ADDIS ABABA UNIVERSTY
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# THE ROLE OF STOCK MARKETS IN ENHANCING CORPORATE GOVERNANCE OF SHARE COMPANIES IN ETHIOPIA.

BY
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# The Role of stock market in Enhancing Corporate Governance of

# Share companies in Ethiopia

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Submitted in partial fulfillment of the requirements for  the Degree of Master of Laws in Business Law

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APPROVAL SHEET

The role of stock market in enhancing corporate governance of Share companies in Ethiopia

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## Declaration

I declare that the thesis is my original work and has not been presented for a degree in any other University before. All referred materials are duly acknowledged.

Hagos Redae ______________________________

Addis Ababa University

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## Abstract

*This study examined the role of stock markets in enhancing corporate governance practices among share companies in Ethiopia. In many economies, stock markets serve as a critical platform for promoting transparency, accountability, and regulatory compliance, all of which are central to strong corporate governance. Although Ethiopia lacks a fully operational stock market, the study explored the potential impact of establishing one on the governance structures of Ethiopian share companies. It discussed how stock markets could improve investor protection, foster better management oversight, and create more stringent regulatory frameworks.. By drawing on lessons from other emerging economies, this study provides policy recommendations aimed at aligning Ethiopia's corporate governance landscape with international standards, thus promoting sustainable economic growth and investor confidence.*

*To enhance corporate governance in Ethiopia, key recommendations include strengthening regulatory oversight by enforcing governance regulations and establishing an oversight body outside the financial sector, improving board and management selection through merit-based appointments, and increasing transparency with mandatory financial reporting and conflict-of-interest disclosures. Additionally, promoting shareholder activism by strengthening rights and protections, offering corporate governance training, enhancing market infrastructure with digital platforms and investor protections, and aligning corporate governance with international best practices to attract foreign investment are essential. Implementing these measures will improve governance, boost investor confidence, and foster sustainable economic growth.*

CHAPTER ONE

Introduction

## 1.1 Background of the Study

Corporate governance is a critical aspect of ensuring the proper management and oversight of companies, particularly those that are publicly traded. In recent years, there has been a growing body of research that focuses on the role of stock markets in enhancing corporate governance practices within share companies. The Ethiopian stock market, as a relatively new and developing market, presents an interesting case study for examining the impact of stock markets on corporate governance.

The Ethiopian stock market has experienced significant growth and expansion in recent years, attracting a growing number of domestic and international investors. However, concerns have been raised about the effectiveness of corporate governance practices in Ethiopian share companies, and the role of the stock market in enhancing these practices remains unclear[1].

Through a comprehensive review of existing literature, this study aims to shed light on the extent to which the Ethiopian stock market has influenced corporate governance practices in share companies. By understanding the mechanisms through which stock markets can enhance corporate governance, policymakers and practitioners can better promote transparency, accountability, and shareholder value within Ethiopian companies.

Good corporate governance enhances the confidence of investors in the companies and positively contributes towards the overall business environment. Well-governed companies often draw huge investment premiums, get access to cheaper debt, and outperform their objectives.[2] In companies with dispersed ownership, shareholders are usually unable to closely monitor management, its strategies and its performance for lack of information and resources. In companies with dispersed ownership, shareholders are usually unable to closely monitor management, its strategies and its performance for lack of information and resources.[3] Hence, the function of non-executive directors in one-tier board structures and supervisory directors in

[1] Gebrehiwot, A., and Tegene, B. "The Ethiopian stock market: Performance, challenges, and future prospects" (2018) 6 International Journal of Economics, Commerce and Management, 33-50.

[2] *Report of High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe*, Brussels, (4 Nov. 2002), p.59

[3] A. C. Fernando, *Corporate Governance: Principles, Policies, and Practices*, (2006) (Pearson Education), p.12

two-tier board structures is to fill the gap between the uninformed shareholders as principals and the fully informed executive managers as agents by monitoring the agents more closely.

corporate governance requires competent board of directors as a supervising body for the executive management of a company.

The term 'corporate governance' is interpreted in varying ways by different scholars and practitioners. Economists and social scientists, for instance, tend to define it broadly as "the institutions that influence how business corporations allocate resources and returns"; and "the organizations and rules that affect expectations about the exercise of control of resources in firms."[4] This definition encompasses not only the formal rules and institutions of corporate governance, but also the informal practices that evolve in the absence or weakness of formal rules.

Corporate managers, investors, policy makers, and lawyers, on the other hand, tend to employ a narrower definition. For them, corporate governance is the system of rules and institutions that determines the control and direction of the corporation and that defines relations among the corporation's primary participants.[5] The definition used in the United Kingdom's 1992 Cadbury Report is widely cited from this perspective, and it reads: "Corporate governance is the system by which businesses are directed and controlled."[6]

This narrower definition focuses almost exclusively on the internal structure and operation of the corporation's decision-making processes, and is central to public policy discussions about corporate governance in most countries.[7]

It is to be noted that corporate governance differs from corporate management. Corporate governance extends beyond management to ensure fair, efficient, and transparent administration, aiming to achieve long-term goals that satisfy stakeholders, comply with laws and regulations, and address environmental and community needs.

Thus, corporate governance refers to all issues related to ownership and control of corporate property, the rights of shareholders and management, powers and responsibilities of

[4] Jeswald W. Salacuse, Corporate Governance in the New Century, (2004) 3 *The company Lawyer*, p.69

[5] Ibid, p.69

[6] The European Corporate Governance Institute, *Report on the Financial Aspects of Corporate Governance, (Cadbury Report)*, www.ecgi.global/publications/codes/cadbury-report-the-financial-aspects-of-corporate-governance, *accessed March 24, 2024.*

[7] Lijalem Endalew, 'The Doctrine of Piercing the Corporate Veil: Its Legal and Judicial Recognition in Ethiopia' (2012) 6 *Mizan Law Revie*

the Board of Directors, disclosure and transparency of corporate information, the protection of interests of stakeholders that are not shareholders, enforcement of rights, etc.[8] Corporate governance systems depend upon a set of institutions such as laws, regulations, contract enforcements and norms that create self-governing firms as the central element of a competitive market economy.[9] These institutions ensure that the internal corporate governance procedures adopted by firms are enforced and they render management responsible to owners and other stakeholders.

The definition of 'corporate governance' is not provided under the Ethiopian company law. For the purpose of this study, it is thus important to adopt a working definition for corporate governance as a system of rules and institutions that determine the control and direction of a company and that define relations among the company's primary participants including board of directors, managers, shareholders and other stakeholders.[10] This combines the narrow and broad definitions and it considers corporate governance as a system of rules and institutions which determine the control and direction of a company. It recognizes not only shareholders but also stakeholders that should be involved in the governance of share companies.

### 1.2. Literature Review

The Ethiopian stock market, though still in its nascent stage, is expected to bring about several improvements in corporate governance practices. The stock market provides a platform for share companies to secure capital, strengthening their financial stability and growth prospects. It also promotes transparency and accountability by mandating compliance with strict disclosure and reporting requirements.

One of the primary ways the stock market can enhance corporate governance is by improving transparency. Listed companies are required to disclose financial and operational information but also stakeholders such as suppliers of finance, depositors, creditors, the community, the regulators and executive organs such as ministry of trade and industry as well as courts which enforce rights and obligations of such participants regularly, which helps in

[8] Fekadu Petros, 'EMERGING SEPARATION OF OWNERSHIP AND CONTROL IN ETHIOPIAN SHARE COMPANIES: LEGAL AND POLICY IMPLICATION' (2010) 4 Mizane Law Rev. p.4; Fekadu Petros, 'Ethiopian Company Law', Far East Trading Ltd., Addis Ababa, Amharic, 2004, p.118.
[9] Fernando,(n3), p.13.
[10] Company primary participants should not be limited to insiders (shareholders, managers and board of directors)

reducing information asymmetry between the management and shareholders. This transparency keeps shareholders informed about the company's performance, enabling them to make more informed investment choices.[11]

The establishment of a stock market necessitates a robust regulatory framework to oversee the activities of listed companies. This framework includes regulations that protect the rights of shareholders, ensure fair trading practices, and prevent market manipulation. By adhering to these regulations, companies can build investor confidence and attract more investments.[12]

The stock market can also promote good governance practices by encouraging companies to adopt international standards of corporate governance. For instance, the OECD Principles of Corporate Governance provide guidelines on the responsibilities of the board, the rights of shareholders, and the role of stakeholders. By adhering to these principles, Ethiopian share companies can strengthen their governance frameworks and boost their overall effectiveness.

Corporate governance refers to the system by which companies are directed and controlled. It involves the interaction between various participants, including shareholders, board of directors, and company management, in shaping the corporation's performance and ensuring accountability. In Ethiopia, the establishment of a stock market is anticipated to play a significant role in enhancing corporate governance among share companies.[13]

The Ethiopian stock market has the potential to significantly enhance corporate governance among share companies. By promoting transparency, strengthening the regulatory framework, and encouraging the adoption of good governance practices, the stock market can contribute to the sustainable growth and development of the corporate sector in Ethiopia.[14]

The Ethiopian stock market has been playing a pivotal role in enhancing corporate governance practices in share companies operating within the country. This literature review explores the role of the Ethiopian stock market in improving corporate governance in share companies.

[11] *Tamiru A.* and *Lamessa G*, 'The Gaps and Lessons of Ethiopian Share Company Governance in Light of International Company Model Laws' (2021) 7 Journal of African and Asian Studies, iiste.org, accessed 05 may 2024.

[12] Simachew G.. 'Ethiopian Share Company Law in Light of OECD Principles of Corporate Governance', (2015) www.abyssinialaw.com/blog/ethiopian-share-company-law-in-light-of-oecd-principles-of-corporate-governance, accessed 10 April 2024,

[13] Corporate Governance, African Peer Review Mechanism (APRM), https://aprm.au.int/en/focus/corporate-governance, accessed 10 April 2024,

[14] Organization for Economic Co-operation and Development (OECD), *Corporate Governance,* www.oecd.org/en/topics/policy-issues/corporate-governance, *accessed 10 April 2024*

## 1.3. Statement of the Problem

Despite the growing importance of corporate governance in ensuring transparency, accountability, and fairness within share companies, there is limited research on the role of the Ethiopian stock market in enhancing corporate governance practices. This gap in the literature hinders a comprehensive understanding of how the stock market can contribute to improving corporate governance standards in Ethiopia. Therefore, this study aims to investigate the extent to which the Ethiopian stock market influences corporate governance practices within share companies and identify key factors that may enhance or impede this relationship.

**1.4.** Research questions:

- What is the current state of corporate governance, stock market and share companies' in Ethiopian share companies?
- What are the overviews of the New Stock market proclamation?
- What is the role of Stock markets in enhancing corporate governance of share companies?
- What are the Challenges of Stock markets in enhancing corporate governance?

## 1.5. Objectives of the Study

The main objective of this study is to assess the role of the Ethiopian stock market in enhancing corporate governance practices in share companies. Specific objectives include:

To analyze the current state of corporate governance, stock market and share companies' in Ethiopian share companies.

2.To assess the scope of the overviews of the New Stock market proclamation?

3.To probe the role of Stock markets in enhancing corporate governance of share companies

4.To Examine the Challenges of Stock markets in enhancing corporate governance?

## 1.6. Significance of the Study

This study is significant as it will provide insights into the relationship between the Ethiopian stock market and corporate governance practices in share companies. The findings of the study can be used by policymakers, regulators, investors, and other stakeholders to make informed decisions regarding corporate governance and stock market development in Ethiopia.

## 1.7. Scope of the Study

This study focused on Ethiopian share companies .It covered the Stock market, and corporate governance of the share companies.. Besides , it analyzed the impact of the stock market on their governance practices.

## 1.8. Limitations of the study

This study may be constraint by the availability and quality of data pertaining to the Ethiopian stock market and corporate governance practices. Another limitation is the scope of the study, as it may not have considered all factors that could influence the relationship between the Ethiopian stock market and corporate governance and this limited its scope of triangulation.

## 1.9. Methodology

For this study descriptive approach was used. Data were collected from primary sources and secondary sources. Primary sources were collected using interview and Legislations assessments Secondary data was collected from academic journals, reports, and other relevant sources.

Data analysis involved qualitative analysis related to the role of the Ethiopian stock market in enhancing corporate governance practices.

# CHAPTER TWO

Essentials of Corporate Governance, Stock Markets, and Share Companies

### 2.1. Definition of corporate governance

Corporate governance has gained unprecedented global significance due to several factors. These include its recognition as a crucial element in enhancing the long-term economic performance of countries and corporations[15], the rising concern over corporate governance following numerous fraud cases[16] corporate failures such as the collapses of Enron in 2001 and WorldCom in 2002[17] and the global financial crisis of 2007/8, which stemmed from poor governance practices in the financial sector.

Corporate governance is a system of rules and institutions that determine the control and direction of the corporation and define relationships among key participants. These key participants include shareholders, management, and the board of directors. Another definition of corporate governance is “the set of processes, customs, policies, laws, and institutions affecting how a corporation is directed, administered, or controlled.” This definition is narrower, focusing primarily on the internal structure and decision-making processes within a company.

The Organization for Economic Co-operation and Development (OECD) principles of corporate governance typically address five main topics related to the internal structure of corporations: the rights of shareholders, equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board of directors. Modern corporate governance may also encompass corporate social responsibility, considering the interests of various stakeholders, including employees, suppliers, customers, banks, other lenders, regulators, the environment, and the broader community.

Generally, modern corporate governance covers all issues related to the ownership and control of corporate property, shareholders’ rights, management, the powers and responsibilities of the board of directors, the disclosure and transparency of corporate information, the protection of stakeholders’ interests in addition to those of shareholders, and the enforcement of rights. A

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[15] Strine L., E., Jr, ‘One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?’ (2010) 66 Business Lawyer, p. 1-26

[16] Khatab H., Masood M., Zaman K., Saleem S., and Saeed B., ‘Corporate Governance and Firm Performance: A Case study of Karachi Stock Market’, (2010) 2 International Journal of Trade, Economics and Finance, p. 39-43

[17] Sanda A., Mikailu A., and Garba T., ‘Corporate governance and firm financial performances in Nigeria’, African Econometrics Research Conference (AERC) (2005) 149 Research Paper, p. 1-16

significant challenge in corporate governance is the separation of ownership and control, which leads to agency costs.

A recent definition describes corporate governance as the establishment of structures, processes, and mechanisms that ensure a firm is directed and managed in a way that enhances long-term shareholder value through managerial accountability, thereby improving firm performance. Consequently, corporate governance has become a vital factor in managing organizations in today's global and complex environment.[18]

Numerous researchers have examined the impact of corporate governance mechanisms on firm performance from various perspectives and in different environments, using a range of variables. These studies have yielded mixed results regarding the relationship between corporate governance mechanisms and firm performance.[19] Beyond its impact on firm performance, corporate governance is also related to the principal-agent relationship between shareholders and managers. Enhancing corporate governance is the primary method for mitigating agency problems. The emergence and growth of private corporations in Ethiopia necessitate improvements in corporate governance mechanisms, as empirical evidence[20] indicates the presence of agency problems that may undermine shareholder interests.

Effective corporate governance is crucial for enhancing investor confidence, expanding the private sector, and stimulating economic growth.[21] In many developing countries, particularly in Africa, there is a growing recognition of the missed opportunities to mobilize financial resources in domestic and international capital markets through good corporate governance. This realization has captured the interest of African Heads of State, including Ethiopia, prompting
them to include corporate governance as one of the four thematic areas under the African Peer
Review Mechanism (APRM)[22].

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[18] Fekadu G.,'Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications', (2010) 4 Mizan Law Review, p. 4

[19] Tewodros M. "Governance of Share Companies in Ethiopia" (2011), 4 Ethiopian Business Law Series, Addis Ababa University School of Law, page 53.

[20] Tura, H., 'Overview of Corporate Governance in Ethiopia: The Role, Composition and Remuneration of Boards of Directors in Share Companies" (2012) 6 Mizan Law Review, p. 45-76

[21] Seward Montgomery, 'Corporate Governance in Developing Countries: Shortcomings, Challenges & Impact on Credit', (2007) 9Modern Law for Global Commerce, p.1.

[22] Corporate Governance, African Peer Review Mechanism (APRM), https://aprm.au.int/en/focus/corporate-governance, accessed 10 April 2024,

The Commercial Code of Ethiopia contains several key provisions related to corporate governance. These provisions (Articles 267-494)[23] address the legal requirements for establishing a share company, management aspects, the board of directors and its mandates, auditors, shareholder rights and the general assembly, different types of meetings, voting processes and rights, minority shareholder rights, auditing and reporting obligations, transparency requirements, the involvement of the Ministry of Trade and Industry, and the grounds for liquidation and dissolution.

Efforts to reform corporate governance in Ethiopia are underway. The Addis Ababa Chamber of Commerce and Sectorial Associations (AACCSA) adopted a "Voluntary Code of Corporate Governance for Ethiopia" on June 3, 2011. This reform initiatives encompass both formal (regulatory) and informal (non-regulatory) approaches to corporate governance. However, there is ongoing debate about which approach would be more effective in the Ethiopian context. Some scholars advocate for a voluntary code of corporate governance, while others support a mandatory or regulatory corporate law to address governance issues.

Although corporate governance is important for all types of business organizations, including small and closely held companies in Ethiopia, this article focuses on publicly held share companies, where shares are dispersed among numerous shareholders, leading to a separation of ownership and control and exposing them to agency costs.

Ethiopian company law lacks comprehensive legislative provisions on key governance issues such as the separation of supervision and management responsibilities, and the composition, independence, and remuneration of the board of directors.[24]

The new Ethiopian Commercial Code, introduced in March 2021, aims to address some of these issues by emphasizing responsible corporate management and updating the composition and accountability of the board of directors. However, the implementation of these changes is

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[23] Commercial Code of the Federal Democratic Republic of Ethiopia, FEDERAL NEGARIT GAZETTE, EXTRA ORDINARY ISSUE, Proclamation No. 1243/2021, 12 April 2021, Addis Ababa.

[24] Misganaw Belete, 'The New Ethiopian Commercial Code: Uncovering the Major Changes in Composition, Role, and Accountability of the Board of Directors', Abyssinia Law Blog, https://www.abyssinialaw.com/blog/the-new-ethiopian-commercial-code-uncovering-the-major-changes-in-composition-role-and-accountability-of-the-board-of-directors, accessed 24 January 2022.

still ongoing, and there is a need for further development to ensure effective corporate governance practices in Ethiopian share companies.[25]

## 2.2 The Concept of Stock and Stock Market: A General Overview

The term stock can be defined as "the capital or principal fund raised by a corporation through Subscribers contributions or the sale of shares".[26] Stocks represent a share of ownership in a corporation.[27] By and large, such kinds of stocks could be identified as security representing equity claims on the earnings and assets of the corporation. In this comment, the term stock is used interchangeably with the term share.

Stocks are generally traded in stock market. Stock market refers to capital market in which stocks of corporations are sold to investors.[28] In simple terms, it is a market place where equity interests are exchanged either at par value, premium value or for less than the par value – also called discount stock.[29] Thus stock market allows stockholders (shareholders) to transfer to another investor when they want to sell their stocks.

It should be noted that stocks could be sold and bought in primary capital market. In primary markets, new business can start by obtaining funds directly from households in which new stocks are sold to investors via the mechanism of underwriting.[30] The selling of common stock to the public through Initial Public Offering (IPO) in the primary market is an instance whereby widely held share companies under formation offer new shares to the investors.[31] It is vital not to lose sight of the fact that secondary markets play an important role in the regulation of initial public offering of shares through the listing standards, subject to the discretion of stock exchanges.[32]

On the other hand, in the secondary market, existing stocks are sold and bought among investors or traders in the stock market through stock exchange. Furthermore, secondary market could be

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[25] Commercial Code of the Federal Democratic Republic of Ethiopia, FEDERAL NEGARIT GAZETTE, EXTRA ORDINARY ISSUE, Proclamation No. 1243/2021, 12 April 2021, Addis Ababa.

[26] Henry C., Black's Law Dictionary, 6th ed., (1991) West Publishing Co. St. Paul

[27] Mishkin, Frederic S 'The Economics of Money, Banking, and Financial Markets' (2004), the Addison-Wesley Series in Economics, 7th ed., p. 5.

[28] Ibid, P. 5

[29] Yuwa Wei, 'The Development of the Securities Market and Regulation in China', Loyola of Los Angeles (2005)

[30] Mebrahtu L. Teklehaimanot, 'Is Ethiopia Ready to Commence Capital Market? Analysis of Potential Beddings, Constraints and the Dubious' (2014) 3 International Journal of African and Asian Studies

[31] See Tikikile Kumulachew, 'Regulation of Initial Public Offering of Shares in Ethiopia: Critical Issues and Challenges', Addis Ababa University LLM Thesis, 2011 for more in-depth discussion on Initial Public Offering (IPO)

[32] Christiansen, H. Koldertsavo, "The Role of Stock Exchanges in Corporate Governance", (2009) Financial Market Trends (OECD), p. 5.

either auction market or dealer market. While the stock market is part of an auction market, over-the counter (OTC) is part of the dealer market. The difference between stock market and OTC is that the former exchange market operates in a structured manner and physical facility with a trading floor to which all stock transactions are supposed to be directed.[33] However, OTC market traditionally operates in unstructured manner without any physical facility in which any qualified firm freely engages in the transactions of stocks.

At this juncture, it is also vital to differentiate bond and stock. Bond is a security instrument which is used either by the government or any other corporation to raise funds in the bond market. Unlike stock which as indicated before is an equity instrument, bond is a debt security evidencing that a promise has been made by a government such as Treasury Bills (TBills) or by corporation such as debenture to pay a specified amount of money in recognition of a loan to the business.[34] Like stock, a bond is another way of obtaining funds but this time "representing funds borrowed by the corporation or the government from the holder of the debt obligation". It should be noted that both stock markets and bond markets are categories of capital market like stock market, bond market helps bond holders to transfer their bond to third party when they want to sell it in the secondary market or use it as collateral to get loan from banks. As the title indicates, this comment deals with stock market in the context where corporations or individual investors sell and buy shares and hence will not deal with bond and bond markets. But it should be noted that some literature generally use stock market to include the trading of also bonds.[35]

In brief, a stock market is an open market place which provides facilities for stock brokers, investors and corporations to trade in stocks. Stock markets generally provide the means by which companies raise capital to start new business or expand the existing business by offering new stocks to the public. It also provides a trading facility for investors to sell their share ownership in corporations. Unlike the bond market, stock market provides an opportunity for companies to finance their business through equity investment. The following section highlights the trends and desirability of stock markets in Ethiopia.[36]

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[33] Ratner, D. 'Securities Regulation Material for a Basic Course', (1980) West Publishing, 2nd Ed, USA, Co., p. 2

[34] Peter S. Rose 'Money & Capital markets: The Financial System in the Economy', (1986) 2nd edition, p. 556.

[35] Black, supra note 26

[36] Yishak Mengesha, 'Prospects for a Securities Market in Ethiopia', (1998) 7 Ethiopian Journal of Economics, p. 91.

## 2.3. The Need for and Challenges in Introducing Stock Market in Ethiopia

Studies show that stock market can benefit the economy of a developing country in a number of ways, particularly when prices fairly and accurately reflect supply and demand.[37] First, companies with prospective growth potential will be able to raise equity capital, forcing banks to compete to supply the same financing. Second, the public issuance of shares can provide precious investment resources for enterprises that do not have enough retained earnings or which are unable, or unwilling, to go to the banks.[38] Third, in addition to acting as a source of finance, the stock market also offers firms the opportunity of varying the costs and risks of their financing structures, potentially insulating them from higher interest rates and a credit crunch.[39] Fourthly, introducing stock markets enhances the liquidity of assets as it provides high level of buying and selling stocks without affecting its market price. Hence, in the absence of stock market facility, the ability to convert stocks into cash quickly could be hampered. Finally, the market can also play a role in facilitating long-term asset management such as private insurance and pension funds.[40]

Studies conducted in the Ethiopian context show that introducing stock market, among other things, allows the "de-concentration of ownership, improve accounting and auditing standards, provide effective tools for monetary and fiscal policy and help privatization efforts".[41]

Another study also states that the establishment of stock market in Ethiopia could contribute to economic growth, since it encourages investment by helping traders buy and sell stocks quickly and efficiently.[42] Hence, absence of stock market in Ethiopia may cause illiquidity of assets as holders of stocks may find it difficult to sell same at a fair market price. Specifically, as Ethiopian investors only have a small portion of their household income to invest, a fair priced stock trading is significant in order to avoid creating systematic losses for the general public. Consequently, in order to ensure the liquidity of assets in Ethiopia, it is vital to introduce stock

[37] ibid, p.85.

[38] Stephen Green , 'China's Stock market: A Guide to its Progress, Players and Prospects', (2003) The Economist Newspaper Ltd, p.3.

[39] Ibid, p.3

[40] ibid

[41] *Asrat Tessema "Prospects and Challenges for Developing Securities Markets in Ethiopia: An Analytical Review", (2003) 15* African Development Review*, p. 50-65*

[42] *Abebe Yitayew "An alternative to Term-Loan Financing on the Horizon, its development dubious: securities market, the missing link" (2006), 1* Ethiopian Journal of Accounting and Finance*, p. 33.*

market because of the limited investor and issuer base.[43] However, a stock market does not automatically provide any of the indicated benefits. This is because it relies on an array of institutions for its benefits to be realized. For instance, institutions, such as a free press, an efficient and independent judicial system, corporate lawyers and accountants, professional underwriters and a group of mature institutional investors are difficult to establish at an early stage of economic development.[44] Without an independent and impartial investigative press and in the absence of adequate and enforced laws, companies will tend to

Defraud thereby impacting investor confidence which is a tenet of stock market development. In the absence of reliable corporate disclosures, trading in immature stock markets may often take place on the basis of rumor. If, in addition, a government lacks the ability, or the will, to create or enforce laws that protect small investors, then insider dealing and price manipulation is likely to be common. For these reasons scholars underline the need for an efficient banking system which is better equipped at valuing businesses and monitoring their use of capital a relatively greater priority rather than stock market for a developing economy such as Ethiopia.[45]

Yet the outright rejection of stock market is not a prudent option for Ethiopia as uncoordinated share trading is a common place. Thus, the issue is whether the challenges that relate to the absence of legal and institutional guidance regarding share trading in Ethiopia can be addressed because the advantages in introducing a stock market seem to outweigh these challenges. Studies show that shareholders in widely held companies face the difficulty to get the buyer easily and sell back their shares at a fair price.[46] Shareholders in non-financial companies with low profit margin face the challenge of higher commission by the brokers to sell back their shares while shares of financial companies were facilitated by insider trading in which brokered

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43 Ruecker, R."Market Potential Assessment and Road Map Development for the Establishment of Capital Market in Ethiopia" (2011).

44 Id. *at p. 14*

45 *Ahferom Teklay* "Should Ethiopia Consider Establishing of a Stock Exchange*?" (2011), (AAU MBA Thesis), p. 53.*

46 *The public expectation of buying shares in financial institutions such as banks and insurance is very high due to their profitability. The most compelling reason is that the legal and institutional frameworks for the regulation of financial institutions in Ethiopia is well regulated by the NBE where financial risks are if any are addressed at the earlier possible time. For more*

shares were traded for clients on their own account.[47] The current limited facilities of the OTCs market in Ethiopia cannot cope with rapidly growing demand as share prices are uncoordinated between counters thereby facilitating arbitrage and manipulation.

Therefore, absence of centralized registration for share certificates and illegal stock trading may grow into a largely unregulated space thereby posing stock investment risks and impacting the benefits of stock markets. It is noted that when everyone is speculating and playing for short-term gains, a stock market has little economic benefit[48]. It does not channel capital towards good-quality firms or productive investments; it does not discipline managers participating in insider trading. And where public funds are involved, it can have damaging consequences for the government's finances. In short, a stock market can have a deleterious impact on a country's economy and its corporate development unless a prudent regulation is designed.

Yet, lack of such regulation does not undermine the positive role of stock market in the enhancement of saving and investment because the regulatory challenges that inhibit its effectiveness can be addressed.

In a nutshell, access to and ease in exchange of stock fundamentally influences the prospects for private sector development in Ethiopia. The extent to which existing firms raise funds by trading stocks, the willingness of households to invest in assets, and the ability to allocate their assets.

Ethiopia is on the brink of launching its first fully-fledged stock market, the Ethiopian Securities Exchange (ESX), which is expected to be operational in 2024.[49] This marks a significant milestone in Ethiopia's financial landscape, as the country has been without a stock market for decades.[50] The ESX aims to provide a platform for businesses to access capital and for investors to find new opportunities for wealth creation.[51]

[47] Ibid.

[48] Ethiopia readies its first full stock market for launch." African Business, 3 April 2024,
freely represent all the necessary conditions for the development of stock market in Ethiopia as an engine of economic development.

[49] "Ethiopian Capital Market" Ethipipian Capital Market.com,2024

[50] "Perspectives on stock market in Ethiopia." Ethiopian Press Agency, 2024.

[51] See Ethiopia's Struggle for a Capital Market," Available at: <http://www.ethiopiainvestor.com/index.php?view=article%3B&catid=69%3Aarchives&id=2195%3Aethiopias-struggle-for-a-capital-market-&format=pdf&option=com_content>.

# CHAPTER THREE

## Over View of the FDRE Capital Market Proclamation

### Capital Market Authority Establishment

The Ethiopian Capital Market Authority is an independent federal regulatory body accountable to the Prime Minister, with the legal authority to manage property, enter contracts, and undertake actions to fulfill its mandate. Headquartered in Addis Ababa, it may establish branch offices as necessary. Its main objectives are investor protection, promoting a transparent and efficient capital market, mitigating systemic risks, and fostering long-term investments. The Authority grants licenses for securities exchanges, derivatives, clearing companies, and market service providers while implementing technology frameworks for electronic trading and market information dissemination. It also enforces penalties, inspects licensed entities, establishes contingency plans and early warning systems, and manages a compensation fund for investor protection. The Authority oversees self-regulatory organizations and collaborates with other regulators on cross-border activities and systemic risks. It regulates securities issuance and trading, supervises listings, and ensures market integrity, with powers to freeze assets in fraud cases and issue corporate governance guidelines. Additionally, the Authority promotes investor education, monitors market risks, and revises regulations to adapt to new challenges, maintaining a well-regulated capital market environment.[52]

3.2 Recognition of a Self-Regulatory Organization

Entities under the jurisdiction of the Capital Market Authority seeking recognition as self-regulatory organizations (SROs), except for automatically recognized exchanges and securities depository and clearing companies, must apply and specify their intended functions and powers. Recognition is granted based on compliance with laws, financial and administrative capacity, competent personnel, and rules consistent with legal standards. The Authority may delegate specific powers and duties to SROs, such as disciplinary actions and regulatory responsibilities, under clearly defined terms. SROs are required to establish Authority-approved rules for governance, member rights, dispute resolution, and investor protection, with prior approval needed for amendments. They can impose disciplinary actions on members for rule violations

[52] Capital Market Proclamation No. 1248/2021, FEDERAL NEGARIT GAZETTE, 27th Year, No. 33, 23 July 2021, Addis Ababa, Ethiopia (Hereinafter referred to as "Capital Market Proclamation), Article 3,

but must notify the Authority within two days, which retains oversight and may intervene if necessary. Additionally, SROs must submit annual reports detailing corporate governance and financial statements, and auditors must report significant risks or irregularities. Any changes in senior personnel require prior notification to the Authority, which can object or direct removal if concerns about fitness or propriety arise.[53]

### 3.3 Securities Exchange Formalities

No person shall establish or launch a business as a securities exchange, derivatives exchange, or over-the-counter trading facility, nor shall they hold themselves out as creating such a market unless they have been licensed or approved by the Authority under this Proclamation. Furthermore, the use of the terms "securities exchange" or "derivatives exchange" in connection with a business is strictly prohibited unless an exchange license has been granted by the Authority.[54]

The Ethiopian Securities Exchange is established as a share company by the Government in partnership with the private sector, including foreign investors. However, the total ownership of the Government and government-owned entities shall not exceed 25% of the Exchange's capital. If there is insufficient interest from the private sector, the Government may increase its ownership to any amount necessary to establish the Exchange. In the absence of private sector interest, including from foreign investors, the Exchange may be established as a fully Government-owned public enterprise through a regulation issued by the Council of Ministers. The Authority shall grant an exchange license to the Exchange upon its establishment, provided it meets minimum capital requirements, fit and proper criteria, operational conditions, management standards, and other directives specified by the Authority. Other relevant provisions of the commercial code shall also apply to the Exchange.[55]

The Authority may grant licenses to other securities exchanges, derivatives exchanges, or over-the-counter trading platforms, which must be established as share companies. The Authority shall determine, through a directive, the minimum capital requirements, fit and proper criteria, operational and managerial conditions, and other licensing requirements. Additionally, the

[53] Ibid, Article 22
[54] Ibid, Article 30
[55] Ibid Article 31

Authority shall regulate the participants, contracts, conditions, and requirements for trading securities and derivative contracts in the over-the-counter market.[56]

The Authority may issue a written directive to close a securities or derivatives exchange for a specified period if a major market disruption occurs, market manipulation is threatened or actualized, it is necessary for public interest or investor protection, or if a government action affects securities trading. To maintain market integrity, the Authority may take necessary steps to ensure fair, efficient, and transparent trading and may liquidate positions in securities or derivatives contracts. If an exchange engages in unauthorized activities, violates licensing conditions, fails to comply with Authority directives, provides false information, or breaches any provision of this Proclamation, its license may be suspended for a period not exceeding three months, with a possible extension for another three months. After this period, the Authority may either lift the suspension or revoke the license.[57]

The Authority may revoke an exchange’s license if it goes into liquidation, fails to rectify the reasons for suspension within the stipulated period, voluntarily requests revocation, has committed repeated violations, or is deemed unfit to hold a license. Before revoking a license, the Authority shall notify the exchange, allowing it to submit objections in writing within 30 days. If no satisfactory objection is received, the license will be revoked, and the decision will be published in a widely circulated newspaper. The revocation becomes effective on the publication date or as specified by the Authority.[58]

The affairs of a securities exchange shall be managed by a board of directors elected by the shareholders. However, this election shall be subject to the consent of the Authority, and if no objection is raised within 30 days, the election shall be deemed approved. Board members must meet specific criteria, including not having been convicted of a crime involving dishonesty, not being declared bankrupt, maintaining a good reputation, and continuously improving their expertise in finance, management, economics, legal, or related fields. The board shall ensure that the exchange operates in compliance with the Proclamation, relevant regulations, and its own rules. It shall oversee general affairs, administrative matters, and financial management.[59]

[56] Ibid
[57] Capital Market Proclamation, Article 34
[58] Ibid
[59] Ibid

The board and its members shall be collectively and individually responsible for any non-compliance with regulatory requirements. The securities exchange shall have a Chief Executive Officer appointed by the board and subject to the Authority's consent. If the Authority does not object within 30 days, the appointment shall be considered approved. The roles of the board chairman and CEO shall not be combined. A securities exchange shall establish rules governing its operations, management, and regulation of the securities market. These rules must be approved by the Authority to ensure the proper and efficient functioning of the exchange.[60]

A securities exchange shall be responsible for monitoring, surveillance, and supervision of the exchange and its members to ensure fairness, efficiency, transparency, and investor protection. It shall establish dispute resolution and appeal mechanisms, maintain technical and record-keeping standards, report suspected legal breaches, and manage client funds and securities where applicable. The exchange must implement trading control mechanisms, monitor credit exposures, provide equitable market access, ensure clear execution rules, and maintain risk management controls. It must also prioritize public interest over conflicts of interest involving its members, shareholders, or management. Additionally, the exchange shall ensure compliance with Authority directives and maintain the confidentiality of information under its custody, disclosing such data only as required by law or authorized by the Authority or a court.[61]

A securities exchange shall provide assistance to the Authority as required for regulatory oversight. It must furnish relevant business information, securities dealings data, or any other information requested by the Authority. The exchange shall immediately inform the Authority if a member violates rules, exhibits financial irregularities, or faces disciplinary action. The board of directors shall also report any disciplinary actions taken against members, including details of violations, penalties imposed, and all related documentation.[62]

A securities exchange seeking to amend its rules must submit a draft of the proposed changes to the Authority for approval. If the Authority does not disallow the amendment within 28 days, it shall be deemed approved. The Authority may direct an exchange to make specific amendments within a certain timeframe, and if the exchange fails to comply, the Authority may amend the

[60] Ibid
[61] Ibid Article 36
[62] Ibid Article 37

rules at the exchange's expense. The exchange shall be obligated to adhere to these amended rules.[63]

No person shall incorporate a Securities Depository and Clearing Company or provide securities depository, clearing, or related services without obtaining a license from, or having its license approved by, the Authority in accordance with this Proclamation. A Security Depository and Clearing Company license may only be granted to a share company that meets minimum capital requirements, fit and proper criteria, conditions of work and management, evidence of competence, and any other requirements specified by directive of the Authority. The Authority shall specify the conditions required for granting a license under these provisions through its directive. Notwithstanding these provisions, other relevant provisions of the commercial code shall remain in effect.[64]

A company licensed by the Authority as a Security Depository and Clearing Company must ensure fair and effective clearing and settlement in relation to any commercial transactions of securities, including repo agreements and securities lending. It is required to manage risks associated with its activities and operations at the highest levels of professionalism, prioritize public interest and that of its clients over its own interests, and manage its services according to the rules approved by the Authority. Additionally, it must maintain confidentiality of all information and data in its possession, except when required by the Authority, the law, or a court order. The company is also obligated to provide services using up-to-date technology and automated systems in line with international standards approved by the Authority or as requested by the Authority.[65]

The Authority shall require the Security Depository and Clearing Company to prepare rules and regulations related to clearing, settlement, registration of securities, and other relevant activities. If the company fails to comply with the directive within the specified period, the Authority may draft or amend the rules on its behalf at the company's expense. Any rules or amendments made by the Security Depository and Clearing Company must be approved by the Authority to be valid. When proposing new rules or amendments, the company must provide the Authority with justifications and outline the desired effects. The Authority retains the power to approve, reject, or amend such rules and must notify the company in writing of its decision within one week of

[63] Ibid Article 38
[64] Capital Market Proclamation, Article 39
[65] Ibid Article 40

making the resolution. In cases of noncompliance by a trader with clearing rules, the Security Depository and Clearing Company may impose penalties for any charges resulting from the noncompliance.[66]

Securities required to be registered at a central securities depository include publicly offered securities and other securities whose issuers authorize the Securities Depository and Clearing Company to act as their transfer agent. Public companies and other issuers must register their securities types and ownership information at the Central Securities Depository.The Security Depository and Clearing Company shall provide custody and safekeeping for immobilized securities and maintain a computerized book-entry system to record changes in ownership electronically. The records of securities ownership maintained by the issuer shall be replaced with electronic records maintained by the central securities depository. A global certificate will replace individual securities certificates for purposes such as attending general assemblies, making interest and dividend payments, securities lending and repurchase agreements, pledging securities, and exercising priority rights. The company must maintain and update electronic ownership records of dematerialized securities and respond to inquiries from issuers, owners, and other interested parties. Additionally, the company shall carry out necessary tasks to complete securities registration, transfer ownership, and record related data, including obtaining information on beneficial owners from nominees.[67]

The Security Depository and Clearing Company shall clear securities transactions for its members to determine their rights and liabilities. It shall settle transactions by delivery versus payment, ensuring that the period between the trade date and settlement date does not exceed the specified timeframe. Settlement obligations between members shall be discharged through book-entry records maintained by the central securities depository. The transfer of securities ownership shall not occur before settlement and clearing of the transaction. The company’s rules must specify the operations and procedures for clearing and settlement and shall be binding on all participants.[68]

A Security Depository and Clearing Company shall specify in its rules the finality and irrevocability of securities transfers once they have been entered into the system. Such book-entry transfers shall be final and may not be revoked or reversed, even in cases of insolvency,

[66] Ibid Article 41
[67] Ibid Article 42
[68] Ibid Article 43

bankruptcy, preventive receivership, winding-up, or reorganization. The Authority may issue directives prescribing finality in securities trades, settlements, netting, and loss allocation. Regardless of any contrary provisions, the insolvency, bankruptcy, preventive restructuring, placement under receivership, or winding-up of a Securities Depository and Clearing Company member shall not affect the finality or irrevocability of book-entry securities transfers that became final before the relevant order or decision was lodged with the company.[69]

If a Securities Depository and Clearing Company member is liquidated or declared bankrupt, any arrangements related to the company, as well as applicable netting rules, shall be binding on administrators such as trustees, receivers, and liquidators. The obligations, rights, and remedies related to a securities transfer or collateral granted for settlement obligations shall not be affected by insolvency proceedings or any judicial stay. In such cases, claims by the Securities Depository and Clearing Company on collateral shall have priority over all other claims, and claims by other members over the same collateral shall take precedence over third-party creditors. The Authority may determine eligible counterparties and transactions through directives.[70]

A Securities Depository and Clearing Company is prohibited from purchasing, acquiring, or dealing in book-entry securities as a principal, except as permitted by the Authority. The Securities Depository and Clearing Company must report any counterparty that fails to abide by clearing and settlement rules or whose financial position shows signs of instability. In cases of disaster or crises that may impact the market, the Authority may direct the Security Depository and Clearing Company to amend or suspend its rules. If the company fails to comply, the Authority may take necessary measures to maintain market stability.[71]

The Authority may suspend the license of a Securities Depository and Clearing Company if it engages in unauthorized activities, violates license conditions, fails to comply with directives, provides misleading information, or breaches regulations. A suspension shall not exceed three months, though it may be extended for another three months if necessary. If the company fails to rectify its shortcomings within the suspension period, the Authority may revoke the license. The

[69] Ibid Articles 45-47
[70] Capital Market Proclamation, Article 48
[71] Ibid Articles 49-51

revocation decision must be published in a widely circulated newspaper and takes effect upon publication.[72]

The National Bank of Ethiopia retains autonomous power to establish and regulate a central securities depository for government securities. It may issue directives regarding the dematerialization, clearing, settlement, and registration of government securities. The finality of securities transfer and collateral provisions shall apply to government securities accordingly. Despite the provisions of this Proclamation, the Authority may authorize the National Bank of Ethiopia to provide securities depository and clearing services for privately traded securities under special terms and conditions.[73]

### 3.4 Licensing of Capital Market Service Providers

Regulated capital market activities and services, such as securities trading, investment advice, fund management, underwriting, and custodial services, are subject to oversight under this Proclamation. Only licensed individuals or entities, including brokers, investment advisers, and custodians, may conduct such activities, provided they meet fit and proper criteria, capital requirements, and other regulatory conditions set by the Authority. Licenses are issued or renewed upon application, with requirements for internal compliance systems and adherence to self-regulatory organization rules. Licensees must submit periodic reports, maintain detailed records, and appoint external auditors approved by the Authority. Licenses may be suspended or revoked for non-compliance, false information, or misconduct, but applicants have a right to be heard before such actions. Additionally, professionals like lawyers and accountants may provide incidental securities advice without a license, while foreign investors must meet national investment criteria. The Authority evaluates applicants based on qualifications, integrity, and reliability, with a provision for further scrutiny of associated individuals. Licensed entities must implement robust internal controls, ensure transaction traceability, and maintain records for at least ten years, subject to regulatory inspection.[74]

[72] Ibid Article 52
[73] Ibid Article 53
[74] Ibid Article 55-58

## CHAPTER FOUR

## 4. The Role of Stock Markets in Enhancing Corporate Governance and Its Challenges in Ethiopia

Stock markets are vital for the efficient functioning of modern economies, providing a platform for the buying and selling of shares. Their role extends beyond capital mobilization to influencing corporate governance, particularly in developing countries like Ethiopia, where corporate governance mechanisms are evolving. Although Ethiopia currently lacks a fully functional stock exchange, its potential introduction could significantly impact corporate governance by promoting transparency, accountability, and efficient management practices. Stock markets play a significant role in enhancing corporate governance of share companies by providing a platform for transparency, accountability, and oversight. The stock market is where shares of publicly traded companies are bought and sold, and it serves as a mechanism for companies to raise capital from investors.[75]

One way in which stock markets enhance corporate governance is by requiring companies to adhere to stringent disclosure and reporting requirements. Companies that are listed on stock exchanges are required to regularly provide financial reports and disclosures to investors and regulators. This level of transparency helps to ensure that shareholders are aware of the company's financial health and performance, allowing them to make informed investment decisions.[76]

Additionally, stock markets also play a role in holding companies accountable to their shareholders through the mechanism of shareholder activism. Shareholders have the ability to vote on important corporate decisions, such as the election of the board of directors and major business transactions. This gives shareholders a voice in the governance of the company and helps to ensure that management acts in the best interests of shareholders. Furthermore, the presence of a liquid stock market can also act as a deterrent to corporate misconduct. Companies that are listed on stock exchanges are subject to market scrutiny and are more likely to face

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[75] Re-Enactment of Urban Lands Lease Holding Proclamation No. 272/2002, FEDERAL NEGARIT GAZETTE, 8th Year, No. 19, 14 May 2002, Art. 13(1) & Rural Land Administration and Land Use Proclamation No.456/2005, FEDERAL NEGARIT GAZETTE, 11th Year No. 44, 15th July 2005, Art.8(3)

[76] Nazareth, A. L., & Pickard, L. A., 'The Role of Stock Exchanges in Corporate Governance', (2005), 61 the Business Lawyer, p. 1425-1454.

Consequences for unethical behavior, as their share price can be negatively impacted by negative news or events.[77]

### 4.1. Increased Transparency and Disclosure

The listing of a company on a stock exchange requires adherence to stringent disclosure and reporting standards. Publicly traded companies are obligated to regularly publish financial statements, performance reports, and other relevant data, which are essential for investor confidence. Such transparency can deter fraudulent practices and compel corporate managers to act in the best interest of shareholders. According to Leuz and Wysocki,[78] transparency in reporting minimizes the information asymmetry between company management and shareholders, fostering a culture of openness and accountability.

In Ethiopia, this could help reduce corruption and promote better governance in companies that go public. Stock markets play a significant role in promoting transparency and disclosure by establishing strict rules for publicly traded companies. Transparency refers to the availability of accurate and timely information about a company's financial performance, while disclosure involves the requirement to publicly share critical financial and non-financial data. Although Ethiopia currently lacks a fully operational stock market, its introduction could substantially enhance transparency and disclosure within the corporate sector.

One of the key contributions of stock markets to transparency is through mandatory financial reporting. Publicly listed companies are often required to publish quarterly and annual reports, including balance sheets, income statements, and cash flow statements. These documents provide investors with critical insights into a company's financial health. According to Leuz and Wysocki,[79] mandatory disclosure reduces information asymmetry between company management and shareholders, ensuring that all stakeholders have access to the same level of information. For Ethiopia, where many private firms do not have stringent financial reporting requirements, a stock market could introduce a higher standard of financial transparency.

Stock exchanges often mandate that listed companies undergo regular independent audits, which verify the accuracy of the financial reports. This requirement not only increases the reliability of the disclosed information but also reduces the risk of financial mismanagement or fraud. An

[77] ibid

[78] Leuz, C., & Wysocki, P. D. (2016), 'the economics of disclosure and financial reporting regulation: Evidence and suggestions for future research', (2016), 54 Journal of Accounting Research, p. 525-622.

[79] ibid

independent audit provides an unbiased opinion on whether the company's financial statements are presented fairly, in all material respects, in accordance with accounting standards. Ethiopia could benefit from such practices, ensuring that financial information is not manipulated by corporate insiders for personal gain, thus enhancing corporate governance.[80]

In addition to financial transparency, stock markets typically require the disclosure of non-financial information, such as environmental, social, and governance (ESG) practices. This broadens the scope of transparency and helps investors evaluate a company's long-term sustainability. For instance, companies may need to disclose their environmental impact, labor practices, and corporate governance structures. In Ethiopia, where corporate governance practices are still evolving, these additional disclosure requirements could drive firms to adopt more responsible and sustainable practices, improving their reputation and attractiveness to investors .[81]

Increased transparency and disclosure also protect minority shareholders by providing them with the same level of information as majority shareholders. This is crucial in ensuring that all shareholders have an equal opportunity to assess the company's performance and make informed decisions. Ethiopia's business landscape, where family-owned businesses dominate, could see improved protection of minority shareholders through the implementation of stock market disclosure standards, preventing the concentration of power among a few individuals or groups.[82]

The introduction of a stock market in Ethiopia would have a profound impact on corporate transparency and disclosure. By requiring regular financial reporting, independent audits, and disclosure of both financial and non-financial information, the stock market could significantly enhance transparency in Ethiopia's corporate sector. This increased level of transparency would not only protect investors but also foster greater trust in the business environment, promoting economic growth and attracting foreign investment.

### 4.2. Strengthening Accountability

A stock market creates an environment where shareholders, both large and small, can hold company executives accountable for their decisions. Shareholders can voice their concerns through general meetings, where they can influence major decisions like appointing board

[80] Shleifer A. & Vishny R. W., 'A survey of corporate governance', (1997), 52 the Journal of Finance, p. 737-783.
[81] Leuz C. & Wysocki P. D, 'the economics of disclosure and financial reporting regulation: Evidence and suggestions for future research', (2016), 54 Journal of Accounting Research, p.525-622.
[82] Ibid

members, auditing, and executive compensation. In countries with active stock markets, poorly performing managers are often replaced when their company underperforms relative to competitors. In Ethiopia, where family-owned businesses dominate, a shift towards this model could bring in external shareholders who demand greater accountability and proper corporate governance structures.[83]

.A well-functioning stock market significantly enhances corporate accountability by creating an environment where company management is answerable to shareholders. Accountability refers to the responsibility of corporate managers and boards of directors to act in the best interests of the shareholders and stakeholders. In Ethiopia, where corporate governance frameworks are still in the developmental stage, the introduction of a stock market could greatly strengthen accountability by increasing scrutiny over managerial decisions and improving governance standards.

The stock market allows shareholders to exercise oversight over company management through mechanisms like annual general meetings (AGMs) and voting rights. Shareholders have the power to question the actions of the board of directors, approve or reject major corporate decisions, and even appoint or dismiss directors. According to Shleifer and Vishny,[84] shareholder involvement ensures that managers do not act solely in their own interest but are held accountable for their actions. In Ethiopia, where family-owned businesses dominate, the introduction of external shareholders via a stock exchange could lead to greater managerial accountability and fewer instances of self-serving behavior by insiders.

A stock market introduces the concept of tying executive compensation to the company's performance, particularly through stock options or bonuses linked to share prices. This practice aligns the interests of management with those of the shareholders, as executives are directly rewarded or penalized based on the company's market performance. Jensen and Meckling[85] argue that this alignment of interests is a critical tool for enhancing managerial accountability. In Ethiopia, this system could motivate company leaders to focus on long-term growth and profitability, reducing the likelihood of mismanagement or short-term opportunism. In a functioning stock market, poorly performing companies are vulnerable to hostile takeovers,

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[83] Claessens S. & Yurtoglu B. B., 'Corporate governance in emerging markets: A survey', (2013),15 Emerging Markets Review, p.1-33

[84] Shleifer A. & Vishny R. W. (1997), 'A survey of corporate governance', (1997), 52 The Journal of Finance, p. 737-783

[85] ibid

where external entities acquire a controlling interest in the company, often replacing the existing management. This threat keeps company leaders accountable to shareholders by creating a check on their actions. According to Jensen,[86] the market for corporate control is a powerful mechanism for disciplining inefficient management. If a stock exchange is established in Ethiopia, this could serve as an additional layer of accountability for corporate managers, encouraging them to maximize shareholder value or risk losing control of the company.

Institutional investors, such as pension funds and mutual funds, often hold significant stakes in companies listed on stock exchanges. These investors tend to be more active in monitoring the performance of company management, given their large investments. They can push for changes in management, demand better governance practices, and influence major corporate decisions. In Ethiopia, where institutional investors are relatively underdeveloped, the introduction of a stock market could attract these large investors, who would play a crucial role in enhancing accountability.[87]

Stock exchanges typically require companies to adhere to higher standards of corporate governance, including the establishment of independent boards and external audits. This creates an environment where corporate leaders are held accountable for their actions not only to shareholders but also to other stakeholders, such as creditors, employees, and the government. Ethiopia could benefit from these improved governance standards, particularly in companies transitioning from private to public ownership, where accountability mechanisms are often lacking.[88]

The introduction of a stock market in Ethiopia would significantly enhance corporate accountability by promoting shareholder oversight, aligning executive compensation with company performance, and subjecting poorly performing firms to the threat of hostile takeovers. Institutional investors and stricter corporate governance standards would also help to keep managers in check, ensuring they act in the best interests of shareholders. These mechanisms of accountability are essential for improving the overall corporate governance framework in Ethiopia and fostering sustainable economic growth.

4.3. Market for Corporate Control

[86] ibid
[87] Claessens & Yurtoglu, (n80), p.1-33
[88] Leuz & Wysocki, (n78), p.525-622

One of the key roles of stock markets in enhancing corporate governance is by creating a market for corporate control. When a company's stock underperforms or when managers are perceived to be underperforming, it becomes vulnerable to hostile takeovers. This is because another company or group of investors could buy a controlling stake and replace the management. Such threats keep managers disciplined and motivated to act in the best interests of shareholders.[89] If Ethiopia establishes a stock market, this mechanism could serve as a check on managerial inefficiency.

A stock market plays a crucial role in creating an active market for corporate control, where ownership of a company can change hands based on the performance and value of its stock. This mechanism ensures that corporate managers are held accountable for their performance, as poorly managed companies become vulnerable to takeovers. In Ethiopia, where corporate governance structures are still evolving, the establishment of a stock market could significantly enhance the market for corporate control, thereby improving managerial accountability and overall corporate efficiency.

In a functioning stock market, if a company is underperforming, its stock price typically falls, making it an attractive target for external investors or rival companies. These entities may acquire a controlling stake in the underperforming company and replace the existing management. This possibility of a hostile takeover forces company managers to prioritize the interests of shareholders by focusing on long-term profitability and efficiency. According to Jensen,[90] the market for corporate control serves as a critical mechanism for disciplining managers and preventing them from pursuing their own interests at the expense of shareholders. For Ethiopia, the introduction of a stock market could provide this much-needed check on managerial inefficiency, encouraging corporate leaders to focus on maximizing shareholder value.

A stock market facilitates mergers and acquisitions (M&A), which are key elements of the market for corporate control. M&A activity allows well-managed firms to acquire poorly performing companies, restructure them, and improve their efficiency. This process not only benefits the acquiring firm but also the economy by reallocating resources to more productive uses. In Ethiopia, where corporate structures are often rigid and dominated by family-owned

[89] Jensen, M. C., ‘Agency costs of free cash flow, corporate finance, and takeovers’, (1986), 76 The American Economic Review, p. 323-329.
[90] ibid

businesses, the introduction of a stock market could stimulate M&A activity, leading to better resource allocation and improved corporate governance.[91]

A robust stock market encourages shareholder activism, where shareholders—especially institutional investors—actively monitor management and push for changes in underperforming companies. This activism can include calls for management changes, improved governance practices, or even the sale of the company. According to Shleifer and Vishny,[92] an active market for corporate control incentivizes shareholders to hold managers accountable, as they can initiate changes to avoid losing control of the company to external bidders. In Ethiopia, where institutional investors are still underdeveloped, the creation of a stock market could attract more active shareholders, leading to improved corporate governance.

The presence of a stock market places market discipline on executives, making them more accountable to shareholders and external investors. If management fails to perform, it risks being replaced, either through internal shareholder pressure or external takeovers. This environment reduces the likelihood of entrenched, inefficient management remaining in control. Ethiopia could benefit from this market-driven discipline, as corporate leaders would be incentivized to adopt better management practices to avoid losing their positions.[93]

The threat of takeovers and M&A activity provides a strong incentive for firms to maintain good corporate governance practices. Poor governance increases the likelihood of management being replaced, as external investors may seek to implement more efficient structures. According to Leuz and Wysocki,[94] transparency, accountability, and efficient corporate governance reduce the likelihood of hostile takeovers by ensuring that the firm operates in the best interests of its shareholders. If Ethiopia establishes a stock market, companies will likely adopt better governance practices to maintain control and attract investors.

The establishment of a stock market in Ethiopia could significantly enhance the market for corporate control, providing a mechanism to discipline management, improve efficiency through M&A activity, and encourage shareholder activism. By creating an environment where ownership of companies can change hands based on performance, a stock market would drive

[91] Claessens & Yurtoglu, (n80), p.1-33
[92] Shleifer & Vishny,(n81), p. 737-783

[93] Jensen M. C., & Meckling W. H., 'Theory of the firm: Managerial behavior, agency costs, and ownership structure', (1976), 3Journal of Financial Economics, p. 305-360.
[94] Leuz & Wysocki, (n78), p.525-622

better corporate governance and operational efficiency. This market-driven discipline would encourage corporate leaders in Ethiopia to adopt best practices, ultimately benefiting the economy and investors.

### 4.4. Enhanced Board Structure and Oversight

Corporate governance is also improved through the establishment of more professional and independent boards of directors, often required as part of stock exchange listing rules. Stock markets typically push for a diverse and independent board, which reduces conflicts of interest and improves decision-making.

In Ethiopia, where boards are often composed of family members or close associates, the stock market could introduce higher governance standards, forcing companies to adopt best practice. The stock market plays a critical role in enhancing board structure and oversight in Ethiopia by fostering corporate governance standards, improving transparency, and enabling better access to capital for companies.[95] Here's how it contributes to these areas:

The stock market encourages companies to adopt best practices in corporate governance, as publicly listed companies are required to adhere to stricter regulatory frameworks. This includes establishing effective board structures with independent directors and clear responsibilities for oversight. In Ethiopia, where corporate governance standards are still developing, the introduction of a stock market would push firms to establish stronger governance frameworks to attract investors and ensure compliance with international norms.[96]

Public companies listed on the stock exchange are obligated to regularly disclose financial statements and other relevant information to shareholders. This transparency allows shareholders to hold the board accountable and ensures that the board maintains ethical standards in overseeing management. For Ethiopia, a stock market would promote transparency and instill trust in investors, encouraging the development of businesses with sound board oversight mechanisms.

The presence of a stock market tends to encourage companies to appoint more skilled and diverse board members, as investors look for experienced leadership when making investment

[95] ibid

[96] Asrat M. & Negash D, 'Corporate Governance and the Role of Stock Markets in developing Economies: The Case of Ethiopia', (2022), Addis Ababa University Press.

decisions. In Ethiopia, this would mean enhancing the qualifications of board members and improving overall board performance in strategic decision-making and risk management.[97]

A well-functioning stock market provides companies with access to broader pools of capital, which often come with expectations of improved governance. Investors, particularly institutional investors, usually demand strong board oversight as part of their investment criteria. This enhances the board's role in maintaining proper checks and balances, which is crucial for companies seeking to attract and retain investment in Ethiopia.[98]

The establishment of a stock market in Ethiopia would significantly enhance the board structure and oversight of companies by driving them towards better corporate governance practices, fostering transparency, and encouraging higher standards of board competence.

### 4.5**.** Access to Capital and Incentive Alignment

A stock market facilitates easier access to capital, enabling companies to raise funds from the public rather than relying solely on banks or internal capital. This access to capital often aligns the interests of management with those of shareholders because managerial compensation is frequently tied to stock performance. According to Shleifer and Vishny,[99] Stock markets provide a mechanism through which shareholder value can be maximized, thereby encouraging managers to focus on long-term performance and profitability. In Ethiopia, this could incentivize companies to adopt more formal governance structures to attract and retain investors.

The introduction of a stock market in Ethiopia would play a significant role in enhancing access to capital and aligning incentives for both companies and investors. Here's how it would impact these areas:

A stock market provides companies with an additional avenue for raising capital by issuing shares to the public. This form of equity financing is particularly crucial for growing businesses that require substantial investments but may not have access to traditional bank loans or other forms of debt financing. In the context of Ethiopia, where access to capital remains constrained for many firms, a stock market would offer an efficient mechanism for raising funds from both domestic and international investors.[100]

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[97] ibid

[98] ibid

[99] Shleifer & Vishny,(n81), p. 737-783

[100] Demissie K., & Wolde A., 'The Role of Financial Markets in Emerging Economies: Insights for Ethiopia', (2021), Mekelle University Press, p.

By facilitating public offerings, companies in Ethiopia could attract a wider range of investors, including institutional investors such as pension funds, insurance companies, and foreign direct investors. This would reduce dependency on traditional financing methods, enabling companies to expand, innovate, and become more competitive. A stock market also improves incentive alignment between shareholders (investors) and management. When companies are listed on a stock exchange, management and employees may be offered stock options or equity-based compensation plans. This incentivizes them to act in the best interest of shareholders, aligning their goals with those of the company's owners.[101]

In Ethiopia, where corporate governance is still evolving, a stock market would serve as a critical tool for fostering this alignment. The ability for employees and management to hold shares in the company enhances their stake in its long-term success, motivating them to improve operational efficiency, productivity, and innovation. Moreover, investors can influence company policies and governance through their voting rights, ensuring that corporate strategies are aligned with shareholder value. The availability of a stock market in Ethiopia would likely attract foreign investors who seek opportunities in emerging markets. These investors bring not only capital but also knowledge, expertise, and higher governance expectations, all of which can contribute to economic growth. Increased capital flows into the stock market would enable Ethiopian companies to fund large-scale projects, expand operations, and contribute to job creation.[102]

The establishment of a stock market in Ethiopia would greatly enhance access to capital by providing companies with a platform to raise funds more efficiently and effectively. It would also create better alignment between management and shareholders through equity-based incentives, driving improved corporate governance and sustainable growth.

The creation of a stock market in Ethiopia would significantly enhance access to capital and improve the alignment of incentives between shareholders and management, fostering economic growth and corporate accountability.[103]

### 4.6. Encouraging Professional Management

Public companies tend to be managed by professionals rather than by the owners or their family members, as is common in private or family-owned businesses. Professional managers, hired

[101] ibid
[102] ibid
[103] Demissie K., & Wolde,(n97), p.

based on expertise and experience, are more likely to adhere to best governance practices. Ethiopia's corporate sector, where family ownership is prevalent, could see a shift towards more professional management practices through the establishment of a stock exchange. As highlighted by,[104] professional management enhances operational efficiency and governance.

The establishment of a stock market in Ethiopia would significantly contribute to encouraging professional management practices within companies. This occurs through several mechanisms that promote accountability, transparency, and the demand for skilled management.

Publicly listed companies are typically held to higher standards of corporate governance, which necessitates the recruitment of professional and skilled management teams. Investors, especially institutional investors, tend to favor companies with strong, experienced leadership to maximize returns on investment. In Ethiopia, where many companies still operate under informal management structures, the presence of a stock market would incentivize firms to hire professional managers with expertise in areas like finance, marketing, and operations. This would enhance the overall efficiency and competitiveness of firms, as well as boost investor confidence.

A stock market imposes certain legal and regulatory obligations on companies, such as regular financial reporting and disclosure requirements. These obligations demand a higher level of professionalism from management teams, who must ensure that accurate and timely information is provided to shareholders. For Ethiopia, where transparency in corporate governance is still maturing, the establishment of a stock market would encourage companies to improve their management practices to meet these standards.

Stock markets often introduce performance-based incentives, such as stock options or equity-based compensation for managers. These incentives align the interests of the management with those of the shareholders, as managers are rewarded for improving the company's financial performance and market valuation. In Ethiopia, this would encourage management teams to focus on long-term profitability and growth, improving decision-making and overall performance.

With a stock market, Ethiopian companies would have a broader base of shareholders who can influence corporate governance. Shareholders, particularly institutional investors, tend to demand more effective oversight of management to ensure that their investments are protected. This

[104] Bebchuk L. A. & Weisbach M. S, (2010), 'The state of corporate governance research', 23 The Review of Financial Studies, p.939-961

creates pressure on companies to appoint independent directors, enhance internal controls, and adopt best practices in management oversight. As a result, the professionalism of management improves, leading to better-run organizations.[105]

The development of a stock market in Ethiopia would play a crucial role in encouraging professional management by attracting skilled leaders, increasing accountability, and aligning management incentives with corporate performance. This would lead to more robust corporate governance and greater investor confidence in Ethiopian companies. The introduction of a stock market in Ethiopia would likely bring numerous corporate governance improvements, such as enhanced transparency, accountability, and better oversight. While Ethiopia is still in the early stages of establishing its stock market, the lessons from other countries indicate that the presence of a well-regulated stock exchange can significantly improve governance standards. By compelling firms to meet higher disclosure requirements and enabling shareholder participation, the stock market could drive more responsible and efficient management in Ethiopia.[106]

### 4.7. Challenges Of Stock markets

In assessing the current state of corporate governance in Ethiopian share companies an interviewee from Wegagen Bank, Nib Bank, Ethiopian Securities Exchange (ESX) and Ethiopian Capital market authority mentioned as follows. Financial institutions such as banks and insurance companies have been able to become more efficient and profitable because they have a strong oversight and control over their corporate governance, meetings, and the selection of board members and managers. However, other joint stock companies are less efficient because they do not have a strong oversight body like the National Bank. Stock companies outside of financial institutions do not have any strong points, but their weaknesses include hiring and appointing professionals who are not suitable for the position due to family ties or other reasons, not properly identifying board members and management bodies and not properly defining their roles, not providing appropriate information to buyers when issuing shares for sale, etc.[107]

Besides the Interviewee explained regarding the primary challenges that share companies face in implementing effective corporate governance practices in Ethiopia as the absence of a clear separation between board and management members, along with the board’s failure to effectively

[105] Leuz & Wysocki, (n78), p.525-622
[106] Shleifer & Vishny,(n81), p. 737-783
[107] Interview with Mr. Gebeyehu Raba ,Business Program Directorate Director of Nib Bank, Addis Ababa, (February19,2025)

fulfill its duties, contributes to weak corporate governance. Additionally, the lack of a dedicated institution, similar to the National Bank, to closely monitor companies like the ECX further exacerbates the issue. Moreover, there is no specialized body solely focused on overseeing corporate governance, leading to gaps in regulation and accountability.[108]

The Ethiopian stock market is evolving, with recent developments shaping its growth and potential. These changes directly influence investor confidence and participation in share companies, as a well-regulated and transparent market attracts more investors. Over the past few years, share companies in Ethiopia have exhibited various performance trends, reflecting both opportunities and challenges in the market. Certain sectors demonstrate stronger governance practices than others, often due to regulatory frameworks, industry standards, and corporate leadership that prioritize transparency and accountability.[109]

An interviewee added that The Ethiopian stock market has long been characterized by opacity, fraud, and a lack of regulation. Even financial institutions under the close supervision of the National Bank struggle with significant corporate governance issues. The primary challenge lies in the National Bank's regulatory focus on cash flow rather than profitability and investor protection. Due to the absence of a clear and structured market, investors have faced confusion when buying or selling shares. However, the recent establishment of the Ethiopian Capital Market Authority presents a significant opportunity to address these challenges at their core. This institution plays a crucial role in transforming the market by ensuring transparency, protecting investors, and fostering a well-regulated stock exchange.[110]

One of the key benefits of this development is the establishment of fair market value for stocks, allowing investors to make informed decisions. Increased transparency also makes it easier to identify companies with corporate governance issues, encouraging managers to operate more effectively. When managers fail to perform, investors can either sell their shares or push for leadership changes. This level of accountability helps build investor confidence, as they can trust that their investments are protected by a regulated and transparent system.[111]

[108] Interview with Mr. Habtamu H/Meskell , senior Compliance manager of Ethiopian securities Exchange , Addis Ababa, (February24,2025)

[109] Interview with Mr. Bahiru Demise, Research and Business Development Directorate Director of Wegagen Bank, Addis Ababa, (February20,2025)

[110] ibid

[111] Interview with Mr. Habtamu H/Meskell, (n105)

Corporate governance issues have also been exacerbated by practices such as delaying operations after stock sales, making false claims in advertisements, appointing unqualified individuals—particularly in family-founded companies—and failing to separate the roles of boards and management. The lack of attention to corporate governance, often managed by unqualified personnel, further weakens investor trust and company performance. Despite these challenges, financial institutions like banks and insurance companies have been relatively more effective, thanks to the National Bank's strict corporate governance guidelines and oversight. These institutions are closely monitored to ensure compliance, making them more stable and reliable compared to other sectors.[112]

Moving forward, the Capital Market Authority and the Ethiopian Securities Exchange (ESX) must ensure proper enforcement of corporate governance laws. By identifying challenges in implementation, issuing additional regulations when necessary, and maintaining strict oversight, these institutions can significantly enhance market stability and investor confidence. The successful enforcement of these laws will bring numerous benefits, including improved corporate governance, increased market transparency, and a more robust investment climate.[113]

The stock market plays a crucial role in enhancing corporate governance among Ethiopian share companies by promoting transparency, accountability, and investor confidence. Stock market regulations and reporting requirements ensure that companies provide accurate financial disclosures, allowing shareholders to make informed decisions and hold management accountable. These regulations create a structured environment where companies must adhere to governance best practices to maintain investor trust.[114]

Market dynamics, such as shareholder activism and trading volume, further strengthen corporate governance by encouraging companies to be more responsive to investor concerns. Active shareholders push for ethical leadership, efficient management, and strategic decision-making, while high trading volumes reflect investor confidence in well-governed companies. As a result, companies strive to maintain good governance standards to attract and retain investors. To further promote corporate governance, the stock market can implement measures such as stricter enforcement of disclosure requirements, stronger penalties for non-compliance, and initiatives

[112] Interview with Mrs Lidiya Getachew , security registration and reporting department acting head of the Ethiopian Capital Market Authority, , Addis Ababa, (February28,2025)
[113] Interview with Abebe Tizazu, legal Research and legal counseling office Manger Nib Bank, Addis Ababa, (February19,2025)
[114] Interview with Mrs Lidiya Getachew, (n109)

that educate companies on best governance practices. Establishing platforms for shareholder engagement and ensuring that corporate boards operate independently with qualified professionals will also enhance governance standards.[115]

Company leaders, regulators, and investors should recognize the stock market as a key driver of corporate governance. Leaders must prioritize transparency and ethical management, regulators should enforce policies that strengthen governance frameworks, and investors should actively participate in corporate decisions. By working together, these stakeholders can create a well-regulated, transparent, and thriving stock market that fosters good governance in Ethiopian share companies. In an interview with the CEO the followings were mentioned. Transparency plays a crucial role in corporate governance, as clear financial disclosures and timely updates—such as the resignation of board or management members—enable investors to make well-informed decisions about buying or selling shares. When companies prioritize openness, they foster trust and stability in the market.[116]

A diverse board and management team also significantly strengthen corporate governance. When members have distinct and specialized roles, they contribute varied perspectives, expertise, and strategic insights, leading to more effective decision-making and oversight. This diversity enhances accountability and reduces the risk of mismanagement.The stock market also creates opportunities for foreign investors, allowing them to contribute not only their wealth but also their management experience and advanced technologies. Their involvement can drive efficiency, innovation, and stronger corporate governance while expanding Ethiopia's economic landscape.[117]

Shareholders play a key role in governance by closely monitoring company rules and reporting requirements. Since their primary objective is to protect their rights and investments, they can evaluate company performance and take necessary actions, such as replacing ineffective board and management members or selling their shares if governance standards are not met. Their active engagement ensures accountability and better corporate performance.Market instability is often linked to broader national issues rather than a company's internal management. Trade volume fluctuations are primarily influenced by supply and demand. However, corporate managers are expected to adapt to these challenges by developing strategic plans that address economic

[115] ibid
[116] Interview with Mr. Habtamu H/Meskell, (n105)
[117] ibid

uncertainties. To remain resilient, they must revise existing plans and implement solutions that mitigate risks and sustain business growth.[118]

According to the Interview that was conducted with Security Exchange Senior Compliance Manger Of Wegagen Bank the new Commercial Code has introduced stronger corporate governance provisions compared to the previous one, particularly in defining the relationship between the board and management to minimize conflicts of interest. Additionally, the National Bank has recently issued corporate governance guidelines for financial institutions. While these developments are positive, the main challenge has been the lack of an institution dedicated to monitoring the implementation of these laws. One of the major obstacles to effective corporate governance is the lack of awareness regarding its benefits, especially among family-owned businesses that do not fully understand its importance. Another critical issue is the absence of a regulatory body to oversee and enforce corporate governance practices. Without such an institution, companies have not been held accountable for their governance structures and practices.[119]

The stock market previously operated in an unregulated and opaque manner, with unclear share pricing and transactions handled by brokers. However, recent reforms have centralized the market, prohibiting the buying and selling of shares outside the Ethiopian Securities Exchange (ESX). Companies must now meet corporate governance standards before listing on the ESX, ensuring compliance with industry-specific regulations such as those governing banking. Additionally, the introduction of an electronic trading platform has improved transparency by making share prices and transaction details clear, eliminating paper-based processes, and requiring share accounts, thereby removing cash transactions.[120]

The Capital Market Authority plays a crucial role in protecting investor rights, one of its four main responsibilities outlined in the Proclamation. This protection is enforced by requiring companies to disclose relevant information regularly, prohibiting insider trading and other illegal activities, and conducting investigations when legal violations are suspected. These measures help investors make informed decisions and safeguard their interests.[121]

[118] ibid
[119] Interview with Mr. Gebeyehu Raba,(n104)
[120] ibid
[121] Interview with Mrs Lidiya Getachew, (n109)

Historically, issues such as fraud, shareholder disputes, misleading advertisements, and missing directors have been prevalent in the market. Financial institutions, however, are subject to strict oversight by the National Bank due to their national security significance. Regulations dictate board structures, education requirements for key personnel, the inclusion of non-shareholder board members for impartiality, committee responsibilities, and reporting timelines. The implementation and monitoring of these guidelines have strengthened corporate governance within the financial sector.[122]

There are five rule books available on the official website, one of which mandates annual corporate governance reporting. If this requirement is strictly enforced, it will significantly enhance corporate governance practices. Additionally, companies are obliged to disclose price-sensitive information promptly, enabling shareholders to make informed decisions. If insider trading harms shareholders, ESX and the regulatory authority will intervene to protect their rights. Board members are held accountable for any management failures that negatively impact the company.[123]

The impact of corporate governance varies by sector, but new regulatory requirements may force companies to revise their plans and adapt their procedures accordingly. To strengthen corporate governance, awareness creation is essential, ensuring that companies recognize its role in profitability and sustainability. A corporate governance code should be mandatory but flexible enough to accommodate industry-specific needs, with stricter requirements for certain sectors. Additionally, an institution must be established to monitor and enforce corporate governance standards across companies. Ultimately, strong corporate governance is vital for ensuring efficiency, profitability, and legal compliance, protecting companies from unnecessary liabilities. Investors should seek professional advice to make informed decisions.[124]

An interview with the Senior Business Development Expert of the Ethiopian Securities Exchange (ESX) on EBS Ethio- Business Program highlighted the current state of the capital market. While the market has been launched, it is not yet operating at full capacity, and efforts are underway to build the necessary infrastructure and expertise. The process of converting or exchanging securities remains complex, adding to the challenges.[125]

[122] ibid
[123] Interview with Mr. Habtamu H/Meskell, (n105)
[124] ibid
[125] Yodit Kassa, EBS, Ethio-Business ,Feb22/2025, https://youtu.be/imGnjxYJRGo?si=u-45Bt1OJmlkzR_a

One of the key hurdles is the limited participation of customers, primarily due to a lack of capacity and full confidence in the newly established exchange. Additionally, three trading members—brokers, broker-dealers, and investment banks—will operate under the regulations set by the ESX rule book to ensure compliance and standardization.Currently, two investment banks, two investment advisory firms, and one private investment advisory firm have been licensed. However, the registration process presents another challenge, as the document requirements are new and lengthy, making it difficult for companies to complete the process efficiently. Despite these obstacles, the market is gradually gaining experience and working towards full functionality.[126]

[126] ibid

# CHAPTER FIVE

## 5. Conclusion and Recommendation

### 5.1. Conclusion

The current state of corporate governance in Ethiopian share companies is evolving but faces several challenges. Ethiopian company law lacks comprehensive legislative provisions on key governance issues such as the separation of supervision and management responsibilities, and the composition, independence, and remuneration of the board of directors. The new Ethiopian Commercial Code, introduced in March 2021, aims to address some of these issues by emphasizing responsible corporate management and updating the composition and accountability of the board of directors. However, the implementation of these changes is still ongoing, and there is a need for further development to ensure effective corporate governance practices in Ethiopian share companies.

Ethiopia has inaugurated its first fully-fledged stock market, the Ethiopian Securities Exchange (ESX), marking a major milestone in the nation's financial sector after decades without a stock exchange. The ESX aims to provide a platform for businesses to access capital and for investors to find new opportunities for wealth creation.

The current state of share companies in Ethiopia is characterized by a mix of traditional practices and emerging reforms. Ethiopian company law has been evolving, with the introduction of the new Ethiopian Commercial Code in March 2021, which aims to modernize corporate governance and improve transparency. However, the implementation of these reforms is still ongoing, and there are challenges related to corporate governance, such as the separation of supervision and management responsibilities and the independence of the board of directors

Stock markets play a significant role in enhancing corporate governance of share companies by providing a platform for transparency, accountability, and oversight. The stock market is where shares of publicly traded companies are bought and sold, and it serves as a mechanism for companies to raise capital from investors. One way in which stock markets enhance corporate governance is by requiring companies to adhere to stringent disclosure and reporting requirements. Companies that are listed on stock exchanges are required to regularly provide financial reports and disclosures to investors and regulators. Such transparency ensures that shareholders remain informed about the company's financial status and performance, enabling them to make well-informed investment choices.

Additionally, stock markets also play a role in holding companies accountable to their shareholders through the mechanism of shareholder activism. Shareholders have the ability to vote on important corporate decisions, such as the election of the board of directors and major business transactions. This gives shareholders a voice in the governance of the company and helps to ensure that management acts in the best interests of shareholders. Furthermore, the presence of a liquid stock market can also act as a deterrent to corporate misconduct. Companies listed on stock exchanges are exposed to market scrutiny and are more likely to be held accountable for unethical conduct, as adverse news or events can negatively affect their share prices. Stock exchanges play a crucial role in promoting corporate governance by setting listing and disclosure requirements and ensuring compliance through ongoing oversight.

They have also taken on the role of promoting corporate governance recommendations for listed companies. Concerns have been raised about conflicts of interest between exchanges' profit-driven activities and regulatory responsibilities, particularly following their conversion to listed companies. The increased competition among exchanges has raised questions about the potential for a regulatory "race to the bottom". The rise of alternative trading systems (ATS) has led to exchanges reducing fees and launching their own off-exchange platforms. The impact of Alternative Trading Systems (ATS) on corporate governance remains uncertain, raising concerns about diminished market transparency and the potential weakening of exchanges' regulatory roles due to declining revenues. Nonetheless, stock markets continue to play a vital role in strengthening corporate governance by fostering transparency, accountability, and effective shareholder oversight in share companies.

In conclusion, the stock market plays a vital role in strengthening corporate governance among shareholders in Ethiopia, fostering a more transparent and accountable business environment. By offering a platform for share trading, it incentivizes companies to uphold strong governance practices to attract investors and build shareholder confidence. The regulatory frameworks put in place by the government and financial institutions are key to ensuring compliance and encouraging ethical conduct. Additionally, the stock market empowers shareholders by giving them a voice in corporate decision-making, thereby promoting active engagement and responsibility. As Ethiopia's capital market continues to evolve, reinforcing these governance structures will be crucial for drawing foreign investment and supporting long-term economic development. Ultimately, a well-functioning stock market benefits not only individual companies and investors but also enhances the stability and credibility of the broader Ethiopian economy.

The gaps in the Ethiopian stock market, including the lack of transparency, institutional capacity, and investor protection mechanisms, impede its ability to contribute to good governance. Addres sing these gaps is crucial for enhancing market integrity, investor confidence, and overall govern ance standards in Ethiopia.

Corporate governance in Ethiopian share companies faces significant challenges, particularly outside financial institutions. While banks and insurance firms benefit from strong oversight by the National Bank, other joint-stock companies struggle due to weak regulatory enforcement, unqualified board appointments, and a lack of transparency. The absence of a dedicated regulatory body further weakens governance, allowing unethical practices such as misleading advertisements and the appointment of unqualified professionals due to personal connections. However, the establishment of the Ethiopian Capital Market Authority aims to address these challenges by enforcing transparency, protecting investors, and fostering a structured and accountable market. Recent reforms have centralized stock trading under the Ethiopian Securities Exchange (ESX), ensuring that companies meet governance standards before listing. Additionally, electronic trading has improved market transparency by eliminating paper-based processes and requiring share accounts. Moving forward, the Capital Market Authority and ESX must strengthen governance through stricter enforcement, enhanced regulatory oversight, and increased awareness of best practices. A well-regulated stock market will not only improve investor confidence but also drive sustainable corporate growth by promoting transparency, accountability, and sound management practices.

## 6.2. Recommendations

Based on the findings of the study, the researcher puts forward the following recommendations:

- Regulatory oversight must be strengthened. The Capital Market Authority and the Ethiopian Securities Exchange (ESX) should enforce corporate governance regulations more strictly. A dedicated regulatory body should be established to oversee share companies outside the financial sector, ensuring compliance with governance standards.
- The board and management selection processes should be improved. Share companies need to adopt merit-based appointment systems for board members and executives. This approach will help reduce nepotism and unqualified appointments, ensuring that

leadership positions are filled based on expertise and experience rather than personal connections.

- Transparency and disclosure requirements must also be increased. Companies should be mandated to provide regular financial reports, disclose conflicts of interest, and share critical information with investors. Enforcing stringent disclosure regulations will enhance investor confidence and minimize fraudulent activities.
- Shareholder activism and protection should be promoted. Shareholders must be empowered to participate actively in corporate governance through stronger voting rights and mechanisms that hold management accountable. Regulatory bodies should also implement measures to protect minority shareholders from unfair practices.
- Capacity-building initiatives and awareness programs are essential for improving corporate governance. Training programs should be introduced for company executives, board members, and regulatory officials to enhance their understanding of governance best practices. Raising awareness about these practices will lead to better compliance and long-term business sustainability.
- Market infrastructure and investor protection must be enhanced. The Ethiopian Securities Exchange should continue developing digital trading platforms to increase market transparency and accessibility. Clear investor protection mechanisms should also be implemented to mitigate risks associated with market manipulation and insider trading.
- Ethiopia should encourage foreign investment and the adoption of best practices. Aligning corporate governance frameworks with international standards, such as those outlined by the OECD, will attract foreign investors and foster a more competitive and resilient business environment.

By implementing these recommendations, Ethiopia can strengthen corporate governance, enhance investor trust, and promote sustainable economic growth through a well-regulated and transparent stock market

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## Interviews

1. Interview with Abebe Tizazu, legal Research and legal counseling office Manger Nib Bank, Addis Ababa, (February 19,2025)

2. Interview with Mr. Bahiru Demise, Research and Business Development Directorate Director of Wegagen Bank, Addis Ababa, (February2o,2025)

3. Interview with Mr. Gebeyehu Raba ,Business Program Directorate Director of Nib Bank, Addis Ababa, (February 19,2025)

4. Interview with Mr. Habtamu H/Meskell, senior Compliance manager of Ethiopian securities Exchange, Addis Ababa, (February24,2025)

5. Interview with Mrs Lidiya Getachew, security registration and reporting department acting head of the Ethiopian Capital Market Authority,, Addis Ababa, (February28,2025)

## You tube

Yodit Kassa, EBS, Ethio-Business,Feb22/2025, https://youtu.be/imGnjx YJRGo?si=u-45Bt1OJmlkzR a