



Corporate Governance of Private Limited Company in Ethiopia: Making Board of Directors Compulsory to Such Companies.

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ABSTRACT

In Ethiopia, the modern concept of corporation and principle of corporate governance is new and at its infant stage even if the commercial code that governs company in Ethiopia has enacted since 1960. The corporate governance regime of private limited company in Ethiopia has many legal and practical problems. This article devoted on the legal and practical problems associated with the Ethiopian private limited companies. In doing so the researcher employed doctrinal research approach. The corporated governance problems associated the absence of governance board to the private limited company in Ethiopia is the main apprehension that makes the researcher to carry out a study on the corporate governance of PLC in Ethiopia. The study divulge that the absence of board of directors in the governance of private limited companies in Ethiopia as a big governance problem of PLCs that the researcher has tried to address.

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Acronyms

PLCs	Private Limited Company/Companies
BoD	Board of Directors
CEO	Chief Executive Officer
OECD	Organization for Economic Cooperation and Development
Com. Code	Commercial Code of Ethiopia
CC	Civil Code
Proc	Proclamation
Art	Article
OHADA	Organisation pour l'Harmonisation en Afrique du Droit des Affaires' or Organization for the Harmonization of Business Law in Africa
ASX	Australian Security Exchange
USA	United States of America
AACCSA	Addis Ababa Chamber of Commerce and Sectoral Association
EU	European Union
NBE	National Bank of Ethiopia
WTO	World Trade Organization

Introduction

Business is an activity pursued primarily with the object of earning profit for the benefit of those on whose behalf the activity is conducted. A business enterprise may be owned by one person or a group of persons (corporations).

In corporations, owners by virtue of being shareholders, have little power to manage the corporation at least in principle. The shareholders are remote from the day to day management or governance of the company. The most common statutory bodies that are key actors in corporate governance of the company are the shareholders, board of directors, managers and auditors.

Among these corporate governance actors the board of directors are the most important and forefront and brain of the company governance. Because when we see the corporate governance practice around the globe, having a board

provides oversight, leadership and strategic vision and value to the business than a corporation simply run by a manager.

Stephen Bainbridge in his article asking "why corporate law calls for a board, rather than just a chief executive officer, to be at the apex of the corporation's management," points to behavioral psychology studies which suggest that groups, such as corporate boards, often produce better decisions than can single individuals when it comes to matters of judgment. A board often includes persons with specialized expertise or professionals who can bring valuable outsider perspectives to the table. Decision making by groups will generally be preferable to decision making by an individual autocrat (managers) when it comes to the sort of critical evaluative judgments boards are asked to make.

In Ethiopia the modern concept of corporation and principle of corporate governance is new and at its infant stage even if the commercial code that governs company in Ethiopia has enacted since 1960. The legal framework of the corporate system is principally set out by two basic codes: the 1960s Commercial Code and the Civil Code of the empire. Even though, the commercial code with subsequent legislations are there to govern the operation and or performance of company in Ethiopia, still there are so many gaps and the very updated principles of corporate governance are not included in the code and other subsequent legislations; mainly private limited companies.

In Ethiopia, We can say that better corporate governance atmosphere (or principles and rules) are legislated in companies those operate in the financial sector. The governance structure and system in financial companies is under strict supervision and control of the government; national bank of Ethiopia. The statutory governance bodies, especially the board of directors, either in the banking, insurance sectors or microfinance institutions is elected and passes through the criteria legislated by the national bank.

1.2. Statement of the problem

The corporate governance regime in Ethiopian companies as a whole is not fertile or poor when we wonder it

in light of different countries and international corporate governance rule or principles. Private limited companies corporate governance law and practices in Ethiopia is surrounding with many legal and practical problems. The absence of up to date corporate governance principles and laws in Ethiopian company law, makes private limited company poorly operated even if they contain massive part of the country's economy. Most of Ethiopian private limited companies are importers and/or not participate in the manufacturing and /or exporters due to the absence of well acquitted corporate governance law and principles that govern them. Among the many problems the following are some

- the absence of strategic corporate body/board of directors; (making private limited company to run by managers than board of directors) makes them not to be strategically, flourishing, values add to the country's economic growth like other countries
- the making of shareholders meeting base up the numbers of shareholders to the company make corporate governance regime in the private limited company incomplete
- the making of auditors, one of the statutory corporate body and element of boards of directors of private limited company in other countries, base up on the number of shareholders to the company.
- the requirement of a minimum of two numbers of shareholders for the formation of private limited companies and the dissolution of the company when the members become below two than allowing formation of the company by one man and make board of directors mandatory to the governance of the company like other countries practices. This makes most private limited companies in Ethiopia nominal shareholders and not take part/participate in the governance of the company.
- Absence of rules concerning how to manage conflict of inters problems in relation to shareholders with the company, managers with the company.

1.3. Research questions

In addressing the problems and searching the possible solutions to the legal and practical problems of governance of Ethiopian private limited company, the researcher tries to raise and address the following questions all the way through the research.

- ? Why aren't corporations run using "direct democracy i.e. to a shareholder vote"? Or why not run by "absolute corporate monarchy i.e. allowing management to make all the decisions without oversight"?
- ? What are the corporate governance characteristics of PLC? What are the causes of the problems that surround PLCs in Ethiopia?
- ? What are the driving forces for improving corporate governance practices of private limited company in Ethiopia?
- ? Is it a necessity to have board of directors system of governance to Ethiopian PLCs? Why/why not?
- ? Does having aboard centered mode of governance system avoid/ at least minimize the problematic behavior of Ethiopian PLCs?

2. Legal and Practical Problems in the Governance of PLC in Ethiopia

2.1.1. Number of Shareholders

In general, legal forms for corporations in the Ethiopia may be distinguished between those, which are limited by shares and those made up of individual partners. The companies with a personal ground depend on the individuals,

which are firmly connected with the existence of the business organization. The respective corporate forms are the general partnership and the limited partnership. Companies with a capital ground are based on a firmly stated registered capital. The typical representatives of this form of companies are the public (share) company and the limited liability company. Even if capital has a paramount importance in the formation of a company, members or the personality of shareholders play a significance role in the formation and operation of company.

Due to this fact, company law of different countries tries to determine the minimum and maximum number of shareholders. Especially they put the minimum number of shareholders as astringent precondition for the formation and operation of a company. For the formation and operation of a private limited company the minimum number of shareholders in most countries is two. However the reduction of the number of members below two does not cause for the dissolution of the company. Rather it changes its form and name and becomes a single member or one man company.

For example a limited liability company in Czech Republic may be founded by a single shareholder, either a natural person or a legal entity. However, a limited liability company with a sole shareholder cannot be a single founder or single shareholder of another limited liability company. Further, one person may become a single shareholder of a maximum of three limited liability companies. To make the corporate governance regime more efficient and effective the Czech Republic corporate law makes private limited company to be governed by three statutory bodies. In Czech Republic, a limited liability company is typically characterized by three bodies. The business activities of the company are managed by the managing director(s), who represent the company vis.vis third parties. The shareholders perform their rights in the shareholders' meeting of the company and the control authorization pertains to the supervisory board. In contrast to the joint stock company the establishment of the supervisory board is not mandatory.

Under French corporate governance law and practice, SARL is a required to be formed of at least two shareholders, created for a commercial purpose. However, a SARL may be created by, and may continue to exist with, only one shareholder. A SARL with only one shareholder is known as an enterprise unipersonnelle a `responsabilite ´ limite ´e (EURL). A EURL is considered to be a special type of SARL and is subject to the regulations applied to SARL unless specifically indicated otherwise by the law. What are required to have is directors to run the company and the reduction of shareholders below two does not cause for the dissolution of the company.

Under the Chinese 2005 company law, the law puts the maximum number of shareholders and does not determine the minimum requirement. A limited liability company established according to 2005 company law shall include the words "limited liability company" or "limited company" in its name. A limited liability company can be established by no more than 50 shareholders that make capital contributions. A private limited company in china can be run by a single individual (single person company) and the state (wholly state-owned limited liability companies). That is the reduction of the members of the private limited company below two does not cause for the dissolution of the company.

Rather, under the china company law what is put as a mandatory requirement for the formation of private limited

company, is to have certain statutory corporate body for governance of the company. The legal structures of the joint stock companies has three mandatory organs; the board of directors, the supervisory board and the general meeting. The private limited liability company is also composed of three mandatory organs: a board of directors, a supervisory board and a board of shareholders (or general meeting). In the private Limited liability company the “manager” is not mandatory for the limited liability company like joint stock company and One-person limited liability companies are not required to establish a board of shareholders (general meeting).

Whereas, a company in India can pursuant to the Companies Act of 1956 legally organize itself as private company or a public company. Whether the company is private or public, it can be organized with limited liability (by shares or by guarantee) or with unlimited liability. As to the 1956 company act of India, private limited company is a voluntary association of not less than two and not more than fifty members, whose liability is limited, the transfer of whose shares is limited to its members and who is not allowed to invite the general public to subscribe to its shares or debentures. Private Limited Companies cannot raise money from public whether as capital or as loan. A private company can be incorporated by a minimum of two (2) members whereas the maximum number of members of a private company cannot exceed fifty (50). In the Indian company act the reduction of shareholders below two does not be a good cause for the dissolution of private limited company rather it recognizes one person company.

When we see Ethiopian private limited companies, the commercial code requires a minimum of two and a maximum of fifty shareholders to the formation and operation of private limited company. Contrary to other countries corporate law, the ultimate fate of the private limited company if the shareholders reduced below two is dissolution of the company. This makes the business society in Ethiopia to search for other means/room to escape from this mandatory requirement. In collecting data from the ministry of trade, I have consult 3000(three thousands) private limited companies. Among these 90% are family base businesses with only two shareholders.

What is worse here is that the share of one of the shareholders (most are wives and children) are nominal shareholders. In the shares of the shareholders I have found that the ratio of 99 to1, 99 to3, 3998 to 2, 990 to 10, etc...of shares. These nominal shareholders are surprisingly minors and the block shareholders are parents. So one can ask the sources/shares for the capital of these minors; most probably the parents are the sources for the capital/shares of the minors. They make this so as to pass the stringent requirement of a minimum of two shareholders for the formation of private limited company.

Whereas the corporate governance practice of other countries show us that a private limited company could formed by one member/shareholder, however what is required is to have is the mandatory statutory bodies for the governance of the company i.e. directors, auditors, shareholders meeting and managers. Therefore, this is a big legal and practical problem in the corporate governance of private limited companies which encourages the kiosk mentality of Ethiopian business community.

2.1.2. Managers vs. Directors

One of the defining characteristics of modern corporations is that the separate legal personality/existence of company from its founders/owners. A company has its own legal personality implies it can be the subject of rights and liabilities. There is a formal separation of the company's management from the shareholders. Since a company is a separate legal entity, it can only make decisions and change its business through the persons authorized for that purpose who in turn are accountable to the members. The primary purpose of a corporate governance structure should always be the efficient management of the company. Therefore, in determining such corporate structure, the company's size and activity should be taken into account.

Distinguishing between ownership and control and explaining the agency factor, i.e. the owners of the company hire directors/ managers (agents) who control and manage the assets of the company is an intrinsic feature of the company and one that is central to any corporate governance model. The key actors in corporate governance are shareholders, board of directors' managers and auditors. These corporate governance bodies have their own fundamental significance in the governance of a company in which one cannot substitute the role of the other. Or it is difficult to make the role played by one governance body to be run by other body since they have their own specific and natural role as to their establishment. For example managers cannot perform the roles of a directors or shareholders at the same legal status. This is the distinct behavior of a company.

One points what we have to recall here is that the difference between directors and managers of corporate governance and corporate management. There are many fundamental differences between being a director and a manager. It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization; establish and maintain its vision, mission and values. In corporate governance principle and practices, it is the responsibility of the board of directors to provide central leadership and direction in formulating company strategy whereas managers carry through the strategy on behalf of the directors. Directors, not managers, have the ultimate responsibility for the long-term prosperity of the company while Managers are not responsible for making strategic decisions for the company and hence are only concerned with implementing the decisions made by the board of directors.

By giving due recognition of this fact different countries company law make private limited company to be run by a certain statutory body. Most of the countries around the world make private limited company to run by directors/board of directors. The countries what we have seen above (French, India and china) make their private limited company to be run by directors than managers.

Under French corporate governance practice, a SARL must have at least one director ("*gérant*"). Two directors ("*co-gérants*"), each of whom will have the right to represent the company, may also be appointed. A SARL may also be managed by a panel of directors ("*collège de gérants*"). Thus French corporate law prefers a SARL to be governed by directors than managers.

The Company Law of the People's Republic of China prescribes for a two tier board not only in joint stock companies but also for limited liability companies. The limited liability company is also composed of three mandatory organs: a board of directors, a supervisory board

and a board of shareholders (or general meeting). One difference between the limited liability company and the joint stock companies is that the “manager” is not mandatory for the limited liability company. The board of directors of limited liability companies must generally comprise 3 to 13 members whereas joint stock limited company shall set up a board of directors, which shall be composed of 5-19 persons.

However, as to the Company Law of the People’s Republic of China, limited liability companies with relatively fewer shareholders or of a relatively smaller scale may appoint an executive director instead of establishing a board of directors. An executive director may hold the post of the company manager concurrently. A limited liability company may set up a board of supervisors, which shall be composed of at least 3 persons. For a limited liability company in which there is a relatively small number of shareholders or which is relatively small in scale, it may have 1 or 2 supervisors and does not have to establish a board of supervisors.

Under the Indian company law, the shareholders own the Company but they do not manage the affairs of the Company. As per the Indian Companies Act of 1956 every Private Limited Company incorporated in India is required to have at least two Directors on Board. A private company is required to have at least two directors while a public company should have a minimum of three directors. This shows us that there is a clear separation of ownership and control in the Indian private limited company. It is the Directors who run the Company as per the provisions of Memorandum and Articles of Association. Shareholders decide who will be the Director by passing a resolution in the Annual General Meeting.

Contrary to other countries corporate governance tradition, the Ethiopian company law dictates private limited company to be run by managers than directors. These tell us that shareholders of a private limited company are by default consider as managers of the company like partnership type of businesses that partners are considered as managers by default by the mere fact of being a partner to the partnership. This is one of the basic nature or characteristics of private limited company in Ethiopia.

This makes one to raise inherent characteristic or question of separation of ownership and control of private limited company. Company is a legal person in its own right and it is separate from those who own it. There is a formal separation of the company's management (under the board of directors) from the shareholders. The latter are sometimes termed as “the owners” of the company. They share the company's profits. As they are communally unconstrained to sign up and take out directors from the board, they exercise ultimate control over management. Ordinarily, the number of shareholders, who are the owners of the company, is might be large and hence all of them or most of them cannot participate in the day-to-day management of the company.

An effective governance framework defines roles, responsibilities and an agreed distribution of power amongst shareholders, the board, management and other stakeholders. Especially in private limited companies/small business, it is important to recognize that the company is not an extension of the personal property of the owner.

However, this does not mean that the shareholders/owners of the company do not involve in the management of the company. Shareholders could be participating in the governance of the company either in director’s status, manager’s status or shareholder status. But what we have to bear in mind is that the shareholders

participate in the governance of the company not only as an owner status rather as a director or manager who run the company by taking the interest of the company and stakeholders as a central or focal point of governance.

When we see Share Company and private limited company there is a possibility that both of them could be formed with same numbers of shareholders and same capital amount. For example, both may have ten or twenty members/shareholders with five million registered capitals. However, as to the 1960 commercial code the share company is obliged to be run by directors and managers whereas the private limited company run by managers. I raise this by taking under consideration that being a director/board of directors and manger/team of managers has different legal and practical status. At this juncture, one can ask “what the rationale behind this distinction is” as far as both have same positive and negative externality respective of the business objective of the company. Thus it is a big governance lacuna for the private limited company in Ethiopia that requires consideration from the business community, the government and the government.

2.1.3. Shareholders Meeting

Mainly, there are three groups of corporate actors playing important roles in managing and monitoring a corporation; shareholders, the board and managers. Effective corporate governance requires a clear understanding of the respective roles of the board, managers and shareholders, their relationships with each other, and their relationships with others that have an interest in the corporation and its well-being. Shareholders are the real company owners because they invest their money.

One of the fundamental elements in the rights, privileges and powers of a shareholder is the power to play a part in the governance of the company. They indirectly control the company by appointing the board of directors as their representatives to supervise the company for their best interest. Shareholders clutch the ultimate right to decide imperative matters.

The shareholders’ meeting is the supreme body of any company. All major decisions that affect the rights of the shareholders and the company are to be taken in the shareholders’ meeting. The shareholders' meeting of a limited liability company may be composed of all the shareholders. Meetings of members are meetings where the members / shareholders of the company meet and discuss various matters. As mentioned earlier, all decisions, which may have a substantial impact on the structure of the company or the framework of its business, are to be taken by the shareholders’ meeting. Kinds of Company meetings in a company can be shareholders meeting, board of directors meeting and other Meetings. The corporate governance practices around the globe show us that in company that has only a sole shareholder, a shareholders’ meeting does not take place. All decisions which fall within the competence of the shareholders’ meeting are taken by the sole shareholder instead.

Shareholders meeting are most of the time annual general meeting and extraordinary general meeting. Under the Indian corporate governance law, every type of company, public or private, limited by shares or by guarantee, with or without share capital or unlimited company, are obliged to conduct shareholders’ meeting once a year. Every company must in each year hold an annual general meeting. Not more than 15 months must elapse between two annual general meetings. In

the case there is any difficulty in holding any annual general meeting (except the first annual meeting), the Registrar may, for any special reasons shown, grant an extension of time for holding the meeting by a period not exceeding 3 months provided the application for the purpose is made before the due date of the annual general meeting. As to the 1956 company act of India, Every general meeting (i.e. meeting of members of the company) other than the statutory meeting and the annual general meeting or any adjournment thereof, is an extraordinary general meeting. Such meeting is usually called by the Board of Directors for some urgent business which cannot wait to be decided till the next AGM.

The china company law contains special law on general meeting of shareholders. The shareholders general meeting of joint stock limited company and of limited liability companies is the “organ of highest authority. The shareholders' meetings are classified into regular meetings and interim meetings. The regular meetings shall be timely held in accordance with the articles of association but it must be annually. The shareholders' meetings shall be convened by the board of directors and presided over by the chairman of the board of directors. Shareholders may needed and pass resolution at a shareholders' meeting on revising the articles of association, increasing or reducing the registered capital, merger, split-up, dissolution or change of the company form.

Under the French company law the shareholders of a company generally exercise the ultimate control over its management by appointing and dismissing the Company Directors. The exercise, by the directors, of their duties is ultimately controlled by the shareholders, who have the authority to revoke the directors and are called upon to resolve on certain material decisions (such as, approval of financial statements, sale of material assets (“*fonds de commerce*”), share capital increases and reductions, etc.). The most important decisions can only be taken by the shareholders by way of general meeting.

When we come to the Ethiopian corporate governance law and practices it is difficult to say shareholders' meeting is considered as one of the formal body in the governance of private limited company. Private limited company is governed by a manager or managers and the shareholders general meeting is required by the law when the number of shareholders is more than twenty. This shows us that shareholders' meeting is conditional body of corporate governance.

Where the number of shareholders in a private limited company is not more than twenty the members to the company are not obliged to conduct general meeting even if certain decisions require the consent or vote of majority of the members such as the dismissal of managers, change of nationality of the company and amendment to the articles of association of the company. However, as we can wonder from scattered provisions of the commercial code these decisions do not required to be made at the shareholders general meeting. It can be done or taken without shareholders meeting, when the managers send to each member the text of resolutions or decisions to be taken and ask for the members' written vote thereon.

One question what we can raise here is that what is the rationale of making shareholders meeting participation in the governance of the private limited company base up on number of shareholders. Does the corporate governance law regulate the members of the company, the capital of the company or the company? We can raise the above example

that when the number of shareholders and registered capital of Share Company and private limited company is the same. At this case the share company is obliged to conduct shareholders meeting or make shareholders meeting as one of mandatory statutory body in the governance of the company while shareholders meeting is not put as a statutory body in the governance of private limited company when the number of shareholders is not more than twenty.

One might raise here another question that what is the need of shareholders meeting in case that the manager and owner of in most private limited companies of Ethiopia is one and same person since most private limited companies are family businesses. However, Share Company may be here establish with family base that the managers, board members and shareholders are same individuals but at the same time the company law and corporate governance tradition in Ethiopia make such company to be governed by managers, auditors, board of directors and shareholders' meeting. The rationale behind such corporate principle and tradition is that company is a separate legal person from its founders or owners and company contain the interests of not only insiders but also outsiders. The brain of company is these statutory governance bodies in which the company runs by these statutory bodies acting in their respective capacity i.e. either as a manager, director or shareholder.

As far as the ultimate purpose or aim of corporate governance principles is to give an assurance or guarantee for the members, stakeholders (creditors, employees, customers etc..) of the long term existence or operation of the company, making all statutory bodies i.e. shareholders, directors, managers and auditors to be functional is not a choice rather it is a necessity. Especially in a country like Ethiopia, private limited companies play a substantial role in the country's economy, making the principles of corporate governance to be functional is not a luxury rather is a necessity/compulsory.

2.1.4. Auditors

Corporate governance is the process on which organizations are managed and controlled. It recognizes the inherent conflict in objectives between owner shareholders and managers and thus establishes institutions, policies, and procedures to protect shareholders' interests. Auditing role is one of the four cornerstones of corporate governance (shareholders, managers board of directors and auditors), and the auditing function of auditors has an important role in assisting the governing organ to monitor the effectiveness of its governance. By helping the governing organ in this way, audit becomes an essential element of the corporate governance process.

As internal auditors are part of the internal control system, one of their important roles is to give assurance on the risk management systems objectively to the management of the organization. Internal audit's relationship with board of directors (or audit committees) is considered to be of fundamental importance to achieve sound corporate governance. Under the Indian company act every company is obliged, at each annual general meeting; to appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting. The company act obliges all companies to have auditors is not base up on either the number of shareholders or capital and income or profit of the companies. Rather as far as the private limited companies are already incorporated are required to appoint auditors.

Where at an annual general meeting the shareholders fail to appoint or re-appoint auditors the Central Government may appoint a person to fill the vacancy. The auditors have same right of getting any information as shareholders any member of the company is entitled to have. That is all notices of, and other communications relating to, any general meeting of a company which any member of the company is entitled to have sent to him shall also be forwarded to the auditor of the company; and the auditor shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part of the business which concerns him as auditor.

In France, whether a company has to have an external auditor depends on the legal form of the enterprise and its size. Enterprises with the legal form SA (*Société Anonyme*), SCA (*Société en Commandite par Actions*) and SAS (*Société par Actions Simplifiée*) must have a statutory auditor, regardless of their size. Enterprises with the legal form SARL (*Société à Responsabilité Limitée*) only need a statutory audit if their numbers (during the two preceding years) are higher than a total balance sheet of 1.55 million Euros, a turnover of 3.1 million Euros. All these enterprise forms can be private or public companies. In France a SARL must appoint an auditor if it exceeds, at the close of a financial year, two of the three following thresholds: €1.550.000 of total assets, €3.100.000 of turnover, 50 employees.

Under the China corporate governance law, all companies are required to prepare financial accounting reports at the end of each accounting year, which shall be audited by an accounting firm. The requirement of auditors and auditing in China is not based on the number of shareholders as Ethiopian commercial code or the capital or assets of the company as French SARL. What is more here, the China company law states companies to be audited by an auditing firm. The Chinese company law prefers company finance to be audited by an accounting firm than to appoint internal auditor like other countries such as French and India and even Ethiopia (when the number of shareholders is more than 20).

When we come to the Ethiopian commercial code, private limited companies in Ethiopia are not obliged to have auditors unless the numbers of shareholders is not more than twenty. In Ethiopia, even if many of the large firms are incorporated as private limited companies they are not legally required to publish their financial statements. As clearly stipulated under article 538 of the commercial code, where a private limited company consists of more than twenty members, not less than three auditors shall be appointed in the memorandum of association. Auditors may be re-elected at such periods and under such conditions as may be provided in the articles of association. Auditors may be dismissed as provided in the articles of association.

The requirement of having auditors for private limited companies based up on the number of shareholders makes Ethiopian private limited company odd from other countries corporate governance law and practice. In company, we are auditing not the members rather the capital or asset of the company. If so, it is not clear why having auditors is based on the number of shareholders of private limited company law in Ethiopia. A private limited company may run a huge capital for that matter may be greater than Share Company even if the number of shareholders is less than twenty. Or there might be a situation in which the number of shareholders and capital of a share company and private limited company be the same.

Nevertheless, the company law makes share companies to have auditors while private limited companies are not obliged to have. Thus, it is illogical to make private limited companies to have auditors based on the number of shareholders. It seems that making private limited company to have auditor based on the numbers of shareholders is that such companies are considered as family business in Ethiopia and so as to make a private limited company not to govern by a board since auditors are taken as one of the committees of board of directors in the corporate governance principle. That is to avoid bureaucratic governance system of private limited companies/family business even if it is castrate when we see it in light of the concept of corporations.

2.1.5. Conflict of Interest

Conflict of interest (or Agency problem) between shareholders and managers are arising from the separation of ownership and control. There can also be conflicts of interests between controlling shareholders (such as family owners) and minority shareholders.

Even though, this is a feature of publicly owned corporations where share ownership is dispersed among a large number of shareholders who do not directly manage the company, it also happens in closely held/ private limited companies. The very cause for the rising of conflict of interest is separation of ownership and control or separate legal existence/personality of companies from its creators/owners. The primary reason for corporate governance is the separation of ownership and control and the agency problem it engenders.

The manifestations of conflict of interest are excess managerial compensation, excess managerial perks, empire building, pet projects (free cash flow problem), slacking, misuse of corporate resources etc.

In the Ethiopian private limited company, the problem of conflict of interest or agency problem mainly arises when the shareholders appoint non-member manager. The commercial code under article 526 allows private limited company shareholders to appoint non-member managers.

During this time the problem of conflict of interest may arise. The code does not put a mechanism about how to solve conflict of interest between the managers vs. shareholders, managers vs. the company and managers vs. other stakeholders except ordering managers to perform their duties within the limits of the objects of the company with due care and diligence. Except these, there is no legal provision in the commercial code dealing on private limited company about the issue of conflict of interest unless one can consult other laws by following principles interpretation of law.

Plus to this the commercial code does say nothing about a conflict of interest between shareholders/members and the private limited company while the code clearly addresses such issue in case of share companies.

2.2. The Necessity of Having Board of Directors to Ethiopia Private Limited Companies

Corporate governance is often, and wrongly, regarded as the exclusive domain of large corporations with shares that are traded in stock exchanges or public subscription. Perhaps this is because the data of those corporations are public and available for scrutiny by investors, academics and other stakeholders. However, the need for better governance is even more important for smaller, non listed family businesses.

Public companies are as visible as the tip of an iceberg, but below the waterline we find a much larger number of companies, mostly family-controlled and private limited

companies in Ethiopia. Corporate governance has through these days received considerable attention, but most of the attention has been given to boards and governance in large publicly held companies. However, most companies are small and medium sized, have concentrated ownership and in most cases they can also be characterized as family businesses.

Distinguishing between ownership and control and explaining the agency factor, i.e. the owners of the company hire directors/ managers (agents) who control and manage the assets of the company is an intrinsic feature of the company and one that is central to any corporate governance model. The key actors in corporate governance are shareholders, board of directors' managers and auditors. These corporate governance bodies have their own fundamental significance in the governance of a company in which one cannot substitute the role of the other. Or it is difficult to make the role played by one governance body to be run by other body since they have their own specific and natural role as to their establishment. For example managers cannot perform the roles of a directors or shareholders at the same legal status. This is the distinct behavior of a company.

One points what we have to recall here is that the difference between directors and managers of corporate governance and corporate management. There are many fundamental differences between being a director and a manager. It is the board of directors who must provide the intrinsic leadership and direction at the top of the organization; establish and maintain its vision, mission and values. In corporate governance principle and practices, it is the responsibility of the board of directors to provide central leadership and direction in formulating company strategy whereas managers carry through the strategy on behalf of the directors. Directors, not managers, have the ultimate responsibility for the long-term prosperity of the company while Managers are not responsible for making strategic decisions for the company and hence are only concerned with implementing the decisions made by the board of directors.

By giving due recognition of this fact different countries company law make private limited company to be run by a certain statutory body. Most of the countries around the world make private limited company to run by directors/board of directors. The countries what we have seen above (French, India and china) make their private limited company to be run by directors than managers.

Contrary to other countries corporate governance tradition, the Ethiopian company law dictates private limited company to be run by managers than directors. These tell us that *shareholders of a private limited company are by default consider as managers of the company like partnership type of businesses that partners are considered as managers by default by the mere fact of being a partner to the partnership.* This is one of the basic nature or characteristics of private limited company in Ethiopia.

This makes one to raise inherent characteristic or question of separation of ownership and control of private limited company. Company is a legal person in its own right and it is separate from those who own it. There is a formal separation of the company's management (under the board of directors) from the shareholders. The latter are sometimes termed as "the owners" of the company. They share the company's profits. As they are communally unconstrained to sign up and take out directors from the board, they exercise ultimate control over management. Ordinarily, the number of shareholders, who are the owners of the company, is might be

large and hence all of them or most of them cannot participate in the day-to-day management of the company.

An effective governance framework defines roles, responsibilities and an agreed distribution of power amongst shareholders, the board, management and other stakeholders. Especially in private limited companies/small business, it is important to recognize that the company is not an extension of the personal property of the owner.

However, this does not mean that the shareholders/owners of the company do not involve in the management of the company. Shareholders could be participate in the governance of the company either in directs status, managers status or shareholder status. But what we have to bear in mind is that the shareholders participate in the corporate governance of the company not as an owner status rather as a director or manager who run the company by taking the interest of the company and stakeholders as a central or focal point of governance.

When we see Share Company and private limited company there is a possibility that both of them could be formed same numbers of shareholders and same capital amount. For example, both may have ten or twenty members/shareholders with five million registered capitals. However, as to the 1960 commercial code the share company is obliged to be run by directors and managers whereas the private limited company run by managers. I raise this by taking under consideration that being a director/board of directors and manger/team of managers has different legal and practical status. At this juncture, one can ask "what the rationale behind this distinction is" as far as both have same positive and negative externality respective of the business objective of the company.

On top of this, when I amassed the data from the ministry of trade almost all of the private limited companies are run or managed by a single manager not by team of managers. The manager is in most private limited company is the husband/father of the wife and children respectively. This makes private limited company more complex and difficult to differentiate separation of ownership and control in Ethiopia. Corporate governance goes beyond the protection of shareholders. Corporate governance of Private limited companies should also aim to protect the interest of other stakeholders, such as employees, suppliers and creditors and the society as a whole.

In Ethiopia, most private limited companies are owned and controlled by two individuals or by a family. In many cases, owners continue to play a significant direct role in management. Good governance in this context is not a question of protecting the interests of absentee shareholders. Rather, it is concerned with establishing a framework of company processes and attitudes that add value to the business and help ensure its long-term continuity and success. In many private limited companies, the distinction between the members of the governance tripod of board, management, and shareholders may often unclear. An owner-manager may fulfil all or several of these roles. Nonetheless, it is important to be acquainted with the unique role that the board plays in the leadership of the company. It has overall responsibility for the company's activities.

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. In Ethiopia, Private limited companies have increased in size and complexity and they require more complex organizational

structures and a more diverse workforce possessing various levels and areas of expertise. Private limited companies are of particular importance in country (Ethiopia) with less developed capital markets. Therefore, it is necessary to put a clear legal framework concerning the governance of private limited companies and making private limited company to be run by board is not a choice rather it is a necessity.

Good corporate governance for private limited companies is not concerned primarily with having a board of directors and the relationship between a company's board of directors and the company's shareholders (as with public/share companies) rather it is more about establishing a framework of company processes and attitudes that will add value to the business and the national economy, help build its reputation and ensure its long-term continuity and success.

Good governance can play a crucial role in gaining the respect of key external stakeholders such as actual and potential financiers, employees, customers, and local communities. Good governance effectively provides a license to operate, since it offers external stakeholders assurance that the company is being run in an appropriate and responsible manner, with due regard for the interests of non-insiders. Even if the private limited company is not breaking any formal laws, it may be operationally affected by the negative perception of employees, consumers and other stakeholders. The implementation of a robust governance framework is the main means by which such significant reputational risks can be mitigated.

The fact that international companies, attracted by the promise of fast-growing emerging and transition markets, are increasingly pursuing growth in these markets, makes improved corporate governance of non-listed/private limited companies a priority. A corporate governance framework must allow companies to ideally match their legal status with their organizational needs, giving them the opportunity to grow and develop in the context of a highly competitive business environment.

Thus, to achieve these, implementing a full-bodied governance framework; having board of directors than managers is at the stage of necessity than a choice to Ethiopian private limited companies.

Today these companies, even if cover majority of the countries business enterprise (companies), (97%), the majority are not that much at the status of value adding to the economic development of the country. Because they are participating or conducting a business of importing; not manufacturing and/or exporting and in the history of development of mankind there is no country that develop base on import base economy. At this time, having Export lead or base economy and competing in the international trade is the fashion of economic development of the globe. To achieve these, making private limited companies to be run by strategic and professional leaders than an individual manager is very significant in the market economy. The strategic and professional leaders as to the principle of corporate governance are boards of directors not managers.

Board of directors play a significant role in the governance of PLC mainly adding value for shareholders' interest,(as there is often no ready market for shares in private/ and shareholders are therefore committed to staying with the company for the medium to long term, which increases their dependence on good governance), balancing the interests of founder families in family companies with the

success of the company and Promoting the long-term success of the company and attracting external investment.

One may think that a board of directors is reserved for large corporations with shareholder investments to oversee and strategic decisions to be made. The truth is that many small businesses can benefit from a board of directors. Not all small businesses have the skills they need to operate effectively especially if they've experienced rapid growth. A board of directors can help by adding to and complementing skills and industry expertise that you might not have in-house. A board can also help ensure you have the right processes in place to manage growth, focus your strategy, and prepare to raise capital.

Therefore, it is important to formulate the most modern corporate governance rules to the private limited companies in Ethiopia particularly making BoD compulsory to the governance of such companies. Making private limited companies to have a governance board that should have an appropriate mix of skills and experience without being too large ,which may render it difficult to manage and therefore less effective, is very vital to make PLC effective and value add to the country's growth.

Currently around the globe, since private limited companies are regarded as the backbone of a robust economy, policymakers have become more and more aware that neglecting the governance needs of these companies will stunt productivity, growth and job creation. The rapid pace of technological change and the decreasing international barriers to trade have not only created new strategic and organizational opportunities for companies, but have also made them more vulnerable to risks. Hence, in order to help private limited companies fully exploit the new opportunities and adjust more easily to immediate uncertainty, policymakers should endeavor to devise the most efficient corporate governance framework as part of their long-term strategy to foster investment, innovation and entrepreneurship.

Although corporate governance reforms in Ethiopia is generally badly chosen for private limited company, a shift in focus from share companies(primarily financial share companies) to private limited companies is arguably important in Ethiopia's emerging and transition economy, where most of the firms are PLC and ownership and control are typically not completely severed. Thus to make private limited companies in Ethiopia to run by board of directors is a cream of the crop thinking of what the present and future business environment seems.

Plus to this the presence of board of directors is very important to avoid the problem of conflict of interest or agency problem. The manifestations of agency problems or conflict of interest are excess managerial compensation, excess managerial perks, empire building, pet projects (free cash flow problem), slacking, and misuse of corporate resources. Even if, conflict of interest is a feature of publicly owned companies, where share ownership is dispersed among a large number of shareholders who do not directly manage the company, it also happens in private limited companies. Because, the very cause for the rising of conflict of interest is separation of ownership and control (separate legal existence/personality of companies from its creators/owners). The primary reason for corporate governance is the separation of ownership and control and the agency problem it engenders. The agency problem in the governance of private limited companies mainly arises when the shareholders

appoint external or a non shareholder manager. So base on the corporate governance principle, the conflict of interest or agency problem is avoided by having a board of directors for the governance of the company. Therefore, having board directors (or making private limited companies to run by a governance board) to the private limited

On top of this, the corporate governance practices of Ethiopian private limited companies tell us that as there are certain companies which are governed by board of directors. In collecting data for the study I have found the following companies run by a governing board. For example, the MIDROC Ethiopia company website tells us that as there are certain groups of MIDROC company group that could be governed by board of directors. All of the MIDROC companies, which plus to the website the data from the ministry of trade shows that total about 84 are private limited companies.

The website states that

“The MIDROC Ethiopia Investment Group is organized with various modalities of management. One set of companies are organized under MIDROC Ethiopia Technology Group, Chief Executive Officer. The other set of companies are organized as totally independent entities, some having Boards of Directors, where as a group have a Consultative Body represented by the Top Management of each of these companies. The Head Office of the MIDROC Ethiopia Investment Group serves also as the secretariat of this Consultative Body.....”

Andnet international plc is another private limited company that runs with a governance board of directors. The board of directors of Andnet international private limited company consists of five members. As I have found from the data and interview what I have conducted from documents and the company manager the main role of the governance board is supervision of the day to day activities of the company manager, designing strategic plans of the company, approve the finance of the company and etc.

Different private limited companies in Ethiopia have advisory boards. This comes from the very problem of Ethiopian investors; having the money but not the knowledge about how to run and utilize it. They have the money but not the knowledge. Most of the owners of Ethiopian business entities do not have the appropriate knowledge about how to run their business professionally. That is why they are obliged to have advisory boards.

When company behavior does not fulfill the expectations of society, the company may suffer significant consequences. Even if the firm is not breaking any formal laws, it may be operationally affected by the negative perception of employees and consumers. The implementation of a robust governance framework is the main means by which such significant reputational risks can be mitigated.

One can wonder here is that these companies are even become elite minded than the policy makers about the importance or role of board of directors in the governance of private limited companies. It is a wakeup call for the Ethiopian policy makers about the necessity of having/ making compulsory board of directors in the governance of private limited company. Thus it is necessary to formulate a rule that could encourage shareholders (the business community) of private limited companies to make companies run by board of directors than only a manager or team of managers for the long term success of companies and development of the country's economy.

Conclusion and Recommendations

Conclusion

The 1960 Commercial Code of Ethiopia incorporates provisions pertinent to the governance of private limited companies. However, such provisions are inadequate/ too little to address specific issues in corporate governance related to board of directors, shareholders meeting, auditors and the mandatory requirement of two shareholders for the formation of private limited companies.

This study has examined the law pertinent to the governance of private limited companies in Ethiopia with specific reference to the necessity of board of directors to such companies, shareholders meeting and appointment of auditors' base on the number of shareholders, the issue of conflict of interest and the mandatory requirement of two shareholders for the formation and existence of private limited companies.

In conducting the study the writer has discovered the following corporate governance tribulations of private limited company. The first corporate governance problem is the absence of board of directors in the governance of PLC. Contrary to other countries corporate governance tradition, the Ethiopian company law makes private limited company to be run by managers than directors. Different countries company laws make private limited company to be run by a certain statutory body. Most of the countries around the world make private limited company to run by directors/board of directors. Countries make their private limited company to be run by directors than managers. Because it is the board of directors who must provide the intrinsic leadership and direction at the top of the organization; establish and maintain its vision, mission and values whereas managers carry through the strategy on behalf of the directors.

The other point that takes my attention is the two person minimum requirement for the formation of private limited company. Even if capital has a paramount importance in the formation of a company, members or the personality of shareholders play a significance role in the formation and operation of company. That is why company law of different countries tries to determine the minimum and maximum number of shareholders for the formation and operation of private limited company.

For the formation and operation of a private limited company the minimum number of shareholders in most countries is two. However the reduction of the number of members below two does not cause for the dissolution of the company. Rather it changes its form and name and becomes a single member or one man company. What they put as a compulsory element is that the single member company must have board of directors.

In Ethiopia, contrary to other countries corporate law, the ultimate fate of the private limited company if the shareholders reduced below two is dissolution of the company. This makes the business society in Ethiopia to search for other means/room to escape from this mandatory requirement. Among the private limited companies 90% are family base businesses with only two shareholders in which one of the shareholders are nominal shareholders.

Whereas the corporate governance practice of other countries show us that a private limited company could formed by one member/shareholder, however what is required is to have is the mandatory statutory bodies for the governance of the company i.e. directors, auditors, shareholders meeting and managers. Therefore, this is a big

legal and practical problem in the corporate governance of private limited companies which encourages the kiosk mentality of Ethiopian business community.

The focal tribulation in the governance of private limited company is the making of the other governing body (shareholders meeting) base on the number of shareholders of the company. Contrary to the corporate governance law and tradition of other countries, the Ethiopian commercial code makes shareholders meeting conditional (conditional corporate governance body) i.e. no shareholders meeting is necessary unless the members to the company are not more than twenty. In the Ethiopian corporate governance law and practices it is difficult to say shareholders' meeting is considered as one of the formal body in the governance of private limited company. So this again makes one to raise the question "does the corporate governance law regulate the members of the company, the capital of the company or the company"?

Recommendations

In Ethiopia private limited companies cover 97% of the country's private type business and plays significant role in the country's economy that it runs massive part of the economy. However, the provisions of the 1960 Commercial Code governing PLC are incomplete and sketchy. Private limited companies experience many legal and practical corporate governance problems.

To begin with, the gigantic corporate governance problem is the absence of board of directors. Ethiopian company law/ commercial code prefer PLC to run by managers only. Thus the researcher recommends governance board of directors to be compulsory to such companies because;

Firstly, the key actors in corporate governance are shareholders, board of directors' managers and auditors. These corporate governance bodies have their own fundamental significance in the governance of a company in which one cannot substitute the role of the other. Or it is difficult to make the role played by one governance body to be run by other body since they have their own specific and natural role as to their establishment. For example managers cannot perform the roles of a directors or shareholders at the same legal status. This is the distinct behaviour of a company. However, in private limited companies, the distinction between the members of the governance tripod of board, management, and shareholders might be unclear since the members are small in number. An owner-manager may fulfill all or several of these roles. Nonetheless, it is important to recognize the unique role that the board plays in the leadership of the company. It has overall responsibility for the company's activities. At an early stage of a company's development, it may be appropriate to operate many aspects of the board's activities in a relatively informal and non-bureaucratic manner.

Secondly, one great advantage of company form of business organization is the separation of ownership and control. Attributable to this, the governance of the company can be left to a group of professionals (boards of directors and managers) who, with their competence, specialized knowledge or skills, qualifications of training, can bring better corporate performance and success. An effective governance framework defines roles, responsibilities and an agreed distribution of power amongst shareholders, the board, management and other stakeholders. Especially in private limited companies/small business, it is important to recognize

that the company is not an extension of the personal property of the owner. The overall performance of a company and the profitability of the business are highly affected by the corporate governance bodies. To achieve the targeted rates of growth and expansion of a company, competent and professional governance bodies of the company is as much important as the accessibility of adequate finance.

Thirdly, corporate governance goes beyond the protection of shareholders. Corporate governance of Private limited companies should also aim to protect the interest of other stakeholders, such as employees, suppliers and creditors and the society as a whole. In Ethiopia, most private limited companies are owned and controlled by two individuals or by a family i.e. owners continue to play a significant direct role in management. In this context, good governance is not a question of protecting the interests of absentee shareholders. Rather, it is concerned with establishing a framework of company processes and attitudes that add value to the business and help ensure its long-term continuity and success. Thus it is important to be acquainted with the unique role that the board plays in the leadership of the company.

Fourthly, in Ethiopia, Private limited companies have increased in size and complexity and they require more complex organizational structures and a more diverse workforce possessing various levels and areas of expertise. Private limited companies are of particular importance in country (Ethiopia) with less developed capital markets. Therefore, it is necessary to put a clear legal framework concerning the governance of private limited companies and making private limited company to be run by board is not a choice rather it is a necessity.

Fifthly, The fact that international companies, attracted by the promise of fast-growing emerging and transition markets, are increasingly pursuing growth in these markets, makes improved corporate governance of non-listed/private limited companies a priority. A corporate governance framework must allow companies to ideally match their legal status with their organizational needs, giving them the opportunity to grow and develop in the context of a highly competitive business environment. Hence, in order to help private limited companies fully exploit the new opportunities and adjust more easily to immediate uncertainty, Ethiopian policymakers should endeavor to devise the most efficient corporate governance framework as part of their long-term strategy to foster investment, innovation and entrepreneurship. Thus, to achieve these, implementing a full-bodied governance framework; having board of directors than managers is at the stage of necessity than a choice to Ethiopian private limited companies.

Plus to this, in Ethiopia, the majority of the private limited companies are participating or conducting a business of importing; not manufacturing and/or exporting. In the history of development of mankind there is no country that develop base on import base economy. At the present time, having export lead or base economy and competing in the international trade is the fashion of economic development of the globe. To achieve these, making private limited companies to be run by strategic and professional leaders than an individual manager is very significant in the market economy. The strategic and professional leaders as to the principle of corporate governance are boards of directors not managers. Thus making PLC to run by a governing board is at the tip of necessity.

Sixthly, the corporate governance practices of Ethiopian private limited companies tell us that as there are certain companies which are governed by board of directors. These companies are even become elite minded than the policy makers about the importance or role of board of directors in the governance of private limited companies. It is a wakeup call for the Ethiopian policy makers about the necessity of having/ making compulsory board of directors in the governance of private limited company. Thus it is necessary to formulate a rule that could encourage shareholders (the business community) of private limited companies to make companies run by board of directors than only a manager or team of managers for the long term success of companies and development of the country's economy.

Different private limited companies in Ethiopia have advisory boards. This comes from the very problem of Ethiopian investors; having the money but not the knowledge about how to run and utilize it. Most of the owners of Ethiopian business entities do not have the appropriate knowledge about how to run their business professionally. That is why they are obliged to have advisory boards.

Seventhly, Conflict of interest (or Agency problem) between shareholders and managers are arising from the separation of ownership and control. Even if, conflict of interest is a feature of publicly owned companies, where share ownership is dispersed among a large number of shareholders who do not directly manage the company, it also happens in private limited companies. Because, the very cause for the rising of conflict of interest is separation of ownership and control (separate legal existence/personality of companies from its creators/owners).

In the Ethiopian private limited company, the problem of conflict of interest or agency problem mainly arises when the shareholders appoint non-member manager. During this time the problem of conflict of interest may arise. The code does not put a mechanism about how to solve conflict of interest between the managers vs. shareholders, managers vs. the company and managers vs. other stakeholders except ordering managers to perform their duties within the limits of the objects of the company with due care and diligence under article 528 and 531.

The commercial code does say nothing about a conflict of interest between shareholders/members and the private limited company while the code clearly addresses such issue in case of share companies. The presence of board of directors is very important to avoid the problem of conflict of interest or agency problem. Base on the corporate governance principle, the conflict of interest or agency problem is avoided by having a board of directors for the governance of the company. Therefore, having board directors (or making private limited companies to run by a governance board) to the private limited companies could avoid the problem of conflict of interest.

Therefore, it is important to formulate the contemporary corporate governance rules to the private limited companies in Ethiopia particularly making board of directors compulsory to the governance of such companies. Making private limited companies to have a governance board that should have an appropriate mix of skills and experience without being too large ,which may render it difficult to manage and therefore less effective, is very vital to make PLC effective and value add to the country's growth. For that matter, at an early stage of a company's development, it may be appropriate to make PLC to have a board of directors in a relatively informal and

non- bureaucratic manner. However, when the private limited companies become more complex and large the legislative organ or any other concerned body shall make them to run by a governance board. The complexity and largeness of the private limited company can be calculated either base on the capital threshold, numbers of employees or the type of activity that the company operates.

To sum up, it is necessary to adopt the latest corporate governance principles and create fertile ground to the Ethiopian private limited company law so as to make them more fruitful and play a significant role in the country's development.

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