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The Legal and Institutional Framework for the Corporate Governance of State-Owned Enterprises in Ethiopia

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June, 2017

THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR THE CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN ETHIOPIA

Thesis

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Declaration

I, the undersigned, declare that the thesis comprises my own work. In compliance with widely accepted practices, I have duly acknowledged and referenced all materials used in this work. I understand that non-adherence to the principles of academic honesty and integrity, misrepresentation/fabrication of any idea/data/fact/source will constitute sufficient ground for disciplinary action by the University and can evoke criminal sanction from the State and civil action from the sources, which have not been properly cited or acknowledged.

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Date

Dedication

I dedicated this thesis to almighty God, I also dedicate it to my sister, Yetemwork Lemenih, who has suffered and devoted much of her life to see the success of her brother, and to my brother Solomon Linger, who brought change in my professional endeavor.

Acknowledgment

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Abbreviations and Acronyms

ICPE	International Center of Public Enterprises
OECD	Organization for Economic Cooperation and Development
PPESA	Privatization and Public Enterprises Supervising Agency
CG	Corporate Governance
SOE	State Owned Enterprise
CEO	Chief Executive officer
BM	Board Member
CGC	Corporate Governance Code
MoPE	Ministry of Public Enterprises
GSM	General Shareholders Meeting
EPA	Ethiopian Privatization Agency
CSR	Corporate Social Responsibility
CBE	Commercial Bank of Ethiopia
NBE	The National Bank of Ethiopia
GAAP	Generally Accepted Accounting Principles
PESA	Public Enterprises Supervising Authority
EPRDF	Ethiopian People Revolutionary Democratic Front

Abstract

Government's direct intervention in the economy is a global phenomenon which gets the approval of almost all economies in the world, including those who considered themselves as advocates of free market system. Yet, the level of intervention varies across jurisdictions laying on specific country context. The intervention may take different forms, but the common way is intervention through establishing State-owned enterprises. In such enterprises, governments have different objectives extending from public value creation to mere profit generation. Due to these different objectives of owners, Governments, SOE are characterized as two dimensional: Public and private dimensions. This will result a governance problem as they are mandated with two contradictory objectives. Hence, there is a need to consider the unique features of SOEs and its impact in their governance especially the role of the government.

Designing a well-established and properly functioning legal and institutional framework for the corporate governance of SOEs is the first footstep in the governance of SOEs. Hence, almost all countries in the world did so. However, the controlling question is how much such framework is able to address governance issues and problems of SOEs.

Ethiopia is not an island to this reality of the world. Hence, the country established SOEs since its modernization attempt in the early twentieth century for the same reason in the world. Though there is variation based on the ideology of the government, SOEs first ever in the history of Ethiopia structured as autonomous entity by the EPRDF government with the new market economy policy, in 1992 via proclamation No.25/1992. Hence their governance structure designed aiming at their efficient, productive, profitable, and competitive performance. The country also started the privatization process through establishing EPA and later centralized the supervision of SOEs via designing Public Enterprises Supervising Authority in 2002. Further, Ethiopia took different measures of reforming the governance of SOEs by enacting various legislations and establishing the institutional framework for their control and supervision.

Based on this reality of the country, this research studies the legal and institutional framework for the CG of SOEs in Ethiopia with the aim of identifying the gaps with possible way-outs. The research was conducted based on qualitative research approach by analyzing laws, documents and data collected through interview. The research particularly studied the countries CG landscape based on the international good practice of CG. Hence, the study found that, in Ethiopia, the state has no clear ownership policy over SOEs. This affects the entire governance of enterprises by allowing unjustified intervention of the state on their day to day operation. The study also reviled the existence of volume of legal and institutional problems in the Ethiopian CG framework for SOEs including the existence of many sectoral supervising authorities, lack of the necessary information disclosure, and unjustified shielding of SOEs from competition.

Based on its findings this research provides recommendations ranging from enacting ownership policy to a specific revision of laws and reformation of the institutional framework for the CG of SOEs.

CHAPTER ONE
INTRODUCTION

1.1. Background of the Study

Though the reasons for state ownership via state owned enterprises (SOEs) varied from jurisdiction to jurisdiction based on political and ideological factors, state ownership is a global phenomenon for its crowd of rationales. However, the most accepted and commonly used justifications are: state ownership is deemed to be more efficient to the delivery of public goods compared that of private companies, the operation of natural monopolies where market regulation is deemed infeasible or inefficient; and support for broader economic and strategic goals in the national interest.[1]

In history, the role of SOEs magnified following the great depression of the 1929 and the Second World War as they were served as tools for economic recovery from the depression and the war.[2] Yet, despite the fact that state ownership is being the order of the day, there is no consensus in the world as to the range of institutions that are considered as SOEs. Therefore, it is crucial to define them and determine what they constituted, given their distinctive nature followed by the request for special legal and regulatory framework for their establishment and operation. Practically, defining SOE is left for national legislations of each jurisdiction.

However, there are efforts to develop a standard definition of SOEs by different organizations like the Organization for Economic Cooperation and Development (OECD). In this respect, if we see the definition given by the OECD, in its guideline for the corporate governance (CG) of SOEs, any corporate entity recognized by national law as an enterprise, and in which the state exercises ownership, should be considered as an SOE.[3] This includes joint stock companies, limited liability companies and partnerships limited by shares.[4] In addition to their definition, their nomenclature is also a point of variation among different countries. Hence, they are known by many names –

[1] Organization for Economic Co-operation and Development (OECD), *Guideline on Corporate Governance of State Owned Enterprises*, (2015), p.29, available at: www.oecd.org/.../OECD-Guidelines-Corporate-Governance-SOEs-201.[Hereinafter The 2015 OECD Guideline].
[2] Boris Crnković, *et al*, *State Ownership and Corporate Governance of Enterprises in Croatia*, p.624, available at:ftp://ftp.repec.org/opt/ReDIF/RePEc/osi/journl/PDF/InterdisciplinaryManagementResearchX/IMR10a46.pdf
[3] The 2015 OECD Guideline, p.15.
[4] *Ibid.*

government corporations, government business enterprises, government-linked companies, parastatals, public enterprises, public sector units or enterprises and so on.

Ethiopia is not an island to this reality of the globe. For the same rationales discussed above, SOEs which are fully or partially owned by the government covered a significant portion of the economy in different sectors. In some sectors, like telecommunication, power and shipping, there is a state monopoly.[5] Like that of the international experience, in Ethiopia, the name of SOE is far from clarity. Hence, different laws refer SOEs differently. In this respect, proclamation No.25/1992, used the term 'enterprise', while other subsequent legislations refer them as 'public enterprises.'[6]

However, despite the naming conundrum, the most important issue to be considered is what constitutes public enterprises in Ethiopia? And what are the thresholds to characterize an entity as a public enterprise? Answering this issue, deferent legislations defined SOEs differently, based on their intended goals. In this respect, Proclamation No. 25/1992, under article 2(1) defined enterprises as a wholly state owned public enterprise established pursuant to the same proclamation to carry on for gain manufacturing, distribution, service rendering or other economic and related activities.[7] This definition modified by other subsequent legislations and extended its scope to the inclusion of partially state owned enterprises and other establishments designated by the government as a SOE for specific purposes like for privatization.[8]

Unlike private corporations, whose only goal is to maximize profits, SOEs have two dimensions; public and private dimensions. As an enterprise operating in the market, they are expected to generate profits and as an entity established by the government, they are expected to meet other policy objectives set in their establishment. Hence, they used as a machinery for the state to bring economic stability, development and sustainability at the national level.[9] They have a large share in the economies of developing countries since they are the main source of employment and access

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5 See. The US State Department's Office of Investment Affairs' 2015, *Investment Climate Statement,2016,* available at: https://www.export.gov/article?id=Ethiopia-Competition-from-State-Owned-Enterprises. [Last accessed:12/02/2017].

6 Tewodros Meheret, The Concept and Characteristics of Public Enterprises in Ethiopia: An Overview, *Mizan law Review,* Vol. 8, No.2, December 2014, p.335. [hereinafter Tewodros Meheret].

7 Public Enterprises Proclamation, 1992, *Federal Negarit Gazeta,* Proc.No.25, 51st year, No. 21, Article 21. (Hereinafter Proc. No. 25/1992).

8 Tewodros Meheret, P. 337.

9 Zhaofeng Wang,Corporate Governance Under State Control: The Chinese Experience, *Theoretical Inquiries in Law,* Vol. 13:487,2012,p.488.

to basic utilities including access to water, electricity, sanitation and transportation is entirely dependent on such enterprises.[10]

Being a policy vehicle for the government to achieve the objectives of public value creation and good growth in one hand and as a business entity that will face stiff competition in the market on the other hand, SOEs should be managed and owned based on clear ownership objectives; they should meet high level of disclosure and transparency requirements, they should protect the rights of stakeholders and shareholders and should develop sound internal management.[11]

In general, they should meet high level of CG. The term CG approached from different perspectives by different scholars of different disciplines since each discipline attempted to define it from its own perspective. However, the definition by The Cadbury Report and the OECD are the most comprehensive and authoritative definitions.[12] The Cadbury Report defines CG as the system by which companies are directed and controlled.[13] And the most comprehensive definition of CG is provided by the OECD task force. It has defined CG as 'Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.'[14]

Coming to the definition of CG in Ethiopia, the Corporate Governance Code for SOEs in Ethiopia (CGC) adopted the above version of the OECD definition, adding a point that CG is about commitment to values, ethical business conduct and transparency.[15] Having a good CG landscape, that contains modern principles of CG, for SOEs will enhance competitiveness, bring efficiency and effectiveness, open doors for an external source of finance, strengthen transparency and

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[10] Sara Sultan Balbuena, State-owned Enterprises in Southern Africa, P.7, available at: http://www.oecd-ilibrary.org/governance/state-owned-enterprise-governance_5jzb5zntk5r8-en. (Last accessed 10, April 2017)
[11] Sultan Balbuena, S., "State-owned Enterprises in Southern Africa: A Stocktaking of Reforms and Challenges", pp.7-10, Available at: http://dx.doi.org/10.1787/5jzb5zntk5r8-en. [last accessed April 23, 2017].
[12] Nomusajane Moy, South African Principles of corporate Governance: Legal and regulatory restraints on powers and Remunerations of Executive Directors, 2010, p.5, available at: http://uir.unisa.ac.za/handle/10500/4254, [hereinafter Nomusajane Moy, South African Principles of corporate Governance].
[13] Sir Cadbury A, Committee on Financial Aspects of Corporate Governance, *Final Report and Code of Best Practice* (December 1992) par 2.5.
[14] The 2015 OECD Guideline.
[15] Code of Corporate Governance, *Privatization and Public Enterprises Supervising Agency,* 2009. [hereinafter the Ethiopia Corporate Governance Code].

accountability and attract investment.[16] Therefore, it is imperative to design clearly defined legal and institutional framework for CG of SOEs in order to benefit from the blessings of good CG.

1.2.Statement of the Problem

In order to achieve their public policy objectives and remain competitive in the market, SOEs should maintain good CG. Good CG manifested itself through the following modern principles: The establishment of adequate legal and institutional framework for CG of SOEs, clear government ownership policy, independent board, protection of the interest of shareholders and stakeholders, transparency and financial disclosure, and separation between the state's ownership function and other state functions especially market regulation. Being cognizant of this fact, Ethiopia has designed a CG landscape through enacting various legislations inherent to the governance of SOEs. The major legislations to be consulted while thinking CG of SOEs in Ethiopia are: The 1995 FDRE Constitution, Public Enterprises Proclamation No. 25/1992, Privatization of Public Enterprises Proclamation No. 146/1998, Privatization and Public Enterprises Supervising Authority Establishment Proclamation No.412/2004, Corporate Governance Code for SOEs issued by Privatization and Public Enterprises supervising Authority in December, 2009, Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No.916/2015 and Public Enterprises Board Administration Directive No. 8/2009, issued by the Ministry of Public Enterprises.

All these legislations have the objective of enhancing the CG of SOEs. In this regard, if we see the corporate governance code, it has the aim of bringing a good CG of SOEs that will increase the long-term competitiveness of SOEs in the global market through making them more credible, transparent, and efficient.[17] However, the main problem is, whether all the above and other legislations in relation to the CG of SOEs and their enforcement institutions reflect modern principles of CG of SOEs, in a way to meet the objectives of the government. This issue demands a tough analysis of the legal and institutional infrastructure of the country in the lenses of good CG principles.

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[16] World bank Group, Corporate Governance of State-Owned Enterprises, available at: https://openknowledge.worldbank.org/bitstream/handle/10986/.../9781464802225.pdf?.

[17] See the preamble of the Ethiopian Corporate Governance Code.

Particularly, though the government control and supervises SOEs in exercising its ownership right and in checking them whether they achieve the public purpose they are created, in order to be efficient and effective in a market, SOEs should get their operational autonomy in their internal management. Therefore, the board, which is the heart of the enterprise in the governance structure should be elected or appointed based on merit rather than that of political affiliation. However, in Ethiopia, it is only one-third of the board members can be elected by the general assembly of workers.[18] The rest will be appointed by the executive, the supervising authority.[19] This will open the door for the executive to interfere in the internal management of the enterprise and casts doubt as to the autonomy of the enterprise. Even, some scholars argue that, practically, the board chairmen are selected among high-ranking civil servants in that sector, some of whom are ministers. This has implications for political interference in monitoring the enterprises.[20] Furthermore, the ownership objectives of the government on SOEs, the level of protection given to the rights of shareholders and stakeholders, and the standards of disclosure and transparency in SOEs are fare from being clear. Furthermore, whether the government created a level playing field for private enterprises by not providing unjustified protection to SOEs is also another problem which needs enquiry. Based on these issues, this study devotes to the analysis of the legal and institutional framework for the CG of SOEs in Ethiopia.

1.3.Objectives of the Study

1.3.1. General Objective:

The general objective of this research is to critically study and analyze the legal and institutional framework of Ethiopia in CG of SOEs and to identify the loopholes with possible way outs for the reform of the CG landscape of SOEs in Ethiopia.

1.3.2. Specific Objectives:

- To provide a comprehensive overview of the current status of the corporate landscape of SOEs in Ethiopia.
- Analyzing the legal and institutional framework for CG of SOEs in Ethiopia.

[18] Proclamation No.25/92, Art.12/2/.
[19] Proclamation No.25/92, Art.11/1/.
[20] Africa Peer Review mechanism(APRM), Country Review Report No.14, Country Review Report Federal Democratic Republic of Ethiopia, p.183. available at: http://aprm-au.org/admin/pdfFiles/CRR_No14-Ethiopia_EN.pdf .[hereinafter, APRM Country Report No.14].

- To explore whether the existing legal and institutional framework of Ethiopia is adequate to achieve the very objectives of SOEs.
- Investigating the specific defects in proclamations, regulations and directives in the area of CG of SOEs.
- To evaluate and formulate the concept for further development of CG of SOEs in Ethiopia by presenting conclusion and recommendations for good CG legal and institutional framework of SOEs.

1.4.Research Questions

To address the above-mentioned general and specific research objectives the researcher has formulated the following general and specific research question: The central research question of this study is; does the legal and institutional framework of Ethiopia that shapes the CG of SOEs uphold modern principles of CG of SOEs that are indispensable to achieve the very objectives of SOEs?

In order to properly answer the general research question and to achieve the research objectives stated before, the study focused on addressing the following specific research questions.

- What are the ownership objectives of the government on SOEs, as reflected in laws? And, is the current legal and institutional framework designed in a way to achieve such objectives?
- Does the legal and institutional framework for CG of SOEs in Ethiopia protect the rights of shareholders and stakeholders?
- What is the level of transparency and disclosure of information in SOEs of Ethiopia?
- What are the requirements for nomination, election, appointment and removal of the board of directors of SOEs and what are their functions and responsibilities?
- Is the legal and institutional framework for SOEs in Ethiopia designed in a way to ensure a level playing field and fair competition in the marketplace?

1.5. Significant of the Research

This research, analyzing the legal and institutional framework of CG of SOEs in Ethiopia, will assist the government`s effort to create a good CG landscape for SOEs. To the extent of the researcher’s inquiry, there is no prior study in the legal and institutional framework for the CG of SOEs in Ethiopia. So that, this study, being a pioneer study in the area, will be an input for further studies in the academia. Moreover, since this research provides a thorough analysis of the legal and institutional framework of CG of SOEs in Ethiopia, taking account of modern principles of CG in SOEs, it will enable the government to draw ownership policies that can address recent CG issues.

1.6. Literature Review

While the researcher decided to study this research problem, he has made a comprehensive review of literature in the area of CG in general and CG of SOEs in particular. However, what the researcher can conclude from his inquiry in the area is, though the concept corporate governance is a recently developed concept which traced back to 1990s, thanks to The International Financial Corporation and the OECD, the international literature is very rich both in public and private sector corporations. However, when we come home, the area of CG is the untouched area of research. And as far as the enquiry of the researcher is concerned, there is no prior research in the legal and institutional framework for the CG of SOEs in Ethiopia.

Yet, though the primary focus of all the literature in the area is CG of private companies, there are many interesting works of different scholars. To begin from the recent literature, Asefa Aregay in his LL.M thesis[21]studied the CG rules of Ethiopia and Germany in a comparative manner. The author made his comparison based on the provisions of the 1960 commercial code of Ethiopia and other special laws in the financial sector and the German stock corporations act of 1965 with its amendments and other German laws in the area. In doing so, he has focused on the board structure, the role of auditors, and shareholders meeting. However, the author didn't address CG of SOEs in ethiopia.

An article by Asnakech Geten**et,** addressed the CG of the financial sector of Ethiopia focusing on private banks. In this study, the author explains major CG issues inherent to the financial sector and contextualized it to the Ethiopian perspective.**[22]** In so doing, she has pointed out core problems of CG in the banking sector. Among the problems raised by this study; the involvement of political parties in the business, the absence of an adequate legislative framework to regulate modern

[21] Asefa Aregay, Corporate governance rules in Ethiopia and in Germany: A comparative analysis, LL.M thesis, CEU, 2015{hereinafter Asefa aregay}.
[22] Asnakech Getnet Ayele , Revisiting the Ethiopian Bank Corporate Governance System: A Glimpse of the Operation of Private Banks, Law, *Social Justice & Global Development* Journal (LGD), 2013.[hereinafter Asnakech Getnet].

complex bank governance issues and the inadequacy of laws to protect the interest of shareholders covered the significant portion of the study. In spite of the author`s effort to evaluate Ethiopia's CG landscape in line with modern principles of CG, the scope of this study is limited to private companies in general and the banking sector in particular.

A well-known Writer, Fekadu Petros, wrote about the emerging separation of ownership and control in Ethiopian share companies and expounded one aspect of good CG, separation of ownership and control and stated his worries on the rights of minorities following the growing separation of ownership and control in Ethiopian share companies.[23]He has argued that the provisions of the commercial code governing the rights of minority shareholders are not sufficient and should be revised to address modern issues of CG in the protection of the rights of minority shareholders. Particularly he requested strengthening the voice and exit rights of shareholders. Like that of the literatures discussed before, this article also limited itself to the analysis of the law and the practice in corporate governance of share companies owned privately. Further, this article limited its scope only in one corporate governance aspect, protection of the rights of minority shareholders.

Gebeyaw Simachew Bekele,[24]in his thesis titled, A Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance, depicted that the Ethiopian legal framework for the CG of share companies, provisions of the commercial code, are lagged behind modern market developments and unable to accommodate contemporary CG issues. Hence, they are not attracting investors. Therefore, he claimed the revision of the commercial code CG provisions. In so doing he insisted on using the OECD corporate governance principles. Especially he has made a deep analysis of the Ethiopian corporate governance provisions based on the six CG principles of the OECD. Though the writer addressed major corporate governance issues in the CG of Share companies, he didn`t address CG of SOEs which demands special emphasis, given its unique nature in many respects.

[23] Fekadu Petros Gebremeskel, The Emerging separation of ownership and Control in Ethiopian Share companies: Legal and Policy Implications, *Mizan Law Review,*Vol. 4 No.1, March 2010. [hereinafter, Fekadu Petros].
[24] Gebeyaw Simachew, A *Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance*, dissertation, University of London, 2011-2012, p 2, unpublished available at: http://sas-space.sas.ac.uk/4733/1/Gebeyaw_Bekele_LLM_ICGFREL_dissertation.pdf {hereinafter, Gebeyaw Simachew}.

Hussein Ahmed Tura,[25] in his article titles, Overview of corporate governance In Ethiopia: The Role, Composition and Remuneration of Board of Directors In Share Companies, addressed one of the most important issues of CG, corporate board. He has made a detail discussion about separation of supervision and management responsibilities in general and the role, composition and remuneration of board of directors in share companies. Like many researches in the area of CG in Ethiopia, he has limited his study to the CG provisions of the commercial code since his study is about share companies in the private sector. Moreover, he wrote another article titles, Reforming Corporate Governance in Ethiopia: Appraisal of Competing Approaches, and addressed many corporate Governance concerns in Ethiopia share companies with special emphasis on the rights of minority shareholders.

Even if the above-mentioned and other scholars wrote about CG in Ethiopia, all of them focused on private owned companies. However, the ownership structure of SOEs affect their governance and lead to the rise of cardinal CG issues peculiar to them like the relationship between politicians and professional managers of SOEs, the level of intervention by the government, their relation with other private enterprises, and the balance between profit maximization and other policy enforcement motives of the government. Therefore, the governance of SOEs in Ethiopia requests special consideration. Based on this reality, this research devotes to a critical analysis of the Legal and institutional framework for the CG of SOEs in Ethiopia.

1.7. Scope and Limitation of the Study

This research is limited to the analysis of the legal and institutional framework of SOEs in Ethiopia to appreciate the CG landscape of the country and evaluate whether the country`s legal and institutional framework upholds modern principles of CG of SOEs. For a better analysis of the problem, addressing CG of private owned companies is out of the scope of this study. However, apart from the existence of peculiar CG features in SOEs, SOEs as business entities operating in the market, share some CG principles with private share companies. Therefore, CG issues inherent to private companies was appreciated since the achievement of the objective of this research necessitated to do so. Furthermore, SOEs may be established by both the federal and regional

[25] Hussein Ahmed Tura, Overview of Corporate Governance In Ethiopia: The Role, Composition and Remuneration of Board of Directors in Share Companies, 46 *Mizan Law Review* Vol. 6 No.1, June 2012, pp. 46-76.[hereinafter Hussien Ahmed].

governments. Hence, regions have designed their own legal and institutional framework for the governance of their enterprises. For instance, we can take proclamation number 236/ 2008 of the Amhara regional state public enterprise`s proclamation. However, to assess the CG of regional SOEs was not the aim of this study and it is intentionally excluded.

The major limitations that the researcher faced while conducting this research was; lack of prior researches in relation to the legal and institutional framework for the CG of SOEs in Ethiopia and time constraint. In addition, inaccessibility of directives and internal regulations in relation to SOEs was also another version of the challenges that the researcher faced in his journey of completing this study. However, the researcher committedly avoided the impact of such limitations on the quality of the study.

1.8. Methodology of the Study

This research has employed a qualitative method of study because of the fact that the research questions of this study was able to be best answered by collecting and analyzing qualitative data. Given the qualitative research approach was chosen for this study, in this research, the researcher analyzed the existing legal documents of the country in the area of SOEs qualitatively. Further, primary data was collected and analyzed qualitatively so as to appreciate the gaps in the legal and institutional framework. In addition, because it was one of the aims of this research to provide a comprehensive overview of the current status of the corporate landscape of SOEs in the lenses of modern principles of CG in SOEs, international CG principles and guidelines including OECD Guideline on Corporate governance of SOEs (2015) was consulted.

1.8.1. Data Source and Collection Tools

The researcher, in doing this study, used both primary and secondary data. Major legislations inherent to public enterprises including Public Enterprises Proclamation No. 25/1992, the Corporate Governance Code of SOEs issued by Privatization and Public Enterprises Supervising Agency on December 2009, and Public Enterprises Board Administration Directive No. 8/2009 issued by MoPE was used as primary data. In order to appreciate the gaps of the legal and institutional frameworks of CG of SOEs in Ethiopia, interview was used as a primary data collection tool. Hence, the researcher conducted semi- structured interview with officials and legal experts at the Ministry of Public Enterprises as well as with a senior professor at Addis Ababa University. A semi-structured interview was chosen for its flexibility.

Books, journals, unpublished materials, reports, newspapers and bulletins and cyber sources was used as secondary data.

1.8.2. Sampling Techniques

In this study, for collecting primary data through interview, the researcher applied nonrandom sampling techniques so as to take representative samples from the study population. Particularly, the researcher used purposive sampling to use the discretions of this kind of sampling and chosen the samples that best served the purpose of the study.

1.8.3. Method of Data Analysis

After collecting the necessary qualitative data, the researcher analyzed the data based on the core principles of qualitative data analysis. In the analysis, the researcher followed four major steps. Firstly, the researcher logically arranged the data collected. Secondly, the data categorized in order to change them into a meaningful group. Thirdly, based on the data and their interpretation, the researcher developed concepts and arrived at some general statement as to the legal and institutional frameworks for the CG of SOEs in Ethiopia. Finally, conclusions about the legal and institutional framework of CG of SOEs in Ethiopia was drawn.

1.9. Organization of the Study

This research is organized into five chapters. The first chapter addresses the proposal part of the thesis. The second chapter devoted to deal about the general overview of state-owned enterprises and corporate governance. This chapter of the study contained two parts. The first part addressed general concepts related to state ownership of enterprises including justifications and objectives for state ownership, definition of SOEs, the history of SOEs, and arguments for and against state`s direct intervention to the economy.

The second part of chapter two deals with major concepts related to CG of SOEs, including the definition of CG, evolution of CG, Models of CG, major CG problems of SOEs**,** and good CG general principles in SOEs. The third chapter designed to address the central part of the study. Hence, it deals about the legal, institutional and regulatory frameworks of CG of SOEs in Ethiopia and answered majority of the research questions. This chapter among other things discusses the history of SOEs in Ethiopia, the institutional and legal framework of CG of SOEs in Ethiopia, board of directors of SOEs, transparency and disclosure in SOEs, and auditing SOEs in Ethiopia.

The fourth chapter investigates the relation of SOEs with shareholders and stakeholders. Particularly this chapter attempted to address, what are shareholders and stakeholders in the context of SOEs, what are their rights and responsibilities, the concept of competitive neutrality in SOEs, and CSR of SOEs. Finally, the last chapter provides conclusions and recommendations.

CHAPTER TWO

GENERAL OVERVIEW OF STATE-OWNED ENTERPRISES AND CORPORATE GOVERNANCE

2.1 State Ownership of Enterprises

Economic activities in an economy of a given country may be classified into four. The first type of economic activities is economic activities which are remunerative and provided by the market through private investments.[26] The second type of economic activities such as road building and irrigation are socially profitable but not privately remunerative. Hence, they are provided by States through social overhead capital since private investors are not encouraged to invest in it.[27] The third one contains those economic activities which are privately remunerative but because they require high technology and capital, they are provided by the state either alone or jointly with private investors. And the fourth economic activities are those which are natural monopolies.[28] Except for the first type of economic activities, it is a universal phenomenon that the state involves in all economic activities.

However, the approaches of the government`s engagement in the economy vary across jurisdictions. Yet, the most common ownership models are, the decentralized model, the dual model, the advisory model, and the centralized model.[29] In the decentralized model, it is the responsibility of ministries to provide the product or service and making sectoral policy.[30] These arrangements were inefficient since such activities were not subjected to competition and because of ministries and bureaucrats exercised direct control over strategic and operational decision making.[31] Therefore, to avoid such inefficiency, governments created separate legal identities for commercial activities through corporatization.[32] And such establishments are referred as

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[26]Public Enterprises: Unresolved Challenges and New Opportunities,UN,2005, available at: https://publicadministration.un.org/publications/content/PDFs/E-Library%20Archives/2005%20EGM%20Public%20Enterprises_Unresolved%20Challenges%20and%20New%20Opportunities.pdf, p.9[hereinafter, UN, 2005].

[27]*Ibid*, p.9.

[28] *Ibid.*

[29]World bank, A toolkit on Corporate governance of State Owned Enterprises, available at: http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf P.70 [hereinafter, World bank Toolkit].

[30] *Ibid.*

[31] *Ibid.*

[32] *Ibid.*

government corporations, government business enterprises, government-linked companies, parastatals, public sector units or enterprises, state-owned enterprise (SOE), and so on.

However, the change in the approach of ownership didn't guarantee the efficiency of state-owned enterprises. Therefore, though in some countries, they were managed effectively and do provide services that are needed for development, in several countries, political intervention and stringent government control limited SOEs from fulfilling their planned missions.[33] Hence, they became another bureaucracy beset by inefficiency, ineffectiveness, corruption, and incompetence, and draining resources from the public treasury.[34] In recognition of their ineffectiveness, many SOEs have been commercialized, corporatized, or privatized since the early 1980s.[35]

Currently, despite extensive privatization over the years, governments around the world continue to own and operate commercial enterprises in such critical sectors as finance, infrastructure, manufacturing, energy, and natural resources.[36] Evidence also point the continued presence, and even expansion, of state-owned sectors in high-income countries, in major emerging market economies, and in many low- and middle-income countries.[37] Indeed, many SOEs now rank among the world's largest companies, the world's largest investors, and the world's largest capital market players,[38] since they are considered as tools for accelerated development and global expansion in many countries.[39]

2.2 Definitions of State-Owned Enterprises

Before rushing to the definition of SOEs, it will be helpful to understand the difference between the public sector and public enterprises since there is some confusion between the two. The distinction is basically in the scope of the two. In general terms, the public sector consists of governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods, or service.[40]In its widest understanding, unlike public

[33] UN,2005, p.22
[34] Ibid.
[35] UN,2005, p.22
[36] World bank Toolkit, p.XXII
[37] *Ibid.*
[38] *Ibid.*
[39] *Ibid.*
[40] Supplemental Guidance: Public Sector Definition, available at: https://na.theiia.org/standards-guidance/Public%20Documents/Public%20Sector%20Definition.pdf ,p.3, last accessed:6/8/23017, [hereinafter: Supplemental Guidance].

enterprises, the public sector encompasses all activities of government which might be commercial or non-commercial.[41] For instance, the government may conduct businesses through departmental undertakings by establishing them as a separate full-fledged ministry or as a major sub-division of a department of the government. Such undertakings are commercial undertakings of the government where user fees are charged for services rendered.[42] They are usually fully owned and managed by the government such as railways, and posts undertakings.[43] Hence, they don't have an independent entity distinct from the government.[44] Thus, both administrative and business activities are carried out by a single entity as part of the state structure. [45]

To the contrary, SOEs are enterprises which are registered as an autonomous business entity as per the provisions of the 1960 commercial code and other relevant legislations. In addition, the public-sector undertakings, are financed through annual budgets of the government. but, though they get initial capital from the government and get subsidies from the government, SOEs doesn`t have annual budget.[46]

Different meanings are given to SOEs by different scholars and institutions based on various factors. These factors are, the level of the government that owns the enterprise (central/federal, state/regional or local), the way in which the enterprise was established, the position in the administration hierarchy, the purpose it has and the status of the SOE if it is in the process of being privatized and other factors.[47] Despite, the differences, having a working definition is pivotal for a proper understanding of public enterprises. Inline to this, the International Center of public Enterprises (ICPE) Expert Groups attempted to drive a comprehensive definition of public enterprises by defining a public enterprise as:[48]

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[41] Daniel Cross Ogohi, Analysis of the Performance of Public Enterprises in Nigeria, *European Journal of Business and Management*, online, 2014, Vol.6, No.25, p.26. [hereinafter Daniel Cross Ogohi]
[42] Public Sector Enterprises, available at: http://download.nos.org/srsec319new/319EL8.pdf ,[last accessed:5/23/2017].
[43] *Ibid.*
[44] Tewodros Meheret, p.351.
[45] *Ibid.*
[46] Proc. No. 25/1992, Art.19.
[47]State-Owned Enterprises Catalysts for public value creation? 2015, p.8, Available at: https://www.pwc.com/gx/en/psrc/publications/.../pwc-state-owned-enterprise-psrc.pdf [hereinafter SOEs Catalysts for Public Value creation?].
[48]Daniel Cross Ogohi, p.26.

> Public enterprise is any commercial, financial, industrial, agricultural or promotional undertaking – owned by public authority, either wholly or through majority shareholding– which is engaged in the sale of goods and services and whose affairs are capable of being recorded in balance sheets and profit and loss accounts. Such undertakings may have diverse legal and corporate forms, such as departmental undertakings, public corporations, statutory agencies, established by Acts of Parliament or Joint Stock Companies registered under the Company Law.[49]

From the above definition of the ICPE expert groups, what we can depict is public enterprises is used to include both those firms in which the state is the single owner and those firms in which the state owns less than 100% of the share. Furthermore, being a bit more formal, a standard definition in the literature is that, public enterprises are government-owned enterprises that engage in commercial activities—that is, they sell output—and that have market sales which cover a substantial portion of operating costs.[50]

In spite of the efforts of international organizations like the OECD and ICPT, to formulate a working definition of SOEs, it is still left to the discretion of each country. Ethiopia is not an exception to this reality of the world. There is no a standard definition for SOEs. But, different laws contained different meaning for public enterprises. For the purpose of illustration, let us see some legislations and their definition for SOEs.

Proclamation No. 25/1992 defined public enterprises as:[51]

> "Enterprise" means a wholly state owned public enterprise established pursuant to this Proclamation to carry on for gain manufacturing, distribution, service rendering or other economic and related activities.

[49] International Centre of Public Enterprises at Ljubljana set up under the guidance of UN with participating Member Governments, see also. a Paper prepared for United Nations Ad-hoc Expert Group Meeting at New York ,27-28th October 2005), p.3.available at:http://unpan1.un.org/intradoc/groups/public/documents/un/unpan021548.pdf [last accessed April 23, 2017].
[50]James A. Schmitz, Jr, The Role Played by Public Enterprises: How Much Does It Differ Across Countries?, *Federal Reserve Bank of Minneapolis Quarterly Review,* 1996, Vol. 20, No. 2, 1996, p.4. [hereinafter, James A. Schmitz, Jr].
[51] Proc. No. 25/1992, Article 2/1/.

Privatization of Public Enterprises Proclamation No. 146/1998 defined Public Enterprises as:[52]

> Enterprise means a public enterprise governed by the Public Enterprises Proclamation No. 25/1992 or an establishment designated by the Government as a public enterprise for the purpose of the application of this Proclamation.

Privatization and Public Enterprises Supervising Authority Establishment Proclamation No. 412/2004 defined Public Enterprises as:

> Public enterprise" means an enterprise as defined under Article 2(1) of the Public Enterprises Proclamation No. 25/1992, or a wholly state-owned share company, but excluding those enterprises for which specific supervising authorities are designated by other laws of decisions of the Government.

In addition to the above laws, which are highly related to public enterprises, other legislations, including the criminal code, defined SOEs from their specific perspective. Hence, the criminal code under Article 42/3/ defined public enterprises as, “"Public enterprise" means a Federal or Regional Government enterprise or share company, in which the Government has total or partial share as an owner.’’ We can also see article 2/4/ of proclamation No. 433/2005, article 2/33/ of proclamation No.686/2010 article 2/9/ of proclamation No 769/2010, article 2/5/ of proclamation No. 669/2010 and article 2/1/ of proclamation No. 208/1992.

In sum, we can conclude that, each definition is relevant to its specific purpose. For instance, as far as privatization is concerned the definition under proclamation No.412/2004 will be applicable (though its contents are degrading via subsequent amendments). And as far as criminal matters are concerned, the definition under the criminal code will prevail over other definitions. However, for the academic purpose, we can conclude that, an enterprise which contains one or more of the following elements can be considered as SOE in Ethiopia. 1. An enterprise which satisfies the definition given under proclamation No. 25/1992. 2. Fully government owned share company,[53] 3. An enterprise which is declared as SOE by the government.[54] 4. An enterprise partially owned

[52]Privatization of Public Enterprises Proclamation,1998, *Negarit Gazzeta,* Proc.No. 146, 5th Year No. 26, article 2/3/, [hereinafter Proc. No.146/1998].

[53]Privatization and Public Enterprises Supervising Authority Establishment Proclamation,2004, *Federal Negarit Gazzeta,* proc.No.*412,* 10th Year No. 57, Article 3 and the Preamble, [hereinafter, Proc.No.412/2004]. See also proclamation No.685/2002 and 686/2002.

[54]*Ibid.* See also Proc. No.146/1998.

by the government. For the purpose of this study the definition provided by the ICPE mentioned above will be used.

2.3. Justification and Objectives of SOEs

2.3.1. Justifications for the Establishment of SOEs

In spite of ideological differences of countries, SOEs play a significant role in every country`s economy. However, the overarching question for the government owners of SOEs is why these enterprises need to be owned by the state. And, the answer for the rationales or justifications of the establishment and popularity of SOEs is not the same everywhere, given different economic development level. So that, there is a large difference in developing and developed countries. To begin with developed countries, the rationales for the establishment of SOEs was the result of their understanding of the failure of the laissez-faire policy and the spread of the unbridled form of capitalism.[55] Hence, they used SOEs to supplement and reform private enterprises.

In communist countries, SOEs were resulted from an ideological commitment to liquidate capitalist system and private enterprises.[56] In the context of developing countries development emphasis is one of the justifications used by governments for their involvement in the economy through establishing enterprises.[57] Therefore, SOEs in most developing countries SOEs was established as a matter of economic necessity.[58] Far from ideological reasons, the OECD and World Bank have adduced many rationales for the establishment of SOEs in many countries. This includes: to provide public goods and merit goods, to improve labour relations, particularly in 'strategic' sectors, to limit private and foreign control in the domestic economy, and to generate public funds.[59]

However, currently, the most common rationale provided for the intervention of the state to the economy is that it is a response to market failure.[60]A number of other rationales for public

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[55] See an Introduction about Public Enterprises, p.2, available at: <*shodhganga.inflibnet.ac.in/bitstream/10603/1507/6/06_chapter1.pdf*> *[hereinafter Introduction]*
[56]*Ibid.*
[57]Daniel Cross Ogohi, p.28.
[58]Introduction, p.2.
[59]SOEs Catalysts for public Value Creation? p.14.
[60]Awoke Tenaw, *the performance of Privatized Public Enterprises in Ethiopia: The Case of hotel Enterprises,* MA Thesis, Addis Ababa University, 2011, [unpublished, archived at AAU library], p.14 (hereinafter Awoke Tenaw).

ownership of enterprises have been offered, including (I) monopolies in sectors where competition and market regulation is not deemed feasible or efficient; (ii) market incumbency, (iii) imperfect contracts, (iv) industrial policy or development strategies.[61]

2.3.2. Objectives of SOEs

Though state-owned enterprises engage in the economy like private enterprises with a profit motive, unlike private enterprises, they are two-dimensional, public and private dimensions. In the one hand, SOEs are instruments for achieving societal objectives, such as distributional justice, protection of national interest, and the creation of employment. On the other hand, SOEs are instruments for generating profit for the state, which may then be spent for welfare purposes, like social insurances.[62] Hence SOEs need to decide between public duty and the financial result. Therefore, it is important to clarify the base objectives and operating principles of all SOEs so these can be translated into quantified and monitored targets.[63] Hence, it is the duty of the owner, the government to draw the grand objectives of SOEs.

Practically, though each state may set a different objective based on its context and the nature of the enterprise, common objectives of SOEs are: to help in the rapid economic growth and industrialization of the country and create the necessary infrastructure for economic development, to earn return on investment and thus generate resources for development, to promote redistribution of income and wealth, to create employment opportunities, to promote balanced regional development, to assist the development of small scale and ancillary industries and, to promote import substitution.[64] In sum, the principal objective of every public enterprise shall be to function as efficient and profitable business that competes with private owned enterprises.

2.4. The History of State-Owned Enterprises

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[61] Hans Christiansen, Balancing Commercial and Non-Commercial Priorities of State-Owned Enterprises, p.3, available at:https://www.oecd.org/daf/ca/OECDCorporategovernanceWorkingPaper6.pdf *,last accessed:6/9/2017.*
[62] Stine Ludwigsen, *State Ownership andCorporate Governance: Empirical Evidence from Norway and Sweden* Ph.D. Dissertation, BI Norwegian School of Management, Department of Public Governance, 2010,p,14.[unpublished, available at: http://web.bi.no/forskning/papers.nsf/0/4f488755c624c943c125771f0030605f/$FILE/2010-03-Ludvigsen.pdf, [hereinafter, Stine Ludvigsen].
[63] Sundarapandian Vaidyanathan and Vidya Sundar, The Role of public Sector Enterprises in Rural Development and Social Welfare, *International Journal of Managing Public Sector Information and Communication Technologies (IJMPICT),* 2011, Vol. 2, No. 1, p.24. [hereinafter, Sundarapandian Vaidyanathan and Vidya Sundar].
[64] Introduction, P.5.

State`s intervention in the economy always presents since the ancient civilizations. But, the Great Depression and other financial crises, the Second World War and its associated destruction of industry and infrastructure, and decolonization brings massive societal disparities in the world.[65] therefore, to correct this economic and social imbalance through investment, production, trade, distribution and consumption, SOEs designed as an instrument by many countries in the world. Hence, since the 1930s and particularly after World War II, numerous SOEs were created in both developed and developing countries.[66]

State ownership experienced a period of popularity among developed nations in the 1930's, 1940's and 1950's, and in developing nations throughout the postwar period. In industrialized nations, state ownership was considered as a remedy for market failures like externalities and monopoly, which at that time were considered prevalent.[67] In developing nations, these justifications were coupled with arguments that SOEs facilitated "economic independence" and planned development.[68]

However, rising corruption, management inefficiencies, overstaffing inflation and rising current account deficits of the 1980s, exposed serious "government failures" and the role of SOEs as major players in economic development faced a serious challenge.[69] Due to such massive failures, a lot of privatization of SOEs was commenced in the 1980s and 1990s, with the following up of multilateral financial institutions.[70]

Yet, SOEs continue to occupy significant roles in many developed and developing countries.[71] By 2012, SOEs were responsible for approximately one-fifth of global stock market value, which is more than two times the level observed just one decade ago.[72] Further, based on a study in 2011,

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[65] OECD, *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries*, p.20, Available at:http://dx.doi.org/10.1787/9789264009431-en (last accessed in April 24,2017). [hereinafter OECD country Survey].
[66]UN,2005, p.9.
[67]Mary M. Shirley and Patrick Walsh, Public versus Private Ownership: The Current State of the Debate, p.3, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=261854, [hereinafter Mary M. Shirley and Patrick Walsh].
[68] *Ibid.*
[69] UN,2005, p.9.
[70] *Ibid.*
[71] Daniel Cross Ogohi, p.26.
[72] Mariana Pargendl, State Ownership and Corporate Governance, *Fordham Law Review,*2012, Vol. 80, Issue 6, Article 19, p.2919. [hereinafter, Mariana Pargendl].

government-controlled firms account for about 80 percent of the market capitalization in China, 60 percent in Russia, and 35 percent in Brazil.[73] This means, despite the fact that states are attempting to privatize SOEs, aiming at increasing the participation of private investors in their economy, SOEs are still the dominant aspects of any economy in the world.

2.5. Arguments for and against Direct Intervention of the Government in the Economy

While regulating the business activities of private enterprises, governments usually went in for direct intervention in the economy and establish SOEs in different areas of business. These enterprises are both owned and managed and controlled by the government. But, the issue of whether collective ownership of the people via state can bring better economic results than private enterprises is an important controversy. This controversy has haunted the academic world since the origination of economic science and such continuing debates on the role of the state in the economy has led to the establishment of different schools of economic thought.

In the late 1980s and 1990s, researches started to express the record of catastrophe and waste by SOEs. Even governments of both developed and developing countries began to express their concerns. Following this, questions as to the performance of SOEs and questions of privatization began to emerge.[74] These concerns brought an increasing insistence to the debate on the merits of state ownership of enterprises in the economy.

The first argument is that, ownership doesn't matter to the enterprise's performance, what matters most is market competition.[75] They insisted that product market competition, not property rights, is the primary determinant of enterprise performance. However, to the contrary, others argue that even in a fully competitive environment, SOEs will be inefficient due to the distorting interference of government officials running for their political objectives.[76] Yet, others argue that a mix of

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[73] *Id.* p.2918.
[74] Mary M. Shirley and Patrick Walsh, p.3.
[75] Muzaffar Razakov, *Corporate Governance of State-Owned Enterprises in Uzbekistan*, Ph.D. dissertation, University of St. Gallen, 2015, Unpublished, Available at: http://www1.unisg.ch/www/edis.nsf/SysLkpByIdentifier/4364/$FILE/dis4364.pdf] p.23. [hereinafter Muzaffar Razakov].
[76] Muzaffar Razakov, p.23.

competition and such viable threats as takeover or bankruptcy will increase the efficiency of SOEs.[77]

The second group of theories argues that state uses SOEs for purposes other than social welfare. This theory deals with the various objectives of state and government. Particularly, two qualities of government behavior and SOEs were mentioned: social-welfare-maximizing governments and self-interested governments. Governments with the former quality, social-welfare-maximizing governments, assumes that public ownership is the best solution for market failures and that the social benefits can offset economic costs.[78] Nonetheless, Scholars like Schleifer and Vishny (1994) argue that decision on public services is similar to a firm's decision to produce in-house or to buy on the market. Hence, in terms of inefficient political market, bureaucrats behave like rational actors who maximize their own screen performance and therefore SOEs will be used to produce political benefits at the cost of SOEs operations.[79]

A third approach argues that, regardless of government's goals, private firms will be more successful than SOEs in addressing problems of corporate governance. In this area of research, scholars have focused on efficiency problems based on studies of separation and control. From the viewpoint of agency theory, the essential contrast in CG of SOEs derives from its characteristic of having the state as the owner. Therefore, the poor performance of many SOEs can be ascribed to the specific challenges they face in governance, as opposed to private firms.[80]

However, limiting the direct intervention of the government in the economy does not by itself ensure more efficient economic management.[81] It is not also argued and is cannot be argued, that all governments intervention to the economy is necessarily unproductive and that accordingly the state should drive out of economic life by private enterprises.[82] Hence, the debate still persists. Generally, though there may be other country specific factors, failure of CG is a major factor that affects the performance of SOEs. But, despite a variety of arguments for and against direct intervention of the government in the economy, currently, the balance is tilted towards the

[77] *Ibid.*
[78] *Ibid.*
[79] *Ibid.*
[80] *Id.*p.54.
[81] Alexander Radygin , et al, "The state-owned company: State Failure or Market Failure", *Russian Journal of Economics*, 2015,Vol.1 pp.55–80.[hereinafter Alexander Radygin].
[82] *Ibid.*

governments direct intervention via SOEs. Hence there is a shift of position by many capitalist countries and they now acknowledge the importance of SOEs to nation building.[83]

2.6 Challenges of SOEs in Developing Countries: Corporate Governance as a Solution

Well-managed state-owned enterprises can become large multinational enterprises with global renown and contribute more to the development of a country. However, many SOEs struggle to operate in a competitive manner that produces a sustainable benefit to the local population. Typically, if SOEs are not effectively staffed or supervised, they will slow project development, decrease the revenue accruing to the state and intensify corruption.[84] In developing countries, SOEs are facing the following major challenges. First, poor management where board members are political appointee without the necessary qualification,[85] Second, Political Interference where government and important government officials make them do things that may not be in the overall interests of the enterprise.[86] Third, over-protection by state where most of SOEs depend on the government for everything,[87]Fourth, over-capitalization: Due to inefficient financial planning, lack of effective financial control and easy availability of money from the government, several public enterprises suffer from over-capitalization.[88]Fifth, lack of a proper price policy: there is no clear-cut price policy for public enterprises and the government has not laid down guidelines for the rate of return to be earned by different undertakings.[89] Overstaffing and problem of ambiguous objectives are also other versions of the challenge of SOEs in developing countries.

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[83] Poor Performance in State Owned Enterprises, available at: http://www.news24.com/MyNews24/Poor-Performance-in-State-owned-Enterprices-20140430 [last accessed 5/23/2017].

[84] Natural Resource Governance Institute, *State Participation and State-Owned Enterprises Roles, Benefits and Challenges*, 2015, p.5, available at: http://www.resourcegovernance.org/sites/default/files/nrgi_State-Participation-and-SOEs.pdf, [hereinafter, Natural Resource Governance Institute,2015]

[85] *Ibid.*

[86] Soumya Sing, what are the Problems of Public Enterprises? available at:http://www.preservearticles.com/2012022823832/what-are-the-problems-of-public-enterprises.html [last accessed on 3/30/2017].

[87]Emeh and Ikechukwu Eke Jeffry, 'Understanding the Poor Performance of Nigerian Public Enterprises Focusing on the Theories of Contemporary Research in Business', 2012, Vol 4, No.5, p.1116. [hereinafter, Emeh and Ikechukwu Eke Jeffry].

[88]Natural Resource Governance Institute,2015, p.5.

[89] Professor Ram Kumar Mishra, Role of State-owned Enterprises in India`s Economic Development, *in OECD Workshop on State Owned Enterprises in the Development Process*, Paris, 4 April 2014, pp.29-30. [hereinafter, Professor Ram Kumar Mishra,]

Generally, SOEs are deeply occupied in most fiscal problems of developing countries, especially African governments because of their inefficiency, losses, budgetary burdens, and provision of poor products and services.[90]

Apart from the above challenges, SOEs play a crucial role in providing economic infrastructure. They provide vital services and products as well as providing employment and capacity building. Yet, in order to achieve the very objectives of SOEs by creating competitive and efficient enterprises, the challenges must be alleviated. In order to avoid the challenges, it is important to take the following measures: Prudently define commercial and non-commercial roles, limit noncommercial activities where sophisticated or expensive commercial activities heighten the risk and cost of conflicts of interest, design an effective revenue retention model, procure external financing by listing some SOEs shares on public stock exchanges or issuing external debt where appropriate, clearly define the role of the state, empower professional, independent boards, invest in SOEs staff integrity and capacity, maximize public reporting of key data, secure independent financial audits, and publish them and choose an effective level of legislative oversight.[91]

As far as ownership objectives are concerned, every enterprise should have a specific objective. The objective should be expressed in clear terms and communicated to all the employees of the enterprise. And they should be set taking into account the prevailing environment and modified according to the changes in the environment.[92] In simple parlance, through clarifying the roles and responsibilities of the state as a SOE owner, establishing SOE boards that are independent and qualified, and through securing a political commitment for SOEs reforms, countries can tackle the challenges of SOEs and achieve their objectives.[93]

2.7. Corporate Governance Theories

2.7.1. Definition of Corporate Governance

[90]Kiarie Mwaura, 'The Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises:The Case of Kenya', *Fordham International Law Journal*, 2017, Volume 31, Issue 1, Article 1, p.34. [hereinafter, Kiarie Mwaura].

[91] Natural Resource Governance Institute, 2015, p.6.

[92] Solutions to Problems Faced by Public Enterprises, available at: http://accountlearning.com/solutions-to-problems-faced-by-public-enterprises/ , [last accessed on22/03/2017].

[93] 4 Key Challenges for Reforming State-Owned Enterprises: Lessons from Latin America, available at: http://blogs.worldbank.org/governance/4-key-challenges-reforming-state-owned-enterprises-lessons-latin-america ,[last accessed on 21/03/2017].

Before delving further on the subject, it is important to define the concept CG. Literary, corporate means a legal entity that is separate and distinct from its owners. And governance includes all processes of governing, whether undertaken by a government, market or network, whether over a family, tribe, formal or informal organization or territory and whether through laws, norms, powers or language.[94] However, CG is one of those fluid concepts in corporate law and finance which scholars seldom try to define.[95] Because of this, there is no generally agreed upon definition of the term. Yet, there are attempts to define it either broadly or narrowly, most of which are center on the manner in which a corporation is governed, directed and controlled.[96]

It is narrowly defined as the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled.[97] In its narrow sense, CG focuses on the control of management by shareholders without considering stakeholders participation to the governance of enterprises. However, the most authoritative and broader definition is the definition provided by the OECD. It has defined CG as follows;[98] "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.

Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined." Unlike the narrow version of the definition mentioned above, this definition encompasses not only internal aspects of CG but also takes into account the role of stakeholders in the decision making and implementation of strategic decisions in the enterprise and the impact of such decisions of the enterprise on them.

There are also many other definitions for the term. For instance, it has defined as the proper allocation of power and responsibilities among the board of directors, the management and the

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[94]Ahmed Ullah Shah, an introduction to Corporate Governance, available at: https://www.slideshare.net/NoumanZia1/1-introduction-43807444 , last accessed: 5/8/2017, [hereinafter: Ahmed Ullah Shah]

[95] Fekadu Petros, p.3.

[96]Winifred Mary Tarinyeba, *Corporate governance in Uganda: The role of the Bank Finance*, LL.M Thesis, Stanford University, Law Faculity, 2016, unpublished, available at: https://www-cdn.law.stanford.edu/wp-content/uploads/2015/03/TarinyebaWinifredM-tft2006.pdf p.6 [hereinafter, Winifred Mary Tarinyeba]

[97] Alemayehu Geda, The Road to Private Sector Led Economic Growth, 2009, pp. 111-112, www.researchgate.net/publication/292139949. [herein after Alemayehu Gada].

[98] OECD Principles of Corporate Governance (2004), available at: https://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf. [last accessed 5/20/2017].

owners of a business.[99] Based on this definition, the primary participants in a business enterprise are the owners and investors who provide capital to fund the business, the executives, managers, and employees who run the business day-to-day and implement the policies and strategies set by the board; and the board of directors.[100] Furthermore, CG has also been defined as- a system of law and sound approaches by which corporations are directed and controlled.[101] For the purpose of this study the broader definition provided by the OECD working group is chosen for its comprehensiveness.

2.7.2. Evolution of Corporate Governance

The history of CG is essentially an economic history and the history of a country's governance and legal system.[102] The first connotation of 'corporate governance' in modern literature was used in 1984 by Robert Tricker.[103] And this concept of CG and corporate governance standards have evolved largely in connection with private share companies. However, it is equally relevant to state-owned enterprises (SOEs),[104] since the only key differences in an SOE are: (1) the State is the exclusive or dominant owner; (2) the State controls or has an influential role on the board of directors; (3) the State determines the objectives of the business according to the public interest and sometimes, has to balance a political agenda in managing the SOE.[105] Corporate Governance has gained deserved attention in the world in the 1980s and 1990s following a serious of concurrent corporate scandals in developed countries.[106]

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[99]Sodali and Governance Consultants S.A., pp.5-7.
[100]*Ibid.*
[101]Sifuna, Anazett Pacy, Disclose or Abstain: The Prohibition of Insider Trading on Trial, *Journal of International Banking Law and Regulation,* 2012, *Vol.* 27, No. 9.
[102] Barcca, *et al*, The Control of Corporate Europe, European Corporate Governance Network, Oxford University Press,oxford. 2001[hereinafter, Baracca et al The Control of Corporate Europe]
[103]Teferi Deyuu Alemi, Corporate Governance Reporting Legal and Regulatory Environment in Ethiopia, *International Journal in Commerce, IT & Social Sciences,* online, 2016, Vol.03, No.02, p.31. [hereinafter, Teferi Dayuu]
[104]Sodali and Governance Consultants S.A, *White paper on the Importance of Corporate Governance in State Owned Enterprises, Available* at: https://www.oecd.org/daf/ca/SecondMeetingLatinAmericaSOECAFWhitePaper.pdf, [last accessed on 28/02/2017. p.5.] (hereinafter, Sodali and Governance Consultants S.A).
[105]*Id*, pp.5-7.
[106] Kamau, A.G.N, Corporate Governance in Kenya`s State Corporations: A critique on the Appointment and Dismissal of Directors of Boards of State corporations, LL.M thesis, University of Nairobi, Law Faculity,2013, p.23, Unpublished, available a: University of Nairobi repository [hereinafter Kamau, A.G.N].

Initially, it was designed to solve agency problems that occur between shareholders and managers of the enterprise. Hence, it was primarily focused on supervision and regulation of the enterprise`s performance for the interest of capital owners and ensure that suppliers of capital get a return on their investment.[107] However, through time, CG became concerned about meeting other social responsibilities of the business.[108] Over the past two decades, the investment world has seen a large number of scandals relating to enterprises due to CG problems.[109] Among the causes, the following were major governance problems: lack of business ethics, considering earning as a primary way of enterprise`s success and ineffective board.[110]

Following the scandals, the world started to react massively. This led to the development of laws and codes for better corporate governance including; The Cadbury Report 1992, Greenbury Report 1995, Hample Report 1998, Combined code 1998, Turnbull Report 1999 and OECD Principles of CG 1999.[111] Following this, CG evolved too fast and many reports, codes, and guidelines were designed in different countries by different institutions. In this regard, the Basel Committee Guidelines 1999, the UK Mayners Report 2001, the Germany Crome Report 2002, the UK Higgs Review 2003, Smith Report 2003, revised Combined Code 2003, the South African Kings Reports of 1994, 2000, 2009, and Serbans Oxley Act of 2002 of USA are prominent.

Furthermore, many other guidelines including the 2004 and 2015 OECD guidelines are issued to develop corporate governance at international level. The evolution of CG in SOEs is the same as the case of private enterprises. Yet, some special governance principles are designed for the CG of SOEs, taking account off their uniqueness in some aspects. Here, the 2015 OECD guideline for the CG of SOEs provide an internationally agreed benchmark to help governments assess and improve the way they exercise their ownership functions in SOEs.[112]

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[107] Stephen Letza and James Kirkbride, et al, Corporate Governance Theorizing: Limits, Critics and Alternatives, *International Journal of Law and Management,* Vol. 50 No. 1, 2008 pp. 17-32.

[108] *Ibid.*

[109]History of Corporate Governance, available at: https://www.slideshare.net/hameed143/history-of-corporate-governance, last accessed: 5/8/2017, [herein after:History of Corporate Governance].

[110] *Ibid.*

[111] Dr, Safdar A Butt, A brief history of Corporate Governance, available at: https://www.slideshare.net/NoumanZia1/2-brief-history?next_slideshow=1 ,last accessed: 5/8/2017, [hereinafter: Dr, Safdar A Butt].

[112]OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, available at: http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en.last [accessed 5/20/2017].

2.7.3. Models of Corporate Governance

CG systems vary from jurisdiction to jurisdiction due to the reason that in some cases, corporate governance focuses on the link between a shareholder and company, some on formal board structure and board practices and yet others on social responsibilities of corporations.[113] Therefore, there is no one universally accepted model of CG as each model has its own pros and cons. The difference is on the following elements of corporate governance: key players in the corporate environment; the share ownership pattern in the given country; the composition of the board of directors, the regulatory framework, corporate actions requiring shareholder approval; and interaction among key players.[114] Internationally, three main models of corporate governance are developed: the Anglo-American system, and the Continental Europe systems, and the Japanese model

2.7.3.1. The Anglo-American System

This model of Corporate Governance is based on free economic theory and operates essentially on the premise that the pre-inter-play of market forces sets the price for capital as well as decides who gets to run a company.[115] Hence it is the market which supervises everything. The ownership pattern of enterprises in this system is scattered or fragmented ownership structures as opposed to concentrated.[116]If we see the composition of the board of directors of enterprises in this system, they have a single-tiered board of directors that is normally dominated by non-executive directors elected by shareholders.[117] Because of this, it is referred as "the unitary system".[118] This model relays on effective communication between shareholders, board and management with all

[113] Dushyant Maheshwari, Models of Corporate Governance, available at: https://www.slideshare.net/dushyantmaheshwari9/dushyant-maheshwari-29002722 , last accessed: 5/8/2017, [hereinafter: Dushyant Maheshwari].
[114]EWMI/PFS Program / Lectures on Corporate Governance - Three Models of Corporate Governance – December 2005, available at:http://www.emergingmarketsesg.net/esg/wp-content/uploads/2011/01/Three-Models-of-Corporate-Governance-January-2009.pdf , p.1, last accessed: 12/8/2017,[herein after Three Models of Corporate Governance].
[115] History of Corporate Governance.
[116]Miko Kamal, Corporate Governance and State-owned Enterprises: A Study of Indonesia's Code of Corporate Governance, *Journal of International Commercial Law and Technology*, 2010, Vol. 5, No. 4, p.214. [hereinafter, Miko Kamal].
[117]OECD Principals of Corporate Governance, 2004, Articles I and V, available at:https://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf,[last accessed 5/9/2017].
[118] *Ibid.*

important decisions taken after getting approval of shareholders by voting.[119] Hence, this system emphasizes shareholders interest. The three major players are management, directors and shareholders.[120] In this regard, we can take UK, US, Canada, and Australia as an example.

2..7.3.2. The Continental Europe Systems

Unlike the Anglo-American System, the ownership structure of enterprises in this system is characterized by a high capital concentration. Shareholders participate in its management and control. However, unlike the Anglo- American system, this model allows stakeholders, in addition to shareholders, to be members of the company's board.[121] Due to this reason, it is also called as "insider model". This model aims to maximize the business' values in general through, making managers of the enterprise responsible to stakeholders, besides shareholders, such as unions, business partners, etc.[122]

Some Continental European countries, including Germany and the Netherlands, require a two-tiered board of directors to improve CG.[123]In the two-tiered board, as the name refers, there are two boards. The first board is the executive board, which runs the day to day operations of the enterprise and the second board is the supervisory board which is completely made up of non-executive directors who represent shareholders and employees, hires and fires the members of the executive board and determines their compensation.[124]

2.7.3.3.The Japanese Model

The Japanese model has its root in post-world war II reconstruction.[125] This model of CG is characterized by a high level of stock ownership and strong financial relationships with a network of affiliated companies.[126] Many Japanese corporations also have these networks, characterized by crossholdings of debt and equity, trading of goods and services, and informal business contacts,

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[119] Dushyant Maheshwari.
[120] Three Models of Corporate Governance, p.2.
[121] Mihaela Ungureanu, Models and Practices of Corporate Governance Worldwide, available at: http://ceswp.uaic.ro/articles/CESWP2012_IV3a_UNG.pdf, [last accessed: 5/9/2017].
[122]*Ibid.*
[123]Cadbury, Adrian, *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee, London, December, 1992, Sections 3.2, 3.3, 4.33, 4.51 and 7.4.
[124] *Ibid.*
[125] Models of Corporate Governance: who`s the first of them of all, available at: https://www.slideshare.net/anantlodha/models-of-corporate-governance?next_slideshow=1 [last accessed: 12/8/2017].
[126] *Ibid.*

which are known as *keiretsu*.[127]In this system, the board of the enterprise is composed of solely and comparatively low level of impute of outside shareholders.[128] And insiders and their affiliates are the major shareholders in most japans corporations.

The key four players in the governance of the enterprise are main bank, affiliated company or Keiretsu (major inside shareholder), management and the government.[129] Hence, non-affiliated companies have little or no voice in the governance. This means, there are few truly independent directors that represent outside shareholders. As a result, the, it is often pointed out that typical Japanese firms have been taking the insider type corporate governance.[130] Currently, due to the globalization of capital markets, though slowly, each of these three systems of CG is opening to influences from other models, while largely retaining its unique characteristics. Legal, economic and financial specialists around the world can profit from a familiarity with each model.

2.7.4. The Importance of Corporate Governance to the Efficiency and Profitability of SOEs and its Link with Development

Corporate governance is crucial to both developed and developing economies by fostering investment and bringing increased interaction of world economies.[131] Studies have shown the link between investment attraction and corporate governance. Hence, Investors often do not invest in emerging market companies with poor governance.[132] From the perspective of the enterprise itself, good CG will ensure that the business activities and strategic planning are conducted electively

[127]Three Models of Corporate Governance from Developed Capital Markets, available at:http://www.emergingmarketsesg.net/esg/wp-content/uploads/2011/01/Three-Models-of-Corporate-Governance-January-2009.pdf , p.6, [last accessed: 5/8/2017].
[128]Models of Corporate Governance, available at:https://www.slideshare.net/joy18_clarisse28/models-of-corporate-governance-44039179 , last accessed: 5/8/2017.
[129] *Ibid*.
[130]Hirotsugu Sakai and Hitoshi Asaoka, The Japanese Corporate Governance System and Firm Performance: toward sustainable growth, available at:http://www.esri.go.jp/jp/prj/int_prj/prj-rc/macro/macro14/05mri1_t.pdf , last accessed:5/9/2017.
[131] Winifred Mary Tarinyeba, p.11.
[132] Vikramaditya Khanna and Roman Zyla,, *Survey Says… Corporate Governance Matters to Investors in Emerging Market Companies*,pp.2-10, available at: http://www.ifc.org/wps/wcm/connect/dbfd8b004afe7d69bcb6bdb94e6f4d75/IFC_EMI_Survey_web.pdf?MOD=AJPERES [hereinafter, Vikramaditya Khanna and Roman Zyla].

and that risk is managed properly.[133]This will serve to enhance the enterprise`s value over the long term, as well as increase its ability to access and retain crucial human resources.[134]

Having a good governance framework can also help with financing as it can increase transparency and accountability of enterprises to investors and credit institutions, which can enhance its financing capabilities.[135] In addition, good CG leads to a better system of internal control, thus leading to greater accountability and better profit margins and pave the way for possible future growth. To the contrary, weak corporate governance leads to waste, mismanagement, and corruption. Irrespective of the type of enterprise, only good governance can deliver sustainable good business performance.[136] Therefore, regardless of some unique features of SOEs their commercial objective remains the same as that of other private enterprises: to produce goods and services, make a profit and achieve sustainable growth. [137]

It is, therefore, clear that for SOEs, as well as for other types of businesses, good corporate governance is necessary to achieve management quality, smooth the achievement of the enterprise objectives, and keep a strong and long-term oriented corporate culture.[138] Furthermore, good corporate governance helps to ensure that enterprises are operated efficiently and in the best interests of shareholders and other stakeholders such as employees, creditors, major suppliers and consumers and society at large.

Currently, countries also realize that good governance of enterprises is a source of competitive advantage and, therefore, critical to economic and social progress. This is not only for the purposes of attracting foreign investors but also to widen and excavate local capital markets effectively through attracting local investors.[139]Corporate governance and development are strongly related as it brings stability to markets, strengthens competitiveness, improves risk mitigation, promotes investment, lowers cost of capital, weakens corruption, strengthens lending, promotes reform of

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[133]International Financial Corporation, Corporate Governance Frequently Asked Questions, available at:http://www.ifc.org/wps/wcm/connect/7063f9de-331b-4f97-af82-fb84e7b76ca0/160416CGSSFAQs-EnglishLR.pdf?MOD=AJPERES, [last accessed on 21/03/2017], [Hereinafter, The IFC Corporate Governance Frequently Asked Questions].
[134]*Ibid.*
[135]*Ibid.*
[136]M. Tarek Youssef, Corporate Governance an Overview – Around the Globe (1), available at:http://www.eiod.org/uploads/Publications/Pdf/Corp.%20Governance-1.pdf ,[last accessed on 28/02/2017]
[137]Sodali and Governance Consultants S.A., pp.5-7.
[138]*Ibid.*
[139] Winifred Mary Tarinyeba, p.13.

state-owned enterprises, builds transparent relationships between business and state, and ultimately helps to combat poverty.[140] It is, therefore, in many countries, corporate governance has been raised to a higher level. [141] It is no longer just a voluntary private sector practice but a major regional and national policy objective.[142]

In Africa, Economic Commission for Africa and the African Union recognized undisputable evidence of the advantages and benefits of good corporate governance and they are working on its development on the continent.[143] However, there is a rethinking of the role and value of State-Owned Enterprises (SOEs). Attention is now shifting towards the need to enhance the performance of the sector through improved governance.[144] Why corporate Governance? Better access to external finance low costs of capital, improve company sustainability, higher firm valuation and share performance, reduced risk of corporate crisis and scandals

2.7.5. Major Corporate Governance Problems of SOEs

Despite their considerable contribution in manufacturing, extractive and service industries for economic developments, and provision of employment, SOEs remain a massive economic burden on many national governments.[145] This is due to huge annual grants, subsidies, and bankruptcy, caused by numerous problems including mismanagement, political interference, and corruption.[146] Particularly, conflicting objectives (agency problem), political interference and lack of transparency are considered as the main problems all over the globe that faced by SOEs.[147]

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[140] Center for International Private Enterprise, *Corporate Governance: The Intersection of Public and Private Reform*, 2009, pp.7-15, available at: www.cipe.org/sites/default/files/publication-docs/CG_USAID.pdf ,[last accessed in April 24, 2017].

[141] Handelshochschule Leipzig (HHL) and Center for Corporate Governance, Key Corporate Governance Issues inEmerging Markets:Theory and Practical Execution, *in the proceeding of International Conference on Corporate Governance*, Leipzig/Germany, June 11 and 12, 2012, p.23, available at:http://www.hhl.de/fileadmin/texte/publikationen/proceedings/Conference_Key_Corporate_Governance_Issues.pdf, [hereinafter, HHL and Center for Corporate Governance].

[142] *Ibid.*

[143] UN Economic Commission for Africa, Promoting the African Peer Review Mechanism Codes and Standards on Corporate Governance in Southern Africa,2013, p.12. available at: http://repository.uneca.org/bitstream/handle/10855/22904/b11552062.pdf?sequence=1, hereinafter, [UN Economic Commission for Africa].

[144] *Ibid.*

[145] Kabir Md. Humayun and Ismail Adelopo, Corporate Governance Disclosure Practices by Swaziland Public Enterprises, *African Journal of Business Management,* 2012, Vol. 6(24), p.7139. [hereinafter, Kabir Md. Humayun and Ismail Adelopo].

[146] *Ibid.*

[147] Miko Kamal, p.214.

Due to conflicting objectives, SOEs do not only have commercial goals but they are also under obligation to serve social objectives such as providing jobs, serving public interests and providing basic necessities. Therefore, due to these multiple tasks, SOEs can be disadvantaged in competing with their private company counterparts for profits.[148] Agency issue is considered as one of the SOEs' main problems because politicians and bureaucrats as agents tend not to carry out their work in accordance with the interests of society as real owners.[149]

The lack of transparency is considered as another problem for SOEs because they do not disclose important information to the public as ultimate owner.[150]Therefore, if governments are committed to improving SOEs` efficiency, they need to comprehensively address the above mentioned and other central governance deficiencies of SOEs. Hence, these three pillars – clear objectives, political insulation, and transparency – are the serious fundamentals upon which any thoughtful attempt to improve the performance of SOEs must base.[151]

2.7.6. Good Corporate Governance General Principles in SOEs

While thinking about the CG of SOEs, the proper question to be answered would be, whether corporate governance approaches in private sector are appropriate for examining corporate governance in SOEs?[152] In this respect, many CG principles were developed by different international institutes. Among them, the OECD is at the forefront of all. It has produced corporate governance guidelines for both private enterprises (OECD, 2004) and SOEs (OECD, 2005, 2015), and suggested that both sets of guidelines should be viewed as complementary. It also recommends that in order to properly carry out its ownership responsibilities, the state can benefit from using tools that are applicable to the private sector, including the 2004 OECD principles of CG.[153] Therefore, there is a sense in which it is possible to assess corporate governance performance in SOEs with reference to the corporate governance guidelines that are specifically applicable to private enterprises.[154]

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[148]*Ibid.*
[149]*Ibid.*
[150]*Ibid.*
[151]Simon C.Y. Wong, Improving Corporate Governance in SOEs: An Integrated Approach, *Corporate Governance International*, 2004, Vol.7, No. 2, pp 6-7. [hereinafter,Simon C.Y. Wong].
[152]Kabir Md. Humayun and Ismail Adelopo, p.7139.
[153]*Ibid.*
[154]*Ibid.*

Furthermore, the OECD has also prepared a Guideline on Corporate Governance of State-owned Enterprises. This guideline is about ensuring an effective legal and regulatory framework and also spell out the role of the state as the owner of the enterprise. It also emphasizes the importance of the equitable treatment of shareholders, the relations of the enterprise with other stakeholders and also the necessity of transparency and disclosure of information about the enterprise. Lastly, it outlines the responsibilities of the board of SOE. Principally, the guidelines discourage governments from involvement in the day-to-day running of the enterprise but follow the laid down legal structures of each enterprise. The guideline also urges the state, as an owner of the enterprise, to make boards fully accountable.[155]

Though the OECD developed various CG principles, a very important issue is, are the OECD principles relevant to developing countries? The OECD principles are highly relevant to non-OECD economies. This is because they reflect not only the experience of OECD countries but also that of emerging and developing countries.[156] The OECD have different round tables for non-member countries including developing countries. In such round tables developing countries raised and addressed different corporate Governance issues.[157] Because of this, the initiatives of the OECD are at the forefront of the global movement towards the setting of minimum standards of good CG framework, and they also form the basis for World Bank and IMF review of countries CG framework based on Reports on Observance of Standards and Codes (ROSC).[158] All these make the principles internationally accepted benchmarks and best practices for sound corporate governance.

Therefore, using the OECD principles with other international principles, as a standard in order to examine the Ethiopian corporate governance landscape of SOEs would have a paramount importance by showing the country`s CG status. Hence, in the forthcoming discussions, the researcher, will use the OECD principles of Corporate governance of SOEs as one of the standards.

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[155] UN Economic commission for Africa, p.12.

[156] By Fianna Jesover and Grant Kirkpatrick, The Revised OECD Principles of Corporate Governance and Their Relevance to Non-OECD Countries, available at; http://www.oecd.org/corporate/ca/corporategovernanceprinciples/33977036.pdf , last accessed/ 6/18/2017, [hereinafter By Fianna Jesover and Grant Kirkpatrick].

[157] *Ibid.*

[158] Gebeyaw Simachew,p.14.

The OECD guidelines on CG of SOEs draw the following principles of good CG of SOEs.[159]

- The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.
- The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness
- Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.
- Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.
- The state ownership policy should fully recognize SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.
- State-owned enterprises should observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance and auditing standards as listed companies.
- The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

[159]The 2015 OECD Guideline.

CHAPTER THREE

CORPORATE GOVERNANCE OF SOEs IN ETHIOPIA: THE LEGAL, REGULATORY, AND INSTITUTIONAL FRAMEWORK

3.1. The History of State-Owned Enterprises in Ethiopia

The emergence of SOEs sector in Ethiopia is connected with the modernization attempts of the country itself in the early twentieth century.[160] SOEs were created for much the same reasons as in most countries in the world to correct market failures, providing public goods, control natural monopoly and seize the commanding heights of the economy.[161] However, the role of these enterprises in the country`s economy is conditional upon the policy adopted by the government in a specific period of time.[162]Hence, their volume, objective, and performance vary with the policy of a particular government or even with the alteration of a policy of a government.[163]

To begin from the imperial regime, prior to 1974, economic enterprises were operated in a free enterprise system with an open policy for the establishment and operation of enterprises.[164] In this era, trade and industry had an insignificant role in the national economy,[165] and the role of the government was mainly limited to encouraging domestic and foreign investments.[166] However, despite the proclaimed market economy, the absence of private capital at the beginning had necessitated the participation of the public sector in the economy.[167] Hence, many SOEs established in response to various modernization attempts of the regime. And, because of the fact

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[160] Dagnachew Asrat and Addissie Shiferaw, *a Course Material on Law of Public Enterprises and Cooperatives, Sponsored by justice and legal systems research institute,* Addis Ababa, Ethiopia 2009, p34 (unpublished available at: https://chilot.files.wordpress.com/2011/06/public-enterprises-and-cooperatives.pdf, [hereinafter, Dagnachew Asrat and Addissie Shiferaw].

[161]Alemayehu W/yohannes, *Effect of privatization on selected Privatized Public Enterprises: pre and post privatization performance analysis(Targeting industries located in Addis Ababa and its periphery)*, MBA Thesis, Addis Ababa University, Faculty of Business and Economics, 2015,unpublished, available at:http://etd.aau.edu.et/bitstream/123456789/6867/1/Alemayehu%20Woldeyohannes.pdf, *[*hereinafter, Alemayehu W/yohannes].

[162] Tewodros Meheret, p.362.

[163] *Ibid.*

[164] Selvam, Jesiah, Privatization Programme in Ethiopia: Is the Cause Justified? *African Renaissance,* online, 2007, Vol. 4, No. 1, p. 2. Available at: https://ssrn.com/abstract=987606 [Hereinafter, Selvam, Jesiah,]

[165] Tewodros Meheret, p.362.

[166] Selvam, Jesiah.

[167] Dagnachew Asrat and Addissie Shiferaw, p.34.

that domestic private investors were almost inexistent,[168] these enterprises were established by the state as a sole owner and as joint ventures with private persons mostly foreigners.[169] Among SOEs of this era, the 1941 established Ethiopian National Corporation can be mentioned as the first SOE.[170]

In 1974, the Dergue regime came into power with a new socialist ideology. Based on this ideological orientation, every major economic activity was expected to be undertaken by the government. Hence, major economic activities were decided to be conducted by the government. And, in some areas of joint investment the government was entitled to take the majority position. This brought the establishment of new SOEs and the expropriation and nationalization of large and medium scale private enterprises. Hence, the government enacted Proclamation No. 20/1975 and established many SOEs including National Textile, Ethiopian Printing, Ethiopian Food, National Metal: Ethiopian liqueur, Leather and Shoe, Fiber work, Ethiopian salt, National Soap, Ethiopian Building Materials, Rift Valley Agriculture Development, Harerge Agricultural Development, and National Transport.[171]

As far as nationalization is concerned, in 1975, 87 manufacturing enterprises were nationalized. And in the following few years, their number grew to 134, and by 1983 as many as 159 enterprises were nationalized.[172] In this regime, there were more than 200 SOEs, covering 20% of the GDP of the country`s economy.[173] In some sectors, like manufacturing, mining, power, and transport the share of them covered up to over 50 % of the total production.[174] Generally, because of the nationalization and large-scale investments of the government in the area of agriculture, manufacturing, construction, mining, and tourism sectors,[175] SOEs remained to be the main form of executing economic activities in the country until 1990.[176]

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[168] *Ibid.*
[169] *Ibid.*
[170] Bahru Zewde, A History of Modern Ethiopia (1855-1991) (2nd Ed) (2002), p. 196. As cited by Tewdoros Meheret, 'The Concept and Characteristics of Public Enterprises in Ethiopia: An Overview', Mizan law Review, Vol. 8, No.2, December 2014, p.362.
[171] Aweke Tenaw, p.19.
[172] Selvam, Jesiah.
[173] *Ibid.*
[174] *Ibid.*
[175] World Investment News, 1999, available at: http://www.winne.com/ethiopia/to07.html. [Last accessed 5/24/2017].
[176] Tewodros Meheret, p.364.

In 1991, the transitional government, later the EPRDF, came into power with a new policy of market economy. Based on this policy, the government took different measures so as to reform the economy, including the reform of SOEs.[177] The new policy stipulates that SOEs will have full autonomy and their performance will be judged by profitability.[178] Hence, they are expected to compete with the private sector and they will not be awarded special privileges. [179] This is a major policy shift came up with the new government in the SOEs realm of Ethiopia.

Moreover, in addition to its determination to develop a market system, the conditionality of the World Bank, the IMF, and other international donors forced the government to privatize SOEs through time.[180] And the government started a massive privatization program. Yet, despite a large scale of privatization program which privatizes more than 115 SOEs, the share of SOEs has been relatively stable covering around 8.6 percent of the GDP.[181] Furthermore, in those areas considered as strategic by the government such as power generation and distribution, telecommunication and air transport, SOEs are either dominate or operate in full monopoly.[182]

In this regard, if we see the current investment legislations of the country, there are still areas of investment which are reserved for the government or for the government`s joint investment with private investors. For instance, transmission and distribution of electrical energy through the integrated national grid system, postal services with the exception of courier services, and air transport services using aircraft with a seating capacity of more than fifty passengers are areas of investment that are exclusively reserved only for the government.[183] And, manufacturing of

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[177]See the document of World Bank, International Development Association and International Finance Corporation and Multilateral Investment Guarantee Agency Country Partnership Strategy for the Federal Democratic Republic of Ethiopia, august 29, 2012, report no. 71884-et, p, I, available at: http://documents.worldbank.org/curated/en/561281468031489534/pdf/718840CAS0P1300se0Only090Box370115B.pdf, [hereinafter, World bank Report no. 71884-et.].

[178] Mekonnen Manyazizewal, privatization and Public Enterprises Reform in Ethiopia, p.105, available at: http://dspace.africaportal.org/jspui/bitstream/123456789/34054/1/Mekonnen%20Manyazewal_The%20macroeconomic%20policy%20environment%20and%20PE%20reform.pdf?1 [last accessed 5/28/2017]. [hereinafter Mekonnen Manyazizewal].

[179] *Ibid.*

[180] Selvam, Jesiah, p.1.

[181] World Bank Report No. 71884-ET, p.10.

[182]APRM Country Report No.14, p.177.

[183] Investment Proclamation, 2012, *Federal Negarit Gazzeta,* Proc.No. 769,18th Year, No. 63 Article 6/1/. [Hereinafter Proc. No 769/2012].

weapons and ammunition and telecom services are reserved for the joint investment of the government.[184]

Generally, though the policies and laws express the government`s goal of limiting the role of the role of the government via encouraging private investment, Ethiopia`s post-1991 policy on SOEs can be characterized as a mix of policies ranging from restructuring and privatization to the escalating numbers of SOEs.[185] Hence, even in this regime, SOEs continue to be a major aspect of Ethiopia's economy, using much of available credit and foreign exchange opportunities.[186]

3.2. Ethiopia's Corporate Governance Framework for SOEs

3.2.1. Ownership Framework and Policy

While establishing SOEs, states may have different objectives to serve. Such objectives are generally divided into two: the strategic and operative objectives. Strategic goals are first and foremost general and superior goals, whereas operating goals refer to specific objectives of the particular SOE.[187] Such objectives vary from jurisdiction to jurisdiction based on the context of states. But, what is commonly required is, every state should have an ownership policy which clearly set outs the objectives of its ownership of SOEs. This is because having a clear ownership policy is pivotal to establish a solid basis for the state's effective exercise of its ownership rights in SOEs through defining measures that can and cannot be taken by the government in controlling and supervising SOEs.[188]

The ownership policy should, among other things, define the overall rationales for state ownership, the state's role in the governance of SOEs, how the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its

[184] *Id*. Article 6/2/.
[185]Tewodros Meheret, p.366.
[186] See the IMF Country Report No. 14/303, released in October 2014, p.6.
available at: https://www.imf.org/external/pubs/ft/scr/2014/cr14303.pdf, [hereinafter IMF Country Report No. 14/303].
[187] Thomas Lenk, *et al*, Public Corporate Governance in Public Enterprises – Transparency in the Face of Divergent Positions of Interest, available at:
http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.699.6764&rep=rep1&type=pdf, p.7. [last accessed 5/26/2017] [herein after: Thomas Lenk].
[188] Alissa Amico, Priorities for Improving Governance and Performance of State-Owned Enterprises in the Middle Eastand North Africa, 2012, p.27, Available at: http://mof.gov.il/gca/about/documents/oecd-broadeningtheownership.pdf .[last accessed 5/22/2017] [hereinafter, Alissa Amico].

implementation.[189] Furthermore, the policy should shortly provide a clear statement of the state's general objectives over SOEs and summarize most important elements of all other related documents on SOEs.[190] Such general policy frameworks should have a broad political and popular support to avoid changes based upon shifting political currents.[191]

In addition to the general policy objectives of state ownership, the state should define its rationales for owning each SOE in a specific sector and subject them to regular assessment.[192] In this regard, the UK Treasury, for instance, has laid out three general objectives for its financial sector interests: maximize sustainable value for the taxpayer, maintain financial stability, and promote competition.[193]

Framing ownership policy and objectives is not enough by itself. Rather, states should go further and translate such general objectives into specific agreements going down to board level. [194] And, they should be widely distributed and not be subject to frequent modifications in order to give SOEs management, boards, and the general public a clear view of the state's objectives and a sense of predictability about the state's behavior as an owner.[195]

The objectives of the government should be clear. This is due to the fact that, when the objectives of enterprises are ambiguous or conflicting, managers will have substantial discretion to govern SOEs in their own interest.[196] Governments, as owners of SOEs, may also abuse the discretion that comes with weakly defined objectives, interfering in SOEs' operations for political purposes.[197] At the same fashion, multiple and contradictory rationales for state ownership can lead to either a very passive conduct of ownership functions, or to the reverses results excessive intervention of

[189] The 2015 OECD Guideline, Chapter I /B/, p.18.
[190]OECD, Network on Corporate Governance of State Owned enterprises in Asia, DRAFT Implementation Guide to Ensure Accountability and Transparency in State Ownership, p.22, available at: https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/40812235.pdf , [last accessed:12/5/2017].
[191]W. Richard Frederick, Enhancing the Role of the Boards of Directors of State-Owned enterprises, p.24, available at: http://observgo.uquebec.ca/observgo/fichiers/53123_ep.pdf , last accessed March 27, 2017. [hereinafter, W. Richard Frederick].
[192]The 2015 OECD Guideline, Chapter I. D, p.17.
[193]Simon Wong, Government Ownership: Why this time it should work, Available at: http://www.mckinsey.com/industries/public-sector/our-insights/government-ownership-why-this-time it-should-work, [last accessed in April 21,2017]. [hereinafter Simon Wong].
[194] Alissa Amico.
[195] *Id.*, p.28.
[196] *Id.*, p.60.
[197] *Ibid.*

the state in the day to day operation of enterprises. Therefore, in order for the state to clearly position itself as an owner, it should clarify and prioritize its rationales for state ownership by developing a clear and explicit ownership policy.[198]

Lack of clear policy and strategy is the main challenge in the SOEs realm of Africa.[199] Ethiopia is not an exception to this reality of the continent`s SOEs. If we see the objectives of establishing SOEs during the Dergue era, there was no comprehensive policy document that shows its ownership objectives over SOEs. However, as SOEs were the result of its command economy ideology, they were established with a general objective of enforcing that economic policy. Particularly, its objectives include the mobilization of resources for large-scale investment and the establishment of control over the major means of production and distribution.[200] But, despite its economic policy, there was no independent ownership policy over SOEs.

Turning to the current government, many SOEs in this regime are not established based on the needs of the government, to serve certain objectives.[201] Rather they are the result of political decision as many of the existing enterprises are nationalized from the previous government.[202] That is why the government is engaging in a wide privatization program.[203] However, still there are enterprises which are reestablished or newly created by the government. In any case, like that of the previous government, there is no a comprehensive ownership policy of a government over SOEs. However, the policy and strategy documents issued by the ruling government since 2001, including the Agricultural Development Leads to Industrialization (ADLI) and the Industry Development Strategy, emphasizing the leading role of the private sector to the country`s economy, underlines two reasons for the direct intervention of the government in the economy: 1. When there is a market failure. 2. When the country`s development necessitates government`s intervention. Hence, in a general expression, we may possibly argue that the government directly intervenes in the economy has the objectives of correcting market failure and satisfying the development needs of the country`s economy. Therefore, since establishing SOEs is the common

[198] The 2015 OECD Guideline, p.30.
[199] Key Corporate Governance, p.23.
[200] Mekonnen Manyazizewal, p.103.
[201] Interview with Professor Tilahun Teshome, a Professor at Addis Ababa University, *on the Corporate governance of SOEs in Ethiopia*, May 2,2017. [Hereinafter, Professor Tilahun Teshome].
[202] *Ibid.*
[203] *Ibid.*

means of intervention, we can say that the SOEs in Ethiopia are established based on the above two general objectives of the state.

As far as operating goals of each SOE are concerned, we can find those objectives scattered in different enabling legislations of enterprises. In this respect, if we see the establishing regulation of The Ethiopian Construction Design and Supervision Works Corporation, the purposes of establishing this enterprise are:[204] 1.To provide study, design, supervision and contract administration services in transport, water, energy, building, urban planning and related engineering works with efficient and effective professional services in accordance with local and international standards that ensure the highest satisfaction of stakeholders and customers. 2. To develop and maintain sets of knowledge, expertise and skill base and own state-of-the-art-technologies that are needed to provide solutions to the challenges of the nation's complex projects. 3. To play key roles in supporting the government's socio-economic transformation endeavors by closing market gaps in the infrastructure development sector. We can also see another council of minister regulation, regulation no.141/2007 which established the Ethiopian Railway Corporation. Pursuant to article 5 of this regulation the objectives of the government to establish this enterprise are: to build railway infrastructure, to operate cargo railway transport services, to operate passenger railway transport services, and to engage in other related activities necessary for the attainment of its purpose.[205] But, even these specific objectives of the government stated under enabling legislations of each SOE are inadequate for corporate planning.

In sum, though the strategy documents of the government contained some general indications about when the government can intervene in the economy, Ethiopia doesn’t have a comprehensive ownership policy guiding the government`s ownership of SOEs. Hence, given the advantages of having a clear and comprehensive ownership policy to the efficiency of SOEs, the government needs to enact an ownership policy and clearly determine its objectives. These objectives in the policy will include: financial and commercial objectives, production and productivity objectives, marketing and service objectives, development objectives, and growth objectives.[206] In addition to

[204] Ethiopian Construction Works Corporation Establishment Council of Ministers Regulation, *2015, Federal Negarit Gazzeta,* Regulation No.366, 22nd year, No.18, Article 5. [hereinafter Regulation No.366/2015].
[205] Ethiopian Railway Corporation Establishment Council of Minister Regulation, 2007, *Federal Negarit Gazzeta,* Regulation No. 141, 14th year, No.1. [hereinafter Regulation No. 141/2007].
[206]Dagnachew Asrat and Addissie Shiferaw, p.63.

enacting an ownership policy containing the general objectives of the government on SOEs, the government also needs to reconsider its specific objectives over each SOE as they lack the necessary clarity.

3.2.2. The Organization of Supervising Authorities Within the State Administration

As private enterprises controlled and managed by the private investors, SOEs also controlled and managed by the owner, i.e. the relevant supervising authority which is established to protects and promotes the interest of the public in SOEs.[207] However, in exercising their ownership function over SOEs, different countries follow different approaches. Yet, there are three dominant models by which states organize supervising authorities of SOEs: the decentralized or sector model, the dual model and the centralized model.[208]

The decentralized or sector ministry model is the most traditional model. In this model, SOEs are under the control and supervision of different sector ministries.[209] However, in the dual model, which is followed by many OECD countries, two ministries together exercise the ownership functions of the government over SOEs.[210] Hence, both sector ministries and a common ministry are responsible for exercising ownership rights.[211] The more recent model is the centralized model. This model is branded by a strong centralization of the ownership function since most SOEs are put under the responsibility of one Ministry or Agency.[212]

In Ethiopia, however, despite the efforts of centralization by establishing MoPE in 2015, the ownership function is still dispersed among various sector ministries.

3.2.3. Regulatory and Institutional Framework

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[207] Tewodros Meheret, p.347.
[208]Maris Vagliasindi, Governance Arrangements for State owned enterprises, 2008, p.9, Available at: http://documents.worldbank.org/curated/en/261991468150589195/pdf/wps4542.pdf, *[last accessed:5/12/2017]*.
[209] *Ibid.*
[210] *Ibid.*
[211]Santosh Pande, Position and Rights of Minority Shareholders in Listed State-Owned Enterprises (SOEs) - Experiences and lessons from India, available at: http://www.tari.co.in/,last accessed:5/13/2017, [hereinafter: Santosh Pande]
[212] Santos Pande.

SOEs, to achieve their very purpose, require a clear, transparent and efficient control mechanism. However, like many other African countries, the regulatory and institutional framework of SOEs is in its infancy stage in Ethiopia.[213]

During the Dergue regime, the nationalized enterprises were converted into corporations which were independent from one another and administered under an executive organ established for this purpose, the ministry of industry.[214] This ministry appointed high-ranking military officers and key individuals who are highly affiliated to the regime as managers of corporations.[215] The ministry was mandated not only to manage the nationalized enterprises but also to establish new enterprises when deemed necessary.[216] Particularly, it was responsible for adopting a plan, budget and appointing a CEO for each enterprise.[217]

Based on Proclamation No. 20/1975, the SOEs of the Dergue regime were restructured under industry, agriculture and resettlement and transport communication ministries. Furthermore, state farms development authority was established under agriculture and resettlement minister based on Proclamation No.142/1978. This ministry was designed to administer large state farms. All in all, the ownership structure of this period was dispersed in different sector ministries of the time.

After the overthrow of the military junta, and the coming of EPRDF, due to a major ideological shift, the government decided to privatize SOEs over time and an important breakthrough in the realm of SOEs happened in 1994 when the government established the Ethiopian Privatization Agency (EPA) under the auspice of Ministry of Trade and Industry through Proclamation No. 87/1994, to supervise the privatization process. This Proclamation was repealed by proclamation No.146/1998 that mandated EPA additional responsibilities including exercising post-privatization monitoring activities.[218] However, though the government showed its commitment to privatize SOEs through establishing EPA, there was no that much significant change in the CG of SOEs due to the establishment of this agency.

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[213] APRM Country Report No.14, p.185.

[214] Negash, Minga, Corporate Governance and Ownership Structure in Sub Sahara Africa: The Case of Ethiopia, *Ethiopian Electronic Journal for Research and Innovation Foresight,* online, 2013, Volume 5, No 1, p.8. Available at: https://ssrn.com/abstract=2121504 or http://dx.doi.org/10.2139/ssrn.2121504, [hereinafter, Negash Minga].

[215] Ibid.

[216] *Ibid.*

[217] *Ibid.*

[218] Proc. No.146/1998, article 19/h/.

However, while the privatization program is underway, there was a need to enable SOEs, including enterprises which are out for privatization, to be competitive and profitable through providing them the necessary support and guidance.[219] To this end, in 2002, Ethiopia established Public Enterprises Supervising Authority as an autonomous government office by proclamation No. 277/2002. This authority by controlling and supervising SOEs, served as a central authority for the government to exercise its ownership rights. In addition to its supervisory functions, the authority has the following objectives: providing support to SOEs to improve their performance, to identify the areas of investments which request the establishment of new enterprises and cause their establishment, and to protect the ownership interests of the government in fully owned SOEs and joint ventures.[220]

In 2004, the government of Ethiopia enacted proclamation No. 412/2004 for the amalgamation of the two independent institutions, the EPA and Public Enterprises Supervising Authority, and established the Privatization and Public Enterprises Supervising Authority (PPESA)[221] This was intended to coordinate the implementation of the privatization program with the activities of supervising SOEs. Therefore, until the establishment of a new ministry in 2015, SOEs fall within the ambit of this authority.

However, despite the fact that Ethiopia established institutions to control and supervise SOEs with the view of increasing their performance and make them internationally competitive, studies shows that many of its SOEs are not meeting their intended goals.[222] And, their import intensiveness, weak export performance, and their indebtedness is proved by international financial conglomerates like the IMF.[223] This is mainly attributable to their governance problem.

In recognition of this reality of the country`s SOEs performance,[224] Ethiopia set up Ministry of Public Enterprises(MoPE) in 2015 to bring good CG of SOEs which makes them more transparent,

[219] Public Enterprises Supervising Authority and the Industrial Development Fund Establishment Proclamation,2002, *Negarit Gazzeta*, Proc.No.277, 8thYear No. 24, Preamble. [hereinafter Proc. No. 277/2002].
[220] Proclamation no.277/2002, Art.5.
[221]Proc.No.412/2004, Article 3 and the Preamble.
[222] African Economic Outlook, Ethiopia 2016, p.8, available at: https://www.afrianeconomyoutlook.org [last accessed in April 25, 2017].
[223] *Ibid.*
[224] African Development Bank Group, Federal Democratic Republic of Ethiopia Country Strategy Paper 2016-2020, p.11, available at: https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ETHIOPIA_CSP_BPPS_EN.pdf , [last accessed:5/24/2017].

credible, efficient and competitive both domestically and globally.[225] This ministry succeeded the rights and obligations of the Privatization and Public Enterprises Supervising Agency pursuant to Article 41 of Proclamation no. 916/2015.[226]And currently, the government exercises its ownership rights in many of SOEs via this ministry. Yet, there are many other sectoral government bodies which are in charge of controlling and supervising SOEs. For instance, the Ethiopian Public Service Transport Enterprise and Public Toll Roads Enterprise are directly accountable to the Ministry of Transport.

3.2.4. The Role of the Supervising Authority in the Corporate Governance of SOEs

The supervising authority is an authority established by the government to protect its ownership rights. As per article 10 of Proclamation no. 25/92, the supervising authority is considered as one of the internal arrangements within the enterprise. However, practically, it has existed as a different, autonomous authority established by law.

Currently, though there are many sectoral authorities which are supervising SOEs, it is the MoPE, which is primarily in charge of supervision of all SOEs in the country. This Ministry is established with the ultimate goal of bringing modern, efficient, transparent and globally competitive SOEs, by helping them to implement good CG.[227] To this ultimate end, the ministry oversees and assists SOEs, by studying their weaknesses and strengths and through sharing international experiences.[228]

By 2017, around 22 SOEs are accountable to the MoPE.[229] And the ministry, to achieve its objectives of controlling and supervising SOEs organized itself into four sectors: Transport and

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The recent IMF rating of 'moderate' risk of external debt distress reflects the rise in public enterprise debts and the weak export performance. The increased risk of debt distress points to the need for the government of Ethiopia to exercise prudence in managing its debt levels. The authorities recognize these challenges and are trying to address them, by setting up a Ministry for public enterprises to closely monitor the operations of public enterprises, increasing economic and export diversification, channeling non-concessional debt proceeds towards revenue-earning projects, initiating a public-private partnership (PPP) framework to bring active participation of the private sector, and focusing on domestic resource mobilization.

[225] Dr. Girma Amente, Minister of Public Enterprises, available at: http://mope.gov.et/minister ,[last accessed 5/24/2017].

[226] Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia,2015, *Federal Negarit Gazzeta,* Proc.No 916, 22nd Year No.12, Article 41/11/. [hereinafter, Proc. No.916/2015].

[227] Ministry of Public Enterprises, Bulletin, February, 2017.

[228] Proclamation No. 916/ 2015, 31/1/A/.

[229]Interview with Mr. Haftom Birhanu, Corporate Governance Board Administration Expert at MoPE, *on the Corporate governance of SOEs in Ethiopia,* May 3,2017. [hereinafter, Mr. Haftom Birhanu].

Communications Sector, Manufacturing Industries and Agriculture Sector, Mineral, Energy and Construction Sector, and Corporate Finance Administration Sector. From these four sectors, the Corporate Finance Administration Sector follows up and supports all SOEs with regard to CG and finance. The remaining three sectors are vested with supervising and controlling specific enterprises which are related to them. In order to show how the ministry is conducting its control and supervisory role over SOEs, based on February 2017 data, specific sectors of the ministry and SOEs are summarized in Table 1 below at the end of this section.

In General terms, the ministry, as far as enterprises which are directly accountable to it are concerned, has the powers stated under article 11 of Proclamation No. 25/1992 and under article 31/1//B/ of proc. No.916/2015. Hence, the ministry will ensure that SOEs, accountable to it, have developed strategies and annual plan consistent with policies, strategies and economic goals of the government, approve plans and monitors their implementation.[230] And in issues related to privatization, it assumed the rights and obligations of the former PPESA.[231]

However, there are many other enterprises which are directly accountable to other sectoral government bodies. In this regard, we can take the case of Metals and Engineering Corporation (METEC) which is overseen by Ministry of Defense, and Ethio Telecom which is under the control and supervision of the Ministry of Communications and Information Technology. The issue is, however, in addition to this sector specific government bodies; MoPE has vested with a general power of supervising all SOEs in Ethiopia.[232] So that, one enterprise is being subjected to the supervision of two different government bodies- by the sector ministry and one by the MoPE. This is practically difficult and considered as governance failure of SOEs in Ethiopia.[233]

The big challenge is, the contents of the reports, as well as the time of reporting by SOEs to the two different supervising authorities, are the same.[234] Hence, it would be worthless to evaluate them by the two ministries which are equal in the power division of the government.[235] Furthermore, while the two authorities exercising their equally granted power; clashes of schedules

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[230]Proclamation No. 916/ 2015, Article 31/1/B/.
[231] *Id.,* Article 41/11/.
[232]*Id.,* 31/1/A/.
[233]Interview with Mr. Shiwangizaw Wessene, Corporate Risk Administration Director and Corporate Governance Board Administration Delegate Director MoPE, *on the Corporate governance of SOEs in Ethiopia*, May 3, 2017.
[234] *Ibid.*
[235] *Ibid.*

are practically happening.[236] For instance, employees of an SOE may be called for meetings by the two ministries at the same time.[237] This will affect the performance of the SOE by creating inconvenience in its operation. Therefore, it is recommended for the government to avoid such arrangements of supervision and subject SOEs only to one supervising authority like what is happening in the contemporary world.

Transport and Communication Sector	**Manufacturing Industries and Agriculture Sector**	**Mineral, Energy and Construction Sector**
Enterprises accountable to it: Ethiopian Railways Corporation Ethiopian Shipping and Logistic Service Shebele Transport Share Company Birhanena selam printing Enterprise Ethiopian Tourist Trading Enterprise	**Enterprises Accountable to it:** Ethiopian Sugar Corporation Ethiopian Chemical Industries Corporation Caustic Soda S.C Awash Melkasa Aluminum Sulfate and Sulfuric Acid S.C Adamitulu Pesticide Processing S.C Ethiopian Pulp & paper S.C Awash Agricultural Development Enterprise National Alcohol &Liquor Factory Assala Malt Factory	**Enterprises Accountable to it:** Ethiopian construction Design and Supervision Works Corporation. Ethiopian Mineral, Petroleum and Bio-fuel Corporation Building Materials supply Enterprise Ethiopian Construction Works Enterprise
Enterprises under the follow-up of this sector: Ethiopian airlines Ethiopian Telecommunications Service Information technology Park Corporation Ethiopian Airports Enterprise	**Enterprises Under the follow-up of this sector:** Industrial Parks Corporation Metal Engineering Corporation	**Enterprises Under the follow-up of this Sector:** Ethiopian Electric Power Ethiopian Electric Utility Ethiopian Petroleum Supply Enterprise Adola Gold Mine Enterprise

Table1: The Sector Division of MoPE.

[236] *Ibid.*
[237] *Ibid.*

3.2.5. The Legal Framework of SOEs in Ethiopia

When we see the legislation history of Ethiopia in CG of SOEs, the country has come up with a number of rigorous special laws and regulations for the establishment and operation of SOEs. The need for enacting special laws for SOEs rises from their public dimension. Yet, given, their private dimension, other commercial laws also apply to fill the gaps of special legislations.

During the imperial regime, despite the existence of some scattered legislations that applied to some enterprises, there was no comprehensive legal regime governing SOEs.[238] So that, many of SOEs during this period were organizationally and operationally similar to private enterprises and were governed by the 1960 commercial code.[239]

In the era of Dergue, the government enacted various legislations for the organization and governance of SOEs. Therefore, SOEs were organized in accordance with public enterprises proclamation No.20/1975, Proclamation No.131/1978, Regulation No.5/1975, Agricultural Development Corporations Regulation No.60/1978 and the Regulation and Coordination of Public Financial Operations Proclamation No.163/1979.[240]

Following the overthrow of the Dergue regime, the transitional government which came into power in 1991, and later the EPRDF, brought various legislations to make CG an integral part of SOEs by initiating measures for improving CG mechanisms. To begin with, the government after, the nationalization of the Dergue regime SOEs to it, enacted proclamation No. 25/1992 based on its transitional charter article 9/d/ aiming to implement its market economy policy and to create organizational structures for SOEs. Moreover, in 1995, the FDRE constitution was enacted and this constitution reaffirmed the government`s economic policy, by declaring the right of every Ethiopian to engage freely in economic activity and the right of ownership of private properties.[241]

However, as it is hardly possible to find an economy which absolutely prohibits a government from direct intervention, the FDRE constitution also leaves rooms for the governments` direct intervention to the economy via SOEs, though not clearly. For instance, an inference about the

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[238]Dagnachew Asrat andAddissie Shiferaw, pp. 34-35.
[239] *Ibid.*
[240]Getachew Regassa, p.41.
[241] Constitution of the Federal Democratic Republic of Ethiopia, 1995, Proclamation No.1/1995.

constitutional authority of the government to establish SOEs can be made from Article 96/3/ of the constitution. In this article, the government is responsible for levying and collecting income, profit, sales and excise taxes on enterprises owned by it. This article presupposes the establishment of SOEs. And practically, now, SOEs have a large stake in the country`s economy.

Following the constitution and before, the government enacted various SOEs related laws. Among them, the major legislations to be consulted while thinking CG of SOEs in Ethiopia are: The 1995 FDRE Constitution, Public Enterprises Proclamation No. 25/1992, Privatization of Public Enterprises Proclamation No. 146/1998, Privatization and Public Enterprises Supervising Authority Establishment Proclamation No.412/2004, Corporate Governance Code for SOEs issued by public Enterprises Agency in December, 2009, Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No.916/2015 and Public Enterprises Board Administration Directive No. 8/2009 The provisions of the commercial code and the Civil Code are also equally relevant since the special law recognizes the gap-filling role of them.[242] In addition, as stated under Article 47/4/ and article 6 of Proclamation No.25/1992, every SOE is to be established by the issuance of regulations. Therefore, we have as many regulations as the number of public enterprises.

To begin with Public Enterprises Proclamation No. 25/1992, it was enacted during the transitional period charter following the declaration of a new economic policy.[243] The general objective of this proclamation, as expressed in its preamble is the regulation of enterprises that have to stay under government control, and those which may be established when deemed necessary. Hence this law, for the first time in the Ethiopian history of SOEs designed the governance structure of SOEs. However, this law limited its scope only to fully SOEs.[244]

Proclamation No.412/2004 is enacted with the aim of establishing Privatization and Public Enterprises Supervising Authority, the authority which is mandated to particular tasks that are essential to the protection of government`s interest in SOEs. Unlike the previous proclamation which limited itself only to fully government owned enterprises, this law widened its scope to the inclusion of partially owned SOEs and gave the supervising authority a controlling power over

[242]Proc. No.25/92, Article 4.
[243]Dagnachew Asrat and Addissie Shiferaw, p.39.
[244]Procl. No.25/92, Article 2/1/.

both fully and partially SOEs.[245] However, this law was amended by Proclamation No. 730/2012 and later repealed by Proclamation No. 916/2015 Article 40/c/ except its article 13 that provides the establishment of the Industry Development Fund.

Proclamation No.916/2015 is the latest proclamation which establishes MoPE as a central ministry for the control and supervision of SOEs in Ethiopia. This law, by repealing the previous law, Proclamation No.412/2004, transferred the rights and obligations of the Privatization and Public Enterprises Supervising Authority to the ministry.[246] Hence, currently, though it shares some powers of controlling and supervision with other supervising authorities, the MoPE is a central ownership entity mandated to control and supervise SOEs in Ethiopia.

Even if the country attempted to bring good corporate governance of SOEs, through enacting different legislations as discussed above, currently, the corporate governance landscape of the country lagged behind the international best practice. Particularly, despite the countries effort to establish governance autonomy of SOEs, the SOEs boards are structured and monitored by a board of directors composed of senior government officials and politically-affiliated individuals.[247] Furthermore, the country is not a member of the OECD and its SOEs do not adhere to the OECD Guidelines on CG of SOEs.[248]

3.3. Organizational Structure of SOEs in Ethiopia

The organizational structure of SOEs refers the decision-making and decision-taking powers of organs and their hierarchical relationship.[249] In Ethiopia, prior to 1991, there seems like no difference between SOEs and other government bodies as far as the organizational structure of them is concerned. Hence, SOEs were not autonomous and structured like other government bodies. However, in 1992, the transitional government enacted Proclamation No. 25/1992, aiming to create an organizational structure which enables SOEs to be efficient, productive and competitive through enjoying their governance autonomy.[250] Hence, chapter three of this proclamation framed the organizational structure of the governance body of SOEs. Accordingly,

[245] Proc. No. 412/2014, Article 2/2 / and 3/ and art 5/5/.
[246] Proc. No. 916/2015, Art.40/11/.
[247] U.S. Department of State, https://www.state.govdocumentsorganization241767.pdf, p.14. [last accessed 5/28/2017].
[248] Ibid.
[249] Dagnachew Asrat and Addissie Shiferaw, p.80.
[250] See the preamble of proclamation no.25/92.

each SOE shall have: 1) a supervising authority; 2) a management board; 3) a general manager, deputy general managers as may be necessary; and 4) the necessary staff.[251] Furthermore, an SOE will also have different committees within its structure. For instance, as an inference can be made from article 16/11/of Proclamation No. 25/1992 and Article 15 of the board administration directive, an SOE will have different committees in its management or board.

As mentioned earlier by this paper, the supervising authority is an authority that is designated by the government, with the aim of protecting the ownership rights of the government over state-owned enterprises.[252] Hence, each SOE has a supervising authority and one of the issues to be addressed in the enabling legislations of each enterprise would be the determination of who the supervising and control authority of a particular SOE.[253] This authority is established outside the internal structure of SOEs being an autonomous government body. It takes the top in the hierarchy of an SOE organizational structure.

The board the central governance division of SOEs which takes the ultimate responsibility, for general SOE performance.[254] However, though its level of functionality varies across countries based on the nature of the board, commonly, the board is not expected to exhibit high functionality rather it is simply to formulate broad directions and policies. Boards of SOEs may take the following three forms.1. The advisory board, which have only the mandate of proposing decisions rather than making them. 2. The functional board, a board which makes routine decisions on the day-to-day operation of an SOE. 3. Policy board, a board which is entrusted with wide powers and make long-term decisions. The management board of a public enterprise in Ethiopia is best categorized under policy boards.[255]

The general manager or the CEO is appointed by the board and accountable to it.[256] Once the board decided the policies of the enterprise it is the duty of the CEO to convert such policies into practice. Hence, for all practical purposes he is considered as the agent of the enterprise and as enshrined under Article 18 of Proclamation No.25/1992, any enterprise shall carry out its activities, acquire

[251] Proc. No.25/92, Article.10.
[252] Proc.No.25/92, Article,2/2/.
[253] Tewodros Meheret, p.348.
[254] Kamau, A.G.N, p.57.
[255] Dagnachew Asrat and Addissie Shiferaw, p.82.
[256] Proc. No.25/1992, Article 16.

rights and incur liabilities via him. Among other things the CEO has the following functions:[257] organize, direct, administer and control the enterprise, represent the enterprise in all dealings with third parties and in legal proceedings brought by or against it, subject to the approval of the board, employ, assign and dismiss the officers of the enterprise accountable to him and define their functions, keep proper books of accounts of the enterprise, and open and operate bank accounts to the enterprise.

3.3.1. Board of Directors of SOEs in Ethiopia

3.3.1.1.The Role of The Supervising Authority in Board Appointment and Removal

Being the owner of SOEs, the government, especially the executive branch, exercises control over the activities of public enterprises. For this purpose, the government established authorities and influence the structure and governance of enterprises. Among other things, the supervising authority have the following powers and duties:[258] appoint and remove the members of the board, appoint the chairman of the board from among the members appointed by it, fix the allowances to be paid to the members of the board, appoint external auditors, cause the allocation of the initial capital of the enterprise, and approve, in consultation with the Board, the annual and long-term corporate targets of the enterprise; and follow up their fulfillment.

This supervising authority, being the guardian of the ownership rights of the government in enterprises, exercises its ownership rights primarily through nominating competent board members and letting them exercise their responsibilities.

The MoPE assumed the right and the duty to select, appoint, induct and develop or remove BM of SOEs. Further, as an inference can be made from article 31/1//b/ of the proclamation, and addresses earlier in this paper, it is not only the ministry who is in charge of supervising SOEs. Hence, other sector specific supervising authorities will also have the same right and duty. However, supervising authorities should take care of not to interfere in the management autonomy of the enterprise in the guise of protecting its ownership rights. Hence, good corporate governance and management

[257] *Ibid.*
[258] Proc.25/1992, Article 11.

of public enterprise require the separation and clarification of the powers and responsibilities of ownership, governance, and management in SOEs.[259]

Additionally, the supervising authority`s duty with regard to the boards of SOEs is not limited to a mere appointment of board members rather, it should go further and ensure that the board has efficient labour division and should put place appropriate follow-up, evaluation and motivation mechanisms in the governance of SOEs.[260] Particularly, it should ensure the long-term interest of the enterprise and able to attract qualified board professionals.[261]

3.3.1.2. Board Composition

After the objectives of SOEs have been clearly defined, governments should proceed to the next stage of selecting competent persons to serve on boards and structure the board of each enterprise. SOE boards are usually structured in the same way as other private companies in their respective countries. Hence, the composition of SOEs boards differs from jurisdiction to jurisdiction based on different factors, including, the level of government intervention in the management, the presence of employee representatives in the board, and the significance of private sector experts and independent members.[262]

Countries with a largely one-tier board system in private companies like New Zealand or the UK also have one-tier boards for their SOEs.[263] Similarly, countries with two-tier systems for private enterprises such as Germany, Austria, the Slovak Republic and the Scandinavian countries, have two-tire board for SOEs.[264] Unlike the one-tire board system, on which SOEs have only one management board, in a two-tier board system, SOEs have supervisory board and management board.[265] Coming home, Ethiopia has one tire board system for both private and state-owned enterprises since the commercial code and other relevant laws of SOEs do not require enterprises to have a supervisory board.

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[259] Pacific Islands Forum Secretariat, *Analysis of Public Enterprise Governance and Management Issues In FICS*, No.25, available at:
http://www.forumsec.org/resources/uploads/attachments/documents/FEMM%202004%20Public%20Enterprise.pdf [hereinafter: Pacific Islands Forum Secretariat].
[260] The 2015 OECD Guideline, Chapter 7, (G).
[261] *Ibid.*
[262] OECD country Survey, pp.122-123.
[263] *Ibid.*
[264] *Ibid.*
[265] *Ibid.*

However, whatever the board system is, the composition of the board has to be suitable to the enterprise`s objectives.[266] Good practice in board composition is, members should be selected on the basis of a broad set of criteria, i.e. merit, professional, experience, the personal qualities of the candidate, independence, and diversity.[267] This will ensure the right mix of skills, experience and personal characteristics that will by itself bring efficiency to the enterprise`s performance. For the efficiency of the board of SOEs, good practice recommends that persons who have a direct relation with the executive powers should not sit on SOEs boards.[268]And, other state representatives should be nominated based on qualifications, subject to specific selection mechanisms.[269] Moreover, having employee representatives in the board of SOEs can enrich board discussion.[270] Yet, the appointment process should ensure that such persons are qualified.[271] In Ethiopia, 1/3 of the board members are appointed by workers association.

Recognizing the importance of independent and competent boards, to the success of SOEs, a number of countries all over the world have taken major steps to professionalize SOEs boards.[272] In Ethiopia, the government, starting from enacting different board related laws, took different measures to improve the competency of board members of SOEs. However, practically, most of SOEs are managed by board members who are appointed from the civil servants, some of whom are Ministers, who may lack not only the necessary independence but also industry knowledge.[273] Hence, there is a high probability of political influence in the board`s decision-making. This will affect the autonomy of the enterprise and hence reduced performance levels.[274] Political interference also weakens the accountability of the board, as the board cannot be held accountable for outcomes they have not generated.[275]

3.3.1.3. Board Size

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[266] European Commission, 2011, Green Paper Brussels, The EU Corporate Governance Framework, p.5, Available at: http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf , last accessed April 25, 2017. [Hereinafter, The EU Corporate Governance Framework].
[267]*Id.*, p.5.
[268]OECD, *Boards of Directors of State-Owned Enterprises: An Overview of National Practices*, pp.12-14, available at:http://www.oecd-ilibrary.org/governance/corporate-governance_20776535 ,last accessed April 25, 2017. [hereinafter, Board of Directors of State-Owned Enterprises]
[269] *Ibid.*
[270] *Ibid.*
[271] *Ibid.*
[272] *Ibid.*
[273]APRM Country Report No.14, p.183.
[274] Pacific Islands Forum Secretariat.
[275] *Ibid.*

In the composition of the boards of SOEs, the number of board members is one of the cardinal issues to be determined. However, due to different factors to be considered in determining the number of board members in the enterprise, like the enterprise`s size, the business environment, and other special considerations, there is no perfect number of board members appropriate for all the different circumstances of enterprises. Yet, it is a general recommendation that the number of board members on the board shall be such that it allows the discussions of the board to be fruitful and the decisions made to be appropriate, swift and prudent.[276] And, much of the public debate on board structure has centered on pressure for smaller board size. This is because, although larger board size at first facilitates key board functions, through time larger boards will result coordination and communication problems in the board.[277] In this regard, many scholars have argued that board size should be no greater than 8 or 9 for all enterprises.[278]

In Ethiopia, there is some disparity between the provisions of Proclamation No. 25/1992 and the CGC as to the number of BMs. The proclamation declares that the number of the board shall be at least three but not more than twelve.[279]And, the CGC requires the number of BM in SOEs to be a minimum of eight in fully government owned enterprises.[280] However, the new board administration directive No.8/2009 reaffirmed the requirements of proclamation No.25/1992.[281] And the directive under its article 23/2/repealed provisions of the CGC if they are contradictory to it. Hence, the number of BM would be what is stipulated under the proclamation and the new directive.

3.3.1.4.Board Appointment and the Nomination Process in SOEs

Having an effective board starts with the identification and appointment of board members. Therefore, before the appointment of board members is made, careful consideration must be made about the appropriateness of each potential board member. Best practice recommends that SOE board members should have skills and experience that contribute to the needs of the SOE.[282] The OECD guideline on CG of SOEs states that SOE board composition should allow the exercise of

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[276]Corporate Governance Code of Ethiopia, Article 1.3.1.].
[277] The Impact of Board Size on Firm Performance: Evidence from the UK, the *European Journal of Finance,* 2009, Vol.15, No. 4, pp.385-404. [hereinafter The Impact of Board Size on Firm Performance].
[278] *Ibid.*
[279] Proc. No. 25/1992, Article 12/1/.
[280] Corporate Governance Code of Ethiopia, Art 1.3.4.
[281]Board Administrative Directive No.8/2017, Art.4/3/.
[282]W. Richard Frederick, p.15.

objective and independent judgment.[283]To this end, all board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.[284] In addition, the boards themselves should be allowed to participate in the nomination process, especially, in defining the new appointments` necessary profiles.[285] This will enable the board to reflect on its composition and improve collective functioning.[286]

Like what the OECD guideline recommends, in Ethiopia, the CGC mandated the supervising authorities to ensuring transparent board appointment process that provides a mix of proficient board members that can improve the values of the enterprises and able to make an independent decision in the governance process.[287] For this purpose, the CGC required that a board of SOEs should contain the necessary mix of knowledge, skills, objectivity and experience.[288] In addition, while the supervising authorities and shareholders (in the case of partially owned enterprises), are appointing or removing BM, there should be a clear and transparent procedure.[289]

To ensure the appointment of competent and qualified board members in public enterprises and to establish a clear standard for the removal and appointment of BMs, the board administrative directive, directive No.8/2009 of the MoPE clearly addressed board nomination and appointment requirements in SOEs.

3.3.1.5.Board Nomination and Appointment Standards

As we have said earlier, board members of SOEs in Ethiopia are either appointed by the supervising authority or elected by the workers association in the case of fully SOEs and by the shareholders in case of joint ventures.[290] Leaving the appointment of BM in case of partially owned enterprises, when we see the appointment of BMs in fully SOEs, the CGC requires a clear standard for the nomination and appointment of BMs. Hence, board administrative directive No.8/2009, designed standards for board nomination and appointment. Based on Article 6 of this

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283 The 2015 OECD Guideline, Chapter 7/c/.
284 *Ibid.*
285 Network on Corporate Governance of State-Owned Enterprises in Asia, Draft Policy Brief on Corporate Governance of State-Owned Enterprises in Asia: Priorities and Recommendations, 2009, p.9.available at: https://www.oecd.org/countries/philippines/45639683.pdf, Recommendation No.II.5.
286 *Ibid.*
287 Corporate Governance Code of Ethiopia, Article 1.2.2.2.
288 *Ibid.*
289 *Id,* Article 1.2.2.2.b.
290 Corporate Governance Code of Ethiopia, Article 1.3.4 and Proc. No 25/92, Art12/2/

directive, an individual to be appointed as a BM should fulfill the following requirements: He must have adequate knowledge about the policies of the government,[291] he must have a work experience which is relevant to the works of the enterprise,[292] he should have sufficient knowledge and skill of leadership and a good background and commitment to the endeavors of the enterprise,[293]He must have at least first degree which considers the behavior of the sector that he is going to be a BM, and a potential BM who is nominated from University and other research centers should be a higher expert.[294]

3.3.1.6.Board Meeting

Board meetings constitute the highest decision-making mechanism in an enterprise.[295] It is a very crucial mechanism for taking strategic decisions.[296] Hence, the board should conduct meetings necessary to the achievement of the objectives of the enterprise. Therefore, it should develop a meeting policy governing the frequency, purpose, and duration of the meeting of the board and the committees.[297]

In Ethiopia, as stipulated by the CGC and proclamation No.25/92, the board shall meet at least once in a month.[298] But, whenever necessary, they may conduct meetings at any time with the satisfaction of the required vote for the meeting, which might be unanimous or simple majority based on the circumstances.[299] This is also reaffirmed by the new board administrative directive No.8/2009, article 7/2/. Hence, the chairman shall call a meeting of the board, at any time, in cases of urgency or where at least two members of the board so request.[300] However, the agenda of the meeting should be communicated to board members in advance.[301] In all board meetings, decision

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[291]Board Administrative Directive No.8/2009, Art.6/1/-/6/.
[292] *Ibid.*
[293] *Ibid.*
[294] *Id.*, Article 4.1.1.
[295] Guidelines for Public Enterprises in Sri Lanka, available at:http://www.treasury.gov.lk/documents/63940/182428/guidelines.pdf/53c33d35-1f6d-4e78-81da-ad281304f1a4 , [last accessed:5/25/2017].[hereinafter Guidelines for Public Enterprises in Sri Lanka]
[296] *Ibid.*
[297] Proclamation No. 25/92, Article 13/9/. Also See Corporate Governance Code of Ethiopia Article 1.2.2.10. See also, Board Administrative Directive No.8/2009, Article 7.1.
[298] Corporate Governance Code of Ethiopia, Article 1.4.1. See also article 13(1) of Proclamation No. 25/92
[299] Corporate Governance Code of Ethiopia, Article 1.4.1
[300] Proclamation No.25/92, Art. 13(2).
[301] Board Administrative Directive No.8/2009, article 7/3/.

will be mad by majority vote and in case of a tie the chairman will give a casting vote.[302] The general manager may participate in the meeting of the board, though he has no right to vote.[303]

As board meeting is the principal way of performing the responsibilities of board members, each board member should have attained meetings. And, if the BM failed to attend at least 25% of board meeting within a year or when he recorded absent in five consecutive board meetings, the supervising authority will remove him from the post.[304]

3.3.1.7. Functions and Responsibilities of the Board

3.3.1.7.1. General Fiduciary Duties of Board Members

Though there are some exceptional circumstances of imposing special duties on BMs of SOEs, most of the time, SOEs boards are usually supposed to have the same level of responsibility and liability as the boards of private enterprises.[305] Hence, when making corporate decisions, board members of both private and public enterprises must fulfill the duties of care and loyalty in order to satisfy their fiduciary obligations. [306] The board members fiduciary duty requires that, in exercising their powers and discharging their duties, board members should act honestly and in good faith.[307] In certain circumstances, directors also have a duty to provide full and fair disclosure.

A. **Duty of Loyalty**: is the principal fiduciary duty of board members. This duty demands board members to devote themselves to advancing the interests of the enterprise rather than their own interests. The easiest way to fulfill this duty is not to engage in transactions that involve a conflict of interest.[308] In other words, board members should not engage in transactions except those in which the best possible results for the enterprise can be achieved.[309] Generally, BMs are not permitted to use their position of trust and confidence to advance their private interests.

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[302] *Id*, Article 7/7/.
[303] Proc.No.25/1992, Art.13/7/.
[304] Board Administrative Directive No.8/2009, Article 21.
[305] OECD country Survey p138.
[306] William M. Lafferty, et al, A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law, *Penn State Law Review*,2012, Vol. 116, No.3, p.842. [hereinafter William M. Lafferty].
[307] Institute of Corporate Directors, Directors' Responsibilities in Canada, October 2014 Sixth Edition, p.3, available at: https://www.icd.ca/getmedia/581897ca-d69d-4d4f-a2a2-ca6b06ef223b/5467_Osler_Directors_Responsibilities_-Canada-FINAL.pdf, last accessed:5/25/2017. [hereinafter Institute of Corporate Directors].
[308] *Ibid*.
[309] Professor Bernard S. Black, 4 April 2001, The Principal Fiduciary Duties of Boards of Directors Presentation at Third Asian Roundtable on Corporate Governance Singapore, p.3, , available at: http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf, last accessed 5/25/2017. [hereinafter: Professor Bernard S. Black].

B. Duty of Care: In discharging their duties, board members should exercise the care, diligence and skill that a reasonable person would exercise in the same situation.[310] The duty of care requires that BM before making a decision should inform themselves, of all the necessary information reasonably accessible to them.[311] This duty includes acting in a good faith consistent with what a BM as a member of the board truly believes is in the best interest of the organization. [312] This standard of care can be achieved by any director who devotes reasonable time and attention to the affairs of the enterprise and exercises informed business judgment.[313]

C. **Duty of Disclosure:** Disclosure refers to the release of financial and nonfinancial information on the state of affairs of an SOE.[314] Disclosures can be made to the general public, through the public release of financial statements or annual reports, or to selected groups such as ownership entities, other shareholders, or debt holders. Laws, regulations, or government policies usually mandate the release of a minimum amount of information.[315] And, it is the duty of board members to provide a complete disclosure of information about the entire operation of the enterprise to shareholders and stakeholders.[316]

3.3.1.7.2. Detail Duties of SOEs Board in Ethiopia

In Ethiopia, board members of SOEs have the above general duties. Moreover, in order to appreciate the specific duties and responsibilities of SOE board and board members, it is imperative to consult the provisions of Proclamation No.25/1992, the CGC of 2009, and board administrative directive No.8/2009. Based on these laws, the board is assigned to a wide range of power in SOE governance.

To begin with, pursuant to Article 14(1) of Proclamation No.25/1992 the board is mandated to decide overall policy issues except those issues reserved to the supervising authority based on article 11 of the same proclamation. Yet, even in those powers given to the supervising authority, the board has the role of providing recommendations.[317] In this regard, we can take article 11(12)

[310] *Id.*, p.9.
[311] William M. Lafferty, p.841.
[312] The Legal Duties of the Nonprofit Board and Its Members.
[313] Institute of Corporate Directors.
[314] World bank toolkit, p.216.
[315] *Ibid.*
[316] Professor Bernard S. Black, p.10.
[317] Dagnachew Asrat and Addissie Shiferaw, p.83

of the proclamation as an example. This article mandated the board to consult the supervising authority in relation to the annual and long-term corporate targets of the enterprise. From the reading of Article 14 (1) and 11 (3) of the proclamation, we may possibly take that policy making powers which are not given to the supervising authority are the residual powers of the board.[318]

Particularly, the board has the following functions: to appoint and dismiss the general manager of the enterprise and fix his salary and allowance,[319] to approve the employment, assignment and dismissal of those officers of the enterprise accountable to the general manager, including their salaries and allowances, approve the internal regulations of the enterprise as well as its work program and budget,[320] approve long-term loans and credits of the enterprise,[321] approve the sale of fixed assets that may not affect the existence of the enterprise,[322] ensure that proper books of accounts are kept for the enterprise,[323] submit books of account to the auditors of the enterprise, and periodic reports on the state of activities of the enterprise and financial reports to the supervising authority, [324]and propose to the supervising authority the increase or decrease of the capital of the enterprise.[325]

In addition to the above functions of the board, the CGC and board administrative directive entrusted a broader and detail functions to the board of SOEs.[326] Hence, the board has the following duties: setting the business goals and strategies of the enterprise, approving business planes and goals, supervising the management and evaluating their performance, supervising risk management and financial control, initiate and oversee the implementation of corporate reform and capacity building programs, etc.[327]

Furthermore, it is the duty of the board to perform social responsibilities of the enterprise and consider the interests of various stakeholders. Yet, the board is not always required to discharge its responsibilities by itself. Hence, it is mandated to delegate some of its functions to the

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[318]*Id.*, p.84.
[319] Proc. No.25/1992, Article 14/2/.
[320] *Id.*, Art.14/3/.
[321] *Id.*, Art. 14/5/.
[322] *Id.*, Art.14/6/.
[323] *Id.*, Art.14/7/.
[324] *Id.*, Art.14/8/.
[325] *Id.*, Art. 14/9/.
[326]Board Administrative Directive No.8/2009, Art.10.
[327] Corporate Governance Code of Ethiopia, Article 1.2.2.

management and to establish internal committees.[328] So that, it will be able to focus only on key management decision-making functions.[329]

Finally, when we evaluate the laws of Ethiopia in relation to the duties and powers provided to boards and BMs of SOEs, in the lenses of the international good practice, Ethiopia seems like adhere modern recommendations. However, the controlling question would be how much BMs are practically competent and autonomous in discharging their responsibilities. This requires further study.

3.3.1.8. Board Evaluation

In order to maximize its performance and minimize the risks of the enterprise, the boards of SOEs should be evaluated regularly based on various standards. Hence, the board should periodically assess its strategic plan, budgets and performance to check that it is performing based on its plan and take corrective measures if it didn't. This evaluation of the board broadly should include assessing its membership, organization and operation as a group, the competence and effectiveness of each board member and of the board committees, and how good the board has performed to achieve its objectives.[330] Such evaluations may range from informal evaluations conducted by a chairperson to more formal self-evaluations conducted by external experts and facilitators.[331]

Good corporate governance practice suggested that board evaluations should focus on the performance of the board as an entity.[332] So that, evaluation of each BM should have the objective of showing whether a BM continues to contribute to the successful operation of the enterprise or not.[333] This will lead the board to ensure that every BM has the required competence, professionalism, authority, integrity and independence.[334]

In Ethiopia, the board should regularly assess its performance and effectiveness as a whole, and that of the individual BM including the CEO and evaluate to which level it achieved its

[328]Board Administrative Directive No.8/2009, Article.15.
[329] *Id.*, Article 1.2.1.4.
[330]The EU Corporate Governance Framework, p.5.
[331]W. Richard Frederick p.20.
[332]Board of Directors of State-Owned Enterprises, pp.12-14.
[333] BALTIC Institute of Corporate Governance, *Guidance on Board Effectiveness: Handbook for State-Owned Enterprises,* October 2013, available at: http://www.bicg.eu/wp-content/uploads/2016/02/Guidance-on-Board-Effectiveness-EN.pdf, p.17. [hereinafter, BALTIC Institute of Corporate Governance].
[334]SOEs Catalysts for Public Value Creation, p. 43.

objectives.[335] The mandate of setting the criteria for board and CEO evaluation is vested on the supervising authorities.[336] And, supervising authorities, while setting standards for board evaluation should lay on objective and tangible criteria, including enterprise performance, accomplishment of long-term strategic objectives and the development of management.[337]

The findings of the board evaluation should be reported to the supervising authority.[338] Particularly, in the MoPE, it is the duty of the corporate finance administration procedure directorate to follow up the performance of the board and the BMs.[339] This directorate also proposes corrective measures to the deputy minister in every month.[340] And the Deputy Minister will report to the minister about the performance of board members in every three months.[341]

Based on the findings of its evaluation, the board must identify key risk areas and key performance indicators of the enterprise and monitor these factors and ensure the continuity of the enterprise as a going concern for its next year.[342] The supervising authority, once the evaluation is completed, will take corrective measures, including removal of incompetent board members and appointment of other qualified members.

3.3.1.9. Liability and Removal of Board Members

From the very beginning, board members of SOEs should carry out their duties on the board with due care. But, if they fail to do so, they will be jointly and severally liable for the damages caused by their failure.[343] However, this liability is not without exceptions since Article 15/3/ of Proclamation No. 25/92 provided that, '…. the board member who has dissented in the decision-making process of the decision that caused the damage will not be liable for the damages.'[344]

Board membership is not a lifetime tenure. Therefore, a board member may resign at any time (by serving notice for this purpose to the supervising authority) or the supervising authority may, at any time, remove him from his post, where there are sufficient grounds that make him unfit to

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[335] Corporate Governance Code of Ethiopia, Article 1.2.2.11.
[336] Corporate Governance Code of Ethiopia, Article 1.2.2.11.A.
[337] *Id*, Article 1.2.2.11. D.
[338] Board Administrative Directive No.8/2009, Article 19.
[339] Management Board Nomination and Assignment Directive, Article 7.1-3.
[340] *Ibid.*
[341] *Ibid.*
[342] Corporate Governance Code of Ethiopia Article 1.2.2.11. and 1.2.2.14.
[343] Board Administrative Directive No.8/2009, Article 20. see also, Proclamation No.25/1992, Article 15.
[344] *Ibid.*

continue as a BM.[345] Particularly, a BM may be removed from office on the following grounds: when he dies, upon the expiry of his term, low performance, when the enterprise is amalgamated with other enterprise or privatized, when the existence of conflict of interest is proofed, and when the BM failed to attend at least 25% of board meeting within a year or when he recorded absent in five consecutive board meetings.[346] Additionally, the supervising authority is also entitled to remove a BM at any time when it deemed necessary to the proper functioning of the enterprise.[347]In all cases, it is the ultimate power of the supervising authority to give the final decision on the removal of BMs.[348]

3.3.1.10. Continuing Professional Development of Board Members

Every SOE should design its own all-inclusive and formal training program based on the needs of the enterprise and individual BMs.[349] This program, among other things, should build an understanding of the nature of the enterprise, its business and the markets in which it operates**,** build a link with the enterprise's people**,** and build an understanding of the company's main relationships including meeting with auditors.[350]

In Ethiopia, the supervising authorities are in charge of organizing trainings time to time taking the needs of board members into account.[351] Seminars may also be arranged by the directorate in order to increase the awareness of board members in relation to laws and new working procedures concerned with public enterprises.[352] This will serve as a way to improve the effectiveness of BMs. Therefore, even if general training for BMs should not be a formal requirement, continuing professional development should be encouraged and supported for a successful SOE operation.[353]

3.3.2. **Committees of the Board**

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[345] Proc.No.25/1992, Article 12/9/.
[346]Board Administrative Directive No.8/2009, Article 21.
[347] *Id.*, Art.21/7/.
[348]Management Board Nomination and Assignment Directive, Article 6 A –G.
[349]BALTIC Institute of Corporate Governance, p.16.
[350] *Ibid.*
[351]Mr. Haftom Birhanu.
[352]Management Board Nomination and Assignment Directive, Article 9/1/ and /2/.
[353]Board of Directors of State-Owned Enterprises, pp.12-14.

Building an effective team by exercising leadership, diplomacy and a deep understanding of the business is a key factor to board effectiveness.[354] For this purpose, it is imperative to have specialized committees within the boards of each SOEs. However, such special committees should contain independent and technically qualified BMs who are able to contribute to the efficiency of the enterprise.[355] Even if the special committees cannot make a decision by themselves,[356] if they got the authorization from the board to decide over certain matters and do the same, it is important to note that, BMs remain responsible for this decision of the committees since this decision have the same effect as the decisions of the board.[357]

In recognition of the necessity of specialized committees within SOEs board, the Ethiopian CGC and board administrative directive No.8/2009 insist the establishment of different specialized committees. Hence, in a fully government owned enterprise, the following three committees should be established within the boards of each SOE: [358] strategy and business development committee, finance committee, and audit and risk management committee. Each committee will have its own specific duty as enshrined under Article 1.5.6.2 and the following of the CGC and Article 16 and the following of board administrative directive. As far as the establishment of internal committees under other forms of ownership concerned, in joint ventures, the decision would be made by shareholders of each enterprise.[359]

3.4. Disclosure and Transparency

Disclosure of corporate information means releasing the company's financial and non-financial information completely, accurately, timely and openly to shareholders and stakeholders for the purpose of enhancing their participation in the enterprise`s governance and protecting their interests.[360]

[354] *Ibid.*
[355] Corporate Governance Code of Ethiopia, Article 1.5.1.
[356] Board Administrative Directive No.8/2009, Article 15/6/.
[357] BALTIC Institute of Corporate Governance, p.16.
[358] Board Administrative Directive No.8/2009, Article 15.
[359] Corporate Governance Code of Ethiopia, Article 1.5.4.
[360] Ma Zhengwu, *Improving Transparency and Standardizing Information Disclosure Is the Social Responsibility of State-owned Enterprises*, available at: https://www.oecd.org/daf/ca/corporategovernanceprinciples/34973924.pdf, p.1, last accessed April 25, 2017. [hereinafter, *Ma Zhengwu*].

A strong, informative and transparent system of corporate disclosure helps to bring better enterprise performance. Traditionally, the issue of SOE disclosure has been limited only to financial reporting and the verification of such reports via auditing.[361]However, increasingly, disclosure encompasses governance practices and is used as a means to create checks and balances in SOEs.[362]

Given the government is the owner of enterprises, transparency and disclosure are even more important for SOE's than private enterprises since it is imperative to clarify the objectives of the government to the general public. By reporting to their ownership entities, the parliament or the general public, SOEs increase their transparency and accountability. Furthermore, the disclosure of key financial information of SOEs is pivotal to avoid corruption.[363]

Transparency is achieved through timely and accurate disclosures of information to allow shareholders, other stakeholders and the market to be informed about the finances, operations and prospects of the enterprise.[364] Therefore, it is the responsibility of BM to ensure that shareholders and other stakeholders are provided with high-quality disclosures on the financial and operating results of the enterprise.[365]

Internationally, almost all corporate governance codes, including the OECD and the International Corporate Governance Network Principles (ICGN), the principles for corporate governance in the commonwealth (CACG Guidelines), and the Cadbury Report, and the King II, specifically require the board of directors to disclose information as to the financial and operating results of the enterprise to shareholders and other stakeholders.[366] Particularly, the OECD guideline chapter VI states that SOEs should observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance and auditing standards as private companies. Hence,

[361]W. Richard Frederick p.27.
[362] *Ibid.*
[363]Ram Kumar Mishra, Geeta Potaraju, 'MoU System in India: A Study on Corporate Governance Practices, *Psychology Research*, 2016, Vol. 6, No. 9, p.551. [hereinafter, Ram Kumar Mishra, Geeta Potaraju]
[364]Sri Lanka Ministry of Finance, Code of Best Practice in Corporate Governance for Public Enterprises In SriLanka, P.5, Section 2, Available at: http://www.treasury.gov.lk/documents/63940/182428/codeofbestpractice.pdf/107546ab-4ffc-4b83-b3a6-8ed0011d8859, Last accessed, March 21,2017. [hereinafter, RI Lanka Ministry of Finance].
[365]UN Guidance on Good Practices in Corporate Governance Disclosure, p.4.
[366] *Ibid.*

they should report financial and non-financial information on the enterprise in line with internationally recognized standards of corporate disclosure.[367]

The board in disclosing information should not only depend on the content of the information but, it should also care for the quality, timeliness and relevance of its disclosure.[368] However, best practice shows that, it is hardly possible to get a country which has a complete disclosure and transparency framework for SOEs. For instance, in China, investors regularly complain about lack of transparency in SOEs finances, particularly over the transfer of assets between listed companies and their state-owned parent groups.[369]

In Ethiopia, as an inference can be made from the CGC, the basic aim of enacting the code was to establish a better governance of SOEs through enhancing transparency and efficiency of their management.[370] In line with this objective, the code contained provisions as to the disclosure of information in SOEs. Hence, SOEs shall disclose information that may influence the decision-making of shareholders and other stakeholders in a timely and accurate manner.[371]This is reaffirmed by the new board administrative directive No.8/2009.[372] The controlling question is, however, what should be disclosed?

Pursuant to Article 5(2) of the CGC, the information required to be disclosed by any SOE in Ethiopia among other things includes the business goals and strategies of the enterprise, profiles of board members, capital increase or decrease and capital expenditure for the fiscal year, business climate and risk elements & their management.[373]The disclosure of corporate information is not limited to facts that have already occurred, but it should also include forecasts on future business performance and financial condition.[374]In addition to the board`s duty of disclosure, the supervising authority should also develop consistent and combined reporting system on SOEs and publish the annual report on their performance.[375]

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[367] The 2015, OECD Guideline, Chapter VI/A/.
[368]Ram Kumar Mishra, Geeta Potaraju, p.549.
[369]China's champions: "Why State Ownership is No Longer Proving a Dead Hand", available at: https://www.ft.com/content/979f69c8-f35b-11dc-b6bc-0000779fd2ac ,[last accessed, April 25, 2017]
[370] See the preamble of the Corporate Governance Code of Ethiopia.
[371] Corporate Governance Code of Ethiopia, Article 5.
[372]Board Administrative Directive No.8/2009, Article.10/15/.
[373]Corporate Governance Code of Ethiopia, Article 5/2/.
[374] *Id*, Art.5/3/.
[375] Corporate Governance Code of Ethiopia, Article 5/6/.

In conclusion, Ethiopia seems like have the necessary law relating to information disclosure and transparency in SOEs. However, in practice, it is hardly possible to know about the financial conditions of SOEs, including their revenue stream, the structure of expenditures, financing, and debt.[376] Hence, the level of disclosure in ethiopia is at its early stage of development. This is because SOEs view disclosure as a burden to the enterprise and didn't give the deserved attention.[377] Due to this reason, Ethiopia lagged behind the international standard of corporate disclosure. Hence, in order to achieve the objectives of SOEs, real commitment towards the improvement of corporate disclosure of information is required.[378]

3.5. Auditing the Accounts of SOEs in Ethiopia

Active external control and supervision of SOEs is vital to ensure the sound investment of public money, to ensure financial management and reporting requirements are met, and that government policy objectives are being achieved.[379] Hence, a well-established system of checks and balances should be in place.[380] The state exercises its controlling power over SOEs through different organs. Basically, control maybe, parliamentary control, judicial control, control through specialized committees (like audit committee), and control by the executive. Among the controlling mechanisms, auditing is one of the effective ways of control. Auditors help SOEs to achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. In recognition of this, SOEs internally contain audit committees and external auditors usually appointed by the government for checking the correctness of the SOE`s account.[381]

Public Enterprises Proclamation 25/1992 requires state-owned enterprises to keep books of accounts following generally accepted accounting principles (GAAP). However, there is no requirement for SOEs to prepare financial statements in compliance with any defined accounting standards or for their auditors to comply with any defined auditing standards.[382] The auditing of accounts of SOEs is governed by Proclamation No. 25/1992 Articles 32-34, the 1960 Commercial

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[376] Professor Tilahun Teshome.
[377] IMF Country Report No. 14/303, p.16.
[378] Professor Tilahun Teshome.
[379] Pacific Islands Forum Secretariat
[380] Guidelines for Public Enterprises in Sri Lanka, p.28
[381] Nomusajane Moy, South African Principles of corporate Governance, p.47.
[382] Reports On Observance Of Standards And Codes Accounting and Auditing November 2007, available at: https://openknowledge.worldbank.org/bitstream/handle/10986/12244/703660ROSC0P100Auditing0ROSC0Report.pdf?sequence=1 [last accessed 5/30/2017].

Code, the CGC and Board Administrative Directive No.8/2009. Based on these laws, every year, SOEs should pass through internal and external auditing.

3.5.1. Internal Auditing

The Institute of Internal Auditors (IIA) defined internal auditing as follows:[383]

> Internal Auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of Internal Auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, Internal Auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost.

In Ethiopia, as it is clearly enshrined under the corporate governance code, internal audit committees should be established in every SOE.[384] This committee should be independent from the management and controlling shareholders. The number of the committee is not specifically determined by the code. Yet, it should be 3 in minimum and one of them should possess knowledge of auditing.[385] As far as their qualification is concerned, an audit committee membership does not require having a professional license, but a BM shall have the understanding of accounting standards, financial reporting, and the internal control systems.[386] Further, the committees and auditors are duty bound to discharge their responsibilities independently.[387]

The general functions of the internal audit committee are mentioned under Article 2.1.8 of the CGC. Among other things, the committee has the following duties:[388] Audit the management's execution of operations; projects, capacity building programs, resource management, etc., review compliance of the company to the governance code as well as laws and guidelines set out by the government, the Ministry and the board, and evaluate the auditing activities of external auditors.

3.5.2. External Auditors

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[383] The Institute of Internal Auditors, available at: http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing/?search%C2%BCdefinition ,[last accessed 5/30/2017]
[384] Corporate Governance Code of Ethiopia, Art. 1.5.3.
[385] *Id.*, Art.2.1.2.
[386] *Id.*, Art.2.1.7.
[387] Corporate Governance Code of Ethiopia, Art 2.1.2.
[388] *Id.*, Art. 2. /1/8//A-I/.

The accounts of each enterprise shall be audited by external auditors appointed by the supervising authority. Yet the Auditor General maybe empowered by other legislations to audit SOEs.[389] The supervising authority while appointing external auditors shall be ascertains that the external auditors meet the requirements of the auditor general. As far as the powers, duties and liability of auditors is concerned, it is imperative to consult the provisions of the commercial code as article 34 of proclamation No. 25/1992 made a cross refers to it. Hence, external auditors will have the powers, duties and liability enshrined under Articles 373, 374, 375, 376, 378, and 380 of the Commercial Code. Accordingly, external auditors have the following duties: to audit the books and securities of the company; to verify the correctness and accuracy of the inventories, balance sheets and profit and loss accounts; to certify that the report of the board of directors reflects the correct state of the company's affairs; and to carry out such special duties as may be assigned to them.[390] And, it is also important to consult the provisions of the CGC especially article 2.2 and the board administration directive No. 8/2009, especially Article 18.

Based on the above discussion what we can infer about auditing of SOEs in Ethiopia is, the executive branch of the government is using auditing as a controlling mechanism via requiring the establishment of internal audit committees within SOEs and by appointing external auditors for each SOE. And, though the practice might be different as it is to be determined based on other studies, the country`s legal framework seems like to provide the necessary right, and responsibilities for both internal and external auditors.

[389] Proc. No. 25/1992, Art.32.
[390] 3. Commercial Code of the Empire of Ethiopia, 1966, *Negarit Gazzeta*, Extraordinary issue, Proc. No. 166, 19th year, No. 3, Art.374.

CHAPTER FOUR

ETHIOPIAN SOEs AND THEIR RELATION WITH SHAREHOLDERS AND STAKEHOLDERS

4.1. Shareholders in the Context of SOEs: Their Rights and Responsibilities

Government`s involvement in the economy may not always be through establishing fully SOEs. Rather, there are scenarios for mixed ownership of enterprises by the government and private investors. Internationally, on average, around 40% of SOEs comprises private investors.[391] Among them, in about a half of these, the state has a majority shareholding.[392] In such cases, the government will be a controlling shareholder. And, as it is defined under the CGC of Ethiopia,[393] a controlling shareholder is ("…one, regardless of his proportion of shareholding, who exercises de facto influence over major matters involving corporate management, such as appointment and dismissal of management.").

If the government is a controlling shareholder, additional complexity will be added to the CG of SOEs. This is because the government as an owner often has public value creation goals that are different from the goals of other shareholders who only seeks to generate profit.[394] Therefore, the state as a controlling shareholder may be in a position to abuse the rights of minority shareholders using its ability to make decisions in general shareholder meetings without waiting for the votes of other shareholders.

Taking account of this possibility of abuse by a controlling shareholder, especially the government, the OECD guideline declared the equitable treatment of all shareholders as one of its principles of good CG.[395] This principle aimed at protecting minority shareholders from potential abuses by the

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[391] OECD Directorate for Financial and Enterprise, Corporate Governance: Relationship of State-Owned Enterprises with Other Shareholders, available at: https://www.cesifo-group.de [last accessed May 18, 2017].
[392] *Ibid.*
[393] Corporate Governance Code of Ethiopia, Article 3.3.2.
[394] Santosh Pande.
[395] The OECD guideline for CG of SOEs, chapter IV declares as follows;
Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.
A. The state should strive toward full implementation of the OECD Principles of Corporate Governance when it is not the sole owner of SOEs, and of all relevant sections when it is the sole owner of SOEs. Concerning shareholder protection this includes:
1. The state and SOEs should ensure that all shareholders are treated equitably.

board, managers and supervising authorities.[396] The principle,[397] recommends that "where SOEs are listed or otherwise include non-state investors among their owners, the state, and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information." However, in most OECD countries, minority shareholders in SOEs have no more rights than they usually have in private enterprises.[398]

In ensuring the equitable treatment of minority shareholders, the role of the ownership entity should be, by exerting its influence on setting up guidelines and policy towards an equitable treatment of minority shareholders and oversight the CG conducts of enterprises.[399] Yet, there are a few countries that guarantee minority shareholders of SOEs a higher level of control and more decision-making power than minority shareholders in private companies.[400] In this regard, we can see the experience of Slovakia. In the Slovak Republic, in SOEs which are more than 51 percent state-owned, the state enters into a shareholders' contract granting minority shareholders majority representation on the board of directors.[401]

However, being a minority shareholder is not always the fate of private investors. Rather, there are many SOEs by which the government is a minority shareholder. In this case, governance problems may also happen due to lack of attention by the government over SOEs. Hence, other shareholders

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2. SOEs should observe a high degree of transparency, including as a general rule equal and simultaneous disclosure of information, towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.
5. Transactions between the state and SOEs, and between SOEs, should take place on market consistent terms.
B. National corporate governance codes should be adhered to by all listed and, where practical, unlisted SOEs.
C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.
D. When SOEs engage in co-operative projects such as joint ventures and public private partnerships, the contracting party should ensure that contractual rights are upheld and that disputes are addressed in a timely and objective manner

[396] Santosh Pande.

[397] The 2015 OECD Guideline chapter IV.

[398] Santosh Pande.

[399] Abdul Wahab Jaafar Sidek, Equitable Treatment of Minority Shareholders, p.16, available at: https://www.oecd.org/daf/ca/corporategovernanceprinciples/41076424.pdf, last accessed:5/17/2017.

[400] *Ibid.*

[401] *Ibid.*

will take the advantage to the detriment of the state. Therefore, the government should also design a mechanism of avoiding such situations.[402]

4.1.1. Shareholders in SOEs of Ethiopia

In Ethiopia, there are many joint investments of the government and private investors in SOEs that are out for privatization as well as in areas of investments which are reserved for joint investment like the manufacturing of weapons, ammunition and telecommunication services. Practically, by February 2016, the Ethiopian government co-owns many enterprises jointly with private investors, including, B.M Textile & Garment S.C., Ethiopian Crown Cork & Can Manufacturing Industry S.C., Ambo Mineral Water S.C., Abiyata Shala Soda Ash S.C., and Tibilla Agriculture Development S.C.[403] In those enterprises, the government owns a 14 to 75% stake.[404] Therefore, in general terms, in such jointly owned enterprises, the ownership rights of other shareholders should be protected.

The major rights of shareholders in Ethiopia SOEs are a right to participate in profit sharing, a right both to attend and to vote at general shareholders meetings, and a right to obtain relevant corporate information in a timely and regular manner.[405] Hence, once granting this rights, an appropriate procedure should be designed and all the relevant information of the enterprise should be disclosed to all shareholders without any form of discrimination.[406] So that shareholders can exercise their rights properly. The CGC of Ethiopia strengthens its stand towards the protection of shareholders rights by prohibiting the avoidance or restriction of shareholders rights through the articles of incorporation, the general shareholder meetings, or the decision of the board.[407]

However, while exercising their rights, shareholders should not ignore their corollary responsibilities. Hence, shareholders, especially controlling shareholders shall exert their efforts to the best interests of the enterprise, rather than attempting to advance their personal interest in the costs of other shareholders.[408] The CGC further governed matters which are potential to bring fundamental change in the rights of shareholders including amendments to the articles of

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[402] World bank toolkit, p.243
[403] Press release From the Ministry of Public Enterprises, *Fortune Magazine*, Vol 16, No 824, Feb 15,2016.
[404] *Ibid.*
[405] Corporate Governance Code of Ethiopia, Article 3.1.1
[406]*Ibid.*
[407]Corporate Governance Code of Ethiopia, Article 3.1.2
[408] *Id*, Article 3.3.1

incorporation, business transfer, and corporate disbanding and dissolution.[409] In such issues, it is the power of the supervising authority or the general shareholders meeting to decide such matters.[410] However, the controlling question in this regard is, is that appropriate to authorize the supervising authority to render such decisions over partially owned enterprises? It is the researcher's opinion that, this mandate is not appropriate because of the reason that, as the supervising authority is an entity established to protect the interests of a shareholder, the government, its rights should also be limited to its contribution. Hence, enabling the supervising authority to decide on such crucial issues is against the ownership rights of other shareholders.

4.2. SOEs and Their Relation with Stakeholders

4.2.1. Stakeholders in the Context of SOEs

With regard to the impact of CG on the performance of enterprises there are basically two different models of the corporation: 1. The shareholder model.[411]2. The stakeholder model.[412]The shareholder model considers only two players in the firm: owners and managers.[413]Because of this, it is considered as a narrow construction of CG. However, based on the wider understanding of CG, stakeholder model, CG can be used to describe the system of formal and informal relations

[409] I*d.*, Article 3.1.3

[410] *Ibid.*

[411]According to the shareholder model the objective of the firm is to maximize shareholder wealth through allocative, productive and dynamic efficiency i.e. the objective of the firm is to maximize profits. The criteria by which performance is judged in this model can simply be taken as the market value (i.e. shareholder value) of the firm. Therefore, managers and directors have an implicit obligation to ensure that firms are run in the interests of shareholders. The underlying problem of corporate governance in this model stems from the principal-agent relationship arising from the separation of beneficial ownership and executive decision-making. It is this separation that causes the firm's behavior to diverge from the profit maximizing ideal. This happens because the interests and objectives of the principal (the investors) and the agent (the managers) differ when there is a separation of ownership and control. Since the managers are not the owners of the firm they do not bear the full costs, or reap the full benefits, of their actions. Therefore, although investors are interested in maximizing shareholder value, managers may have other objectives such as maximizing their salaries, growth in market share, or an attachment to particular investment projects, etc

[412] The stakeholder model takes a broader view of the firm. According to the traditional stakeholder model, the corporation is responsible to a wider constituency of stakeholders other than shareholders. Other stakeholders may include contractual partners such as employees, suppliers, customers, creditors, and social constituents such as members of the community in which the firm is located, environmental interests, local and national governments, and society at large. This view holds that corporations should be "socially responsible" institutions, managed in the public interest. According to this model performance is judged by a wider constituency interested in employment, market share, and growth in trading relations with suppliers and purchasers, as well as financial performance

[413] Bruno Dallago, Corporate Governance and Governance Paradigms, *Journal of Economics and Business* ,2002, Vol. 2002, No 2 pp. 173 – 196, p.177

concerning the enterprise. [414] This model also recognizes that business ethics and stakeholder relations can also have an impact on the reputation and long-term success of the enterprise.[415] The main intention of the stakeholder's concept as theory is to affirm and show that the company together with its executive board is responsible not only for shareholders but also for individuals or groups that have a stake in the actions and decisions of such organization. [416]

Currently, CG is evolved and constructed in its wider understanding. Hence, consensus is reached that, the involvement of stakeholders in corporate decision making is both a right and is also economically beneficial.[417]

Stakeholder relations and responsible business is one of the principles of CG recommended under the OECD guideline for the CG of SOEs.[418] Chapter IV.A of the guideline recommends that governments, the coordinating or ownership entity and SOEs should themselves recognize and respect stakeholders' rights established by law or through mutual agreements since it is pivotal for building sustainable and financially sound enterprises.[419] Hence, by consulting with their supervising authority, SOEs should develop and disclose a clear stakeholder policies.[420] Yet, the interests of shareholders should not be endangered in the pretext of protecting the rights of

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[414] Maria Maher And Thomas Andersson, Corporate Governance: Effects On Firm Performance And Economic Growth, available at: https://www.oecd.org/sti/ind/2090569.pdf , p.5.[last accessed:5/30/2017].
[415] *Ibid.*
[416] Introduction to Corporate Governance, Chapter I p.3.
[417] *Ibid.*
[418] The OECD guideline under Chapter V enshrined that;
The state ownership policy should fully recognize SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.
A. Governments, the state ownership entities and SOEs themselves should recognize and respect stakeholders' rights established by law or through mutual agreements.
B. Listed or large SOEs should report on stakeholder relations, including where relevant and feasible with regard to labour, creditors and affected communities.
C. The boards of SOEs should develop, implement, monitor and communicate internal controls, ethics and compliance programs or measures, including those which contribute to preventing fraud and corruption. They should be based on country norms, in conformity with international commitments and apply to the SOE and its subsidiaries.
D. SOEs should observe high standards of responsible business conduct. Expectations established by the government in this regard should be publicly disclosed and mechanisms for their implementation be clearly established.
E. SOEs should not be used as vehicles for financing political activities. SOEs themselves should not make political campaign contributions.
[419] The 2015 OECD Guideline, annotation to chapter V, p.57.
[420] *Ibid.*

stakeholders. Particularly, the general shareholders meeting and the board should retain their decision-making powers in the enterprise.[421]

The CGC of Ethiopia has recognized the roles of stakeholders for the sustainable success of SOEs and explicitly mentioned their rights. At the very beginning, it is essential to know what are considered as stakeholders from the perspective of SOEs in Ethiopia. For this purpose, the code determined what constitutes stakeholders in SOEs as follows;[422]

> Stakeholders include individuals, group of people, organizations, etc. who have a stake or legitimate interest in a particular enterprise, including employees, lenders, suppliers, consumers and the society.

Having this definition in mind, when we go back to the purposes of SOEs, public value creation is one their primary objectives. Therefore, in order to build sustainable and financially sound enterprise, every enterprise should acknowledge the importance of stakeholders. Initially, the state ownership policy (if we will have) should fully recognize SOEs' responsibilities towards stakeholders.[423] Based on this ownership policy, the board of any SOEs should prepare and outline a policy or policies determining and regulating its relationships with stakeholders.[424] Particularly, the rights of stakeholders recognized under the law and contract should be protected, and there should be proper means of remedy for violations of stakeholder`s rights. [425] The challenge is, however, unlike the international experience, Ethiopia doesn`t have a comprehensive ownership policy on its own SOEs. Hence, the enforcement of the rights of stakeholders enshrined under the CGC would face practical repercussion, since there is a lack of a clear commitment in a policy level at the very beginning.

4.2.1.1. Creditors and SOEs

Creditors and board members, while the enterprise is borrowing money they often assume that there is an implicit state guarantee on SOE debts.[426]This situation has in many instances led to

[421] *Ibid*
[422] See the definition part of the Corporate Governance Code of Ethiopia.
[423] The 2015 OECD Guideline, Chapter V
[424] Corporate Governance Code of Ethiopia, Article, 1.2.2.8
[425] *Id.* Art. 4.1.1
[426] OECD Country Survey. P.86

excessive indebtedness and wasted resources of the SOE.[427] In a number of cases, SOEs are to a large extent protected from insolvency or bankruptcy procedures by their specific legal status.[428] This is sometimes due to the necessity to ensure continuity in the provision of public services, but overall it should not weaken creditors' rights.[429] However, in Ethiopia, SOEs are not protected from bankruptcy. Hence, they may be declared bankrupt following the same procedure as private companies. Yet, special summary procedures maybe followed by courts.[430]

The CGC of Ethiopia, as far as the relation of SOEs and creditors is concerned stated that, SOEs in Ethiopia should safeguard the interests of creditors and care not to disrupt the structural and financial status of the enterprise against creditor`s interest.[431] And if something that will affect the priority position of the creditors happened in the enterprise, they should be informed about the situation as quick as possible.[432] Furthermore, creditors shall have the right to access information necessary to assess their risk and to manage their credit.[433] However, this right is not without restriction, and creditors shall not use such information for unjust purposes.[434]

4.2.1.2. Employees and SOEs

The major means of engagement SOE employees in its CG is the participation of labour representatives on the board. Employee representation on boards is designed to increase accountability to employees as stakeholders, to provide employees with an opportunity to discuss and negotiate alternative strategies while keeping in mind the overall financial and service obligation objectives and to facilitate communication between employees and the CEO as well as senior officers.[435] Last but not least, employee representation may also be a source of primary information for outside board members about the overall situation of the enterprise.[436] All this will enhance board performance. In this respect if we see the experience of the Slovak Republic, if the company has more than 50 employees, one third of the Supervisory Board members are elected by

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[427] *Ibid.*
[428] *Ibid.*
[429] *Ibid.*
[430] Proc. 25/1992, Art.40, see also The Commercial code of Ethiopia, Art.1166.
[431] Corporate Governance Code of Ethiopia, Art. 4.1.2.
[432] *Ibid.*
[433] *Id.* Art 4.1.6.A.
[434] *Id.*, Art 4.1.6.C.
[435] OECD country survey, p.129.
[436] OECD country survey, p.129.

the employees. [437] In Ethiopia as discussed earlier by this paper, based on article 12/2/ of Proclamation No. 25/1992 up to one-third of the members of SOE board shall be elected by the general assembly of the enterprise`s workers.

In addition to allowing the participation of employee's representatives on their board, SOEs, having a public dimension, shall strive for maintaining and improving labour conditions by devotedly adhering labour-related legislations and principles. They shall also exert their maximum effort to observe labour conditions and to stabilize employment.[438] Like that of creditors, employees shall also have access to corporate information to protect their rights.[439] Hence, the enterprise should disclose any relevant information to the employees. Particularly, the management of enterprises should regularly organize labour management consultative meetings and expound the business plans, plan implementation, quarterly production plans and performances, personnel plans, and the company's financial status to employees.[440] Again, like creditors, employees shall not use such information of the enterprise for unjust purposes.[441]

4.2.1.3. Corporate Social Responsibility(CSR) of SOEs in Ethiopia

Globally, nowadays, CSR has become a topic of major importance. However, it is understood differentially from country to country, being in a continuing process since its emergence in the 1950s.[442]Yet, despite the non-existence of common definition, CSR is understood as self-regulation of enterprises through integrating the social, environmental, and economic concerns of the people where they operate into their values and operations in a transparent and accountable manner.[443]

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[437] *Id*., p.84.
[438] *Id,* Article 4.1.3.
[439]Corporate Governance Code of Ethiopia, Art. 4.1.6.B.
[440] *Ibid.*
[441] *Id,* Art 4.1.6.C.
[442] Buturoaga Cristina Mioara, CSR of State-Owned Companies in a European Developing Country – The Case of Romania, *Journal of Organizational Management Studies,* 2016, Vol. Article ID 934180, p.2
[443]Biyan Tang, Contemporary Corporate Social Responsibility (CSR) in China: A Case Study of a Chinese Compliant, online, *Seven Pillars Institute Moral Cents* ,2012, Vol. 1 Issue 2, p.13, available at: http://sevenpillarsinstitute.org/wp-content/uploads/2012/10/Corporate-Social-Responsibility-in-China-EDITED.pdf , , last accessed:5/16/2017.

CSR has emerged from the realization of enterprises that, conducting business with the only motive of profit generation, by ignoring its impact on the society, is bound to fail in the long run.[444] In particular, maintaining CSR in enterprises will have various significant both to the enterprise itself and to the public at large. To begin with the importance of CSR from the perspective of the enterprises itself, CSR provides an important contribution in risk management, cost savings, access to capital, customer relationships, human resource management, and their ability to innovate.[445]

From the point of view of the society, CSR offers a set of values on which the country can build a more cohesive society and base the transition to a sustainable economic system.[446] In sum, the notion of CSR is generally understood as a business approach that contributes to sustainable development by delivering economic, social and environmental benefits for all stakeholders. Hence, any form of business enterprise including SOEs should strive for it and earn its blessing.

When we come to the case of Ethiopia, the concept of CSR is at its early stage of development. It is first introduced by large international companies CSR programs. But, most Ethiopian enterprises do not practice CSR.[447]Yet, there are efforts to develop CSR programs by the Ministry of Industry in collaboration with the World Bank, U.S. Agency for International Development, and others.[448] However, the government didn`t issue specific guidelines for CSR. Furthermore, there are attempts of stakeholders to develop the concept in Ethiopia. In this regard, the Ethiopian Chamber of Commerce & Sectorial Associations published a 'Model Code of Ethics for Ethiopian Businesses in early 2015.[449]

Having said this as to the general CSR landscape of Ethiopia, when we turned to CSR of SOEs, as a business entity, registered and operating in Ethiopia, like that of private enterprises, SOEs are expected to comply with the country`s CSR regime. Even more, as SOEs are enterprises ultimately owned by the general public, and aimed at public value creation, they are highly expected to promote CSR, as it is one of the values required to develop in the country`s economy. Hence,

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[444] Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises, p.39 available at: http://www.dpemou.nic.in/MOUFiles/Revised_CSR_Guidelines.pdf ,[last accessed:5/15/2017].

[445]Corporate Social Responsibility (CSR), http://ec.europa.eu/growth/industry/corporate-social-responsibility_en , [last accessed:5/17/2017]

[446] *Ibid*

[447] Ethiopia **-** Corporate Social Responsibility, January,2017, available at: https://www.export.gov/article?id=Ethiopia-Corporate-Social-Responsibility ,last accessed:5/17/2017

[448] *Ibid.*

[449] *Ibid.*

SOEs should pioneer the country`s effort of promoting CSR. Specifically, the CGC required them not to be negligent in their social responsibilities, such as consumer protection and environmental protection.[450] And, if they infringe the rights of stakeholders, they shall take appropriate and immediate corrective measures.[451] Generally, all decisions and actions of SOEs in Ethiopia must be well-suited with legitimate societal issues pertinent to its location of activities.[452]

4.3. The Concept of Competitive Neutrality: Separation of Ownership from Regulatory Functions

SOEs compete directly with private, profit-maximizing enterprises in many important markets.[453] However the issue is, states often hold a dual position of a market regulator and an owner of SOEs.[454] This dual position, may in some cases opens a possibility of favorable treatment granted to SOEs merely because of their ownership. [455] Accordingly, despite its role as regulator, the government may, in fact, restrict competition through granting SOEs various benefits not offered to private firms.[456]These advantages can take various forms including, direct subsidies, concessionary financing, state-backed guarantees, preferential regulatory treatment, exemptions from antitrust enforcement or bankruptcy rules.[457]

Such advantages are not necessarily based on better performance, superior efficiency, better technology or superior management skills but are merely government-created and can distort competition in the market.[458] However, In the international realm of SOEs, there is a concept called competitive neutrality which implies that no business entity is advantaged (or disadvantaged) solely because of its ownership.[459]

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[450] Corporate Governance Code of Ethiopia, Article 4.1.4.
[451] *Id,* Article 4.1.5.
[452] *Id,* Article, 1.2.2.8.
[453] David E.M. Sappington, J. Gregory Sidak, Competition Law for State-Owned Enterprises, *Antitrust Law Journal,*2003, Vol. 71, pp. 479-523, p.479.
[454] Alissa Amico, p.30.
[455] Capobianco, A. and H. Christiansen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options,* OECD Publishing, Paris, 2011, p.4. [hereinafter, Capobianco, A. and H. Christiansen, Competitive Neutrality and State-Owned Enterprises]
[456] The 2015 OECD Guideline.
[457] *Ibid*
[458] Capobianco, A. and H. Christiansen, Competitive Neutrality and State-Owned Enterprises
[459] *Id.*p.3

Competitive neutrality coined that a state should not use its legislative or fiscal powers to advantage its own enterprises over the private enterprises.[460] And SOEs should not get competitive advantages over their counterparts in the private sector.

Yet, it does not mean that the government should not give aid to its enterprises. State support provided to SOEs does not necessarily result in an uneven playing field between SOEs and private competitors.[461] In fact, when SOEs are responsible for both commercial and noncommercial activities, state support should be directed towards the latter. This can help SOEs avoid the competitive disadvantages that impact their commercial objectives when focusing on non-commercial ones.[462]The question is, such aids should not be arbitrary and to distort the competition environment in the market. In this regard, the European commission set outed clear standards to characterize state aids as arbitrary or not. And it mentioned three standards that a state aid should fulfil to be considered as a proper aid: (1) If the state aid addresses a market failure or other objectives of common interest;[463](2) if the state aid is well targeted and (3) the distortions of competition are sufficiently limited so that the overall balance is positive.[464]

Practically, there are often exceptions to the rule of competitive neutrality. For example, there is cross subsidization opportunities, advantages in raising capital due to the reduced bankruptcy risk, which results from protective coverage guaranteed by the government, and SOEs can often make use of an information advantage over their private competitors, which stems from close connections to political leaders.[465] This is a significant competitive advantage of SOEs over private enterprises.[466]

Turning to the concept of competitive neutrality in Ethiopia, the Ethiopian trade competition and consumer protection proclamation No. 813/2013 has a general application to any commercial activities conducted in Ethiopia without consideration of ownership.[467] Yet in some exceptional

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[460] Competitive Neutrality Policy Statement, available at: www.treasury.gov.au/documents/275/PDF/cnps.pdf [last accessed: May 18, 2017].
[461] OECD, Practices and Financing for Latin American State-Owned Enterprises, available at the OECD library.
[462] *Ibid.*
[463] Josef Drexl, et al, Economic Theory and Competition Law, edward elgar publishing limited, UK, Cheltenham, 2009, p.1. [Hereinafter, Josef Drexl].
[464] *Ibid.*
[465] *Ibid.*
[466] *Ibid.*
[467] Trade Competition and Consumer Protection proclamation,2013, *Negarit Gazzeta,* Proc.No.813,20th year, No. 28, Article, 4/1/. [hereinafter, Proc.No. 813/2013].

circumstances, the council of minister may enact a regulation that may exclude some trade activities from the ambit of the competition law. [468] However, to date, there is no such regulation enacted by the council of minister to exclude the application of the competition provisions of the proclamation over any form of business including SOEs. Therefore, theoretically speaking, all SOEs in the country are governed by this proclamation. And there is no specific legislation which entitles preferential treatment of SOEs.

However, practically, the Ethiopian government is improperly shielding its enterprises against the competition law provisions. Especially, the shielding is worse in the financial sector. For Instance, there are some preferential treatments for SOEs in the import market like from China. This went up to restricting imports through private banks.[469] Given the majority of the country`s import market is from China, prohibiting traders from using private owned commercial banks will result in a shift of customers to the state-owned bank, Commercial Bank of Ethiopia (CBE). This puts private owned commercial banks out of the competition by affecting their customer base. Moreover, saving of the grand housing program is only possible through a state-owned bank, CBE. Again, this is one form of unfavorable treatment by the state to its SOEs.[470]

Furthermore, in Ethiopia, SOEs continue to captivate a large share of new credit to the economy.[471]They may also benefit from preferential access to foreign exchange.[472] These factors constrain the private sector's ability to start new businesses and expand existing ones. [473] In this respect, the IMF has recommended Ethiopia to avoid crowding out the private sector in credit and foreign exchange markets using SOEs.**[474]** However, the government may justify its treatments towards SOEs in a domestic context, for example, to correct market failures, provide public goods, and foster economic development.[475]

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[468] Id. Article 4/2/.
[469] Professor Tilahun Teshome.
[470] Yismaw Zemene, The Need to Ensure Fair Competition in the Ethiopian Banking Business: An Appraisal of Legal Framework and Practice, The *International Journal* of *Ethiopian Legal Studies,* 2015, Vol.1, No. 1, p.66.
[471] See p.12 and p.31of the IMF Country Report No. 15/300, released 2015, available at: https://www.imf.org/external/pubs/ft/scr/2015/cr15300.pdf. [hereinafter, IMF Country Report No. 15/300].
[472] *Ibid.*
[473] *Ibid.*
[474] *Ibid.*
[475] Max Büge.

Generally, the state can facilitate incentive mechanisms for its enterprises, like finding domestic and international market, and even provide subsidies.[476] However, what the government should avoid is, it should not create a restriction on private enterprises. Hence, it should create a level playing ground.[477] Therefore, since there are indications of unjustified protection of SOEs in Ethiopia, the government should reconsider it and avoid unnecessary support as it affects the enterprises by themselves and distorts the countries journey towards market system.

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[476] Professor Tilahun Teshome.
[477] *Ibid.*

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

Direct intervention of the Government via SOEs is a global phenomenon for various rationales given by governments of different jurisdiction, commonly for social value creation and correction of market failure. Though there is variation in the volume of SOEs to operate in a certain country, all jurisdictions in the world, whatever their economic ideology is, agreed on the importance of SOEs to the social, cultural and economic prosperity of countries. However, the most crucial issue is not the importance of SOEs, rather, it is their possibility of success. Ethiopia is not an exception to this reality of the world. Hence, currently, because of the nationalization and large-scale investments of the government, SOEs became one of the major aspects of the country`s economy.

Unlike private owned enterprises, which have only the motive of profit making, SOEs have the duty of public value creation in addition to their profit generating purpose. Hence, there is a need to balance the two objectives and avoid the possible contradictions of the two objectives. Therefore, to achieve their dual objective, SOEs should adhere modern principles of CG. Hence, SOEs should be managed and owned based on clear ownership objectives, they should meet a high level of disclosure and transparency requirements, they should develop sound internal management and protect the rights of stakeholders and shareholders.

Designing a proper legal and institutional framework is the foundation of good CG. And many countries in the world designed a proper legal and institutional framework to bring good CG principles into their SOEs. However, in Ethiopia, unlike the global experience, the legal and institutional framework of CG of SOEs is in its early stage of development.

In General

- ❖ It is an internationally accepted practice of good CG that a state as an owner of SOEs should enact a clear ownership policy document that articulates its intended goals in SOEs. The state should also go further and identify specific objectives of each SOE. In Ethiopia, the general objectives of the Government to directly intervene in the economy, as reflected in different policy and strategy documents are to correct market failure and to meet the development necessities of the country. In addition, there are some indications in each enabling legislation of SOEs about their strategic objectives. However, despite the above general indications, this research concluded that Ethiopia lacks a clear and comprehensive ownership policy of the Government in SOEs. And, even the existing strategic objectives are not properly designed. Hence, they are not enough for corporate planning of enterprises.

- As far as the institutional framework of the ownership entity of SOEs is concerned, unlike the international experience which is moving to the centralization of ownership entities in to one ministry or agency, in Ethiopia, there are many supervising authorities. Particularly, due to conflicting mandates given to multiple authorities, a single SOE is being subjected to dual control and supervision. This is affecting the performance of SOEs by creating inconveniences in their operation. Hence, it is deterring them from achieving their general and strategic goals.
- The Ethiopian laws of CG of SOEs, especially the CGC, seems like uphold modern concepts of shareholder`s rights protection. However, there is still a shortfall since the supervising authority, which is established to protect the ownership rights of the government in joint investments, is mandated to decide on matters which affects the rights of other shareholders like amendment of the articles of incorporation, business transfer, and corporate disbanding and dissolution.
- With regard to protection of the rights of stakeholders, the Ethiopian CG framework recognized the importance of stakeholders in enterprise governance. Particularly, it contained the protection of the rights of creditors and allowed the participation of employees in the board. However, when we see the CSR of SOEs, though there are efforts by the side of the government and other domestic and international stakeholders to develop CSR in Ethiopia, let alone for SOEs, even for the private sector, the concept of CSR is in its early stage of development.
- Though the laws of the country, especially the CGC, contained some provisions of information disclosure, still there is a problem of information disclosure and transparency. Particularly, it is hardly possible to know about the financial conditions of SOEs in Ethiopia.
- The board, being the center of the management of SOEs, should be autonomous. In Ethiopia, despite the fact that the public enterprises proclamation No.25/1992 and the CGC of SOEs of the country framed the organizational structure of SOEs aiming at management autonomy,

the legal framework governing board nomination and appointment process favors government officials who may lack the required qualification. And, currently, there is a strong political influence on the operation of SOEs as they are structured and monitored by a board of directors composed of senior government officials. Hence, the boards of SOEs in Ethiopia doesn`t have the required management autonomy that helps to achieve their objectives.

- States by separating their ownership function from their regulatory functions, especially market regulation should create a level playing field and fair competition in the marketplace. Hence, there should not be improper treatment to SOEs merely because of their ownership. In Ethiopia, even if the trade competition and consumer protection proclamation governs all enterprises without any discrimination, practically, contrary to the international trend, the government is favoring its enterprises improperly and distorting the competition in the marketplace. Hence, this research concluded that, the existing CG landscape of Ethiopia is not designed in a way to ensure a level playing field and fair competition.
- In sum, the legal and institutional framework that shaped the CG of SOEs attempted to uphold modern Corporate Governance Principles. However, in all the principles, there are drawbacks which necessitates actions.

5.2. Recommendations

Based on the findings of this paper, the researcher would like to recommend the following;

- Initially, as there is no a comprehensive definition of SOEs in Ethiopia, the state is required to develop a comprehensive meaning and determine what constitutes a SOE in Ethiopia. This helps to avoid the complexity of characterizing an enterprise as a SOE or not. Hence clear and standard definition of SOEs should be formulated.
- Given the advantages of having a clear and comprehensive ownership policy framework of the government, to the efficiency and successful operation of SOEs, the state as an owner of enterprises should take more active role and enact a comprehensive ownership policy framework which determines the ownership functions of the state and its objectives on SOEs. Furthermore, the strategic objectives of SOEs should be regularly reviewed and adjusted as required.
- Effort should go into enhancing the autonomy of SOEs and their boards. In order to reduce the risk of political intervention in the day-to-day business of SOEs, Ethiopia should strive for the designing of a more strong and transparent board nomination and appointment procedure. Especially, the trend of appointing senior government officials and civil servants as a board member should be reconsidered. And, the board nomination and appointment procedure should provide a room for the participation of board members themselves. So that, the board composition will contain members with the necessary skill and qualification. The government to improve the efficiency and qualification of board members can establish training and certification programs for board of directors and establish institutes of board of directors.
- Although there are laws and regulations aiming at enhancing transparency and disclosure in SOEs, there is still a need to improve them, since the practice in Ethiopia lagged behind the international standard. Therefore, the researcher recommends Ethiopia to improve the level of transparency and disclosure of information in SOEs through strengthening the reporting mechanism of financial and non-financial information on the enterprise. Particularly, especial emphasis should be given to financial information as it is in its minimum. For this purpose, SOEs and supervising authorities can use web-based communications and facilitate information access by the general public.

- ❖ In relation to the right of shareholders, this study recommends the state to protect the interests of minority shareholders in joint investments where the government is a controlling shareholder. Specifically, the mandate of the supervising authority given by the CGC to decide over matters which are potential to bring fundamental change should be avoided since it will affect the interest of other shareholders. Hence, discourage investment.
- ❖ Centralization of ownership function is the order of the day for its multiple advantages. However, In Ethiopia, despite the early efforts of centralization via MoPE there are still various sector ministries in charge of controlling and supervising SOEs. Therefore, this study recommends the country to go further and centralize its supervision and control over SOEs. Hence, sectoral control should be avoided and all SOEs should be accountable to MoPE. Yet, the controlling and supervising capacity of the ministry should also be enhanced.
- ❖ With regard to the separation of ownership and regulatory functions, this research recommends the country to follow the footsteps of the world and avoid its unjustified favorable treatments of SOEs in the costs of private enterprises. To this end, the government can design or adopt a standard guideline for state subsidy and favorable treatments to SOEs. Unless, it would hardly be possible to achieve its market policy objectives as it is distorting the competition.
- ❖ As far as the protection of the rights of stakeholders especially the CSR of SOEs is concerned, though the Ethiopian government is attempting to develop the concept of CSR in both private and public enterprises, it doesn't uphold specific guidelines for its programs of maintaining CSR in Ethiopia. Therefore, the researcher recommends the country to develop specific CSR guidelines and encourage the efforts of other stakeholders.
- ❖ Adopting the OECD principles and guideline for the CG of SOEs is one of the mechanism of reforming CG of SOEs. Therefore, this study recommends the country to adopt the OECD principle and Guideline for its CG of SOEs.
- ❖ Advancing good corporate governance of SOEs is not a onetime task, rather it needs a real political commitment of the government. Therefore, the researcher recommends the Ethiopian government to focus on long-term activities of enhancing good CG at the grass root level, rather than attempting to try to build CG overnight through one time reform.
- ❖ Finally, in Ethiopia, CG of SOEs is in its early stage of development. Therefore, given CG promotion is the first step to develop good CG land scape, the author recommends the country to work on promoting the concept using various forums. This can be done through public

education campaigns and by creating informal CG promotion systems within civil society, business, and regulatory bodies.

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