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MASTERS OF BUSINESS LAW (LL.M)
COLLEGE OF LAW AND GOVERNANCE STUDIES, SCHOOL OF LAW
ADDIS ABABA UNIVERSITY

***The Regulation of Business Unit Divestiture under
the Ethiopian Commercial Code***

Binyame Nibret Tiruneh

January 2025

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Commercial Code***

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Advisor

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A thesis Submitted to Addis Ababa University, College of Law and Governance studies, School of Law, in partial fulfillment of LL.M degree in Business Law

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APPROVAL SHEET

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Examiners

January, 2025

DECLARATION

I declare that the thesis is my original work and has not been presented for a degree in any other University. All sources of materials used in the thesis have been duly acknowledged.

Declared by
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Addis Ababa University
(January 2025)

Dedication

This thesis is dedicated to my late mother, Birhan G/kiros, whose unwavering love and dreams for my success were a constant source of inspiration, even though she could not witness its completion. Her memory continues to guide me every day.

It is also dedicated to my father, Nibret Tiruneh, whose steadfast belief that "knowledge is power" has been my guiding principle since childhood. His encouragement, wisdom, and support have been invaluable throughout my journey.

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Abstract

Divestiture is a widely practiced and strategically significant form of corporate restructuring, involving the divestment, sale, disposal, or transfer of assets, facilities, product lines, subsidiaries, divisions, or business units. Companies adopt different forms of divestiture—such as sell-offs, spin-offs, and carve-outs—to optimize resource allocation, enhance financial performance, and strengthen their market positioning by shedding non-core or underperforming assets. Despite its prominence globally, the legal recognition and regulation of divestiture as a corporate restructuring strategy remain unclear in Ethiopia. This thesis investigates the adequacy of Ethiopia’s legal framework in governing business unit divestitures. Through a qualitative/doctrinal approach, it critically examines the provisions of the Ethiopian Commercial Code on mergers and divisions, alongside other relevant sectorial legislations, to assess whether such provisions sufficiently address the concept and complexities of divestiture. The findings highlight a significant regulatory gap in the division section of the Commercial Code. The provisions, as currently existing, fail to align with the unique nature of divestiture and are inadequate to comprehensively address its legal and procedural requirements. As a result, Ethiopia’s legal framework on divestiture remains insufficient, posing challenges to businesses seeking to utilize this strategy. The thesis concludes by recommending amendments to the Commercial Code to include a distinct and comprehensive framework for regulating divestiture. These amendments should, however, align with global best practices to ensure effective governance of divestiture and support Ethiopia’s evolving business landscape.

ACRONYMS

IPO	Initial Public Offering
LBO	Leverage Buyouts
M&A	Merger and Acquisition
MBO	Management Buyouts
PE	Private Equity
RCC	Revised Commercial Code
OCC	Old Commercial Code

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CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

The dynamic evolution of the global economy has sparked intense competition among traders. Emerging market prospects, foreign direct investment opportunities and incentives, privatization initiatives, innovative business models, technological advancements, diversification, and other influential factors drive traders to compete vigorously in the marketplace. Consequently, some traders strategically pursue transactions to expand their market share and flourish in a competitive market, while others implement such strategies to prevent market obsolescence amidst ongoing modernization and fierce (aggressive) competition from all corners of globe.

In the current competitive market landscape, organizations frequently encounter the necessity of corporate restructuring to bolster their competitiveness. Corporate restructuring involves modifying the organizational, operational, financial, and legal frameworks of an organization to address market challenges, enhance efficiency, maximize shareholder value, and improve overall productivity.¹ Corporate restructuring can be carried out either internally or externally. Internal restructuring occurs when a company restructures its operations, management, or process without the participation of third parties. On the other hand, external restructuring involves asset, capital, or financial changes in resources and ownership.² External restructuring is usually carried out through strategies like M&A, divestitures, equity carve-outs, spin-offs, split-offs, exchange offer, and split-ups.

The origin of M&A can be traced back to the United States. The practice began to develop in the late 19th century.³ During those days, corporations were involved in significant expansions, usually through the acquisition of other enterprises as a strategy to increase their market capitalization. This period of expansion came to an unexpected halt subsequent to modifications in tax regulations and other regulatory actions, along with a downturn in the equity market. Since this impediment resulted in weak economic demand, companies were compelled to turn themselves into divesting and selling-off their divisions in order to generate cash and re-focus to their core business.⁴ Consequently, divestiture strategies became the most favored means to raise urgently required capital and reduce operating concerns, like reducing difficulty in managing multiple businesses acquired through M&A during earlier diversification strategy, and reducing

¹ Muazu Adeiza Umar, "Corporate Restructuring: A Strategy for Improving Organizational Performance" (2023) 14 International Journal of Strategic Decision Sciences 1, p. 3

² Ibid p. 4

³ Gaughan PA, Mergers, Acquisitions, and Corporate Restructurings: Gaughan/mergers (John Wiley & Sons, Inc 2018), p. 41

⁴ Ibid, p. 393

the challenges in allocating resources effectively across multiple divisions of the company.⁵ Furthermore, diversification is becoming no longer fashionable in recent years, and companies that once produced everything from small tools to large machinery have now engaged in divesting many businesses in which they do not have a competitive advantage.⁶ However, this does not mean that M&A are old fashioned and divestitures are the new ones. One should understand that the reason behind M&A is mostly expansion and in the case of divestiture it is contraction. Also, it should be understood that there is a reverse relation between divestiture and acquisition. When a company sells-off its division, it is contracting, and on the other hand, the company buying the divested unit acquires it, thereby expanding the contours of its business through acquisition.

Divestiture is defined as “the parent company’s disposal and sale of assets, facilities, product lines, subsidiaries, divisions and business units.”⁷ Therefore, divestiture involves the separation or divestment of a large asset, segment, or business unit from the parent company and transferring it through different modes of corporate restructuring. Divestiture takes various forms. The most common forms of divestiture are: spin-offs, sell-offs and equity carve-outs.⁸ In a spin-off, the spun-off entity will be independently incorporated and new shares will be issued and distributed to the shareholders of the parent organization on a *pro rata* basis. As a result of proportional allotment of shares, the share structure in the spun-off entity is the same as the parent organization.⁹ Conversely, a sell-off involves selling a business unit to a buyer in exchange for cash and transferring the full ownership of the unit to the buyer. After the completion of this transaction, the parent organization will have no further ties to the divested unit.¹⁰ In an equity carve-out, the division must be incorporated first as a separate company and then sells its shares through an IPO, while the parent company maintains its control over the newly created company.¹¹

In Ethiopia, the current economic liberalization, coupled with the national and international competitiveness, signals a significant shift in its approach to foreign investment, paving the way

⁵ Richard J Schmidt, *The Divestiture Option: A Guide for Financial and Corporate Planning Executives* (Praeger 1990), P. 4.

⁶ Chandrashekar Krishnamurti and SR Vishwanath, *Mergers, Acquisitions and Corporate Restructuring* (SAGE Publications India 2008), p. 275

⁷ Caterina Moschieri and Johanna Mair, “Research on Corporate Divestitures: A Synthesis” (2008) 14 *Journal of Management & Organization* 399, p. 2.

⁸ See Kalin D Kolev, “To Divest or Not to Divest: A Meta-Analysis of the Antecedents of Corporate Divestitures” (2015) 27 *British Journal of Management*; Eric A Powers, “Spinoffs, Selloffs and Equity Carveouts: An Analysis of Divestiture Method Choice” [2001] SSRN Electronic Journal; Caterina Moschieri and Johanna Mair, “Research on Corporate Divestitures: A Synthesis” (2008) 14 *Journal of Management & Organization* 399; and Myron B Slovin, Marie E Sushka and Steven R Ferraro, “A Comparison of the Information Conveyed by Equity Carve-Outs, Spin-Offs, and Asset Sell-Offs” (1995) 37 *Journal of Financial Economics* 89.

⁹ *Supra* note 3, p. 390.

¹⁰ Jan-Hendrik Sewing, *Corporate Divestiture Management: Organizational Techniques for Proactive Divestiture Decision-Making* (Springer Science & Business Media 2010), p. 16.

¹¹ Kimberley E Frank and J William Harden, “Corporate Restructurings: A Comparison of Equity Carve-outs and Spin-offs” (2001) 28 *Journal of Business Finance & Accounting* 503, p. 503.

for increased competition across various sectors. For instance, the recent investment laws that permit foreign investors to participate in sectors once reserved for domestic investors mark a pivotal development.¹² Furthermore, the opening of telecommunication sector to foreign investors, after years of state monopoly demonstrates the shift and highlights a real commitment to modernizing the economy.¹³ The Government's decision to open the banking sector to foreign investors¹⁴ also signals this commitment. Consequently, as Ethiopia continues to embrace these economic reforms, it is reasonable to anticipate an increase in mergers, acquisitions, and divestitures activity—as foreign investors seek to capitalize on new opportunities in the market.

On the other hand, as part of a legal reform to modernize the Ethiopian commercial laws, the Ethiopian Commercial Code was revised in April 2021.¹⁵ Unlike the OCC¹⁶ which served for about 62 years, one can notice that the RCC attempts to provide more legal framework for regulating mergers, acquisitions, and other corporate restructuring activities, categorizing these activities primarily into two sections: mergers and divisions.¹⁷ Under the RCC, merger can be carried out through either the formation of a new organization¹⁸ or through acquisition.¹⁹ Likewise, the division of a business organization can be executed through acquisition²⁰ or the formation of new organizations.²¹

Furthermore, the RCC introduces a new and important concept in the division section which allows business organizations to divest a certain portion of their assets and transfer it to an existing or a newly formed business organization.²² However, it remains unclear whether Article 566(4) implies a divestiture transaction. In addition, it is unclear whether divestiture is

¹² Anthony Giustin and others, “ETHIOPIA’S NEW INVESTMENT FRAMEWORK – THE REGULATION” [2021], (Clifford Chance), <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/01/ethiopias-new-investment-framework-the-regulation.pdf> > accessed August 09, 2024.

¹³ “PM Abiy Says Telecom Liberalization towards Dawn of New Era in Ethiopia” (ENA English) < https://www.ena.et/web/eng/w/en_23407 > accessed August 09, 2024.

¹⁴ “Opening Banking Sector to Foreign Investors Lures FDI, Advances Financial Inclusion: Ethiopian Finance Minister” (ENA English) https://www.ena.et/web/eng/w/en_38692 accessed August 09, 2024.

¹⁵ Commercial Code of the Federal Democratic Republic of Ethiopia, FEDERAL NEGARIT GAZETTE, EXTRA ORDINARY ISSUE, Proclamation No. 1243/2021, 12 April 2021, Addis Ababa, (Hereinafter “RCC”).

¹⁶ Commercial Code of the Empire of Ethiopia, Proclamation No. 166 of 1960, NEGARIT GAZETA, Gazette Extraordinary, 5th May 1960, Addis Ababa, (Hereinafter “OCC”).

¹⁷ From Article 565 to Article 577 of the RCC.

¹⁸ As per Article 565(2) of the RCC, a merger by the formation of a new organization is the operation whereby two or more business organizations are wound up without liquidation by transferring all their assets and liabilities to an organization they themselves form.

¹⁹ As per Article 565(3) of the RCC, a merger by acquisition is the operation whereby one or more business organizations are wound up without liquidation by transferring all their assets and liabilities to a preexisting organization.

²⁰ According to Article 566(2) of the RCC, a division by acquisition is the operation whereby a business organization is wound up without liquidation by transferring all its assets and liabilities to more than one preexisting organizations;

²¹ According to Article 566(3) of the RCC, a division by the formation of new organizations is the operation whereby a business organization is wound up without liquidation by transferring all its assets and liabilities to organizations formed by it.

²² RCC, Article 566(4).

adequately addressed in the RCC and if the provisions governing mergers and divisions also encompass divestitures.

Therefore, this thesis intends to explore the concept of divestitures, and examines the motivations behind divestitures, and assesses whether the RCC recognizes and adequately regulates divestitures.

1.2. Statement of the Problem

The RCC does not use the term, “divestiture” vividly. However, it holds some provisions or contents that appear divestiture. For instance, Article 566(4) of the RCC provides that:

“Dividing a certain portion of asset means separating a business unit that can subsist separately or part of assets of an organization and transferring the same to a business organization that is under formation or to an existing organization by way of contribution.”

In the context of the above provision, the phrase “...separating a business unit that can subsist separately or part of assets of an organization and transferring the same to a business organization that is under formation or to an existing organization...” seems to imply a divestiture transaction. As pointed out above, the RCC does not use the term divestiture explicitly or nor does it specifically mention the types of divestitures, and therefore this needs further investigation to find out whether the phrase implies a divestiture transaction or not. A straightforward reading of the remaining phrase “...by way of contribution” also implies that the divested asset or unit cannot simply be sold, but rather must be transferred as a contribution to the capital of the receiving entity—likely in exchange for shares. Moreover, the wording “...to an existing organization by way of contribution” also diverges from the typical concept of divestiture, which poses an important question warranting further investigation.

Furthermore, the provisions of the RCC governing mergers and divisions require that shareholders or partners of a merged or acquired business organization receive shares in the entity resulting from the merger or in the entity that acquired the divided assets. In addition to the share allotment requirement, such shareholders or partners are also entitled to receive supplementary cash payments, depending on the circumstances.²³ At this juncture, Article 574(1)(d) of the RCC that deals with the effects of merger and division provides:

“[Merger or division shall have the effects that follow] conferral of shares on members of the business organization that transferred a portion of its assets or a business unit to a business organization under formation or to an existing organization in the transferring organization itself or the newly formed business organization or the organization to which the assets are transferred, depending on the terms of their agreement.”

²³ See RCC, Articles 565(2) & (3), 566(1), (2), & (3), 567(2)(f), 568(2)(c), 569(4)(a), and 574(1)(c)&(d).

However, given the absence of a clear recognition of the concept of divestiture under the RCC, the applicability of the aforementioned provision to divestitures remains unclear. This in turn triggers the need for further investigation to determine whether this provision is targeting divestiture transactions. If it is indeed designed to regulate divestitures, it is essential to assess whether this requirement is functional and aligns with the underlying principles of divestitures.

Additionally, according to Article 566(1), (2)&(3) of the RCC, a division results in the dissolution of the business organization undertaking the division transaction without going through liquidation. In contrast, divestiture enables the parent organization to exist even after separating or disposing of its divested unit. Here, if Article 566(4) is indeed found to govern divestitures, Article 574(1)(d) grants shareholders of the business organization that transferred a portion of its assets or business unit, among others, the right to receive shares in that organization, indicating the parent company's continued existence after the transfer, while the definition of division says a division results in the dissolution of the business organization undertaking the division transaction without going through liquidation. Therefore, this raises the question of whether divestitures should be classified under the division section or warrant a separate section in the RCC, which requires further investigation.

In addition to the aforementioned points, an equity carve-out is carried out through an IPO i.e., the company first divests its assets, and then forms a new public company from the divested assets. This newly formed company will offer its shares to the public for the first time. This procedure is further supported by the Ethiopian Capital Market Proclamation.²⁴ According to the Proclamation, a company intending to offer shares to the public must be a share company.²⁵ Consequently, any private company engaged in a carve-out transaction must incorporate its divested unit as a share company. This means that the divested entity is initially established by the parent company as a share company, the parent as a sole shareholder of the divested company, before inviting other investors via a public offering. However, the RCC requires a minimum of five members for the formation of a share company.²⁶ Therefore, if the provisions of the RCC governing merger and division are found to govern divestitures after investigation, whether there is a legal framework for executing a carve-out process or not will be an additional issue that necessitates further investigation.

Given that corporate restructurings are carried out under the rules of the RCC, this research explores the extent to which the concept of divestitures has been recognized under the RCC, and assesses whether its provisions are adequate for effectively implementing divestitures. It also

²⁴ Capital Market Proclamation No. 1248/2021, FEDERAL NEGARIT GAZETTE, 27th Year, No. 33, 23 July 2021, Addis Ababa, Ethiopia, (Hereinafter "Capital Market Proclamation"); See Article 2(32) and from Article 75 to 78. Article 2(32) of the Proclamation defines "IPO" as "an offer to the public of any securities or a company, if: a) no securities of that company have previously been the subject of an offer to the public; or b) all of the securities of that company that had previously been the subject of an offer to the public have subsequently been re-acquired by the company.

²⁵ Ibid Article 2(13).

²⁶ RCC, Article 552(2).

evaluates whether the existing classification of corporate restructuring modalities adequately address the nuances of divestiture and considers whether the RCC should be amended to incorporate a separate section.

1.3. Objectives of the Study

1.3.1. General Objective

The main objective of this research is to assess and critically examine the RCC in regulating business unit divestitures as one form of corporate restructuring and to forward policy recommendations for legal reform.

1.3.2. Specific Objectives

The study has the following specific objectives:

- ✓ To evaluate the level of recognition of business unit divestitures as one form of corporate restructuring under the RCC;
- ✓ To investigate the adequacy of the current provisions of the RCC related to business unit divestitures;
- ✓ To explore the specific legal loopholes (lacunas) under the RCC in relation to the regulation of business unit divestiture;
- ✓ To identify and propose detail recommendations for legal reform which are necessary to improve the regulation of business unit divestitures in Ethiopia.

1.4. Research Questions

- 1.4.1.** How does a business unit divestiture differ from other types of corporate restructuring?
- 1.4.2.** To what extent is business unit divestiture recognized as one form of corporate restructuring strategy under the RCC?
- 1.4.3.** To what extent are the current provisions of the RCC adequate and effective for regulating business unit divestitures?
- 1.4.4.** What legal reforms are necessary to address the current gaps/lacunas in the framework involving regulation of business unit divestitures under the RCC?

1.5. Research Methodology

To effectively address the research questions, the Study has employed the following methodologies:

1.5.1. Research Design

Since the research examines the regulation of business unit divestiture under the RCC, it is qualitative study by its nature, predominantly adopts a doctrinal (analytical) research approach.

1.5.2. Data Sources

Primary Sources: Among others, the researcher analyzed the Commercial Code, Tax laws, Capital Market Laws, and Trade Competition and Customer Protection Laws of Ethiopia. This involves a thorough interpretation and discussion of the relevant provisions pertaining to divestitures. The researcher critically evaluated these legal frameworks to ascertain their implications and effectiveness in relation to divestitures.

Secondary Source: The Study explored books, Articles, academic journals, explanatory notes, legal databases, government reports, archived documents, and other scholarly publications to gather diverse perspectives and insights related to the topic.

1.5.3. Data Collection

The data for this research was primarily gathered through extensive desk research, utilizing a range of secondary sources. These sources were carefully selected to ensure a comprehensive examination of the research questions. Hence, relevant legal and academic books were reviewed to provide foundational knowledge and theoretical frameworks. In doing so, texts focusing on divestiture were prioritized to ensure a broad understanding of the subject.

Articles from recognized academic journals were also extensively analyzed. These sources offer updated findings, scholarly debates, and in-depth analyses of the issues under study. Databases such as JSTOR, Google Scholar, Research Gates, Heinonline, and Wiley Online Library were the primary sources for accessing these journals.

Parliamentary notes, government reports, and policy documents were also analyzed to understand the legislative intent, historical development, and policy considerations relevant to the research topic. These sources provide authoritative insights and legal interpretations.

The internet was also utilized to access updated reports, news, articles, and online publications that are pertinent to the research topic. Websites of recognized institutions, legal blogs, and professional organizations were also explored to enrich the review process and ensure a comprehensive examination of the subject matter.

1.5.4. Data analysis and interpretation

The collected data was critically evaluated based on relevance, credibility, and the authority of the sources. A thematic analysis approach was adopted to categorize information and draw connections between different pieces of literature. This method helped the researcher with identifying patterns, trends, and gaps in the RCC concerning the regulation of divestitures. This structured approach to data collection ensures a comprehensive and reliable exploration of the research topic, providing a solid basis for subsequent analysis and conclusions.

1.6. Scope of the Study

The study has focused on the RCC. In doing so, it limited its scope to divestitures. To supplement this, different legislations were also examined.

1.7. Limitation of the Study

One of the limitations of the study is the absence of ample references. This is because the RCC was promulgated recently that no abundant works were done to examine it both nationally and internationally.

1.8. Organization of the Study

The research consists of five chapters. The first Chapter is the introduction part that contains background, statement of the problem, objectives, research questions, research methodology, and the scope of the study. The second chapter discusses corporate restructuring: rationale and modalities while the third chapter deals divestiture as a form of corporate restructuring strategy and procedures followed in business unit divestitures. The fourth chapter is about regulating business unit divestiture in Ethiopia: exploring possible gaps and constraints and the last chapter is Conclusion and recommendation.

1.9. Citation rules

The study followed the OSCOLA referencing style as required by the Addis Ababa University, School of Law, LLM Thesis Guidelines of 2018.

CHAPTER TWO

CORPORATE RESTRUCTURING: RATIONALE AND MODALITIES

2.1. General Overview

In today's global marketplace, businesses around the world face more competition in their markets than ever before. The reasons can be traced to the declining competitiveness of their product, technology advancement, globalization, lack of economies of scale, customers taste, poor efficiency in operations, high-cost structure, mismanagement of fixed and working capital, lack of fund to support brand and distribution network, high cost of capital, market dynamics and economic conditions, etc.

Competition plays a crucial role in shaping and reshaping the restructuring strategies of companies. For instance, the situation of performance oversupply acts as one of the key influences that urge companies to pursue competitive practices. As the performance standards of products surpass the contemporary market necessities, organizations face a change in competitive dynamics. Once consumers attain satisfaction with specific product attributes, their propensity to incur additional costs for further enhancements within that dimension diminishes significantly. This transition compels organizations to investigate alternative attributes to effectively distinguish their offerings.²⁷ Changing bases of competition also constitutes an additional determinant for rivalry enterprises. The introduction of new technologies can lead to change in the basis of competition. For instance, in the desktop PC market, the transition from larger drives to smaller drives highlighted how size became a more critical factor than other features once performance needs were met. This change requires firms to adapt their strategies to focus on new competitive dimensions.²⁸ Market saturation is another crucial factor influencing competition among companies. Once the demand for specific product features is met, businesses need to adjust their strategies to address new customer needs. For instance, after manufacturers optimized their designs for smaller drives, the demand for even smaller sizes declines, resulting in customers being less willing to pay for further reductions in size. Such saturation can drive firms to revise their offerings or reposition themselves in the market.²⁹

According to Michael Porter, five forces shape competition: the threat of new entrants, the threat of substitution, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among existing competitors.³⁰

²⁷ Christensen Clayton M, "The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail, Boston: Harvard Business School Press, (1997) 15 Journal of Product Innovation Management 95, p. 145

²⁸ Ibid, p. 146

²⁹ Ibid

³⁰ Porter ME, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York : Free Press; Toronto : Maxwell Macmillan Canada 1980), p. 6

Treat of New Entrants: new companies entering an industry can introduce additional capacity, a strong desire for market share, and often considerable resources. This influx can result in lower prices or increased costs for established firms and ultimately diminish their profitability.³¹

Treat of Substitution: firms within an industry face competition from firms offering substitute products. These substitutes impose a constraint on the industry's profit potential by capping the prices that firms can charge profitably.³²

Bargaining Power of Buyers: buyers can impact the industry by pushing prices down, demanding higher quality or more services, and leveraging competition among suppliers, at the cost of industry profitability.³³

Bargaining Power of Suppliers: suppliers can influence an industry by threatening to raise prices or lower the quality of their goods and services. When suppliers hold significant power, they can squeeze profits from firms that cannot offset increased costs through its own pricing.³⁴

Rivalry among existing competitors, this competition can be manifested in various forms, such as price wars, advertising campaigns, new product launches, and enhanced customer service or warranties. Rivalry intensifies when firms feel pressured to improve their market position or see an opportunity to do so. Therefore, competitive actions taken by one firm often prompt visible reactions from others, and this resulting in a mutually dependent environment among competitors.³⁵

In the today's dynamic market, Darwin's renowned theory of biological evolution, known as "survival of the fittest," is equally relevant to the business world. Accordingly, Companies that can adapt, innovate, and respond effectively to market changes are more likely to thrive, while those that fail to evolve may struggle to survive. Be that as it may, many executives still tend to believe that they have full control over their organizations, and when making key decisions they expect everyone to bring it to completion. However, it is actually the customers who dictate what a company can and cannot do. Consequently, if businesses need to thrive, they must align their teams and processes with the needs of their customers by delivering the right products and services. Companies that fail to do so will likely struggle, even perish, as they will lack the revenues necessary for survival. Therefore, through the "survival of the fittest" theory, firms that effectively adapt to their market and meet customer needs are more likely to succeed and sustain long-term growth than those that do not align with market demands and customer expectations which risk decline and eventual obsolescence.³⁶

³¹ Ibid, p 7

³² Ibid, p. 23

³³ Ibid, p 24

³⁴ Ibid, p 27

³⁵ Ibid, p. 17

³⁶ Supra note 27, p. 89

These factors highlight the fluid nature of competition and the need for companies to adapt or redefine their strategies in response to shifting market conditions and technological innovations. This process of repositioning is achieved through corporate restructuring, which, in today's volatile business landscape, is not a one-time occurrence but rather a continuous effort that aligns with the changing demands of both the market and the organization.

Corporate restructuring involves modifying the organizational, operational, financial, and legal frameworks of an organization to address market challenges, enhance efficiency, maximize shareholder value, and improve overall productivity. It is a critical process that many companies embrace to realign with customer demands, global trends, and competitive pressures.³⁷ It can be carried out either internally or externally. Internal restructuring occurs when a company restructures its operations, management, or process without the participation of third parties. External restructuring, on the other hand, involves asset, capital, or financial changes in resources and ownership. External restructuring is usually carried out through strategies like merger and acquisitions, divestitures, split-offs, split-ups, leverage buyouts, and management buyouts.

Corporate restructuring plays a critical role in helping firms compete more effectively in the marketplace. For instance, mergers and acquisitions can lead firms to potential synergy, i.e., the amalgamation of the firms and their combined resources enable the firms access a larger market share. This consolidation allows firms to leverage economies of scale, reducing costs and enhancing pricing power in the market. Again, in the current fast-paced competitive market, companies, through acquisitions, can enter new geographic or emerging markets more rapidly than through organic growth. This expansion can diversify revenue streams and reduce dependency on existing markets, making the firm more resilient to market fluctuations. Furthermore, M&A can provide access to new technologies, expertise, and talent that a firm may lack. This infusion of capabilities can lead to improved product offerings and innovation, which are critical for staying competitive in fast-paced industries. On the other hand, divestiture helps firms streamline operations by shedding non-core or underperforming assets. Companies, by divesting less profitable divisions, can focus their efforts and resources on areas with the highest growth potential, and, hence, improve overall efficiency and profitability.

The selection of restructuring methods is largely influenced by the firm's strategic objectives. Depending on their overall strategy, companies assess and determine the most effective restructuring approaches that align with their goals. Additionally, the specific circumstances surrounding each firm—such as its market position, financial health, and industry trends—play a crucial role in shaping the choice of restructuring modalities. Ultimately, the most successful firms are those that carefully analyze their strategic direction and tailor their restructuring efforts to support their long-term vision and adaptability in a changing business environment.

³⁷ Muazu Adeiza Umar, "Corporate Restructuring: A Strategy for Improving Organizational Performance" (2023) 14 International Journal of Strategic Decision Sciences 1, p.3

2.2. Modalities Of Corporate Restructuring

2.2.1 Merger and Acquisitions

Various scholars define mergers in their works, and while their phrasing differ slightly, their definition is mostly similar which can be put in a way that merger involves the combination of two or more entities for a range of strategic, financial, and operational purposes, typically aiming to create a more competitive, efficient, or profitable organization. Gaughan defines “merger” as “a business combination whereby two or more companies join to form an entirely new company. All of the combining companies are dissolved and only the new entity continues to operate.”³⁸ This definition highlights that a merger results in the formation of a new entity rather than one company simply absorbing another. In contrast to an acquisition, where one company remains as the parent, a merger creates a completely new company that integrates the assets, resources, and operations of the merging firms. This new company often has a different legal identity from the merging entities and may also have different name. As a merger transaction entails the dissolution of the merging entities, both companies formally dissolve their individual corporate identities, and their assets, liabilities, and shareholders are transferred to the newly formed entity. What is more, this definition implies that shareholders from each of the merging companies receive equity in the new company that reflects the agreed-upon valuation of each entity involved in the merger.

There are different types of mergers. Mergers can be vertical, horizontal, or conglomerate.

Vertical Merger: involves companies at different stages of the supply chain merging or acquiring one another. For example, a manufacturer might acquire a supplier to gain better control over its raw materials or production processes.³⁹

Horizontal Merger: it occurs between companies that operate at the same level in the supply chain, typically among competitors. For instance, two rival firms might merge to consolidate their market position, expand their customer base, or achieve economies of scale.⁴⁰

Conglomerate: involves the merger of companies that operate in entirely different industries or sectors. For example, a tech company might merge with a food processing firm.⁴¹

On the other hand, while there is slight differences in defining an acquisition, various scholars give similar meaning to an acquisition referring it as a situation in which one company acquires a controlling interest in another company. In this transaction, the acquiring company—often referred to as the “acquirer”—takes whole or majority ownership of the target company—often

³⁸ Gaughan PA, *Mergers, Acquisitions, and Corporate Restructurings: Gaughan/mergers* (John Wiley & Sons, Inc 2018), p. 11

³⁹ Burner RF, *Applied Mergers and Acquisitions, University Edition* (John Wiley & Sons 2004), p. 141.

⁴⁰ Pignataro P, *Mergers, Acquisitions, Divestitures, and Other Restructurings: A Practical Guide to Investment Banking and Private Equity* (John Wiley & Sons 2015), p. 4.

⁴¹ *Ibid*, p. 5.

referred to as the “acquired”—which enables it to gain control over the target’s assets, operations, and typically its customer base.⁴²

Pignataro describes an acquisition as the purchase of a business entity, a group of entities, or specific assets. While the terms "acquisition" and "merger" are frequently used interchangeably, they differ in one key aspect: the acquirer is usually much larger than the asset or entity being purchased which is known as the “target” or the “acquired entity.” Pignataro further elaborates that acquisitions can occur in two primary forms: an asset acquisition, which involves purchasing an asset or a group of assets along with their associated liabilities, and an equity acquisition, which entails acquiring a controlling interest in a business entity.⁴³ In an asset acquisition, however, the buyer does not necessarily gain an ownership interest in the target company itself. Instead, this process involves purchasing specific assets rather than acquiring the business in its entirety. During this transaction, the buyer selectively acquires particular assets—such as equipment, inventory, intellectual property, or real estate—and may assume certain liabilities tied to those assets. This strategy allows the buyer to avoid taking on the entire company's obligations, risks, or unwanted assets which makes it a more tailored approach compared to a full business acquisition. This helps buyers to align their purchases with their specific operational and financial objectives.⁴⁴

The RCC also defines M&A, but it uses the term "merger" to refer to both types of transactions. As stipulated in the Code, merger can occur through the formation of a new organization or via an acquisition.

Article 565 (2) of the RCC describes "a merger by forming a new organization" in the following manner:

a merger by the formation of a new organization is the operation whereby two or more business organizations are wound up without liquidation by transferring all their assets and liabilities to an organization they themselves form. The shareholders or partners of the business organizations that are wound up are issued in exchange shares in the new organization. They may also be given, as the case may be, additional payment in cash.

Article 565 (3) of the Code describes “a merger by acquisition” as follows:

a merger by acquisition is the operation whereby one or more business organizations are wound up without liquidation by transferring all their assets and liabilities to a preexisting organization. The shareholders or partners of the business organization

⁴² Rima Tamosiuniene and Egle Duksaite, 'The Importance of Mergers and Acquisitions in Today's Economy' [2009] 3 *Intellectual Economics* 7, p. 11.

⁴³ Supra note 40, p. 3

⁴⁴ Brown R, *The Concise Guide to Mergers, Acquisitions and Divestitures: Business, Legal, Finance, Accounting, Tax and Process Aspects* (Palgrave Macmillan 2007), P. 22

that is wound up are issued in exchange shares in the acquiring organization. They may also be given, as the case may be, additional payment in cash.

Businesses frequently opt for M&A instead of other forms of corporate restructurings because of the distinct advantages they provide in terms of growth, competitive positioning, resource acquisition, and operational efficiency. There are two primary avenues for growth: internal (or organic) growth, which involves strategies such as hiring additional sales personnel, developing new products, and expanding into new geographic markets—an approach that can be time-consuming and resource-intensive; and inorganic growth, achieved through mergers or acquisitions, which allows companies to quickly access new product lines, customer segments, or geographic areas. As the primary motivation behind mergers and acquisitions is expansion, companies aiming to expand their market share and maintain competitiveness often prefer these modalities over organic growth strategies.⁴⁵

One of the principal incentives underlying mergers and acquisitions is the realization of operational and financial synergies. Synergy means “the whole is greater than the sum of its parts,” a concept often illustrated by the equation $2 + 2 = 5$.⁴⁶ This implies that the profitability derived from a corporate amalgamation exceeds that of the individual entities that were merged. Synergy can be operating or financial. Operating synergy encompasses economies of scale and scope, as well as the acquisition of complementary resources such as technologies, skills, and materials. Economies of scale denote the cost advantages that an enterprise attains through an increase in its production capacity. For example, a corporation engaged in the manufacture of cell phones, upon scaling up its production, experiences a reduction in the average cost per unit. This occurs because fixed costs—such as the depreciation of equipment, amortization of capitalized software, maintenance expenditures, and obligatory payments including interest and lease obligations; along with union, customer, and vendor contracts; and taxes—do not escalate in direct proportion to the level of production. Therefore, by increasing the output of cell phones, the firm disseminates these fixed costs across a greater number of units, thereby diminishing the cost incurred per phone.⁴⁷ Economies of scope, on the other hand, refer to the cost efficiencies realized when an organization diversifies its production to deliver a range of related products rather than concentrating on a singular product.⁴⁸ The underlying premise is that the simultaneous production of multiple products incurs lower costs than the production of each product in isolation. This often occurs due to the company can share resources, technology, distribution channels, or brand value across various products. For example, a firm may simultaneously manufacture both toothpaste and toothbrushes by utilizing the same marketing strategies, distribution networks, and production facilities for both items. Hence, by sharing

⁴⁵ Supra note 42, p. 11

⁴⁶ Supra note 39, p. 325; See also supra note 38, p. 136

⁴⁷ DePamphilis D, *Mergers, Acquisitions, and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions* (Academic Press 2021), p. 5-6

⁴⁸ Ibid, p. 7.

resources, the overall production and marketing costs are reduced.⁴⁹ Financial synergy refers to the economic benefits that can be achieved when two entities merge or undergo an acquisition. The premise is that the newly combined organization will enjoy improved financial performance and reduced costs compared to the two companies operating independently. For example, following a merger, the unified entity may be perceived as less risky by lenders and investors, allowing it to obtain more favorable loan terms or attract a broader pool of investors due to its increased size, enhanced stability, and expanded revenue streams.⁵⁰

Another benefit is the tax advantage that can arise from mergers and acquisitions. This allows the buyer to transfer net operating losses (NOLs) from the target company, which can be helpful if the target couldn't fully use those losses to offset taxes before they expired. Essentially, it's like a "2 + 2 = 5" situation—by merging with a profitable company, the losses can be utilized more effectively or more quickly than if the target were operating on its own. Additionally, when a buyer acquires a company, the increase in the asset's value can provide new opportunities for tax deductions through depreciation that wouldn't be available otherwise.⁵¹

2.2.2 Leveraged Buyouts

An LBO is a strategy for acquiring a company by primarily financing the purchase with borrowed money, where a substantial part of the acquisition cost is covered through debt.⁵² In this scenario, the assets of the target company are typically used as collateral for the loans.⁵³ This approach enables buyers to acquire the business with a reduced equity contribution. LBOs are commonly pursued by PE firms, who have expertise in this type of financing. These investors not only bring professional management practices to the acquired company but also closely monitor its performance. They are often proactive in implementing measures to enhance the company's efficiency and profitability in order to make sure that the firm can meet its principal and interest obligations on the debt.⁵⁴

LBOs are pursued for various reasons. One of the advantages of LBOs is tax-shield. When a company incurs debt, the interest expenses associated with that debt are usually tax-deductible.⁵⁵ This results in a tax shield, reducing the taxable income due to the interest payments. In essence, the company pays less in taxes because these payments decrease the amount of income that is subject to corporate tax. Therefore, by opting for debt financing rather than relying solely on equity, a company can effectively lower its overall cost of capital. This is because debt generally

⁴⁹ Chandrashekar Krishnamurti and SR Vishwanath, *Mergers, Acquisitions and Corporate Restructuring* (SAGE Publications India 2008) p. 11-13

⁵⁰ Supra note 38, p. 145

⁵¹ Supra note 39, p. 328,

⁵² Supra note 40, p. 3

⁵³ Supra note 47, P. 12

⁵⁴ Pascal Quiry and others, 'Leveraged Buyouts' in *Corporate Finance: Theory and Practice* (4th edn, John Wiley & Sons Ltd 2014) ch 46, p. 842

⁵⁵ Pignataro P, *Leveraged Buyouts: A Practical Guide to Investment Banking and Private Equity* (John Wiley & Sons 2014), p. 44.

carries a lower cost than equity, partly due to the tax-deductibility of interest payments, which helps to reduce the company's total financing expenses.⁵⁶ Another advantage of an LBO is debt reduction. As the firm repays its debt obligations, its equity value typically increases. In essence, the rise in equity is generally proportional to the amount of debt that has been repaid. Consequently, by the time the firm completes its debt repayments, its overall market value is likely to be at least equal to, if not greater than, the initial investment made by the private equity firm. This reduction in debt significantly enhances the company's cash flow by decreasing future liabilities associated with interest and principal payments. With lower obligations, the company's financial position improves, which benefits both shareholders and potential buyers in the event of a sale or exit strategy. Ultimately, this strengthened financial health can lead to greater investment opportunities and increased attractiveness in the marketplace.⁵⁷

An LBO also brings fiscal discipline in company management by creating a binding obligation to make regular interest and principal payments to lenders. Unlike equity, which allows for discretionary dividend payments, debt repayments follow a strict schedule. This financial pressure encourages managers to be more careful in allocating the company's cash flow by preventing them from investing in low-return projects that fail to meet the company's cost of capital.⁵⁸ Moreover, PE firms often favor acquiring underperforming and poorly managed companies through an LBO strategy. They specifically target businesses they perceive as undervalued or struggling due to ineffective management. By acquiring these companies, PE firms aim to implement improvements that enhance operational performance. As the business becomes more efficient and its cash flow increases, it can repay its debt more quickly. Therefore, by boosting profitability, the investors can eventually sell the company at a higher price.⁵⁹ However, not every LBO transaction is successful. While LBOs offer their own advantages, they also come with significant risks. One major risk associated with LBOs is the potential for bankruptcy. These transactions often lead to a highly leveraged capital structure, with debt levels potentially reaching as high as ninety percent of the firm's equity. If the company's cash flow becomes inadequate to meet the substantial interest payments on this leveraged debt, the excessive burden of debt can dramatically heighten the risk of bankruptcy.⁶⁰

2.2.3 Management Buyout

An MBO is a specific type of LBO in which a group led by the current management team of a company acquires the majority or all of the company's shares from existing shareholders, thereby gaining control of the business. This arrangement allows management to leverage their intimate

⁵⁶ Pettit J, *Strategic Corporate Finance: Applications in Valuation and Capital Structure* (John Wiley & Sons 2007), p. 169-170

⁵⁷ Supra note 47, p. 365

⁵⁸ Supra note 56, p. 170

⁵⁹ Supra note 55, p. 4

⁶⁰ Laura Femino, 'Ex Ante Review of Leveraged Buyouts' (2014), *The Yale Law Journal*, p. 1834, <https://objects.scraper.bibcitation.com/user-pdfs/2024-11-27/4f8ab259-9232-426f-b30b-4bd24e36e73e.pdf> p. 1834, last accessed November 23, 2024

knowledge of the company and its operations to drive improvements and create value.⁶¹ In some instances, a PE firm may collaborate with a management team to acquire a company. In this arrangement, the management team typically acquires a substantial portion of the company's equity which serves as an incentive for them to drive growth and enhance the business's performance.⁶² The ideal candidates for an MBO are firms with stable and predictable cash flows that can comfortably cover the additional fixed costs associated with interest and principal repayments on the debt. The primary motivation for pursuing an MBO is that management will directly benefit from their efforts by sharing in the firm's profits through equity returns, rather than relying solely on a fixed or semi-variable salary. This alignment of interests incentivizes manager-owners to work more efficiently, as they get both ownership and control, to further driving the company's growth and success.⁶³ Given their in-depth understanding of the business, the management team is well-positioned to leverage an MBO to restructure the company which places them in a role similar to—or even more advantageous than—that of the original founders. This transition motivates them to operate the company under their own leadership with a renewed focus on enhancing performance and driving growth.⁶⁴

In terms of financing, much like LBOs, MBOs are funded through a combination of debt and equity. However, in most cases, managers do not personally finance their equity stakes since they often cannot afford such substantial investments. Instead, they are frequently granted significant equity shares with little to no personal financial contribution.⁶⁵ This can primarily be accomplished through seller's assistance, as the seller may be inclined to provide support due to their long-standing relationship with the management team. When the seller agrees to finance part of the purchase price, it is referred to as seller financing. One common structure for seller financing involves deferred compensation, i.e., where the seller accepts a promissory note from the managers that allows them to pay a portion of the purchase price over time using the company's future cash flows. In fact, this arrangement serves as a loan to the acquiring managers. In addition to deferred compensation, the seller may also agree to authorize company debt to further facilitate the managers' acquisition.⁶⁶

In situations where the seller is unwilling to consider a seller financing arrangement, the acquiring managers typically seek the participation of PE firms. This type of deal is commonly referred to as a sponsor buyout. In this scenario, the PE sponsor provides the necessary capital

⁶¹ Supra note 37, P. 5

⁶² Frankel MES and Forman LH, *Mergers and Acquisitions Basics: The Key Steps of Acquisitions, Divestitures, and Investments* (John Wiley & Sons 2017), p. 17

⁶³ Altman EI and Hotchkiss E, *Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt* (John Wiley & Sons 2006), p. 124

⁶⁴ Supra note 62, p. 25

⁶⁵ Andrei Shleifer and Robert W Vishny, 'Management Buyouts as a Response to Market Pressure' (1987), University of Chicago Press, p. 98, <https://objects.scrapier.bibcitation.com/user-pdfs/2024-11-27/064a6cee-3781-4808-9e1a-a2797ec7f2bd.pdf>, last accessed November 23, 2024

⁶⁶ Scott D Miller, *Buyouts: Success for Owners, Management, PEGs, Families, ESOPs, and Mergers and Acquisitions* (Wiley 2012), p. 105-106

and leverages its relationships with investment banks to assist in raising the required debt capital⁶⁷ In this arrangement, a PE firm collaborates with the management team to acquire a company, resulting in ownership being shared between the PE firm and the management team. And to ensure that the management team holds a controlling interest and is motivated to operate the company effectively, they usually receive a substantial portion of the equity. This structure encourages them to drive the business's growth and benefit both the PE owners and themselves in the process.⁶⁸ When the management team partners with PE investors for an acquisition, it's important to understand that more than half of the firm's equity, which represents the controlling interest, is not given to the management team without conditions. Hence, in order to benefit from this arrangement, the management team needs to demonstrate certain commitments upfront. Key factors that PE firms consider when entering into such agreements with management teams include their skills relevant to the transaction, their track record of profitably growing the business, their willingness to invest some of their own financial resources, and their readiness to pledge personal assets as collateral.⁶⁹ Consequently, by requiring managers to back their commitments with personal and family assets, PE firms motivate them to work diligently not only to meet their financial obligations but also to ensure the company's profitability and capability to repay its debts.

2.2.4 Split-ups

A split-up is a restructuring strategy in which a single firm splits into two or more independent firms, resulting in the dissolution of the parent company.⁷⁰ In this process, the shareholders of the parent automatically become shareholders of the newly formed entities.⁷¹

One primary reason companies pursue split-ups is to improve corporate governance by eliminating diseconomies of scale⁷² and by serving as a disciplining device for management.⁷³ Additionally, firms may adopt a diversification strategy that initially attracts higher equity valuations, particularly during a bull market conditions when overall optimism boosts most businesses. However, over time, the market may reassess the effectiveness of the firm's strategy and its various operations, leading owners to favor investments in specialized businesses over a conglomerate. When this occurs, management may feel compelled to implement significant

⁶⁷ Joshua Rosenbaum and Joshua Pearl, *Investment Banking: Valuation, Leveraged Buyouts, and Mergers & Acquisitions* (2nd edn, Wiley 2009); see also Supra note 34, p. 127

⁶⁸ Supra note 62, p. 17

⁶⁹ Supra note 66, p. 128

⁷⁰ Supra note 44, p. 165

⁷¹ Brauer M, "What Have We Acquired and What Should We Acquire in Divestiture Research? A Review and Research Agenda" (2006) 32 *Journal of Management* 751, p 754

⁷² Diseconomies of scale happen when a company becomes too large and instead of saving money, it starts to spend more for each product it makes. This is the opposite of economies of scale, where larger production leads to lower costs. If costs go up, the company might have to raise prices, which can lead to losing customers. Therefore, split-up will be the best strategy to implement.

⁷³ Larger firms may suffer from bureaucratic inefficiencies that hinder decision-making. Through split-up strategy, each unit management can streamline operations, reduce layers of bureaucracy, and respond more swiftly to market changes, which can enhance overall performance.

changes, making a split-up a viable strategy.⁷⁴ Furthermore, management of a diversified firm may consider a split-up for its tax advantages. If no gain or loss is recognized during the transfer of assets to the parent company or its shareholders, the transaction can be tax-free.⁷⁵ However, certain conditions must be met to qualify for this tax benefit. To mention some, the parent company's shareholders must maintain control—at least to the minimum percentage required by tax law—over the voting power and shares of the new entities. Additionally, the primary purpose of the transaction cannot be tax avoidance. Shareholders must also retain a continuing interest in the new firms, and the split-up must be part of a broader plan to separate ongoing operations rather than merely distributing investment assets.⁷⁶

2.2.5 Divestiture

Divestiture is defined as “the parent company’s disposal and sale of assets, facilities, product lines, subsidiaries, divisions and business units.”⁷⁷ This process enables the company to separate from or relinquish a substantial asset, business segment, or business unit through various forms of divestiture methods.

Companies often pursue divestitures to streamline their operations, concentrate on core competencies, reduce debt, address antitrust issues, or enhance overall financial performance. By shedding non-essential or underperforming assets, divestitures enable firms to adapt more effectively to market changes and increase shareholder value. In the next chapter, we will explore the nature and rationale behind divestiture, as well as the most common forms of divestiture.

⁷⁴ Supra note 38, p. 422

⁷⁵ Swenson CEMC, “Structuring Divisive Reorganizations” *The Tax Adviser* (May 1, 2019) <https://www.thetaxadviser.com/issues/2019/may/structuring-divisive-reorganizations.html>, last accessed November 23, 2024.

⁷⁶ Ibid

⁷⁷ Caterina Moschieri and Johanna Mair, “Research on Corporate Divestitures: A Synthesis” (2008) 14 *Journal of Management & Organization* 399, p. 2.

CHAPTER THREE

DIVESTITURE AS A FORM OF CORPORATE RESTRUCTURING STRATEGY AND PROCEDURES FOLLOWED IN BUSINESS UNIT DIVESTITURES

3.1. Nature and Rationale of Divestiture

Divestiture is a corporate restructuring strategy where a company sells, disposes, or divests part of its assets, facilities, product lines, subsidiaries, divisions and business units. This approach helps organizations realign operations, enhance financial stability, and improve shareholder value. Companies often divest non-core, underperforming, or misaligned units to focus on core competencies and profitable areas.

Divestitures can be attractive for various reasons. The parent company may be in need of more liquidity, reduced financial commitments, or planning to execute fundamental modifications in its marketing strategy.⁷⁸ Moreover, the intensity of competition to businesses that are subject to constant enhancements or adjustments due to technological advancement could be challenging and requires such businesses to inject a substantial amount of capital for the purpose of maintaining their competitiveness in the industry; however, if a significant amount of capital has already been allocated to a division but more capital is still needed to maintain its competitiveness and the company is no longer willing to provide further financial resources, then the most effective strategy to recover the investment already expended could be divestitures.⁷⁹

Divestitures have also become the best strategy for numerous companies that carried out diverse acquisition strategies to form conglomerates.⁸⁰ Companies that involved in diversification through acquisitions have become more interested in divesting their non-performing divisions, and divestitures emerged as the most favorable strategy for companies seeking to rectify previous mistakes. Thus, assets that no longer align with the company's core business become subject to divestitures to ultimately unlocking shareholders value.⁸¹ The reasons for adopting divestiture are explained as follows.

First, divestiture plays a pivotal role in helping companies streamline their operations by shedding non-core or underperforming units.⁸² This strategy enables firms to allocate resources,

⁷⁸ Gordon Bing, *CORPORATE DIVESTMENT: AN IN-DEPTH PROGRAM FOR GETTING THE BEST RESULTS FROM SELLING AND BUYING SUBSIDIARIES, DIV., AND PRODUCT LINES.* (Gulf Publishing Company, Houston, Texas 1978), p. 1.

⁷⁹ *Ibid*, p. 4.

⁸⁰ Gaughan PA, *Mergers, Acquisitions, and Corporate Restructurings: Gaughan/mergers* (John Wiley & Sons, Inc 2018), p. 20.

⁸¹ Chandrashekar Krishnamurti and SR Vishwanath, *Mergers, Acquisitions and Corporate Restructuring* (SAGE Publications India 2008), p. 287.

⁸² Weston JF and Weaver SC, *Mergers and Acquisitions* (McGraw-Hill Companies 2001), p180.

including time, capital, and talent, toward their primary business areas. By doing so, companies can enhance operational efficiency and bolster their competitive advantage in their core markets. For instance, a manufacturing company may divest its retail distribution wing to concentrate on innovating and producing high-quality products. Such focused operations often lead to improved decision-making and execution in areas where the company excels, driving long-term profitability.⁸³

Second, divestiture provides an effective mechanism for companies to improve financial health by reducing debt. The funds generated from the sale of business units can be utilized to pay down liabilities which lead to a stronger balance sheet. For highly leveraged firms, this reduction in debt burden can lower interest expenses and enhance financial flexibility which allows them to invest in growth opportunities or weather economic downturns. For example, during periods of financial stress, selling a less profitable division can provide the liquidity needed to stabilize operations and safeguard the company's core business.⁸⁴

Third, another major benefit of divestiture is the ability to realign a company's portfolio with its long-term strategic goals. Organizations often adapt their strategies in response to changing market dynamics, technological advancements, or emerging customer needs. Divesting business units that no longer fit within the company's vision allows management to redirect efforts toward more promising opportunities.⁸⁵ For example, a technology firm might divest its hardware division to focus on software development in order to achieve higher growth potential. This realignment not only sharpens the company's market focus but also positions it for sustained growth and competitive differentiation.

Finally, divestiture can unlock the hidden value of a business unit that may be underappreciated within the parent company. Such subsidiaries or divisions might perform better as independent entities or under new ownership. By divesting these units, companies can realize their inherent value through sales proceeds or improved market valuation. For shareholders, this often translates into higher returns, as the company's overall portfolio becomes more efficient and strategically aligned.⁸⁶ A classic example is when a conglomerate spins-off a high-growth subsidiary into a standalone entity to be able to thrive with focused leadership and independent resources.

Divestitures can be carried out either voluntary or involuntary. Voluntary divestitures occur when a company proactively decides to sell-off, spin-off, or carve-out a business unit to improve

⁸³ Pettit J, *Strategic Corporate Finance: Applications in Valuation and Capital Structure* (John Wiley & Sons 2011), p. 54

⁸⁴ Amiri S, "Strategic Restructuring: Study of Divestitures and Acquisitions" (Dissertation, Iowa State University 2019), p. 32.

⁸⁵ Vidal E, "Divestitures, Value Creation, and Corporate Scope" (2021) 2 *Strategic Management Review* 413, pp. 6-8.

⁸⁶ Alam Iqbal B and Nyiwul L, "Evidence on Divestment Motives: An Overview" (2022) 17 *Global Trade and Customs Journal* 501, p. 507.

its strategic focus, enhance financial performance, or capitalize on market opportunities. As previously noted, companies may choose voluntary divestitures to streamline operations, reduce debt, or reallocate resources to core business areas. On the other hand, involuntary divestitures are those that are mandated by external forces such as regulatory authorities or legal requirements. These divestitures are often necessary to comply with antitrust laws, avoid conflicts of interest, or meet specific conditions set by regulatory bodies. Involuntary divestitures are typically driven by regulatory interventions to maintain competitive markets.⁸⁷

The divestiture process involves several key steps that are explained below.

1. Strategic Assessment

The initial step in a divestiture involves a strategic evaluation of the business units to identify which ones should be divested. Companies analyze the strategic fit, market potential, and financial performance of their business units to determine their contribution to long-term goals. Units that no longer align with the company's core objectives, or underperforming, or operate in declining markets are prime candidates for divestiture. When business units are empowered to act in their own best interests, free from those of the parent company, significant opportunities to create substantial new value often emerge.⁸⁸ Therefore, this assessment helps firms prioritize their resources and focus on areas of greater profitability and growth potential. By carefully selecting which units to divest, companies ensure that the process supports their broader strategic vision.

2. Valuation

Once a business unit has been identified for divestiture, determining its fair value is critical. Valuations always involve engaging a financial advisor who has in-depth knowledge of the market to determine the fair value of the business unit. The valuation process involves financial analysis, including revenue, profit margins, asset base, and future growth potential. Market conditions and comparable transactions are also considered to establish a competitive price range.⁸⁹ Accurate valuation not only maximizes proceeds for the selling company but also ensures that buyers perceive the transaction as fair. For example, a well-conducted valuation can help a company avoid undervaluing a promising division and it ensures a better return on investment for its stakeholders.

3. Identifying Buyers

The success of a divestiture also hinges on finding the right buyers for the business unit. Companies typically seek buyers who have strategic interest in the unit, such as competitors,

⁸⁷ Supra note 80, p. 396-397.

⁸⁸ Pettit J, *Strategic Corporate Finance: Applications in Valuation and Capital Structure* (John Wiley & Sons 2011), p. 58-59.

⁸⁹ Gole WJ and Hilger PJ, *Corporate Divestitures: A Mergers and Acquisitions Best Practices Guide* (John Wiley & Sons 2008), pp.112-113.

private equity firms, or investors looking to expand their portfolio. Identifying potential buyers requires market research, networking, and often the assistance of investment banks or financial advisors.⁹⁰

4. Transaction Execution

Executing the divestiture involves negotiating terms, drafting legal agreements, and completing the transfer of ownership. Negotiations cover critical aspects such as purchase price, payment terms, liabilities, and future commitments between the seller and buyer. Legal documentation, such as sale agreements and transfer contracts, ensures that all parties' rights and obligations are clearly defined. Additionally, companies must navigate regulatory approvals and compliance requirements. Smooth execution minimizes disruptions and ensures that the divestiture is completed within the intended timeline and budget.

5. Post-Divestiture Management

After the transaction is completed, companies must monitor the impact of the divestiture and manage transitional operations effectively. Post-divestiture management includes addressing any operational gaps, reallocating resources, and supporting employees impacted by the process. Companies may also work with the new owners to facilitate a seamless transition, ensuring that customers, suppliers, and other stakeholders experience minimal disruption. Effective post-divestiture management is key to realizing the intended benefits of the strategy.

3.2. Forms of Divestiture

Divestitures can be executed in several forms. Each form serves a different strategic purpose for the company. The most common forms of divestiture are sell-offs, spin-offs, and carve-outs.

3.2.1. Sell-offs

A sell-off involves the outright sale of a business unit, subsidiary, or asset to another company—often for cash or stock. This form of divestiture allows the parent company to immediately liquidate its interest in the unit and generate cash, which can be used to pay down debt, reinvest in core operations, or distribute to shareholders. Sell-offs are typically pursued when the divested unit no longer fits within the strategic vision of the parent company. This form of divestiture is typically undertaken to raise funds, improve liquidity, or exit non-core businesses.⁹¹ For instance, companies often use sell-offs to eliminate underperforming divisions or those that no longer align with the corporate strategy. By doing so, firms can streamline their operations and focus on their primary business objectives.

⁹⁰ Schmidt J Richard, *The Divestiture Option: A Guide for Financial and Corporate Planning Executives* (Praeger 1990), 95-96.

⁹¹ *Supra* note 86, p. 506

In some cases, even well-performing units may be sold-off if the company encounters critical cash flow challenges. Such strategic divestitures can provide significant immediate financial relief by facilitating a substantial influx of cash. Here the parent sells a long-term asset that has been yielding a sustainable cash flow for a long period in exchange for a larger payment in the short run.⁹²

3.2.2. Spin-offs

A spin-off occurs when a parent company creates a new, independent company by distributing shares of the new company to its existing shareholders. This method is used to separate a subsidiary or division that may perform better as a standalone entity. Spin-offs allow the parent company to maintain control and benefit from the growth of the new entity.⁹³ Spin-offs can help companies streamline operations and focus on their core competencies. This strategy is commonly used when the parent company believes the subsidiary has growth potential that can be better realized as a standalone entity. Spin-offs often improve shareholder value by allowing the new entity to operate with greater flexibility and strategic focus.⁹⁴

In addition, by separating a division, the parent company can enhance the management team's concentration on its core operations, while the divested and newly formed entity can establish its own independent leadership team. This arrangement allows both the parent company and the spun-off entity to tailor their management approaches, optimizing performance in ways that align with their distinct goals and market conditions.⁹⁵

3.2.3. Carve-outs

Carve-outs involve the divestment and sale of a minority interest in a subsidiary through an IPO. This form of divestiture provides the parent company with cash while retaining control over the divested unit.⁹⁶

The rationale behind implementing such a strategy may include considerations such as efficiency, financial aspects, and other incentives. Parent companies might opt for carve-outs to enhance efficiency through the utilization of capital markets. In such scenarios, potential investors are provided with the opportunity to review the financial records of the divested entity and access additional information that was previously undisclosed within the parent company. This could convince investors to purchase the shares that are being offered. Carve-outs could

⁹² Supra note 80, p. 401.

⁹³ Myron B Slovin, Marie E Sushka and Steven R Ferraro, "A Comparison of the Information Conveyed by Equity Carve-Outs, Spin-Offs, and Asset Sell-Offs" (1995) 37 *Journal of Financial Economics* 89, p. 506

⁹⁴ Thomas J Chemmanur and An Yan, "A Theory of Corporate Spin-Offs" (2004) 72 *Journal of Financial Economics* 259, p. 260.

⁹⁵ Katherine Schipper and Abbie Smith, "Effects of Recontracting on Shareholder Wealth" (1983) 12 *Journal of Financial Economics* 437, p. 488.

⁹⁶ Supra note 93, p. 91

also serve as a means of generating funds and could be the most efficient financing strategy to parent companies while still maintaining control in the divested unit.⁹⁷

Further to the above, companies that undertake an equity carve-out strategy may also benefit from a second event advantage. In other words, the choice to undertake an equity carve-out serves as the initial phase of a two-part strategy with the subsequent steps involving either selling-off the subsidiary gradually or reacquiring it depending on the circumstances that give rise to such decision.⁹⁸

3.3. Procedures Followed In Business Unit Divestitures

3.3.1. Divestiture Plan

A divestiture plan outlines the steps and strategies a company will take to divest a business unit or asset. This plan typically includes the identification of the asset to be divested, valuation, marketing, negotiation, and the final process. Among others, a divestiture plan may include how the parent company's equity will be distributed between the two newly created firms. This includes the portion of ownership (shares) that the existing shareholders retain in each of the two firms and the management control of the two entities.⁹⁹ The allocation of the parent company's debt to the two entities is also another critical part of the plan. This distribution is done in a way that reflects the operational needs and financial capacity of each entity.¹⁰⁰ Therefore, a well-designed divestiture plan ensures the process aligns with the company's strategic goals and maximizes shareholder value.

3.3.2. Valuation and Fairness Opinion

Valuation, as discussed above, is the process of determining the market value of the business unit or asset to be divested. This involves financial analysis, market comparisons, and other quantitative assessments. A fairness opinion is a professional evaluation provided by an independent third party (mostly from investment banks) to assess whether the terms of the divestiture are fair from a financial perspective. A fairness opinion helps protect the interests of shareholders and ensures transparency in the divestiture process.¹⁰¹

3.3.3. Shareholders' Approval

For many divestitures, especially those involving significant assets or business units, shareholder approval is required to ensure transparency and protect shareholders' interests. Obtaining

⁹⁷ Eric A Powers, "Deciphering the Motives for Equity Carve-Outs" (2003) 26 *Journal of Financial Research* 31, p. 33.

⁹⁸ Enrico C Perotti and Silvia Rossetto, "Unlocking Value: Equity Carve Outs as Strategic Real Options" (2007) 13 *SSRN Electronic Journal* 771, p. 773.

⁹⁹ Chemmanur J Thomas and Yan An, "A Theory of Corporate Spin-Offs" (2004) 72 *Journal of Financial Economics* 259, p. 262.

¹⁰⁰ *Ibid*, p. 279 and 297

¹⁰¹ *Supra* note 90, p. 95-96.

shareholders' approval is a crucial step in the divestiture process as it legitimizes the decision and aligns it with the interests of the company's owners. This process typically involves presenting the divestiture plan to shareholders during a general meeting and securing a majority vote in favor of the transaction.¹⁰²

Shareholders' approval is a critical step in the divestiture process, especially for large-scale transactions that significantly impact the company's operations, structure, or valuation. For public companies, corporate governance norms and regulatory frameworks often mandate shareholder voting on divestiture decisions, particularly for substantial asset sales or spin-offs. This ensures that the interests of shareholders are represented in decisions that may influence stock value or corporate strategy.

The process typically involves:

- 1. Board Approval:** The board of directors endorses the divestiture plan.
- 2. Information Dissemination:** Shareholders are provided with detailed disclosures about the transaction, including financial impacts and strategic rationale.
- 3. Voting:** Shareholders vote on the proposal by extra-ordinary general meeting.

3.3.4. Regulatory Approvals

Regulatory approvals are essential to ensure that the divestiture complies with relevant laws and regulations. This may include antitrust reviews, environmental clearances, and other sector-specific regulations. Regulatory bodies, such as the Federal Trade Commission (FTC) in the United States or the European Commission in the European Union, review the proposed divestiture to prevent monopolistic practices and maintain market competition. Regulatory approvals are necessary to ensure that the divestiture aligns with public interest and legal standards.¹⁰³

Regulatory approvals are often required for divestiture transactions to ensure compliance with local, national, or international laws. Key regulatory considerations include:

- 1. Antitrust and Competition Laws:** Regulatory bodies such as the Federal Trade Commission (FTC) in the U.S. or the European Commission in the EU evaluate whether the transaction will reduce market competition or create monopolistic conditions.
- 2. Industry-Specific Regulations:** Certain sectors, like telecommunications, energy, or healthcare, may have additional regulatory oversight.

¹⁰² Frankel MES and Forman LH, *Mergers and Acquisitions Basics: The Key Steps of Acquisitions, Divestitures, and Investments* (John Wiley & Sons 2017), p. 97-98

¹⁰³ *Supra* note 80, p. 116

3. Cross-Border Approvals: For international transactions, companies must comply with the laws of all relevant jurisdictions, which may involve multiple regulatory agencies.

Obtaining regulatory approvals can be a lengthy and complex process, and often involves detailed documentation and negotiations to address any concerns raised by the authorities.

CHAPTER FOUR

REGULATING BUSINESS UNIT DIVESTITURE IN ETHIOPIA: EXPLORING POSSIBLE GAPS AND CONSTRAINTS

4.1. Divestiture as Corporate Restructuring Strategy under the Ethiopian Commercial Code

Ethiopia revised the OCC after 62 years of service to align with the country's growing economy and increasing integration into global markets. The RCC was enacted to modernize commercial laws and address contemporary business needs. It replaces Books I, II, and V of the OCC, which govern traders, business organizations, and insolvency, respectively. However, Books III (covering carriage and insurance) and IV (addressing negotiable instruments and banking transactions) of the OCC remain in effect. These sections will be in force until they are eventually replaced by the Financial Services Code.

The RCC has introduced significant updates to Ethiopia's commercial law. Some of the major changes include: the introduction of Limited Liability Partnerships (LLPs) and One-Person Private Limited Company (OPPLC); recognition of holding companies and group of companies; broader and more detailed provisions on mergers; the inclusion of division as a corporate restructuring strategy; the introduction of preventive restructuring measures; and provisions for the discharge of bankrupt individuals, among others.

While the RCC provides a general framework for mergers, acquisitions, and reorganizations, it does not specifically mention the term "divestiture" in any provision. The Code addresses related concepts through various provisions about restructuring, dissolution, and the sale of business entities and assets. Dissolution of companies, which involves legally ending a company's existence, is detailed in the Code, including voluntary dissolution through shareholder resolution, involuntary dissolution by court order due to bankruptcy, illegal activities, or statutory non-compliance, and the liquidation process for settling debts and distributing remaining assets to shareholders. Additionally, the sale of business assets is governed by the Code under the bankruptcy proceedings section, covering the drafting and execution of asset sale agreements, valuation of assets to ensure fair transactions, and the transfer of ownership, including necessary approvals and documentation.

Although the RCC provides a legal basis and procedural framework for corporate restructuring, it has significant gaps in addressing various types of divestitures and facilitating their implementation. Notably, the Code does not explicitly mention the term "divestiture" or classify its different forms. Furthermore, it imposes conditions that are inconsistent with divestiture concepts, particularly in the case of sell-off and carve-out transactions. For example, the Code

mandates that shareholders or partners of a merged or acquired business must receive shares in the resulting entity or the entity acquiring the divided assets, with supplementary cash payments when necessary. These requirements conflict with the nature of divestitures, especially sell-offs and carve-outs, where such mandatory share issuance or cash payments may not align with the objectives of these strategies.

Before the promulgation of the RCC, during its drafting stage, the Commercial Code Policy Document sought to emphasize the importance of including "division" within the Code. The policy document, prepared in Amharic, explains that:

የማኅበራት ክፍፍል በሁለት መንገድ ሊከናወን ይችላል። አንደኛው የተከፋፈሉት ማኅበራት ራሳቸውን ችለው እንደአዲስ የሚቋቋሙበት ወይም ወደ ሌላ ማኅበር የሚተላለፉበትና በዚህም የተነሳ የቀድሞው (የተከፈለው) ማኅበር ህልውና የሚያክትምበት (Split-up) ሲሆን ሁለተኛው ደግሞ የማኅበሩ የተወሰነ ሀብት ተከፍሎ አዲስ ማኅበር የሚመሠረትበት ወይም ወደ ሌላ ማኅበር የሚተላለፍበትና የአካፋዩ ማኅበር ህልውና ግን የሚቀጥልበት አሠራር ነው (Spin-off)። በንግድ ሕጉ ውስጥ ማኅበራት የሚከፋፈሉበትን ሥርዓት የሌለ በመሆኑ እንደዚህ ዓይነት ሁኔታዎች ቢፈጠሩ ተግባራዊ ለማድረግ የሚቻልበት ሁኔታ የለም። ለተሞክሮ በመረጥናቸው በሁሉም አገራት የከባንያ ሕግ የከባንያዎች መከፈል አሠራር የተለመደ ነው።

ስለዚህ የሚሻሻለው የንግድ ሕግ ማኅበራት የሚከፋፈሉበት ሥርዓትና ሲከፋፈሉ የማኅበራቱ ባለአክሲዮኖች መብትና ግዴታ ወደ ሌሎች ማኅበራት እንዴትና በምን ዓይነት መንገድ ተከፋፍሎ እንደሚተላለፍ በግልጽ መደንገግ ይኖርበታል።¹⁰⁴

The above is translated into English as follows:

The division of business organizations can be carried out in two ways: the first is when a business organization is divided and the divisions are established as new entities, or transferred to another entity, and as a result, the parent (the divided business organization) ceases to exist (Split-up). And second when a certain portion of the business organization's assets is divided and the division is established as a new entity or is transferred to another entity while the parent continues to exist (Spin-off).

Under the commercial code, there is no specific procedure for the division of business organizations. Therefore, in cases where such situations arise, there is no clear legal framework for practical implementation. However, the company laws of some countries we considered as a sample, the process of company division is commonly governed by corporate law in such countries.

¹⁰⁴ የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች፣ መጋቢት 2006፣ ገጽ 19.

Therefore, the commercial code under revision must include a clear framework for the division of business organizations, and also stipulate the rights and obligations of shareholders and how these rights and obligations are transferred to other entities when division is underway.¹⁰⁵

From the policy document, it can be understood that only spin-offs were considered as part of a division strategy, while sell-offs and carve-outs were overlooked. This limitation is also evident in Article 566(4) of the RCC, which states: “*Dividing a certain portion of asset means separating a business unit that can subsist separately or part of assets of an organization and transferring the same to a business organization that is under formation or to an existing organization by way of contribution.*”

The above sub-article may apply to spin-offs, as they involve separating a business unit of a company to form a standalone subsidiary. However, it does not apply to sell-offs, which involve the sale of a business unit and the transfer of ownership. Again, the phrase “...by way of contribution” also implies that the divested asset or unit cannot simply be sold, but rather must be transferred as a contribution to the capital of the receiving entity—likely in exchange for shares. This demonstrates sell-off was not envisaged as part of division during the drafting stage.

The provision is also vague when it comes to carve-outs. At first glance, it appears that a carve-out transaction could be carried out under this sub-article, as a carve-out involves separating a business unit from a company to form a standalone entity. However, as will be discussed in detail later in this paper, the procedural guidelines for division are not aligned with this sub-article to facilitate smooth execution of a carve-out strategy.

Further to the above, a team of national experts tasked with reviewing and providing feedback on the revision of the Old Commercial Code shared their observations and recommendations regarding division as follows:

The concept of “division” of business organizations is introduced in this title of the Draft. We appreciate the need for such concept which is now missing in the Code and recommends that further study be made on the matter and that the necessary provisions be included to regulate conversion, amalgamation and division under Title VIII of Book II. The extension of the application of these provisions to public enterprises and cooperative societies should also be examined.¹⁰⁶

The team’s recommendation, as clearly noted above, is for further study on conversion, amalgamation, and division, along with the inclusion of necessary provisions to regulate these processes. Apart this, the study makes no mention of divestiture, or forms of divestiture.

¹⁰⁵ Translation by author.

¹⁰⁶ Position of the Business Community on the Revision of the Commercial Code of Ethiopia, Prepared by A team of Fourteen National Experts, Private Sector Development Hub/Addis Ababa Chamber of Commerce and Sectorial Associations, 2009, p. 30.

The researcher also reviewed the explanatory note of the Revised Commercial Code. The note, particularly addressing mergers and divisions, states:

ሌላው የንግድ ሕጎችን ክፍተት የከባንያዎች መዋሃድ እና መከፈልን በተመለከተ ነው። በተለይም አንድ ከባንያ ለሁለት ወይም ከዚያም በላይ ሲከፈል በድርጅቱ ገንዘብ ጠያቂዎች እና በዚህ ውሳኔ በማይስማሙ ባለአክሲዮኖች ላይ ሊደርስ የሚችለውን ጉዳት ለመከላከል የሚረዳ አንድም ድንጋጌ አላካተተም። በአንጻሩ ከአንቀጽ 544 እስከ 554 ያሉት የንግድ ሕጎችን ድንጋጌዎች ስለመዋሀድ የሚደነግጉ ቢሆንም ከማሕበራት መለወጥ ጋር አንድ ላይ ነው፣ የተሟሉም አይደሉም። ረቂቅ ሕጉ በዚህ ረገድ ሕጎችን ያለበትን ክፍተት ለመድፈን በአንቀጽ 565-577 ሥር ዝርዝር ድንጋጌዎችን አካቷል።¹⁰⁷

The above is translated into English as follows:

The other gap in our commercial code pertains to merger and division of companies. In particular, it lacks a single provision to prevent potential damage to creditors of the company or dissenting shareholders when a company is divided into two or more entities. Conversely, while Articles 544 to 554 of our commercial code provide for mergers, they are grouped with conversion of companies and are not comprehensive. The draft law, however, incorporated detailed provisions under Articles 565 to 577 to fill this gap.¹⁰⁸

The explanation above highlights the shortcomings of the OCC in adequately and distinctly regulating mergers and divisions, noting that this gap was addressed in the draft RCC. When the RCC was issued, it introduced more comprehensive provisions on mergers and divisions, placing them in a separate section, yet it does not include detailed provisions governing divestitures. As a result, the explanatory note indicates that divestitures were not envisaged during the drafting of the Code.

Generally, the above background documents of the RCC indicate that while significant updates were made regarding mergers and divisions, the Code falls short of explicitly addressing "divestitures" as a distinct corporate restructuring strategy. This gap is evident in the provisions of the Code governing mergers and divisions, which neither adequately define nor comprehensively regulate divestitures.

Among the forms of divestitures, carve-outs, in particular, face legal and procedural challenges under the current framework. As discussed before, a carve-out involves divesting a business unit and establishing it as a subsidiary wholly owned by the parent company (the divesting entity). Subsequently, minority shares of the subsidiary are offered to investors through an IPO. While

¹⁰⁷ ረቂቅ የንግድ ሕግ አጭር ማብራሪያ፣ 2012 ዓ.ም፣ ገጽ 21.

¹⁰⁸ Translation by author.

the Ethiopian Capital Market Proclamation supports IPOs¹⁰⁹ by requiring that companies offering shares to the public to be established as share companies,¹¹⁰ the RCC does not facilitate carve-out transactions effectively.

Firstly, the Code does not recognize carve-outs as a distinct restructuring mechanism. Secondly, it requires a minimum of five members to form a share company,¹¹¹ which conflicts with the carve-out process where the parent company initially acts as the sole shareholder of the newly created subsidiary. As a result, the lack of a legal framework for carve-outs hinders their execution.

If the RCC explicitly recognized carve-outs within its corporate restructuring provisions, it could provide exceptions allowing the formation of a share company with a single shareholder during the carve-out process. Such recognition would enable businesses to establish divested units as share companies without being constrained by the minimum number of shareholders requirement, and thereby align with the practical realities of carve-out transactions.

One of the major challenges in implementing divestiture strategies in Ethiopia is the novelty of the concept in the country. The OCC lacked comprehensive provisions governing mergers, acquisitions, divisions, or divestitures. However, the RCC has made an effort to provide a more robust legal framework for regulating mergers, acquisitions, divisions, and other corporate restructuring activities by categorizing these activities primarily into two sections: mergers and divisions. Although the RCC attempts to include spin-off under the division section, it remains unclear whether Article 566(4) explicitly addresses divestiture. This ambiguity stems from the fact that the term "divestiture" is not explicitly mentioned in the Code. Moreover, this provision fails to adequately address the most common types of divestitures discussed earlier in this paper which leaves significant gaps in the legal framework.

Since the RCC does not explicitly address divestiture and lacks a dedicated section that recognizes and governs its various types, it remains unclear whether divestiture is considered as one of the corporate restructuring strategies in Ethiopia under the Code. Furthermore, the absence of specific provisions regulating divestitures creates legal uncertainty for companies seeking to divest their business units. For example, the lack of clear guidelines on the procedural and regulatory requirements for divestiture transactions may expose companies to inconsistent interpretations by regulatory bodies.

To address these gaps and constraints in regulating business unit divestitures in Ethiopia—and to determine whether divestiture is indeed recognized as a corporate restructuring strategy under the RCC—it is essential to explore the concept of divestiture beyond its limited association with division.

¹⁰⁹ Capital Market Proclamation, Article 2(32).

¹¹⁰ See Articles 2(13), 2(32) and 75 to 78.

¹¹¹ RCC, Article 552(2).

4.2. Looking at the Concept of ‘Divestiture’ Outside of ‘Division’: The Basis of Confusion and the Way Out

From the definitions provided in Article 566, it is evident that the RCC of Ethiopia integrates the concept of divestiture into its framework for division, albeit without explicitly recognizing divestiture as a distinct restructuring strategy. The inclusion of "dividing a certain portion of assets" under Article 566(4) suggests an attempt to accommodate the transfer of specific business units or assets as part of the division process. However, this provision remains limited in scope and does not fully capture the diverse forms and purposes of divestitures, such as sell-offs, carve-outs, or spin-offs.

The Code’s focus on the transfer of assets through division by acquisition or the formation of new organizations reflects a broader legal framework for restructuring but leaves significant gaps. For instance, the provision under Article 566(4) does not provide detailed guidance on the procedural, regulatory, or transactional requirements for divestitures that occur outside the context of a full division. Moreover, the absence of explicit recognition of divestiture types creates ambiguity, particularly for businesses seeking to implement strategies like carve-outs, which involve the transfer of a business unit into a subsidiary and the subsequent offering of its minority shares to the public.

From the Code's definition of "division," it can be understood that the term refers to the process of splitting a single entity into two or more separate entities, with the parent entity dissolving without liquidation. While the Code opts for the term "division," most countries and scholars commonly use the term "split-up" to describe this restructuring strategy.

Interestingly, the Commercial Code Policy Document, as discussed earlier, used the term "split-up" when referring to the division of a single business organization into multiple separate entities. However, when the RCC was issued, it adopted the term "division" instead. Despite this distinction, the terms "division" and "split-up" are often used interchangeably, though "split-up" is the more prevalent term internationally.

Unlike division, divestiture involves a company divesting or disposing of its assets, business units, facilities, or subsidiaries. Divestiture focuses on transferring parts of the company’s operations or assets without necessarily splitting the entity into new independent entities and without requiring the dissolution of the parent company. Moreover, divestiture—particularly through sell-offs—entails the transfer of ownership or control of a business unit or asset to an external party. Additionally, the motives behind division and divestiture differ significantly, as discussed in detail in Chapters Two and Three of this paper.

This lack of specificity raises important questions about how businesses can effectively navigate divestiture transactions within Ethiopia’s legal framework. Companies attempting to separate and transfer assets through processes not explicitly defined in the Code may face uncertainty in regulatory compliance, tax treatment, and shareholder rights. Consequently, there is a pressing

need to distinguish divestitures from divisions and establish a separate, comprehensive legal framework to govern these transactions. Doing so would provide clarity and consistency for businesses pursuing such strategies while fostering greater confidence in Ethiopia's corporate restructuring framework.

4.3. The Concept of Divestiture in Other Ethiopian Laws

4.3.1. Tax Legislations

The Federal Income Tax Proclamation¹¹² recognizes the concept of restructuring under the term “reorganization.” According to Article 35(1) of the Proclamation, if a resident company (“transferor”) transfers a business asset to another resident company (“transferee”) as part of reorganization:

- the transfer shall not be treated as a disposal of the business asset by the transferor;
- the transferee shall be treated as having acquired a business asset for a cost equal to the transferor’s cost for the asset at the time of the transfer; and
- if the transferee has issued shares in exchange for the transferred asset, the cost of the shares is equal to the cost of the transferred asset at the time of the transfer.

For the implementation of Article 35(1), the Proclamation provides a definition of "reorganization." Under Article 35(3), "reorganization" is defined as:

- a) *A merger of two or more resident companies;*
- b) *The acquisition or takeover of 50% or more of the voting shares and 50% or more of all other shares by value of a resident company solely in exchange for shares in another resident company that is a party to the reorganization;*
- c) *The acquisition of 50% or more of the assets of the resident company by another resident company that is a party to the reorganization solely in exchange for shares with voting rights but no preferential right to dividends;*
- d) *A division of a resident company into two or more resident companies; or*
- e) *A spin off.*

As discussed in Chapters Two and Three of this paper, a divestiture strategy typically allows the transferor to shed parts of its business assets, operations, or units to focus on core activities, enhance financial stability, or comply with regulatory obligations. This transfer can take various forms, including sell-offs, spin-offs, or carve-outs. However, the Federal Income Tax Proclamation appears to explicitly recognize only division and spin-off strategies for tax purposes.

¹¹² Federal Income Tax Proclamation, FEDERAL NEGARIT GAZETTE, EXTRA ORDINARY ISSUE, Proclamation No. 979/2016, 18 August 2016, Addis Ababa, (Hereinafter “Income Tax Proclamation”).

This recognition can be attributed to the nature of spin-offs. In a spin-off, a parent company establishes a new, independent company by distributing shares of the subsidiary to its existing shareholders on a *pro rata* basis. As a result, the ownership remains with the same group of shareholders as the parent company, and no immediate gain or profit is realized to trigger a tax event. Similarly, in the case of a division, the ownership in the newly formed or existing divided entities remains unchanged, as the shareholders of the original company retain proportional ownership in the divided entities. For these reasons, both spin-offs and divisions are treated as restructuring activities rather than taxable sales.¹¹³

Conversely, a sell-off transaction involves a company selling a business unit or assets to an external buyer for cash or other consideration. In such cases, ownership and control of the sold unit or assets are entirely transferred to the buyer. This transfer represents a realization event, as the seller receives cash or other assets in exchange for the business or asset sold, and there is no continuity in ownership or control. Consequently, sell-off transactions are subject to taxation under normal tax rules because they result in the recognition of gain or profit at the time of the sale.¹¹⁴

While the Income Tax Proclamation explicitly recognizes division and spin-off transactions, it does not specifically address carve-outs. In a carve-out, the parent company first divests a portion of its assets by establishing a new public company, which then offers shares of the subsidiary to the public through an IPO. Importantly, in a carve-out, only a minority stake is sold, and the parent company retains control over the subsidiary. Because of this structure, carve-outs are typically viewed in tax laws as a form of broader corporate restructuring rather than a full sale of assets. As a result, they are often treated as tax-free transactions¹¹⁵, similar to spin-offs and divisions, which do not trigger immediate taxation due to the lack of a complete transfer of ownership or control. However, the absence of clear legal provisions for carve-outs within the Income Tax Proclamation leaves room for potential ambiguity regarding their tax treatment. This highlights the need for further clarification or specific provisions addressing carve-out transactions within Ethiopia's tax laws to provide greater certainty for companies engaging in such restructuring strategies.

From the above analysis, we can conclude that the concept of divestiture is recognized within Ethiopia's income tax law. While only spin-offs are explicitly expressed in the form of reorganizations under the Proclamation, carve-outs also satisfy the conditions outlined in the corporate reorganization section of the Proclamation, and therefore must be accorded the same treatment as spin-off.

¹¹³ Rega, A. "THE TAX TREATMENT OF CORPORATE REORGANIZATION UNDER ETHIOPIAN LAW" (Thesis, Bahir Dar University, School of Law, 2019), p. 62.

¹¹⁴ DePamphilis D, *Mergers, Acquisitions, and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions* (Academic Press 2021), p. 318.

¹¹⁵ Kimberley E Frank and J William Harden, "Corporate Restructurings: A Comparison of Equity Carve-outs and Spin-offs" (2001) 28 *Journal of Business Finance & Accounting* 503, p. 510-511.

As divestiture plays a key role in corporate restructuring, it is crucial for Ethiopia's commercial law to establish a robust legal framework specifically tailored to address divestitures. Revising the Commercial Code in this manner would allow tax laws to better support and regulate diverse forms of divestitures beyond spin-offs, based on the specific characteristics of each transaction. Such amendments would not only provide greater clarity and consistency within the legal framework but also improve the flexibility and efficiency of corporate restructuring in Ethiopia.

4.3.2. Capital Market Legislations

The Capital Market Proclamation¹¹⁶ provides a legal framework for the establishment and regulation of a capital market in Ethiopia, covering stock exchanges, securities trading, and related financial transactions. Notably, the term "divestiture" is explicitly mentioned in the Proclamation under the section on "regulated capital market activities and services."

Article 55(1)(e) of the Proclamation outlines that corporate finance advice related to acquisitions, mergers, divestitures, combinations, and other activities involving the buying, selling, and exchanging of securities falls under the regulation of the Proclamation. This provision recognizes the importance of divestiture as a key element of corporate restructuring and the capital markets.

The Proclamation also defines an IPO,¹¹⁷ a critical component in executing a carve-out transaction. The Proclamation's stringent disclosure requirements also ensure that potential investors have access to comprehensive financial and operational information regarding both the parent company and the divested entity. This transparency is essential for fostering investor confidence and promoting the efficient functioning of the capital market.¹¹⁸

4.3.3. Trade Competition Legislations

Ethiopian trade competition laws also play a role in regulating divestiture transactions, particularly in assessing their impact on market competition. However, these laws primarily focus on mergers and acquisitions, with limited applicability to divestitures. For example, the Trade Competition and Consumer Protection Proclamation¹¹⁹ consolidates all corporate restructuring strategies under the single term "merger." As a result, the Proclamation lacks comprehensive provisions specifically addressing divestiture transactions.

Nevertheless, Article 9(3)(b) of the Proclamation provides that any direct or indirect acquisition of assets from a business organization is considered a merger and must be notified to the Ministry of Trade and Regional Integration if it meets the minimum threshold for notification. This provision could be interpreted to include divestiture transactions, as they typically involve

¹¹⁶ Capital Market Proclamation No. 1248/2021, FEDERAL NEGARIT GAZETTE, 27th Year, No. 33, 23 July 2021, Addis Ababa, (Hereinafter "Capital Market Proclamation").

¹¹⁷ See Article 2(32) of the Capital Market Proclamation.

¹¹⁸ See Article 77 of the Capital Market Proclamation.

¹¹⁹ Trade Competition and Consumers Protection Proclamation No. 813/2013, FEDERAL NEGARIT GAZETTE, 20th Year, No. 28, 21 March 2014, Addis Ababa, (Hereinafter "Trade Competition Proclamation").

the transfer of assets. However, the Proclamation's approach remains inadequate when it comes to regulating divestitures specifically. Therefore, there is a need for more specific legal provisions that directly address divestiture transactions, providing clearer guidance and greater legal certainty for businesses undertaking divestitures within the framework of competition law.

Generally, the regulation of business unit divestiture in Ethiopia faces significant gaps and constraints, including conceptual ambiguities, inadequate recognition in the RCC, and insufficient provisions in tax and trade competition laws. Addressing these challenges requires adopting clear legal definitions of divestiture, revising the Commercial Code to include divestiture-specific provisions, and amending tax and trade competition laws to provide comprehensive guidelines. By doing so, Ethiopia can foster a more conducive legal environment for corporate restructuring and economic growth.

4.4. Applying the Provisions of Division to the Execution of Divestitures under the Revised Commercial Code

The RCC outlines the necessary steps and requirements for both mergers and division transactions to ensure that they are carried out in a structured and legally sound manner. Below is an analysis of these provisions and their relevance to divestitures.

4.4.1. Division Plan

The Division Plan is a comprehensive document that outlines the economic rationale, conditions, and procedures for dividing a business organization. It must be approved by the Board of Directors or General Managers and should include detailed information on the distribution of assets and liabilities as required by the RCC.¹²⁰ Among the required details of Article 567, sub-article (2)(f) of the Code stipulates that the plan must specify “*the ratio applicable to the exchange of shares to be allotted owing to the merger or division and the determination of the amount of payment in cash, if any; the date from which the holding of such shares entitles the holder to participate in profits and any special conditions affecting that entitlement.*” While this provision is relevant for spin-offs, it is less applicable to sell-off and carve-out divestitures. In a sell-off, the transaction involves the outright sale of a business unit or asset, typically for cash or other consideration, without the issuance of new shares. Consequently, share exchange ratios are not relevant in such cases.

In a carve-out, the newly formed company, which results from the divested asset, is initially fully controlled by the parent company. The parent retains sole ownership until a minority stake is sold through an IPO. As a result, the shares sold belong to the carved-out subsidiary or the parent company itself, and there is no direct exchange of shares between entities. Therefore, share exchange ratios do not apply in carve-out transactions either.

¹²⁰ See Article 567 of the RCC.

Similarly, the provision under Article 567(2)(j), which states “*the rights and benefits to be accorded to preferred shareholders,*” is not applicable to sell-offs, as sell-offs do not involve the issuance of new shares or restructuring of shareholder rights. In a sell-off, the business unit or assets are sold outright, and existing shareholders' rights remain unchanged, making this provision irrelevant. Article 567(2)(g), which says “*the amount of money to be paid to members that leave owing to their opposition to the merger or division,*” is also not relevant to sell-offs. When a company sells a business unit, the cash received from the sale benefits the company and its shareholders. As a result, there is no need for shareholders to leave the company or be compensated for their opposition, as the transaction does not trigger such scenarios.

Furthermore, a division plan may not be entirely suitable for a sell-off, as a sell-off involves the transfer of part of the company's assets or business units to a third party. This is fundamentally an asset transfer or divestiture, not a division of the company. Unlike a division, which results in the splitting of the organization into multiple entities, a sell-off is focused on the transfer of ownership and control of assets or business units to external parties.

4.4.2. Directors or Managers Division Report

Directors or Managers are required to prepare a division report, which provides a comprehensive overview of the proposed division. This report includes financial statements, asset valuations, and other relevant information to ensure transparency and accountability.¹²¹ However, as previously noted, the specifics required by the Code to be included in the division report—such as shares to be exchanged,¹²² payment to the leaving shareholders,¹²³ and the division agreement¹²⁴—are not applicable to sell-offs and carve-outs. This is because sell-offs are typically governed by sale agreements, rather than division agreements, and carve-outs involve the formation of a new entity with no direct share exchange between the parent and the divested unit. Therefore, some items in the division report, as outlined in the Code, do not align with the nature of these transactions.

4.4.3. Examination of Division Report

The Division Report must be reviewed by an independent body and impartial expert or authority to ensure its accuracy and compliance with legal requirements. This examination helps identify any potential issues or discrepancies that need to be addressed before the division can proceed.¹²⁵ Each of the business organizations involved in the division is required to appoint its own

¹²¹ See Article 568 of the RCC.

¹²² See Article 568(2)(c) of the RCC.

¹²³ See Article 568(2)(d) of the RCC.

¹²⁴ See Article 568(2)(b) of the RCC.

¹²⁵ See Article 569 of the RCC.

independent and impartial expert for the examination. However, a joint expert may be appointed if all the business organizations involved in the division agree to that effect.¹²⁶

First, the mandatory requirement under the Code for the appointment of independent and impartial experts is not applicable to sell-offs and carve-outs. In these transactions, experts are engaged in a more limited capacity, primarily for valuation and compliance purposes, rather than to meet the extensive division requirements outlined in the Code. The appointment of experts in sell-offs and carve-outs differ from that in divisions, and it should not follow the same stipulations in the Code. In a sell-off, the appointment of experts typically involves internal management or financial advisors handling valuation and planning. These experts do not serve the same role as those in divisions, where their task is to ensure fairness and compliance with the division's intricate legal and financial structure. In contrast, in a carve-out, experts may be engaged to value shares for the IPO, but this process is specific to the carve-out and does not require independent experts to be appointed under the same rules as auditors or for the purpose of reviewing a division.

Second, as previously noted, the expert opinion required by the Code on certain conditions—such as the fairness and reasonableness of shares to be exchanged,¹²⁷ share exchange ratios and valuation methods,¹²⁸ and the appropriateness of the payments proposed to leaving shareholders¹²⁹—are irrelevant in the context of sell-offs and carve-outs. In a sell-off, since there is no share exchange or issuance of new shares, these conditions do not apply. Similarly, in a carve-out, while a new company is formed, the transaction does not involve the same type of share exchange or shareholder compensation that the Code requires for divisions. Instead, the focus is on the valuation of the divested assets or business units and the structuring of the sale or the IPO, not on matters like fairness opinions regarding share exchange or the payment to departing shareholders. Therefore, the expert's role in sell-offs and carve-outs is much more focused and limited compared to the comprehensive review required in divisions.

4.4.4. Publicizing Division Plan

The Division Plan must be made public to ensure transparency and allow stakeholders, including shareholders and employees, to be informed about the proposed division. This publicizing process helps build trust and ensures that all parties are aware of the changes.¹³⁰ However, as noted earlier, a division plan may not be required for a sell-off. Consequently, the publication requirement may not be relevant for divestitures executed through sell-offs. That said, should the RCC be amended to formally recognize sell-offs as a form of divestiture, the publication of the sell-off decision might become necessary. The specific requirements for publication could

¹²⁶ Ibid.

¹²⁷ See Article 569(4)(a) of the RCC.

¹²⁸ See Article 569(4)(b) of the RCC.

¹²⁹ See Article 569(4)(c) of the RCC.

¹³⁰ See Article 572 of the RCC.

depend on factors such as the size of the sale and its potential impact on the company's structure or financial position.

4.4.5. Effects of Division

According to Article 574 of the RCC, division results in the following effects:

1. The winding up of the business organization that ceases to exist, without the need for liquidation.
2. The transfer of all the assets and liabilities of the business organization that ceases to exist due to the division, to the acquiring or newly formed business organization.
3. The issuance of shares in exchange to the shareholders or partners of the business organization that is wound up, in the acquiring or newly formed business organization, with payment in cash, if necessary.
4. The conferral of shares to members of the business organization that transferred a portion of its assets or a business unit, to either a business organization under formation or an existing organization, depending on the terms of their agreement. This may involve the transferring organization, the newly formed business organization, or the organization to which the assets were transferred.

From the above effects of division, it is clear that almost all the stipulated effects are tailored to a split-up/division restructuring. The only effect that may apply to a spin-off is effect No. 4. Apart from this effect, the rest are not relevant to divestitures. Furthermore, effect No. 4 does not apply to sell-offs and carve-outs for the reasons discussed in detail earlier.

Additionally, effects such as winding up without liquidation, the transfer of all assets and liabilities, and the issuance of shares in exchange are specific to split-ups and not applicable to divestitures. These effects are integral to division transactions, but do not align with the nature of divestitures.

In general, an examination of the provisions of the RCC governing division in the context of divestiture reveals that these provisions were primarily designed to regulate split-up transactions and, to some extent, spin-offs. However, beyond these specific types of corporate restructuring, the Code does not adequately address other forms of divestiture transactions. A careful review of the relevant provisions of the Code, alongside international practices in divestiture, highlights that the existing legal framework is insufficient to effectively support a comprehensive divestiture strategy.

Moreover, since a split-up or division is considered an independent transaction, conflating spin-offs with divisions within the Code creates unnecessary ambiguity. The Code's failure to recognize sell-offs and carve-outs as distinct forms of divestiture further compounds this

confusion, posing significant challenges for both practitioners and regulators. This lack of clarity inhibits the smooth execution of divestiture strategies and creates unnecessary hurdles in practice.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

In the rapidly evolving global marketplace, competition is a critical driver of corporate restructuring strategies. Businesses face countless challenges, including shifting customer preferences, technological advancements, market dynamics, and economic conditions. These factors necessitate constant adaptation to maintain competitiveness and ensure survival. Concepts such as performance oversupply, market saturation, and changing bases of competition underscore the importance of strategic agility in addressing evolving market demands.

Michael Porter's five forces framework further highlights the dynamics of competition, demonstrating how the interplay of new entrants, substitutes, buyer and supplier power, and industry rivalry shapes market outcomes. Companies that fail to adapt to these forces risk diminished profitability and market relevance.

In alignment with Darwin's "survival of the fittest" theory, the ability to innovate, adapt, and align with customer needs determines a company's longevity and success. Customers, not companies, ultimately dictate the trajectory of business decisions. As such, organizations must prioritize customer-centric approaches, delivering products and services that meet evolving expectations.

The fluid nature of competition and evolving market dynamics underscore the necessity for companies to continually adapt and redefine their strategies. Corporate restructuring emerges as a pivotal mechanism to address these challenges by ensuring businesses remains aligned with shifting market demands, technological advancements, and competitive pressures. Far from being a singular event, corporate restructuring is an ongoing process that encompasses both internal and external approaches to modify an organization's operational, financial, and legal frameworks. Hence, it is not merely a reaction to challenges but also serves as a proactive strategy for sustained growth. Firms that embrace competitive pressures as opportunities for innovation and adaptation are better positioned to thrive in an ever-changing market landscape. Conversely, those that resist change or misalign with market demands risk obsolescence and decline.

Among the various modalities of corporate restructuring, mergers and acquisitions (M&A) stand out as transformative strategies. By combining resources, expanding market reach, achieving economies of scale, and fostering innovation, M&A enable firms to enhance their competitiveness and resilience. Whether through horizontal, vertical, or conglomerate mergers or through asset and equity acquisitions, these approaches offer companies a faster, more strategic path to growth compared to organic methods. Additionally, M&A allow firms to diversify

revenue streams, access new technologies, and strengthen their market positions, making them a preferred choice for businesses aiming to thrive in today's volatile landscape.

The Revised Commercial Code (RCC) reinforces the importance of these strategies by providing a legal framework for M&A. Its provisions recognize both the formation of new organizations and the acquisition of preexisting entities through M&A, reflecting the significance of these transactions in modern business operations.

Mergers, acquisitions, leveraged buyouts (LBOs), and management buyouts (MBOs) are powerful corporate restructuring strategies that help companies achieve operational, financial, and strategic objectives. By leveraging these approaches, businesses can unlock synergies, enhance competitiveness, and optimize their financial structures in response to evolving market dynamics.

One of the central benefits of M&A lies in the realization of operational and financial synergies. Economies of scale and scope enable companies to reduce costs and optimize resources, while financial synergies improve access to capital and create tax advantages. Similarly, LBOs provide firms with opportunities to acquire underperforming businesses, apply fiscal discipline, and enhance financial health through debt reduction and operational improvements. Despite the risks, such as potential bankruptcy due to excessive leverage, LBOs present unique opportunities for value creation. MBOs, on the other hand, empower management teams to assume ownership and leadership of a business, aligning their interests with its long-term success. By leveraging a combination of debt, equity, and seller or private equity (PE) financing, MBOs incentivize managers to drive growth and profitability. Although these transactions involve significant financial commitments and personal stakes from PE partners, the management team's deep operational expertise often mitigates such risks.

In contrast, split-ups facilitate the creation of independent entities, enabling shareholders to benefit from streamlined governance and a sharper focus on specialized operations. This restructuring strategy often leads to improved valuations and operational efficiencies, particularly when addressing diseconomies of scale or adapting to shifting market preferences. Companies that once pursued diversification during economic booms may later adopt a split-up strategy to prioritize investment in specialized businesses over maintaining a conglomerate structure, depending on the business environment.

Divestitures provide firms with a tactical approach to refining their strategic focus by shedding non-core or underperforming assets. By reallocating resources to areas of strength, companies can enhance their competitive positioning, reduce debt, and optimize shareholder value. This strategy is particularly effective in addressing regulatory challenges, improving financial performance, and fostering agility in dynamic markets.

As a corporate restructuring strategy, divestiture plays a pivotal role in helping organizations refocus on core operations, strengthen financial performance, and navigate regulatory or strategic

challenges. Its various forms—sell-offs, spin-offs, and carve-outs—offer distinct pathways for companies to achieve their objectives, each tailored to specific strategic needs. While sell-offs generate immediate liquidity, spin-offs unlock shareholder value through independent operations, and carve-outs provide access to public capital markets, demonstrating the flexibility and utility of divestiture strategies. Ultimately, divestitures represent a versatile tool for businesses seeking to adapt to changing market conditions, streamline operations, and maximize shareholder value, underscoring their integral role in modern corporate strategy.

Executing divestitures effectively requires meticulous planning, including strategic assessments, accurate valuations, buyer identification, and post-transaction management. The distinction between voluntary and involuntary divestitures highlights the various drivers behind such transactions—whether proactive corporate decisions or regulatory mandates. Incorporating valuation processes and fairness opinions enhances transparency and safeguards shareholder interests.

The divestiture process involves several critical steps, including formulating a comprehensive plan, conducting valuations, obtaining fairness opinions, securing shareholder and regulatory approvals, and ensuring proper publication and disclosure. These elements contribute to the transparency, efficiency, and alignment of the transaction with corporate goals and stakeholder interests. The distinction between voluntary and involuntary divestitures further underscores the strategic and external forces influencing these decisions, whether driven by proactive realignment or regulatory compliance.

The RCC took a significant step toward modernizing the country’s corporate legal framework. However, despite its efforts to comprehensively regulate mergers and divisions, it falls short of explicitly recognizing and addressing divestitures as a distinct corporate restructuring strategy. The absence of clear legal provisions governing divestitures creates ambiguity, and this makes it difficult for businesses to navigate divestiture transactions effectively. This gap is especially apparent in the RCC’s approach to divestiture, where it conflates divestiture with division and lacks comprehensive provisions that align with the diverse transactional and strategic objectives of such transactions.

While the Ethiopian tax and capital market laws offer some level of recognition for divestiture-related transactions, they, too, lack clarity in defining and regulating divestitures comprehensively. The existing tax framework primarily acknowledges spin-offs, while the capital market laws refer to divestitures in the context of securities trading and corporate finance. However, without explicit legal recognition and procedural guidelines, divestiture transactions will remain subject to inconsistent regulatory interpretations which will have a deterring effect to businesses seeking this strategy.

To bridge these gaps, Ethiopia’s commercial law must adopt a more structured approach to divestitures by explicitly defining their various forms and providing a dedicated legal framework

for their execution. Such amendments would ensure greater legal certainty, facilitate strategic corporate restructuring, and align Ethiopia’s business environment with global best practices. Incorporating divestiture-specific provisions into the RCC would also enhance regulatory consistency across different legal domains, including tax, capital markets, and competition law. By doing so, Ethiopia can create a more dynamic and investor-friendly corporate landscape that encourages business growth, financial stability, and economic competitiveness.

5.2. Recommendations

Ethiopian companies, like their global counterparts, operate in an increasingly dynamic business environment shaped by evolving customer preferences, rapid technological advancements, shifting market conditions, and the growing influence of foreign direct investment under the government’s ongoing economic liberalization policy. These factors necessitate continuous corporate restructuring to maintain competitiveness and operational efficiency.

While the revision of the OCC aimed to regulate the modern business landscape, and the RCC is designed to remain in force for decades, its failure to adequately address divestiture—an essential and widely practiced corporate restructuring strategy—creates a regulatory gap that could hinder business flexibility and strategic realignments. The current framework conflates divestiture with corporate division and lacks tailored provisions to accommodate the diverse transactional and strategic objectives of divestitures. Addressing this shortfall is crucial to fostering a more comprehensive and adaptive corporate legal framework.

To bridge this gap, the researcher recommends the following key amendments to the RCC:

❖ Introduce a Dedicated Legal Framework for Divestitures

The RCC should be amended to include a dedicated section with comprehensive and specific provisions governing divestiture transactions, outlining procedural requirements and their legal implications. This revision should encompass key aspects such as mechanisms for asset and liability allocation, shareholder approval and disclosure obligations, shareholder rights, and creditor protections to ensure transparency, fairness, and legal certainty in divestiture processes.

❖ Recognize and Define Various Forms of Divestiture Strategies

The revised Commercial Code should introduce various forms of divestitures, including spin-offs, split-offs, and equity carve-outs, and give clear legal definitions to align with international best practices. Each form should be supported by tailored regulatory provisions that address its distinct legal and procedural implications to ensure clarity, consistency, and effective implementation.

❖ **Align Divestiture Regulations with International Standards**

The RCC should be revised to incorporate legal principles and best practices from jurisdictions with advanced corporate restructuring frameworks to enhance investor confidence and encourage foreign direct investment. Additionally, clear guidelines should be established to facilitate cross-border divestitures to enable Ethiopian businesses engage in international transactions without excessive legal uncertainties.

By implementing these recommendations, the RCC can foster a more comprehensive, transparent, and business-friendly regulatory environment that supports corporate restructuring, enhances market efficiency, and strengthens Ethiopia's position as an attractive investment destination.

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Explanatory Notes

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