

**Impediments to Raising
Capital Effectively:
Law and Practice Regarding
Formation of Companies**

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Outline

- **Introduction**
- **Requirements for Formation**
- **Problems in the existing system**
- **Prospects for change**

Introduction

Company formation involves, *inter alia*

1. Raising capital, and
2. Completing formalities

Introduction

Legal provisions dealing with the above two have the purposes of;

- 1. Facilitating raising of capital, and**
- 2. Safeguarding the legitimate interests of all involved and the enterprise**

Such provisions could however make raising capital unjustifiably difficult

Requirements for Formation

- *Cont'd*

- Submission and valuation of contribution in kind (Art. 339(1) and 315)
- Adoption of memorandum and articles of association (Art. 313 and 314)
- Registration and publicity requirements

Requirements for Formation

- 1960 Commercial Code provides for 7 requirements
 - Min. of five members (Art. 307(1))
 - Minimum initial capital of 50,000 Birr (Art. 306)
 - Full subscription of capital (Art. 312(1))
 - Payment of 1/4th of the *par value* of cash shares (Art. 338(1))

Requirements for Formation

- *Cont'd*
 - Submission and valuation of Contributions in kind. (Arts 339(1) and 315)
 - Adoption of Memorandum and Articles of Association. (Arts 313 and 314)
 - Registration and Publicity Requirements. (Arts 323, 223 and 87)

Requirements for Formation

- **Changes introduced by subsequent legislations**
 1. **Valuation of contributions no longer to be made by disinterested experts. Agreement of subscribers suffices (Proc. No. 67/1997 *cum.* Proc. No. 376/2003)**
 2. **Publication of notice no longer required (Proc. No. 376/2003 Art. 2(2) *cum.* Art. 8(1) of Proc. No. 67/1997**

Requirements for Formation

- *Cont'd*
 3. Each and every subscriber to sign before a notary on the Memorandum and Articles of Association. (Proc. No. 334/2003 on the Authentication of Documents)
 4. Notary to ascertain the subscriber's title with respect to property ownership of which is provable by title certificate. (Proc. No. 334/2003 Art. 4(7))
 5. Notary in IN PRACTICE requires proof of ownership over ANY PROPERTY contributed

Requirements for Formation

- *Cont'd*

6. Companies doing banking business Proc. No. 592/2008

- min. capital is 75 million Birr
- Shareholders holding directly or indirectly 2% or more of the capital to meet fitness and propriety criteria (Art 4(1)(h))
- No person allowed to hold more than 5% of the bank's total shares either on his own or jointly with spouse or with persons below 18 years old related to him by consanguinity (Art. 11(1))

Problems in the existing system

1. Valuation of contributions by subscribers
 - a) Impractical when there are many subscribers...
 - b) Exaggeration of value possible
 - c) Valuation method not indicated

Problems in the existing system

2. Problems related to authentication and registration requirements
 - a) Property not amenable to proof of ownership not accepted as contribution.
 - b) The requirement that every subscriber signs on establishment documents problematic when membership is large

Problems in the existing system

3. Deposit of $\frac{1}{4}$ of the *par value* of cash shares
 - a) In blocked accounts, hence no interest.
 - b) Money to be returned if company is not registered within one year from deposit **by subscribers**. (Article 312 (3)(b))

4. Banking Proclamation makes raising capital even more difficult.

Prospects for change

- The new draft of the Revised Comm. Code identical with the 1960 Code in regard to matters covered in this presentation.
- The position paper of the business community suggests
 1. Period for return of deposited money to run from the closing of subscription period
 2. Contributions in kind to be valued by subscribers. But, is this the right approach?

**THE END,
THANK YOU.**