers and brokers
 - ❑ Establishment of a Government Agency for regulation and support
 - ❑ Market Action only (Laissez Faire)



IV. Securities Market

History in Ethiopia

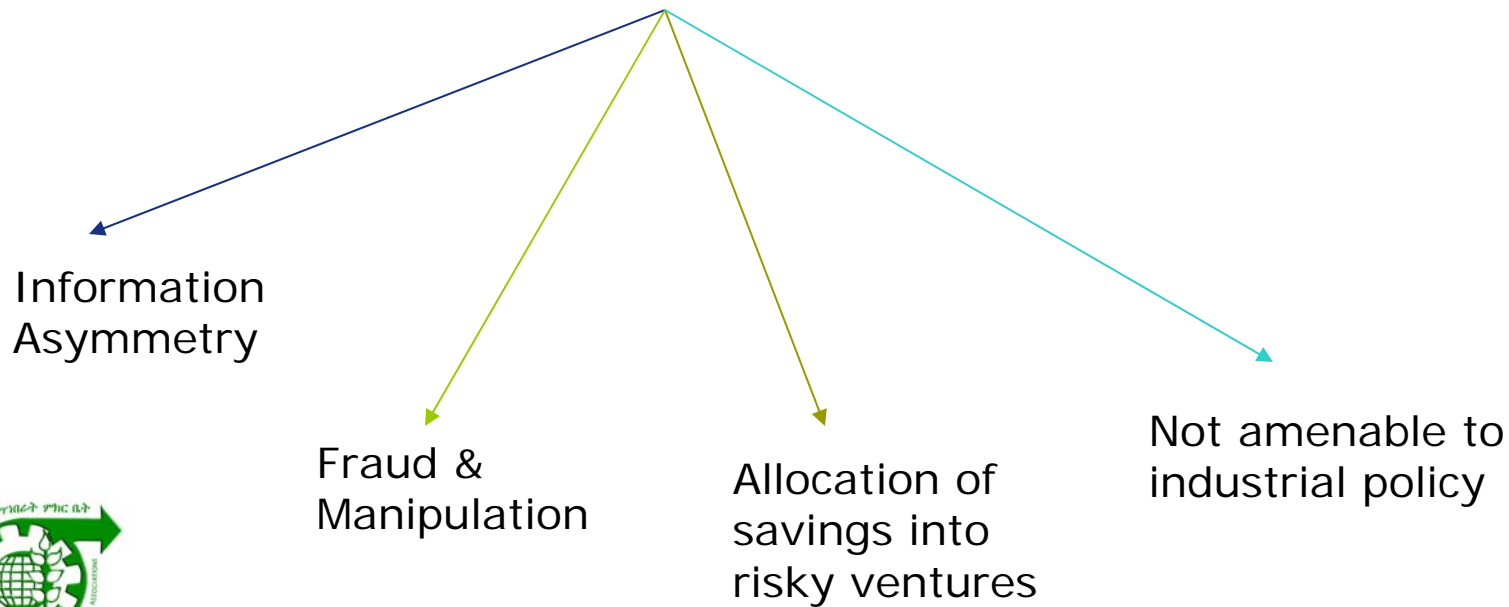
- ❑ The Share Dealing Group was established in the 1960s which was a self regulated association (During the Imperial Era)
- ❑ Twenty two companies were members of the Share Dealing Group during the Imperial Era
- ❑ The revolution in 1974 reversed the process and the Share Dealing Group was suspended.
- ❑ Post 1991, some companies in the Bank, Insurance Companies and industrial companies floated shares either for establishment or for expansion.
- ❑ The government also sells Treasury Bills to the public
- ❑ Yet no legislation on the establishment of a **Stock Market** or **Share Public Offering** has as yet been drawn up and adopted
- ❑ Formation of Share Companies by Public Offering is on the Rise;
Currently, A Cement Factory and a City Taxi Company



IV. Securities Market

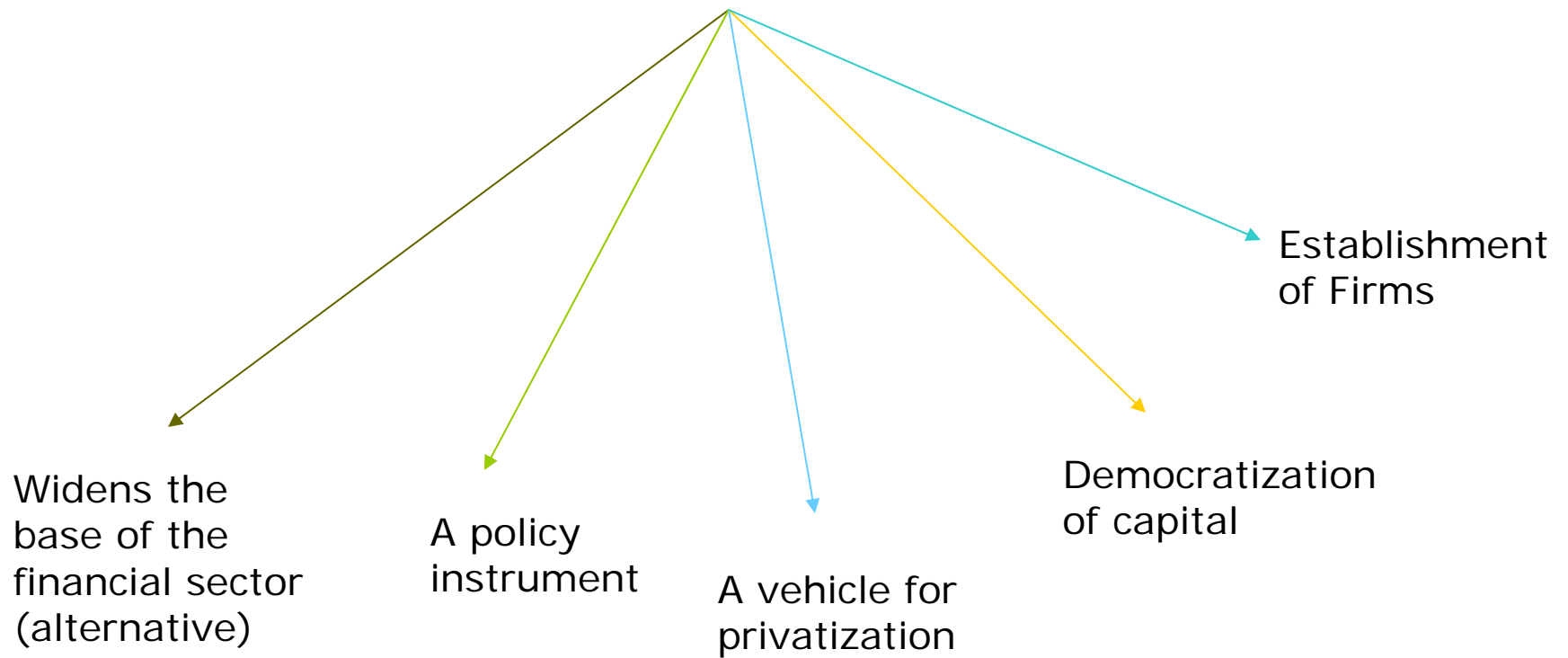
- Hence, the reality points to the need to form a Capital Market. One needs to acknowledge the reality on the ground.
- In the absence of a Capital Market, dealing in secondary transactions is **informal** and **time taking** rendering Securities much less liquid than they should be.

Cases Against a Capital Market



IV. Securities Market

Cases for a Capital Market



IV. Securities Market

- The conclusion is that it takes time to have a full fledged capital market, hence, better start sooner than latter.

Subject to the following:

1. Prudent Regulation and strong Institutional framework in order to *promote public confidence, ensure efficiency of the market and ensure stability*. The regulation will be in respect of:
 - a. Operation of the market
 - b. Listing of Companies
 - c. Public Offer of shares
 - d. Qualification of Actors
 - e. Disclosure
2. An Effective Commercial Register
3. Accounting and Auditing Standards
4. Strong Market Players: Investment Brokers, Business Advisors, Lawyers etc



V. Consolidation and Business Exit

- ❑ Mergers, Acquisition and Takeover are not common in the Ethiopian Market. ' (Non-existence of the Capital Market and the underdevelopment of the Economy.)
- ❑ Firms have low capital base and resource. Hence, a room for amalgamation. There is scanty reference to this in the law.
- ❑ The concept of 'Holding Company' and 'Subsidiary Company' is not adequately addressed by the law.
- ❑ Secondary Market for securities is weak. Also, sale of business in its entirety (plus Good Will and incorporeal elements) is not common.
- ❑ Hence, exit strategy for creators of capital is a cause for concern.



Thank You

